DAVID J. MEYER
VICE PRESIDENT, CHIEF COUNSEL REGULATORY & GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE: (509) 495-4316
FACSIMILE: (509) 495-4361

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF AVISTA CORPORATION FOR THE AUTHORITY TO INCREASE ITS RATES AND CHARGES FOR ELECTRIC AND NATURAL GAS SERVICE TO ELECTRIC AND NATURAL GAS CUSTOMERS IN THE STATE OF IDAHO	CASE NO. AVU-E-08-01 CASE NO. AVU-G-08-01 DIRECT TESTIMONY OF MALYN K. MALQUIST

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

I. INTRODUCTION

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

A. My name is Malyn K. Malquist. My business address is 1411 East Mission Avenue, Spokane, Washington. I am employed by Avista Corporation as Executive Vice President and Chief Financial Officer.

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

A. I received a Bachelors degree and a Master of Business Administration degree from Brigham Young University. I have also attended a variety of utility finance courses and leadership programs during my 25+ year utility career.

I joined Avista in September of 2002 as Senior Vice President. In November 2002 I was named to the additional position of Chief Financial Officer. I was named Executive Vice President in May 2006. Prior to joining Avista, I was General Manager of Truckee Meadows Water Authority in Reno, Nevada, which was separated out from Sierra Pacific Power Company in 2001. I was Chief Executive Officer of Data Engines, Inc., a high tech company located in Reno from June to October of 2000. From April 1994 to April 2000, I was employed by Sierra Pacific Resources, first as the company's Chief Financial Officer and later as its

Chairman of the Board and Chief Executive Officer. Following the merger of Sierra Pacific Resources with Nevada Power Company in 1999, I became the President of both Sierra Pacific Power Company and Nevada Power Company. For the sixteen-year period prior to 1994, I was employed by San Diego Gas & Electric Company in various positions, including Treasurer and Vice President - Finance.

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

A. I will provide a financial overview of the Company and will explain the overall rate of return proposed by the Company in this filing for its electric and natural gas operations. The proposed rate of return is derived from Avista's long-term cost of debt and common equity, weighted in proportion to the proposed capital structure.

I will address the proposed capital structure and debt cost components. Company witness Dr. Avera will testify to the appropriate return on equity for the Company.

In brief, I will provide information that shows:

- Avista's plans call for significant capital expenditure requirements for the utility over the next three to five years to assure reliability in our energy systems, and to keep pace with regional growth and customer demand. Capital expenditures are planned for 2008-2009 of approximately $390 million 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.

- Avista's corporate rating from Standard & Poor's is currently BBB-. Avista Utilities should operate at a level that will support a strong investment grade credit rating, meaning "BBB+" or "A-". The Company's financial performance has improved; however, we have not improved financial ratios to a level that would result in a strong investment grade credit rating.

- The Company has proposed an overall rate of return of 8.74%, including a 47.94% equity ratio and a 10.8% return on equity. We believe the 10.8% provides a reasonable balance of the competing objectives of continuing to improve our financial health, and the impacts that increased rates have on our customers.

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 from the general rate request for our electric and natural gas businesses in these cases. 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.

Q. Are you sponsoring any exhibits with your direct testimony?

A. Yes. I am sponsoring Exhibit No. 2 pages 1 through 4, which were prepared under my direction. Avista's credit ratings by the three principal rating agencies are summarized on page 1, and Avista's actual capital structure at December 31, 2007 and pro forma capital structure at December 31, 2008 are included on page 2, with supporting information on pages 3 through 4.

<u>II. FINANCIAL OVERVIEW</u>

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. The Company has been able to reduce outstanding debt, refinance debt at lower rates and improve cash flows from operations, resulting in improved financial ratios. Additionally, Avista has reduced investments in unregulated subsidiaries and redeployed the majority of the proceeds from the sales of the unregulated subsidiaries to the Utility. The Company has been able to improve its debt ratio and balance the overall debt / equity ratio by paying down debt and issuing additional common stock.

