BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DOCKET NO. UE-05_____

DOCKET NO. UG-05_____

DIRECT TESTIMONY OF

SCOTT L. MORRIS

REPRESENTING AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, employer and business address.

A. My name is Scott L. Morris and I am employed as the President of Avista Utilities (Avista or Company) and Senior Vice-President of Avista Corporation, at 1411 East Mission Avenue, Spokane, Washington.

Q. Would you briefly describe your educational background and professional experience?

A. I am a graduate of Gonzaga University with a Bachelors degree and a Masters degree in organizational leadership. I have also attended the Kidder Peabody School of Financial Management.

I joined the Company in 1981 and have served in a number of roles including customer service manager. In 1991, I was appointed general manager for Avista Utilities' Oregon and California natural gas utility business. I have served as President and General Manager of Avista Utilities, an operating division of Avista Corporation, since August 2000. In February 2003, I was appointed Senior Vice-President of Avista Corporation.

In 1999, I was appointed by then-Governor John Kitzhaber as a board member of the Oregon Economic and Community Development Commission. I served as a director and board president of the Medford/Jackson County Chamber of Commerce, and board member and board president of the Providence Community Health Foundation.

Currently, I am a member of the Providence Services of Eastern Washington board of directors, a member of the Gonzaga University board of trustees, a director of the Washington Roundtable, and immediate past Chair of the Spokane Regional Chamber of Commerce board of trustees. In 2002, I was appointed by Governor Locke to the Chairmanship of the Washington Economic Development Commission, and as of March 2005 serve on the board of the Spokane Economic Development Commission.

Q. What is the scope of your testimony in this proceeding?

A. I am testifying as the policy witness for the Company. I provide an overview of Avista Corporation and Avista Utilities. I describe Avista Utilities' overall utility operations, the Company's rate requests in this filing, and the primary factors driving the Company's need for general rate relief. I will also explain the Company's customer support programs that are in place to assist our customers.

In addition, I will briefly address some of the current and future challenges that are being faced by the Company, such as the Spokane River relicensing project, transmission upgrades, volatility of energy markets and the Company's efforts to regain its investment grade credit rating, to name a few. I will briefly explain Avista's plans for installation of an Advanced Meter Reading system in Washington. Finally, I introduce each of the other witnesses providing testimony on the Company's behalf.

A table of contents for my testimony is as follows:

Q. Are you sponsoring an exhibit in this proceeding?

A. Yes. I am sponsoring Exhibit No. ____(SLM-2), which was prepared under my direction.

Q. Please describe Avista's current business focus for the utility and subsidiary operations.

A. The Company has worked hard to continue to operate what I believe to be a very efficient utility. The Company has historically run its operations with attention to minimizing expense while providing quality service and a high level of customer satisfaction.

The Company is continuing its recovery from the serious financial challenges that it faced in 2000 and 2001. During that period Avista experienced record low hydro conditions and unprecedented high wholesale market prices that required it to increase its outstanding debt from $715 million at December 31, 1999 to $1,175 million at December 31, 2001, in order to acquire electricity and natural gas to serve its customers.

At the end of 2001, Avista had electric and natural gas deferral balances (costs incurred by Avista but not yet paid by customers) totaling $254 million. In order to mitigate the impact of these costs on our customers, the Company proposed, and the Commission approved recovery of these costs over a period of time.

With large electric and natural gas deferrals on its books, the Company's credit ratings dropped in October 2001 to below investment grade. In 2005, the Company continues to be below investment grade and the total electric and natural gas deferral balances as of December 31, 2004 were $151 million on a system basis, and $122 million for the Washington jurisdiction.

In order to improve its financial condition, the Company scaled back and sold subsidiary businesses and made significant temporary reductions in capital and operation and maintenance (O&M) budgets. Through this process, however, the Company exercised discretion to avoid cuts that could have had long-term negative consequences in its utility operations. Mr. Malquist will discuss further the actions taken by the Company to improve cash flow, reduce debt, and work toward regaining an investment grade credit rating.

Our strategy continues to focus on our energy and utility-related businesses, with our primary emphasis on the electric and natural gas utility business. There are four distinct components to our business focus for the utility, which we have referred to as the four legs of a stool, with each leg representing customers, employees, the communities

we serve, and our financial investors. For the stool to be level, each of these legs must be in balance by having the proper emphasis. This means we must maintain a strong, low-cost utility business by delivering efficient, reliable and high quality service to our customers and the communities we serve. We are fortunate to have dedicated employees who, despite the challenges of recent years, have maintained high morale and high customer satisfaction.

Q. Please briefly describe Avista's subsidiary businesses.

A. Avista Corp.'s primary subsidiaries include the energy marketing and resource management business, Avista Energy, and the information and technology business, Avista Advantage, described below. These subsidiaries are headquartered in Spokane, Washington. In 2001, Avista disposed of substantially all of the assets of Avista Communications, and sold the majority of Avista Labs in 2003. A diagram of Avista's corporate structure is provided on page 1 of Exhibit No.___ (SLM-2).

Avista Energy, which commenced operations in 1997, is an electricity and natural gas marketing, trading and resource management business, operating primarily within the Western Electricity Coordinating Council (WECC) geographical area. Besides the Spokane headquarters, Avista Energy also has an office in Vancouver, British Columbia, Canada. Avista Energy focuses on optimization of combustion turbines and hydroelectric assets owned by other entities, long-term electric supply contracts, natural gas storage, and electric transmission and natural gas transportation arrangements.

