

**EXHIBIT NO. ___(EMM-1T)
DOCKET NO. UE-07___/UG-07___
2007 MERGER PROCEEDING
WITNESS: ERIC M. MARKELL**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Joint Application of

PUGET HOLDINGS LLC

and

PUGET SOUND ENERGY, INC.

For an Order Authorizing Proposed Transaction

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

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
ERIC M. MARKELL
ON BEHALF OF PUGET SOUND ENERGY, INC.**

DECEMBER 17, 2007

PUGET SOUND ENERGY, INC.

**PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
ERIC M. MARKELL**

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1 **PUGET SOUND ENERGY, INC.**

2 **PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF**
3 **ERIC M. MARKELL**

4 **I. INTRODUCTION**

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

7 A. My name is Eric M. Markell. I am the Executive Vice President and Chief
8 Financial Officer of Puget Energy, Inc. (“Puget Energy”) and its wholly-owned
9 subsidiary, Puget Sound Energy, Inc. (“PSE”). My business address is 10885
10 N.E. Fourth Street, Bellevue, WA 98004.

11 **Q. Have you prepared an exhibit describing your education, relevant**
12 **employment experience and other professional qualifications?**

13 A. Yes. Exhibit No. ___(EMM-2) describes my education, relevant employment
14 experience and other professional qualifications.

15 **Q. Have you previously testified or sponsored testimony before the Washington**
16 **Utilities and Transportation Commission (the “Commission”) or any other**
17 **utility commissions?**

18 A. Yes. I have testified before the Commission in Docket Nos. UG-040640 *et al.*

1 and have sponsored testimony in Commission Docket Nos. UE-50870 and UE-
2 072300 *et al.* Prior to joining Puget Energy and PSE, I testified in proceedings
3 before the New York Public Service Commission in my capacity as the controller
4 (and other financial and regulatory positions) of Central Hudson Gas & Electric
5 Corporation.

6 **Q. What are your duties as Executive Vice President and Chief Financial**
7 **Officer of PSE and Puget Energy?**

8 A. I have overall responsibility for the financial management and financial health of
9 PSE and Puget Energy. More particularly, my present responsibilities include
10 oversight of the finance, financial planning, budgeting, accounting, tax, insurance,
11 portfolio optimization and regulatory functions of PSE and Puget Energy.

12 **Q. What position will you hold with PSE and Puget Energy after the proposed**
13 **acquisition of Puget Energy is closed?**

14 A. After the proposed acquisition of Puget Energy is closed, I will continue to serve
15 as Executive Vice President and Chief Financial Officer of PSE and Puget
16 Energy.

17 **Q. What is the purpose of your direct testimony in this proceeding?**

18 A. The purpose of my direct testimony is to describe:

- 19 • Puget Energy and PSE from a financial perspective;
- 20 • The Stock Purchase Agreement, dated as of October 25, 2007 (the
21 “Stock Purchase Agreement”), by and among Puget Energy and
22 the nine purchasers (collectively, the “Purchasers”);

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- The Agreement and Plan of Merger, dated as of October 25, 2007 (the “Merger Agreement”), by and among Puget Energy, Puget Holdings LLC¹ (“Puget Holdings”), Puget Intermediate Holdings Inc.² (“Puget Intermediate”) and Puget Merger Sub Inc.³ (“Merger Sub”) (collectively, the “Merger Parties”), and the proposed transaction underlying the Merger Agreement (the “Proposed Transaction”);
- The multi-staged plan of recapitalization of Puget Energy and PSE through pro forma balance sheets;
- Financial matters and commitments made in the Merger Agreement and the joint application that PSE and Puget Holdings (collectively, the “Joint Applicants”) are filing contemporaneously with this testimony (“Joint Application”); and
- Why the Proposed Transaction is consistent with the public interest.

Q. Please summarize your testimony.

A. My testimony:

- Explains why executing the Merger Agreement was the best course of action to meet the challenges that PSE is currently facing.
- Describes the Stock Purchase Agreement and how it fits in the overall recapitalization plan for PSE.
- Describes the terms of the Proposed Transaction, and how it is funded.
- Presents pro forma balance sheets that demonstrate the very favorable impact that the Proposed Transaction is projected to have on PSE’s capital structure.
- Describes the commitments being made by Puget Holdings and PSE to address issues associated with capital structure, financial

¹ Please note that Puget Holdings was called Padua Holdings LLC at the time the Merger Parties executed the Merger Agreement. Since such time, the name has been changed to Puget Holdings LLC.

² Please note that Puget Intermediate Holdings Inc. was called Padua Intermediate Holdings Inc. at the time the Merger Parties executed the Merger Agreement. Since such time, the name has been changed to Puget Intermediate Holdings Inc.

³ Please note that Puget Merger Sub Inc. was called Padua Merger Sub Inc. at the time the Merger Parties executed the Merger Agreement. Since such time, the name has been changed to Puget Merger Sub Inc.

1 integrity, Commission oversight and ring-fencing provisions.

- 2 • Explains why the Proposed Transaction is consistent with the
3 public interest.

