

**EXHIBIT NO. ___(RG-11HC)
DOCKET NO. UE-07___/UG-07___
2007 PSE GENERAL RATE CASE
WITNESS: ROGER GARRATT**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

**Docket No. UE-07___
Docket No. UG-07___**

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

**REDACTED
VERSION**

DECEMBER 3, 2007



PUGET SOUND ENERGY

The energy to do great things

**Klondike Wind Power III LLC
50 MW Wind Energy
20-year Power Purchase Agreement**

Energy Management Committee Meeting
March 15, 2007

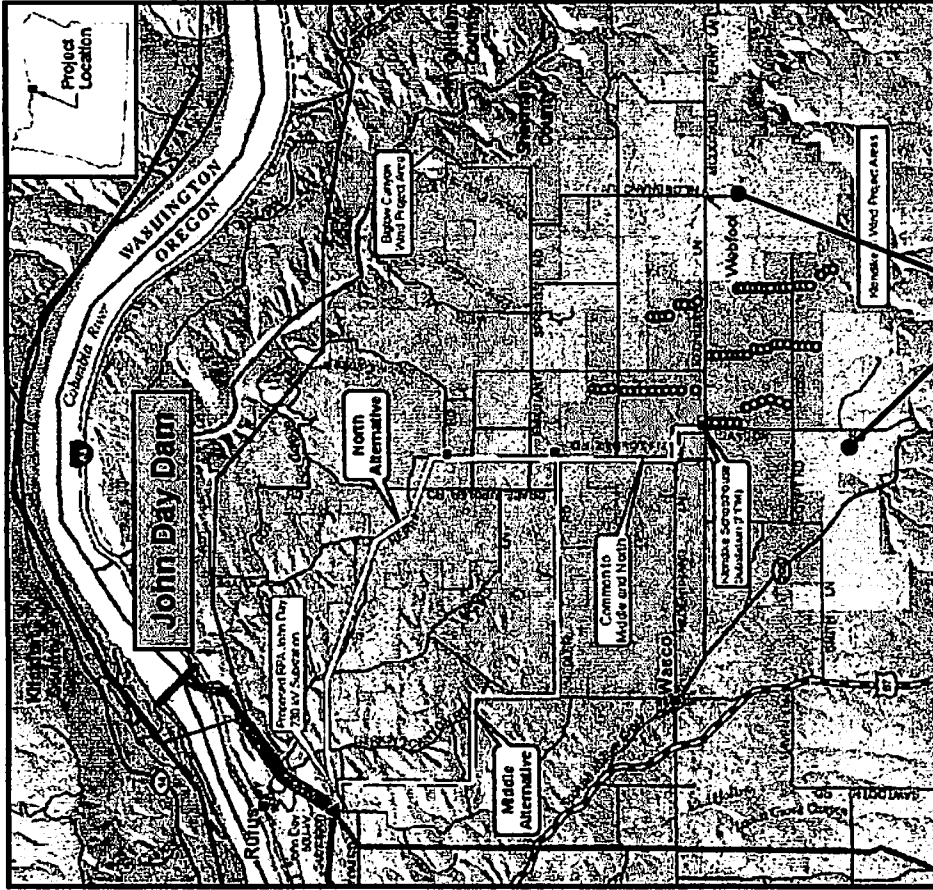
Klondike III Presentation Outline

- Objective – Energy Management Committee Decision

Recommendation to the EMC for approval of entering into a 20-year agreement with Klondike Wind Power III LLC for the purchase of up to 50 MW of wind energy and associated environmental attributes from the 120 MW Klondike Wind Power III Project

- Description of Klondike III Project
- Key Commercial Terms of Power Purchase Agreement
- Accounting and Credit Summary
- Key Findings and Next Steps
- Appendix


Klondike III Project Description



Developer: PPM Energy, Inc

Location: Sherman County, Oregon
Columbia River Gorge

Size: 120 MW

Capacity Factor:  (83) – GE 1.5 MW;
77m rotor; 80m hub

Turbines: 14,500 acres leased;
12 landowners;
cultivated wheat land

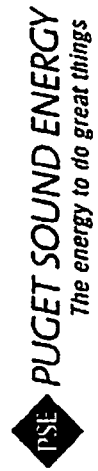
Interconnection: BPA John Day 230kV Sub

Transmission: Firm PTP to PSE-Covington

Other:

- EWEB 25 MW off-taker
- Adjacent (44) – Siemens 2.3 MW
Project in negotiations w/ other party

KLONDIKE III



Redacted

Key Commercial Terms

Energy Price: [redacted] MWh; includes environmental attributes
[redacted] MWh escalates at 2.5% each year
[redacted] MWh escalates at CPI each year

Energy Quantity: 42% of project; i.e. 50 MW of 120 MW
- [redacted] MWh annual average energy (≈36% c.f.)

Product: Hourly Firm; includes generation imbalance

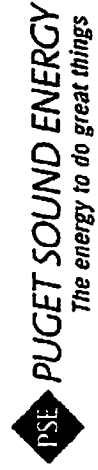
Term: 20 years; beginning at COD ~12/01/2007

Delivery Point: Period 1) "Start date – July 2011" to PSE's Covington substation
- PSE reimburses transmission costs to PPM
Period 2) "July 2011 – end of term" to project busbar
- PPM will assign PSE firm PTP transmission rights to Covington

Regulatory Tariff Changes: Share 50/50 basis any new charge for "wind integration"
arriving out of the BPA's *NW Integration Action Plan*

Credit Support: Scottish Power Finance (US) corporate guaranty; \$10,000,000 cap

Termination / Defaults: i) Guaranteed COD, ii) Credit Downgrade, iii) Availability Thresholds



