

EXHIBIT NO. ___(RG-9)
DOCKET NO. _____
2005 POWER COST ONLY RATE CASE
WITNESS: ROGER GARRATT

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

Docket No. UE-_____

**EIGHTH EXHIBIT TO THE PREFILED DIRECT TESTIMONY OF
ROGER GARRATT (NONCONFIDENTIAL)
ON BEHALF OF PUGET SOUND ENERGY, INC.**

JUNE 7, 2005

Least Cost Plan Advisory Group Meeting

October 12, 2004

Risk & Credit

Don Gaines
Vice President Finance & Treasurer

Risk & Credit

Credit Impacts of Resource Acquisitions

- Owned Generation
 - ◆ Plant - financed with debt & equity
 - ◆ Fuel - volatility

- Purchased Power Agreements
 - ◆ Credit
 - ◆ Imputed Debt

Risk & Credit

Sources of Credit

■ Liquidity Facilities (# of Counterparties)		\$425
◆ Receivables Securitization	(1)	\$ 75 (a)
◆ Credit Agreement	(17)	\$350
■ Trading Counterparty Credit		\$285
◆ Gas	(58)	\$109
◆ Power	(73)	\$103
◆ Financial	(9)	\$ 73
■ Total Sources		\$710

(a) Due to seasonal fluctuations in receivables balances, the minimum available is \$75 million, the maximum is \$150 million.

Risk & Credit

Uses of Credit

- Liquidity Facilities
 - ◆ Sized to meet working capital needs
 - ◆ Fluctuations in working capital needs

- Trading Counterparty Credit
 - ◆ Hedging of gas & power positions
 - ◆ Reduce volatility

Risk & Credit

Imputed Debt

- Standard & Poor's and Moody's Rating Agencies add imputed debt and interest cost to utilities with long term power purchase agreements.
- Purpose is to make a fair comparison between utilities who buy power and utilities that own their resources.
- The impact of imputed debt is a less favorable debt to capital ratio and interest coverage ratio for companies with PPAs, and possible rating downgrade.

Risk & Credit

Need for Stronger Balance Sheet

- PSE is presently rated “BBB-” / “Baa3”
- Striving for “BBB+” rating
- General Rate Case
 - ◆ 45% equity ratio - leverage
 - ◆ 11.75% return on equity - coverage ratios
- Increased credit quality

