Exhibit AVA-100

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Avista Corporation	)	Docket No. ER10-____-000

PREPARED DIRECT TESTIMONY OF
MARK T. THIES
ON BEHALF OF AVISTA CORPORATION

October, 2009

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Avista Corporation	)	Docket No. ER10-____-000

PREPARED DIRECT TESTIMONY OF
MARK T. THIES
ON BEHALF OF AVISTA CORPORATION

I. INTRODUCTION

Q. Please state your name, business address, and present position with Avista Corp.

A. My name is Mark Thies. My business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corporation ("Avista" or "Company") as Senior Vice President and Chief Financial Officer.

Q. Would you please describe your education and business experience?

A. I received a Bachelor of Arts degree in Accounting and Business Administration from Saint Ambrose College in Davenport, Iowa, and became a Certified Public Accountant in 1987. I have extensive experience in finance, risk management, accounting and administration within the utility sector, primarily in the Midwest.

I joined Avista in September of 2008 as Senior Vice President and Chief Financial Officer ("CFO"). Prior to joining Avista, I was Executive Vice President and CFO for Black

Hills Corporation, a diversified energy company, providing regulated electric and natural gas service to areas of South Dakota, Wyoming and Montana. I joined Black Hills Corporation in 1997 upon leaving InterCoast Energy Company in Des Moines, Iowa, where I was the manager of accounting. Previous to that I was a senior auditor for Arthur Anderson & Co. in Chicago, Illinois.

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

A. I will provide an overview of Avista. I will also provide a financial overview of the Company and will explain the overall rate of return proposed by the Company in this filing for its transmission rate increase. The proposed rate of return is derived from Avista's total cost of debt including long-term and common equity, weighted in proportion to the Company's actual capital structure. Dr. William E. Avera will provide additional testimony on behalf of the Company related to the appropriate return on equity for Avista, based on the specific circumstances of the Company, together with the current state of the financial markets.

In brief, I will provide information that shows:

- Avista's plans call for significant capital expenditure requirements for the utility over the next two years to assure reliability in serving growth in the number of customers and customer demand. Capital expenditures of approximately $420 million are planned for 2010-2011 for customer growth, investment in generation, transmission and distribution facilities for the electric utility business as well as necessary maintenance and replacements of our natural gas utility systems. Avista needs adequate cash flow from operations to fund these requirements, together with access to capital from external sources under reasonable terms.

- Avista's corporate credit rating from Standard & Poor's is currently BBB- and Baa3 from Moody's. Avista needs to operate at a level that will support a strong investment grade corporate credit rating, meaning "BBB" or "BBB+", in order to access capital markets at reasonable rates, which will decrease long-term costs to customers. Maintaining solid credit metrics and credit ratings will also help support a stock price necessary to issue equity to fund capital requirements.

- The Company has proposed an overall rate of return of 8.92%, including a 50.27% equity ratio and a 10.9% return on equity. The proposed 10.9% return on equity provides a reasonable balance of the competing objectives of continuing to improve Avista's financial health, and the impacts that increased rates have on Avista's customers.

The Company's initiatives to carefully manage its operating costs and capital expenditures are an important part of improving performance, but certainty of cash flows from operations can only be achieved with the continued support of regulators in allowing the timely recovery of costs and the ability to earn a fair return on investment.

Finally, I will introduce each of the other witnesses providing testimony on the Company's behalf.

A table of contents for my testimony is as follows:

II. TRASMISSION RATE REQUEST

Q. Please summarize the proposed changes in transmission rates in this filing.

A. In this filing, Avista proposes to increase its annual transmission revenue requirement ("TRR") from $28.6 million to $49.4 million to reflect Avista's substantial investment in transmission facilities since its rates were last set in 1996. The rate increase will result in 73% higher rates for Network Integration Transmission Service ("NITS") and 43%

higher rates for point-to-point service under Avista's Tariff. Avista is not seeking rate incentives and the rates for ancillary services will not be affected.

Q. Why is Avista proposing a transmission revenue increase?

A. Avista last filed a general rate case on July 5, 1996, when it filed an open access transmission tariff ("OATT") in Docket No.OA96-162-000 to establish the rates, terms, and conditions of point-to-point and NITS consistent with Order No. 888's *pro forma* OATT.[1] Since then, Avista has added $212 million in gross plant investment to its transmission system, representing an 85% increase since 1996. Likewise, Avista's net transmission plant has gone up by $121 million since 1996, an increase of 67%.

To recoup its extensive transmission investment since its rates were last established, Avista proposes to increase its annual TRR from the $28.6 million approved in 1996 to $49.4 million. This increase in TRR will result in a 73% increase in rates to Avista's sole NITS customer, Bonneville, whose monthly rates will continue to be based on an approximate 12% load ratio share of Avista's monthly TRR.

[1] On February 29, 1996, Avista (then known as Washington Water Power Company) filed a pre-Order No. 888 open access transmission tariff with a requested effective date of May 1, 1996, under Docket No. ER96-1210-000. The Commission set the filing for hearing and made the rates effective May 1, 1996. After Order No. 888 was issued, but before the pre-hearing conference in Docket No. ER96-1210-000 was held, Avista requested a stay of the proceeding until it could re-file its transmission rates under Order No. 888. Avista did re-file its rates and OATT in compliance with the *pro forma* OATT under Order No. 888 in Docket No. OA96-162 on July 5, 1996. Those rates became effective July 9, 1996 pursuant to Order No. 888, and were accepted for filing by letter order on February 24, 1999 in Docket No. OA96-162. *See* Order 888, *Promoting Wholesale Competition Through Open Access Non-discriminatory Transmission Serv. by Pub. Util., Recovery of Stranded Costs by Pub. Util. and Transmitting Utilities; FERC Statutes and Regulations, Regulations Preambles January 1991-June 1996* ¶31,036 at p. 31,769 (1996) (holding that tariff filings by utilities necessitated by Order No. 888 "go into effect, subject to refund, 60 days after publication of this Rule in the *Federal Register*"); *order on reh'g, FERC Statutes and Regulations, Regulations Preambles July 1996-December 2000* ¶31,048 (1997) (Order 888-A), *order on reh'g,* Order No. 888-B, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 86 FERC ¶ 61,048 (1998), *aff'd and remanded sub nom Transmission Access Policy Study Group, v. FERC*, 225 F.3d 667 (D.C. Cir. 2000).