Accounting and Credit Summary

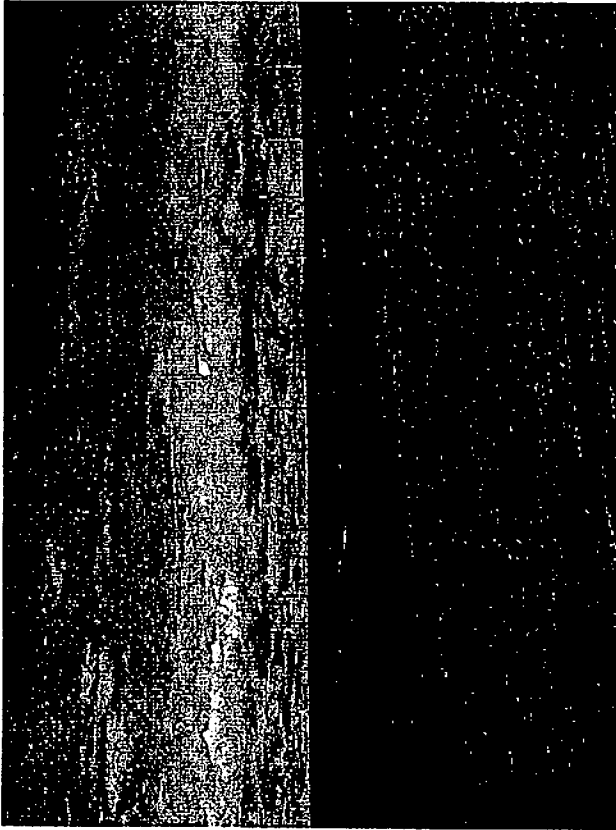
Accounting Treatment

- EITF 01-08: no lease accounting
 - ◆ No right to operate
 - ◆ More than minor output by other party
- FIN 46(R): no consolidation
 - ◆ No capacity payment
 - ◆ Financing not reliant on PPA
- SFAS 133
 - ◆ Embedded derivatives to be evaluated
 - ◆ Energy output evaluated against position
 - ◆ May qualify as cash flow hedge for term
- Imputed Debt
 - ◆ ≈\$14.6 million imputed debt in 1st year
 - ◆ ≈\$390 million current imputed debt
 - ◆ ≈\$41.6 million forecast decline in 2008


Credit Summary

- SPFUS, BBB+ rated
- \$10MM Parent Guarantee
- Ratings downgrade event trigger
- Specific Performance provision
- Claim against K3, LLC
- Right Way Exposure
- Operational risks – take & pay
- Terms consistent with marketplace

Summary of Key Findings & Next Steps



Findings

- "Short-listed" in 2006 RFP evaluation
-  MWh 20-yr levelized cost
• Attractive compared against other proposals
- \$22.826 million portfolio benefit
 - Cost benefit compared to generic portfolio
- Opens other acquisition opportunities with PPM Energy, Inc
- Adds to PSE's Renewable Portfolio Standard ("RPS") requirement and to corporate renewable goal

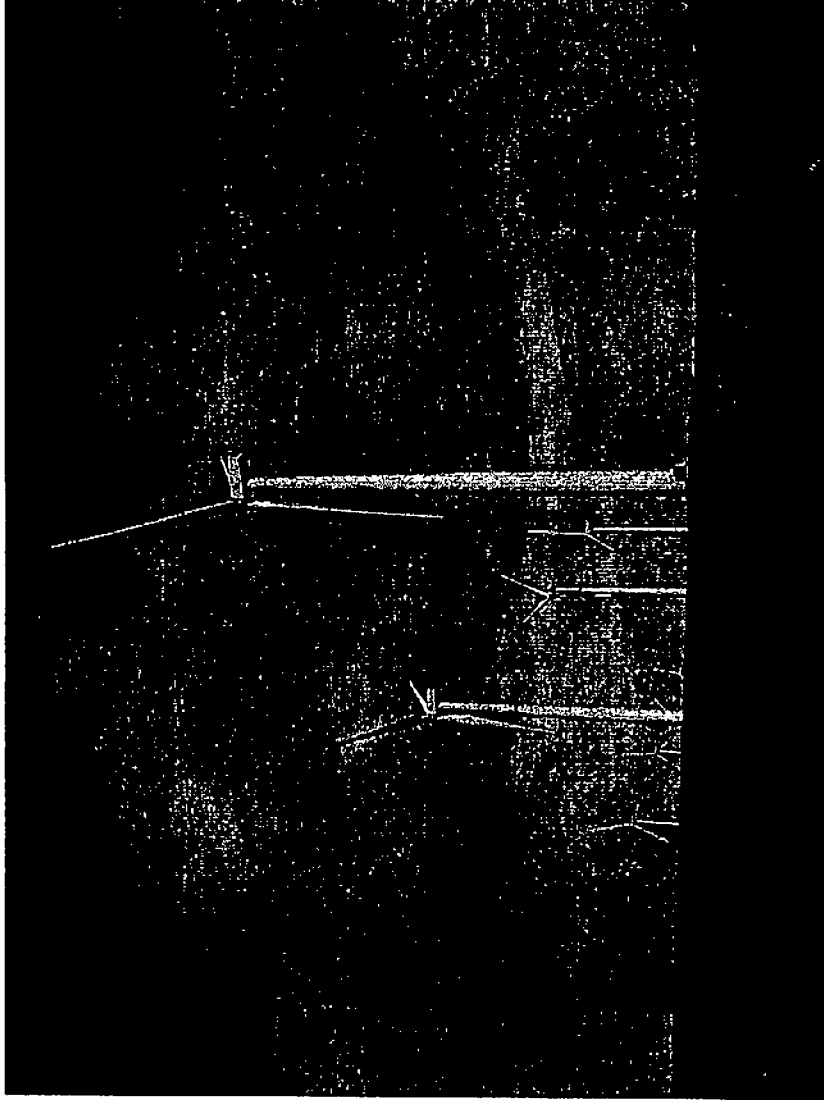
Next Steps

- Today – Request approval from EMC
- Q2 2007 – Finalize PPA
- Feb - Dec 2007 – Construction
- Dec 2007 – Start date of agreement