4 **Q. How is your testimony organized?**

5 A. The remainder of my testimony is divided into six substantive sections. In
6 Section II of my testimony, I describe the challenges that PSE currently is facing,
7 and how executing the Merger Agreement addresses those challenges. As part of
8 that explanation, I describe the multi-stage plan of recapitalization that the
9 Investor Consortium⁴ has enabled PSE and Puget Energy to undertake.

10 Section III of my testimony contains a description of the Stock Purchase
11 Agreement that was consummated by Puget Energy and the Purchasers on
12 December 3, 2007. The sale of Puget Energy's common stock to the Purchasers
13 constitutes the first of three stages of an overall recapitalization plan
14 ("Recapitalization – Part One"), by which PSE will use the approximately \$293
15 million of net proceeds in order to redeem debt, fund the Company's ongoing
16 construction program and provide for working capital. Importantly, this equity
17 infusion in Puget Energy and PSE was not made contingent upon Commission
18 approval of the Proposed Transaction. At the end of Section III, I address several
19 transactional and regulatory implications of the Stock Purchase Agreement.

20 Moving to Section IV of my testimony, I start by providing a general description

⁴ The Investor Consortium comprises a group of infrastructure funds and institutional investors: Macquarie Infrastructure Partners, Canada Pension Plan Investment Board, British Columbia Investment Management Corporation, Alberta Investment Management, Macquarie-FSS Infrastructure Trust and Macquarie Capital Group Ltd. The Investor Consortium owns Puget

1 of the Merger Agreement and the Proposed Transaction and several related
2 securities and regulatory implications. I also explain why Puget Energy decided
3 to execute the Merger Agreement and, therefore, to seek regulatory approval of
4 the Proposed Transaction, which collectively form the second of three stages of
5 recapitalization of PSE and Puget Energy (“Recapitalization – Part Two”). I then
6 discuss the timeframe of the Proposed Transaction, including the timing of the
7 various regulatory filings that must be made in order to obtain approval from or
8 notify various administrative agencies. Next, I mention the status of Puget
9 Energy’s and PSE’s business operations and the nature of their expected
10 interactions with Puget Holdings and its subsidiaries between now and the
11 consummation of the Proposed Transaction. After addressing these topics in
12 Section IV, I describe the nature of the consideration that Puget Energy’s
13 shareholders will receive upon consummation of the Proposed Transaction, the
14 total equity market value of which is approximately \$3.52 billion. Lastly, I
15 explain how Puget Holdings and Merger Sub have arranged to fund the Proposed
16 Transaction, namely through shareholder funding, debt assumption and debt
17 financing. A fundamental element of such funding, from the perspective of Puget
18 Energy and PSE, is that the obligations of Puget Holdings and Merger Sub to
19 close the Proposed Transaction are not subject to any funding or financing
20 contingency.

21 The focal point of my testimony is found in Section V, entitled “Multi-Part Plan
22 of Recapitalization.” I have already introduced Recapitalization – Parts One and

Holdings and, through Puget Holdings, indirectly owns Puget Intermediate and Merger Sub.

1 Two. The third stage of recapitalization, by which the Investor Consortium
2 expects to invest an additional \$393 million of equity in PSE shortly after the
3 closing, will occur once PSE exercises the “make whole” provisions under the
4 bonds that PSE anticipates are to be redeemed with such equity proceeds
5 (“Recapitalization – Part Three”). My Exhibit No. ____ (EMM-4), which contains
6 PSE and Puget Energy pro forma balance sheets for the period September 30,
7 2007 through September 30, 2008, demonstrates the very favorable impact that
8 the multi-part plan of recapitalization is projected to have on PSE’s capital
9 structure.

10 Another central component of the Proposed Transaction is the comprehensive
11 package of financial and associated commitments made in the Merger Agreement
12 and the Joint Application. The testimony of Christopher J. Leslie on behalf of
13 Puget Holdings describes this comprehensive package of commitments. In
14 Section VI of my testimony, I focus on certain of these commitments addressing
15 capital structure, corporate and debt credit rating, accounting, Commission
16 oversight and ring-fencing protections.

17 Finally, Section VII explains why the Proposed Transaction is consistent with the
18 public interest.

19 **Q. Are you sponsoring any exhibits?**

20 A. Yes. Exhibit No. ____ (EMM-2) describes my education, relevant employment
21 experience and other professional qualifications. A schedule entitled “Use of

1 Proceeds,” which identifies in summary fashion how PSE intends to use the
2 proceeds associated with the issuance of the shares governed by the Stock
3 Purchase Agreement, is set forth in Exhibit No. ___(EMM-3). The two pages
4 comprising Exhibit No. ___(EMM-4) are PSE and Puget Energy “Roll-forward
5 Balance Sheets” for the period between September 30, 2007 and September 30,
6 2008, which illustrate the multi-staged plan of recapitalization of PSE and Puget
7 Energy.

