EXHIBIT NO. ___(EMM-1CT)
DOCKET NO. UE-04____/UG-04____
2004 PSE GENERAL RATE CASE
WITNESS: ERIC M. MARKELL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-04____** **Docket No. UG-04____**

PREFILED DIRECT TESTIMONY OF ERIC M. MARKELL (CONFIDENTIAL) ON BEHALF OF PUGET SOUND ENERGY, INC.

REDACTED VERSION

APRIL 5, 2004

PUGET SOUND ENERGY, INC.

PREFILED DIRECT TESTIMONY OF ERIC M. MARKELL

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PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

Q. Please state your name, business address, and position with Puget Sound Energy, Inc.?

A. My name is Eric M. Markell. My business address is 10885 N.E. Fourth Street Bellevue, WA 98004. I am the Senior Vice President Energy Resources for Puget Sound Energy, Inc. ("PSE" or "the Company").

Q. Have you prepared an exhibit describing your education, relevant employment experience, and other professional qualifications?

A. Yes, I have. It is Exhibit No. ___(EMM-2).

Q. What are your duties as Senior Vice President Energy Resources for PSE?

A. My present responsibilities include oversight of: (i) the operation and maintenance of the Company's electric generating facilities and gas storage facilities; (ii) contracts for electric supply, transmission services, long-term gas supply, and long-term gas transportation services; (iii) generation resource acquisition and management activities; and (iv) Least Cost Resource planning.

Q. Please summarize the contents of your testimony?

A. The purpose of my testimony is: (i) to identify and explain the Company's need to acquire additional energy supply resources over the next several years and to describe the status of our current acquisition efforts; (ii) to describe the expected magnitude and potential range of expenditures to meet those energy needs and to discuss the importance of improving the Company's financial strength to enable and support these acquisitions; (iii) to briefly describe the Company's current resource portfolio; and (iv) to explain the Company's request for recovery of deferred costs related to its White River Hydroelectric Project.

II. RESOURCE NEEDS AND CURRENT ACQUISITIONS

Q. Please provide a brief overview of the Company's resource acquisition needs.

A. As described in the testimony of Mr. Stephen Reynolds, Exhibit No. ___(SPR-1T), PSE is committed to meeting its public service obligations. The Company's Least Cost Planning efforts during the past two years have established that significant resource acquisitions will be required to meet those obligations. While the ultimate selection of such resources has yet to be made, these resource acquisitions are projected to require (i) direct capital investment of approximately $[redacted], and (ii) additional purchased power agreements ("PPAs") over that time period. Following that, additional investment of up to $1.7 billion over the 2009-2013 time period may also be required. In addition to such direct use of funds, additional equity capital and credit capacity may be needed to

provide credit support for potential long-term fixed price fuel agreements and to support portfolio risk management activities such as hedging of fuel supply costs, as described in the testimony of Ms. Julia Ryan, Exhibit No. ___(JMR-1T).

Q. Please describe the Company's resource planning process.

A. In accordance with the Least Cost Planning Rules (WAC 480-100-238 and 480-90-238), the Company filed a Least Cost Plan ("LCP") in April of 2003, and updated the LCP in August of 2003. The April 2003 LCP established a planning standard, analyzed resource needs and alternatives, and established a long-term resource strategy. Pursuant to the Commission's rules, PSE's next LCP is due to be filed in April 2005. In the meantime, the Company continues to inform itself about developments in the marketplace, works to improve its analytical tools and updates information such as long-term resource needs, projected capital costs of generation technologies, and projected wholesale natural gas and electric prices for use in its on-going long-term planning process.

Q. What are the Company's current resource adequacy standards used for planning purposes?

A. This topic was presented in the Company's April 2003 LCP.[1] The Company analyzed eight combinations of energy and capacity levels using different combinations of resources to assess the costs and cost volatility of different standards and methods for meeting those standards. The following is a summary

[1] April 2003 LCP, Chapter XI Electric Portfolio Analysis, Chapter XII Analytical Results

of the resource planning standards and resource strategy that were developed based on the analysis and judgment included in the Least Cost Plan:[2]

1. The Company will plan to acquire long-term firm energy resources sufficient to ensure that customer energy needs are met on an expected monthly basis.

2. The Company will plan to meet a capacity planning level associated with loads at a minimum hour temperature of 16 degrees Fahrenheit and will seek lower-cost approaches than relying only on simple-cycle gas turbines to meet this capacity planning level.