Although we have made progress in improving the Company's financial condition, we are still not as strong as we need to be. Avista's goal is to operate at a level that will support a strong credit rating of BBB+ / A-. Operating at this level will help reduce long-term costs to customers. We expect that a continued focus on the regulated utility, conservative financing strategies (including the issuance of common equity) and a continued supportive regulatory environment will contribute to an overall improved financial situation.

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

A. We are working to assure we have adequate funds for operations, capital expenditures and debt maturities, through lines of credit with our banks and maintaining adequate access to the capital markets. We have worked with our banks to insure that we have adequate liquidity through the availability of our credit facility on the most economic basis possible. Additionally, the Company plans to obtain a portion of our capital requirements through equity issuance. We also maintain an ongoing dialogue with the rating agencies regarding the measures being taken by the Company to improve our credit rating.

Additionally, the Company is working through regulatory processes to recover our costs in a timely manner 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.

III. CREDIT RATINGS

Q. Please explain the credit ratings for Avista's debt and other 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 on page 1 of Exhibit No. 2. Additionally, the following rating actions occurred during 2007 and 2008:

a. S&P upgraded Avista's corporate credit rating to BBB- from BB+ (February 2008) and Avista's secured debt rating to BBB+ from BBB- (September 2007).

b. Moody's upgraded Avista's corporate credit rating to Baa3 from Ba1 and Avista's secured rating to Baa2 from Baa3 (December 2007).

c. Fitch upgraded Avista's long-term issuer default rating to BB+ from BB and its secured debt rating to BBB from BBB- (August 2007 and affirmed in February 2008).

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

A. 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. Thus, lower credit ratings may result in a company having more difficulty accessing financial markets and/or increased financing costs.

Q. What risks are facing Avista and the utility sector that may have an impact on companies' credit ratings?

A. Among the risk factors are 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, streamflow and weather conditions, changes in legislative and governmental regulations, relicensing hydro projects, rising construction and raw material costs and access to capital markets at a reasonable cost.

Higher capital expenditures for environmental compliance, new generation and transmission and distribution facilities are also impacting the utility sector. The significant need for capital expenditures causes increased competition for financial capital. Regulation supporting the full and timely recovery of prudently incurred costs is critical to the utility sector, including Avista.

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

A. Avista Utilities should operate at a level that will support a strong investment grade credit rating, meaning a "BBB+" or an "A-," using S&P's rating scale. In fact, S&P stated in its November 2007 U.S. Utilities and Power Commentary that "About 68% of the companies in the industry carry a 'BBB' category rating (BBB+, BBB, and BBB-) and 24% are rated 'A-' and above."[1] Ratios required to support this level of credit rating are included in Table 1 below.

Financially healthy utilities have lower financing costs which, in turn, benefits customers. In addition, financially healthy utilities are better able to invest in the needed infrastructure over time to serve their

[1] Standard and Poor's, *U.S. Utilities And Power Commentary*, November 2007

customers, and to withstand the challenges and risks facing the industry.

Q. Why is it important to have a strong investment grade credit rating?

A. A utility is a capital-intensive business and, as such, needs to have ready access to capital markets under reasonable terms. Access is more difficult and more expensive for lower rated companies. As new financing is required in the future to finance utility plant additions, new customer additions, and debt maturities, the cost of new and replacement debt will be higher for lower rated issuers.

The lower credit rating also requires the Company to post more collateral with counterparties than would otherwise be required with a higher credit rating. This results in increased costs. It also reduces financial flexibility since we must always maintain a certain amount of capacity under our credit line for letters of credit.

Q. What credit rating ratios are used by the rating agencies?

A. S&P modified its electric and 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.

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

Table 1

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	$\boxed{10 - 30}$	$\boxed{2.0 - 3.5}$	$\boxed{45 - 60}$
Highly leveraged	Below 15	2.5 or less	Over 50
December 31, 2007 Ratios:			
Avista Unadjusted	14.0	2.9	53.8
Avista Adjusted	13.3	2.8	58.7

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

Table 2

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-	$\boxed{\text{BBB-}}$	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 the 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 $226 million related to the accounts receivable program, purchased power and post-retirement benefits. The adjusted financial ratios for Avista are included in Table 1 above.