Avista Energy is also involved in trading electricity and natural gas, including derivative commodity instruments. Its customers include commercial and industrial end-users, electric utilities, natural gas distribution companies, and energy marketing and trading companies. We are managing the size and the risk associated with this business by limiting operations generally to the WECC region, to make the best use of our knowledge and experience in markets we know well.

Avista Energy also manages Avista Power's 49 percent ownership of a 270 MW natural gas-fired combined cycle combustion turbine plant in Rathdrum, Idaho, (Lancaster Project) which commenced commercial operation in September 2001. Avista Power is inactive at this time with no plans for additional generation projects.

Avista Advantage, which commenced operations in 1998, is a provider of utility bill processing, payment and information services to multi-site customers. Avista Advantage analyzes and presents consolidated bills on-line, and pays utility and other facility-related expenses for multi-site customers throughout North America, such as the Federal Aviation Administration, Alaska Airlines, Frito Lay, Hard Rock Café, and Starbucks, to name a few. Information gathered from invoices, providers and other customer-specific data allows Avista Advantage to provide its customers with in-depth analytical support, real-time reporting and consulting services with regard to facility-related energy, waste, repair and maintenance, and telecom expenses.

II. OVERVIEW OF AVISTA UTILITIES

Q. Please briefly describe Avista Utilities.

A. Avista Utilities provides electric and natural gas service within a 26,000 square mile area of eastern Washington and northern Idaho. The Company, headquartered in Spokane, Washington, also provides natural gas distribution service in southwestern and northeastern Oregon, and in the South Lake Tahoe area of California. Maps showing the Company's electric and natural gas Washington service area and Avista's total electric and natural gas service areas are provided in pages 2 and 3 of Exhibit No. ___(SLM-2). As I will explain in more detail later, Avista received approval from the California Public Utilities Commission (CPUC) on March 17, 2005 to sell its South Lake Tahoe properties to Southwest Gas. The transfer is expected to close near the end of April 2005.

As of December 31, 2004, Avista Utilities had total assets (electric and natural gas) of approximately $2.6 billion (on a system basis), with electric retail revenues of $507 million (system) and natural gas retail revenues of $321 million (system). As of December 2004, the Utility had 1,485 full-time employees.

Q. Please describe Avista Utilities' Washington electric and natural gas utility operations.

A. Of the Company's 331,000 electric and 305,000 natural gas customers (at year end 2004), 219,000 and 134,000, respectively, were Washington customers. The

Company serves the Washington counties of Adams, Asotin, Ferry, Franklin, Grant, Lincoln, Pend Oreille, Stevens, Spokane, Whitman, Klickitat and Skamania. Approximately 43% of 2004 Washington electric retail usage was from residential customers, with 55% from commercial and industrial customers and the remaining 2% from pumping and street lighting. Approximately 50% of Washington natural gas retail usage was from residential and small commercial customers (Schedule 101), with the remaining 50% from larger commercial and industrial customers. The Company has 24 natural gas transportation customers in Washington. Additional details of usage and number of customers for each customer class are shown on page 4 of Exhibit No.___ (SLM-2).

Avista expects retail electric load growth to average between 2.0 and 3.0 percent annually for the next four years, primarily due to expected population increases and business growth in its service territory. While the number of electric customers is expected to increase, the average annual usage for residential customers is not expected to change significantly. Natural gas load growth is expected to average between 4.0 and 4.5 percent annually for the next four years in Avista's Washington service territory. The natural gas load growth is primarily due to increases in both population and the number of businesses in Avista's service territory, and expected conversions from electric and oil space heat and electric water heating to natural gas.

Q. Please provide an update on the Company's plan to move the natural gas procurement functions from Avista Energy back to Avista Utilities.

A. In April 2004 the WUTC approved Avista's transition plan to move the natural gas procurement functions under the Benchmark Mechanism from Avista Energy back to Avista Utilities, effective April 1, 2005.

All necessary steps to complete the transition by the required effective date of April 1, 2005 have been completed. This includes the hiring of three of the four additional employees needed at the Utility to manage the natural gas procurement operations, including a Director of Natural Gas Supply. Avista also increased its credit line facility from $245 million to $350 million in May 2004 in preparation of the transfer back to the Utility.

The Company has included in its pro forma adjustments Washington's allocated portion of the estimated additional costs for labor and associated administrative support costs for the four additional employees. Witness Hirschkorn explains this adjustment in more detail.

Q. Please explain the sale of Avista's South Lake Tahoe gas properties to Southwest gas.

A. On March 17, 2005, the CPUC approved the sale of Avista's South Lake Tahoe, California natural gas distribution properties to Southwest Gas, in accordance with the terms of a settlement agreement between Avista, Southwest Gas and the

CPUC Office of Ratepayers Advocates (ORA). It is anticipated that the effective date of the transfer of properties will be near the end of April 2005.

The South Lake Tahoe properties, which include approximately 18,600 customers, are isolated from the rest of our system, and it is the only area we serve in California. In comparison, Southwest Gas has been serving much of the Lake Tahoe Basin for 40 years, and the South Lake Tahoe community is contiguous to existing Southwest Gas Service territories. Mr. Falkner discusses in more detail additional information regarding the sale of the South Lake Tahoe properties.

