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September 29, 1999

Ms. Carole J. Washburn, Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
Olympia, WA 98504-7250

Re: Petition for an Order Approving Proposed Accounting Treatment for the Purchase of a Cogeneration Project, and Authorizing Assumption of Securities Under RCW 80.08.130

Dear Ms. Washburn:

Enclosed is a petition whereby Puget Sound Energy (PSE or the "Company") is requesting authority for specific accounting treatment associated with the purchase of a cogeneration project, and authorization to assume certain liabilities in connection with the purchase. The transaction provides PSE with the opportunity to reduce the effective cost of purchases the Company is currently obligated to make from a cogeneration project under a power purchase agreement with the owner. The cost reductions are estimated to produce savings with a net present value of approximately \$27 million for customers over the remaining 23-year useful life of the cogeneration project. To accommodate the scheduled closing date of November 1, 1999, the Company respectfully requests issuance of the requested Commission order on or before October 27, 1999.

Thank you for your assistance.

Very truly yours,

PUGET SOUND ENERGY, INC.

By Stephen A. McKeon
Stephen A. McKeon
Vice President & General Counsel

Enclosures

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WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION
COMMISSION

Petition of

PUGET SOUND ENERGY, INC.

For an Order (1) Approving Proposed
Accounting Treatment for the Purchase of a
Cogeneration Project, and (2) Authorizing
Assumption of Securities Under
RCW 80.08.130

Docket No. UE-99 _____

PETITION

In accordance with WAC 480-09-420(7), Puget Sound Energy, Inc. ("PSE" or "the Company") respectfully petitions the Washington Utilities & Transportation Commission (the "Commission") for an order which:

- (1) approves the proposed accounting treatment in connection with PSE's acquisition of the cogeneration project identified in Exhibit A; and
- (2) authorizes PSE pursuant to RCW 80.08.130 to assume certain liabilities in connection with such acquisition.

The transaction, which is scheduled to close on or before November 1, 1999, provides PSE with the opportunity to reduce the effective cost of purchases the Company is currently obligated to make from a cogeneration project under a power purchase agreement with the owner, as identified in Exhibit A ("Owner"). It is currently estimated that these cost reductions will produce savings with a net present value of approximately \$27 million for customers over the remaining 23-year useful life of the cogeneration project.

The order requested by this Petition is necessary to enable the Company to enter into the transaction. To accommodate the scheduled closing date of November 1, 1999, the Company respectfully requests issuance of the requested Commission order on or before October 27, 1999.

BACKGROUND

1. PSE is engaged in the business of furnishing electric and gas service within the State of Washington as a public service company, and is subject to the regulatory authority of the Commission as to its rates, service, facilities and practices.

2. In the early 1990s the Company entered into an Agreement for Firm Power Purchase ("Agreement") with the Owner to purchase the output of the cogeneration project pursuant to the Public Utility Regulatory Policies Act of 1978 ("PURPA").

3. Over the past several months, the Company has been in negotiations with the Owner regarding the restructuring of the Agreement with the Company's objective to achieve a reduction in the power supply costs under the Agreement. These negotiations resulted in the parties entering into an Interest Purchase Agreement ("Purchase Agreement") whereby PSE would purchase the cogeneration project. A copy of the Purchase Agreement is included as Exhibit B to this Petition.

4. The purchase price agreed upon by the parties ("Purchase Price") is set forth in the Purchase Agreement. In addition to the purchase by PSE of all of the equity interests in the project, PSE would assume or guarantee certain obligations of the project, including borrowings ("Loan Amounts") under certain loans in connection with the project, as

described in the Purchase Agreement. In addition, the Company will incur certain transaction costs, currently estimated to be \$500,000, in connection with the purchase.¹

BENEFITS OF THE TRANSACTION

5. The Company's objective in entering into the transaction is to achieve reductions in the power supply costs of output from the cogeneration project. The savings in power costs provided as a result of the transaction are estimated to be substantial. Exhibit C shows the benefits to customers from PSE's purchase of the cogeneration project versus continuing to purchase the output of the project under the existing Agreement. That Exhibit shows a reduction of \$27 million in the revenue requirement, on a net present value basis, from the transaction.²

6. This transaction is consistent with PSE's commitment in the merger proceeding to mitigate increasing power costs. As part of the proceedings leading to approval of the Puget/WNG merger, the parties committed to pursue an aggressive strategy to mitigate power costs. The Commission ordered that "PSE shall aggressively pursue best operating practice savings, *power stretch goals*, and synergy savings during the Rate Plan Period." Docket Nos. UE-951270 and UE-960195, Fourteenth Supplemental Order, p. 27 (emphasis added).

7. In the Company's next general rate proceeding, the Company will request the unamortized purchase price (including unamortized transaction costs) be included in rate base

¹ These transaction costs include taxes, third party costs associated with the due diligence effort, and costs incurred to refinance on more favorable terms the debt assumed by the Company.

² Paragraph 6.2 of the Agreement grants the Company an option to purchase the plant for one dollar (\$1) at the end of the fifteen-year term of the Agreement. The Case I scenario considered in the analysis in Exhibit C therefore assumes the purchase of the project in 2008 for \$1.

and that the debt incurred in the transaction be included in the Company's capital structure. Until that rate proceeding, the Company would bear the amortization of the costs associated with the transaction.

RELIEF REQUESTED

Proposed Accounting Treatment

8. The acquisition cost of the project ("Acquisition Cost") -- the sum of the Purchase Price, the assumed Loan Amounts, and the transaction costs -- exceeds the net book value of the project (original cost less accumulated depreciation as recorded by the Owner). As required by Electric Plant Instructions 2 and 5 in the FERC Uniform System of Accounts, the Company proposes to include in Electric Production Plant the original cost of the project incurred by the Owner, and the Accumulated Depreciation recorded by the Owner. PSE proposes to depreciate this net book value of the project (original cost net of accumulated depreciation) over the remaining useful life of the project, currently estimated at 23 years.

9. The difference between the net book value and the Acquisition Cost would be recorded as an acquisition adjustment in Account 114, "Electric Plant Acquisition Adjustments." The Company proposes to amortize this acquisition adjustment to Account 406, "Amortization of Electric Plant Acquisition Adjustments," over the same remaining useful life of the project, 23 years. The unamortized balance of this acquisition adjustment would be included in rate base, and the related amortization included in cost of service, for ratemaking purposes in future electric rate proceedings. This accounting treatment matches the cost of the project with the benefits produced by the transaction. The costs would be properly allocated to customers receiving power from the project over its remaining service life. The amortization period is consistent with the requirements of the FERC Uniform System of Accounts for acquisition adjustments associated with the purchase of a plant.

10. The Company is acquiring the partnership that owns the cogeneration project. It is anticipated that the partnership will be liquidated into PSE, and that the assets and liabilities of the partnership will simply be absorbed by the Company. If for tax or other reasons, however, the Company cannot liquidate that partnership into the Company, the Company requests authorization, for ratemaking purposes, to consolidate the assets and liabilities of the partnership into the Company, treating them as if the assets and liabilities were owned directly by the Company.

11. The Company requires an accounting order that obtains the desired effect for ratemaking purposes and satisfies the Company's financial reporting and accounting needs. It is proposed that the order authorize the Company to do the following for accounting and ratemaking purposes:

- (a) Include in Electric Plant Account 101, "Electric Plant In-Service" (Production Plant) the original cost of the project as recorded by the Owner;
- (b) Include in Account 108, "Accumulated Provision for Depreciation and Amortization of Electric Utility Plant," the accumulated depreciation recorded by the Owner;
- (c) Depreciate this net Electric Production Plant over the remaining useful life of the project, currently estimated to be 23 years;
- (d) Record as an acquisition adjustment in Account 114, "Electric Plant Acquisition Adjustments," the difference between the net book value of the project and the Acquisition Cost of the project (defined as the sum of the Purchase Price, the Loan Amounts, and transaction costs);
- (e) Amortize this acquisition adjustment to be recorded in Account 114 above the line in Account 406, "Amortization of Electric Plant Acquisition

Adjustments," for accounting and ratemaking purposes over the remaining useful life of the project, currently estimated to be 23 years, with the unamortized balance included in rate base; and

(f) If the partnership is not dissolved into the Company, consolidate the assets and liabilities of the partnership into the Company for ratemaking purposes, thereby treating such assets and liabilities of the partnership as if they were owned directly by the Company.

Assumption of Securities

12. RCW 80.08.130 requires that the Company comply with the filing requirements of RCW 80.08.040 whenever it "assumes any obligation or liability as guarantor, indorser, surety or otherwise in respect to the securities of any other person, firm or corporation, when such securities are payable at periods of more than twelve months after the date thereof." The Loan Amounts, as described in the Purchase Agreement, are within the scope of "securities" for purposes of RCW 80.08.130.

13. In accordance with RCW 80.08.040, the Company states as follows:

(a) The purpose for which the assumption is requested is as stated in this Petition;

(b) Such purpose is for one or more of the purposes allowed by RCW 80.08.030, as certified by the authorized officer signing this Petition; and

(c) The assumption is in the public interest for the reasons stated herein.

Requested Order

14. The Company seeks an order in the form shown on Exhibit D that would allow the Company to enter into the transaction with the Owner. By this Petition, the Company requests that the Commission authorize the Company to:

- (a) Include in Electric Plant Account 101 (Production Plant) the original cost of the project as recorded by the Owner;
- (b) Include in Account 108, "Accumulated Provision for Depreciation and Amortization of Electric Utility Plant," the accumulated depreciation recorded by the Owner;
- (c) Depreciate this net Electric Production Plant over the remaining useful life of the project, currently estimated to be 23 years;
- (d) Record as an acquisition adjustment in Account 114, "Electric Plant Acquisition Adjustments," the difference between the net book value of the project and the Acquisition Cost of the project (defined as the sum of the Purchase Price, the Loan Amounts, and transaction costs);
- (e) Amortize this acquisition adjustment above the line in Account 406, "Amortization of Electric Plant Acquisition Adjustments," for accounting and ratemaking purposes over the remaining useful life of the project, currently estimated to be 23 years, with the unamortized balance included in rate base;
- (f) Consolidate that partnership with the Company for ratemaking purposes (if necessary where the Company owns the cogeneration project through a partnership); and
- (g) Assume the Loan Amounts, pursuant to RCW 80.08.130, in connection with its acquisition of the cogeneration project.

15. As noted above, the Purchase Agreement requires that the Company close the transaction on or before November 1, 1999. In order to enable the Company to enter into the transaction, the Company respectfully requests that the Commission issue its order in this matter on or before October 27, 1999.

WHEREFORE, PSE respectfully requests that the Commission enter an order in the form attached as Exhibit D authorizing the Company's assumption of securities under

RCW 80.08.130 and approving the proposed accounting treatment for the purchase of the cogeneration project.

DATED this 29th day of September, 1999.

PUGET SOUND ENERGY, INC.

By Steve Hinton
Its VP President

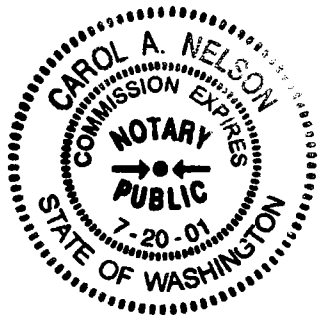
VERIFICATION

Steve McKeon, being first duly sworn, on oath deposes and says:

That he is Vice President and General Counsel of Puget Sound Energy, Inc., that he has read the foregoing Petition for an Order Regarding their Accounting Treatment for the Purchase of a gas supply contract, that he knows the contents thereof, and that he believes the same to be true and the best of his knowledge and belief.

Carol A Nelson

SUBSCRIBED AND SWORN to before me this 28th day of September, 1999.



Carol A Nelson
Print Name: Carol A Nelson
Notary Public in and for the State of Washington,
residing at 17408 NE 34 St, Redmond WA 97052
My commission expires: 7-20-01

LIST OF EXHIBITS

EXHIBIT A	Identification of Owner and Project
EXHIBIT B	Interest Purchase Agreement
EXHIBIT C	Economic Benefits of Transaction
EXHIBIT D	Proposed Order

EXHIBIT A

The identity of Owner is Encogen Northwest, L.P., a partnership comprising ENSAT Northwest Cogeneration, Inc. and EDC Northwest Cogeneration, Inc.

The cogeneration project is the Encogen facility, a 160-MW natural gas-fired combined cycle electric generating project in Bellingham, Washington.

INTEREST PURCHASE AGREEMENT

BY AND AMONG

PUGET SOUND ENERGY, INC.,

GP ACQUISITION CORP.,

LP ACQUISITION CORP.,

ENCOGEN NORTHWEST, L.P.,

EDC NORTHWEST COGENERATION, INC.,

ENSAT NORTHWEST COGENERATION COMPANY AND

TXU DEVELOPMENT COMPANY

DATED SEPTEMBER 29, 1999

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INTEREST PURCHASE AGREEMENT

This Interest Purchase Agreement (this "*Agreement*") is made as of September 29, 1999, by and among Puget Sound Energy, Inc., a Washington corporation ("*Puget*"), GP Acquisition Corp. ("*GPAC*") and LP Acquisition Corp. ("*LPAC*"), each Washington corporations and wholly owned subsidiaries of Puget (collectively, the "*Puget Affiliates*"), Encogen Northwest, L.P., a Delaware limited partnership ("*Encogen*"), EDC Northwest Cogeneration, Inc., a Delaware corporation and the sole general partner of Encogen ("*NW*"), ENSAT Northwest Cogeneration Company, a Texas corporation and the sole limited partner of Encogen ("*ENSAT*" and together with NW, the "*Partners*"), and TXU Development Company, a Texas corporation and indirect 100% owner of NW ("*TXUD*").

RECITALS

A. NW and ENSAT desire and intend to sell to GPAC and LPAC, respectively, their entire general and limited partnership interests in Encogen, representing all the outstanding equity interests in Encogen, at the price and on the terms and conditions herein set forth.

B. GPAC and LPAC desire and intend to purchase the entire general and limited partnership interests of NW and ENSAT, respectively, in Encogen at the price and on the terms and conditions herein set forth.

AGREEMENT

In consideration of the representations, warranties, covenants and agreements set forth herein, and subject to the terms and conditions set forth herein, the parties hereby agree as follows:

1. Definitions

As used in this Agreement, the following capitalized terms shall have the meanings set forth below:

1.1 "*Affiliate*": Of any person (the "*Subject*") means any other Person which, directly or indirectly, controls or is controlled by or is under common control with the Subject and, without limiting the generality of the foregoing, includes, in any event, (a) any Person which beneficially owns or holds 25% or more of any class of voting securities of the Subject or 25% or more of the legal or beneficial interest in the Subject and (b) any Person of which the Subject beneficially owns or holds 25% or more of any class of voting securities or 25% or more of the legal or beneficial interest. "Control" (including, with correlative meanings, the terms "controlled by" and "under common control with"), as used with respect to any Person, means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of such Person, whether through the ownership of voting securities, by contract or otherwise.

1.2 "*Agreement*": This Agreement and all Schedules and Exhibits hereto.

1.3 "**Assumed Liabilities**": Except as otherwise provided in Sections 3.3 and 9, (a) any obligation or liability of Encogen, TXU Gas Company, a Texas corporation (formerly known as ENSERCH Corporation) which is the 100% owner of NW and wholly owned subsidiary of TXUD ("**ENSERCH**"), NW or ENSAT arising on or after the Closing Date in connection with (i) the Credit Agreements, (ii) the Contracts set forth in **Schedule 4.11**, and (iii) the ownership and operation of the Project; (b) current liabilities for reimbursement of goods and services to third parties, which shall not include current liabilities to ENSERCH, the Partners or TXUD (or any of their Affiliates), reflected on the Closing Balance Sheet; and (c) other reserve accounts of Encogen associated with accrued maintenance for the Project to be performed after the Closing Date.

1.4 "**Balance Sheet Date**": As defined in Section 4.5.

1.5 "**Balance Sheet Notice**": As defined in Section 6.8(b).

1.6 "**Claim**": Any claim, demand, cause of action, suit, proceeding, arbitration, hearing or investigation.

1.7 "**Closing**": The consummation of the purchase and sale of the Partnership Interests under this Agreement.

1.8 "**Closing Balance Sheet**": As defined in Section 6.8(a).

1.9 "**Closing Date**": The date on which the Closing becomes effective.

1.10 "**Closing Distribution**": As defined in Section 6.8(c).

1.11 "**Code**": The Internal Revenue Code of 1986, as amended, and all regulations promulgated thereunder, as in effect from time to time.