Klondike III 50 MW 20-year PPA

Appendix



Quantitative Analysis

Redacted

HIGHLY CONFIDENTIAL
Per WAC 480-07-160

Levelized Cost v Portfolio Benefit

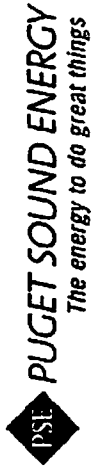
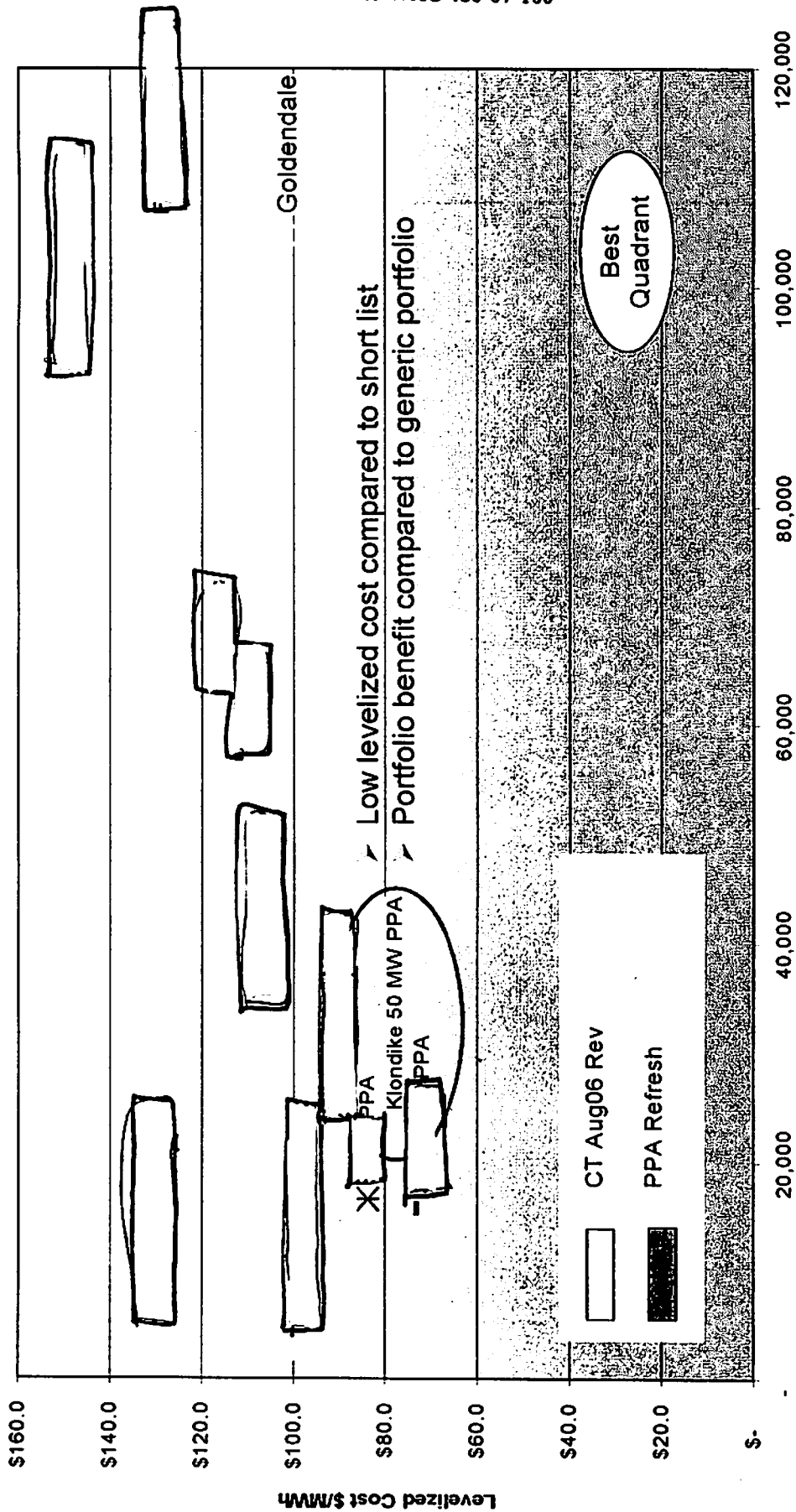


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Klondike III PPA / EMC Meeting / March 15, 2007

Text in box is Highly Confidential

Accounting / Financial Reporting Effects

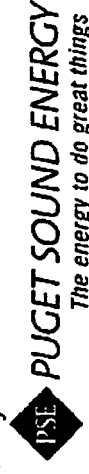
- EITF 01-08:
 - Likely would NOT fall under lease accounting
 - ♦ PSE does not have the right to operate or control access to any PP&E
 - ♦ Other party takes more than minor amount of output

- FIN 46(R):
 - Probably would NOT qualify for consolidation under FIN 46(R)
 - ♦ Project does not rely on PPA for financing
 - ♦ No capacity payment, take & pay contract

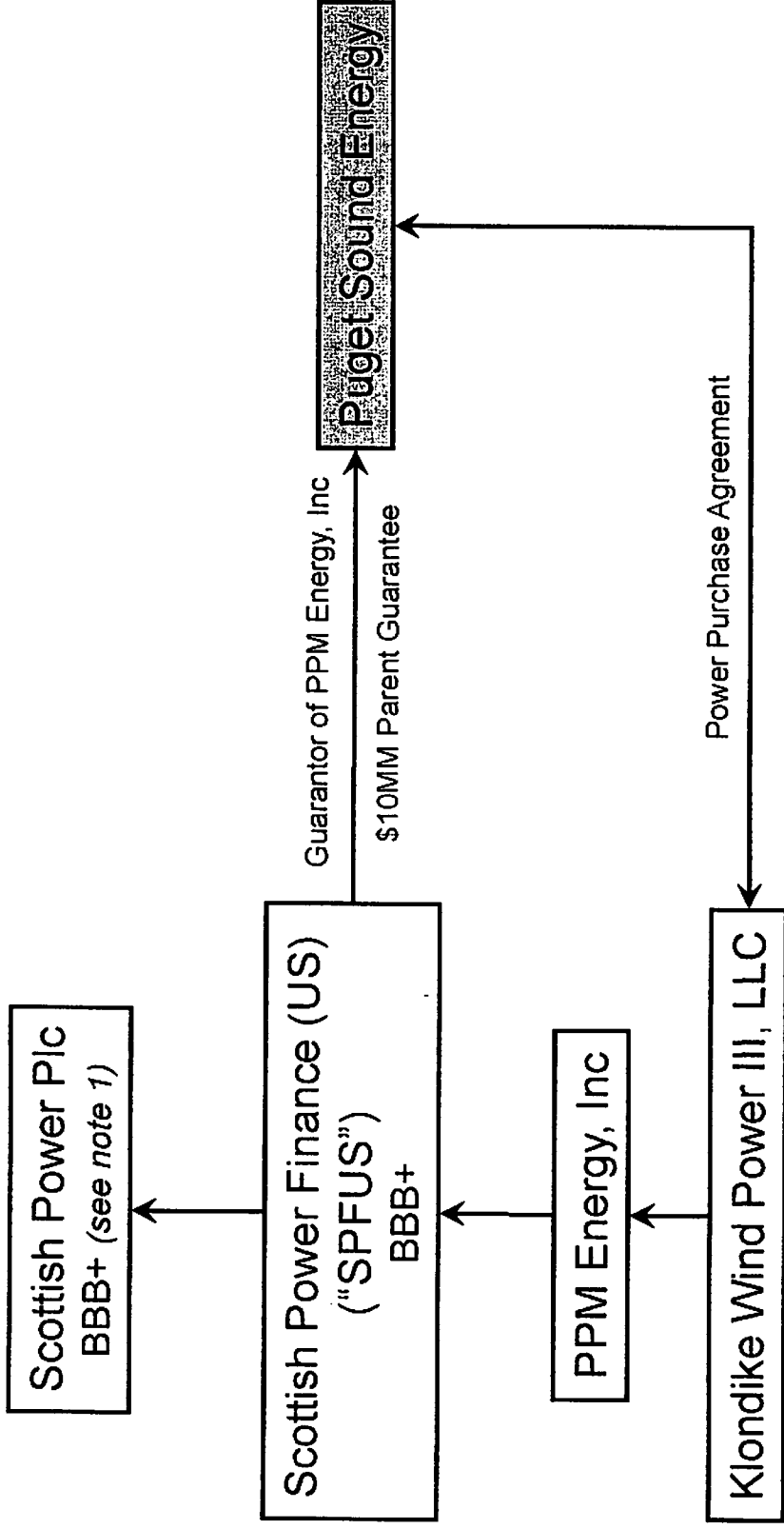
- SFAS 133:
 - Embedded derivatives would have to be evaluated
 - ♦ Potential value of the environmental attributes