III. RATE REQUESTS

Electric

Q. Please provide an overview of Avista's electric rate request in this filing.

A. Through this filing the Company is requesting that the Commission grant an electric rate increase of $35,833,000 or 12.5% in base retail rates.

The Company's request is based on a proposed rate of return of 9.67% with a common equity ratio of 44.0% and an 11.5% return on equity. As explained further by Mr. Hirschkorn, the spread of the proposed revenue increase by service (rate) schedule results in moving the relative rates of return for the individual rate schedules one-third toward unity. The proposed increase for each rate schedule is shown below.

Illustration 1

Service Schedule	Proposed Net Increase
Residential Service Schedule 1	14.3%
General Service Schedules 11 & 12	8.8%
Large General Service Schedules 21 & 22	10.5%
Extra Large General Service Schedule 25	13.3%
Pumping Service Schedules 31 & 32	12.0%
Street & Area Lighting Schedules 41-49	11.0%
Overall Increase	12.5%

The Company is proposing to raise the residential basic charge to $5.50 from the current $5.00 charge.

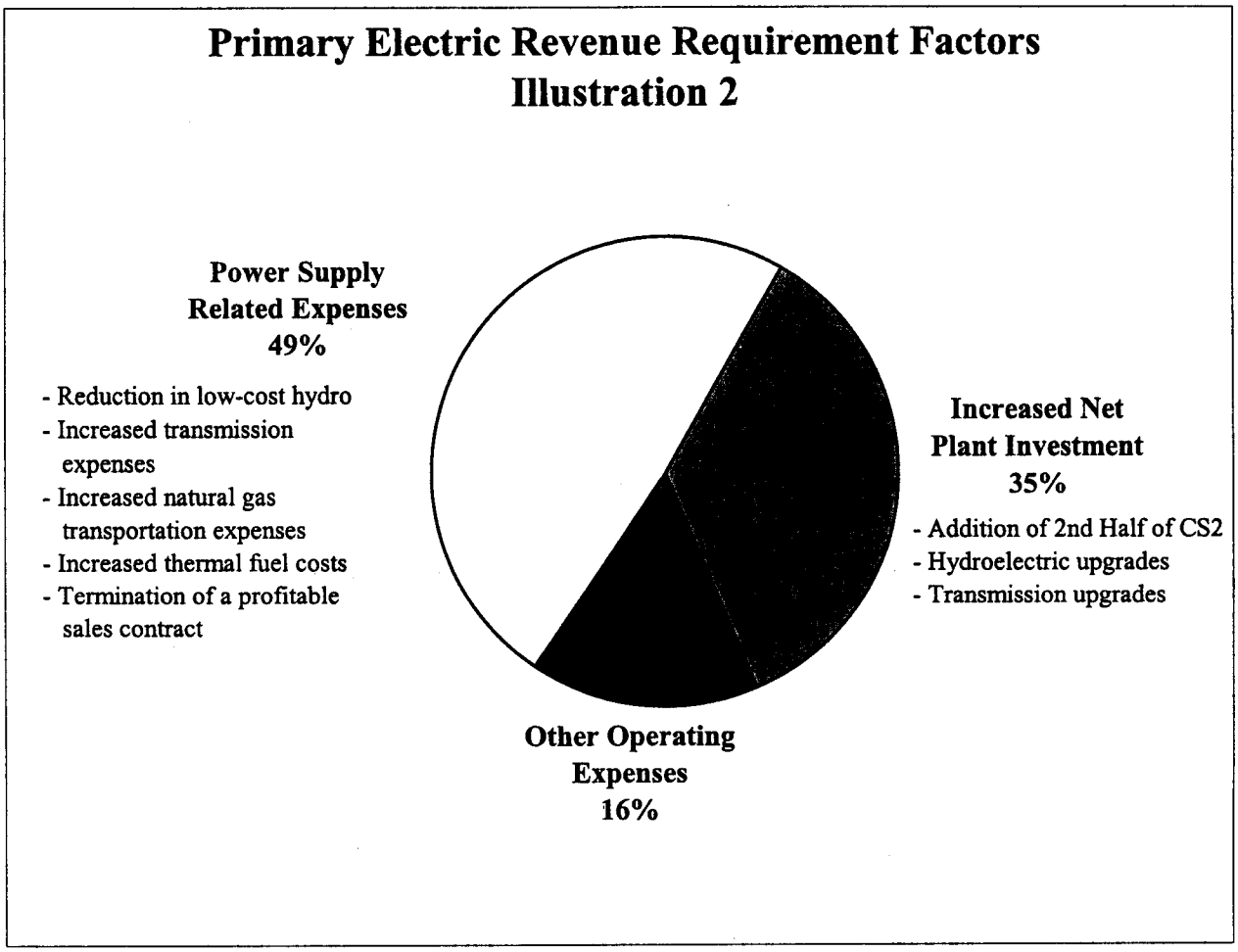
The monthly bill for a residential customer using an average of 1,000 kwhs per month would increase from $55.09 to $63.01 per month, an increase of $7.92 or 14.4%. Mr. Hirschkorn will provide additional details related to rate spread and rate design issues.

Q. What are the primary components causing the Company's request for an electric rate increase?

A. The Company's last electric general rate case in Washington was based on 2000 test year data. The current filing includes a 2004 test period. Therefore, the Company's electric rate request is based on changes in costs over roughly a four-year period.