Risk & Credit

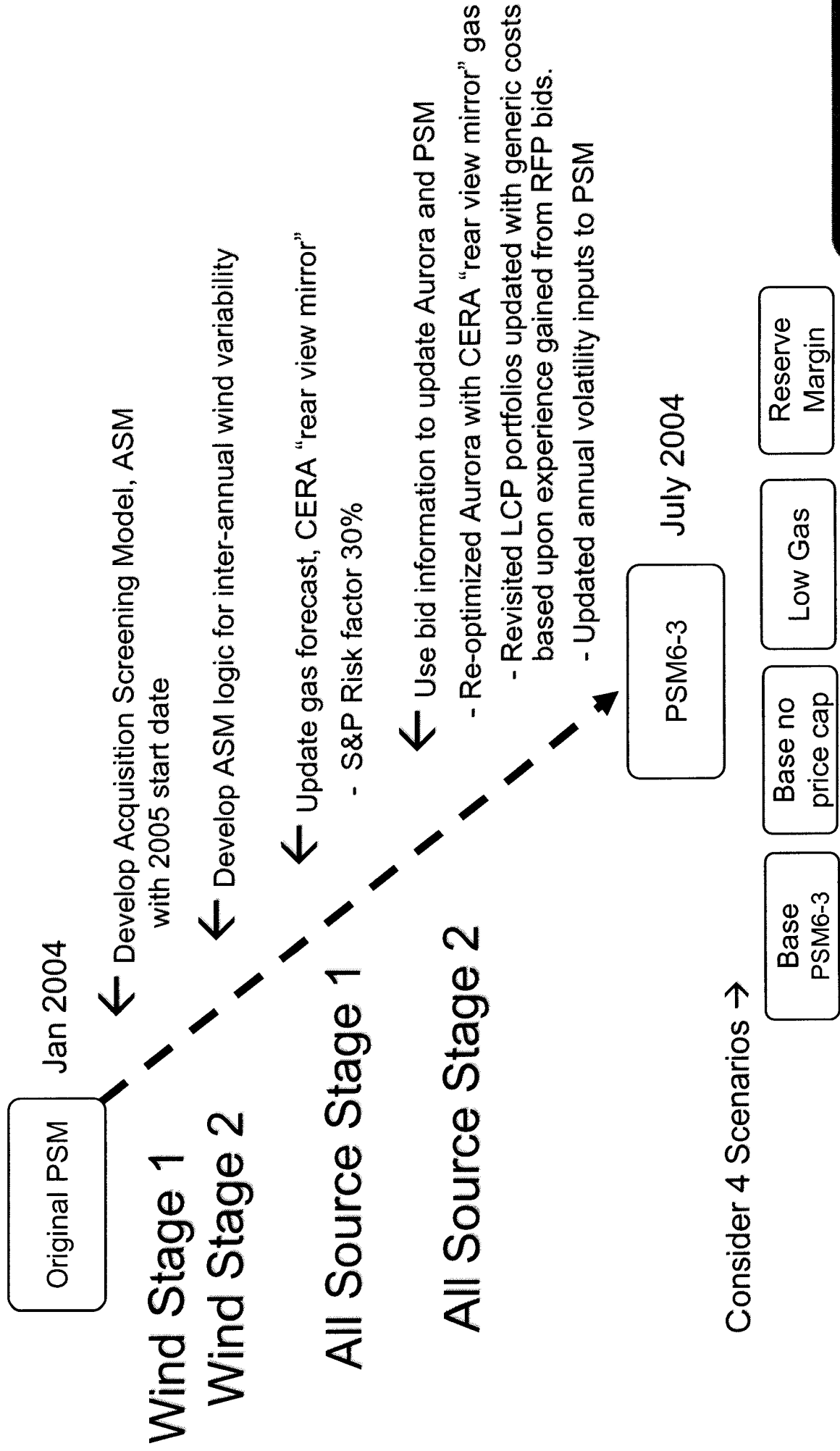
Benefits of a Stronger Balance Sheet

- Attract equity capital for owned resources
- Lower cost of debt capital
- Additional trading counterparty credit
- Offset impacts of imputed debt
- Increased credit quality
- Increased financial flexibility

Acquisition Analysis

Jim Elsea
Financial Analysis Manager

Acquisition Analysis Overview – Analysis Process



Acquisition Analysis

Imputed Debt

...included in LCP & Resource Acquisition Modeling

- S&P Methodology
 - ◆ Demand charge or 50% of contract payment
 - ◆ Discount at 10% to PV
 - ◆ Multiply by 30% risk factor
 - ◆ Calculate equity offset
 - ◆ = equity ratio * (imputed debt / (debt ratio))
 - ◆ Cost penalty
 - ◆ = equity offset * pre-tax ROE

- Declines each year of forecast as current year of contract payment rolls off

Acquisition Analysis

Credit Support

PPAs & Gas Supply

- New World of Contracting post 2001 – both sides concerned with the other side’s credit
- Existing PSE credit facilities not enough to cover credit requirements for new long-term power or fuel contracts
- Purchasing Letters of Credit may require issuance of securities (bonds) that will need an equity offset to maintain credit ratings.
- Off Balance Sheet Financing – rating agencies may impute debt on the possibility that cash collateral will have to be posted.
- Other Costs: Letter of Credit fees