3. The Company will develop a diversified portfolio of multiple resource technologies to meet its customers' future energy and capacity needs, including establishment of a goal based on the analysis to meet 5% of its customers' energy needs by 2013 through the use of renewable resources.

Q. Does the Company have a need to acquire additional electric supply resources?

A. Yes. The August 2003 LCP Update concluded, based on application of the resource adequacy standards described above, that the Company has a present

and Judgement, and XIII Electric Resource Strategy.

[2] April 2003, Chapter XIII at p. 26.

need to acquire resources for approximately 476 aMW by 2005 growing to approximately 618 aMW by 2008 and to approximately 1,715 aMW by 2013.

Q. Has the Company updated the resource needs presented in the August 2003 LCP Update?

A. Yes, the Company's load-resource balance (thus its needs) described above have been updated to reflect the following:

1. assumed acquisition of the Frederickson 1 project;
2. acquisition of energy efficiency resources consistent with the August 2003 LCP Update;
3. an updated long-term load forecast;
4. updated long-term hydro conditions; and
5. a few minor adjustments to power contracts.

After updating for these factors, the need is approximately 280 aMW by 2005, 355 aMW by 2008, and 1,380 aMW by 2013. These aMW numbers represent the highest average monthly energy need during the year, consistent with the Company's resource adequacy standard, explained above. *See* Exhibit No. ___(EMM-3).

Q. What is driving the growing need for resources?

A. The growing need for resources is primarily driven by load growth and by the

need to replace expiring energy supply contracts as well as other reductions of generation from existing resources.

As shown in the April 2003 LCP, PSE is short on an energy basis in seven months during 2004, and that short position grows. By 2012, PSE will be short in every month.[3] Additionally, there is a shortfall between PSE's projected winter peak demand and peak capacity, which grows over time. The result is that the Company has a significant near-term need for resources that grows significantly over time.

Q. What is the Company's strategy to meet the growing needs noted above?

A. In order to balance exposure to a variety of risks, the Company has adopted a strategy of acquiring a balanced portfolio of resources to meet its needs. This portfolio includes a mix of energy efficiency, renewable and thermal resources.[4] The Company is pursuing a program to acquire resources consistent with this strategy.

Q. Please describe the Company's resource acquisition program.

A. The Company is currently engaged in a number of efforts to acquire resources consistent with its resource strategy, including the following:

- Closing the Frederickson 1 acquisition;

[3] April 2003 LCP, Appendix F.

[4] See April 2003 LCP, Chapter XIII, and August 2003 LCP Update, Chapter IX, p. 2, Chart IX-1.

- Acquiring energy efficiency resources consistent with the analysis and strategy described in the August 2003 LCP Update; and

- Pursuing acquisition of resources under three Requests for Proposals (RFPs) that have been issued under the Commission's WAC Chapter 480-107 process; one for wind resources, one for energy efficiency resources, and one for all generation sources.

In addition, the Company monitors the marketplace for resource opportunities that may arise outside the formal RFP processes in an effort to identify potentially valuable transactions that may not present themselves through the formal RFP process.

Q. What is the status of the Frederickson 1 acquisition?

A. In October 2003, PSE agreed to purchase a 49.85% share of the 249 MW Frederickson 1 facility located near Tacoma, Washington. The Company's acquisition and inclusion of costs associated with the Frederickson 1 transaction are presently before the Commission for prudence review and related ratemaking treatment in Docket No. UE-031725. As of the date my testimony was filed, the Company was also still awaiting FERC's approval of the transaction with respect to the "Section 203 filing" for Frederickson 1. Transmission service from BPA was granted by letter dated March 17, 2004, and has been accepted by the Company. Once the transaction closes, the Company will true-up the proforma adjustment to the closing date, as described in the testimony of Mr. John Story,

Exhibit No. ___(JHS-1T).

Q. What is the status of the Company's Wind Power Projects RFP (Wind RFP)?

A. The Wind RFP seeks proposals for long-term PPAs or PSE ownership of wind-power projects. The Wind RFP was issued in November 2003 and replies were received in January 2003. The Company is currently engaged in the technical evaluation of various wind resources and project due diligence. The Company anticipates the Wind RFP process will result in one or more projects that could come online by the end of 2006.