As shown in Illustration 2, the primary factors driving the electric rate increase are increases in power supply related expenses, and increased net plant investment.

Primary Electric Revenue Requirement Factors
Illustration 2



As explained in detail by Mr. Johnson, the increase in power supply costs is driven primarily by reduced hydro generation, resulting in part from the termination of a contract with Grant County PUD for low-cost hydroelectric generation. Other changes in power supply-related costs include increased transmission and natural gas transportation costs, the termination of a profitable wholesale sales contract, and increased thermal fuel costs.

Increased net plant investment of approximately $56 million (Washington allocation) is driven primarily by Avista's recent purchase of the second half of the

Coyote Springs 2 (CS2) project, hydroelectric upgrades at the Company's Cabinet Gorge project, and the multi-year major transmission upgrades that are currently in progress. Mr. Peterson will explain the recent purchase of the second half of Coyote Springs 2. Mr. Kopczynski will address the transmission upgrades.

Natural Gas

Q. What is Avista's natural gas rate request in this filing?

A. Through this filing the Company is requesting that the Commission grant an increase of $2,943,000 or 1.8% for Avista Utilities' Washington natural gas operations.

The Company's request is based on a proposed rate of return of 9.67% with a common equity ratio of 44.00% and an 11.5% return on equity. The proposed change by rate schedule is shown in the illustration below.

Illustration 3

Service Schedule	Proposed Increase
General Service Schedule 101	2.1%
Large General Service Schedule 111/112	0.8%
High Annual Load Factor – Lg. General Service Schedule 121/122	0.7%
Interruptible Sales Service Schedule 131/132	(3.2%)
Transportation Service Schedule 146 (excluding gas costs)[1]	2.2%
Overall Increase	1.8%

[1] The calculation of the percentage increase excludes the cost of natural gas and transportation for this schedule.

The proposed increase by rate schedule results in rates of return for each schedule that are within 5% of cost of service study results (within 5% of unity). The monthly bill for a residential customer using 75 therms per month would increase from $74.77 to $76.25 per month, an increase of $1.48 or 2.0%. Mr. Hirschkorn will address these rate spread and rate design issues.

Q. Would you please explain why the Company is filing a natural gas general rate case so soon after a natural gas case was settled last fall?

A. The settlement in Docket. UG-041515, approved by the WUTC in November 2004, resulted in a revenue increase of approximately $5.4 million compared to the initial request of approximately $8.6 million. The Settlement excluded pro forma adjustments and resulted in an overall rate of return of 8.68%. The Company had plans to file an electric general rate case early in 2005. The Company opted to settle in UG-041515 and then file a combined electric and gas case in which major issues, such as rate of return, could be addressed for its electric and natural gas operations at the same time.

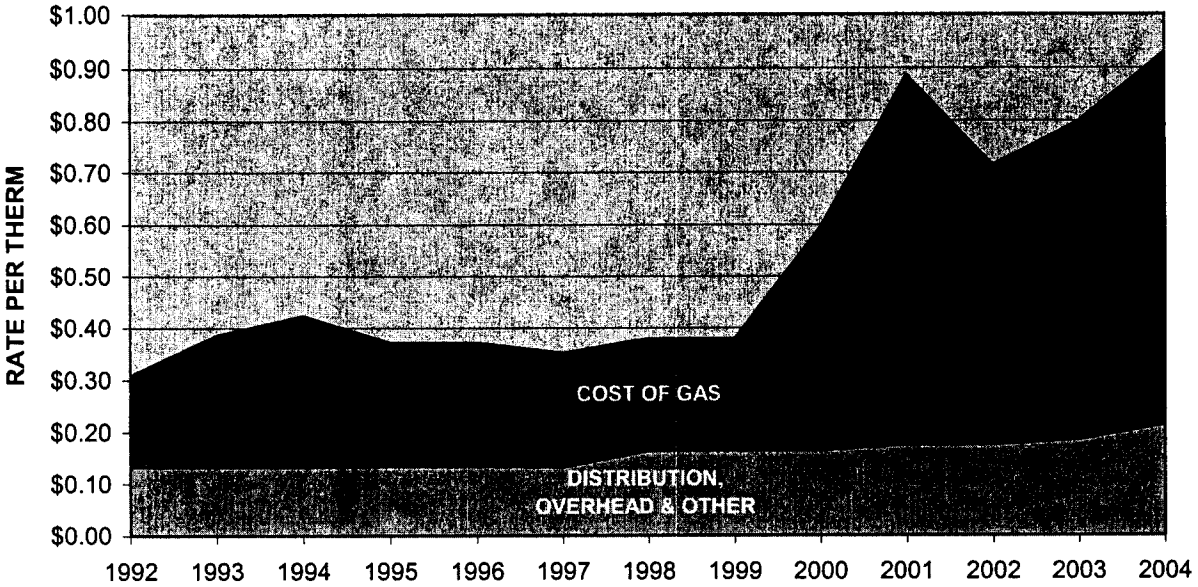
The primary factors driving the 1.82% natural gas request are the cost of capital and the proforma adjustments that were excluded from the prior settlement. Mr. Falkner provides additional details related to the Company's revenue requirement request.

Q. You have discussed the base or fixed costs of Avista's natural gas business. There have been significant increases in natural gas supply costs. Would you please describe these changes?