Avista is proposing to increase its point-to-point transmission rates from $1.40 per kW-month to $2.00 per kW-month. This will result in a 43% increase in rates for Avista's long-term firm point-to-point customers Consolidated Irrigation District No. 19, East Greenacres Irrigation District, Public Utility District No. 2 of Grant County, the City of Seattle, and Tacoma Power.

Notably, Avista has discussed its need and justifications for the proposed rate increase with its affected long-term customers prior to making this rate filing. Based on those discussions, Avista understands that its affected long-term customers do not intend to oppose the proposed increase in rates.

III. OTHER COMPANY WITNESSES

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

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

Mr. Ronald McKenzie, Manager, Regulatory Accounting, will discuss financial data and cost of service statements filed in support of the increased transmission rates set forth in this filing.

Mr. Jeff Schlect, Manager, Transmission Services, will provide testimony related to Statements AU – Revenue Credits, AX – Other Recent and Pending Rate Changes, BA – Wholesale Customer Rate Groups, BB – Allocation Demand and Capability Data, BC – Reliability Data, BG – Revenue Data to Reflect Changed Rates, BH – Revenue Data to Reflect Present Rates, BL – Rate Design Information, and revisions to Tariff sheets.

Dr. William E. Avera, President of Financial Concepts and Applications (FINCAP), Inc., has been retained to present testimony with respect to the Company's rate of return on common equity (ROE). He concludes that:

- Application of the Commission's discounted cash flow (DCF) approach to a risk-comparable group of proxy companies implies an ROE zone of reasonableness of 8.6 percent to 17.5 percent, with a midpoint of 13.1 percent and a median of 11.5 percent.
- Because Avista's requested ROE of 10.9% percent falls below both the midpoint and the median of the DCF results for the proxy group of risk-comparable electric utilities, it represents a conservative estimate of investors' required rate of return.
- Excluding the 17.5 percent estimate at the upper end of Dr. Avera's zone of reasonableness would not alter his conclusion that Avista's requested ROE is reasonable. Similarly, Dr. Avera demonstrated that Avista's requested ROE of 10.9 percent would fall within the range and below the midpoint of DCF results for a regional proxy group based on membership in the Western Electricity Coordinating Council.
- Considering investors' expectations for capital markets and the need to support financial integrity and fund crucial capital investment even under adverse circumstances, 10.9% percent is a reasonable, albeit conservative, ROE for Avista.
- Because of Avista's reliance on hydroelectric generation, the Company is exposed to relatively greater risks of power cost volatility.
- Avista's requested capitalization is consistent with the Company's need to strengthen its credit standing and financial flexibility as it seeks to raise additional capital to fund significant system investments and meet the requirements of its service territory.
- The reasonableness of a minimum 10.9% percent ROE for Avista is also supported by the greater risks associated with the Company's relatively weak credit standing, small size, and the need to consider flotation costs.

IV. OVERVIEW OF AVISTA

Q. Please describe Avista's current utility business focus.

A. Avista's strategy continues to focus on its energy and utility-related businesses, with the Company's primary emphasis on the electric and natural gas utility business. There are four distinct components to Avista's business focus for the utility, which the Company has referred to as the four legs of a stool, with each leg representing customers, employees, the communities Avista serves, and Avista's financial investors. For the stool to be level, each of these legs must be in balance by having the proper emphasis. This means Avista must maintain a strong utility business by delivering efficient, reliable and high quality service, at a reasonable price, to Avista's customers and the communities Avista serves, and provide the opportunity for sustained employment for the Company's employees, while providing an attractive return to investors.

The Company recently received upgrades to its corporate credit ratings to investment grade by Moody's Investors Service in December 2007, Standard & Poor's in February 2008, and Fitch Ratings in May 2009. Although Avista is continuing to make progress in improving the Company's financial condition, Avista is still not as strong financially as it needs to be. Timely rate relief through this and other filings is an important element in continuing to gain financial strength and improving Avista's credit rating. With higher levels of capital spending required over the next several years, it is more important than ever that the Company remain financially healthy in order to attract capital investment and financing at a reasonable cost. Later I will discuss further actions taken by the Company to improve cash flow, reduce debt, and the Company's continuing efforts to improve its financial condition.

Q. Please briefly describe Avista.

A. Avista is headquartered in Spokane, Washington. Avista provides electric and natural gas service within a 26,000 square mile area of eastern Washington and northern Idaho. The Company also provides natural gas distribution service in southwestern and northeastern Oregon.

As of December 31, 2008, Avista had total assets (electric and natural gas) of approximately $3.4 billion (on a system basis), with electric retail revenues of $636 million (system) and natural gas retail revenues of $448 million (system). As of December 2008, the Company had 1,482 full-time employees.

Avista has a long history of innovation and environmental stewardship. At the turn of the 20^{th} century, the Company built its first renewable hydro generation plant on the banks of the Spokane River. In the 1980's, Avista developed an award-winning biomass plant (Kettle Falls) that generates energy from wood-waste.