1.12 "**Computer Systems**": (a) Computer software, computer firmware, computer hardware (whether general or special purpose) or other similar or related items of automated, computerized or software systems and (b) equipment containing embedded microchips (including systems and equipment supplied by others) used or relied on by Encogen in the operation of the Project.

1.13 "**Contract**": Any contract, agreement, lease, license, grant of immunity from suit in regard to intellectual property rights, commitment, arrangement, purchase or sale order, or undertaking, whether written or oral.

1.14 "**Credit Agreements**": All of the obligations arising under the agreements set forth in **Schedule 1.14**.

1.15 "**Debt**": With respect to any Person, all obligations of such Person (a) for borrowed money, (b) evidenced by notes, bonds, debentures or similar instruments, (c) under or relating to letters of credit (including, without limitation, any obligation to reimburse the letter of credit issuer with respect to amounts drawn under such instruments), (d) for the deferred purchase price of goods or services (other than trade payables or accruals incurred and paid in the

ordinary course of business, but only to the extent that such payables or accruals are not interest-bearing and all applicable discounts for prompt payment are taken in the ordinary course of business), (e) under capital leases, (f) with respect to check overdrafts, cash/book overdrafts or otherwise reflected as negative cash in the financial statements of such Person, (g) for deferred compensation, (h) to pay any accrued dividends, and (i) in the nature of Guarantees of the obligations described in clauses (a) through (h) above of any other Person.

1.16 "**Deposits**": As defined in Section 6.7.

1.17 "**EEX**": EEX Power Systems Company.

1.18 "**Employee Benefit Plans**": Each retirement, pension, profit sharing, deferred compensation, savings, bonus, incentive, cafeteria, flexible benefits, medical, dental, vision, hospitalization, life insurance, dependent care assistance, tuition reimbursement, disability, sick pay, holiday, vacation, severance, stock purchase, stock option, stock appreciation rights, change of control, fringe benefit and other employee benefit plan, fund, policy, program, contract, arrangement or payroll practice (including, but not limited to, each "employee benefit plan," as defined in Section 3(3) of ERISA) and each employment or consulting contract or agreement, whether formal or informal, whether written or unwritten and whether legally binding or not, (a) sponsored, maintained or contributed to by Encogen, (b) covering or benefiting any current or former officer, employee, agent, director or independent contractor of Encogen (or any dependent or beneficiary of any such individual) or (c) with respect to which Encogen has (or could have) any actual or potential obligation or liability.

1.19 "**ERISA**": The Employee Retirement Income Security Act of 1974, as amended, and all regulations promulgated thereunder, as in effect from time to time.

1.20 "**Encumbrance**": Any security interest, mortgage, lien, charge, pledge, option, easement, lease, conditional sale agreement or license, including, but not limited to, any restrictions of record on the use, transfer, voting, receipt of income or other exercise of any attributes of ownership, excluding current taxes and assessments that are not due and payable.

1.21 "**ENSERCH**": As defined in Section 1.3.

1.22 "**Environment**": The air, ground (surface and subsurface) or water (surface and groundwater), or the workplace.

1.23 "**Environmental and Safety Law**": Any federal, state, local or other law, statute, rule, ordinance or regulation or any common law in effect as of the date hereof pertaining to public or worker health, welfare or safety or the Environment, including, but not limited to, the Comprehensive Environmental Response, Compensation, and Liability Act of 1980, 42 U.S.C. § 9601 et seq., as amended by the Superfund Amendments and Reauthorization Act of 1986 ("**CERCLA**"); the Resource Conservation and Recovery Act of 1976, as amended, 42 U.S.C. § 6901 et seq.; the Federal Clean Air Act, 42 U.S.C. §§ 7401-7626; the Federal Water Pollution

Control Act and Federal Clean Water Act of 1977, as amended, 33 U.S.C. § 1251 et seq.; the Federal Insecticide, Fungicide and Rodenticide Act, 7 U.S.C. § 135 et seq.; the Federal Environmental Pesticide Control Act, the Federal Toxic Substances Control Act, 15 U.S.C. § 2601 et seq.; the Federal Safe Drinking Water Act, 42 U.S.C. § 300(f) et seq.; the Emergency Planning and Community Right-To-Know Act of 1986, 42 U.S.C. § 11001 et seq.; and the Occupational Safety and Health Act of 1970, 29 U.S.C. § 651 et seq.

1.24 "**Environmental Liabilities**": Any liabilities, obligations or responsibilities under or related to former or current Environmental and Safety Laws, whether such liability, obligation or responsibility is known or unknown, contingent or accrued, arising as a result of or in connection with (a) any violation or alleged violation of Environmental and Safety Laws relating to the ownership or operation of the Project; (b) compliance with applicable Environmental and Safety Laws relating to the ownership or operation of the Project; (c) the storage, disposal, transportation, discharge, Release or recycling of Hazardous Materials at or to locations other than the Real Property; (d) loss of life, injury to persons or property or damage to natural resources (whether or not such loss, injury or damage was made manifest before or after the Closing) caused (or allegedly caused) by the presence or Release of Hazardous Materials at, on, in, under, adjacent to or migrating from the Project; and (e) any Remedial Action which is performed in connection with any Claim brought by any Governmental Body or any other person or entity (including, but not limited to, any threatened enforcement action or any action under any Environmental and Safety Law), or any Remedial Action which is performed by or on behalf of Puget or the Puget Affiliates (or any of their Affiliates) in the absence of a Claim brought by any Governmental Body or any other person or entity to address conditions as may be required by any Environmental and Safety Law.

1.25 "**Excluded Liabilities**": Except as otherwise provided in Sections 1.3(c), 1.3(b), 3.3 and 9 of this Agreement (a) any obligation or liability of Encogen, ENSERCH, NW or ENSAT arising prior to the Closing Date in connection with (i) the Credit Agreements, (ii) the Contracts set forth on **Schedule 4.11** and (iii) the ownership or operation of the Project; (b) any Claim, liability or obligation of Encogen or the Partners for Taxes in respect of periods prior to the Closing Date; and (c) any Pre-Closing Environmental Liabilities, subject to the limitations set forth in Section 9.4(d)(i).

1.26 "**Financial Statements**": As defined in Section 4.5.

1.27 "**First Deposit**": As defined in Section 6.7.

1.28 "**GAAP**": Generally accepted accounting principles, consistently applied throughout the period or periods in question.

1.29 "**General Partnership Interest**": As defined in Section 2.1.

1.30 "**Governmental Body**": Any federal, state or other court or governmental body, any subdivision, agency, commission or authority thereof, or any quasi-governmental or private body exercising any regulatory or taxing authority thereunder, domestic or foreign.

1.31 "**Guarantee**": (a) Any guarantee of the payment or performance of, or any contingent obligation in respect of, any Debt or other obligation of any other Person, (b) any other arrangement whereby credit is extended to one obligor on the basis of any promise or undertaking of another Person (i) to pay the Debt of such obligor, (ii) to purchase any obligation owed by such obligor, (iii) to purchase or lease assets (other than inventory in the ordinary course of business) under circumstances that would enable such obligor to discharge one or more of its obligations, or (iv) to maintain the capital, working capital, solvency or general financial condition of such obligor, and (c) any liability as a general partner of a partnership or as a venturer in a joint venture in respect of Debt or other obligations of such partnership or venture.

1.32 "**Hazardous Materials**": Any hazardous or toxic substances, materials and wastes, including, but not limited to, those substances included in the definitions of "Hazardous Substances," "Hazardous Materials," "Toxic Substances," "Hazardous Waste," "Solid Waste," "Pollutant," or "Contaminant" in any Environmental and Safety Law and the Hazardous Material Transportation Act, 49 U.S.C. § 1801 *et seq.*, and in the regulations promulgated pursuant to those laws; those substances listed in the United States Department of Transportation Table (49 C.F.R. § 172.101 and any amendments thereto); such other substances, materials and wastes that are regulated or are classified as hazardous or toxic by any Governmental Body; and asbestos, polychlorinated biphenyls and oil and petroleum products or by-products.

1.33 "**HSR Act**": The Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended.

1.34 "**Indemnified Claims**": As defined in Section 9.4(a).

1.35 "**Indemnified Claims Threshold**": As defined in Section 9.4(a).

1.36 "**indemnified party**": As defined in Section 9.5(a).

1.37 "**indemnifying party**": As defined in Section 9.5(a).

1.38 "**Insurance Claim**": As defined in Section 2.2.

1.39 "**Intellectual Property**": All trade names, trademarks (including common-law trademarks), service marks, artwork, packaging, plates, emblems, logos, insignia and copyrights, and their registrations and applications, and all goodwill associated therewith, all domestic and foreign patents and patent applications, all technology, know-how, show-how, trade secrets, manufacturing processes, formulae, drawings, designs, systems, forms, technical manuals, data, computer programs, product information and development work-in-progress, customer lists and data, and all documentary evidence of any of the foregoing.

1.40 "**Judgment**": Any judgment, order, award, writ, injunction or decree of any Governmental Body or arbitrator.

1.41 "**June Balance Sheet**": As defined in Section 4.5.

1.42 "**knowledge**": Whenever reference is made herein, directly or indirectly, to the knowledge or awareness (or similar terminology) of Encogen with respect to any matter, it is understood to refer to the current, actual knowledge, after an inquiry of Encogen, NW, ENSAT and TXUD that is reasonable in light of the timing and circumstances of the transactions contemplated by this Agreement. As part of their reasonable inquiry, Encogen, NW, ENSAT and TXUD agree to inquire into EEX's actual knowledge with respect to any such matters; provided, however, that in no event will Encogen, NW, ENSAT or TXUD be charged with constructive knowledge of matters known to EEX.

1.43 "**Lenders**": As defined in Section 6.4(a).

1.44 "**Limited Partnership Interest**": As defined in Section 2.1.

1.45 "**Loss**": Any loss, damage, Judgment, Debt, existing liability, fine, penalty, cost or expense (including, but not limited to, any legal and accounting fee or expense), whether or not relating to personal injury, property damage, public or worker health, welfare or safety or the Environment and whether or not relating to violations of or liability under Environmental and Safety Law.

1.46 "**Mutual Release**": As defined in Section 7.7(c).

1.47 "**1998 Balance Sheet**": As defined in Section 4.5.

1.48 "**O&M Contract**": As defined in Section 4.13.

1.49 "**Partnership Agreement**": The Second Amended and Restated Agreement of Limited Partnership of Encogen, dated December 15, 1992, between NW and ENSAT.

1.50 "**Partnership Interests**": As defined in Section 2.1.

1.51 "**Permit**": Any permit, license, approval, authorization, consent, order, registration, certification, endorsement or qualification of any Governmental Body.

1.52 "**Person**": Any corporation, limited liability company, limited liability partnership, limited partnership, general partnership, sole proprietorship, association or other organization, or any individual, or any Governmental Body.

1.53 "**Personal Property**": As defined in Section 4.8(b).

1.54 **"Potentially Responsible Party"**: A person potentially responsible for response costs set forth in CERCLA, 42 U.S.C. § 9601 et. seq.

1.55 **"Pre-Closing Environmental Liabilities"**: Those Environmental Liabilities (a) attributable to the presence, storage, recycling, Release or transportation of Hazardous Materials on, at, under, from or to the Project or (b) arising from or relating to the ownership and operation of the Project, in each case during the period on or prior to the Closing Date.

1.56 **"Project"**: The 160 megawatt natural gas-fired, combined-cycle cogeneration plant owned by Encogen, including the real property situated in Bellingham, Washington, where such plant is located, and all plants, buildings, structures, improvements, machinery, equipment and any other assets located thereon or used by Encogen in the operation of such plant.

1.57 **"Purchase Price"**: As defined in Section 3.1.

1.58 **"Real Property"**: As defined in Section 4.8(a).

1.59 **"Release"**: means any release, spill, emission, pouring, leaking, pumping, injection, deposit, disposal, discharge, emptying, dispersal, dumping, leaching or migration into or through the indoor or outdoor environment, including the movement of Hazardous Materials through ambient air, soil, surface water, groundwater, wetlands, land, surface or subsurface strata.

1.60 **"Remedial Action"**: Any investigation, site assessment, monitoring or other evaluation of conditions relating to the Environment at a site, or any cleanup, treatment, containment, removal, restoration, corrective action or remedial work involving any Hazardous Materials.

1.61 **"Second Deposit"**: As defined in Section 6.7.

1.62 **"Stipulated Order"**: As defined in Section 7.7(c).

1.63 **"Tax" or "Taxes"**: All taxes, charges, fees, levies or other assessments, including, without limitation, income, excise, gross receipts, personal property, real property, sales, use, ad valorem, transfer, franchise, profits, license, withholding, payroll, employment, severance, stamp, occupation, windfall profits, social security and unemployment or other taxes imposed by the United States or any agency or instrumentality thereof, any state, county, local or foreign government, or any agency or instrumentality thereof, and any interest or fines, and any and all penalties or additions relating to such taxes, charges, fees, levies or other assessments.

1.64 **"Tax Returns"**: As defined in Section 4.7(a).

1.65 **"Third-Party Claim"**: As defined in Section 9.5(a).

1.66 "**Transaction Documents**": Any and all of the agreements and documents referenced in Sections 7.7 and 8.5.

1.67 "**transfer**": As defined in Section 2.1.

1.68 "**WUTC Order**": As defined in Section 7.9.

1.69 "**Year 2000 Compliant**": With respect to a Computer System, that the item will accurately process date data (including, but not limited to, calculating, comparing and sequencing) from, into and between the twentieth and twenty-first centuries, including, without limitation, leap year calculations, without a decrease in the functionality, is designed to be used prior to, during and after the calendar year 2000 A.D., and will operate during each such time period without error relating to date data, specifically including any error relating to, or the product of, date data that represents or references different centuries or more than one century. Without limiting the generality of the foregoing, the item (a) will not abnormally end or provide invalid or incorrect results as a result of date data, specifically including date data that represents or references different centuries or more than one century; (b) has been designed to ensure year 2000 compatibility, including, but not limited to, date data century recognition, calculations that accommodate same century and multicentury formulas and date values, and date data interface values that reflect the century; and (c) includes "Year 2000 Capabilities" meaning that the item (i) will manage and manipulate data involving dates, including single century formulas and multicentury formulas, and will not cause an abnormally ending scenario within the application or generate incorrect values or invalid results involving such dates; (ii) provides that all date-related user interface functionalities and data fields include the indication of century; and (iii) provides that all date-related data interface functionalities include the indication of century.

2. Purchase and Sale of Interests

2.1 Purchase and Sale

Subject to the terms and conditions of this Agreement, at the Closing, (a) NW shall sell, transfer, convey, assign and deliver (collectively, "**transfer**") to GPAC, free and clear of all Encumbrances, and GPAC shall purchase, acquire and assume from NW, NW's entire right, title and interest in and to NW's general partnership interest in Encogen, including, without limitation, any and all rights of NW to capital, profits, losses, distributions and voting rights of Encogen (the "**General Partnership Interest**") and (b) ENSAT shall transfer to LPAC, free and clear of all Encumbrances, and LPAC shall purchase, acquire and assume from ENSAT, ENSAT's entire right, title and interest in and to ENSAT's limited partnership interest in Encogen, including, without limitation, any and all rights of ENSAT to capital, profits, losses, distributions and voting rights of Encogen (the "**Limited Partnership Interest**" and together with the General Partnership Interest, the "**Partnership Interests**"). Except as expressly provided in this Agreement, GPAC, by execution of this Agreement, agrees to accept the transfer of the General Partnership Interest on the Closing Date and, on the Closing Date, to expressly assume any and all duties, obligations and liabilities arising on or after the Closing Date with respect to the

General Partnership Interest. Except as expressly provided in this Agreement, LPAC, by execution of this Agreement, agrees to accept the transfer of the Limited Partnership Interest on the Closing Date and, on the Closing Date, to expressly assume any and all duties, obligations and liabilities arising on or after the Closing Date with respect to the Limited Partnership Interest.

2.2 Insurance Claim

The Partners shall retain as an excluded asset any and all rights relating to the insurance claim submitted by Encogen to Lloyd's of London with respect to damage to equipment and interruption of business arising from the events of April 20, 1999 (the "*Insurance Claim*"), including the right to receive the proceeds of such claim, regardless of whether such proceeds are paid prior to or after the Closing Date. The Partners shall have the sole authority to control and direct the disposition of the Insurance Claim.

2.3 Closing

Subject to the terms and conditions of this Agreement, the Closing shall take place at the offices of Perkins Coie LLP, 1201 Third Avenue, 48th Floor, Seattle, Washington 98101, on November 1, 1999, or at such other location or time as the parties may agree, and shall be effective as of 12:01 a.m., Pacific standard time, on November 1, 1999.