A. Yes. The natural gas industry has experienced significant volatility and upward price pressure on the wholesale cost of natural gas. Natural gas prices in the Pacific Northwest are increasingly affected by supply and demand factors in other regions of the United States and Canada because of growth in transcontinental pipeline capacity. Global energy markets, including oil prices, are also affecting natural gas prices.

Avista does not have any natural gas reserves and purchases all its natural gas requirements in the wholesale market. The following graph shows the history of gas supply cost changes. The bottom portion of the graph shows the change in the Company's distribution and overhead costs (base rate costs) over time. As shown in the illustration, the Company's management of its costs has resulted in these costs remaining relatively stable over time, as measured on a per-therm basis. Changes in the cost of natural gas supply are addressed in the periodic Purchased Gas Adjustment (PGA) filings. Therefore, Avista is not requesting a rate change in this filing related to the cost of gas supply.

Illustration 4
Avista Utilities Residential Rates
Natural Gas - Washington



Q. Has the Company considered the possible economic impacts of the Company's rate proposals in its service territory?

A. Yes. Through my involvement with area chambers and economic development agencies, I am particularly mindful of the impact that rate increases have on our customers, including the businesses within our service area and the important role the utility plays in the communities we serve. The company will continue to aggressively manage its costs and strive to achieve the appropriate balance in providing safe and reliable service at competitive rates, while working toward a financially healthy utility. In the long term, a financially healthy utility will foster satisfied customers and enable the utility to finance under reasonable terms the necessary additional infrastructure needed over time to serve customers.

IV. CUSTOMER SUPPORT PROGRAMS

Q. Please outline the programs the Company has in place to mitigate the impacts on customers of the proposed rate increase.

A. Avista Utilities offers a number of programs to assist customers who have difficulty in paying their energy bills. Some of these programs are operated in cooperation with local Washington community action agencies who are experienced in targeting the assistance where it is needed most. These programs include energy efficiency programs, Project Share for emergency assistance to customers, Low Income Rate Assistance Program (LIRAP), a CARES program, level pay plans, and payment arrangements. These programs are briefly described below. Mr. Kopczynski provides additional details related to these programs in his testimony.

- Energy efficiency programs. Avista Utilities offers energy efficiency services to electric and natural gas residential, commercial, and industrial customers.

- Project Share. Project Share is a voluntary option allowing customers to contribute funds that are then distributed through community action agencies to customers in need. Avista itself contributed $150,000 to the program in the past year.

- LIRAP. Avista's Low Income Rate Assistance Program collects approximately $3 million per year through electric and natural gas tariff surcharges. The Company, with the assistance of community action agencies, directs these funds toward those customers least able to pay for electric and natural gas service.

- Comfort Level Billing. The Company offers the option for customers to pay the same bill amount each month of the year by averaging their annual usage.

- Payment arrangements. The Company's Contact Center Representatives work with customers to set up payment arrangements to pay energy bills.

- CARES program. Special needs customers have access to specially trained (CARES) representatives who provide referrals to area agencies and churches for help with housing, utilities, medical assistance, etc.

- Customer service automation. Customers are able to access Avista's Interactive Voice Response system (IVR) for automated transactions to enter their own payment arrangements, listen to outage messages and conduct other business such as obtaining account balances and requesting a duplicate bill.

Q. Are there other noteworthy accomplishments that you would like to address?

A. Yes. There are several items of which I am particularly proud which recognizes both the accomplishments and excellence of Avista, its employees and its leadership.

- In February 2005, during the African-American, Hispanic, Asian and Native American Business and Professional Association's (AHANA) 6th Anniversary Celebration, Avista was awarded the *2004-2005 AHANA Corporate Excellence Award,* which recognized Avista's support of diversity in the region. The AHANA organization supports the development and growth of minority and women owned businesses in the Inland Northwest.

- In January 2005, the Spokane County Air Pollution Control Authority (SCAPCA) awarded Avista Corp. the *2005 Clean Air Award,* recognizing Avista's recent air pollution control system upgrades to its Northeast Combustion Turbine facility and for its partnership in developing two air quality programs which repaired or replaced nearly 700 of Spokane's highest emitting motor vehicles over the past three years.
- In June 2004, for the fifth straight year, Avista Corporation has received an *Outstanding Stewards of America's Rivers* award from the National Hydropower Association (NHA). The group honored Avista for its preservation work in the Clark Fork River basin. In addition, the NHA also recognized Avista with the *2004 Hydro Achievement Award.* This award recognizes hydro industry leaders who expand the industry's commitment to the environment and local communities through recreational enhancement.
- The Kettle Falls Generating Station, the first wood waste fired plant in the United States built by a utility solely for the generation of electricity, marked its 20th anniversary in December 2003. This plant has won several awards, such as the Washington State's *Environmental Excellence Award,* for reducing emissions from burning waste in open wigwam burners, and *Power Magazine's* Energy Conservation Award.
- During 2004, Avista Utilities' employees who volunteer in the community contributed over 55,800 volunteer hours to non-profit organizations in the Inland Northwest. Employees supported more than 500 organizations through volunteer efforts for Bloomsday, Hoopfest, Boy Scouts, Girl Scouts, Vanessa Behan Crisis Nursery, SNAP, United Way and Habitat for Humanity, to name a few.