- Energy output evaluated against position (need for energy)
 - ♦ Normal purchase normal sale (NPNS) criteria would be evaluated, but not likely to qualify due to:
 - ♦ PSE is already surplus energy (long) in some periods
 - ♦ Price escalated by CPI factor
 - ♦ Could qualify as a cash flow hedge over the life of the contract

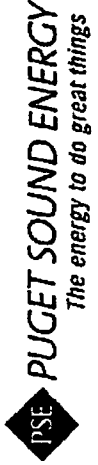
- Imputed Debt:
 - ♦ Increases the PSE's imputed debt by approximately \$14.8 million in first year of contract
 - ♦ The current outstanding imputed debt is ≈\$390 million and is forecast to decline by about \$41.6 million in 2008 if no new PPAs are added to the portfolio



Klondike Wind Power III LLC



Note: (1) Negative outlook due to possible buy out by Iberdola, S.A., A Rated



Credit Summary

Counterparty is Klondike Wind Power III, LLC

- PSE not allowed permission to review the project's pro forma financials
- Project should be treated as sub investment grade credit

Credit risk partially mitigated by:

- 1) Parent Guarantee
 - \$10MM Parent Guarantee from Scottish Power Finance (US) ("SPFUS")
 - SPFUS is rated BBB+ with a negative outlook ¹
 - Reasonable probability that Guarantee is not large enough to fully cover potential credit exposure

2) Specific Performance / Willful Breach Language

- PSE has the contractual right to force delivery of energy rather than payment of damages

3) Right Way Exposure

- Generally speaking, one would expect a positive correlation between PSE's credit risk position and the value of the project

4) Credit risk associated with operational risk

- No capacity payment
- PSE only pays for what is delivered

(1) Negative outlook due to possible buy out by Iberdola, S.A., A Rated, could lower the rating to BBB

Additional Credit Summary

Ratings trigger, sort of:

- If PSE or SPFUS is downgraded below investment grade, then non-downgraded party may request collateral not to exceed \$10,000,000
- If the downgraded party refuses, the non-downgraded party may terminate the contract
- However, neither party will be required to pay damages pursuant to this type of termination
- The termination right expires after 120 days

Generally, PSE avoids ratings triggers to protect the company's liquidity in the event of a downgrade. The trigger in this deal does not pose a serious threat to PSE's liquidity.

Credit terms consistent with current market:

- External counsel LeBoeuf, Lamb, Greene & MacRae LLP advises PSE that the credit terms with PPM are similar to what others are getting in the current market place

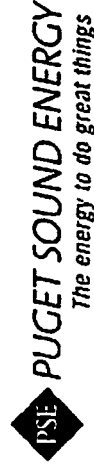
Credit Market Comparables

- 100 MW Wind Facility 20-yr PPA
 - ◆ \$10MM guaranty from an A rated entity
 - ◆ \$15MM cap on total Seller liability (except due to intentional breaches)
 - ◆ Perfected lien on all cash and other liquid assets of the Seller (an SPE), but not a lien on the Facility itself

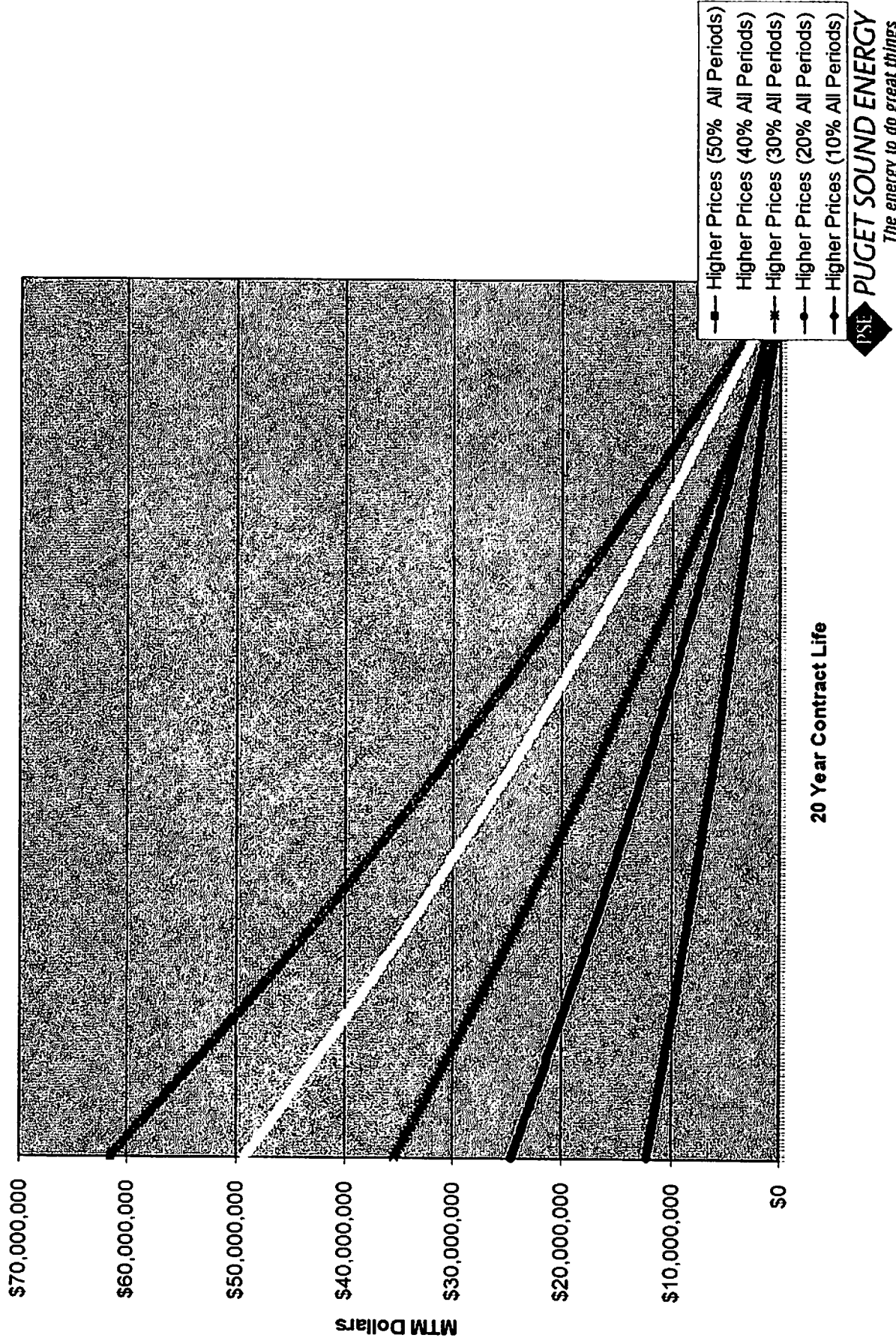
- 120MW Wind Facility PPA
 - ◆ \$15MM in Seller provided credit support
 - ◆ Lien on the Facility (subordinate to Seller project financing)