Q. What is the status of the All-Source RFP?

A. The All-Source RFP is seeking proposals for long-term purchase-power agreements or PSE ownership of generation resources of all types and was issued in early February 2004. By the response deadline of March 12, 2004, PSE received 47 multi-part proposals. The Company has begun evaluating the proposals and anticipates acquiring one or more resources as a result of the All-Source RFP process.

Q. What are the Company's expectations with regard to growth in gas sales load?

A. Exhibit No. ___(EMM-4) includes a chart illustrating the projected annual growth in sales volumes, the amount of annual sales met by conservation and storage, and the annual volume met by flowing supplies; i.e., load met by supply contracts. Exhibit No. ___(EMM-4) also includes a table showing load growth and growth

in load served by flowing supplies.

III. CAPITAL REQUIREMENTS/COSTS

Q. Earlier in your testimony, you explained that by 2008, the Company would need 355 aMW of energy. How is the Company projecting that those needs will be met over the next five years?

A. Although the Company has not yet made any decisions with respect to actual resource selections, for purposes of understanding the potential range of capital needs associated with resource acquisitions, the Company estimates that by 2008, it may acquire assets with capital costs totaling approximately [redacted] million plus enter into additional PPAs, based on the following planning scenario:

1. Addition of a [redacted] MW combined cycle gas turbine plant with an estimated average cost of [redacted]/kW;

2. Acquisition of a [redacted] MW base load PPA;

3. Acquisition of one [redacted] MW wind plant (name plate capacity) of which PSE would own [redacted] and purchase the other [redacted] of output through a PPA. Capital costs are assumed to be approximately [redacted]/kW;

4. Acquisition of a second [redacted] MW wind plant (name plate capacity), which again would be owned [redacted] by PSE, with the other [redacted] acquired through a PPA. Capital costs are assumed to

be [redacted]/kW;

5. Purchase of peaking resources such as call-options; and

6. Investment of an additional [redacted] million in transmission.

Q. Do non-capital additions increase the Company's financial needs?

A. Yes. To the extent the Company acquires PPAs to meet its resource needs, additional capital requirements will be placed on the Company. Certain PPAs carry with them imputed debt characteristics and require equity capital support, as discussed in the testimony of Mr. Donald Gaines, Exhibit No. ___(DEG-1CT). In addition, as described below, the Company must have the financial strength to assure potential counterparties that it will meet its long-term obligations under such agreements.

Q. If the Company were to acquire more "hard" assets and fewer PPAs, would the capital requirement be different than the estimated $[redacted] million?

A. Yes. For instance, if the Company were to acquire hard assets to meet all of its energy and capacity needs identified in the August 2003 LCP Update (as opposed to relying in part on PPAs), the Company may need to invest approximately $800 million in such assets by 2008 (not including Frederickson 1) based on the generic resource costs described in the LCP.

Q. Are there other uncertainties associated with the Company's projections of capital needs?

A. Yes. The actual capital costs associated with future resource acquisitions may be significantly different from the generic resource costs from the 2003 LCP or other current estimates. In general, such LCP estimates do not include such "soft" costs as interest during construction, development fees, due diligence costs, spare parts costs and the legal costs of negotiating and documenting complex commercial terms and conditions. Transmission costs, too, are very difficult to estimate for a generic resource because one does not know the actual site of construction. Risks related to timing can also influence actual capital costs. Inflation, regulatory and siting requirements, legal costs of permits and appeals, along with numerous other variables, are very difficult to predict with accuracy. Nevertheless, we believe the estimated costs above present a reasonable range of future resource costs for financial and resource planning purposes.

Q. Does the Company's Least Cost Plan indicate that the Company will continue to have significant needs to invest in generating resources beyond 2008?

A. Yes. If the Company acquired hard assets consistent with the Company's resource strategy in the August 2003 LCP Update, the Company could require an additional investment of approximately $1.7 billion over the 2009-2013 time period (assuming asset ownership). This figure is taken from the LCP process and is based on generic costs. I provide these estimates simply to demonstrate the potential range of future capital needs as the Company plans to meet its public service obligations.

Q. Does the Company's financial condition impact its resource acquisition program?

A. Yes. In order to fund the acquisition or construction of additional generation resources, the Company must have the capability to pay cash to asset sellers, contractors, or vendors engaged respectively, in the sale or construction of a facility. Similarly, if the Company is the purchaser of energy from a third party in connection with a PPA, the counterparty must have confidence the Company will be able to perform its obligations under the agreement over the long term. In particular, the Company must have the credit capacity to post cash or other security as may be required as markets move in relation to such purchase obligations.