In the future, Avista and other utilities face new state and federal mandates for renewable energy and carbon control standards. For example, Washington's Senate Bill 6001 and Initiative 937 require certain public and private utilities to produce 15 percent of their power from new renewable resources by 2020, not including legacy hydro production, and to eliminate the option of coal-fired generation through carbon emission limitations. Recognizing these changes, the Company dropped all new coal generation in its 2007 electric Integrated Resource Plan, instead relying on natural gas, renewables, and energy efficiency. Today, Avista has one of the smallest carbon footprints of any utility in the U.S.

V. FINANCIAL OVERVIEW

Q. Please provide an overview of Avista's financial situation.

A. The Company has made solid progress in improving its financial health in recent years, as demonstrated by improved financial ratios. Avista has reduced investments in unregulated subsidiaries and redeployed the majority of the proceeds from the sales of the unregulated subsidiaries to the Company. The Company has been able to improve its debt ratio and balance the overall debt/equity ratio by paying down debt, by issuing additional common stock, and through additional retained earnings. Although Avista has made progress in improving the Company's financial condition, Avista is still not as strong as it needs to be given the current unrest in capital markets, which may continue for some time.

Avista's goal is to operate at a level that will support a strong corporate credit rating of at least BBB/BBB+, and thus move away from the "cliff" of the investment grade rating scale. Operating at a higher rating will help reduce long-term costs to customers. It will also reduce collateral requirements and allow Avista to maintain access to more counterparties for acquisition of natural gas and electricity. Avista expects its continued focus on the regulated utility, conservative financing strategies and a continued supportive regulatory environment will contribute to an overall improved financial situation that will allow the Company to move up from the current BBB- rating.

Q. What additional steps is the Company taking to improve its financial health?

A. The Company is working to assure it has adequate funds for operations, capital expenditures and debt maturities. In September 2009, Avista issued $250 million of 12-year debt at favorable rates in the public markets.

Avista is maintaining its $320 million line of credit, which will expire in April 2011, as well as its Accounts Receivable Sales program. The Company plans to obtain a portion of its capital requirements through equity issuance in 2010 and beyond. Avista also maintains an ongoing dialogue with the rating agencies regarding the measures taken by the Company to improve its credit rating.

Additionally, the Company is working through regulatory processes to recover its costs in a timely manner so that earned returns are closer to those allowed by regulators in each of the states Avista serves. This is one of the key determinants from the rating agencies' standpoint when they are reviewing Avista's overall credit standing.

Q. In addition to having credit ratings that will allow Avista to attract debt capital under reasonable terms, is it also necessary to attract capital from equity investors?

A. It is absolutely essential. Avista has two primary sources of external capital – debt lenders and equity investors. Avista currently has approximately $2.0 billion of net investment in place to serve its customers. Approximately half of that investment is funded by debt holders, and half is funded by equity investors. Therefore, even though there tends to be a lot of emphasis on maintaining credit metrics and credit ratings that will provide access to debt capital under reasonable terms, access to equity capital is equally important.

Additional equity capital generally comes in two forms – retained earnings and new equity issuances. Retained earnings represent the annual earnings (return on equity) of the Company that is not paid out to investors in dividends. The retained earnings are reinvested by the Company in utility plant, and other capital requirements, to serve customers, which avoids the need to issue new debt. Occasionally it is necessary to issue new common stock to maintain the proper balance of debt and equity in the capital structure, which allows Avista access to both debt and equity markets under reasonable terms, on a sustainable basis. Because of the large capital requirements at Avista, it is imperative that Avista have ready-access to both the debt and equity markets at reasonable costs.

Q. Are the debt and equity capital markets competitive markets?

A. Yes. Our ability to attract new capital, especially equity capital, under reasonable terms is dependent on our ability to offer a risk/reward opportunity that is better than the equity investors' other alternatives. Avista is competing with not only other utilities, but businesses in other sectors of the economy. As an example, if an equity investor believes, or perceives, that the risk/reward opportunity is better with Wal-Mart than with Avista, or the utility industry in general, the investor will put the equity dollars in Wal-Mart stock. Demand for the stock supports the stock price, which provides the opportunity to issue additional stock under reasonable terms to fund capital investment requirements.

To the extent that the equity investor holds a diversified portfolio of companies that includes utilities and other energy companies, Avista would be competing with those companies to attract those equity dollars.

In the debt markets, utilities are the third largest issuers, right behind governments and financial services. Therefore, it is a very competitive market and the Company must be able to attract debt investors as well as equity investors.

Q. What is Avista doing to attract equity investment?

A. Avista is carrying a capital structure that provides the opportunity to have financial metrics that offer a risk/reward proposition that is competitive and/or attractive for equity holders.

Avista has increased its dividend for common shareholders, and has publicly stated that it intends to work toward a dividend payout ratio that is comparable to other utilities in the industry. This is an essential element in providing a competitive risk/reward opportunity for equity investors.

Avista is operating its business efficiently to keep costs as low as practicable for its customers, while at the same time ensuring that its service is reliable, and results in a high level of customer satisfaction. An efficient, well-run business is not only important to Avista's customers, but also to investors.

Avista has been seeking rate relief to provide timely recovery of costs and earned returns closer to those allowed by regulators. If Avista is not able to achieve a reasonable, actual, earned return on its equity investment, Avista will not be able to attract equity dollars that are absolutely necessary to support its business going forward.

Dr. Avera provides additional testimony related to the appropriate return on equity for Avista that would allow the Company access to equity capital under reasonable terms, and on a sustainable basis.