3. Purchase Price

3.1 Purchase Price

The aggregate purchase price payable by the Puget Affiliates to the Partners (the "*Purchase Price*") for the Partnership Interests shall be Fifty-Five Million Dollars (\$55,000,000), payable to the Partners in accordance with the allocation set forth on *Schedule 3.1*, subject to adjustment as provided in Sections 6.8 and 3.3. In addition to such consideration, effective at the time of Closing, Puget shall assume or guarantee all of the Assumed Liabilities under the Credit Agreements set forth on *Schedule 1.14*.

3.2 Closing Payments

At the Closing, the Purchase Price (net of the Deposits) shall be paid by wire transfers of immediately available funds to such bank accounts of the Partners as they may designate in writing at least two (2) business days prior to the Closing, such amount to be paid to the Partners pro rata according to the allocation set forth on *Schedule 3.1*.

3.3 Prorations

The following items relating to the ownership and operation of the Project will be allocated pro rata per diem for the calendar or policy year, as the case may be, that includes the date of the Closing. The Partners and TXUD shall be liable for such items to the extent they are

allocable to the period prior to the date of the Closing, and Puget shall be liable for such items to the extent they are allocable to periods beginning with and subsequent to the date of the Closing, and shall pay to the Partners, at the Closing, the pro rata portion of any prepayment with respect to such items allocable to the periods for which Puget is liable:

(a) Real property taxes on or with respect to the Real Property payable in the year in which the Closing occurs, prepaid for calendar year 1999 in the amount of One Million Four Hundred Sixty-Five Thousand Four Hundred Ninety Thousand Dollars (\$1,465,490).

(b) Project level insurance premiums prepaid for the period June 1, 1999 through May 31, 2000 in the amount of Three Hundred Eleven Thousand Eight Hundred Sixty-Five Dollars (\$311,865) (including premium of \$304,558 and taxes of \$7,307); provided, however, that such premiums shall only be prorated to the extent Encogen is required by the Lenders to maintain the Project level insurance after the Closing. If the Lenders do not require Encogen to maintain the Project level insurance after the Closing, then the Partners and TXUD shall be liable for all such premiums (and entitled to all refunds thereof) and Encogen shall assign the Project level insurance to the Partners or TXUD, as the case may be.

4. Representations and Warranties of Encogen, NW and TXUD

To induce Puget and the Puget Affiliates to enter into and perform this Agreement, Encogen, NW and TXUD jointly and severally represent and warrant to Puget and the Puget Affiliates (which representations and warranties shall survive the Closing as provided in Section 9) all as follows in this Section 4:

4.1 Organization and Good Standing

(a) Encogen is a limited partnership duly organized, validly existing and in good standing under the laws of the state of Delaware. Encogen is duly qualified to do business, and is in good standing, in all jurisdictions where such qualification is required, except where the failure to be so qualified and in good standing would not have a material adverse effect on the assets, business, operations, properties, condition (financial or otherwise) of Encogen.

(b) NW is a corporation duly organized, validly existing and in good standing under the laws of the state of Delaware. ENSAT and TXUD are corporations duly organized, validly existing and in good standing under the laws of the state of Texas. The Partners and TXUD are duly qualified to do business, and are in good standing, in all jurisdictions where such qualification is required, except where the failure to be so qualified and in good standing would not have a material adverse effect on the assets, business, operations, properties, condition (financial or otherwise) of the Partners or TXUD (as the case may be).

4.2 Authority; Authorization; Enforceability

(a) Encogen has all requisite partnership power and authority to own, operate and lease its assets and to carry on its business as now being conducted. Encogen has full partnership power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a party and to perform its obligations hereunder and thereunder. The execution and delivery by Encogen of this Agreement and the Transaction Documents to which it is a party, the performance by Encogen of its obligations hereunder and thereunder and the consummation by Encogen of the transactions contemplated hereby and thereby have been duly authorized by all necessary partnership action. This Agreement has been duly executed and delivered by Encogen and constitutes a valid and binding obligation of Encogen, enforceable against Encogen in accordance with its terms, and the Transaction Documents to which Encogen is a party, when executed and delivered by Encogen, will constitute valid and binding obligations of Encogen, enforceable against Encogen in accordance with their respective terms.

(b) Each of the Partners and TXUD has all requisite corporate power and authority to own, operate and lease its assets and to carry on its business as now being conducted. Each of the Partners and TXUD has full corporate power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a party and to perform its obligations hereunder and thereunder. The execution and delivery by each of the Partners and TXUD of this Agreement and the Transaction Documents to which it is a party, the performance by each of the Partners and TXUD of its obligations hereunder and thereunder and the consummation by each of the Partners and TXUD of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action. This Agreement has been duly executed and delivered by each of the Partners and TXUD and constitutes a valid and binding obligation of the each of the Partners and TXUD, enforceable against each of the Partners and TXUD in accordance with its terms, and the Transaction Documents to which each of the Partners and TXUD is a party, when executed and delivered by each, will constitute valid and binding obligations of each, enforceable against each in accordance with their respective terms.

4.3 No Conflict

(a) Except as set forth in **Schedule 4.3 (a)**, the execution, delivery and performance of this Agreement and the Transaction Documents by Encogen and the consummation of the transactions contemplated hereby and thereby will not (i) violate, conflict with, or result in any breach of any provision of the Partnership Agreement; or (ii) violate, conflict with, result in any breach of, or constitute a default (or an event that, with notice or lapse of time or both, would constitute a default) under any Contract or Judgment to which Encogen is a party or by which it is bound or to which any assets of Encogen are subject; or (iii) result in the creation of any Encumbrance on any assets of Encogen; or (iv) violate any applicable law, statute, rule, ordinance or regulation of, or require any notification to, filing with, approval or authorization of or other procedure with, any Governmental Body (other than compliance with the requirements of the HSR Act); or (v) violate or result in the suspension, revocation,

modification, invalidity or limitation of any Permits used in the conduct of the business of Encogen; or (vi) give any party with rights under any Contract, Judgment or other restriction to which Encogen is a party or by which it is bound, or to which any assets of Encogen are subject, the right to terminate, modify or accelerate any rights, obligations or performance under such Contract, Judgment or restriction.

(b) Except as set forth in **Schedule 4.3(b)**, the execution, delivery and performance of this Agreement and the Transaction Documents by each of the Partners and TXUD and the consummation by each of the Partners and TXUD of the transactions contemplated hereby and thereby to be consummated by them will not (i) violate, conflict with, result in any breach of any provision of the articles of incorporation or bylaws (or equivalent documents) of the Partners or TXUD (ii) violate, conflict with, result in any breach of, or constitute a default (or an event that, with notice or lapse of time or both, would constitute a default) under any Contract or Judgment to which any of the Partners or TXUD is a party or by which any of the Partners or TXUD is bound; or (iii) result in the creation of any Encumbrance on any assets of any of the Partners or TXUD (including, without limitation, the Partnership Interests); or (iv) violate any applicable law, statute, rule, ordinance or regulation of, or require by the Partners or TXUD any notification to, filing with, approval or authorization of or other procedure with, any Governmental Body (other than compliance with the requirements of the HSR Act); or (v) violate or result in the suspension, revocation, modification, invalidity or limitation of any Permits used in the conduct of the business of Encogen; or (vi) give any party with rights under any Contract, Judgment or other restriction to which Encogen is a party or by which it is bound, or to which the assets of Encogen are subject, the right to terminate, modify or accelerate any rights, obligations or performance under such Contract, Judgment or restriction.

4.4 Consents and Approvals

Except as set forth in **Schedule 4.4**, (a) no consent, approval or authorization of, or declaration, filing or registration with, any Governmental Body is required by Encogen, the Partners or TXUD for the execution, delivery and performance by Encogen, the Partners and TXUD of this Agreement and the Transaction Documents to which any such entity is a party and for the consummation by such entities of the transactions contemplated hereby and thereby (other than compliance with the requirements of the HSR Act), and (b) no consent, approval or authorization of any third party is required, under any Contract or otherwise, in connection with the execution, delivery and performance by Encogen, the Partners and TXUD of this Agreement and the Transaction Documents to which any such entity is a party and the consummation by such entities of the transactions contemplated hereby and thereby.

4.5 Financial Statements

Encogen has delivered to Puget the following financial statements, accurate and complete copies of which are attached to **Schedule 4.5(a)** (collectively, the "**Financial Statements**"): audited balance sheets as of December 31, 1997 and December 31, 1996, the related audited statements of income and cash flow for each of the years then ended, an audited balance sheet

(the "**1998 Balance Sheet**") as of December 31, 1998 (the "**Balance Sheet Date**"), and the related audited statements of income and cash flow for the year then ended, an unaudited balance sheet as of June 30, 1999 (the "**June Balance Sheet**"), and the related unaudited statements of income and cash flow for the six-month period then ended. The Financial Statements were prepared from the books and records of Encogen and fairly present the financial position of Encogen as of their respective dates and the results of operations of Encogen for the respective years or periods covered thereby; subject, in the case of the unaudited financial statements, to normal recurring period-end adjustments; in accordance with GAAP, except as may be indicated in the notes thereto. Each accrual, reserve or allowance reflected in the Financial Statements is adequate to meet the liability or contingency underlying such accrual, reserve or allowance. The foregoing balance sheets reflect all properties and assets, real, personal or mixed, that are used by Encogen in its business and that are required to be reflected on such balance sheets pursuant to GAAP. There are no liabilities or obligations of Encogen that are not reflected in the 1998 Balance Sheet, other than liabilities or obligations incurred in the ordinary course of business since the date of the 1998 Balance Sheet which are not material individually or in the aggregate. Encogen maintains and will continue to maintain through the Closing Date standard systems of accounting established and administered in accordance with GAAP. **Schedule 4.5(b)** sets forth all of Encogen's Debt or Guarantee obligations.

4.6 Absence of Certain Changes or Events

Except as set forth in **Schedule 4.6**, since the Balance Sheet Date, Encogen has conducted its business in the ordinary course consistent with its past practice, and has not, directly or indirectly, and other than as contemplated in this Agreement:

- (a) failed to maintain the Project in the ordinary course of business, consistent with past practice;
- (b) failed to use its commercially reasonable best efforts to maintain its business intact and to preserve the goodwill of customers, lenders and other Persons with whom Encogen otherwise has significant business relationships in connection with the operation of the Project;
- (c) failed to meet its contractual obligations or perform and pay its obligations as they mature in the ordinary course of business;
- (d) failed to comply with (i) all Judgments; (ii) all material laws, statutes, rules, ordinances and regulations promulgated by any Governmental Body applicable to the conduct of the business or the ownership or operation of the Project; (iii) all Permits applicable to the conduct of the business or the ownership or operation of the Project (or failed to maintain and prosecute applications for such Permits or to pay all Taxes, assessments and other charges applicable thereto);

(e) sold, leased (as lessor), transferred, distributed (other than cash permitted to be distributed under the Credit Agreements) or otherwise disposed of any of the assets of Encogen or the Project, other than assets used, consumed or replaced in the ordinary course of business, consistent with past practice;

(f) entered into any contract, agreement or other binding obligation relating to (i) the purchase or sale of any equity securities or options, warrants or other rights to acquire equity securities of any party, (ii) the purchase of assets either material in amount or constituting a business, or (iii) any merger, consolidation or other business combination;

(g) canceled or compromised any Debt owing to Encogen or any material claim in excess of \$20,000 individually or \$100,000 in the aggregate, waived or released any right of material value in excess of \$20,000 individually or \$100,000 in the aggregate, or instituted, settled or agreed to settle any material litigation (provided that such dollar limitations set forth in this Section 4.6(g) shall not apply with respect to claims or rights against an Affiliate or employee of Encogen);

(h) disposed of, or permitted to lapse, any rights to the use of any material trademark, service mark, trade name, patent, copyright or other Intellectual Property;

(i) made any gifts or sold, leased, transferred or exchanged any material property for less than the fair value thereof;

(j) experienced any material adverse change in its relationships with its operators, agents, customers or suppliers, except as has not had and could not reasonably be expected to have, individually or in the aggregate, a material adverse effect on the assets, business, operations, properties or condition (financial or otherwise) of Encogen or the Project;

(k) acquired any corporation, partnership, other business organization or division thereof;

(l) entered into any contract, agreement or other binding obligation to do any of the things referred to in clauses (a) through (k) above; or

(m) experienced any event or series of events which has had or could reasonably be expected to have, or become aware of any pending or potential developments that could reasonably be expected to have, individually or in the aggregate, a material adverse effect on the assets, business, operations, properties or condition (financial or otherwise) of Encogen or the Project.

4.7 Taxes

(a) (i) All tax returns, information returns and reports ("*Tax Returns*") for all Taxes required to be filed by or on behalf of Encogen have been filed on a timely basis with the

appropriate governmental authority in all jurisdictions in which such Tax Returns are required to be filed, and all such Tax Returns were (at the time they were filed) true, correct and complete in all respects; (ii) all Taxes of Encogen shown on such Tax Returns have been fully and timely paid; (iii) no waivers of statutes of limitation have been given or requested with respect to Encogen in connection with any Tax Returns covering Encogen with respect to any Taxes payable by it; (iv) to Encogen's knowledge, no governmental authority in a jurisdiction where Encogen does not file Tax Returns has made a claim, assertion or threat to Encogen that Encogen is or may be subject to taxation by such jurisdiction; (v) all Taxes required to be withheld by Encogen as a result of payments to foreign partners or foreign Persons have been collected and withheld and have either been paid or set aside for payment; (vi) there are no liens with respect to Taxes on any of Encogen's property or assets other than liens for current Taxes not yet payable; (vii) there are no Tax rulings, requests for rulings, or closing agreements relating to Encogen which could affect the liability for Taxes or the amount of taxable income of Encogen for any period (or portion of a period) after the date hereof; and (viii) any adjustment of Taxes of Encogen made by the Internal Revenue Service in any examination which is required to be reported to the appropriate state, local or foreign taxing authorities has been reported, and any additional Taxes due with respect thereto have been paid.

(b) Encogen has been taxable as a partnership for state, federal and local income tax purposes at all times since its formation, and no taxing authority has taken a position contrary to such treatment.

(c) Neither Encogen nor any other Person on behalf of Encogen (i) has executed or entered into a closing agreement pursuant to Section 7121 of the Code or any predecessor provision thereof or any similar provision of state, local or foreign law or (ii) has agreed to or is required to make any adjustments pursuant to Section 481(a) of the Code or any similar provision of state, local or foreign law by reason of a change in accounting method initiated by Encogen or has notice that a governmental authority has proposed any such adjustment or change in accounting method.

(d) There is no dispute or claim concerning any Tax liability of Encogen either (i) claimed or raised by any authority in writing or (ii) as to which Encogen has knowledge based on contact or correspondence with any agent of such authority. *Schedule 4.7* lists all Tax Returns filed with respect to Encogen that have been audited, and indicates those Tax Returns that currently are the subject of audit. Encogen has delivered to Puget or its counsel correct and complete copies of all Tax Returns, examination reports and statements of deficiencies assessed against or agreed to by Encogen since its inception.

(e) NW and ENSAT are not "foreign persons" within the meaning of Section 1445 of the Code, and they have furnished, or will furnish prior to the Closing, Puget with an affidavit that satisfies the requirements of Section 1445(b)(2) of the Code.

4.8 Property

- (a) **Schedule 4.8(a)** constitutes a complete and accurate list of all real property, and rights thereto, owned, leased, subleased or otherwise occupied or used by Encogen in the operation of the Project (the "**Real Property**").
- (b) **Schedule 4.8(b)** constitutes a complete and accurate list of each item of tangible personal property that is owned, leased, rented or used by Encogen, as of the date hereof, for use in the operation of the Project (the "**Personal Property**").
- (c) Encogen has delivered to Puget true and complete copies of all leases, subleases, rental agreements, contracts of sale, tenancies or licenses of any portion of the Real Property and the Personal Property.
- (d) Encogen has good and marketable title to all assets reflected on its books or used in the operation of the Project (other than the leased Real Property and the leased Personal Property), free and clear of all Encumbrances, except as specifically described in **Schedule 4.8(d)** and except for (i) assessments for Taxes not yet due and payable; (ii) mechanics', materialmen's, carriers' and other similar liens securing indebtedness that is in the aggregate less than \$10,000, is not yet due and payable, and was incurred in the ordinary course of business; (iii) any easements, liens, encroachments, adverse use or possession claims, rights-of-way, servitudes, restrictions and other minor defects, encumbrances and irregularities in the title to any Real Property that do not materially impair the operation of the Project, as presently operated; and (iv) any encumbrances, liens, encroachments, adverse use or possession claims, restrictions on or title defects to real property as to which Encogen does not have fee title, such as, for example, real property owned by a third party as to which Encogen holds an easement. The Encumbrances described in **Schedule 4.8(d)** and any Encumbrances that are excluded from **Schedule 4.8(d)** as a result of clause (iv) of this Section 4.8(d) do not materially impair the operation of the Project, as currently operated.
- (e) The operation of the Project, as currently operated, is in compliance in all material respects with all zoning, building or land use codes or rules, ordinances, regulations or other restrictions relating to zoning or land use that are currently applicable to the Real Property or to the use of all or any portion of the Real Property for the operation of the Project as currently operated, and, to the knowledge of Encogen, there are no proposed or pending amendments, revisions or other changes to any zoning, building or land use codes or rules, ordinances, regulations or other restrictions relating to zoning or land use that may materially interfere with the operation of the Project, as currently operated, or cause the imposition of material fines or penalties as the result of the use of all or any portion of the Real Property for the operation of the Project, as presently operated. Encogen possesses all necessary Permits with regard to occupancy and maintenance of the Real Property.