Q. Where does Avista fall within those coverage ratios?

A. Avista's cash flow ratios lag primarily because of high cost debt that is outstanding. The cash flow ratios should improve as the 2008 debt maturities are refinanced. 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 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 resulting inability to eliminate electric deferral balances, and higher capital expenditures that require cash up front before we 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?

A. Yes, they also look at a number of qualitative factors. The rating agencies evaluate the company's

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

resource picture, the competitive environment in which we operate, the regulatory environment including the timely recovery and certainty of recovery of costs, quality of management and financial policy. 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. 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 2007 credit ratings report:

> Moody's is assuming that the company's regulators in its Washington, Idaho, and Oregon jurisdictions will continue to support timely and adequate recovery of, and return on, the capital investments through decisions in future general rate cases that we expect will be filed on a regular basis.[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

[3] Standard and Poor's, *Avista Corp's Corporate Credit Rating Raised One Notch to BBB-*, February 2008
[4] Moody's Investor Service, *Moody's Upgrades Avista Corp* (December 20, 2007)

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 important to Avista's financial health. Additionally, although Avista has electric and natural gas tracking mechanisms (PCA 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.

IV. CASH FLOW

Q. What are the Company's sources of funding 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 facility to fund capital expenditures until longer-term financing can be obtained.

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

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

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 2008-2009 is approximately $390 million. For 2008 alone, these costs equate to a total of $190 million. Total net rate base at December 31, 2007 was $1.7 billion for the total Company; therefore, these planned capital additions represent substantial new investments. A few of the major capital expenditure items on a system basis for 2008 include $46 million for electric transmission and distribution upgrades, $43 million for electric and natural gas customer growth, $21 million for natural gas system upgrades, $9 million for environmental (associated with the Spokane River relicensing and the 2001 Clark Fork River license implementation issues), $26 million for generation upgrades, and $15 million for Jackson Prairie capacity and deliverability expansions.

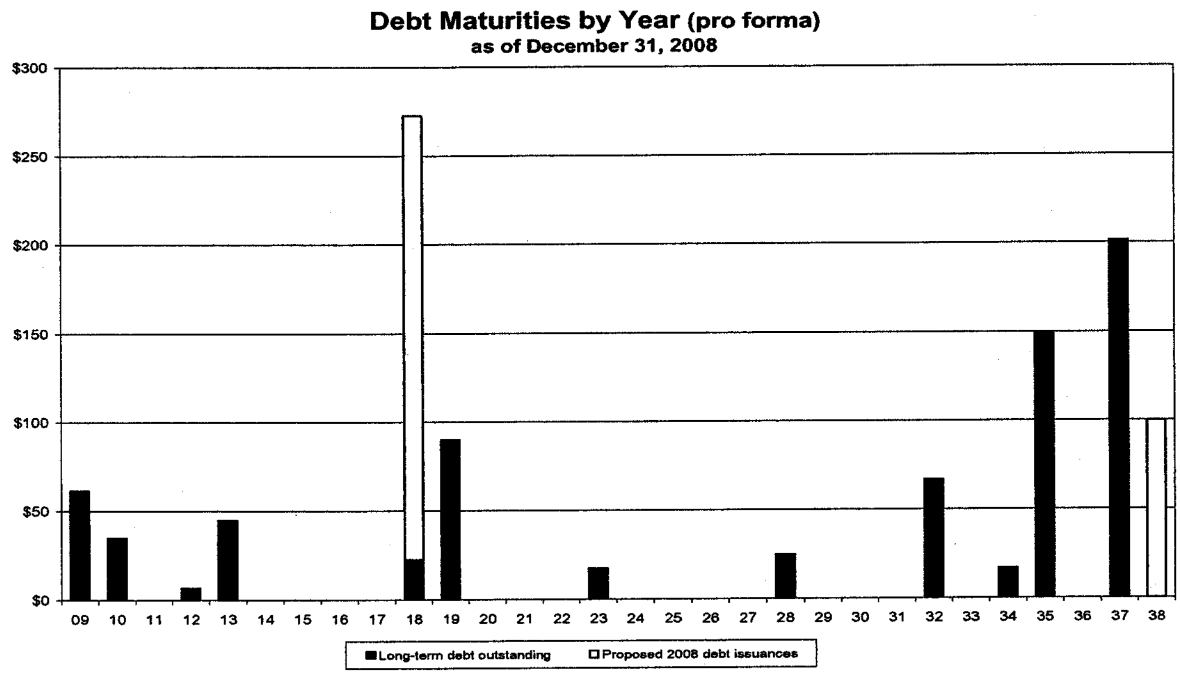
Q. What are the Company's long-term capital requirements?