VI. CREDIT RATINGS

Q. How important are credit ratings for Avista?

A. Utilities need ready access to capital markets in all types of economic environments. I believe few, if any, would have predicted the kind of financial markets we have experienced during the past year. The nature of Avista's business with long-term capital projects, its obligation to serve, and the potential for high volatility in fuel and purchased power markets, necessitates the ability to tap the financial markets under reasonable terms on a regular basis.

In the past year there has been ample evidence of the benefit of having a higher credit rating. As an example, in December 2008, El Paso Electric, with a BB credit rating, issued bonds at an effective cost of 15%.

In April 2008, Avista issued $250 million of 10-year debt at 5.95%. In the fall of 2008 Avista planned to issue an additional $100 million of long-term debt. In the fall of 2008, however, because of the unrest in the financial markets, there were times when Avista could not issue debt at <u>any</u> interest rate and, when it could issue debt, the all-in interest rates were 9.5% or higher. Fortunately, Avista was able to negotiate the acquisition of an additional credit line of $200 million for a period of 364 days, under favorable terms, and avoid issuing new long-term debt at these high rates. The financial markets were more stable in the later part of 2009, allowing Avista to issue $250 million of 12-year debt at 5.125%.

Q. Please explain the credit ratings for Avista's debt securities.

A. Rating agencies are independent agencies that assess risks for investors. The three most widely recognized rating agencies are Standard & Poor's ("S&P"), Moody's Investors Service ("Moody's") and FitchRatings ("Fitch"). These rating agencies assign a credit rating to companies and their securities so investors can more easily understand the risks associated with investing in their debt and preferred stock. Avista's credit ratings by the three principal rating agencies are summarized below:

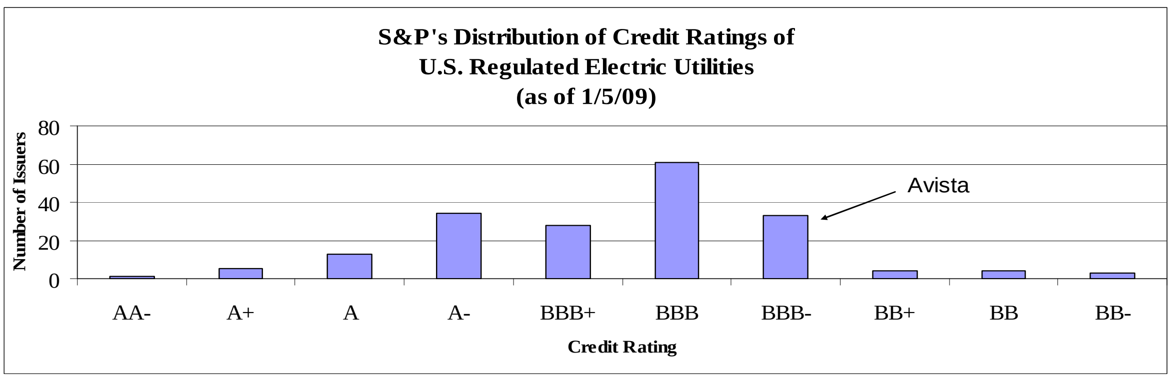
The following table summarizes our credit ratings as of October 29, 2009:

	Standard & Poor's (1)	Moody's (2)	Fitch, Inc. (3)
Avista Corporation			
Corporate/Issuer rating	BBB-	Baa3	BBB-
Senior secured debt (4)	BBB+	Baa1	BBB+
Senior unsecured debt	BBB-	Baa3	BBB
Avista Capital II (5)			
Preferred Trust Securities	BB	Ba1	BBB-
Rating outlook (6)	Positive	Positive	Stable

(1) Ratings were upgraded in February 2008.
(2) Ratings were upgraded in December 2007, and the senior secured debt rating was further upgraded to Baa1 from Baa2 in August 2009.
(3) Ratings were upgraded in May 2009.

(4) Based on our understanding of the methodology currently used by Standard & Poor's, the rating on senior secured debt may depend on, among other things, the amount of our utility property (net of depreciation) relative to the amount of such debt outstanding and the amount currently issuable. Thus, the rating on senior secured debt as of any particular time may depend on factors affecting our utility property accounts, as well as factors affecting the principal amount of such debt issued and issuable, including factors affecting our net income.
(5) Only assets are subordinated debentures of Avista Corporation.
(6) Rating outlook for Standard & Poor's and Moody's was changed to "Positive" from "Stable" in August 2009.

As shown below, Avista is on the lowest rung of the investment grade credit rating scale. As I noted earlier, I believe it is important that Avista move up the scale to at least a BBB or BBB+, so that it is not on the edge of the investment grade cliff.



Q. Please explain the implications of the credit ratings in terms of the Company's ability to access financial markets.

A. Credit ratings impact investor demand and expected return. More specifically, when a company issues debt, the credit rating helps determine the interest rate at which the debt will be issued. The credit rating also determines the type of investor who will be interested in purchasing the debt. For each type of investment a potential investor could make, the investor looks at the quality of that investment in terms of the risk they are taking and the priority they would have in the event that the organization experiences severe financial stress. Investment risks include the likelihood that a company will not meet all of its debt obligations in terms of timeliness and amounts owed for principal and interest. Secured debt receives the highest ratings and priority for repayment and, hence, has the lowest relative risk. In challenging credit markets, where investors are less likely to buy corporate bonds, a higher credit rating will attract more investors, and a lower credit rating could shrink or eliminate the number of potential investors. Thus, lower credit ratings may result in a company having more difficulty accessing financial markets and/or incur significantly higher financing costs.