8 **II. DESCRIPTION OF CURRENT CHALLENGES**
9 **FACING PSE**

10 **Q. What are the current challenges facing PSE?**

11 A. The Company’s current challenges center on meeting the energy needs of a
12 rapidly growing service territory and replacing aging infrastructure to continue to
13 provide safe and reliable service to our customers. The Puget Sound region,
14 which constitutes a significant part of PSE’s service territory, is experiencing and
15 is projected to continue to experience strong population growth. The population
16 in PSE’s service area is expected to grow by 28 percent – or about 1 million
17 people – over the next 20 years. In addition to providing for the related growth in
18 energy consumption, PSE needs to update and replace its aging power generating
19 and delivery infrastructure and to increase its focus on energy efficiency and
20 renewable energy to comply with new laws.

21 Recognizing the impact of this anticipated substantial growth on its infrastructure
22 and on its need for significant resources, including large amounts of “green”

1 energy, PSE has projected a capital expenditure requirement of approximately
2 \$5.7 billion between 2008 and 2013 and is expecting to expend large annual
3 amounts thereafter. This six-year projected capital investment alone exceeds
4 PSE's net plant valued at \$5.5 billion as of September 30, 2007. As a point of
5 reference, this is the largest capital spending program relative to market
6 capitalization of 13 comparable utilities identified for their significant capital
7 spending plans over the next three years. Stated simply, PSE's capital need is
8 exceptionally large relative to its size.

9 Timely investment in infrastructure of all kinds, including PSE's gas and electric
10 infrastructure, is critical to the long-term economic vitality of the State of
11 Washington. In order to continue to meet the needs of its customers, the
12 community and its shareholders, Puget Energy and PSE recognized that they
13 would have to achieve a business solution which would allow them continued
14 access to capital on reasonable terms as PSE enters this period of significant
15 capital spending to continue to meet the needs of its customers, the community
16 and its shareholders.

17 **Q. What is driving this significant capital investment cycle?**

18 A. The Company's capital expenditures are being driven by a variety of factors.
19 These include: new energy supply projects; infrastructure to serve new gas and
20 electric customers; expansions of the gas and electric system capacity to meet
21 existing and future customer loads; planned reliability improvements and projects
22 needed to comply with various laws and regulations; projects to maintain and

1 strengthen gas and electric systems; and projects to restore and reduce outages;
2 and projects in which PSE is responding to external requirements such as
3 relocating facilities when roads are widened.

4 The Company carefully considers whether various expenditures need to be made.
5 The \$5.7 billion in capital spending that the Company is projecting to spend for
6 the 2008 to 2013 period is a portion of the total estimated cost that the Company
7 believes will be necessary to undertake to continue to provide high quality service
8 to its customers.

9 **Q. How much external capital will be needed to fund such capital investments?**

10 A. For the six-year period 2008 to 2013, after giving account to retained internally
11 generated funds from operations of about \$2.3 billion, an estimated \$3.4 billion
12 will be needed to be acquired from the capital markets to fund these capital
13 investments.

14 **Q. What are the primary drivers of increased investment costs?**

15 A. Customer growth and increases in the cost of construction materials, labor, and
16 services are key drivers of rising investment requirements. Given demographic
17 forecasts for our region over the next twenty years, the Company expects
18 customer growth to continue. Customers are also demanding a higher level of
19 service due to telecommuting, the use of home electronic devices and the
20 increasingly electrically intensive nature of the workplace.

21 Further, the cost of construction materials and electrical equipment continues to

1 escalate at rates above the general rate of price increases. This price escalation is
2 being caused by the global demand for such materials and equipment and a
3 relatively weak U.S. dollar, which makes imported materials such as copper and
4 equipment such as wind turbines and towers more costly than just a few years
5 ago.

6 **Q. In order to meet these challenges facing PSE, why did Puget Energy and PSE**
7 **decide to execute the Merger Agreement rather than to remain a stand-alone**
8 **business or to combine with other strategic or financial partners?**

9 A. Puget Energy and PSE have continually evaluated their financial needs and
10 strategic imperatives with the long view in mind. Asset acquisition, divestiture,
11 merger, combination and strategic alliance are all opportunities considered from
12 time to time by the management and Boards of Puget Energy and PSE. A more
13 complete description of these considerations will be set forth in Puget Energy's
14 Proxy Statement ("Proxy Statement") to be filed with the Securities and Exchange
15 Commission ("SEC") in January 2008.

16 Simply stated, Puget Energy and PSE concluded that partnering with a
17 consortium of committed and experienced infrastructure investors, like the
18 Investor Consortium, that have access to significant investment capital and that
19 are focused on the long-term investment in the U.S. utility business was the best
20 means to balance all the interests of customers, shareholders and employees.
21 Partnering with the Investor Consortium provides a more reliable method of
22 obtaining needed capital now and in the future on reasonable terms without being

1 subject to the vagaries of quarterly and annual earnings forecasts and short-term
2 market reactions. The Investor Consortium's expected infusion of such capital in
3 PSE (through a multi-staged plan of recapitalization) will continue to help
4 strengthen and grow PSE in the years ahead, while providing the same safe,
5 reliable service expected by PSE's customers.