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 2007 Integrated Resource Plan included total expenditures of $1.25 billion by 2018, 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. We are seeing significant increases in the costs of materials, including the cost of steel, cement, asphalt, and transformers. 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 plans to issue up to $350 million of secured, fixed rate bonds during 2008. The proceeds from the issuance of the securities will be utilized to fund debt maturities and repay funds borrowed under our credit facility. The Company has $318 million of debt maturing in 2008 and capital expenditures of approximately $190 million during 2008. The proposed 2008 issuance of debt securities has been reflected in the chart below.



In addition to the $318 million of debt maturities in 2008, we have $83.7 million of Pollution Control Bonds ($66.7 million with a maturity date of October 2032 and $17.0 million with a maturity date of March 2034) that are subject to remarketing on December 30, 2008. These bonds are puttable at the option of the security holders on December 30, 2008. If the bonds cannot be remarketed on that date, we will be required to purchase the outstanding bonds. In addition, we have $25 million of Medium-Term Notes with a maturity date of June 2028 that are puttable at the option of the security holders in June 2008.

Q. The debt maturities graph above reflects a proposed 2008 debt issuance of $250 million maturing in 2018. Why is the Company proposing such a large maturity in one year?

A. Avista has had discussions with various investment bankers regarding our proposed 2008 debt issuances. The investment bankers have indicated that investors are charging a premium for debt issuance transactions that are not "index eligible", due to volatilities that have occurred in the market over the past year. A debt issuance must be at least $250 million in order to be index eligible. The investment bankers have indicated that the premium could range from 10 - 15 bps, which is $250,000 to $375,000 annually. Due to the significance of the premium, Avista believes it would be beneficial to customers to issue debt that is index eligible. Additionally, based upon the projected growth of Avista, the maturity will be much smaller by the time the debt issuance is required to be refinanced, on a relative basis. Avista will continue to monitor the capital markets and balance the impact of debt issuances on the maturity graph and the cost of debt as well as the impact to customers and rates.

Q. Has the Company taken any steps to address the uncertainty related to interest rate exposure for the significant debt maturities it faces in 2008?

A. Yes, it has. As a result of the historically low interest rate environment that existed in 2004, the Company entered into two forward-starting interest rate swaps totaling $125 million or almost 46% of the June 1, 2008 debt maturity. The swaps have contract terms of ten years beginning in 2008. These agreements secured a fixed rate for a significant portion of the total future interest rate. These agreements only lock in a portion of Avista's credit spread. The swaps will be cash settled on the same day we issue new debt securities to fund the June 1, 2008 maturity.

Q. What other financing activities did the Company complete in 2004 through 2007 that will lower its interest costs?

A. The Company completed the following financing activities from 2004 through 2007 that lowered interest costs:

Table 3

Description of Securities Issued	Amount (in millions)	Rate	Life
Trust Preferred Stock:			
April 2004	$60	6.50%	5
First Mortgage Bonds:			
November 2004	$90	5.45%	15
November 2005	$150	6.25%	30
December 2006	$150	5.70%	30.5

The financing activity described in Table 3 above has had a direct impact on the Company's debt costs. Cost of total debt has decreased from 8.68% at December 31, 2003 to 7.91% at December 31, 2007. The cost of debt should decrease significantly once the 2008 debt maturities are refinanced, as evidenced by the pro forma cost of debt of 6.84% as of December 31, 2008 reflected in this filing.

