BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

DOCKET NO. UE-010395

REBUTTAL TESTIMONY OF JON E. ELIASSEN
REPRESENTING AVISTA CORPORATION

Exhibit T-___ (JEE-T)

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

A. My name is Jon E. Eliassen. I am employed Senior Vice President and Chief Financial Officer by Avista Corporation at 1411 East Mission Avenue, Spokane, Washington.

Q. Have you previously filed direct testimony in this proceeding?

A. Yes.

Q. Could you please summarize your rebuttal testimony?

A. Yes. In their testimony, the Staff, ICNU and Public Counsel witnesses have made recommendations that, if approved by the Commission, would preclude Avista from obtaining financing under reasonable terms, if at all. Since additional financing is necessary to fund ongoing operations of the Company, the recommendations of Staff and other parties fail in many material aspects to address the Company's immediate and critical financial condition. Specifically, their recommendations include 1) discontinuing the power cost deferred accounting mechanism retroactively to June 30, 2001, 2) reducing the size of the surcharge beneath the requested amount, 3) setting all surcharge revenues aside so that they do not directly reduce the deferred balance, and 4) shortening the duration of the surcharge period to a mere three months. Their proposals result in a level of uncertainty that is unacceptable to lenders and investors.

Q. If the Commission adopts the Staff's case, how will the financial community, including rating agencies, react?

A. Based on their reading of the Staff testimony, our lead commercial bank informed the Company on August 28 that our "regulatory risk has increased exponentially". Based on their initial reaction, I was told that our commercial bank line would not be available for the Company to use to meet its ongoing day-to-day cash requirements.

This reaction on the part of our lead bank was based, in part, on the Staff recommendation to end the deferral of energy costs effective June 30, 2001. In the opinion of the bankers, this would require the Company to write off all deferred energy costs incurred since June 30, 2001. For the months of July, August and September alone, these costs are expected to exceed $74 million. Our banks have informed us that, in their opinion, we will be unable to issue equity and probably will be unable to issue additional debt, given the risk that a write off of this magnitude could occur. Our commercial banks believe that unless this issue is clearly resolved in the surcharge order, the Company will be unable to access any financing.

Our commercial banks have also informed me that absent additional credit support, we cannot borrow under our lines. In that case, we would be in default under our bank line covenants at the end of September and would require a waiver from our banks to allow us to continue to maintain access to the line.

Q. Is the response from the investment community limited to one or two institutions, or is it more widespread?

A. I have been in conversations with a number of our banks in the past few days, and the reaction has been quite uniform. The negative components of the Staff case have heightened lender concerns that energy costs incurred by the Company to meet system load requirements would continue to mount and might not be recovered. Commercial banks are unwilling to take the risk of financing any part of our ongoing operations or our capital construction budget, including the Coyote Springs project, based on our current deteriorating financial condition and lack of liquidity. We will only be able to access bank financing if we can establish other means of credit support, and we are currently working with them to maintain our ability to retain the outstanding loans. It is unclear at this point if we will be able to 1) obtain waivers of covenants to avoid default at the end of September, and 2) be able to continue to borrow under the line. Even if we do not borrow any more under the line, we still need a waiver from the banks at September 30 to avoid a technical default under the bank line, which could trigger other events of default through cross-default provisions in certain financing agreements.

Even if we obtain waivers, the lines by themselves maybe insufficient to fund the Company's cash requirements through the fourth quarter, especially since we have $64 million of maturing securities in December of this year.

If we are granted forbearance by the banks relating to the covenants, and we were to obtain financing in some way for the Coyote Springs Project, we still must recover the $265 million of deferred power costs over some reasonable time to remain solvent. Absent recovery of that expense we will be unable to continue to fund our utility operations. Of this total, over $150 million relates to electric energy costs for serving Washington customers. A clear recovery mechanism is critical to Avista's financial health.

Q. Do the reactions of the banks and other lenders raise additional concerns related to the Company's credit rating?

A. Yes. I am extremely concerned that the lack of support evidenced by the Commission Staff in their case will cause further negative reaction on the part of credit rating agencies as well, especially in light of the negative reaction of the banks. We are barely a BBB- with Standard and Poor's, and a combination of increased borrowing costs, lack of recovery of deferrals, the risk of writing off a major portion of the energy costs already incurred and deferred, will likely result in a downgrade to BB. Both Moody's and S&P continue to rate Avista with a negative outlook. If a downgrade occurs, we may be unable to access capital at all. It is clear that the operating costs of the Company could increase dramatically, as testified to by Mr. Norwood, if the Company loses its tenuous hold on the BBB- rating.