Possible Credit Exposures with Upward Price Stresses

Percent Price Stress	Potential Exposure using Contract Price	Potential Exposure using Klondex Forward Price Curve
10%	\$12 MM	\$24 MM
20%	\$24 MM	\$37 MM
30%	\$36 MM	\$47 MM
40%	\$49 MM	\$64 MM
50%	\$61 MM	\$77 MM



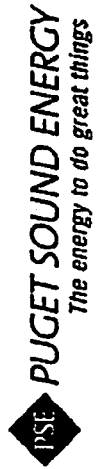
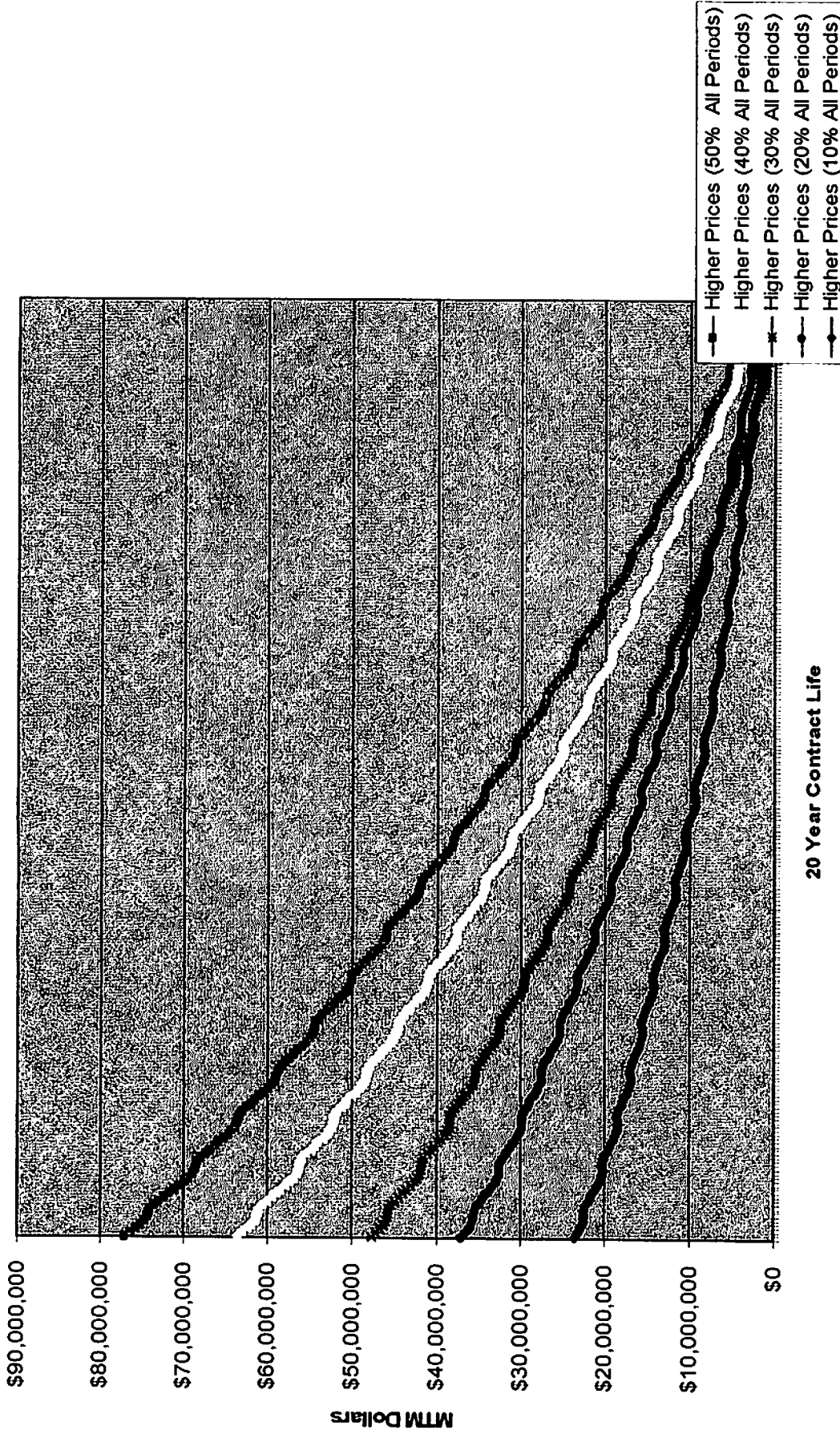
Klondike III Credit Exposure Using Stressed Contract Prices as Forward Prices