Q. What is the status of the Company's line 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. The Company has the option of increasing the 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 agreement includes the option to release the first mortgage bond security when the Company has an investment grade credit rating. Additionally, the Company has an $85 million accounts receivable funding program that expires in March 2009. This demonstrates increased confidence by our banks in Avista's financial condition.

The facilities have been sized to allow the Company to fund at least one year of capital expenditures, plus required working capital and counterparty collateral requirements to assure flexibility given 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 during 2007 and 2008 have reduced the amount of collateral required to be posted with counterparties. If Avista is upgraded above its current credit ratings, the collateral requirements are expected to decrease, resulting in reduced borrowing costs. The line of credit and accounts receivable program are our 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. We will continuously assess the need to issue additional common equity based upon our overall capital structure. Avista entered into a sales agency agreement in December 2006 to issue up to two million shares of our common stock from time to time.

During the second half of 2008, we are planning to issue common stock under this sales agency agreement in order to maintain our equity ratio at an appropriate level. It is important to the rating agencies who rate the Company's securities, and hence an important component of the Company's cost of doing business, for Avista to maintain a balanced debt/equity ratio in order to minimize the risk of default on required debt interest payments. Avista is committed to maintaining an appropriate level of equity to support a strong credit rating.

Q. What are Avista's plans regarding preferred equity and other financing structures (for example hybrid instruments)?

A. Avista does not have any preferred equity or other financing structures outstanding at December 31, 2007. Currently, Avista does not plan to issue preferred equity or other financing structures. Avista will continue to evaluate the appropriateness of preferred equity and other financing structures within its overall capital structure.

V. 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 long-term debt and common equity necessary to support the assets and operating capital of the Company. The proportionate shares of Avista Corp.'s actual capital structure on December 31, 2007, are shown on page 2 of Exhibit No. 2. A pro forma capital structure is also shown on page 2 in the Exhibit, which reflects expected changes for the period ending December 31, 2008. Supporting workpapers provide additional details related to these adjustments on pages 3 through 4.

The rate of return to be applied to rate base in this proceeding is equal to the weighted average cost of capital, taking into account the pro forma adjusting items. As shown on page 2 of Exhibit No. 2, Avista Utilities is proposing an overall rate of return of 8.74%.

VI. COST OF DEBT

Q. How have you determined the cost of debt?

A. Cost of debt in the Company's proposed capital structure includes long-term debt. As shown on page 2 of Exhibit No. 2, the actual weighted average cost of long-term debt outstanding on December 31, 2007 was 7.91%. The size and mix of debt changes over time based upon the actual financing completed. We have made certain pro forma adjustments to update the debt cost through December 31, 2008 to 6.84%. Pro forma adjustments to long-term debt reflect expected maturities of outstanding debt and the issuance of new debt to fund those maturities. The pro forma weighted cost of long-term debt was reduced from 4.17% to 3.56%.

VII. COST OF COMMON EQUITY

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

A. The company is proposing a 10.8% return on common equity (ROE), which is within the lower end of Dr. Avera's recommended range of required return on equity. Dr. Avera testifies to analyses related to the cost of common equity with an ROE range of 10.7% to 12.2%. 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 10.8% percent is reasonable. (P. 5, L. 19-23)

Q. Dr. Avera suggests an ROE range of 10.7% to 12.2%. Why is Avista requesting an ROE on the lower end of the range?

A. As I have testified, Avista has made solid progress towards improving its financial health. If Avista can earn a 10.8% ROE in 2009, I believe the financial condition would continue to improve and would 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. Avista is attempting to balance the ability to continue to improve our financial health and access capital markets under reasonable terms with the impacts that increased retail rates have on its customers. In this case, although we believe an ROE greater than 10.8% is supported and is warranted, we also believe the 10.8% provides a reasonable balance of the competing objectives.