Q. What credit rating does Avista Corporation believe is appropriate?

A. The move to investment grade for Avista last year was a significant step in improving the ability to access capital at a reasonable cost. However, a credit rating at the bottom of investment grade is not acceptable to Avista. In adverse conditions – whether unique to Avista or by all market participants – a downgrade from BBB- (investment grade) to BB+ (high-yield) is significantly harder to overcome than a downgrade from BBB to BBB-. As Avista experienced, it took approximately six years for the Company to regain its investment grade rating from S&P after it was downgraded during the energy crisis. The difference between investment grade and non-investment grade is not only a matter of debt pricing, it can be a matter of any access at all. During the period from mid-September 2008 to mid-December 2008, the credit markets were essentially closed to non-investment grade issuers. In order to be able to weather a potential downgrade, Avista needs to operate at a level that will support a strong corporate investment grade credit rating, meaning a “BBB” or a “BBB+,” using S&P’s rating scale.

A solid investment grade credit rating would also allow the Company to post less collateral with counterparties than would otherwise be required with a lower credit rating. This results in lower costs. It also increases financial flexibility since the credit line capacity would not be reduced for outstanding letters of credit.

Financially healthy utilities have lower financing costs which, in turn, benefit customers. In addition, financially healthy utilities are better able to invest in the needed infrastructure over time to serve their customers, and are better able to withstand the challenges and risks facing the industry.

Q. What financial metrics are used by the rating agencies to establish credit ratings?

A. S&P modified its electric and natural gas utility rankings in November 2007 to conform to the "business risk/financial risk" matrix used by their corporate ratings group. The change by S&P was designed to present their rating conclusions in a clear and standardized manner across all corporate sectors.

The 2007 S&P's financial ratio benchmarks used to rate companies such as Avista are set forth below.

2007 Standard & Poor's Financial Risk Indicative Ratios - US Utilities

	FFO/Debt (%)	FFO/Interest (x)	Debt Ratio (%)
Modest	40 - 60	4.0 - 6.0	25 - 40
Intermediate	25 - 45	3.0 - 4.5	35 - 50
Aggressive	10 - 30	2.0 - 3.5	45 - 60
Highly leveraged	Below 15	2.5 or less	Over 50
12 Month End 12/31/08 Ratios:			
Avista Adjusted*	19.4	4.13	55.8

* Calculated as of 12/31/08 based on S&P methodology at that time

The ratios above are utilized to determine the financial risk profile. Avista was in the "Aggressive" category. The financial risk category along with the business risk profile (Avista was in the Strong category) is then utilized as illustrated below to determine a company's rating. S&P has Avista's corporate credit rating as a BBB-, as indicated in the following illustration.

Standard & Poor's Business Risk / Financial Risk Matrix

	Financial Risk Profile				
Business Risk Profile	Minimal	Modest	Intermediate	Aggressive	Highly leveraged
Excellent	AAA	AA	A	BBB	BB
Strong	AA	A	A-	BBB-	BB-
Satisfactory	A	BBB+	BBB	BB+	B+
Weak	BBB	BBB-	BB+	BB-	B
Vulnerable	BB	B+	B+	B	B-

The other rating agencies (Moody's and Fitch) use a similar methodology to analyze and determine utility credit ratings.

Q. Please describe how these ratios are calculated and what they mean?

A. The first ratio, “Funds from operations/total debt (%)”, calculates the amount of cash from operations as a percent of total debt. The ratio indicates a company’s ability to fund debt obligations. The second ratio, “Funds from operations/interest coverage (x)”, calculates the amount of cash from operations that is available to cover interest requirements. This ratio indicates how well a company’s earnings can cover interest payments on its debt. The third ratio, “Total debt/total capital (%)”, is the amount of debt in our total capital structure. The ratio is an indication of the extent to which the company is using debt to finance its operations. S&P looks at many other financial ratios; however, these are the three most important ratios they use when analyzing our financial profile.

Q. Do rating agencies make adjustments to the financial ratios that are calculated directly from the financial statements of the Company?

A. Yes. Rating agencies make adjustments to debt to factor in off-balance sheet commitments (for example, the accounts receivable program, purchased power agreements and the unfunded status of pension and other post-retirement benefits) that negatively impact the ratios. S&P has historically made adjustments to Avista’s debt totaling approximately $237 million related to the accounts receivable program, purchased power, post-retirement benefits, and other items. The adjusted financial ratios for Avista are included in the illustration above.

Q. Where does Avista fall within those coverage ratios?

A. Avista’s cash flow ratios have improved as a result of the refinancing of the high cost debt that matured in June 2008. S&P and Moody’s took this into account when they upgraded Avista in December 2007 and February 2008. Progress in increasing the cash flow ratios in recent years has been slower than anticipated due to below normal stream flows affecting hydro generation, higher thermal fuel costs than the amount included in rates and the resulting inability to eliminate electric deferral balances, and higher capital expenditures that require cash up front before Avista can recover the costs from customers. Each has an impact on the Company by reducing the amount of available cash flow from operations, requiring external financing and ultimately resulting in higher debt and lower cash flow ratios. In fact, S&P stated the following in a January 2008 research report on Pacific Northwest Hydrology:

> We find that Avista and Idaho Power, which are comparably sized companies, face the most substantial risk (related to hydro power) despite their PCAs and cost update mechanisms.[2]

Additionally, S&P stated the following in its February 2008 research update of Avista Corporation:

> The Company's financial performance will continue to be significantly affected by hydro conditions and gas prices. And the Company's key utility risk going forward is its exposure to high-cost replacement power, particularly in low water years.[3]

In order to improve the cash flow ratios, Avista must reduce its total debt balances and increase its available funds from operations. Although the Company has continued to work towards paying down its total debt, the negative impacts to cash flow caused by below-normal hydroelectric generation and volatility of wholesale electric market prices and natural gas prices in recent years, has adversely affected Avista's progress in improving the cash flow ratios.