A company with a strong balance sheet, strong earnings and cash flow and highly rated debt is best positioned to offer such comfort and to transact on favorable terms and conditions. Debt ratings are one of the most widely accepted measures of a company's ability to perform its financial obligations. Generally speaking, the higher one's debt ratings, the more favorable the terms of such debt, including its cost as described by Mr. Donald Gaines and Dr. Charles Cicchetti, Exhibit No. ___(CJC-1T). A higher rated company will be more likely to have greater success with contractors in avoiding onerous credit terms such as excessively large up-front deposits, the posting of letters of credit, and hidden margins designed to provide the vendor a risk premium for doing business with a weak credit party.

Q. Will execution of the Company's resource strategy create other financial pressures on the Company?

A. Yes. My testimony up to this point has only addressed the Company's current estimates of the fixed or capital costs needed for acquiring new generation resources or purchased power contracts. If the Company's acquisition process results in purchase of generation assets with fuel requirements, whether through a supply contract or through direct ownership, such acquisition will substantially increase the Company's need for credit to support the acquisition and management of fuel supply to such facilities.

For example, in the event the Company were to elect to acquire a gas-fired resource with a long-term fixed-price source of gas for part of its fuel requirements, the supply counterparties would likely require that unencumbered credit be available to post as cash, an irrevocable direct pay letter of credit or similar liquidity instrument to support contractual mark-to-market terms of such gas supply agreement. Hedging issues related to gas supply are further addressed in the testimony of Ms. Julia Ryan.

Q. What are some of the other issues that impact the Company's resource acquisition program and consequent need for financial strength?

A. Financial strength is also needed to provide the Company with the flexibility to respond to uncertainties in the current resource acquisition environment. One such risk that can have significant financial consequences is timing risk, which is

the possibility for a project development or acquisition to be delayed. This can be caused by numerous factors including siting issues and permit appeals. Such risks are pervasive in today's development environment. Delay in the on-line date of a new resource leaves the Company exposed to market prices to a greater degree and for a longer time. The Company's ability to mitigate such risk is dependent upon the Company's ability to utilize hedging strategies, as described by Ms. Julia Ryan, which strategies in turn create a need for enhanced financial strength.

IV. PORTFOLIO DISCUSSION

Q. Please provide a summary of PSE's electric and gas supply portfolio.

A. Please see Exhibit No. ___(EMM-5).

Q. Have there been changes to PSE's existing long-term electric resource portfolio since the Company's recent Power Cost Only Rate Case (PCORC), Docket UE-031725?

A. No.

Q. What are PSE's natural gas supply portfolio changes since the Company's last general rate case, Docket No. UG-011571?

A. There are two transportation capacity additions to the gas supply portfolio, both on upstream pipelines. PSE has acquired long-term transportation for approximately 40,000 Dth per day on Westcoast Pipeline from Station 2 in

northern British Columbia (B.C.) to the interconnect with Northwest Pipeline at Sumas. Additionally, PSE has acquired long and medium term transportation contracts for approximately 80,000 Dth per day on the Trans-Canada Alberta system (formerly known as NOVA) and the Trans-Canada B.C. system (formerly known as ANG) to transport gas supplies from the AECO market to the interconnect with Gas Transmission Northwest (formerly known as PGT) at Kingsgate.

Finally, PSE has continued to participate with its partners in the expansion of the Jackson Prairie natural gas storage facility.

Q. Why did the Company acquire transportation capacity on upstream pipelines in Canada?

A. The transportation capacity from the AECO market on the Trans-Canada Alberta System and the Trans-Canada B.C. system was acquired to replace transportation capacity currently included in the long-term, bundled supply contract for Alberta gas delivered to Kingsgate that expires October 31, 2004. By bundled, I mean the contract includes both gas commodity and transportation capacity to transport gas to Kingsgate. PSE has a long-term transportation agreement on Gas Transmission Northwest to transport Alberta gas from Kingsgate to Northwest Pipeline. The commercial challenge, however, is that Kingsgate is a relatively less liquid trading point for natural gas--there are no monthly market indices and not always daily indices published for Kingsgate. Therefore, in order for PSE to retain the geographic diversity and pricing diversity of supply from Alberta, the Company

acquired capacity on NOVA and ANG to access the AECO market. PSE has been paying for a comparable level of firm upstream transportation capacity in the demand charge for this expiring bundled gas supply agreement. Beginning November, 2004 PSE will be able to acquire gas directly at the more liquid AECO trading hub rather than through a bundled supply and capacity agreement at the Kingsgate interconnect.