(f) There are no existing leases, subleases, service contracts, tenancies or licenses of any portion of the Real Property except for those identified in **Schedule 4.8(f)**, true and complete copies of which have been delivered to Puget by Encogen.

(g) Each lease of any portion of the leased Real Property, and each lease, license, rental agreement, contract of sale or other agreement to which any Personal Property is subject, is valid and in good standing, Encogen has performed in all material respects the obligations imposed on it thereunder, and neither Encogen nor, to the knowledge of Encogen, any other party thereto is in default thereunder in any material respect, nor is there any event that with notice or lapse of time, or both, would constitute a default thereunder by Encogen or, to the knowledge of Encogen, any other party thereto. Encogen has not received notice, and is not otherwise aware, that any party to any such lease, license, rental agreement, contract of sale or other agreement intends to cancel, terminate or refuse to renew the same or to exercise or decline to exercise any option or other right thereunder. Except as set forth in **Schedule 4.8(g)**, no Real Property or Personal Property is subject to any lease, license, contract of sale or other agreement that, as of the Closing Date, could reasonably be expected to have a material adverse effect on the assets, business, operations, properties or condition (financial or otherwise) of Encogen.

(h) Except as specifically set forth in **Schedule 4.8(h)**, Encogen has no knowledge of any material physical defect in the Real Property and, to the knowledge of Encogen, is not in default in any material respect under any covenant, condition, restriction, easement, right-of-way or governmental approval relating to the Real Property.

(i) Except as specifically set forth in **Schedule 4.8(i)**, there are no outstanding rights of first refusal, options or other similar rights or agreements, either directly or indirectly, for the purchase or acquisition from Encogen or the Partners of the Project, including, without limitation, the Real Property, the Personal Property or any other assets used in the operation of the Project.

4.9 Assets and Operation of the Project

(a) Except as specifically set forth in **Schedule 4.9**, the machinery, equipment and other physical assets of Encogen are in good operating condition and repair and are adequate for the current operation of the Project, and they conform to, and are free of any building, fire or other violations under, all applicable zoning, pollution, health and safety and other laws, statutes, rules, ordinances and regulations, and, to the knowledge of Encogen, they do not have any structural defects. No machinery, equipment or physical assets other than those owned or leased by Encogen are used or presently required for the operation of the Project as currently conducted by Encogen. The matters disclosed on **Schedule 4.9** do not materially impair the operation of the Project.

(b) Encogen has furnished Puget and its technical consultants with all material information relating to any material casualty, physical damage, destruction or physical loss

respecting, or material adverse change in the physical condition of, the Project, as currently operated.

4.10 Environmental and Safety Matters

(a) Encogen has delivered to Puget copies of all written documentation in Encogen's possession or control, including communications with any Governmental Body, indicating the presence of any Hazardous Materials or the Release or the threat of a Release of any Hazardous Materials into the Environment on, at, around or under the Project or other properties related to the operation of the Project.

(b) Encogen has made available to Puget (i) all material environmental reports and/or audits prepared by or for Encogen that discuss the environmental conditions of the Project; and (ii) a list of, to Encogen's knowledge, all underground storage tanks and/or surface impoundments located on the Project which contain or have contained Hazardous Materials.

(c) Except as disclosed on *Schedule 4.10*:

(i) Encogen has not received notice of any violation of any Environmental and Safety Law with respect to the ownership, operation and maintenance of the Project that has not heretofore been resolved.

(ii) Encogen has not received any request for information, or been notified that it is a Potentially Responsible Party, under any Environmental and Safety Law with respect to the ownership, operation and maintenance of the Project.

(iii) Encogen has not entered into or agreed to any consent decree or order, and is not subject to any outstanding Judgment relating to compliance with any Environmental and Safety Law or to investigation or cleanup of Hazardous Materials under any Environmental and Safety Law relating to the ownership, operation and maintenance of the Project.

(iv) There are no Claims, actions, proceedings or investigations pending or, to the knowledge of Encogen, threatened against Encogen before any court or Governmental Body relating to any Environmental and Safety Law with respect to the ownership, operation and maintenance of the Project.

4.11 Contracts

Schedule 4.11 is an accurate and complete list of all the Contracts to which Encogen is a party or by which it is bound (except, with respect to Sections 4.11(a) and 4.11(f) for Contracts that do not meet either the applicable dollar or time threshold and, in the case of any oral Contracts, *Schedule 4.11* contains accurate and complete descriptions thereof), including, but not limited to:

- (a) all Contracts for the purchase or sale of goods, raw materials supplies, machinery, equipment, services or other tangible or intangible property, in each case involving the payment or receipt by Encogen of \$10,000 or more in the case of any single Contract, or providing for performance, regardless of dollar amount, over a period of one year or more;
- (b) all Contracts with lenders;
- (c) all Contracts providing for the services of consultants or independent contractors, other than contracts with attorneys or consultants that shall not be continued by Encogen after the Closing Date;
- (d) all Contracts relating to patents, trade names, trademarks, service marks, copyrights, or applications for any of the foregoing, or inventions, formulas, processes, technology, know-how, trade secrets, technical information or other intellectual property rights;
- (e) all Contracts relating to the Real Property or any interest therein or the Personal Property located at, or used in the operation of, the Project; and
- (f) all other Contracts relating to the business of Encogen that involve the payment or receipt by Encogen of \$10,000 or more in the case of any single Contract, or providing for performance, regardless of dollar amount, over a period of one year or more, other than contracts with attorneys or consultants that shall not be continued by Encogen after the Closing Date.

All such Contracts are valid and in full force and effect and are enforceable in accordance with their respective terms. Encogen is in compliance in all material respects with the obligations required to be performed by it under all such Contracts, and Encogen is not in material breach or default of any provision thereof, nor does Encogen have knowledge of any condition or event that, with notice or lapse of time or both, would constitute such a breach or default. To the knowledge of Encogen, no other party to any Contract is in material breach or default of any provision thereof, nor does Encogen have knowledge of any condition or event that, with notice or lapse of time or both, would constitute such a breach or default. Encogen has not received any notice of any future modification, termination or cancellation of any Contract and knows of no intent to effect the same or any reasonable basis therefor, except with respect to Contracts between Encogen and Puget. Except for matters set forth in **Schedule 4.4** no consent, approval or authorization of any third party is required in connection with the consummation of the transactions contemplated by this Agreement and the Transaction Documents, and Encogen has not received notice, and is not otherwise aware, that any party to any such contract, agreement, arrangement or understanding intends to cancel, terminate or refuse to renew such contract, agreement, arrangement or understanding or to exercise or decline to exercise any option or right thereunder.

4.12 Claims and Legal Proceedings

Except as specifically set forth in **Schedule 4.12**, there are no Claims pending or, to the knowledge of Encogen, threatened against Encogen, before or by any Governmental Body or nongovernmental department, commission, board, bureau, agency or instrumentality or any other Person, except for any claims pending or threatened by Puget and/or any Puget Affiliate against Encogen. To the knowledge of Encogen, there is no valid basis for any Claim, other than as specifically set forth in **Schedule 4.12**, adverse to Encogen by or before any Governmental Body or nongovernmental department, commission, board, bureau, agency or instrumentality, or any other Person. There are no outstanding or unsatisfied Judgments to which Encogen is a party that involve the transactions contemplated herein or that would alone or in the aggregate have a material adverse effect on the assets, business, operations, properties or condition (financial or otherwise) of Encogen or the Project.

4.13 Labor Matters

Encogen has no employees. All operations relating to the Project are conducted pursuant to the Amended and Restated Operation and Maintenance Agreement between Encogen and EEX, the operation and maintenance contractor for the Project (the "**O&M Contract**"). Except for the O&M Contract, Encogen is not a party to or otherwise bound by any:

- (a) management, employment or other contract providing for the employment or rendition of executive or management services;
- (b) collective bargaining agreement or other agreement with any labor union or other employee organization (and no such agreement is currently being requested by, or is under discussion by management with, any group of employees or others);
- (c) Employee Benefit Plan; or
- (d) other employment contract or other compensation agreement or arrangement, oral and written, affecting or relating to current or former employees of Encogen.

4.14 Intellectual Property Rights

Encogen has not received notice that it is infringing any Intellectual Property of any other Person in connection with the operation of the Project, and no claim is pending or has been made against Encogen to such effect that has not been resolved. To its knowledge, Encogen is not infringing any Intellectual Property of any other Person.

4.15 Compliance With Laws

Encogen is in compliance, in all material respects, with all laws, statutes, rules, ordinances and regulations promulgated by any Governmental Body and all Judgments

applicable to the ownership or operation of the Project. Encogen has not received any notice of any alleged current violation (whether remedied or not), nor, to the knowledge of Encogen, is there any valid basis for any claim of any such violation, of any such law, statute, rule, ordinance, regulation or Judgment. To the knowledge of Encogen, there is no law, statute, rule, ordinance or regulation promulgated by any Governmental Body or any Judgment that materially and adversely affects or is reasonably expected to materially and adversely affect the ability of Encogen to own or operate the Project.

4.16 Permits and Qualifications

All Permits that are required for the ownership or operation of the Project have been obtained by Encogen, are in full force and effect and are listed in **Schedule 4.16** with their expiration dates, if any. Encogen is in compliance, in all material respects, with all such Permits, and has not received any notice of any alleged current violation (whether remedied or not) of, or any threat of the suspension, revocation, modification, invalidity or limitation of, any such Permit, nor, to the knowledge of Encogen, is there any valid basis for any claim of any such violation or any such threat. Each Permit that requires the consent, approval or authorization of, or declaration, filing or registration with, any Governmental Body in connection with the execution, delivery and performance by Encogen, the Partners and TXUD of this Agreement and the operation of the Project by Puget and the Puget Affiliates immediately after the Closing is listed in **Schedule 4.4**.

4.17 Insurance

Except as set forth in **Schedule 4.17**, all material policies of fire, liability, workers' compensation and other forms of insurance owned or held by Encogen and insuring its assets are in full force and effect, all premiums with respect thereto covering all periods up to and including the date as of which this representation is being made have been paid, and no notice of cancellation or termination has been received by Encogen with respect to any such policy that was not replaced on substantially similar terms prior to the date of such cancellation. Except as set forth in **Schedule 4.17**, Encogen has not been refused any insurance with respect to its assets nor has its coverage been limited by any insurance carrier to which it has applied for any such insurance or with which it has carried insurance during the last twelve months.

4.18 Brokerage

Except as set forth on **Schedule 4.18**, no investment banker, broker or finder will be entitled to any fee or other compensation in connection with the transactions contemplated by this Agreement.

4.19 Partnership Interests

NW is the sole general partner of Encogen, and ENSAT is the sole limited partner of Encogen. The Partnership Interests are duly authorized and validly issued in compliance with all

applicable federal and state laws. Except for Puget's existing right of first refusal pursuant to that certain Agreement Regarding Security, dated August 31, 1992, between Puget and Encogen, there are no outstanding rights of first refusal, preemptive rights, options or other agreements, either directly or indirectly, for the purchase or acquisition from Encogen of any partnership interest or from the Partners of their respective Partnership Interests. At the Closing, the Puget Affiliates will acquire valid title to their respective Partnership Interests, free and clear of any lien, encumbrance, security interest or adverse claim of any kind.

4.20 Subsidiaries and Affiliates

Encogen does not have, and has never had, any subsidiaries. Encogen does not own, directly or indirectly, any ownership, equity, profits or voting interest in, or otherwise control, any corporation, partnership, joint venture or other entity, and has no agreement or commitment to purchase any such interest.

4.21 Year 2000 Readiness

(a) Encogen has undertaken, in accordance with standards generally applied in the utility industry ("**Industry Standards**"), a review and assessment of all areas within its business and operations that could be adversely affected by the failure of any Computer System to be Year 2000 Compliant. With respect to any Computer System that is not Year 2000 Compliant, Encogen has developed and implemented a plan in accordance with Industry Standards to remediate such systems prior to November 1, 1999. Encogen shall continue to implement such plan and shall consult and cooperate with Puget and the Puget Affiliates regarding such implementation during the period prior to the Closing Date. To the knowledge of Encogen, the operations of the Project will not be adversely affected in a material way by the Year 2000 issue, meaning the risk that Computer Systems may not be Year 2000 Compliant.

(b) Encogen has undertaken an investigation, consistent with Industry Standards, of its suppliers and vendors to determine the extent to which the operations of the Project are exposed to third party Year 2000 compliance failures. To the knowledge of Encogen, the Computer Systems of suppliers and vendors that are material to the operations of the Project will be Year 2000 Compliant on or before December 31, 1999.

(c) Encogen has undertaken to develop, consistent with Industry Standards, the Year 2000 Contingency Plan attached to **Schedule 6.14**, which, to Encogen's knowledge, will provide for the operation of the Project after December 31, 1999, notwithstanding the failure of any Computer System of Encogen, or any of its suppliers or vendors, to be Year 2000 Compliant.

4.22 Full Disclosure

No information furnished by Encogen, the Partners or TXUD (or any of their Affiliates) to Puget or the Puget Affiliates in connection with the transactions contemplated by this Agreement (including, but not limited to, the Financial Statements and all information in the

Schedules and the Exhibits to this Agreement) or to be furnished prior to the Closing by or on behalf of Encogen, the Partners or TXUD (or any of their Affiliates) to Puget or the Puget Affiliates, or to others in connection with obtaining approval of the transaction contemplated by this Agreement, is false or misleading in any material respect. Neither Encogen nor the Partners nor TXUD (nor any of their Affiliates) has made any untrue statement of a material fact or omitted to state a material fact necessary in order to make the statements made or information delivered in, or in connection with the transactions contemplated by, this Agreement, including, but not limited to, the Financial Statements and the Schedules and Exhibits to this Agreement, or in or pursuant to closing certificates executed or delivered by Encogen, the Partners or TXUD not misleading. Encogen has no reason to believe that the facts or assumptions underlying any projections made in the information delivered in, or in connection with the transaction contemplated by, this Agreement, are no longer valid or reasonable.

5. Representations and Warranties of Puget and the Puget Affiliates

To induce Encogen, the Partners and TXUD to enter into this Agreement, Puget and the Puget Affiliates, jointly and severally, represent and warrant to Encogen, the Partners and TXUD (which representations and warranties shall survive the Closing as provided in Section 9) all as follows in this Section 5:

5.1 Organization and Valid Existence

Each of Puget and the Puget Affiliates is a corporation duly organized, validly existing and in good standing under the laws of the state of Washington. Each of Puget and the Puget Affiliates is duly qualified to do business, and is in good standing, in all jurisdictions where such qualification is required, except where the failure to be so qualified and in good standing would not have a material adverse effect on the assets or the conduct, business, operations, properties or condition (financial or otherwise) of Puget or the Puget Affiliates.

5.2 Authority; Authorization; Enforceability

Each of Puget and the Puget Affiliates has all requisite corporate power and authority to own, operate and lease its assets and to carry on its business as now being conducted. Each of Puget and the Puget Affiliates has full corporate power and authority to execute and deliver this Agreement and the Transaction Documents to which it is a party and perform its obligations hereunder and thereunder. The execution and delivery by each of Puget and the Puget Affiliates of this Agreement and the Transaction Documents to which it is a party, the performance by each of Puget and the Puget Affiliates of its obligations hereunder and thereunder and the consummation by each of Puget and the Puget Affiliates of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action of Puget and the Puget Affiliates. This Agreement has been duly executed and delivered by each of Puget and the Puget Affiliates and constitutes a valid and binding obligation of each of Puget and the Puget Affiliates, enforceable against each of Puget and the Puget Affiliates in accordance with its terms, and the Transaction Documents to which Puget and the Puget Affiliates are a party, when executed and

delivered by Puget and the Puget Affiliates (as the case may be), will constitute valid and binding obligations of such party, enforceable against such party in accordance with their respective terms.