6 **III. DESCRIPTION OF THE**
7 **STOCK PURCHASE AGREEMENT**

8 **Q. Please describe the Stock Purchase Agreement.**

9 A. Pursuant to the Stock Purchase Agreement, the Purchasers agreed to acquire from
10 Puget Energy, and Puget Energy agreed to issue to the Purchasers, 12.5 million
11 shares of Puget Energy's common stock. The Purchasers paid \$23.67 per share of
12 issued common stock, which equates to an aggregate purchase price of
13 approximately \$296 million less approximately \$3 million of transaction expenses
14 (the "Initial Equity Placement").

15 **Q. Have Puget Energy and the Purchasers consummated the Stock Purchase**
16 **Agreement?**

17 A. Yes. Puget Energy and the Purchasers consummated the transactions
18 contemplated by the Stock Purchase Agreement on December 3, 2007. All of the
19 net proceeds from those transactions have been invested as equity capital in PSE
20 by Puget Energy under Recapitalization – Part One. PSE will utilize the net
21 proceeds from Puget Energy to repay short-term debt, which had increased as a

1 result of capital expenditures, debt redemption and working capital needs.

2 Exhibit No. ____ (EMM-3) summarizes PSE's projected uses of the proceeds.

3 **Q. Who are the Purchasers of the Initial Equity Placement?**

4 A. The Purchasers of the Initial Equity Placement are all the investors in the Investor
5 Consortium or their wholly owned indirect subsidiaries. The Purchasers are:
6 Macquarie Infrastructure Partners A, L.P. (14.0%), Macquarie Infrastructure
7 Partners International L.P. (14.6%) and Macquarie Infrastructure Partners
8 Canada, L.P. (3.1%); Padua MG Holdings, Inc. (15.9%); Macquarie FSS
9 Infrastructure Trust (3.7%); CPP Investment Board (USRE II) Inc. ("CPP")
10 (28.1%); 6860141 Canada Inc. in trust for Padua Investment Trust (14.1%);
11 PIP2PX (PAD) Ltd. (3.9%); and PIP2GV (PAD) Ltd. (2.4%).⁵ Please see Exhibit
12 No. ____ (CJL-3) for a glossary describing the entities mentioned above.

13 **Q. Was the Stock Purchase Agreement executed contingent upon Commission**
14 **approval of the Proposed Transaction?**

15 A. No. The Initial Equity Placement made by the Purchasers was not contingent
16 upon Commission approval of the Proposed Transaction. The Purchasers will
17 own the shares associated with the Stock Purchase Agreement and the equity
18 associated with the Initial Equity Placement will remain with PSE regardless
19 whether the Proposed Transaction is consummated.

⁵ Please note that the ownership interests add to 99.8% due to rounding.

1 **Q. Why did Puget Energy decide to execute the Stock Purchase Agreement with**
2 **the Purchasers?**

3 A. The consummation of the Stock Purchase Agreement has enabled Puget Energy
4 and PSE to execute Recapitalization – Part One. Puget Energy executed the
5 Stock Purchase Agreement because of PSE’s commitment to strengthen its
6 balance sheet and financial position. As a result of funding capital expenditures
7 and additional working capital over the past two years with debt, PSE’s equity
8 ratio declined from 44% as of December 31, 2005. To restore PSE’s equity ratio
9 to the authorized 44% level, Puget Energy needed to issue over \$250 million in
10 new equity.

11 As shown on Exhibit No. ____ (EMM-4), which I will describe later in my
12 testimony, the Initial Equity Placement is responsible for the projected
13 improvement of PSE’s common equity ratio, as of September 30, 2008, to 43.7%
14 from 39.6% on a pro forma basis (before reflecting the Proposed Transaction). In
15 addition, Puget Energy believes that the Stock Purchase Agreement represented a
16 preferable source for securing the equity required to finance its needs compared
17 with the public equity and capital markets. Relying on the public equity and
18 capital markets for PSE’s upcoming equity needs, in Puget Energy’s business
19 judgment, would have exposed PSE to substantial risks while the Proposed
20 Transaction is pending. Indeed, as will be described in the Proxy Statement,
21 capital market volatility caused the temporary suspension of merger negotiations
22 while Puget Energy and the Purchasers were discussing the Stock Purchase

1 Agreement in late Summer and early Fall 2007. Importantly, Puget Energy
2 believed that the lack of meaningful precedent for a company attempting to issue
3 equity while simultaneously being subject to a pending merger agreement would
4 have further depressed the offering price for its shares in a public offering. That
5 situation also could have precluded such a sale to long-term investors altogether,
6 realistically leaving only hedge funds and arbitrageurs as potentially interested
7 buyers. All of these reasons led Puget Energy to pursue a private sale of equity to
8 the Purchasers at a favorable price to Puget Energy.

