

EXHIBIT NO. ____ (DEG-1CT)
DOCKET NO. UE-07 ____
2007 PSE PCORC
WITNESS: DONALD E. GAINES

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

Docket No. UE-07 ____

**PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF
DONALD E. GAINES
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**REDACTED
VERSION**

MARCH 20, 2007

PUGET SOUND ENERGY, INC.

**PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF
DONALD E. GAINES**

I.	INTRODUCTION	1
II.	HEDGING LINE OF CREDIT	2
III.	CONCLUSION	5

PUGET SOUND ENERGY, INC.

**PREFILED DIRECT TESTIMONY (CONFIDENTIAL) OF
DONALD E. GAINES**

I. INTRODUCTION

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

A. My name is Donald E. Gaines. My business address is 10885 NE Fourth Street, P.O. Box 97034, Bellevue, Washington 98009-9734. I am the Vice President Finance & Treasurer 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. ____ (DEG-2).

Q. What are your duties as Vice President Finance and Treasurer for PSE?

A. I have overall responsibility for raising capital in the financial markets. I am also responsible for maintaining relations with credit rating agencies, commercial and investment banks. In addition, I oversee the Company's financial planning, tax and energy credit activities.

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1 **Q. What is the nature of your testimony in this proceeding?**

2 A. My testimony describes PSE's progress in establishing a separate credit line to
3 support its wholesale energy market transactions. I also describe the Company's
4 plans to recover these costs of this credit facility in the same manner as other power
5 and gas commodity costs, as was approved by the Commission in the Company's
6 2006 general rate case, Docket No. UE-060266 and UG-060267 (the "2006 GRC").

7 **II. HEDGING LINE OF CREDIT**

8 **Q. How was the line of credit sized?**

9 A. The Company subjected the augmented power and Core Gas hedging strategies to
10 changes in price and compared the results to the amount of trade credit granted by
11 PSE's hedging counterparties. Although not included in the mathematical
12 modeling, the Company also considered the effects that changes in volumes would
13 have on the hedging strategies. The amount of collateral needed in excess of the
14 trade credit granted was used to determine the size of the credit facility. This
15 analysis suggested that a credit facility in the amount of \$[REDACTED] million dollars would
16 be sufficient approximately [REDACTED] percent of the time, while a credit facility of \$[REDACTED]
17 million would be sufficient approximately [REDACTED] percent of the time. The analysis
18 suggested a credit facility in the amount of \$[REDACTED] million would be sufficient
19 approximately [REDACTED] percent of the time. In the end, the Company determined that a
20 \$350 million credit facility, with an option to extend the facility to \$525 million
21 (otherwise referred to as an "accordion" feature), would be a level it could

1 reasonably expect banks to commit and would be an adequate line of credit to
2 support the augmented and extended hedging activities.

3 **Q. Please describe how the accordion feature works.**

4 A. The accordion feature notifies the banks that are parties to the facility that the
5 Company may desire to increase the size of the facility during its five-year term.
6 Although they cannot object to the increase, the banks then providing the facility
7 may, but are not obligated to, increase their commitment to the higher level. The
8 Company retains the right to include additional banks in the facility to achieve the
9 higher level, if needed. The benefit to customers is that the Company only pays for
10 a \$350 million facility until it decides it is appropriate to increase the size of the
11 facility. The Company would exercise the accordion feature if there were
12 substantial use of the \$350 million base level or if substantial additional use were
13 projected.

14 **Q. How would the Company use the credit facility?**

15 A. At the time the Company enters into a hedge, it is "at the market"; as a result, the
16 value of the hedge is then neutral. As prices or exposures change, the value of the
17 hedge will change as it is marked to current market. To the extent the value of a
18 hedge exceeds the amount of trade credit granted by the counterparty, the Company
19 will be asked to post collateral in the amount by which the value of the hedge
20 exceeds the amount of trade credit granted. If a counterparty makes a valid request
21 for collateral, the Company would provide that collateral by either posting a letter

1 of credit or providing cash borrowed under the facility.

2 **Q. What are the type and magnitude of costs that would be related to such a line**
3 **of credit?**

4 A. The up-front costs for such a facility are expected to be about \$275,000, which will
5 be amortized over the five year term of the facility. The annual commitment fee is
6 12.5 basis points, or \$437,500, and the annual administrative agent fee is \$12,500.
7 The rate for funds drawn from the line would be between 52.5 and 62.5 basis points
8 above LIBOR (the variable London Inter-Bank Overnight Rate). For letters of
9 credit, there is a 12.5 basis point fronting fee that is added to these spreads,
10 resulting in letters of credit costing a total of 65 to 75 basis points. The total annual
11 cost for this line of credit, absent the cost of letters of credit draws and fronting
12 fees, is \$505,000. These costs are substantially lower than those expected when the
13 Company proposed this facility in its 2006 GRC.

14 **Q. How will the costs of this new line of credit be allocated between the Power and**
15 **Core Gas books?**

16 A. In this proceeding, the Company has allocated up-front costs to Core Gas and
17 Power based upon the results of reviewing several energy costs scenarios. In the
18 95th percentile of the scenarios, the ratio of Power portfolio trade credit need
19 compared to Core Gas portfolio trading credit need was 61:39. This suggests a line
20 of credit cost allocation of 61% to Power and 39% to Core Gas. In addition, as
21 draws are made under the line of credit, those costs will be allocated directly to the

1 underlying transaction via the Company's existing Power Cost
2 Adjustment ("PCA") and Purchased Gas Adjustment ("PGA") Mechanisms. In this
3 proceeding, of the estimated \$505,000 annual costs (excluding costs of draws),
4 \$308,050 has been included in the rate year baseline rate. See Exhibit
5 No. ____ (JHS-1T).

6 **Q. Has the Company executed an agreement for a specific line of credit for**
7 **hedging?**

8 A. The Company is in the process of executing a five-year \$350 million line of credit,
9 expandable to \$525 million through an accordion feature, as discussed above.
10 Negotiations are expected to be finalized by the end of March 2007. Any required
11 updates to the costs included in the baseline rate will be provided during this
12 proceeding.

13 III. CONCLUSION

14 **Q. Does that conclude your testimony?**

15 A. Yes, it does.