Q. Do the rating agencies look at any other factors when evaluating a company's credit quality?

[2] Standard and Poor's, *Pacific Northwest Hydrology and Its Impact on Investor-Owned Utilities' Credit Quality* , January 2008

[3] Standard and Poor's, *Avista Corp's Corporate Credit Rating Raised One Notch to BBB-*, February 2008

A. Yes. In addition to financial ratios and metrics, rating agencies also look at a number of qualitative factors which directly or indirectly may affect a company's cash flow. These factors include:

- Regulation
- Markets
- Operations
- Competitiveness, and
- Management

In evaluating these factors, the rating agencies look for regulatory actions that are supportive of cost recovery and that eliminate or minimize volatility of cash flows. They also consider the strength and growth of the economy in our service territory, operations' ability to control costs, whether our service is competitive, and the effectiveness of management.

Therefore, while the ratios are utilized in their quantitative evaluation of a company, they are not the only factors that are taken into account.

Q. What risks are Avista and the utility sector facing that may impact credit ratings?

A. Avista's credit ratings are impacted by risks that could negatively affect the Company's cash flows. These risks include, but are not limited to, the level and volatility of wholesale electric market prices and natural gas prices for fuel costs, liquidity in the wholesale market (fewer counterparties and tighter credit restrictions), recoverability of natural gas and power costs, stream flow and weather conditions, changes in legislative and governmental regulations, relicensing hydro projects, rising construction and raw material costs, customers' ability to timely pay their bills, and access to capital markets at a reasonable cost.

Credit ratings for the utility sector are also adversely impacted by large capital expenditures for environmental compliance, and the need for new generation and transmission and distribution facilities. The utility sector is in a cycle of significant capital spending, which will likely be funded by large issuances of debt and equity. This increases the competition for financial capital at a time when the average utility credit rating is just above investment grade.

Given the downturn in the economy and the tightened credit markets, the rating agencies are keeping closer tabs on all companies in order to make sure there is sufficient liquidity in case the credit markets are inaccessible. Not having sufficient sources of cash for potential cash requirements could prompt a credit rating downgrade.

The increased capital spending needs and resulting increased debt issuances make regulation supporting the full and timely recovery of prudently incurred costs even more critical to the utility sector than in previous years.

Q. How important is the regulatory environment in which a Company operates?

A. The regulatory environment in which a company operates is a major qualitative factor in determining a company's creditworthiness. Moody's stated the following regarding Avista's regulatory environment in a December 2008 credit ratings report:

> "Avista benefits from credit supportive ratemaking practices in all three of its jurisdictions, which include periodic mechanisms to account for variations in the power and natural gas costs incurred as compared to the levels included in rates." However, Moody's also pointed out that "Failure to obtain adequate and timely support for recovery of and return on core utility investments through pending and expected future regulatory proceedings, or any unexpected material deviation from the back-to-basics

> strategy, are among the more important factors that could have negative rating implications."[4]

Additionally, in a January 2008 article published by S&P entitled "Top Ten US Electric Utility Credit Issues for 2008 and Beyond", S&P stated that "Recovering in a timely manner federally and/or state mandated compliance costs is paramount to preserving credit quality for regulated electric utilities."[5]

Due to the major capital expenditures planned by Avista, the continued supportive regulatory environment will be critical to Avista's financial health. Additionally, although Avista has retail electric and natural gas tracking mechanisms ("ERM" and "PGA") to provide recovery of the majority of the variability in commodity costs, these changes in costs must be financed until the costs are recovered from customers. Investors and rating agencies are concerned about regulatory lag and cost-recovery related to these items.

Indeed, as testified to by Dr. Avera, investors recognize that volatile energy markets, and unpredictable stream flows can expose the Company to the risk of reduced cash flows and unrecovered power supply costs. For its part, S&P has commented on the risks to Avista, notwithstanding the ERM, and it went on to note that its recovery mechanism is not as strong as Idaho Power Company's for a number of reasons, including the imposition of "deadbands" which "in recent years have resulted in it absorbing the majority of its cost undercollections."[6]

VI. CASH FLOW

[4] Moody's Investor Service, *Moody's Upgrades Avista Corp* (December 3, 2008)

[5] Standard and Poor's, Top Ten US Electric Utility Credit Issues for 2008 and Beyond, January 2008

Q. What are the Company's sources to fund capital requirements?

A. The Company utilizes cash flow from operations, long-term debt and common stock issuances to fund its capital expenditures. Additionally, on an interim basis, the Company utilizes its credit facilities to fund working capital needs and capital expenditures until longer-term financing can be obtained.

Q. What are the Company's near-term capital requirements?

A. As a combination electric and natural gas utility, over the next few years, capital will be required for customer growth, investment in generation, transmission and distribution facilities for the electric utility business, as well as necessary maintenance and replacements of our natural gas systems. The amount of capital expenditures planned for 2010-2011 is approximately $420 million.

Q. What are the Company's long-term capital requirements?

A. Avista's Integrated Resource Plan has identified the potential need for the Company to finance significant expenditures for electric facilities. The preferred strategy outlined in our 2009 Integrated Resource Plan included total expenditures of $1.00 billion over the next 20 years, including investment in wind resources and upgrades at hydroelectric stations.