5.3 No Conflict

The execution, delivery and performance of this Agreement and the Transaction Documents by Puget and the Puget Affiliates and the consummation of the transactions contemplated hereby and thereby will not (a) violate, conflict with or result in any breach of any provision of Puget's and the Puget Affiliates' articles of incorporation or bylaws; or (b) violate, conflict with, result in any breach of or constitute a default (or an event that, with notice or lapse of time or both, would constitute a default) under any material Contract or Judgment to which Puget or the Puget Affiliates are a party or by which any of such entities is bound; or (c) violate any applicable law, statute, rule, ordinance or regulation of any Governmental Body.

5.4 Consents and Approvals

(a) No consent, approval or authorization of, or declaration, filing or registration with, any Governmental Body is required for the execution, delivery and performance by Puget and the Puget Affiliates of this Agreement and the Transaction Documents to which any such entity is a party and for the consummation by such entities of the transactions contemplated hereby and thereby (other than compliance with the requirements of the HSR Act and receipt of the WUTC Order in form and substance satisfactory to Puget).

(b) No consent, approval or authorization of any third party is required, under any contract binding upon Puget or the Puget Affiliates, in connection with the execution, delivery and performance by Puget and the Puget Affiliates of this Agreement and the Transaction Documents to which any such entity is a party and the consummation by such entities of the transactions contemplated hereby and thereby.

5.5 Brokerage

No investment banker, broker or finder will be entitled to any fee or other compensation in connection with the transactions contemplated by this Agreement.

5.6 Full Disclosure

No information furnished by Puget or the Puget Affiliates to Encogen, the Partners or TXUD in connection with this Agreement or to be furnished prior to the Closing by or on behalf of Puget or the Puget Affiliates to Encogen, the Partners or TXUD, or to others in connection with obtaining approval of the transactions contemplated by this Agreement, is false or misleading in any material respect. Neither Puget nor the Puget Affiliates have made any untrue statement of a material fact or omitted to state a material fact necessary in order to make the

statements made or information delivered in or pursuant to this Agreement, or in or pursuant to closing certificates executed or delivered by Puget or the Puget Affiliates, not misleading.

6. Certain Covenants

6.1 Access

Prior to the Closing Date, Encogen shall (a) give Puget and the Puget Affiliates and their accounting, legal, business, environmental, engineering, intellectual property and other authorized representatives and advisors full access, during normal business hours, to all facilities of Encogen relating to the Project; (b) furnish Puget and the Puget Affiliates and their authorized representatives and advisors with all documents and information relating to its business, goods and assets as may be reasonably requested by Puget or the Puget Affiliates or their authorized representatives or advisors; (c) permit Puget and the Puget Affiliates and their authorized representatives and advisors to review all books, records and Contracts relating to its business, goods and assets as may be reasonably requested by Puget or the Puget Affiliates or their authorized representatives and advisors, and make copies thereof; (d) give Puget and the Puget Affiliates and their authorized representatives and advisors full access to the Project for environmental site characterization work, including, without limitation, tests, inspections, studies and examinations; (e) make available Encogen's advisors and contractors, including those responsible for the management of the Project, and cause Encogen's advisors and contractors to furnish Puget and the Puget Affiliates and their authorized representatives and advisors with data and other information with respect to the Project, goods and assets as may be reasonably requested, and discuss with Puget and the Puget Affiliates and their authorized representatives and advisors the affairs of the Project; and (f) fully cooperate with Puget and the Puget Affiliates and their authorized representatives and advisors in their investigation and examination of the Project, goods and assets; provided however, that Encogen shall have no obligation under this Section 6.1 to disclose any communications or other materials if Encogen reasonably believes, upon the advice of outside legal counsel, that nondisclosure of such communications or other materials is necessary to preserve the attorney-client privilege. No investigation, or receipt of information provided by or on behalf of Encogen or review thereof by Puget or the Puget Affiliates or their representatives or advisors, shall diminish or obviate, or relieve Encogen, the Partners or TXUD from, or affect Puget's or the Puget Affiliates' ability or right to rely on, any of the representations, warranties, covenants and agreements of Encogen, the Partners and TXUD contained in this Agreement and the Transaction Documents. All information obtained by either party pursuant to this Section 6.1 shall be subject to the provisions of and kept confidential in accordance with the Confidentiality Agreement, dated July 27, 1999, between Encogen and Puget.

6.2 HSR Filings

Each of the parties to this Agreement will (a) consult with each other party as to appropriate timing of filings and take promptly all actions necessary to make the filings required of each party or their Affiliates under the HSR Act, (b) comply at the earliest practicable date

with any request for additional information received by each such party or their Affiliates from the Federal Trade Commission or the Antitrust Division of the Department of Justice pursuant to the HSR Act, and (c) cooperate with each other party in connection with their filings under the HSR Act and in connection with resolving any investigation or other inquiry concerning the transactions contemplated by this Agreement commenced by either the Federal Trade Commission or the Antitrust Division of the Department of Justice or state attorneys general.

6.3 Conduct of Business Prior to Closing

Except for actions taken with the prior written consent of Puget, or as specifically contemplated by Section 6.6 or in *Schedule 6.3*, from the date of this Agreement until the Closing Date, Encogen shall conduct its business in the ordinary course consistent with past practice, shall not, directly or indirectly, take or permit to exist any action or condition specified in Section 4.6 and shall

(a) not enter into any new material Contracts or make any material alterations to any Contracts listed in Schedule 4.11;

(b) not alter or amend Encogen's certificate of limited partnership or the Partnership Agreement, or merge or consolidate with any other entity;

(c) not, directly or indirectly, enter into any agreement or commitment with respect to any of the matters set forth in clauses (a) and (b) above;

(d) promptly advise Puget and the Puget Affiliates in writing of any material adverse change in the assets, business, operations, properties or condition (financial or otherwise) of Encogen or the Project;

(e) not take any action, or omit to take any action, directly or indirectly, that would result in any of the representations and warranties made in Section 4 being inaccurate at the time of such action or omission as if made at and as of such time;

(f) give notice to Puget and the Puget Affiliates promptly upon becoming aware of any inaccuracy of any of the representations or warranties made in Section 4 (including in the Schedules to this Agreement) or of any event or state of facts that would result in any such representation or warranty being inaccurate at the time of such event or state of facts as if made at and as of such time (any such notice to describe such inaccuracy, event or state of facts in reasonable detail); and

(g) give notice to Puget and the Puget Affiliates promptly upon becoming aware of any failure of Encogen, the Partners or TXUD to perform any covenant or other obligation required of any such entity under this Agreement, or any facts or circumstances that would cause any of the conditions specified in Section 7 to be incapable of, or substantially unlikely to be, fulfilled.

6.4 Assumption or Guarantee of Assumed Liabilities; Discharge of Excluded Liabilities

(a) Puget agrees to assume or guarantee all of the Assumed Liabilities under the Credit Agreements set forth on *Schedule 1.14*, effective at the time of the Closing, and shall use its commercially reasonable best efforts to obtain the release by First National Bank of Chicago, Prudential Insurance Company of America, Fuji Bank, Limited, Citibank, N.A., and Heller Financial (collectively, the “*Lenders*”) of all obligations and liabilities of ENSERCH arising under the agreements set forth on *Schedule 6.4(a)*, which efforts shall include, to the extent necessary, but are not limited to, (i) negotiation of additional terms and conditions as the Lenders under the Credit Agreements may require or deem necessary for the avoidance or waiver of any default under the Credit Agreements as a result of the consummation of the transactions contemplated by this Agreement and (ii) execution of all documents necessary to obtain the consent of the Lenders to the change in ownership of Encogen under the Credit Agreements. Puget shall provide Encogen with written notice of the status of its efforts to obtain the release by the Lenders of all obligations and liabilities of ENSERCH arising under the agreements set forth on *Schedule 6.4(a)* on a weekly basis until the Closing Date.

(b) The Excluded Liabilities shall remain obligations and liabilities of Encogen, the Partners, TXUD or ENSERCH, as the case may be, and shall not be assumed, guaranteed or succeeded to by Puget or the Puget Affiliates as a result of the transactions contemplated by this Agreement or otherwise. Encogen, the Partners and TXUD shall do all things necessary after the Closing to promptly discharge any such Excluded Liabilities when the same shall become due and payable.

6.5 Section 754 Election

The Partners shall prepare, sign and file, within the appropriate time periods specified in the Code, all necessary Tax Returns of Encogen for the period ending on the Closing Date, including, without limitation, the U.S. partnership return on Form 1065 due as a result of the technical termination of Encogen, and, with respect to such Form 1065, shall make an appropriate election under Section 754 of the Code so that immediately after the Closing Date, Puget or the Puget Affiliates (as the case may be) shall, in accordance with Section 743(b) of the Code, be entitled to an adjustment with respect to the adjusted tax basis of Encogen's property.

6.6 Certain Transfers

Notwithstanding any other provision of this Agreement, the parties acknowledge that Encogen shall transfer to NW, immediately prior to the Closing, all rights with respect to, and ownership of, Encogen's communications and other materials that Encogen reasonably believes, upon the advice of outside legal counsel, constitute attorney-client privileged communications and materials.

6.7 Deposits

Prior to the execution of this Agreement, Puget paid Encogen One Million Dollars (\$1,000,000) (the "**First Deposit**"), the receipt of which by Encogen is hereby acknowledged by Encogen, the Partners and TXUD. In connection with the execution and delivery of this Agreement, Puget has paid Encogen an additional One Million Dollars (\$1,000,000) (the "**Second Deposit**" and together with the First Deposit, the "**Deposits**"), the receipt of which by Encogen is hereby acknowledged by Encogen, the Partners and TXUD. The Deposits shall be credited against the Purchase Price at the Closing. If this Agreement is terminated, the Deposits shall be treated as set forth in Section 10.

6.8 Closing Date Distribution

(a) Within twenty (20) business days after the Closing Date, the Partners shall prepare and deliver to Puget a balance sheet dated as of the Closing Date, reflecting Encogen's financial position, prepared in accordance with GAAP and in a manner consistent with that used to prepare the Financial Statements (the "**Closing Balance Sheet**"). After the Closing Date, the Partners shall permit Puget and the Puget Affiliates and their authorized representatives and advisors to review, during normal business hours, all books, records and other documents and information of Encogen, provided such review is necessary in connection with the preparation of the Closing Balance Sheet.

(b) Puget shall notify the Partners in writing within five (5) business days after its receipt of the Closing Balance Sheet whether it approves of the Closing Balance Sheet (the "**Balance Sheet Notice**"). In the event that Puget does not approve the Closing Balance Sheet, it shall describe in the Balance Sheet Notice the areas of disapproval with reasonable specificity. Puget and the Partners shall thereafter negotiate in good faith to resolve their differences with respect to the Closing Balance Sheet within thirty (30) days of the Partners' receipt of the Balance Sheet Notice. If Puget and the Partners are unable to resolve their differences with respect to the Closing Balance Sheet within thirty (30) days after the Partners' receipt of the Balance Sheet Notice, either Puget or the Partners may elect to submit the matter to arbitration pursuant to Section 11.10.

(c) Within five (5) business days after approval of the Closing Balance Sheet by Puget, the Puget Affiliates shall cause Encogen to pay to the Partners (in accordance with the allocation set forth on **Schedule 3.1**) an amount in cash equal to current assets of Encogen, plus cash or cash equivalents in restricted accounts to the extent not included in current assets, less the current liabilities, excluding the current maturities of long-term debt assumed by Puget and the Puget Affiliates, reflected on such balance sheet (the "**Closing Distribution**"). If Encogen does not have a sufficient amount of cash to satisfy the Closing Distribution in full, Puget shall pay to NW and ENSAT (as additional consideration) an amount in cash equal to such shortfall. If any prepaid amounts with respect to real property taxes or project level insurance premiums identified in Section 3.3 are included in the current assets of Encogen on the Closing Balance

Sheet without a corresponding current liability, the Closing Distribution shall be reduced by such amounts.

6.9 Notification of Claims

From the date of this Agreement to and including the Closing Date, Encogen will promptly advise Puget and the Puget Affiliates in writing if Encogen has notice or knows of the commencement or threat of any claim, litigation or proceeding against or affecting Encogen or its business or any ruling, decree or other material development in any claim, action or suit described in *Schedule 4.12* or arising after the date hereof.

6.10 Covenants to Satisfy Conditions

Each party shall proceed with all reasonable diligence and use commercially reasonable efforts to satisfy or cause to be satisfied all of the conditions precedent to the other party's obligation to purchase or sell the Partnership Interests as set forth in Section 7 or 8, as the case may be, insofar as such matters are within the control of such party.

6.11 Exclusivity

Encogen, the Partners and TXUD shall not, directly or indirectly, through any officer, director, agent or otherwise, solicit, initiate or encourage the submission of any proposal or offer relating to any acquisition or purchase of all or (other than in the ordinary course of business) any portion of the assets of, or any significant interest in, Encogen or any business combination with Encogen or participate in any negotiations regarding, or furnish to any third party any information with respect to, or otherwise cooperate in any way with, or assist or participate in, facilitate or encourage, any effort or attempt by any party to do or seek any of the foregoing. Encogen, the Partners and TXUD immediately shall cease and cause to be terminated or suspended all existing discussions or negotiations with any parties conducted heretofore with respect to any of the foregoing. Encogen shall notify Puget and the Puget Affiliates promptly if any such proposal or offer, or any inquiry or contact with any party with respect thereto, is made and shall, in any such notice, indicate in reasonable detail the identity of the party making such proposal, offer, inquiry or contact and the terms and conditions of such proposal, offer, inquiry or contact.

6.12 Cooperation

Puget and the Puget Affiliates on the one hand, and Encogen, the Partners and TXUD on the other hand, shall fully cooperate in matters related to this Agreement, the Transaction Documents and the transactions contemplated hereby and thereby, including obtaining the consent of parties to contracts with Encogen, regardless of whether such consent is expressly required by the terms of the applicable contract.

6.13 Puget Due Diligence

Puget and the Puget Affiliates acknowledge and agree that Puget and the Puget Affiliates substantially completed due diligence review with respect to Encogen, the Partners and the Project as of September 20, 1999.

6.14 Year 2000 Contingency Plan

Following the Closing, Puget and the Puget Affiliates shall use their commercially reasonable best efforts to implement the Partners' Year 2000 Contingency Plan for the Project attached to *Schedule 6.14*.

6.15 The Partnership Agreement

Prior to the Closing, NW and ENSAT shall take all necessary action to amend, or waive any provisions of, the Partnership Agreement so that the consummation of the transactions contemplated by this Agreement and the Transaction Documents will not violate, conflict with or result in any breach of any provision of the Partnership Agreement.

6.16 Corrections to Disclosure Schedules

For a period of fifteen (15) days after the date of this Agreement, Encogen, NW and TXUD shall be allowed to correct, delete or add to the information set forth in the Schedules to this Agreement, provided that any such correction, deletion or addition is immaterial, both individually and in the aggregate when considered together with all other corrections, deletions and additions.

7. Conditions Precedent to Obligations of Puget and the Puget Affiliates

The obligations of Puget and the Puget Affiliates with respect to the purchase of the Partnership Interests at the Closing shall be subject to the satisfaction at or prior to the Closing of each of the following conditions, any one or more of which may be waived by Puget in writing:

7.1 No Injunction or Litigation

As of the Closing Date, there shall not be any Claim or Judgment of any nature or type threatened, pending or made by or before any Governmental Body that questions or challenges the lawfulness of the transactions contemplated by this Agreement or the Transaction Documents under any law or regulation or seeks to delay, restrain or prevent such transactions.

7.2 Representations, Warranties and Covenants

The representations and warranties of NW and TXUD made in this Agreement, the Transaction Documents and any certificate furnished pursuant hereto or thereto shall be true, complete and correct on and as of the Closing Date with the same force and effect as though

made on and as of the Closing Date. Encogen, the Partners and TXUD shall have performed and complied with the covenants and agreements required by this Agreement to be performed and complied with by them on or prior to the Closing Date.

7.3 No Material Adverse Change

From June 30, 1999 to the Closing Date, there shall not have occurred any material adverse change in the assets, business, operations, properties or condition (financial or otherwise) of Encogen, and Encogen shall have no knowledge of any such change which is reasonably likely to occur.