Q. Will the Company be able to issue new equity if the Commission adopts the Staff's proposals?

A. No, we will not. In my opinion, the Staff makes recommendations that, if adopted by the Commission, will preclude the issuance of any equity, and may preclude the sale of debt securities as well. The heightened uncertainty of recovery of any deferred power costs, as included in the Staff testimony, currently places the Company in jeopardy of even being able to fund operations through September. Furthermore, the positions taken by Staff to limit the duration of the surcharge to 90 days, and to preclude the Company from using the proceeds from the surcharge to reduce the deferral balance exacerbates the problem. Adding to those issues, the risk resulting from Mr. Elgin's proposals may cause the Company to write off all deferred power costs incurred since July, or the risk created by Mr. Lott that would require us to write off all of the deferred costs of providing service, results in a situation that makes it very difficult – if not impossible – to obtain any financing at this time.

I'm not aware that the Commission Staff has done any analysis to determine what impact eliminating deferrals would have on the Company or its ability to obtain financing.

Q. If the surcharge were approved under conditions that would allow Avista to issue new equity at a reasonable price, would the Company be able to meet the covenants under its line of credit?

A. Not immediately. The surcharge, even as proposed by the Company, only recovers about $87 million annually, and it will take two years or more to eliminate the deferral. The surcharge and the issuance of equity will allow us to begin to meet covenants by the first or second quarter of 2002. We will need to complete additional financing in addition to the surcharge to meet covenants by early 2002.

And, while the cash recovery is critical, it is also critical for us to reduce and eliminate the deferral balance as quickly as we can to help restore our balance sheet. We have also proposed to reduce the deferral through the acceleration of the PGE contract benefits to further expedite reduction of the deferral balance, as we testified to in our original filing.

Q. Why hasn't the Company cut its dividend on common shares?

A. Cutting the dividend at a time when we need to issue additional common equity would be counterproductive. We need to show investors that we can continue to pay interest and dividends, if we hope to have any chance of continuing to finance the Company. We substantially reduced the dividend three years ago, and today have a very low dividend payout and one of the lowest yields when compared to others in our industry.

Companies that have eliminated dividends either haven't faced the need to immediately issue more equity, or they have much higher earnings growth rates which provide an opportunity to increase share value over time.

Even our banks, who have all encouraged us to eliminate cash expenditures, sell assets, and cut costs, have not asked us to cut the dividend. Quite the contrary, they want to see us issue more common stock to provide more debt protection, improve interest coverage and cash flow and strengthen the balance sheet.

Ultimately, the credit rating agencies will want to see us do the same: issue more equity to strengthen and improve our financial profile.

Q. Even if a dividend cut were made, would it solve the crisis faced by the Company?

A. No, it would not. In my opinion, the 'savings' from totally eliminating the dividend, about $23 million annually, would not make an appreciable difference in our financial situation, and would eliminate any chance of issuing common in the near term. The Company intends to issue a minimum of $70 million of additional common equity in the next year, which is several times the amount paid in dividends. Therefore, a dividend cut would result in the opposite outcome implied by the Staff recommendation.

Q. Mr. Thornton claims that the Company is not in financial distress because the dividend has not been cut. How do you respond to such an assertion?

A. We must maintain all payments to investors, including the common dividend, if we hope to be able to continue to access capital markets. We are continually asked by our bankers and by rating agencies if our plans include issuance of common equity. The company is very close to a 60% debt ratio and will need to issue additional equity to help offset and support such a heavy debt burden. If we were to reduce or eliminate the common dividend, we would surely be precluded from issuing any additional common equity for some time.

Q. Were the cash savings from the prior dividend cuts used mainly for investments in unregulated subsidiaries, as Mr. Thornton alleges on page 4, lines 9-24 and on page 12, lines 2-4 of his testimony?

A. The dividend reduction amounted to less than $35 million on an annual basis, and provided the Company with additional cash for utility capital expenditures, payment of ongoing operating costs, purchase of energy for customers, and a reduction in otherwise required debt levels. Through this time, the Company was also investing equity in non-regulated subsidiaries as well. It is not possible or reasonable to claim that all of the reduction went to a single investment or a single purpose.

Q. Do you view the Staff's case as responsive to the financial crisis faced by Avista?

A. Absolutely not. While the Staff does seem to agree that a surcharge is justified and that the Company is facing a financial crisis, their recommendations effectively eliminate the financial benefits that the rate increase was designed to provide. The Staff recommendations fail to constructively provide the opportunity for the Company to deal with high power costs and also fail to address the deferral balance accumulated in the mechanism approved by the Commission. As I mentioned earlier, the reaction on the part of our commercial banks was that the regulatory risk "increased exponentially" given the Staff position, including the Staff's creation of the potential for huge write off.