The upstream transportation capacity on Westcoast ("T-South") was purchased to diversify the pricing location for a portion of PSE's B.C.-sourced supply and to ensure firm delivery of B.C. gas to PSE's receipt point capacity on Northwest Pipeline at Sumas. Previously, all of PSE's B.C.-originated gas supply was acquired via supply contracts that bundled gas commodity and T-South transport capacity to Sumas; such supply agreements generally required PSE to pay demand charges for the T-South capacity. Effective November 2003, PSE established the ability to acquire up to 40,000 Dth/day of gas at Station 2, where gas is typically priced as a function of the AECO Index rather than the Sumas Index. Further, PSE has now established control over such pipeline capacity for purposes of capacity assignment (release) at times when gas is not flowed from Station 2.

Such flexibility, at a modest increase in cost, provides a diversity of supply and pricing options to meet PSE's supply needs. As the Company surveils the marketplace, it has become apparent that many B.C. producers are intent upon reducing their holdings of T-South transportation capacity in favor of having

options to move gas into the U.S. Midwest (through Alberta via the Alliance system) or into the more liquid market in Alberta. The expected effect of such supplier behavior will be to diminish the diversity and availability of counterparties for contracts for supplies at the Sumas interconnect point, and with such lost diversity, there is a prospect of less competitive prices. Therefore, in order to help ensure firm delivery and a diversity of supply, PSE acquired the T-South capacity.

Q. Please describe the expansion program of Jackson Prairie storage.

A. Jackson Prairie is an underground aquifer storage field that is designed and constructed to deliver large quantities of gas over a relatively short period of time. The most recent significant expansion of Jackson Prairie storage facility was completed in 1999. That expansion was addressed in Washington Natural Gas's 1995 LCP and noted in PSE's 2000/2001 Least Cost Plan. The expansion increased both the capacity (the amount of gas that can be held in the facility) and deliverability (the amount of gas that can be withdrawn in a single day). Jackson Prairie's total working gas capacity is 18.3 Bcf and maximum firm deliverability is 850,000 Mcf per day.

Since completion of the 1999 expansion, owners of Jackson Prairie (PSE, Avista, and Northwest Pipeline) have commenced a capacity expansion with FERC approval. This is anticipated to add an additional 1.75 Bcf of storage capacity to the facility each year for the six years from 2003 to 2008. The total planned expansion capacity of the facility is 10.5 Bcf. Expanding the storage capacity of

Jackson Prairie will increase the amount of summer-priced gas used to offset higher-priced winter gas and will increase the physical reliability of winter gas supplies by increasing the amount of gas stored near our customers. The means by which such storage capacity will be added is water withdrawal from the acquifer, which is most effectively implemented at a slow rate, thus the 6-year timeline. Forty percent of the new capacity created is expected to be used for cushion gas--gas that is injected and used to pressurize the reservoir. The remaining 60% of new capacity will be used to provide working storage capacity. PSE will own one third of the additional capacity.

V. RECOVERY OF DEFERRED WHITE RIVER COSTS

Q. Please describe the White River Hydroelectric Project ("White River Project" or "Project").

A. The Project was built in 1911 and has remained a generating resource in the Company's energy supply portfolio until January 15, 2004. The Project diverted water from the White River to Lake Tapps, a man-made reservoir, and from this reservoir, water was released to generate electricity and then discharged back into the White River. The Project generated electricity with an average annual net generation output of 26.3 aMW over the period 1987-2001.

Q. What costs have been deferred with respect to the White River Project?

A. During the pendency of FERC proceedings on PSE's application for a license for the White River Project, the Company deferred costs related to such licensing

effort, as described in the testimony of Mr. John Story.

The Commission has before it the Company's request for ratemaking and accounting treatment of these costs in Docket No. UE-032043. In late 2003, PSE decided to retire the White River Project rather than accept a FERC license containing provisions that would render uneconomic continued hydroelectric production. Accordingly, the Company is seeking in this proceeding recovery of its deferred costs. The Company's accounting petition in Docket No. UE-032043 proposed to defer any decision on the prudence and ratemaking treatment of such deferred costs to the Company's next general rate case.