In addition, I am most pleased with the response of Avista Utilities' employees in the past four years as the Company faced its most serious financial challenge in its 116 year history. Employees have maintained quality customer service and reliability while being challenged to do more with less. While we have maintained tight controls on capital and O&M budgets, our customer service surveys indicate that customer satisfaction has remained high. Our most recent overall customer satisfaction survey results show a satisfied customer rating of 92% in our Washington and Idaho operating divisions. These results can be achieved only with very committed and competent employees.

V. CURRENT AND FUTURE ISSUES

Q. What are some of the major issues that will be addressed by the Company in the next five years?

A. In the next five years Avista will face a number of major issues, some of which will involve challenges such as Spokane River Relicensing, Cabinet Gorge dissolved gas, and volatility of energy markets, while others, such as Advanced Meter Reading, will present positive opportunities. A number of these issues are described briefly below.

Spokane River Relicensing

Avista's license for the Spokane River hydroelectric projects expires in 2007. These projects include Post Falls, Upper Falls, Monroe Street, Nine Mile and Long Lake,

with a total generating capacity of 156 MW and average annual energy production of approximately 105 aMw. Since 2001, we have been working with numerous stakeholders to understand and resolve issues related to the Spokane River Project. The Company's goal is to develop with the stakeholders a comprehensive and cost-effective settlement agreement to be filed as part of the Company's license application to the FERC in July 2005. The Company provided a Draft License Application for public comment in February 2005. Mr. Peterson provides additional discussion related to these efforts. The Company is not proposing a change in rates in this case related to this relicensing process.

Cabinet Gorge Dissolved Gas

As Mr. Peterson explains in his testimony, when the Clark Fork relicensing process was completed, an issue related to high levels of dissolved gas occurring during spill periods at Cabinet Gorge Dam remained unresolved. A plan to mitigate the dissolved gas levels has been developed with stakeholders including the Idaho Department of Environmental Quality. The plan calls for the phased modifications of two existing diversion tunnels. The first tunnel would be constructed by 2010 at an estimated cost of $38 million, which would allow the Company to divert streamflows through the tunnel when flows are in excess of turbine capacity. The second tunnel would be constructed only after an analysis of the performance of the first tunnel and an evaluation of the environmental benefits. Although preliminary work has begun on the project, the Company has not requested an increase in rates in this filing related to these costs.

CDA Tribe

In 1998 the United States district Court for the District of Idaho issued its finding that the Coeur d' Alene Tribe of Idaho (CDA Tribe) owns, among other things, portions

of the bed and banks of Lake Coeur d' Alene lying within the current boundaries of the Coeur d' Alene Reservation (essentially the Southern one-third of Lake Coeur d' Alene). The Company owns and operates the Post Falls Hydroelectric Generating Station (Post Falls), a facility constructed in 1906, which is located approximately seven river miles downstream from the outlet of Lake Coeur d' Alene. This will result in the Company being liable to the CDA Tribe for compensation for the storage of water on reservation lands under Section 10(e) of the Federal Power Act. The Company and the CDA Tribe are engaged in discussions with respect to past and future compensation. The Company has not requested an increase in rates in this filing related to these costs.

Transmission Upgrades

As Mr. Kopczynski explains in his testimony, to reinforce the electric transmission grid in eastern Washington and northern Idaho, Avista Utilities, in collaboration with the Bonneville Power Administration, is building and upgrading transmission infrastructure that will improve the delivery of electricity to meet existing and future power needs in Avista's service territory. The projects will relieve current transmission congestion in the area and improve system reliability. It will also provide additional transmission capacity to meet future growth needs. These major transmission upgrades began in 2003 and are expected to be completed in 2007. The projects represent over $100 million in new infrastructure investment. Approximately $28.5 million of these projects will be completed in the near-term and Washington's jurisdictional capital costs of $18 million have been included in this case. The costs associated with the remainder of the projects will be the subject of a future rate proceeding.

Volatility of Energy Markets

The Company and its customers continue to face the challenges associated with the volatility of electric and natural gas wholesale market prices. Volatile wholesale

prices affect the costs to the Company's retail natural gas customers, the cost to produce power from the Company's natural gas-fired generating projects, and the Company's financing requirements in covering these electric and natural gas purchase costs. The variability of Avista's hydroelectric generation, in particular, exposes the Company and its customers to the volatile wholesale electric and natural gas prices, when the Company must purchase replacement power from the market or run gas-fired generation to cover low streamflow conditions. The Company continues to focus on resource management and resource procurement strategies that will reduce exposure to volatile wholesale market prices and provide a level of price stability for our customers.

Power cost deferral and recovery tracking mechanisms, such as the electric Energy Recovery Mechanism in Washington, the Power Cost Adjustment in Idaho and the Purchased Gas Adjustments in both states, are very important to the Company in addressing the variability of the costs included in these mechanisms. This is especially true given Avista's heavy reliance on highly variable hydroelectric generation, and increased reliance on natural gas for thermal generation.

Regional Transmission Organization

The Company has expended a significant amount of time and effort in recent years in discussions with utilities and others in the Pacific Northwest related to the development of some form of regional transmission organization (RTO). Recent efforts have shifted to the development of a regional platform that would incorporate an initial or beginning state of an RTO structure. Avista, along with others in the region, is also considering alternative structures to a full-blown RTO, which would accomplish the same or similar objectives targeted by an RTO. The Company has not included costs associated with these efforts in this filing.

