

**EXHIBIT NO. ___(KO-6HC)
DOCKET NO. UE-06 ___/UG-06 ___
2006 PSE GENERAL RATE CASE
WITNESS: KRIS OLIN**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

**Docket No. UE-06 ___
Docket No. UG-06 ___**

**FIFTH EXHIBIT (HIGHLY CONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF
KRIS OLIN
ON BEHALF OF PUGET SOUND ENERGY, INC.**

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FEBRUARY 15, 2006

November 12, 2004

TO: Edward R. Schild
FROM: Energy Production & Storage Staff
RE: **Update of April 15, 2004 Assessment of Baker River Hydroelectric Project Alternatives**

I. Summary

This memorandum updates the Company's April 15, 2004 analysis of the Baker River Hydroelectric Project ("Project") FERC relicensing alternatives. As noted in that assessment, settlement discussions then underway presented the Company with an opportunity to secure a cost-effective resource and to substantially reduce the Company's regulatory risk of unfavorable license terms and conditions. Subsequent efforts to arrive at a multi-party settlement have been successful. The Company and 23 other parties (including all federal and state resource agencies, three Indian tribes, Skagit County and several nongovernmental organizations) have arrived at a settlement and are prepared to enter into a formal Settlement Agreement. A copy of the Settlement Agreement is attached to this memorandum as Tab A.

If this Settlement Agreement is approved by FERC, the Company will be authorized to continue to generate 707,600 MWh (annual average output) at a levelized cost of approximately \$████/MWh (based on a 30-year analysis—consistent with FERC methodology and our prior analysis). However, all parties to the Settlement Agreement have expressed support for a 45-year license which, if granted, would provide fifteen additional years of dependable generation at a stable and favorable cost. The settlement is truly comprehensive in that the Settlement Agreement will be signed by all parties participating in the FERC proceeding. This degree of certainty is rarely achieved at this stage of a FERC relicensing proceeding, and will substantially reduce the Company's litigation risk and the attendant risks of an unfavorable license and of an uneconomic Project.

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Based upon the analysis summarized below, we recommend that the Company enter into the Settlement Agreement and file it with FERC as an offer of settlement on or before November 30, 2004.

II. Background

A summary of the relevant background information was provided in the April 15, 2004 assessment. As you will recall, in April the parties had yet to reach consensus with respect to several key issues, including instream flows, flood control and terrestrial habitat (acquisition of mitigation lands). These issues have now been resolved through extended negotiations, and in the case of flood control, by incorporating significant measures responsive to demands that threatened to upset the entire settlement. We have taken these additional factors into consideration and, as described below, we have reevaluated the "Settlement Proposal" described in our prior memorandum and we have compared the revised proposal to the other relicensing alternatives.

III. Need For the Project

The need for the Project was summarized in our April 15, 2004 analysis. This analysis concluded that the Company needed to retain this Project as a cost-effective element of its existing resource portfolio. Nothing has occurred over the ensuing six months that alters this analysis or the conclusion we reached in April. We do note, however, by way of comparison the results of the Company's current resource acquisition process. This provides a timely and useful benchmark for assessing the need for this Project and the attractiveness of the revised Settlement Proposal. The Company's resource acquisition needs remain large (486 aMW in 2005) and growing to 943 aMW in 2010. Referencing information presented to the Company's Least-Cost Planning Advisory Group (see page 4 of Tab B), the cost of the Project under the revised Settlement Proposal compares very favorably with all alternative resources. Additionally, the project costs are projected to be much more stable over time as compared to alternative resources, presenting much less risk to our customers. This is a key consideration in the Company's Least-Cost Planning and resource acquisition efforts.

IV. Alternatives

There are three relicensing alternatives under consideration as well as a decommissioning alternative. The details behind the cost of power references are included in Tab C – Draft Comparative Economics.

PSE's License Application: The Company filed its license application on April 29, 2004. If the proposed application were adopted by the FERC, the cost of power under this alternative would be approximately \$█/MWh (levelized) over the thirty-year term of a new FERC license. FERC has not acted on this proposal, other than to accept the application for further consideration. After the application was filed, FERC deferred further action (at the request of the parties) to afford the parties time to complete their settlement discussion. This deferral ends on November 30, 2004, at which point (absent settlement) FERC will proceed to consider PSE's application in a contested case.

Agency/NGO Proposal: Resource agencies, tribes and other interested parties maintain a "litigation position" that, if implemented, would result in a cost of power in the range of \$█/MWh to \$█/MWh (levelized) over the thirty-year term of a new FERC license.

Settlement Proposal: If approved by FERC, the proposed settlement would authorize the Company to continue to generate 707,600 MWh (annual average output) at a 30-year levelized cost of approximately \$█/MWh. A more detailed description of this proposal and a corresponding economic analysis is attached at Tabs A and C. The settlement recommends that the FERC grant a 45 year license, providing 15 additional years of dependable generation at a stable and favorable cost.