Q. Was the White River plant operated under a FERC hydroelectric license?

A. No. For many years, the Project was believed to fall outside of the jurisdiction of the Federal Power Act. This jurisdictional question was litigated in the 1970s and resolved in 1981, establishing FERC's jurisdiction over the Project. PSE submitted a license application to FERC in December 1983. Proceedings on that application continued for 14 years until, in December of 1997, FERC issued a license for the White River Project ("1997 License"). As described below, various parties to the licensing proceeding appealed the 1997 License, and PSE elected to file its own appeal, albeit for different reasons.

Q. Please describe the nature of the appeals.

A. Various natural resource agencies appealed the 1997 License, including NOAA Fisheries ("NOAA Fisheries" or "NMFS"), U.S. Fish and Wildlife Service,

Washington State Department of Fish and Wildlife, and Washington State Department of Ecology ("Ecology"). A principal focus of such appeals was a desire to increase the amount of water dedicated to in-stream flows for the benefit of fish. PSE also filed an appeal because it believed the 1997 License contained terms and conditions, including instream flows, that would render ongoing operations of the Project uneconomic relative to alternative resources available at the time.

Q. During the period from when PSE submitted its license application to FERC in 1983 through December of 1997, was the Company allowed to operate White River?

A. Yes. By filing a license application with FERC, and subsequently appealing the 1997 License, the Company was allowed to continue to operate the White River Project as a generation resource to meet our customers' energy needs.

Q. What happened after the FERC license was appealed?

A. Initially, the 1997 License was not stayed. As the appeal moved forward, PSE was able to continue to operate the Project. In 1999, PSE, local citizens and state and local elected officials concerned with the future of Lake Tapps reservoir and its impact upon neighboring Pierce County communities, initiated a collaborative settlement process to address the contested license terms and conditions and related issues. To facilitate this collaborative process of interested parties, FERC issued a two-year stay of the 1997 License order and related appeals.

One of the tasks that needed to be completed during the two-year stay was completion by NMFS of a biological opinion. A biological opinion was needed to determine the measures that PSE would be required to undertake if a settlement were to be structured around a FERC license. Unfortunately, NMFS did not complete its biological opinion during that two-year time period, which delayed other tasks related to a potential settlement.

Q. During this two-year stay, was PSE allowed to continue operating White River as a hydroelectric facility while the various parties sought to resolve outstanding issues?

A. Yes. During the two-year stay granted by FERC, PSE was permitted to continue operating White River to meet our customers' energy needs. The stay also permitted PSE to defer significant capital costs that would have been required by the terms of the 1997 License order. The stay did impose certain interim flow restrictions, but the Project was able to continue to generate power economically.

Q. After the two-year stay expired, did the FERC licensing and collaborative settlement effort continue?

A. Yes. In 2001, the parties sought and FERC granted a second two-year stay of the litigation, through June 30, 2003. This second stay further extended the deferral of significant capital expenditures, and allowed the Project to keep operating on an economic basis. In October of 2002, NOAA Fisheries completed a preliminary draft Biological Opinion. In the view of PSE and many other

stakeholders, this draft contained conditions that, if adopted, would render the Project uneconomic as a hydropower facility. It also required flow restrictions that threatened the very existence of Lake Tapps. In response to the preliminary draft Biological Opinion, stakeholders provided NOAA Fisheries with detailed recommendations for further consideration. In June of 2003, FERC granted a further extension of the stay, giving the parties until January 15, 2004 to complete a settlement agreement. As before, such stay again continued the deferral of capital expenditures and allowed the Project to stay in operation.

Q. What kinds of actions was PSE pursuing during the 2001-2004 time period in the licensing and collaborative settlement effort?

A. PSE initially approached the collaborative settlement process with the purpose and expectation of licensing the existing hydroelectric project. PSE hoped that, through collaboration with interested parties, alternative conditions for a FERC license could be developed, and agreed to, that would preserve the Project as an economic resource within its electric generation portfolio. However, PSE and the Lake Tapps Task Force also recognized that the existing infrastructure (e.g., dams, dikes, flowlines) and the Lake Tapps reservoir itself had other intrinsic values that served recreational and aesthetic interests. Moreover, the parties also determined that the existence of the reservoir (and the continued operation of the infrastructure that maintains the reservoir), unlike operation of a hydroelectric project at the reservoir, would not depend upon securing a FERC license.

