

**EXHIBIT NO. ___(RG-13)
DOCKET NO. UE-06___/UG-06___
2006 PSE GENERAL 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-06___
Docket No. UG-06___**

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

FEBRUARY 15, 2006

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

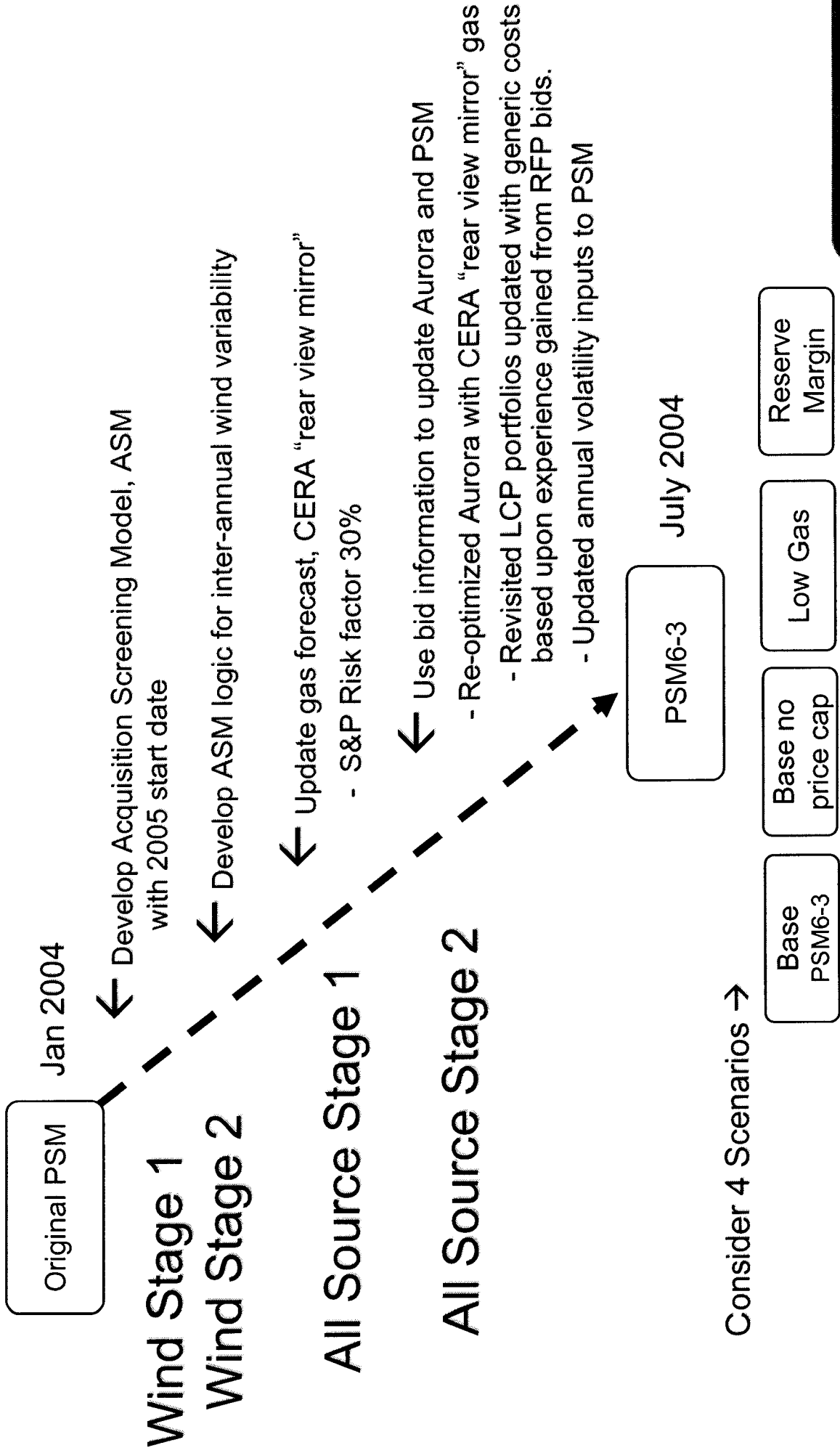
Benefits of a Stronger Balance Sheet

- 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						
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 – Equity Offset Cost