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

A. As also shown on page 2 of Exhibit No. 2, the following table shows the capital structure and cost components proposed by the Company.

Table 4

PRO FORMA

Cost of Capital as of December 31, 2008	Amount	Percent of Total Capital	Cost	Component
Long-term Debt	$1,075,800,000	52.06%	6.84%	3.56%
Common Equity	990,683,000	47.94%	**10.80%**	5.18%
TOTAL	$2,066,483,000	100.00%		**8.74%**

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

A. Yes.

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IDAHO PUBLIC
UTILITIES COMMISSION

DAVID J. MEYER
VICE PRESIDENT, GENERAL COUNSEL, REGULATORY &
GOVERNMENTAL AFFAIRS
AVISTA CORPORATION
P.O. BOX 3727
1411 EAST MISSION AVENUE
SPOKANE, WASHINGTON 99220-3727
TELEPHONE: (509) 495-4316
FACSIMILE: (509) 495-8851

BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION	)	CASE NO. AVU-E-08-01
OF AVISTA CORPORATION FOR THE	)	CASE NO. AVU-G-08-01
AUTHORITY TO INCREASE ITS RATES	)	
AND CHARGES FOR ELECTRIC AND	)	
NATURAL GAS SERVICE TO ELECTRIC	)	EXHIBIT NO. 2
AND NATURAL GAS CUSTOMERS IN THE	)	
STATE OF IDAHO	)	MALYN K. MALQUIST
	)	

FOR AVISTA CORPORATION

(ELECTRIC AND NATURAL GAS)

AVISTA CORPORATION
Long-term Securities Credit Ratings

	Standard & Poor's		Moody's		Fitch	
Last Reviewed	February 2008		December 2007		August 2007	
Credit Outlook	Stable		Stable		Positive	
	A+		A1		A+	
	A		A2		A	
	A-		A3		A-	
	BBB+	First Mortgage Bonds Secured Medium-Term Notes	Baa1		BBB+	
	BBB		Baa2	First Mortgage Bonds Secured Medium-Term Notes	BBB	First Mortgage Bonds Secured Medium-Term Notes
	BBB-	Avista Corp./Corporate rating Senior Corporate Notes 9.75%	Baa3	Avista Corp./Issuer rating Senior Corporate Notes 9.75%	BBB-	Senior Corporate Notes 9.75%
	INVESTMENT GRADE					
	BB+		Ba1	Trust-Originated Preferred Securities	BB+	Avista Corp./Issuer rating Trust-Originated Preferred Securities
	BB	Trust-Originated Preferred Securities	Ba2		BB	
	BB-		Ba3		BB-	

AVISTA CORPORATION
Capital Structure and Overall Rate of Return

PRO FORMA

Cost of Capital as of December 31, 2008	Amount	Percent of Total Capital	Cost	Component
Long-Term Debt	$1,075,800,000	52.06%	6.84%	3.56%
Common Equity	990,683,000	47.94%	**10.80%** (1)	5.18%
TOTAL	$2,066,483,000	100.00%		**8.74%**

EMBEDDED

Cost of Capital as of December 31, 2007	Amount	Percent of Total Capital	Cost	Component
Long-term Debt	$1,043,660,000	52.71%	7.91%	4.17%
Common Equity	936,501,238	47.29%	**10.40%**	4.92%
TOTAL	$1,980,161,238	100.00%		**9.09%**

(1) Proposed Return on Common Equity - See Avera testimony
See supporting documentation
All costs are shown before tax

Assumptions
1. Started with 12-31-2007 actual
2. Proforma through 12-31-2008
3. The forecasted equity and debt numbers come from forecast DEC6 model run
4. Equity is adjusted for Other Comprehensive Income and capital stock expense of $21,921,000
5. Forecasted issuance of $12.5 million of additional equity through different company programs