Major capital expenditures are a normal part of utility operations. Customers are added to the service area, roads are relocated and require existing facilities to be moved, and facilities continue to wear out and need replacement. These and other requirements create the need for significant capital expenditures each year. Avista saw significant increases in the costs of raw materials over the past years, which our suppliers are continuing to pass through to us in the

---

[6] Standard and Poor's Corporation, "Pacific Northwest Hydrology and Its Impact on Investor-Owned Utilities'

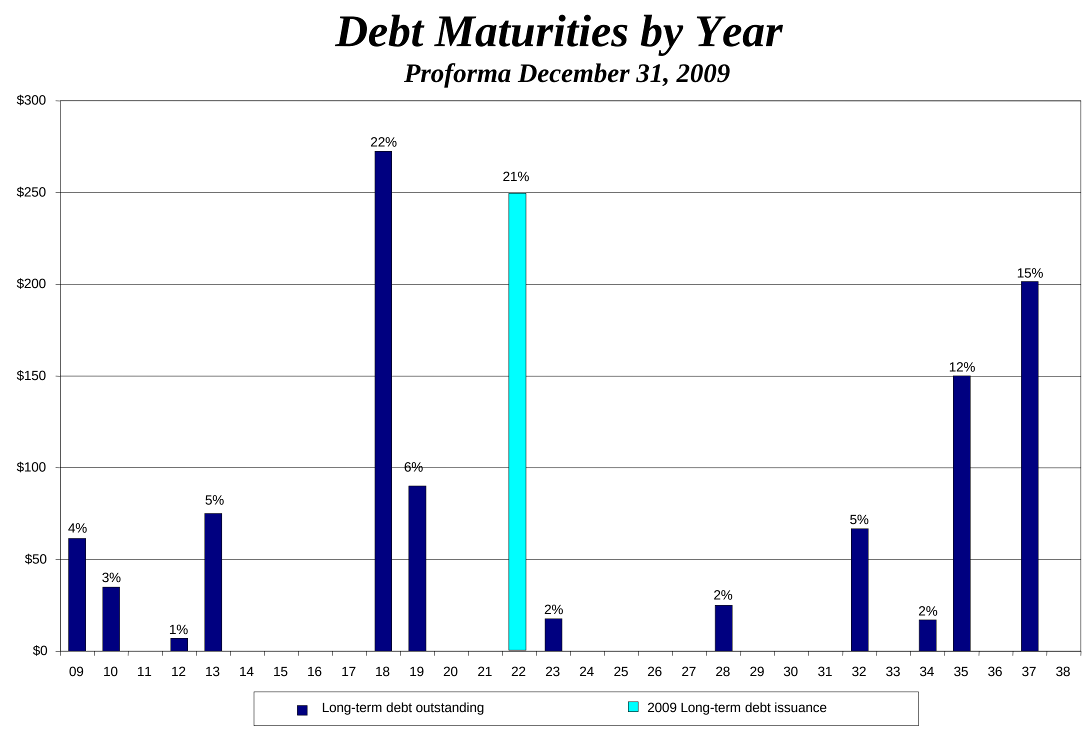
pricing of their finished products. Access to capital at reasonable rates is dependent upon the Company maintaining a strong capital structure, sufficient interest coverage, and investment grade credit ratings.

Q. What are the Company's near-term plans related to its debt?

A. The Company currently issued $250 million of secured, fixed rate bonds. The proceeds from the issuance of the securities were utilized to repay funds borrowed under our credit facilities and general corporate purposes. The Company has no long-term debt scheduled to mature in 2009.

The illustration below shows the amount of debt maturities for Avista each year:

Credit Quality," Ratings Direct (January 28, 2008) (p.11)



Q. What is the status of the Company's lines of credit secured by first mortgage bonds and its accounts receivable program?

A. The Company has a $320 million line of credit that expires in April 2011, and a $200 million line of credit that expires November 24, 2009. The Company has the option of increasing the $320 million line by $100 million (up to $420 million) at any time during the term of the agreement, subject to additional fees and obtaining bank commitments. The Company also has the option of renewing the $200 million deal and expects to renew this facility at an amount not to exceed $100 million. Additionally, the Company has an $85 million accounts receivable funding program that expires in March 2010. This agreement has been renewed on a year-to-year basis, and Avista expects to extend the agreement for another year.

The facilities have been sized to allow the Company to maintain a liquidity cushion of at least $125 million at all times to cover required working capital, counterparty collateral requirements, and avoid issuing debt in unfavorable market conditions if they persist through 2009. Avista's liquidity is strong and the Company is confident that its current agreements give it flexibility while facing both the volatile financial markets and volatile energy commodity prices.

Many purchases of natural gas, or contracts for pipeline capacity to provide natural gas transportation, require collateral, and/or prepayments, based upon the Company's credit rating. Upgrades to Avista's credit ratings have reduced the amount of collateral required to be posted with counterparties. If Avista is upgraded above its current credit ratings, the Company should see an increase in the number of counterparties willing to do business with it and the collateral requirements are expected to decrease even further, resulting in reduced borrowing costs. The lines of credit and accounts receivable program are Avista's primary sources of immediate cash for borrowing to meet these needs and for supporting the use of letters of credit. A line of credit is required to manage daily cash flow since the timing of cash receipts versus cash disbursements is never totally balanced.

Q. What are Avista's plans regarding common equity and why is this important?

A. Avista will continue to monitor the common equity ratio of its capital structure, and assess the need to issue additional common equity. Avista entered into a sales agency agreement in December 2006 to issue up to two million shares of the Company's common stock from time to time. During the third quarter of 2008, Avista issued 750,000 shares of common stock under this agreement. Avista plans to continue with the periodic offering of common stock as needed to support the Company's common equity ratio. It is important to the rating agencies for Avista to maintain a balanced debt/equity ratio in order to minimize the risk of default on required debt interest payments.

As Dr. Avera explains in his testimony, the 50.27 percent common equity ratio requested by Avista in this case is consistent with the range of equity ratios maintained by the firms in the Electric Utility Proxy Group.