7.4 Consents and Approvals

All consents, approvals or authorizations of, or declarations, filings or registrations with, all Governmental Bodies required for the consummation of the transactions contemplated by this Agreement and the Transaction Documents shall have been obtained or made on terms satisfactory to Puget and the Puget Affiliates and shall be in full force and effect. All consents, approvals or authorizations of any other Persons required for the consummation of the transactions contemplated by this Agreement and the Transaction Documents, and all Permits (including, but not limited to, all certifications, endorsements and qualifications) of any third parties required in connection with the transactions contemplated hereby, shall have been obtained to the satisfaction of Puget and the Puget Affiliates and shall be in full force and effect.

7.5 Affiliate Contracts

All Contracts between or among Encogen on the one hand, and the Partners, TXUD or any of their Affiliates on the other hand, other than this Agreement and the Transaction Documents, shall have been terminated, or, if not terminated, the parties to such Contracts shall have provided for the termination of such Contracts immediately after the Closing without further action by any Person (including Encogen, the Partners, TXUD or any of their Affiliates), and, in either event, Encogen shall have no continuing obligations after the Closing under any such Contract.

7.6 Letter Agreement Relating to O&M Contract

All of ENSERCH's rights and obligations under that certain letter agreement, dated December 6, 1996, between ENSERCH and Lone Star Energy Plant Operations, Inc., as predecessor to EEX, concerning the O&M Contract, shall have been assigned to Puget, effective on or immediately after the Closing.

7.7 Delivery of Documents

Encogen, the Partners and/or TXUD, as the case may be, shall have delivered the following documents, agreements and supporting papers to Puget and the Puget Affiliates at the

Closing, and the delivery of each shall be a condition to Puget's and the Puget Affiliates' performance of its obligations to be performed at the Closing:

- (a) the originals of all the consents, approvals, authorizations and Permits referenced in Section 7.4;
- (b) counterparts of an Assignment and Acceptance of Partnership Interest in customary form, executed by each of the Partners with respect to the Partnership Interest each is selling;
- (c) counterparts of a stipulated order and a mutual release in the forms of *Exhibits 7.7(c)(i) and 7.7(c)(ii)* (the "*Stipulated Order*" and the "*Mutual Release*," respectively), executed by Encogen.
- (d) certificates from NW, as the general partner of Encogen, and each of the Presidents of NW, ENSAT and TXUD in a form satisfactory to Puget and the Puget Affiliates, dated the Closing Date, certifying that all the conditions set forth in Sections 7.1, 7.2, 7.3, 7.4, 7.5 and 7.6 have been fulfilled and, in the case of NW's certificate as the general partner of Encogen, certifying as to the authenticity and effectiveness of the actions of the Partners in authorizing the transactions contemplated by this Agreement and as to the Partnership Agreement and such other documents as are reasonably specified by Puget's counsel; and
- (e) certificates of the Secretaries of NW, ENSAT and TXUD in a form satisfactory to Puget and the Puget Affiliates, dated the Closing Date, as to the authenticity and effectiveness of the actions of the Board of Directors and shareholders of each such entity authorizing the transactions contemplated by this Agreement, and as to each such entity's charter documents and such other documents as are reasonably specified by Puget's counsel.

7.8 Legal Opinions

- (a) Puget and the Puget Affiliates shall have received the opinions of Davis Wright Tremaine LLP and other counsel to Encogen, NW and TXUD, dated the Closing Date, in form and substance acceptable to Puget acting reasonably.
- (b) Puget and the Puget Affiliates shall have received the opinion of counsel to ENSAT, dated the Closing Date, in form and substance acceptable to Puget acting reasonably.

7.9 WUTC Order

Puget shall have received, in form and substance satisfactory to Puget in its sole discretion, an order from the Washington Utilities and Transportation Commission with respect to Puget's accounting treatment of the transactions contemplated by this Agreement (the "*WUTC Order*"). Puget shall file its application for the WUTC Order within two (2) business days after the date hereof and shall exercise commercially reasonable best efforts to obtain the WUTC

Order as soon as practicable. Puget shall immediately notify Encogen of any correspondence or other communications from the Washington Utilities and Transportation Commission relating to the timing or issuance of the WUTC Order.

7.10 Satisfaction of Conditions

All agreements and other documents required to be delivered by Encogen, the Partners and TXUD hereunder on or prior to the Closing Date shall be satisfactory in the reasonable judgment of Puget, the Puget Affiliates and their counsel. Puget and the Puget Affiliates shall have received such other agreements, documents and information as they may reasonably request in order to establish satisfaction of the conditions set forth in this Section 7.

8. Conditions Precedent to Obligations of Encogen, the Partners and TXUD

The obligations of Encogen, the Partners and TXUD with respect to the sale of the Partnership Interests at the Closing shall be subject to the satisfaction at or prior to the Closing of each of the following conditions, any one or more of which may be waived by Encogen in writing:

8.1 No Injunction or Litigation

As of the Closing Date, there shall not be any Claim or Judgment of any nature or type threatened, pending or made by or before any Governmental Body that questions or challenges the lawfulness of the transactions contemplated by this Agreement or the Transaction Documents under any law or regulation or seeks to delay, restrain or prevent such transactions.

8.2 Representations, Warranties and Covenants

The representations and warranties of Puget and the Puget Affiliates made in this Agreement or in the Transaction Documents or any certificate furnished pursuant hereto or thereto shall be true, complete and correct on and as of the Closing Date with the same force and effect as though made on and as of the Closing Date. Puget and the Puget Affiliates shall have performed and complied with the covenants and agreements required by this Agreement to be performed and complied with by them on or prior to the Closing Date.

8.3 No Material Adverse Change

From the date of this Agreement to the Closing Date, there shall not have occurred any material adverse change in the conduct, business, operations, properties or condition (financial or otherwise) of Puget, and Puget shall have no knowledge of any such change which is reasonably likely to occur.

8.4 Consents and Approvals

Puget shall have made or obtained all consents, approvals or authorizations of, or declarations, filings or registrations with, all Governmental Bodies required for it to consummate the transactions contemplated by this Agreement and the Transaction Documents. All consents, approvals or authorizations of, or declarations, filings or registrations with, Persons other than Governmental Bodies, and all Permits (including, but not limited to, all certifications, endorsements and qualifications) of any third parties required in connection with the transactions contemplated by this Agreement and the Transaction Documents, shall have been made or obtained to the satisfaction of the Partners and TXUD and shall be in full force and effect; but only to the extent that the failure to obtain or make any such consent, approval, authorization, declaration, filing, registration or Permit would have a material adverse effect on the assets or the conduct, business, operations, properties or condition (financial or otherwise) of the Partners or TXUD after the Closing.

8.5 Delivery of Documents

Puget and/or the Puget Affiliates, as the case may be, shall have delivered the following documents, agreements and supporting papers to Encogen, the Partners and/or TXUD at the Closing, and the delivery of each shall be a condition to Encogen's, the Partners' and TXUD's performance of their obligations to be performed at the Closing:

- (a) counterparts of an Assignment and Acceptance of Partnership Interest in customary form, executed by each of the Puget Affiliates with respect to the Partnership Interest each such party is purchasing;
- (b) counterparts of the Stipulated Order and the Mutual Release, executed by Puget;
- (c) a certificate of an officer of Puget and the officers of the Puget Affiliates in form satisfactory to Encogen, dated the Closing Date, certifying that all the conditions set forth in Sections 8.1, 8.2, 8.3 and 8.4 have been fulfilled; and
- (d) a certificate of the Secretaries of Puget and the Puget Affiliates in form satisfactory to Encogen, dated the Closing Date, as to the authenticity and effectiveness of the actions of the Board of Directors and shareholders of each such entity authorizing the transactions contemplated by this Agreement, and as to each such entity's charter documents and such other documents as are reasonably specified by Encogen's counsel.

8.6 Legal Opinion

Encogen, the Partners and TXUD shall have received the opinion of Perkins Coie LLP, counsel to Puget and the Puget Affiliates, dated the Closing Date, in form and substance acceptable to the Partners and TXUD acting reasonably.

8.7 Satisfaction of Conditions

All agreements and other documents required to be delivered by Puget and the Puget Affiliates hereunder on or prior to the Closing Date shall be satisfactory in the reasonable judgment of Encogen, the Partners and TXUD and their counsel. Encogen, the Partners and TXUD shall have received such other agreements, documents and information as such entities may reasonably request in order to establish satisfaction of the conditions set forth in this Section 8.

9. Survival and Indemnification

9.1 Survival

All representations and warranties of NW, TXUD, Puget and the Puget Affiliates contained in this Agreement or in the Transaction Documents or in any certificate delivered pursuant hereto or thereto shall survive the Closing to the following extent, and shall not be deemed waived or otherwise affected by any investigation made or any knowledge acquired with respect thereto:

(a) The representations and warranties of NW and TXUD in Section 4.7 (Taxes) shall survive until 30 days after the expiration of the applicable statute of limitations periods for the matters addressed in such representations and warranties.

(b) All other representations and warranties of Encogen NW, TXUD, Puget and the Puget Affiliates shall survive for a period of two years from the Closing Date.

The covenants and agreements of NW, TXUD, Puget and the Puget Affiliates contained in this Agreement and in the Transaction Documents shall survive the Closing and shall continue until all obligations with respect thereto shall have been performed or satisfied or shall have been terminated or waived in accordance with their terms.

9.2 Indemnification by NW and TXUD

From and after the Closing Date, subject to the limitations set forth in Section 9.4, NW and TXUD, jointly and severally, shall indemnify and hold Puget and the Puget Affiliates, and each of their respective Affiliates, harmless from and against, and shall reimburse Puget and the Puget Affiliates, and each of their respective Affiliates, for, any and all Losses arising out of or in connection with:

(a) any inaccuracy in any representation or warranty made by NW or TXUD in this Agreement or in the Transaction Documents or in any certificate delivered pursuant hereto or thereto;

(b) any failure by Encogen, the Partners or TXUD to perform or comply with any covenant or agreement required of such party in this Agreement or in the Transaction Documents;

(c) any Excluded Liabilities or any Claim relating to any of the Excluded Liabilities; and

(d) any Pre-Closing Environmental Liability, subject to the limitations set forth in Section 9.4(d)(i); provided, however, that NW and TXUD shall not be required to indemnify Puget or the Puget Affiliates (or any of their respective Affiliates) for Losses to the extent attributable to acts or omissions of Puget or the Puget Affiliates (or any of their respective Affiliates) after the Closing Date resulting in an increase in, or aggravation of, such Environmental Liabilities, whether arising from a change in use of the Project or otherwise.

9.3 Indemnification by Puget and the Puget Affiliates

From and after the Closing Date, subject to the limitations set forth in Section 9.4, Puget and the Puget Affiliates, jointly and severally, shall indemnify and hold harmless Encogen, the Partners and TXUD, and each of their respective Affiliates, from and against, and shall reimburse each such party and their respective Affiliates for, any and all Losses arising out of or in connection with:

(a) any inaccuracy in any representation or warranty made by Puget or the Puget Affiliates in this Agreement or in the Transaction Documents or in any certificate delivered pursuant hereto or thereto;

(b) any failure by Puget or the Puget Affiliates to perform or comply with any covenant or agreement required of them in this Agreement or the Transaction Documents;

(c) any failure to obtain any consent, approval or authorization of any third party that is required in connection with the consummation of the transactions contemplated by this Agreement under any Contract to which Encogen is a party or Permit of Encogen, provided that Puget and the Puget Affiliates waive the requirement that such consent, approval or authorization be obtained as a condition to closing pursuant to Section 7.4; and

(d) any Assumed Liabilities or any Claim relating to any of the Assumed Liabilities.

9.4 Threshold and Time Limitations

(a) Notwithstanding any other provision of this Agreement, except as provided in Section 9.4(d), no Person shall be entitled to receive any indemnification hereunder with respect to Claims for indemnification made under Sections 9.2(a), 9.2(b), 9.3(a), 9.3(b) or 9.3(c) (the "*Indemnified Claims*"), unless and until the aggregate amount of Losses in respect of

Indemnified Claims for which such Person and its Affiliates would otherwise be entitled to receive indemnification exceeds Five Hundred Fifty Thousand Dollars (\$550,000) (the "*Indemnified Claims Threshold*"); provided, however, that once such aggregate Losses exceed the Indemnified Claims Threshold, such Person and its Affiliates shall be entitled to receive indemnification for the aggregate amount of all such Losses without regard to the Indemnified Claims Threshold.

(b) None of the parties or their Affiliates shall be entitled to assert any right of indemnification with respect to any Indemnified Claim of which such party or its Affiliates shall not have given written notice to the other parties on or prior to the end of the applicable survival period (if any) set forth in Section 9.1, except that if such party or its Affiliates shall have given written notice of any Indemnified Claim to the other parties on or prior to the end of such survival period, then they shall continue to have the right to be indemnified with respect to such pending Indemnified Claim, notwithstanding the expiration of such survival period.

(c) Notwithstanding any other provision of this Agreement, Claims for indemnification made under Sections 9.2(c), 9.2(d), and 9.3(d) shall not be subject to the Indemnified Claims Threshold or to the time limitations set forth in Section 9.1.

(d) (i) If within five (5) years following the Closing Date Puget, the Puget Affiliates or any of their respective Affiliates gives written notice (pursuant to Section 9.5) to the other parties of an Indemnified Claim pursuant to Section 9.2(d) with respect to Pre-Closing Environmental Liabilities, Puget shall be responsible for 50% of Losses attributable to the Pre-Closing Environmental Liabilities identified in the notice up to a maximum aggregate ceiling of \$250,000 and NW and TXUD shall be responsible for the remaining Losses. If after five years following the Closing Date Puget, the Puget Affiliates or any of their respective Affiliates gives written notice (pursuant to Section 9.5) to the other parties of an Indemnified Claim pursuant to Section 9.2(d) with respect to Pre-Closing Environmental Liabilities, NW and TXUD shall be responsible for 50% of Losses attributable to the Pre-Closing Environmental Liabilities identified in the notice up to a maximum aggregate ceiling of \$650,000 and Puget or the Puget Affiliates shall be responsible for, and shall hold the Partners and TXUD harmless from, the remaining Losses.

(ii) Notwithstanding any other provision of this Agreement, the obligations of NW and TXUD to indemnify Puget and the Puget Affiliates for any Indemnified Claim pursuant to Section 9.2(a) for Losses arising out of the representations and warranties contained in Section 4.21 (Year 2000 Readiness) shall be limited to an aggregate amount of \$1,000,000; provided that this limit shall not apply to any Losses attributable to any Third-Party Claim (as defined below) against Puget or Encogen to the extent, if any, that Encogen would have been obligated to indemnify Puget against such Third Party Claim under the Agreement for Firm Power Purchase between Puget and Encogen dated as of September 26, 1990, as amended. The \$550,000 Indemnified Claims Threshold shall not apply to Indemnified Claims by Puget and the Puget Affiliates made pursuant to Section 9.2(a) for Losses arising out of the representations and

warranties contained in Section 4.21 (Year 2000 Readiness). Notwithstanding the foregoing, NW and TXUD shall not be obligated to indemnify Puget and the Puget Affiliates to the extent a Loss occurs as a result of the failure by Puget and the Puget Affiliates to implement the Partners' Year 2000 Contingency Plan for the Project attached as *Schedule 6.14* and to use their commercially reasonable best efforts to otherwise make the Computer Systems Year 2000 Compliant.

9.5 Procedure

(a) Any party hereto or any of its Affiliates seeking indemnification hereunder (in this context, the "*indemnified party*") shall notify the other party (in this context, the "*indemnifying party*") in writing reasonably promptly after the assertion against the indemnified party of any Claim by a third party (a "*Third-Party Claim*") in respect of which the indemnified party intends to base a Claim for indemnification hereunder, but the failure or delay so to notify the indemnifying party shall not relieve it of any obligation or liability that it may have to the indemnified party except to the extent (and only to the extent) that the indemnifying party demonstrates that its ability to defend or resolve such Third-Party Claim is materially and adversely affected thereby.

(b) (i) Subject to the provisions of Section 9.5(d), the indemnifying party shall have the right, upon written notice given to the indemnified party within 30 days after receipt of the notice from the indemnified party of any Third-Party Claim, to assume the defense or handling of such Third-Party Claim, at the indemnifying party's sole expense, in which case the provisions of Section 9.5(b)(ii) shall govern.