AVISTA CORPORATION
Cost of Long-Term Debt Detail
December 31, 2008

Line No.	Description	Coupon Rate	Maturity Date	Settlement Date	Principal Amount	Issuance Costs	Redemption Costs	Net Proceeds	Yield to Maturity	Principal Outstanding 12-31-2008	Effective Cost	Line No.
	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	
1	SMTN Series A	Series Costs A	08-31-2010	05-01-1993		373,693					21,663	1
2	SMTN Series A	6.67%	07-12-2010	07-12-1993	5,000,000	35,081	690,464	4,274,455	8.275%	5,000,000	413,765	2
3	SMTN Series A	7.18%	08-11-2023	08-12-1993	7,000,000	54,364		6,945,636	7.244%	7,000,000	507,064	3
4	SMTN Series A	7.37%	05-10-2012	05-10-1993	7,000,000	49,114	1,227,883	5,723,003	9.455%	7,000,000	661,877	4
5	SMTN Series A	7.39%	05-11-2018	05-11-1993	7,000,000	54,364	1,227,883	5,717,753	9.287%	7,000,000	650,114	5
6	SMTN Series A	7.45%	06-11-2018	06-09-1993	15,500,000	170,597	2,140,440	13,188,963	8.953%	15,500,000	1,387,715	6
7	SMTN Series A	7.53%	05-05-2023	05-06-1993	5,500,000	42,712	963,011	4,494,277	9.359%	5,500,000	514,744	7
8	SMTN Series A	7.54%	05-05-2023	05-07-1993	1,000,000	7,726	175,412	816,862	9.374%	1,000,000	93,742	8
9	SMTN Series B	Series Costs B	05-01-2009	05-01-1994		329,022					21,935	9
10	SMTN Series B	6.90%	07-01-2010	06-09-1995	5,000,000	37,944		4,962,056	6.982%	5,000,000	349,077	10
11	5.70% FMB's	5.70%	07-01-2037	12-15-2006	150,000,000	8,646,793		141,353,207	6.119%	150,000,000	9,178,493	11
12	6.125% FMB's	6.125%	09-01-2013	09-08-2003	45,000,000	931,413	815,824	43,252,763	6.664%	45,000,000	2,998,615	12
13	5.45% FMB's	5.450%	12-01-2019	11-18-2004	90,000,000	1,435,924		88,564,076	5.608%	90,000,000	5,047,387	13
14	6.25% FMB's	6.250%	12-01-2035	11-17-2005	150,000,000	-2,185,830	1,696,694	150,489,136	6.226%	150,000,000	9,338,427	14
15	PCB's Kettle Falls	6.00%	12-01-2023	07-29-1993	4,100,000	282,248		3,817,752	6.523%	4,100,000	267,441	15
16	[1] PCB's Series 1999A	5.00%	10-01-2032	09-01-1999	66,700,000	2,800,631	4,751,984	59,147,385	5.770%	66,700,000	3,848,883	16
17	[1] PCB's Series 1999B	5.125%	03-01-2034	09-01-1999	17,000,000	979,886	1,266,265	14,753,849	6.041%	17,000,000	1,026,907	17
18	MTN's Series C	Series Costs C	06-15-2013	06-15-1998		610,794					40,720	18
19	MTN's Series C	6.37%	06-19-2028	06-19-1998	15,000,000	174,178		14,825,822	6.458%	15,000,000	968,711	19
20	MTN's Series C	6.37%	06-19-2028	06-19-1998	10,000,000	172,775		9,827,225	6.502%	10,000,000	650,164	20
21	MTN's Series C	8.02%	10-26-2010	10-26-1999	25,000,000	161,287	707,527	24,131,186	8.513%	25,000,000	2,128,207	21
22	Trust Preferred Securities	6.500%	04-01-2034	04-05-2004	60,000,000	3,389,726	3,501,270	53,109,004	7.464%	60,000,000	4,478,559	22
23	[2] Proforma Debt	6.28%	05-01-2018	05-01-2008	250,000,000	2,500,000		247,500,000	6.417%	250,000,000	16,042,591	23
24	[3] Proforma Debt	6.75%	09-01-2038	09-01-2008	100,000,000	1,000,000		99,000,000	6.829%	100,000,000	6,828,799	24
25												25
26								995,894,410	6.513%	1,035,800,000	67,465,601	26
27												27
28	Repurchase [4]	7.740%	12-31-2017	06-30-2006	6,875,000		483,582	6,391,418	8.721%		[5] 66,586	28
29	Repurchase [4]	8.170%	06-30-2015	06-30-2005	26,000,000		1,696,694	24,303,306	9.181%		[5] 266,489	29
30	Repurchase [4]	8.410%	06-30-2014	06-30-2004	36,590,000		7,244,895	29,345,105	11.840%		[5] 1,273,845	30
31	Repurchase [4]	8.680%	09-30-2012	06-30-2003	52,485,000		2,735,044	49,749,956	9.536%		[5] 466,190	31
32	Repurchase [4]	8.760%	09-30-2010	06-30-2002	203,590,000		11,549,094	192,040,906	9.773%		[5] 2,146,950	32
33											4,220,060	33
34												34
35	[6] Trust Preferred Securities	4.514%	06-01-2037	06-03-1997	40,000,000	1,362,388	36,146	38,601,466	4.709%	40,000,000	1,883,616	35
36												36
37	TOTAL DEBT OUTSTANDING AND COST OF DEBT AT December 31, 2008							1,034,495,876	6.839%	1,075,800,000	73,569,277	37