9 **IV. DESCRIPTION OF THE MERGER AGREEMENT AND**
10 **THE PROPOSED TRANSACTION**

11 **A. General Description**

12 **Q. Please generally describe the Merger Agreement.**

13 A. The Merger Parties executed the Merger Agreement on October 25, 2007. A
14 copy of the Merger Agreement is provided as Appendix 1 to the Joint
15 Application. Generally speaking, the Merger Agreement sets forth the terms and
16 conditions of the Proposed Transaction, pursuant to which Puget Holdings will
17 acquire all of the outstanding shares of Puget Energy. Mr. Leslie's testimony
18 provides a more complete description of how the Proposed Transaction will be
19 effected.

1 **Q. Why did Puget Energy decide to execute the Merger Agreement with Puget**
2 **Holdings, Puget Intermediate and Merger Sub and enter into the Proposed**
3 **Transaction?**

4 A. As I indicated earlier in my testimony and as Mr. Stephen Reynolds explains in
5 his testimony, PSE faces significant future capital requirements to meet the
6 growing energy needs of its customers, while continuing to provide safe and
7 reliable service to its dynamic service territory. The Merger Agreement and the
8 Proposed Transaction will provide PSE with about \$700 million of equity over
9 the next eighteen months to support its need for new debt, trade credit, and
10 funding for its growing business, thus helping to insulate it from volatility in the
11 public equity markets. Puget Holdings and the Investor Consortium are
12 comprised of committed and experienced long-term infrastructure investors. As
13 an integral part of a large, financially stable enterprise that includes Puget
14 Holdings and the Investor Consortium, PSE will have reliable access to equity
15 capital on reasonable terms, thus reducing the risks that PSE would have on a
16 stand-alone basis seeking to frequently acquire substantial amounts of equity on
17 reasonable terms. Moreover, the Investor Consortium shares PSE's vision of
18 continuing PSE's aggressive pursuit of cost-effective energy efficiency measures
19 and its plans to procure additional environmentally sustainable energy resources.
20 Consequently, the Merger Agreement and the Proposed Transaction will enhance
21 PSE's ability to maintain its leadership position as an environmental steward and
22 a long-time employer and responsible corporate citizen in Washington. The
23 Merger Agreement and the Proposed Transaction also provide that PSE's

1 customers will continue to receive reliable, responsible and economical energy
2 service from the same team of dedicated local PSE employees. For all of these
3 reasons, PSE's partnering with Puget Holdings and the Investor Consortium will
4 provide a beneficial end result over both the short- and long-term for PSE's
5 customers, its employees and the communities that PSE serves in Central and
6 Western Washington.

7 **Q. If the Proposed Transaction is consummated, will Puget Energy continue to**
8 **be a public company?**

9 A. No. Upon consummation of the Proposed Transaction, Puget Energy will no
10 longer be a public company. Its common stock will be delisted from, and will no
11 longer be traded on, the New York Stock Exchange or any other securities
12 exchange, and will be deregistered under the Securities Exchange Act.

13 **Q. Will PSE continue to file any public financial reports with the SEC?**

14 A. Yes. Because PSE will remain an SEC registrant and its outstanding notes will
15 continue to trade in the public capital markets, PSE will continue to prepare and
16 file the same comprehensive financial reports with the SEC that it does today.

17 **Q. Will PSE continue to be a regulated utility upon completion of the Proposed**
18 **Transaction?**

19 A. Yes. PSE will continue to be subject to the regulations of the Commission and,
20 among other agencies, the Federal Energy Regulatory Commission ("FERC").

1 **B. Progression of the Merger Agreement and the Proposed Transaction**

2 **1. Timeframe of the Proposed Transaction**

3 **Q. When do the Merger Parties expect the Proposed Transaction to be**
4 **completed?**

5 A. The Merger Parties expect to complete the Proposed Transaction in the second
6 half of 2008, subject to, among other conditions set forth in the Merger
7 Agreement, receipt of all the customary regulatory approvals.

8 **2. Regulatory Filings and Approvals**

9 **Q. Please describe the regulatory filings and approvals needed to consummate**
10 **the Proposed Transaction.**

11 A. As a condition to each Merger Party's obligation to consummate the Proposed
12 Transaction, Puget Energy and Puget Holdings must obtain customary approvals,
13 consents or waivers from, or make filings with, a number of regulatory
14 authorities. In addition to the Commission's approval, Puget Sound Energy and
15 Puget Holdings must obtain approvals from FERC under the Federal Power Act
16 and from the Federal Communications Commission under the Communications
17 Act of 1934, as amended by the Telecommunications Act of 1996. Moreover,
18 filings must be made with the Department of Justice and the Federal Trade
19 Commission pursuant to the Hart-Scott-Rodino Act, and with the U.S. Committee
20 on Foreign Investment, pursuant to the Exon-Florio Amendment to the Defense
21 Production Act of 1950.

1 **Q. Do the Merger Parties believe that they will satisfy all the regulatory**
2 **requirements needed for the Proposed Transaction to be consummated?**

3 A. Yes. The Merger Parties believe that they will receive the required consents and
4 approvals needed to complete the Proposed Transaction. If additional approvals,
5 consents and/or filings are required to complete the Proposed Transaction, the
6 Merger Parties contemplate that such consents, approvals and/or filings will be
7 sought.