As the collaborative process moved forward, certain water purveyors in the

central Puget Sound area began expressing interest in the Lake Tapps reservoir as a potential source of drinking water. Accordingly, in order to realize the potential of the reservoir as a resource for drinking water, and to add another potential source of revenue to reduce the cost of operating the Project under a FERC license, PSE applied for a new water right for municipal water supply purposes. PSE, as owner of the reservoir, was the party with a sufficient property interest to pursue an application for a consumptive water right.

On June 30, 2003, the Washington State Department of Ecology issued its decision granting PSE's application to develop a new municipal water right. With Ecology's decision in hand, PSE negotiated a Memorandum of Understanding ("MOU") to sell the new water right and related project assets to a consortium of municipalities, known as the Cascade Water Alliance ("Cascade"). Cascade is actively conducting due diligence on the Project assets and is evaluating alternative acquisition structures as part of negotiations to acquire the necessary Project assets from PSE to develop the reservoir as a municipal water supply. Cascade and PSE originally intended to finalize their negotiations before the end of 2003, but appeals by certain parties of Ecology's decision to grant a new municipal water right must be resolved before a sale can be completed.

In November of 2003, NOAA Fisheries issued a revised Biological Opinion that did not differ materially from its prior draft. As with the preliminary draft issued in October of 2002, PSE and the Lake Tapps Task Force concluded that the Biological Opinion still rendered the hydropower facility economically infeasible.

The collaborative concluded that the concerns they had raised with respect to the prior draft had not been addressed or answered. PSE and the Lake Tapps Task Force concluded that their interests would be better served by turning their attention to developing alternative uses for the Project assets that do not require generation of hydropower or a FERC license. The collaborative has now turned its full attention to developing this settlement option.

Q. Did the Company's continued pursuit of an economic FERC license and sequential stays granted by FERC in 1999, 2001 and in 2003 allow the Company to continue operating the hydroelectric facility at White River?

A. Yes. Such stays allowed the Company to keep the Project in operation without making the substantial capital investments required by the 1997 License. The Company did, however, make dam safety improvements during this time frame that FERC required to ensure public safety.

Q. Given the collaborative's conclusion that it was no longer productive to pursue a FERC license, what further actions did the Company take?

A. The second extension of the FERC stay expired on January 15, 2004. On that date, PSE discontinued the generation of electricity at the Project and rejected the 1997 License. PSE then entered into an interim agreement with the U.S. Army Corps of Engineers ("the Corps"), NOAA Fisheries and others to operate the diversion dam for fish passage purposes. Such agreement facilitates the Corps' execution of its obligations to trap and haul endangered Puget Sound Chinook

salmon above its Mud Mountain dam flood control project on the White River. This agreement provides for reimbursement of certain costs incurred by PSE in connection with these interim operations. It is anticipated that these fish management interim operations will continue until the Corps develops and implements a long-term solution for its fish passage needs. The Corps is working with Pierce County, other agencies, several Native American tribes, and PSE to develop this long-term solution.

Q. If the FERC licensing and appeal efforts and related deferred costs accrued during this period did not result in an acceptable FERC license, how do these costs benefit PSE's customers?

A. As noted above, the expenditures made to prosecute the licensing effort allowed PSE to continue to generate relatively inexpensive power for its ratepayers. PSE had to file a license application in 1983 to keep the Project in operation, and these costs were (until December of 1997) incurred in anticipation of a FERC license granted on reasonable terms and conditions. When the 1997 License was appealed, the additional licensing and dam safety expenditures were incurred in expectation of a reasonable settlement, and were incurred pursuant to a stay that deferred significant capital expenditures required by the 1997 License order. Without these expenditures, PSE would have had to retire the Project sooner, thereby depriving customers of relatively inexpensive power during the course of settlement discussions.

Regardless of the outcome of the FERC proceeding, it is also the case that at

some point PSE would need to address the potential retirement of the Project. Given the importance of Lake Tapps as a regional resource, some kind of reclamation activity would likely have been necessary. Expenditures made to create and obtain a new municipal water right ultimately reduce the cost for everyone when the hydro project is retired, because the municipal water right provides a basis for water purveyors to operate the Lake Tapps reservoir as a "going concern" as opposed to a more costly retirement of the reservoir and the associated hydraulic works.

IV. CONCLUSION

Q. Please summarize your testimony.

A. Our resource planning activity indicates that the Company must make significant investments in new generation resources and undertake material new, long-term obligations to purchase power in order to continue to meet its public service obligations.

Q. Does that conclude your testimony?

A. Yes, it does.

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