Decommissioning Alternative: This alternative would come into play if a new FERC license could not be secured on favorable terms. Nothing has occurred, to date, in connection with the relicensing efforts that would cause the Company to conclude that decommissioning is preferable to pursuing a new FERC license.

V. Analysis

The April 15, 2004 analysis compares costs, risks, and benefits associated with the foregoing licensing alternatives and project decommissioning. This analysis is updated, as follows:

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PSE's License Application: Our prior analysis of this alternative and the conclusions drawn from this analysis has not changed. The application was filed on April 29, 2004 in order to meet the FERC deadline for submitting a license application. At the time the application was filed, the Company was optimistic about the prospects of settlement but significant outstanding issues had yet to be resolved. The application therefore reflected the Company's most likely "litigation position" in the event of a contested FERC proceeding. The application proposed terms and conditions that would allow the Company to continue to generate 714,000 MWh per year at a cost of approximately \$█/MWh (levelized based on 30-year analysis).

In the event a favorable settlement could not be reached, the Company was prepared to pursue this application in a contested FERC proceeding. This course of action would, however, entail significant regulatory risk, particularly in view of the outstanding issues. As noted in our April 15th assessment, some of the agencies pursuing demands for significantly more expensive terms and conditions have direct decision-making authority (and/or significant influence upon the decision that FERC ultimately makes). Based upon positions asserted by these agencies in the relicensing proceeding (i.e., see "Agency/NGO Proposal"), the regulatory risk associated with a contested FERC proceeding (and subsidiary proceedings associated with mandatory conditioning) of pursuing the application in a contested proceeding was determined in April to be significant and could have resulting in a Project cost of \$█/MWh. Much of this increased risk was associated with very expensive fish and wildlife measures, and with agencies authorized to impose these measures in a contested proceeding

After the license application was filed, it became clear that this regulatory risk was increasing, primarily due to an unresolved dispute over appropriate flood control measures. If these flood control measures had been imposed by FERC in a contested proceeding, these measures could have added an additional \$ 6.6/MWh to the cost of the Project. Thus, taking these additional costs into consideration, the risk of a "bad result" from a contested case, in economic terms, could have easily exceeded \$█/MWh.

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Settlement Proposal: If the revised Settlement Proposal is approved by FERC, the result would be a project with an annual output of 707,600 MWh, at a cost of approximately \$█/MWh (levelized) for 30 years. While this is an increase in cost of approximately \$4.5/MWh as compared to the proposed license application, it falls well within an acceptable range of costs that could result from a contested FERC process and is significantly below the economic risk of a bad result (i.e., \$█/MWh to \$█/MWh). Moreover, with the support by the settling parties for a license of 45 years, we are cautiously optimistic that FERC will approve the longer term. If this occurs, the Company and its customers will benefit from 15 additional years of dependable generation at a stable and favorable cost.

The opportunity for settlement, on these terms, is available now and it is difficult to foresee a set of circumstances in the FERC proceeding that would lead to a more favorable settlement. We have reached the end of the period afforded by FERC to work out a settlement, and were the Company not to settle at this time, a contested FERC proceeding (and the subsidiary proceedings that afford resource agencies mandatory conditioning authority) would commence. As these proceedings move forward, resource agencies and other parties would likely take positions that will substantially depart from the proposed settlement (i.e., see "Agency/NGO Proposal"). It is therefore not reasonable to assume that a better settlement proposal would evolve over time. The parties to the settlement have already invested substantial time and resources in the current settlement proposal. One of the incentives for many of the parties to settle now is to avoid the further delays and costs associated with litigation, and to invest these resources in the implementation of the settlement. It is fair to characterize many of their contributions to the settlement as reflecting their best and final offer and a reasonable compromise. For these reasons, we conclude that the best opportunity for a settlement on reasonable terms is now available and this opportunity should be pursued.

Agency/NGO Proposal: As a fallback position in the event of no settlement, the resource agencies, tribes and other interested parties have identified their preferred terms and conditions for a new FERC license. This sets a benchmark for measuring the regulatory risk associated with a contested FERC proceeding (\$█/MWh to \$█/MWh). However, in light of the other alternatives, there is no reason at this juncture to pursue a license application or a settlement on these terms.

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Decommissioning Alternative: Based upon our current assessment of the alternatives, and the fact that relicensing alternatives present a reasonable opportunity to obtain a new license that will secure a reliable and cost-effective resource, the decommissioning alternative is not viewed as a viable alternative. However, as with other alternatives, this alternative will be reassessed as the FERC proceeding continues.

VI. Selection of Alternatives

The Company should enter into the proposed comprehensive settlement agreement and file it with FERC as an offer of settlement on or before November 30, 2004.

VII. Reevaluation

The foregoing analysis and associated conclusions should be reevaluated after the Company has had the opportunity to present its settlement proposal to FERC. It likely will take FERC 12 to 18 months to consider and act on this proposal. During this timeframe, if and as additional information becomes available, we will provide a further update of this analysis.

cc: Eric Markell
George Pohndorf
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