Dr. Avera notes that electric utilities are facing, among other things, rising cost structures, the need to finance significant capital investment plans, and uncertainties over accommodating future environmental mandates. A more conservative financial profile, in the form of a higher common equity ratio, is consistent with increasing uncertainties and the need to maintain the continuous access to capital that is required to fund operations and necessary system investment, even during times of adverse capital market conditions.

He also discusses Moody's warning to investors of the risks associated with debt leverage and fixed obligations and their advice to utilities to not squander the opportunity to strengthen the balance sheet as a buffer against future uncertainties. Moody's noted that, absent a thicker equity layer, utilities would be faced with lower credit ratings in the face of rising business and operating risks:

> There are significant negative trends developing over the longer-term horizon. This developing negative concern primarily relates to our view that the sector's overall business and operating risks are rising – at an increasingly fast pace – but that the overall financial profile remains relatively steady. A rising risk profile accompanied by a

> relatively stable balance sheet profile would ultimately result in credit quality deterioration.[7]

This is especially the case for Avista, which faces the dual challenge of financing significant capital expansion plans in a turbulent market while at the same time endeavoring to improve its credit standing. Avista is committed to maintaining an appropriate level of equity to support an improvement in its credit rating, which is presently at the bottom of the investment grade scale.

VIII. CAPITAL STRUCTURE

Q. Please explain the capital structure proposed by Avista in this case.

A. Avista's current capital structure consists of a blend of debt and common equity necessary to support the assets and operating capital of the Company. The proportionate shares of Avista's actual capital structure on December 31, 2008, are shown on Statement AV.

The rate of return to be applied to its annual transmission revenue requirement in this proceeding is equal to the weighted average cost of capital. As shown on Statement AV, Avista is proposing an overall rate of return of 8.92%.

Q. How have you determined the cost of debt?

A. As shown on Statement AV, the actual weighted average cost of total debt outstanding on December 31, 2008 was 6.92%.

Q. What rate of return on common equity is the Company proposing in this proceeding?

A. The Company is proposing a 10.9% return on common equity (ROE), which falls well within Dr. Avera's recommended ROE zone of reasonableness, and below the midpoint and

[7] Moody's Investors Service, "U.S. Electric Utility Sector," *Industry Outlook* (Jan. 2008).

median of the DCF estimates for the Electric Utility Proxy Group. In addition, Dr. Avera testifies that Avista's requested ROE falls within the DCF range for a group of western utilities and below the resulting midpoint value. In his testimony Dr. Avera states that:

> Considering investors' expectations for capital markets and the need to support financial integrity and fund crucial capital investment even under adverse circumstances, I concluded that Avista's requested ROE of 10.9% percent is reasonable.[8]

Q. Why is Avista requesting an ROE below the values indicated by Dr. Avera's analyses?

A. Dr. Avera's recommended DCF analyses for the Electric Utility Proxy Group resulted in midpoint and median values of 13.3% and 11.5%, respectively.[9] As I have testified, Avista has made solid progress towards improving its financial health. If Avista can earn a 10.9% ROE for its transmission rates, I believe this will appropriately assist in Avista's overall approach to improve its financial condition and further strengthen the credit ratings ratios.

Furthermore, as the Company has worked toward improving its financial condition over the last several years, it has done so with the customer in mind. In this filing, this balanced approach applies to Avista's transmission customers as well. Avista is attempting to balance the ability to continue to improve its financial health and access capital markets under reasonable terms with the impacts that increased transmission rates have on both its transmission customers and, ultimately, its retail customers. In this case, although I believe an ROE greater than 10.9% is supported and is warranted, I also believe the 10.9% ROE provides a reasonable balance of the competing objectives.

[8] See Exhibit AVA-400 at p. 5, lines 6-9.

Q. Please summarize the proposed capital structure and the cost components for debt and common equity.

As also shown on Statement AV, the following illustration shows the capital structure and cost components proposed by the Company.

AVISTA CORPORATION
Capital Structure and Overall Rate of Return

Cost of Capital as December 31,	Amount	Percent Total	Cost	Component
Total	$1,005,800,000	49.73	6.92	3.44
Common	1,016,663,291	50.27	**10.90%** (1	5.48
TOTA	$2,022,463,291	100.00		**8.92%**

(1) Proposed Return on Common Equity - See Avera testimony

Q. Would you please describe Statement AW?

A. Statement AW consists of one page and indicates that the cost of short-term debt is not applicable to Avista's transmission revenue requirement. The calculation of the cost of capital does not include short-term debt.

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

A. Yes.

[9] Dr. Avera also noted that DCF results for a group of western utilities resulted in an ROE zone of reasonableness of 8.6% to 14.0%, with a midpoint of 11.3%.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Avista Corporation) **Docket No. ER10-___-000**

State of Washington)
)ss:
City of Spokane)

AFFIDAVIT OF MARK T. THIES

I, Mark T. Thies, being first duly sworn, depose and state that I am the Mark T. Thies referred to in the document entitled "Prepared Direct Testimony of Mark T. Thies on Behalf of Avista Corporation," that any exhibits accompanying that document were prepared by me or under my direction, that I have read such testimony and am familiar with the contents thereof, and that the facts set forth therein are true and correct to the best of my knowledge, information and belief in this proceeding.

Mark T. Thies

SUBSCRIBED AND SWORN TO before me, the undersigned notary public, this 29 day of October, 2009.

Anita L Swanson
Notary Public

My Commission Expires: 6-17-13

Notary Public
State of Washington
ANITA L. SWANSON
MY COMMISSION EXPIRES
June 17, 2013