8 **3. Operations Prior to the Closing of the Proposed Transaction**

9 **Q. How do Puget Energy and PSE plan to operate their business activities until**
10 **the closing of the Proposed Transaction?**

11 A. Until the closing of the Proposed Transaction, Puget Energy and PSE will operate
12 in the ordinary and usual course of business, consistent with past practice and in a
13 manner substantially consistent in all material respects with the financial
14 assumptions of their business models and evolving law and regulation. Moreover,
15 Puget Energy and PSE will use commercially reasonable efforts to preserve their
16 business organizations, maintain existing relations with their employees and third
17 parties and continue all material governmental permits, franchises and other
18 operational authorizations.

19 **Q. How will Puget Energy and PSE interact with Puget Holdings and its**
20 **affiliates until the closing of the Proposed Transaction?**

21 A. Even though Puget Energy and PSE will not be affiliated with Puget Holdings and

1 its affiliates until the closing of the Proposed Transaction, Puget Energy and PSE
2 have agreed to interact with Puget Holdings and its affiliates during such time in a
3 manner consistent with Commission and FERC rules.

4 **C. Consideration to be Received by Shareholders of Puget Energy's**
5 **Common Stock**

6 **Q. What will become of Puget Energy's common stock and current**
7 **shareholders after the Proposed Transaction is completed?**

8 A. After the Proposed Transaction is completed, there will be no public market for
9 shares of Puget Energy's common stock, and Puget Energy's current shareholders
10 will cease to have any ownership interest in Puget Energy or rights as Puget
11 Energy shareholders.

12 **Q. What consideration will Puget Energy's shareholders receive upon**
13 **completion of the Proposed Transaction?**

14 A. Each issued and outstanding share of Puget Energy common stock (par value
15 \$0.01 per share) will be converted into the right to receive \$30.00 in cash, without
16 interest and less any applicable withholding tax (the "Consideration").

17 **Q. Please compare the level of the Consideration with the current value of**
18 **issued and outstanding shares of Puget Energy common stock.**

19 A. The \$30.00 per share represents over a 25% premium based upon Puget Energy's
20 closing share price on October 25, 2007, the last trading day prior to the

1 announcement of the Proposed Transaction. On that date, the closing price of
2 Puget Energy's common stock was \$23.95 per share.

3 **Q. What is the total equity market value of the Consideration?**

4 A. The Consideration has a total equity market value of approximately \$3.52 billion,
5 based upon the approximately 117.2 million of Puget Energy's common shares
6 outstanding on the date of execution of the Merger Agreement (which does not
7 reflect the 12.5 million of Puget Energy's common shares issued to the Purchasers
8 pursuant to the Stock Purchase Agreement).

9 **D. Funding the Proposed Transaction**

10 **Q. How will Puget Holdings and Merger Sub fund the Proposed Transaction?**

11 A. Puget Holdings and Merger Sub have arranged to fund the Proposed Transaction
12 through shareholder funding, debt assumption and debt financing.

13 **Q. What would happen if any portion of these funding mechanisms were to
14 become unavailable?**

15 A. Under the Merger Agreement, if any portion of the committed funding
16 mechanisms were to become unavailable on the terms and conditions
17 contemplated, Puget Holdings has agreed, as promptly as practicable, to use its
18 reasonable best efforts to arrange to obtain alternative funding from other sources
19 in an amount sufficient to consummate the Proposed Transaction.

1 **Q. Are the obligations of Puget Holdings and Merger Sub under the Merger**
2 **Agreement conditioned in any manner on their obtaining funding?**

3 A. No. The Merger Agreement contains no condition that Puget Holdings and
4 Merger Sub obtain funding. The Merger Agreement provides that the failure, for
5 any reason, of Puget Holdings or Merger Sub to have sufficient cash available on
6 the Closing Date of the Proposed Transaction to pay the Consideration will
7 constitute a breach of the Merger Agreement by Puget Holdings and would entitle
8 Puget Energy to damages. That is, the obligation of Puget Holdings and Merger
9 Sub to close the Proposed Transaction is not subject to any equity investment or
10 debt financing contingency.

11 **1. Shareholder Funding and Debt Assumption**

12 **Q. Please describe the shareholder funding that Puget Holdings and Merger**
13 **Sub have obtained in connection with the Proposed Transaction.**

14 A. Members of the Investor Consortium have agreed to contribute an aggregate
15 investor contribution amount of approximately \$3.2 billion to Puget Holdings and
16 Merger Sub in connection with the Proposed Transaction and Stock Purchase
17 Agreement.

18 **Q. Have the members of the Investor Consortium agreed to assume indirectly**
19 **any debt of Puget Energy as a result of the Proposed Transaction?**

20 A. Yes. The members of Puget Holdings will assume indirectly approximately \$2.6
21 billion of Puget Sound Energy's redeemable securities and outstanding debt

1 obligations. These debt obligations will remain at the PSE corporate level,
2 subject to the implementation of the multi-part recapitalization plan that I will
3 address later in my testimony.