Advanced Meter Reading

We believe a combination of decreases in capital and installation costs of Advanced Meter Reading (AMR) technology together with expected continuing increases in meter reading expenses now supports the installation of this technology. Over a six-year period beginning in 2006, the Company plans to upgrade Washington electric and natural gas meters for automatic reading capability. This will allow the Company to manage meter reading labor costs, provide improvements on meter data accuracy, lower customer service costs, and virtually eliminate estimated meter readings. The Company is not proposing an increase in rates in this filing associated with the proposed AMR program. Mr. Falkner explains the Company's accounting proposal associated with this program. Mr. Holmes provides an expanded description of the Company's plans for AMR and the associated costs and benefits.

Q. What is the status of the Company's efforts to regain its investment grade credit rating?

A. The Company is continuing to rebuild its financial health. We maintain an ongoing dialogue with the rating agencies regarding the measures being taken by the Company to regain an investment grade credit rating. These measures include working with the financial community to insure we have adequate funds for operations, for capital expenditures and for debt maturities and to insure that we have adequate liquidity through the availability of our credit facility on the most economic basis possible. Other measures include working through regulatory processes to recover our costs so that earned returns are closer to those allowed by regulators in each of the states we serve.

This is one of the key determinants from the rating agencies standpoint when they are reviewing our overall credit rating.

Improved credit ratings are only likely if the Company's financial strength and its outlook improve for a sustained period of time. The effort and sustained performance required to return Avista's credit ratings to investment grade levels will take time, and can be achieved only with the continued support of regulators in allowing the timely recovery of costs. The Company's initiatives to carefully manage its operating costs and capital expenditures are an important part of improving performance, but are not sufficient without revenues that cover costs and provide a fair return on investment.

Q. How do the current drought conditions affect the Company's ability to improve its financial condition?

A. Drought conditions experienced by the Company negatively impact our hydro generation requiring us to purchase more expensive replacement power or run more expensive thermal generation. Based on recent forecasts, the Company expects hydroelectric generation will be approximately 80 percent of normal in 2005, assuming normal precipitation for the remainder of the year.

This, in conjunction with the continuing volatility of wholesale electric and natural gas prices, results in a significant increase in Avista's power supply-related costs. Although the earnings impact of replacement power is mitigated through electric and natural gas deferral and recovery mechanisms in each of Avista's jurisdictions, the large

deferral balances on the Company's books negatively impact the amount of available cash flow from operations, may lead to additional borrowings from the financial community, and ultimately results in higher debt, lower interest coverage ratios and a weaker financial condition for the Company.

The repeated below-normal hydroelectric conditions that Avista has experienced in five out of the last six years makes it all the more difficult for the Company to regain its financial health, and its credit rating. Mr. Peterson, in his testimony, explains the Company's request to eliminate the $9.0 million "deadband" from the Energy Recovery Mechanism (ERM). The persistence of the adverse hydroelectric conditions and the volatility of wholesale electric and natural gas prices is causing Avista to continue to absorb at least $9.0 million per year through the "deadband," which undermines Avista's efforts to improve its financial health. The Company is requesting that the "deadband" be eliminated, at least until Avista is able to regain its investment grade credit ratings.

Given the current circumstances faced by Avista, it is especially important that the Commission's order in this case be supportive of the additional financial progress that needs to be made for Avista to regain its credit ratings.

VI. OTHER COMPANY WITNESSES

Q. Would you please provide a brief summary of the testimony of the other witnesses representing Avista in this proceeding?

A. Yes. The following additional witnesses are presenting direct testimony on behalf of Avista.

Mr. Malyn Malquist, Senior Vice President, Chief Financial Officer and Treasurer will describe, among other things, the overall financial condition of the Company, its current credit ratings, the Company's plan for a return to investment grade credit ratings, the proposed capital structure, and the return on equity requested by the Company. Mr. Malquist explains that:

- The Company's credit rating is below investment grade for unsecured debt. This general rate request is an important component in the continuing improvement of Avista's financial condition, providing the opportunity to regain an investment grade credit rating;
- Avista is aggressively rebuilding its financial health, including retiring higher cost debt and conserving cash;
- The Company has proposed an overall rate of return of 9.67%, including a 44.01% equity ratio and an 11.5% return on equity;
- Although the analyses of Dr. Avera support a return on common equity in excess of 11.5%, Avista has limited it request to 11.5% in an effort to balance the competing objectives of Avista regaining its financial health within a reasonable period of time, and the impacts that increased rates have on our customers.

Dr. William E. Avera, as a principal in Financial Concepts and Applications (FINCAP), Inc., has been retained to present testimony with respect to the Company's cost of common equity. He concludes that:

- Analyses related to the cost of common equity for a benchmark group of utilities in the western U.S. yields an ROE in the range of 11.1% to 12.1%;
- Avista's "BB+" corporate credit rating and the investment risks associated uniquely with Avista, however, are significantly greater than those of the utilities in the benchmark group and investors require a higher rate of return to compensate for that risk;
- Based on capital market analyses, even an 11.5% ROE falls below the current required rate of return for Avista, in light of investors' economic requirements for the utility operations and the Company's specific risks;
- The challenges imposed by the evolving structural changes in the industry imply that utilities will be required to incorporate relatively greater amounts of equity in their capital structures. The equity ratio of 44.00% proposed by Avista in this case falls at the bottom end of the target range that Standard & Poors expects for an investment grade utility.