1 Includes the annual insurance premium
2 Forecasted issuance of $250 million of FMB's with a 10-year life and a weighted average coupon rate of 6.28%
The weighted average rate is a combination of a $75 million swap at 7.0%, $50 million swap at 6.44% and $125 million of a forecasted rate at 5.78%
3 Forecasted issuance of $100 million of FMB's with a 30-year life and a forecasted coupon of 6.75%
4 The coupon rate used is the cost of debt at the time of the repurchases
5 The amounts are calculated using the IRR function
6 Information pulls from the - Var. Rate Long-Term tab

AVISTA CORPORATION
Proforma Cost of Long-Term Variable Rate
December 31, 2008

1		Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Avg of
2	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)	(o)
3	Trust Preferred	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000
4	Total Short Term Debt	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000	$40,000,000
5															
6	Number of Days in Month		31	29	31	30	31	30	31	31	30	31	30	31	366
7	Forecasted Trust Preferred Borrowing Rate		5.13%	5.13%	5.13%	4.63%	4.63%	4.63%	4.13%	4.13%	4.13%	3.88%	3.88%	3.88%	
8	Trust Preferred Interest Expense		176,700	165,300	176,700	154,333	159,478	154,333	142,256	142,256	137,667	133,644	129,333	133,644	1,805,644
9	Total Interest Expense		176,700	165,300	176,700	154,333	159,478	154,333	142,256	142,256	137,667	133,644	129,333	133,644	$1,805,644
10	Forecasted Monthly Borrowing Rate		5.13%	5.13%	5.13%	4.63%	4.63%	4.63%	4.13%	4.13%	4.13%	3.88%	3.88%	3.88%	
11										Average borrowing rate used in the caluclation of the effective costs below					4.51%
12															
13															
14															
15															

16										Principal	
17		Coupon	Maturity	Settlement	Principal	Issuance	Loss/Reacq	Net	Yield to	Outstanding	Effective
18	Description	Rate	Date	Date	Amount	Costs	Expenses	Proceeds	Maturity	12-31-2008	Cost
19	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)
20	Trust Preferred	4.51%	06-01-2037	06-03-1997	40,000,000	1,362,388	36,146	38,601,466	4.709%	40,000,000	1,883,616
21											
22											

* $10 million of the Series was purchased on 12-18-2000 for $7.5 million