4 **2. Debt Financing**

5 **Q. Please describe the bank financing agreements that Puget Holdings and**
6 **Merger Sub have obtained in connection with the Proposed Transaction.**

7 A. Puget Holdings has received debt financing commitment letters from Barclays
8 Bank PLC and Dresdner Bank AG New York Branch (collectively, the “Banks”).
9 Under each commitment letter, each Bank has agreed to provide one-half of the
10 following amounts in connection with the consummation of the Proposed
11 Transaction: (1) up to \$1.425 billion principal amount of senior unsecured term
12 loan facility at Merger Sub/Puget Energy; (2) up to \$1 billion principal amount
13 senior unsecured capital expenditure facility at Merger Sub/Puget Energy; (3) a
14 senior unsecured capital expenditure facility of up to \$400 million principal
15 amount at PSE; (4) a senior unsecured energy hedging facility of up to \$350
16 million principal amount at PSE; and (5) a senior unsecured liquidity facility for
17 working capital of up to \$400 million principal amount at PSE.

18 **Q. What would happen if the Banks withdrew their agreement to finance the**
19 **Proposed Transaction?**

20 A. As I stated earlier in my testimony, Puget Holdings and Merger Sub would not be
21 absolved of their obligation to close the Proposed Transaction if they were to fail

1 to obtain financing from the Banks. Failure to have sufficient cash available on
2 the Closing Date of the Proposed Transaction to pay the Consideration, however,
3 would constitute a breach of the Merger Agreement by Puget Holdings and entitle
4 Puget Energy to damages.

5 **V. MULTI-PART PLAN OF RECAPITALIZATION**

6 **Q. Please describe Exhibit No. ___(EMM-4), which illustrates the multi-part**
7 **plan of recapitalization of PSE and Puget Energy.**

8 A. Each page of Exhibit No. ___(EMM-4) is a balance sheet; page 1 is PSE's
9 balance sheet and page 2 is Puget Energy's balance sheet. From top to bottom,
10 the rows first balance PSE's and Puget Energy's respective assets with their
11 respective capitalization and liabilities, and then compute PSE's and Puget
12 Energy's respective capital structure. From left to right, the columns show:
13 (1) actual balance sheet amounts at September 30, 2007; (2) pro forming
14 adjustments made to the actual amounts at September 30, 2007, to reflect the
15 Initial Equity Placement and dividend payments (but not the Proposed
16 Transaction); (3) the pro forma balance sheet amounts at September 30, 2008, that
17 reflect the Initial Equity Placement and dividend payments (but not the Proposed
18 Transaction); (4) additional pro forming adjustments made to the pro forma
19 amounts at September 30, 2008, to reflect the Proposed Transaction and the post-
20 Closing equity infusion (in addition to the Initial Equity Placement and dividend
21 payments); and (5) the pro forma balance sheet amounts at September 30, 2008,
22 that reflect the Proposed Transaction and the post-Closing equity infusion (in

1 addition to the Initial Equity Placement and dividend payments).

2 **Q. How is your testimony regarding Exhibit No. ___(EMM-4) structured?**

3 A. My testimony regarding Exhibit No. ___(EMM-4) is divided in four subsections.
4 Each of the first three subsections reflects one of the three stages of the plan of
5 recapitalization of PSE and Puget Energy. First, I will explain the pro forming
6 adjustments made to PSE's and Puget Energy's respective actual balance sheet
7 amounts at September 30, 2007 to reflect the Initial Equity Placement and
8 dividend payments (*i.e.*, Recapitalization – Part One). Second, I will describe the
9 pro forming adjustments made to PSE's and Puget Energy's respective pro forma
10 amounts at September 30, 2008 to reflect the Proposed Transaction (*i.e.*,
11 Recapitalization – Part Two). Third, I will discuss the pro forming adjustments
12 associated with an additional investment in PSE that is expected to be made after
13 the Proposed Transaction has closed (*i.e.*, Recapitalization – Part Three). Fourth,
14 I will demonstrate that this multi-staged plan of recapitalization is projected to
15 significantly improve the balance sheets of PSE and Puget Energy.

16 **Q. Are any pro forming adjustments made to PSE's and Puget Energy's actual**
17 **balance sheet amounts at September 30, 2007, before reflecting**
18 **Recapitalization – Part One?**

19 A. Yes. Columns "a" on pages 1 and 2 of Exhibit No. ___(EMM-4) reflect the
20 operating results for PSE and Puget Energy, respectively, from October 1, 2007
21 through September 30, 2008, before incorporating the Initial Equity Placement

1 and dividend payments. These operating results are derived from PSE's 2007
2 Updated Business Plan and are contemplated in the 2008 Operating Budget.

3 **A. Recapitalization – Part One**

4 **Q. What pro forming adjustments are made to PSE's and Puget Energy's pro**
5 **forma balance sheet amounts at September 30, 2008 in order to reflect the**
6 **Initial Equity Placement and dividend payments?**

7 A. The pro forming adjustments made to reflect the Initial Equity Placement and
8 dividend payments are shown under columns "b" and "c" on Exhibit
9 No. ___(EMM-4), page 1 (PSE) and under columns "b" through "e" on Exhibit
10 No. ___(EMM-4), page 2 (Puget Energy).