Hypothetical Example

			Year	% Price Stress	Stress Price	MTM \$MM	Approx. Treasury Yield Curve	Discount MTM \$MM
250	MW plant capacity		1	30%	\$3.50	\$ 14.2	2.30%	\$ 14.0
60%	capacity factor		2	20%	\$4.00	9.5	2.80%	9.08
7200	Heat Rate		3	20%	\$4.00	9.5	3.00%	8.79
150	aMW Expected annual generation		4	20%	\$4.00	9.5	3.40%	8.42
25,920	mmbtu / day gas requirement		5	20%	\$4.00	9.5	3.80%	8.00
20	years		6	20%	\$4.00	9.5	4.00%	7.63
\$5.00	average gas price		7	20%	\$4.00	9.5	4.20%	7.24
			8	20%	\$4.00	9.5	4.35%	6.87
			9	20%	\$4.00	9.5	4.50%	6.51
\$ 129.5	Imputed Debt		10	20%	\$4.00	9.5	4.60%	6.17
\$ 106.0	Equity Offset		11	20%	\$4.00	9.5	4.65%	5.87
			12	20%	\$4.00	9.5	4.70%	5.58
			13	20%	\$4.00	9.5	4.75%	5.30
			14	20%	\$4.00	9.5	4.80%	5.02
			15	20%	\$4.00	9.5	4.85%	4.76
			16	20%	\$4.00	9.5	4.90%	4.51
			17	20%	\$4.00	9.5	4.95%	4.26
			18	20%	\$4.00	9.5	5.00%	4.03
			19	20%	\$4.00	9.5	5.00%	3.84
			20	20%	\$4.00	9.5	5.00%	3.65
								\$ 129.5
	2005 GRC							
	Year-end Estimate	Imputed Equity Offset 2005						
	\$ MM							
Debt	\$2,440	55.0%	\$2,440	53.7%				
Equity	\$1,997	45.0%	\$2,103	46.3%	1.3%	incremental equity ratio		
	\$4,437	100.0%	\$4,543	100.0%				

Acquisition Analysis

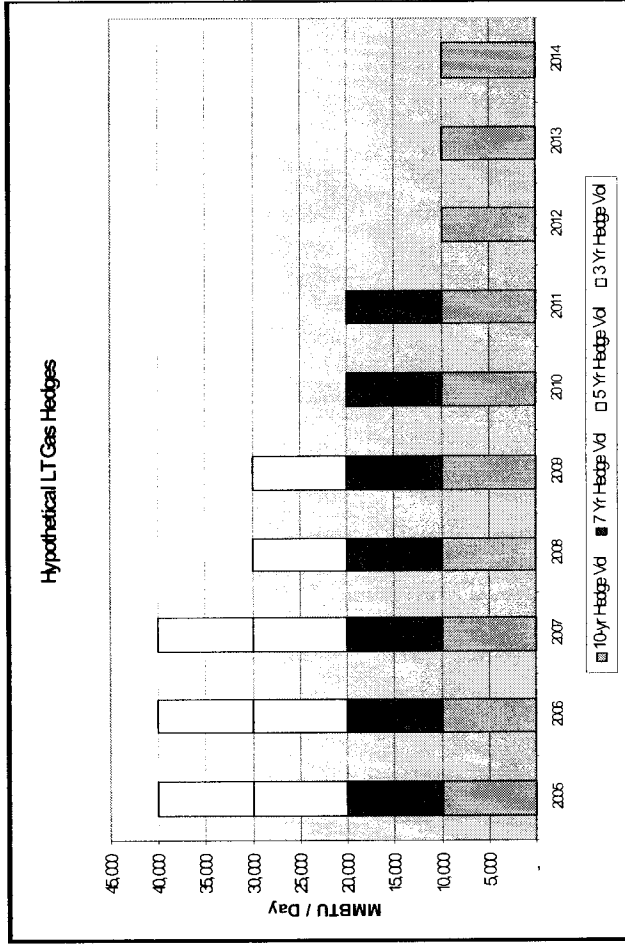
Gas Hedge

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