Acquisition Analysis

Credit Costs - 10-year PPA

Preliminary Analysis

		Nominal \$000	XNPV \$000	Levelized \$/MWh
A	Contract Payments (no transmission)	633,446	414,510	43.50
B	Transmission	11,348	7,353	0.77
C	Imputed Debt Equity Offset	41,831	32,276	\$3.39
	SUBTOTAL			\$47.66
D	LoC Interest - PSE	14,375	9,718	\$1.02
E	LoC Interest - Counterparty	14,375	9,718	\$1.02
F	LoC Imputed Debt Equity Offset	190,385	124,156	\$13.03
	SUBTOTAL Credit			\$15.07
	TOTAL Levelized Cost			\$62.73

Credit Assumptions:

- ◆ Rate = 1.15%
- ◆ Credit Cap = \$125 million
- ◆ 100% Equity Offset

Acquisition Analysis Recovery of Equity Offset Costs

...resulting from LOC imputed debt

Approximate...

LoC Imputed Debt Equity Offset								
Key Assumptions:								
LoC Posted Amount	\$	125,000						
Yr LoC put on Balance Sheet		2005						or year S&P imputes debt on Letter of Credit
S&P Risk Factor		100%						
		2005 GRC						
		Year-end Estimate						
		\$ 000						
Debt		\$2,440,398		55.0%		\$2,440,398		53.8%
Equity		\$1,996,690		45.0%	\$	102,273		46.2%
		\$4,437,088		100.0%		\$4,539,361		100.0%
								1.2% incremental equity ratio

- This increase in allowed equity ratio is in addition to the increase needed to recover the equity offset for the imputed debt related to PPA payments.

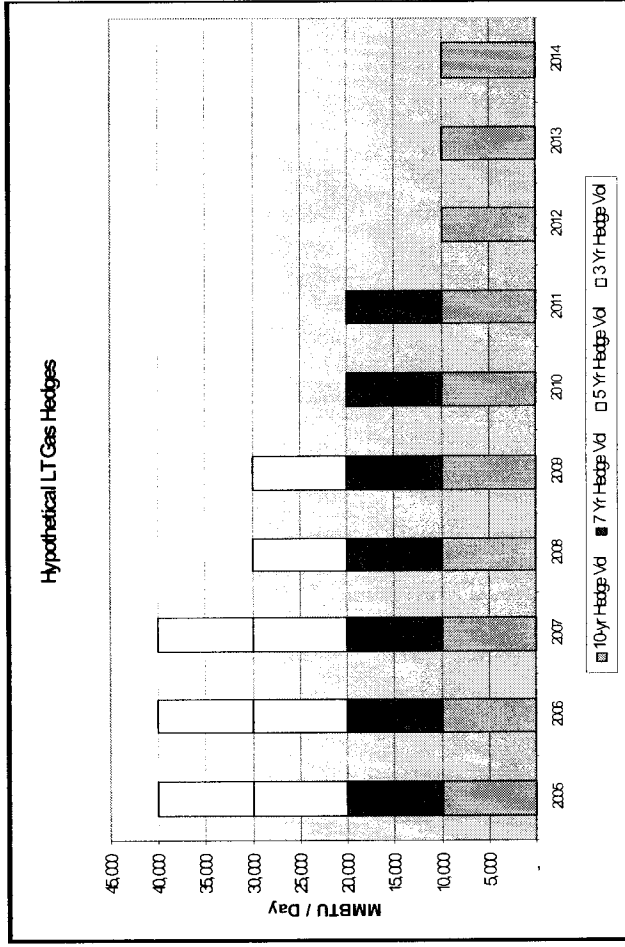
Acquisition Analysis

Gas Hedge

10,000 mmbtu/day
\$22 million Credit Requirement

Assumptions:

- S&P liquidity stress test of 30% price change in first year and 20% thereafter
- Hedges are comprised of an equal mix of 10, 7, 5, and 3-year fixed price deals
- 10,000 mmbtu/day and a \$5 nominal fixed price
- Discounted at Libor/Treasury rates for terms of 1 to 10-years



First year Credit	
10yr	\$ 32.4M
7yr	\$ 24.7M
5yr	\$ 18.9M
3yr	\$ 12.5M
Average	\$ 22.1M