(ii) Upon assuming the defense or handling of a Third-Party Claim, the indemnifying party shall select counsel reasonably acceptable to the indemnified party, and the indemnifying party shall defend or handle such Third-Party Claim in consultation with the indemnified party, and shall keep the indemnified party timely apprised of the status of such Third-Party Claim, and shall not, without the prior written consent of the indemnified party, directly or indirectly assume any position or take any action that would impose any obligation of any kind on, or restrict the actions of, the indemnified party. The indemnifying party shall not, without the prior written consent of the indemnified party, which consent shall not be unreasonably withheld, agree to a settlement of any Third-Party Claim unless such settlement includes a full and complete release of the indemnified party in form and substance satisfactory to the indemnified party in its sole discretion. The indemnified party shall cooperate with the indemnifying party and shall be entitled to participate in the defense or handling of such Third-Party Claim with its own counsel and at its own expense. Notwithstanding the foregoing, in the event the indemnifying party fails to conduct the defense or handling of any Third-Party Claim in good faith after having assumed such defense or handling, then the provisions of Section 9.5(c)(ii) shall govern.

(c) (i) If the indemnifying party does not give written notice to the indemnified party, within 30 days after receipt of the notice from the indemnified party of any Third-Party

Claim, of the indemnifying party's election to assume the defense or handling of such Third-Party Claim, the provisions of Section 9.5(c)(ii) shall govern.

(ii) The indemnified party may, at the indemnifying party's expense, select counsel in connection with conducting the defense or handling of such Third-Party Claim and defend or handle such Third-Party Claim in such manner as it may deem appropriate; provided, however, that the indemnified party shall keep the indemnifying party timely apprised of the status of such Third-Party Claim and shall not settle such Third-Party Claim without the prior written consent of the indemnifying party, which consent shall not be unreasonably withheld. If the indemnified party defends or handles such Third-Party Claim, the indemnifying party shall cooperate with the indemnified party and shall be entitled to participate in the defense or handling of such Third-Party Claim with its own counsel and at its own expense.

(d) If the indemnified party intends to seek indemnification hereunder, other than for a Third-Party Claim, then it shall notify the indemnifying party in writing within six months after its discovery of facts upon which it intends to base its Claim for indemnification hereunder, but the failure or delay so to notify the indemnifying party shall not relieve the indemnifying party of any obligation or liability that the indemnifying party may have to the indemnified party except to the extent that the indemnifying party demonstrates that the indemnifying party's ability to defend or resolve such Claim is materially and adversely affected thereby.

(e) The indemnified party may notify the indemnifying party with respect to an Indemnified Claim even though the amount thereof plus the amount of other Indemnified Claims about which the indemnifying party was previously notified by the indemnified party aggregate less than the Indemnified Claims Threshold.

9.6 Election of Remedies

In the event that any party or any of its Affiliates alleges that it is entitled to indemnification hereunder, and that its Claim is covered under more than one provision of this Section 9, such party or Affiliate shall be entitled to elect the provision or provisions under which it may bring a claim for indemnification.

9.7 Specific Performance

The parties to this Agreement acknowledge that it may be impossible to measure in money the damages that a party would incur if, prior to the Closing, any covenant or agreement contained in this Agreement were not performed in accordance with its terms and agree that each of the parties hereto shall be entitled, prior to the Closing, to seek an injunction to require specific performance of, and prevent any violation of the terms of, this Agreement, in addition to any other remedy available hereunder. In any such action specifically to enforce any provision of this Agreement, each party hereby waives any claim or defense therein that an adequate remedy at law or in damages exists. The parties further agree that none of the parties hereto shall be entitled, after the Closing, to seek an injunction to require specific performance of, or to

prevent any violation of the terms of, this Agreement, but that each party shall continue to be entitled to any other remedy available hereunder.

10. Termination

10.1 Termination

This Agreement may be terminated before the Closing:

(a) by Encogen, by giving written notice to Puget at any time, if Puget or the Puget Affiliates has materially breached any representation, warranty, covenant or other provision contained in this Agreement, which breach cannot be cured prior to the Closing;

(b) by Puget, by giving written notice to Encogen at any time, if Encogen, the Partners or TXUD has materially breached any representation, warranty, covenant or agreement contained in this Agreement, which breach cannot be cured prior to the Closing;

(c) by any party, by giving written notice to the other parties at any time, if any condition to the obligations of the terminating party becomes incapable of being satisfied at or prior to the Closing; or

(d) unless Encogen or Puget otherwise agrees, by either of those parties, by giving written notice to the other, if the Closing has not occurred on or before November 1, 1999.

10.2 Effect of Termination

In the event of the termination of this Agreement pursuant to Section 10.1, (a) each party shall return or destroy all documents containing confidential information of the other party (and, upon request, certify as to the destruction thereof), and (b) no party hereto shall have any liability or further obligation to the other party hereunder, except for (i) retention or return of the Deposits as set forth in Section 10.3 and (ii) obligations of confidentiality, nonuse and nondisclosure with respect to the other parties' confidential information, which shall survive the termination of this Agreement. In addition, subject to Section 10.3, no termination of this Agreement shall relieve any party from any liability under this Agreement for breach of any provision hereof.

10.3 Break-Up Fees

In the event of the termination of this Agreement pursuant to Section 10.1, the Deposits shall be distributed as follows:

(a) If Puget does not receive or is not satisfied with the WUTC Order on or before November 1, 1999 (or such later date as the parties may agree) and, for that reason, Puget or Encogen elects to terminate this Agreement pursuant to Section 10.1(c), Encogen shall be entitled to retain the First Deposit as a break-up fee.

(b) If Puget or the Puget Affiliates breach their obligations to close under the terms of this Agreement and, for that reason, Encogen elects to terminate this Agreement pursuant to Section 10.1(a), then Encogen shall be entitled to retain the First Deposit and the Second Deposit as break-up fees.

(c) Subject to subsection 10.3(a), if the Closing has not occurred by November 1, 1999 (or by such later date as the parties may agree) and Puget elects to terminate this Agreement pursuant to Section 10.1(b), (c) or (d) or Encogen elects to terminate this Agreement pursuant to Section 10.1(c) or (d), then Encogen shall promptly return the Deposits to Puget.

(d) If Encogen, the Partners and/or TXUD breach their obligations to close under the terms of this Agreement and, for that reason, Puget elects to terminate this Agreement pursuant to Section 10.1(b), then Encogen shall promptly return the Deposits to Puget.

To the extent the First Deposit or the Second Deposit is retained as break-up fees by Encogen pursuant to this Section 10, such amounts shall constitute liquidated damages to Encogen, and the parties acknowledge and agree that such amounts are their reasonable, good faith estimate of Encogen's damages that it would suffer as a result of Puget's or the Puget Affiliates' breach, notwithstanding that Encogen's damages may not be susceptible of precise determination at such time. The parties further acknowledge and agree that this Section 10.3 is not intended to limit the parties' right to obtain an injunction to require specific performance of, and prevent any violation of the terms of, this Agreement, pursuant to Section 9.7.

11. General

11.1 Public Announcements

Encogen, the Partners and TXUD, on the one hand, and Puget and the Puget Affiliates, on the other hand, agree not to make any public announcement in regard to the transactions contemplated by this Agreement and the Transaction Documents without the other parties' prior consent in writing, except as may be required by law, in which case the parties shall use reasonable efforts to coordinate with each other with respect to the timing, form and content of such required disclosures.

11.2 Severability

If any court determines that any part or provision of this Agreement is invalid or unenforceable, the remainder of this Agreement shall not be affected thereby and shall be given full force and effect and remain binding upon the parties. Furthermore, the court shall have the power to replace the invalid or unenforceable part or provision with a provision that accomplishes, to the extent possible, the original business purpose of such part or provision in a valid and enforceable manner. Such replacement shall apply only with respect to the particular jurisdiction in which the adjudication is made.

11.3 Modification and Waiver

This Agreement may not be amended or modified in any manner, except by an instrument in writing signed by each of the parties hereto. No waiver of any provision of this Agreement shall be effective unless in writing and signed by the waiving party. The failure of any party to enforce at any time any of the provisions of this Agreement shall in no way be construed to be a waiver of any such provision, or in any way affect the right of such party thereafter to enforce each and every such provision. No waiver of any breach of this Agreement shall be deemed to be a waiver of any other or subsequent breach.

11.4 Notices

All notices and other communications required or permitted to be given under this Agreement shall be in writing and shall be sent by facsimile transmission, or mailed postage prepaid by first-class certified or registered mail, or sent for next business morning delivery via a nationally recognized express courier service, or hand-delivered, addressed as follows:

if to Puget or the Puget Affiliates: Puget Sound Energy, Inc.
411 108th Avenue N.E.
Bellevue, Washington 98004
Fax: (425) 462-3300
Attention: Stephen A. McKeon

with a copy to: Perkins Coie LLP
1201 Third Avenue, 48th Floor
Seattle, Washington 98101-3019
Fax: 206-583-8500
Attention: Andrew Bor

if to Encogen, the Partners
or TXUD: TXU Development Company
10375 Richmond Ave., Suite 1575
Houston, TX 770442
Fax: (713) 954-4697
Attention: Allan V. Smith

TXU Development Company
1817 Wood Street
Dallas, TX 75201
Fax: (214) 670-2974
Attention: Russell Duree

with a copy to: Davis Wright Tremaine LLP
One Embarcadero Center, Suite 600

San Francisco, CA 94111-3834
Fax: (415) 276-6599
Attention: Steven F. Greenwald

Either party may change the persons, fax numbers or addresses to which any notices or other communications to it should be addressed by notifying the other party as provided above. Any notice or other communication, if addressed and sent, mailed or delivered as provided above, shall be deemed given or received five days after the date sent as indicated on the certified or registered mail receipt, or on the next business day if mailed by express courier service, or on the date of delivery or transmission if hand-delivered or sent by facsimile transmission.

11.5 Assignment

Neither Encogen, the Partners or TXUD, on the one hand, nor Puget and the Puget Affiliates, on the other hand, may assign any of their rights or obligations hereunder without the prior written consent of the other parties. Notwithstanding the foregoing, each of Puget and the Puget Affiliates may assign its rights and obligations under this Agreement to any Affiliate of Puget or the Puget Affiliates, and each of Puget and the Puget Affiliates may assign its rights and obligations hereunder to any successor of such party; provided, however, that any such assignment shall not relieve the assigning party from its obligations hereunder. This Agreement shall be binding upon, and inure to the benefit of, the parties and their respective successors and assigns.

11.6 Captions

The captions and headings used in this Agreement have been inserted for convenience of reference only and shall not be considered part of this Agreement or be used in the interpretation thereof.

11.7 Entire Agreement

Except as the parties may otherwise agree, this Agreement, and the agreement (or the specific portions thereof, as the case may be) referenced in Section 6.1, constitutes the entire agreement and understanding between the parties with respect to the subject matter hereof and supersedes all prior agreements, understandings, negotiations, representations and statements, whether oral, written, implied or expressed, relating to such subject matter.

11.8 Counterparts

This Agreement may be executed in one or more counterparts, each of which shall be deemed to be an original, but all of which shall constitute one agreement.

11.9 Governing Law

This Agreement shall be governed by, and construed in accordance with, the laws of the State of Washington as though made and to be fully performed in that State. The parties irrevocably consent to the jurisdiction and venue of the state and federal courts located in King County, Washington, in connection with any action relating to this Agreement.

11.10 Arbitration

Any controversy, dispute or claim arising out of or relating to this Agreement or the breach hereof that cannot be settled by mutual agreement (except for actions by any party seeking equitable or injunctive relief pursuant to Section 9.7) shall be finally settled by arbitration as follows: Any party who is aggrieved shall deliver a notice in the manner set forth in Section 11.4 to the other parties hereto setting forth the specific points in dispute. Any points remaining in dispute 20 days after the giving of such notice shall be submitted to arbitration in Denver, Colorado, administered by the American Arbitration Association in accordance with its Commercial Arbitration Rules then in effect, modified as expressly provided. The arbitration shall be conducted by a single neutral arbitrator mutually selected by the parties. If the parties are unable to agree on an arbitrator, then the arbitrator shall be appointed by the American Arbitration Association; provided, however, that (i) the arbitrator may enter a default decision against any party who fails to participate in the arbitration proceedings, (ii) the decision of the arbitrator on the points in dispute will be final, unappealable and binding, and judgment on the award may be entered in any court having jurisdiction, and (iii) the arbitrator may construe or interpret but shall not vary or ignore the terms of this Agreement, and shall be bound by controlling law. The decision of the arbitrator shall be accompanied by written findings of fact and conclusions of law. The prevailing party shall be entitled to recover costs, expenses and reasonable attorneys' fees. The parties agree that this Section 11.10 has been included to rapidly and inexpensively resolve any disputes between them with respect to any controversy, dispute or claim arising out of or relating to this Agreement, and that this Section 11.10 shall be grounds for dismissal of any court action commenced by either party with respect to this Agreement, other than actions by any party seeking equitable or injunctive relief or post arbitration actions relating to the enforcement of an arbitration award. The parties shall keep confidential, and shall not disclose to any person, except as may be required by law, the existence of any controversy hereunder, the referral of any such controversy to arbitration or the status or resolution thereof.

11.11 Transfer Taxes

The Partners shall be responsible for the payment of any transfer taxes and similar taxes relating to the sale or transfer of the Partnership Interests hereunder.

11.12 Transaction Costs

Except as the parties may otherwise agree, each party shall be responsible for its own costs and expenses incurred in connection with the preparation, negotiation and delivery of this

Agreement and the Transaction Documents, including but not limited, to attorneys', accountants' and investment bankers' fees and expenses; provided, however, that the Partners shall be responsible for all fees and expenses of Encogen.

11.13 Attorneys' Fees

In the event of any suit under this Agreement, the prevailing party shall be entitled to reasonable attorneys' fees and costs, to be included in any Judgment recovered. In addition, the prevailing party shall be entitled to recover reasonable attorneys' fees and costs incurred in enforcing any Judgment arising from a suit under this Agreement.

IN WITNESS WHEREOF, the parties have caused this Agreement to be duly executed by their respective representatives hereunto authorized as of the day and year first above written.

PUGET SOUND ENERGY, INC.

By Steve McKean

Title Vice President

GP ACQUISITION CORP.

By Steve McKean

Title Vice President

LP ACQUISITION CORP.

By Steve McKean

Title Vice President

ENCOGEN NORTHWEST, L.P.

By: EDC Northwest Cogeneration, Inc.,
as general partner

By Allan V. Smith

Title Vice President

EDC NORTHWEST COGENERATION, INC.

By Alan V. Smith

Title Vice President

ENSAT NORTHWEST COGENERATION, INC.