Even if we found the cash to continue to fund day to day operations and our construction budget, we must have a mechanism in place to allow recovery of the legitimate costs we have incurred to by power. Without recovery of the deferred energy costs, we do not have any opportunity to regain our financial strength, improve our credit rating or remain financially viable long term.

Q. Was the deterioration in the Company's financial condition due primarily to the Company's subsidiaries as suggested by Mr. Thornton?

A. While it could be argued that the subsidiaries have historically had some impact on its financial condition, the deterioration of the Company's financial condition during 2000 and 2001 is primarily due to the unexpected need to fund the more than $300 million we have 'invested' in deferred electric and gas costs, while also investing approximately $190 million in the Coyote Springs II resource.

In fact, I believe that Avista Capital will be a net contributor of cash to Avista in 2001-2002, not a net cash drain on the Company. In addition, the earnings contribution of Avista Energy has been critical to support the total earnings and equity of the Company.

Q. Has the Company asked for more than is necessary because some financial ratios will be above minimums, as suggested by Mr. Thornton on page 14, lines 10 to 23?

A. We have not asked for more than we need, and in fact may not be asking for enough, in my opinion. Even Mr. Schooley's recommendation is insufficient. Mr. Schooley determines that a 32.6% increase is required based solely on his analysis of what it would take to reach the minimum fixed charge coverage ratio of 1.25, and only for a limited period of time. We have attempted to balance the needs of the Company to regain financial viability with the concern we have for holding customer rates to the lowest practical level. We need as much cash return of the deferral balances, as soon as we can get it, to meet cash interest coverage tests, to continue to access other forms of financing and to hopefully maintain our current BBB- credit rating.

Q. What were the immediate impacts of the August 2, 2001, S&P rating downgrade?

A. Several counterparties that the Company relies upon to provide short-term and real-time energy suspended their authority to transact with Avista. We were precluded from buying energy from those parties absent prepayments or other unusual terms. The obvious and acknowledged cause for suspending their authority to transact with Avista was the concerns expressed by S&P in their downgrade, including S&P's continued negative outlook.

Q. What additional actions have counterparties taken related to the S&P ratings downgrade?

A. In the energy resource markets, parties trade with one another by entering contracts for future delivery of energy to one another and for the right to use energy delivery facilities (gas transportation and power transmission). The value of the future obligations associated with energy and delivery rights is supported by the contracting party's perceived (and real) ability to perform on its delivery or settlement obligations. A party is generally granted an unsecured credit limit determined by the extent that its continuing cash flows and balance sheet are strong enough to warrant confidence by its counterparties that it will meet those obligations. To the extent that obligations exceed the amount that parties will grant unsecured credit, transactions may be subject to collateral or other assurance of performance, generally in the form of prepayments or irrevocable letters of credit by a creditworthy entity (such as a bank). In addition, as I explained earlier, counterparties may restrict future transactions completely. Mr. Norwood provides additional discussion to the impacts on power supply operations.

Q. In the testimony of WUTC Staff witness Mr. Schooley, he includes an assumption that "Avista is able to finance the Coyote Springs II plant and that Avista successfully issues $67,600,000 of common stock in the remainder of 2001" (TES-1T, page 20). Is Mr. Schooley's assumption valid?

A. The potential to obtain financing is a complex matter, conditioned on the outcome of this rate surcharge proposal. The Company's ability to finance Coyote Springs II and the ability to issue common stock on any reasonable terms are both predicated on the Company receiving reasonable recovery of its deferred power costs. Lenders and other investors have continued to stress their reluctance to provide additional funding absent a regulatory decision that provides cash flow to cover power costs and to reduce, and ultimately eliminate, the deferred power costs.

In addition, the ability to obtain financing is impacted by the Company's credit ratings. Since Avista is now one step above the 'BB' rating level (a level that precludes many investors from participating) and the Company is rated with a negative outlook. Any further ratings deterioration would have a serious detrimental effect on the Company's ability to obtain new financing and to use existing credit facilities, let alone add to them. Increased confidence in the Company's financial performance is critical to support the possibility of both the Coyote Springs project financing and any new common equity issuance in the near term.

Therefore, Mr. Schooley's assumption is only valid if the Company's proposed surcharge is granted. However, the Staff has proposed conditions that would make Mr. Schooley's assumption unattainable. Giving full effect to the Staff's recommendations, Mr. Schooley's assumptions about the availability of financing Coyote and of raising capital through a common stock sale are invalid.

Q. Does that conclude your rebuttal testimony?

A. Yes, it does.