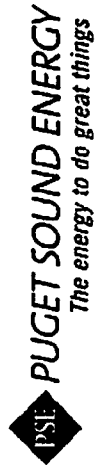
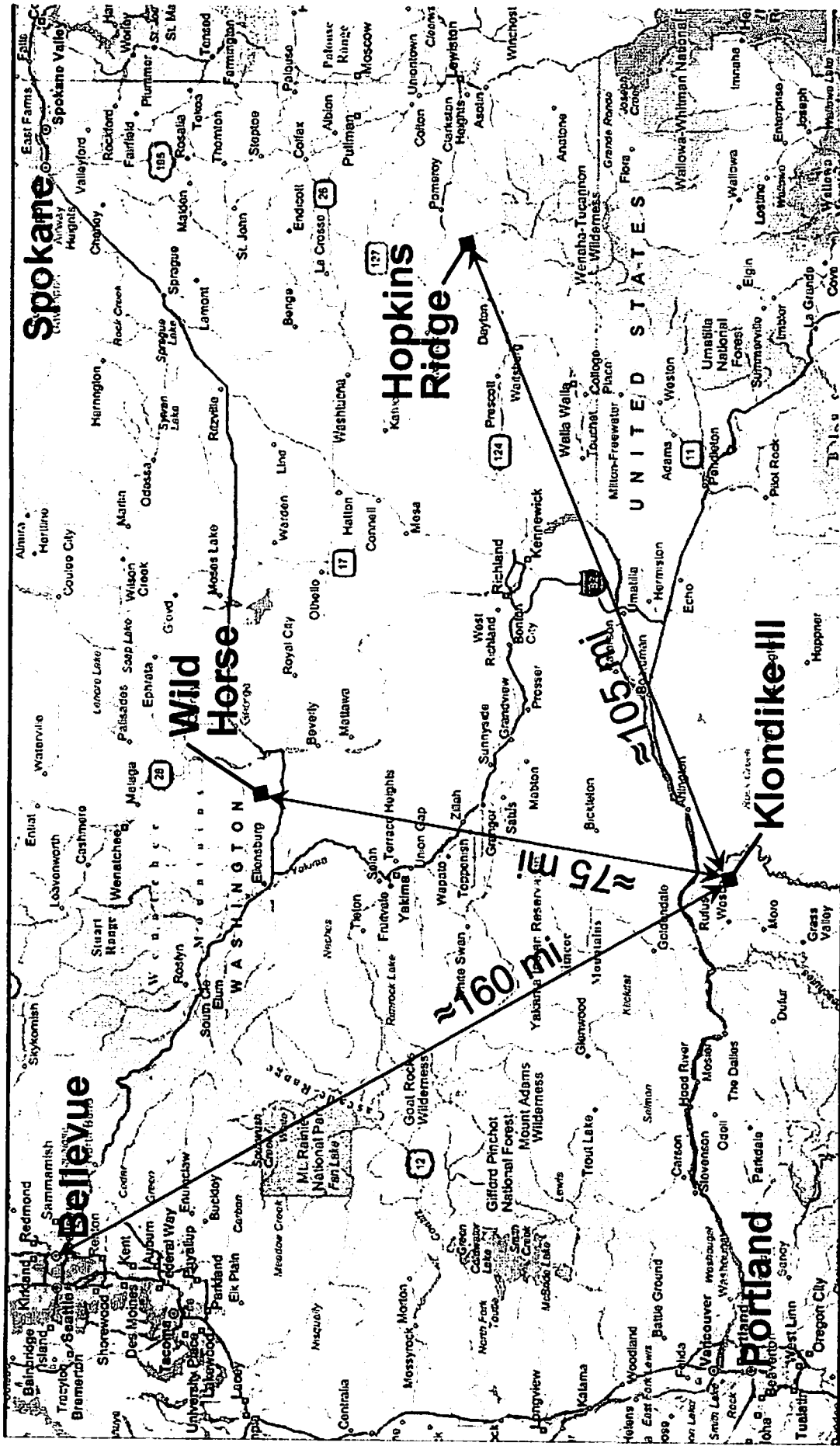
20 Year Contract Life