Mr. Don Kopczynski, General Manager of Energy Delivery, will describe Avista's energy delivery operations, the Company's vegetation management program, and the major transmission upgrades currently in progress. Mr. Kopczynski describes:

- Avista's customer service programs such as energy efficiency, Project Share, and payment plans. Some of these programs will serve to mitigate the impact on customers of the proposed rate increase;
- The effort, in collaboration with the Bonneville Power Administration, to build and upgrade transmission infrastructure that will improve the delivery of electricity to meet existing and future power needs in Avista's service territory. These projects represent over $100 million in new infrastructure investment that will be completed by 2007;
- Avista's comprehensive and professionally-staffed vegetation management program that reduces customer outages, improves safety, and enhances system reliability.

Mr. Ron Peterson, as Vice President of Power Supply, will provide an overview of Avista's resource planning and power operations. He will also discuss the Company's hydro upgrades, a status report on the Company's license commitments at the Clark Fork

River hydroelectric projects, and the current re-licensing effort for the Spokane River hydroelectric projects. Next, he will discuss the Company's acquisition of the second half of Coyote Spring 2 (CS2) and will discuss the Company's proposal to eliminate the deadband from the ERM calculations. Finally he will address the Company's proposed treatment of expenses related to two small Wartsila generating units, and the Company's proposed treatment of production tax credits related to its Kettle Falls wood-fired plant.

Mr. Don Falkner, Manager of Revenue Requirements, will discuss the Company's overall revenue requirement proposals. In addition, his testimony generally provides accounting and financial data in support of the Company's need for the proposed increase in rates. He sponsors:

- Electric and natural gas revenue requirement calculations;
- Electric and natural gas results of operations;
- Proformed operating results including expense and rate base adjustments;
- System and jurisdictional allocations;
- Advanced Meter Reading accounting proposal.

Mr. Brian Hirschkorn, Manager of Pricing, discusses the spread of the proposed annual revenue changes among the Company's general service schedules and addresses the Company's revenue normalization adjustment. He explains, among other things, that:

- The proposed electric annual revenue increase is $35,833,000, or 12.5%;
  - The monthly bill for a residential customer using an average of 1,000 kwhs per month would increase from $55.09 to $63.01 per month, an increase of $7.92 or 14.4%. This includes the proposed increase in the monthly basic or customer charge from $5.00 to $5.50.

- The proposed natural gas annual revenue increase is $2,943,000, or 1.8%;
  - The monthly bill for a residential customer using 75 therms per month would increase from $74.77 to $76.25 per month, an increase of $1.48 or 2.0%.

Mr. Clint Kalich, Manager of Resource Planning & Power Supply Analyses, will present evidence that will show that the 60-year hydroelectric record should be used for ratemaking purposes. He will also describe the Company's Aurora model (Dispatch Model) inputs, assumptions, and results related to the economic dispatch of Avista's resources to serve load requirements. He explains:

- The use of the entire 60-year record is superior to both the 40-year rolling average and the 50-year average;
- The key assumptions driving the Dispatch Model's market forecast of electricity prices. This discussion includes the variables of natural gas, Western Electricity Coordination Council ("WECC") loads and resources, and hydroelectric conditions;
- The model dispatches Avista's resources and contracts in a manner that maximizes benefits to customers;
- The output results from the model, including thermal generation and short-term wholesale sales and purchases, were provided to Mr. Johnson to incorporate into the power supply proforma adjustments.

Mr. William Johnson, Senior Power Supply Analyst, will describe the adjustments made to normalize power supply revenue and expense items in the proforma period compared to the 2004 test period. Mr. Johnson describes:

- The adjustment of revenues and expenses based on normal stream flow and weather conditions, and expected wholesale market power prices;
- Adjustments are made to reflect known and measurable power contract changes between the 2004 test period, and the proforma period beginning January 1, 2006 and ending December 31, 2006;

- The net effect of the adjustments to the 2004-test period power supply revenues and expenses is a decrease in net expense of $18,912,000 on a system basis, or $12,323,059 for the Washington jurisdiction.

Ms. Tara Knox, Rate Analyst, sponsors the cost of service studies for electric and natural gas service and the weather normalization adjustments to retail usage. Ms. Knox studies indicate:

- Electric service residential and extra large service schedules are earning substantially less than the overall rate of return under present rates, while general service and large general service are earning substantially more than the overall rate of return under present rates;
- Gas general service schedule 101 (primarily residential customers) is earning slightly less than the overall return under present rates, the interruptible gas service schedule is earning substantially more than the overall rate of return at present rates, all other schedules are earning more than the overall return, but less than the requested return;
- Mr. Hirschkorn incorporates these findings in his rate spread recommendation.

Mr. David Holmes, Manager of Distribution Engineering, will present the Company's plan to implement an advanced meter reading (AMR) program in Washington. Mr. Holmes explains:

- The Company plans to install new electric meters and upgrades to existing natural gas meters in Washington over a six-year period beginning in 2006 at a cost of approximately $38.9 million;
- The benefits include savings in meter reading costs, customer billing, maintenance expense, and future customer service enhancements;
- The Company does not seek an increase in rates at this time for AMR costs.

Q. Does this conclude your pre-filed direct testimony?

A. Yes.