By R. Mark Lawrence

Title President

TXU DEVELOPMENT COMPANY

By Melvin E. Wentz

Title President

Exhibit C

Encogen Purchase Assumptions

Generation Plant Assumptions

Purchase Date 01-Nov-99

Plant Purchase Assumptions

Plant Purchase Price \$(000)	55,500
Debt Assumed \$(000)	108,174
Total Cost \$(000)	163,674

Operating Assumptions

Plant Life	30
Tax Life	15
Remaining Book Life	23
Heat Rate With Separate Boiler	8,625

Boiler Assumptions

Purchase Price \$(000) 2,000

Operating Assumptions

Book Life	22
Tax Life	20
In Service Date	2001
Purchase Date	2000

Rates

PSE FIT Rate	35%
PSE's alternative Debt Rate	7.25%
PSE Equity Rate	10.5%
PSE Pre-Tax Equity Rate	16.15%
After Tax Discount for Revenue Requirement	7.32%

Other Assumptions

Scenario 1 and 2 use same gas costs: Fixed contracts until June, 2008 and then switch to market

Scenario 1 and 2 use the same operating costs post June, 2008 except for depreciation expense

Purchase of boiler allows 100% displacement of turbines

Exhibit C

Case 1 Continue Contract Purchase
with Case 2 Owning Plant

4	5 Year:	1999	2000	0.5	1.5	2.5	3.5	4.5	5.5	6.5	7.5	8.5	9.5	10.5	11.5	12.5
		1999	2000	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
5	Year:															
6	Case 1: Continue Contract With \$1 Purchase Option	\$000	-12,404	-75,832	-74,527	-76,855	-79,457	-82,423	-84,934	-87,810	-90,959	-87,393	-37,707	-43,556	-44,590	-42,191
7	Case 2: Purchase Plant in 1999															
8	Revenue Steam Sales, Displacement	\$000	657	6,625	8,677	8,810	8,875	8,960	9,012	9,084	9,157	6,833	4,294	4,294	4,294	4,294
9	Fuel Expenses	\$000	-6,502	-39,867	-42,290	-44,511	-46,251	-48,571	-50,422	-52,474	-55,058	-45,415	-35,520	-36,601	-37,717	-38,869
10	O&M Expenses	\$000	-1,020	-5,020	-9,930	-7,902	-5,185	-6,679	-5,950	-5,718	-6,791	-6,439	-6,213	-10,973	-10,884	-7,326
11	Admin Expenses	\$000	-114	-684	-670	-657	-641	-625	-603	-579	-567	-333	-278	-285	-292	-299
12	Depreciation Expense	\$000	-1,186	-7,162	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207
13	Case II Operating Profit / (Expense) be	\$000	-8,166	-46,108	-51,421	-51,488	-50,410	-54,124	-55,171	-56,895	-60,467	-52,562	-44,924	-50,772	-51,807	-49,408
14																
15	Case 2 vs. Case 1 Operating Income (Expense)	\$000	4,238	29,724	23,106	25,387	29,047	28,300	29,763	30,915	30,493	14,831	-7,217	-7,217	-7,217	-7,216
16		\$000	43	258	297	265	247	313	295	300	311	671	0	0	0	0
17	Non Operating Income	\$000	-1,494	-8,051	-7,237	-6,734	-6,212	-5,712	-5,171	-4,564	-3,781	-3,545	-3,222	-2,898	-2,575	-2,251
18	Interest Expense	\$000	-1,451	-7,793	-6,940	-6,469	-5,965	-5,399	-4,876	-4,264	-3,470	-2,874	-3,222	-2,898	-2,575	-2,251
19	Total Non-Operating	\$000	2,787	21,931	16,166	18,917	23,082	22,901	24,887	26,651	27,023	11,957	-10,438	-10,115	-9,791	-9,468
20	Pre-Tax Income	\$000	1,812	14,255	10,508	12,296	15,003	14,886	16,176	17,323	17,565	7,772	-6,785	-6,575	-6,364	-6,154
21	After Tax Income	\$000	1,109	6,992	6,970	6,538	6,127	5,734	5,351	4,967	4,584	4,201	3,818	3,434	3,051	2,668
22	Required Return on Equity	\$000	-1,134	-11,715	-5,706	-9,288	-14,317	-14,760	-17,461	-19,929	-20,937	-5,760	17,101	16,143	15,186	14,229
23	Delta Revenue Requirement	\$000	-1,134	-11,308	-5,133	-7,785	-11,182	-10,742	-11,841	-12,593	-12,328	-3,161	8,743	7,691	6,742	5,886
24	Delta Revenue Requirement	(27,512)														
25	Delta Revenue Requirement	(lower/higher cost to customers)														
26	Delta Revenue Requirement															
27	Delta Revenue Requirement															
28	Case 2 (1999 Plant Purchase) Cost of mills		49	47	50	50	48	50	50	50	52	45	39	43	43	41
29	Case 1 (Contract and 2008 Purchase) Cost of Power mills		54	56	55	57	59	61	63	65	67	37	28	32	33	31
30	Market Power Cost (Aurora Midpoint) mills											38	37	39	39	38

Exhibit C

Case 1 Continue Contract Purchase
with Case 2 Owning Plant

4	13.5	14.5	15.5	16.5	17.5	18.5	19.5	20.5	21.5	22.5
5 Year	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
6 Purchase Option	-43,978	-44,659	-45,463	-48,265	-49,024	-49,915	-52,966	-53,811	-54,800	-58,111
\$000										
7 Case 2: Purchase Plant in 1999										
Revenue Steam Sales, Displacement	4,294	4,294	4,294	4,294	4,294	4,294	4,294	4,294	4,294	4,294
8 Margin, Gas Arbitrage	-40,057	-41,283	-42,548	-43,853	-45,200	-46,590	-48,024	-49,504	-51,031	-52,605
9 Fuel Expenses	-7,918	-7,365	-6,896	-6,385	-7,788	-7,281	-8,889	-8,245	-7,697	-9,434
10 O&M Expenses	-307	-315	-322	-331	-339	-347	-356	-365	-375	-384
11 Admin Expenses	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-7,207	-5,976
12 Depreciation Expense	-51,195	-51,876	-52,679	-55,482	-56,240	-57,132	-60,183	-61,027	-62,016	-64,105
13 Case II Operating Profit / (Expense) be	-7,216	-7,216	-7,216	-7,216	-7,216	-7,216	-7,216	-7,216	-7,216	-5,994
14										
Case 2 vs. Case 1 Operating Income										
15 (Expense)	0	0	0	0	0	0	0	0	0	0
16										
17 Non Operating Income	-1,928	-1,672	-1,427	-1,238	-1,050	-861	-673	-485	-298	-118
18 Interest Expense	-1,928	-1,672	-1,427	-1,238	-1,050	-861	-673	-485	-298	-118
19 Total Non-Operating	-9,145	-8,889	-8,643	-8,455	-8,266	-8,078	-7,889	-7,702	-7,514	-6,112
20										
21 Pre-Tax Income	-5,944	-5,778	-5,618	-5,496	-5,373	-5,251	-5,128	-5,006	-4,884	-3,973
22 After Tax Income	2,285	1,981	1,691	1,467	1,244	1,021	797	575	353	140
23 Required Return on Equity	13,272	12,515	11,788	11,230	10,673	10,115	9,557	9,002	8,448	6,633
24										
25 Delta Revenue Requirement	5,116	4,495	3,945	3,502	3,102	2,739	2,412	2,117	1,851	1,354
26 PV Delta Rev Requirement										
27 (lower/higher cost to customers)										
28 Power	41	41	41	43	43	43	45	46	46	47
29 Cost of Power	32	33	33	35	36	36	39	39	40	42
30 Market Power Cost (Aurora Midpoint)	42	42	43	44	46	48	50	51	53	55

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION
COMMISSION

Petition of

PUGET SOUND ENERGY, INC.

For an Order (1) Approving Proposed
Accounting Treatment for the Purchase of a
Cogeneration Project, and (2) Authorizing
Assumption of Securities Under
RCW 80.08.130

Docket No. UE-99 _____

ORDER (PROPOSED)

On September 29, 1999, Puget Sound Energy, Inc. ("PSE" or "the Company") filed a petition for an order regarding the accounting and ratemaking treatment in connection with PSE's purchase of a cogeneration project from the owner of the facility ("Owner"). Such Owner was identified in Exhibit A to the Petition. In addition, PSE seeks authorization pursuant to RCW 80.08.130 to assume certain liabilities in connection with the acquisition. According to the Petition, the transaction is scheduled to close on or before November 1, 1999, and provides PSE with the opportunity to reduce the effective cost of purchases the Company is currently obligated to make from a cogeneration project under a power purchase agreement with the Owner. PSE estimates that these cost reductions will produce savings with a net present value of approximately \$27 million for customers over the remaining 23-year useful life of the cogeneration project. The Petition states that the order requested is necessary to enable the Company to enter into the transaction.

Background

In the early 1990s the Company entered into an Agreement for Firm Power Purchase (“Agreement”) with the Owner to purchase the output of the cogeneration project pursuant to the Public Utility Regulatory Policies Act of 1978, or PURPA. Over the past several months, the Company has been in negotiations with the Owner regarding the restructuring of the Agreement with the Company's objective to achieve a reduction in the power supply costs under the Agreement.

According to the Petition, these negotiations resulted in the parties entering into an Interest Purchase Agreement (“Purchase Agreement”) whereby PSE would purchase the cogeneration project. A copy of the Purchase Agreement was included as Exhibit B to this Petition. The purchase price agreed upon by the parties (“Purchase Price”) was set forth in the Purchase Agreement. In addition to the purchase by PSE of all of the equity interests in the project, PSE would assume or guarantee certain obligations of the project, including borrowings (“Loan Amounts”) under certain loans in connection with the project, as described in the Purchase Agreement. In addition, the Company will incur certain transaction costs, currently estimated to be \$500,000, in connection with the purchase.¹

The Petition states that the Company's objective in entering into the transaction is to achieve reductions in the power supply costs of output from the cogeneration project. The savings in power costs provided as a result of the transaction are estimated by the Company to be substantial. Exhibit C to the Petition showed the benefits to customers from PSE's purchase of the cogeneration project versus continuing to purchase the output of the project

¹ These transaction costs include taxes, third party costs associated with the due diligence effort, and costs incurred to refinance on more favorable terms the debt assumed by the Company.

under the existing Agreement. That Exhibit shows a reduction of \$27 million in the revenue requirement, on a net present value basis, from the transaction.

According to the Petition, this transaction is consistent with PSE's commitment in the merger proceeding to mitigate increasing power costs. As part of the proceedings leading to approval of the Puget/WNG merger, the parties committed to pursue an aggressive strategy to mitigate power costs. The Commission ordered that "PSE shall aggressively pursue best operating practice savings, *power stretch goals*, and synergy savings during the Rate Plan Period." Docket Nos. UE-951270 and UE-960195, Fourteenth Supplemental Order, p. 27 (emphasis added).

The Petition states that in the Company's next general rate proceeding, it will request the unamortized purchase price (including unamortized transaction costs) be included in rate base and that the debt incurred in the transaction be included in the Company's capital structure. Until that rate proceeding, the Company would bear the amortization of the costs associated with the transaction.

Proposed Accounting Treatment

The acquisition cost of the project ("Acquisition Cost") -- the sum of the Purchase Price, the assumed Loan Amounts, and the transaction costs -- exceeds the net book value of the project (original cost less accumulated depreciation as recorded by the Owner). As required by Electric Plant Instructions 2 and 5 in the FERC Uniform System of Accounts, the Company proposes to include in Electric Production Plant the original cost of the project incurred by the Owner, and the Accumulated Depreciation recorded by the Owner. PSE proposes to depreciate this net book value of the project (original cost net of accumulated depreciation) over the remaining useful life of the project, currently estimated at 23 years.

The difference between the net book value and the Acquisition Cost would be recorded as an acquisition adjustment in Account 114, "Electric Plant Acquisition Adjustments." The Company proposes to amortize this acquisition adjustment to Account 406, "Amortization of Electric Plant Acquisition Adjustments," over the same remaining useful life of the project, 23 years. The unamortized balance of this acquisition adjustment would be included in rate base, and the related amortization included in cost of service, for ratemaking purposes in future electric rate proceedings. According to the Company, this accounting treatment matches the cost of the project with the benefits produced by the transaction. The costs would be properly allocated to customers receiving power from the project over its remaining service life. The Petition states that the amortization period is consistent with the requirements of the FERC Uniform System of Accounts for acquisition adjustments associated with the purchase of a plant.

The Company is acquiring the partnership that owns the cogeneration project. It is anticipated that the partnership will be liquidated into PSE, and that the assets and liabilities of the partnership will simply be absorbed by the Company. If for tax or other reasons, however, the Company cannot liquidate that partnership into the Company, the Company requests authorization, for ratemaking purposes, to consolidate the assets and liabilities of the partnership into the Company, treating them as if the assets and liabilities were owned directly by the Company.

The Petition states that an accounting order is necessary to obtain the desired effect for ratemaking purposes and to satisfy the Company's financial reporting and accounting needs. The Petition requested that the order authorize the Company to do the following for accounting and ratemaking purposes:

- (a) Include in Electric Plant Account 101, "Electric Plant In-Service" (Production Plant) the original cost of the project as recorded by the Owner;
- (b) Include in Account 108, "Accumulated Provision for Depreciation and Amortization of Electric Utility Plant," the accumulated depreciation recorded by the Owner;
- (c) Depreciate this net Electric Production Plant over the remaining useful life of the project, currently estimated to be 23 years;
- (d) Record as an acquisition adjustment in Account 114, "Electric Plant Acquisition Adjustments," the difference between the net book value of the project and the Acquisition Cost of the project (defined as the sum of the Purchase Price, the Loan Amounts, and transaction costs);
- (e) Amortize this acquisition adjustment to be recorded in Account 114 above the line in Account 406, "Amortization of Electric Plant Acquisition Adjustments," for accounting and ratemaking purposes over the remaining useful life of the project, currently estimated to be 23 years, with the unamortized balance included in rate base; and
- (f) If the partnership is not dissolved into the Company, consolidate the assets and liabilities of the partnership into the Company for ratemaking purposes, thereby treating such assets and liabilities of the partnership as if they were owned directly by the Company.

Assumption of Securities

RCW 80.08.130 requires that the Company comply with the filing requirements of RCW 80.08.040 whenever it "assumes any obligation or liability as guarantor, indorser, surety or otherwise in respect to the securities of any other person, firm or corporation, when

such securities are payable at periods of more than twelve months after the date thereof." The Loan Amounts, as described in the Purchase Agreement, are within the scope of "securities" for purposes of RCW 80.08.130. In accordance with RCW 80.08.040, the Petition states as follows:

- (a) The purpose for which the assumption is requested is as stated in this Petition;
- (b) Such purpose is for one or more of the purposes allowed by RCW 80.08.030, as certified by the authorized officer signing this Petition; and
- (c) The assumption is in the public interest for the reasons stated herein.

FINDINGS

THE COMMISSION FINDS:

1. Puget Sound Energy, Inc. is engaged in the business of furnishing electric and gas service within the State of Washington as a public service company, and is subject to the regulatory authority of the Commission as to its rates, service, facilities and practices.
2. On September 29, 1999, the Company filed a petition for an order regarding the accounting and ratemaking treatment in connection with PSE's purchase of a cogeneration project from the owner of the facility ("Owner"). In addition, PSE seeks authorization pursuant to RCW 80.08.130 to assume certain liabilities in connection with the acquisition.
3. The transaction will provide the Company with the opportunity to reduce the effective cost of purchases the Company is currently obligated to make from a cogeneration project under a power purchase agreement with the Owner, thereby producing significant savings for customers.
4. The acquisition cost of the project ("Acquisition Cost") -- the sum of the Purchase Price, the assumed Loan Amounts, and the transaction costs -- exceeds the net book

value of the project (original cost less accumulated depreciation as recorded by the Owner). The Company's proposed treatment of the Acquisition Cost is reasonable. The Company should be allowed to: (a) include in Electric Plant Account 101 the original cost of the project as recorded by the Owner; (b) include in Account 108 the accumulated depreciation recorded by the Owner; (c) depreciate this net Electric Production Plant over the remaining useful life of the project, currently estimated to be 23 years, (d) record as an acquisition adjustment in Account 114 the difference between the net book value of the project and the Acquisition Cost of the project (defined as the sum of the Purchase Price, the Loan Amounts, and transaction costs), and (e) amortize this acquisition adjustment to be recorded in Account 114 above the line in Account 406 for accounting and ratemaking purposes over the remaining useful life of the project, currently estimated to be 23 years, with the unamortized balance included in rate base. If the partnership is not dissolved into the Company, PSE should be authorized to consolidate the assets and liabilities of the partnership into the Company for ratemaking purposes, thereby treating such assets and liabilities of the partnership as if they were owned directly by the Company.

5. The Company has provided the requisite information pursuant to RCW 80.08.130, and should be authorized to assume the Loan Amounts in connection with its acquisition of the cogeneration project.

ORDER

WHEREFORE, THE COMMISSION HEREBY ORDERS:

1. Approval is hereby given for the accounting treatment in the Company's Petition dated September 29, 1999 with respect to the Company's purchase of a cogeneration project from the owner of the facility ("Owner"). The Company is authorized to:

(a) Include in Electric Plant Account 101 (Production Plant) the original cost of the project as recorded by the Owner;

(b) Include in Account 108, "Accumulated Provision for Depreciation and Amortization of Electric Utility Plant," the accumulated depreciation recorded by the Owner;

(c) Depreciate this net Electric Production Plant over the remaining useful life of the project, currently estimated to be 23 years;

(d) Record as an acquisition adjustment in Account 114, "Accumulated Provision for Amortization of Electric Plant Acquisition Adjustments," the difference between the net book value of the project and the Acquisition Cost of the project (defined as the sum of the Purchase Price, the Loan Amounts, and transaction costs²);

(e) Amortize this acquisition adjustment above the line in Account 406, "Amortization of Electric Plant Acquisition Adjustments," for accounting and ratemaking purposes over the remaining useful life of the project, currently estimated to be 23 years, with the unamortized balance included in rate base; and

(f) Consolidate that partnership with the Company for ratemaking purposes (if necessary where the Company owns the cogeneration project through a partnership).

2. The Company is authorized to assume the Loan Amounts, pursuant to RCW 80.08.130, in connection with its acquisition of the cogeneration project.

3. The Company's actions in purchasing the cogeneration project are subject to review in future rate proceedings. Any costs determined to be unreasonable or imprudent in such proceedings are subject to disallowance.

4. The Commission retains jurisdiction to effectuate the provisions of this order.

² Transaction costs shall include taxes, third party costs incurred by the Company in connection with the due diligence effort, and costs incurred by the Company to refinance on more favorable terms the debt assumed by the Company under the transaction.