Klondike III PPA / EMC Meeting / March 15, 2007

Klondike III Credit Exposure Using KIODEX Stressed Forward Prices



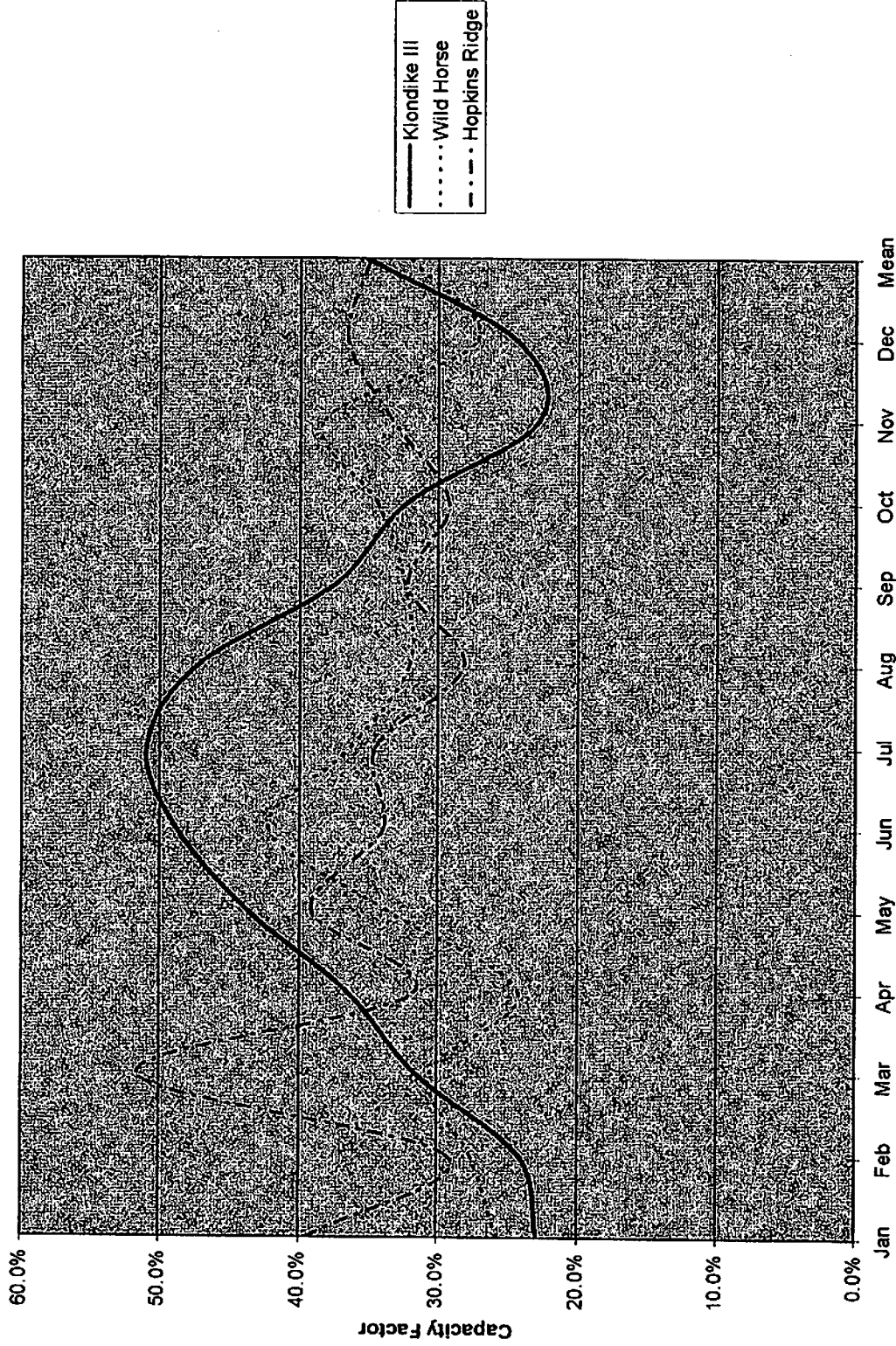
K3 relative to PSE wind projects



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Klondike III Wind Energy Profile compared to Hopkins Ridge & Wild Horse



Klondike III PPA / EMC Meeting / March 15, 2007

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**Update on Accounting Issues for:
Klondike Wind Power III LLC
50 MW Wind Energy
20-year Power Purchase Agreement**

Energy Management Committee Meeting
April 30, 2007

Overview of Klondike III Wind PPA

Redacted

Energy Price: [redacted] MWh

- incl.'s environ. attributes
- [redacted] MWh @ 2.5% per year
- [redacted] MWh @ CPI per year

PPA Quantity: 50 MW of 120 MW (42%)

- 17.8 aMW annually
- [redacted] MWh annual average

Term: 20 years

- COD ≈ 12/01/2007

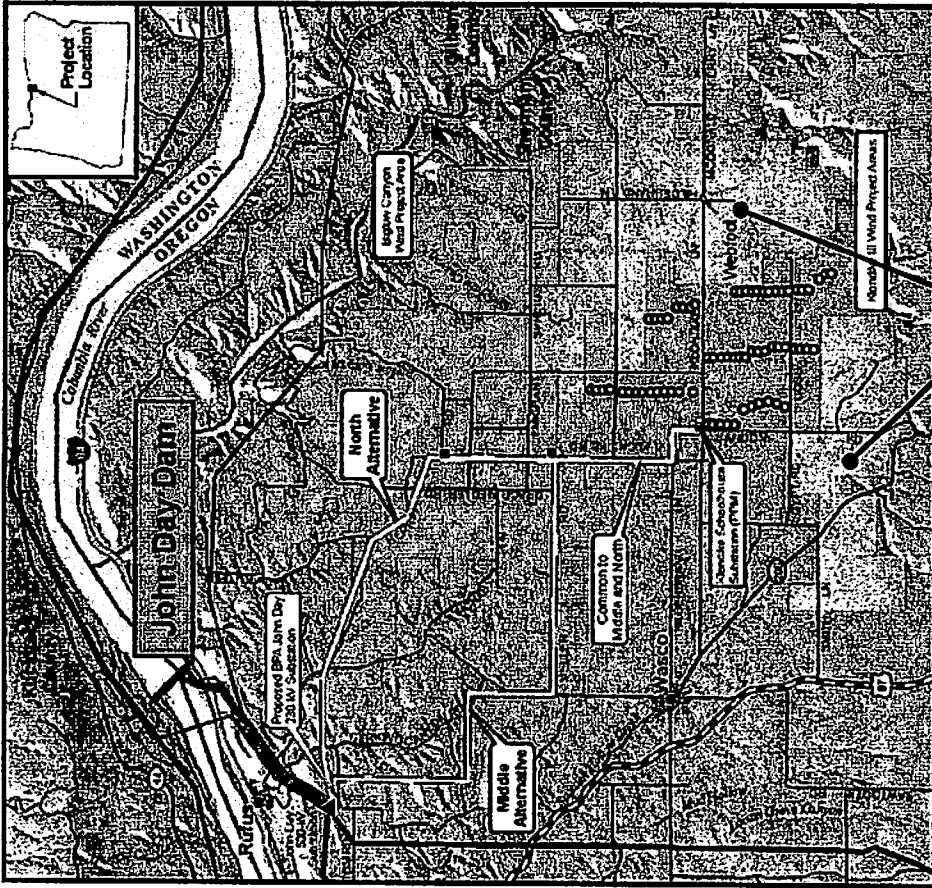
Developer: PPM Energy, Inc

Location: Sherman County, Oregon
Columbia River Gorge

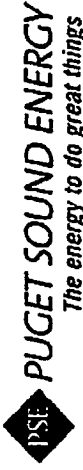
Capacity Factor: [redacted]

Turbines: (83) – GE 1.5 MW;
77m rotor; 80m hub

Transmission: Firm PTP to PSE-Covington



KLONDIKE III



Accounting Evaluation & Conclusions¹

EITF 01-08 – Lease Accounting

- Would NOT be considered a lease because it fails all three criteria
 - ♦ PSE does not have the right to operate the PP&E
 - ♦ PSE does not have right to control access to any PP&E
 - ♦ Other parties will take more than minor amount of output (>10%) and the price paid for energy is not fixed

FIN 46(R) – Consolidation

- Would NOT qualify for consolidation under current proposed contract
 - ♦ Project financing does not rely on PSE's PPA
 - ♦ No capacity payment; the PPA is a "take & pay" contract
 - ♦ Contract will contain provision that provides PSE access to K3 financials

SFAS No. 133 – Derivative Accounting

- Would NOT qualify for derivative contract under current proposed contract
 - ♦ No notional value; PPA does not specify or indicate fixed or minimum quantity
 - ♦ No settlement/default provisions that determine notional quantity for a requirements contract

• Environmental Attributes

- ♦ Not currently considered liquid thus does not meet criteria of a derivative
- ♦ Over the contract term this could change with potential MTM for environmental attributes

Note 1. See Accounting Memorandum dated April 7, 2007

Klondike III PPA / EMC Meeting / April 30, 2007

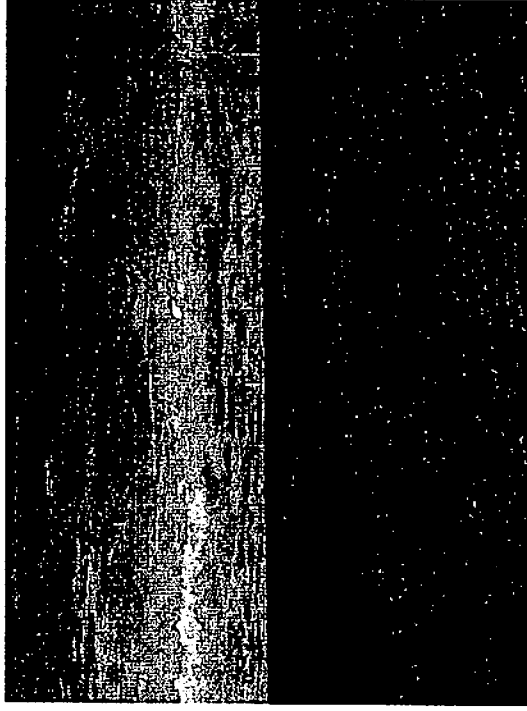


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Approval Request

Recommendation to the EMC for approval of entering into a 20-year agreement with Klondike Wind Power II LLC for the purchase of up to 50 MW of wind energy and associated environmental attributes from the 120 MW Klondike Wind Power III Project



Puget Sound Energy, Inc.
Minutes of the
Energy Management Committee
Meeting on April 30, 2007

Attendees

The following members of the Energy Management Committee (EMC) attended the meeting in person: Bert Valdman, Kimberly Harris, Jennifer O'Connor, and Eric Markell.

The following non-voting members of the EMC attended the meeting: Paul Wiegand, Don Gaines, David Mills, Jim Elsea, Salman Aladin, Roger Garratt, and Tom DeBoer.

Guests included: Aliza Seelig, Jorg Steyskal, Scott Williams, Chris Bevil, Christine Philipps, Sam Osborne, Connie Mander, Bev Ikeda, Wayne Gould, and Rob Neate.

Call to Order

The meeting was called to order at 3:00 p.m.

Approval of Previous Meeting Minutes

The minutes of the Energy Management Committee (EMC) on April 20, 2007 were unanimously approved by voice vote of the Committee.

Standards of Conduct Requirements and Guidelines

A reminder of the Standards of Conduct was distributed by the EMC secretary in advance of the meeting. That reminder stated:

Meeting attendees are reminded that the FERC Standards of Conduct prohibit discussion or sharing of non-public transmission information. Specifically, attendees are reminded of the "no conduit" rule that prohibits an employee who has knowledge of non-public transmission information from acting as a conduit to transfer that information to merchant employees.

Redacted

New Matters

1. **Clay Basin Storage Optimization:** Jorg Steyskal presented a recommendation to manage the Clay Basin natural gas storage capacity to improve cost recovery for core gas customers by taking advantage of the forward spreads between the price of summer gas and winter gas. This proposal is a repeat of last year's trading and is expected to recover an incremental [redacted] million which will reduce costs for core gas customers. David Mills clarified that this storage is in excess of what is needed to manage core gas requirements. Following discussion, the Committee unanimously approved the recommendation.
2. **Extension of Hedging Program:** Jorg Steyskal then presented a recommendation to extend the hedging strategies from [redacted] to [redacted] and [redacted] the [redacted] monthly limit on open exposure from [redacted] to [redacted]. Following discussion, the EMC unanimously approved the recommendation, but deferred implementation until the May 17 EMC meeting to allow the long-term acquisition team to finalize the PPA opportunities arising from the 2005 RFP.
3. **Hopkins Ridge Wind Infill Project:** Scott Williams presented a recommendation that the EMC authorize the negotiation and execution of turbine supply and balance of plant/turbine installation agreements for the Hopkins Ridge Wind Infill (four additional turbines) Project. Following discussion about the 150 MW transmission capacity limit and other matters, the EMC unanimously approved the authorization to proceed.
4. **Klondike III wind PPA:** Chris Bevil presented an update on the accounting treatment for the Klondike III 20-year Power Purchase Agreement and sought EMC approval to enter into the PPA. This is a follow-up to the presentation made at the EMC meeting held on March 15, 2007. File memoranda on credit and accounting treatment were distributed. Following discussion, the EMC unanimously approved entering into the 20-year agreement.
5. **Trading Position Review:** Salman Aladin presented an outline of risk management discussion topics that he will present over the next several EMC meetings. He also reviewed the current trading positions and exposures.
6. [redacted] **Update:** Christine Philipps gave an update of the [redacted] PPA and explained that market prices moved above the target price presented to the EMC on April 20, 2007. Discussions centered on how the [redacted] product is shaped to PSE need. The Committee directed Christine to obtain two other indicative offers and a refreshed offer from [redacted] on Tuesday, May 1. Assuming the offer still looks attractive, the EMC would be notified by email.

Redacted

Meeting Postscript: Following a favorable price update on May 1, 2007, the EMC was contacted by email for approval to enter into a four-year seasonal on-peak power purchase agreement with [REDACTED] (December through February 2008-2012) at a revised price cap of [REDACTED] levelized. The EMC members responded by email and unanimously approved the agreement on Tuesday, May 1.

- 7. Wild Horse Solar Demonstration Project:** Roger Garratt asked the Committee about completing the approval process for the Wild Horse Solar Demonstration Project. The project had been previously discussed by the officers and CEO at an officer meeting on February 13, 2007 and Stephen Emmert had given an earlier informational presentation at the EMC on December 21, 2006. The Committee members had questions about the proposed schedule of the project and the timing of possible application of Investment Tax Credit (ITC). A recommendation was circulated after the meeting with an explanation of the possibility of ITC on this project. The recommendation was approved via email on May 2, 2007, by the four EMC members who attended this meeting.

Next Meeting

The next meeting of the Energy Management Committee is scheduled for 2:30 p.m. on Thursday, May 17, 2007 in the Meydenbauer Conference Room, PSE-12.

There being no further business, the meeting was adjourned at 4:30 p.m.

Respectfully submitted:



Jim Elsea or David Mills, Secretary

Accepted by the Energy Management Committee:



Eric Markell, Bert Valdman, or Kimberly Harris