11 **Q. What are the adjustments to PSE's and Puget Energy's actual balance sheet**
12 **amounts to reflect the Initial Equity Placement?**

13 A. There are several adjustments that reflect the Initial Equity Placement. Column
14 "b" on Exhibit No. ___(EMM-4), page 2, shows Puget Energy's sale of 12.5
15 million shares of common stock to the Purchasers in December 2007 for
16 approximately \$296 million less approximately \$3 million of transaction
17 expenses. Shortly after the Purchasers made the Initial Equity Placement, Puget
18 Energy invested approximately \$293 million of additional equity in PSE. This
19 investment is displayed under column "c" on Exhibit No. ___(EMM-4), page 2.
20 PSE used this investment to redeem an equivalent amount of its short-term debt,
21 as reflected under column "b" on Exhibit No. ___(EMM-4), page 1. Finally,

1 Puget Energy made a consolidating entry related to the redemption of PSE's
2 short-term debt of \$293 million principal amount, which is recorded under
3 column "d" on Exhibit No. ____ (EMM-4), page 2.

4 **Q. Under this Recapitalization – Part One, is Puget Energy prohibited from**
5 **paying regular dividends to its shareholders?**

6 A. No. One of the reasons why Puget Energy's Board decided that the Stock
7 Purchase Agreement was in the best interests of the shareholders was because it
8 enabled Puget Energy to continue paying regular dividends to shareholders prior
9 to the consummation of the Proposed Merger.

10 **Q. Has Puget Energy recently paid regular dividends to its shareholders?**

11 A. Yes. Puget Energy most recently paid regular cash dividends to its shareholders
12 on November 15, 2007, at the current quarterly rate of \$0.25 per share.

13 **Q. Have Puget Energy and PSE reflected that dividend payments in Exhibit**
14 **No. ____ (EMM-4)?**

15 A. Yes. Columns "c" and "e" of Exhibit No. ____ (EMM-4), pages 1 and 2,
16 respectively, reflect the dividend of November 15, 2007, at the currently quarterly
17 rate of \$0.25 per share and the estimated dividend payments through August 15,
18 2008 plus an estimated prorated share due September 30, 2008.

1 **B. Recapitalization – Part Two**

2 **Q. What pro forming adjustments are made to PSE’s and Puget Energy’s pro**
3 **forma balance sheet amounts at September 30, 2008 in order to reflect the**
4 **Proposed Transaction?**

5 A. The pro forming adjustments made to reflect the Proposed Transaction are shown
6 under column “d” on Exhibit No. ___(EMM-4), page 1 (PSE) and under columns
7 “f” through “l” on Exhibit No. ___(EMM-4), page 2 (Puget Energy).

8 **Q. Does Exhibit No. ___(EMM-4) reflect the Consideration that the members of**
9 **the Investor Consortium will pay to Puget Energy shareholders associated**
10 **with the Proposed Transaction?**

11 A. Yes. The cash payments to be made by the Investor Consortium to Puget Energy
12 shareholders, equal to approximately \$3.5 billion, is reflected under column “h”
13 of Exhibit No. ___(EMM-4), page 2.

14 **Q. Does Exhibit No. ___(EMM-4) also show the impact of the Investor**
15 **Consortium’s approximately \$3.2 billion investment to fund the purchase of**
16 **Puget Energy?**

17 A. Yes. The goodwill related to the Investor Consortium’s investment to fund the
18 Proposed Transaction is recorded under column “f” of Exhibit No. ___(EMM-4),
19 page 2. As I will discuss later in my testimony, the Merger Parties have
20 committed to not seek recovery in PSE’s rates of the goodwill (or acquisition
21 premium) associated with the Proposed Transaction.

1 **Q. How is the debt amount associated with the Proposed Transaction recorded**
2 **on Exhibit No. ___(EMM-4)?**

3 A. The merger of Puget Energy and Merger Sub, and the related cash, debt, goodwill
4 and amount owed to Puget Energy shareholders as a result of that transaction, is
5 recorded under column “g” of Exhibit No. ___(EMM-4), page 2.

6 **Q. As part of Recapitalization – Part Two, has the Investor Consortium**
7 **committed to securing credit facilities on behalf of PSE?**

8 A. Yes. In connection with the Proposed Transaction, the Investor Consortium has
9 committed to securing credit facilities of at least \$1.15 billion on behalf of PSE.
10 This is comprised of the two \$400 million credit facilities and the \$350 million
11 hedging facility described earlier in my testimony.

12 **Q. What is the purpose of the Investor Consortium securing such credit**
13 **facilities?**

14 A. PSE’s current short-term bank facilities used for working capital and hedging
15 activity will be paid down and extinguished upon closing. The credit facilities
16 arranged by the Investor Consortium, upon the closing of the Proposed
17 Transaction, will replace such existing facilities and assist PSE to fund its capital
18 expenditure program and working capital needs and to support energy hedging
19 activities.

1 **Q. How will PSE reflect the costs associated with the new credit facilities?**

2 A. PSE will amortize the costs associated with the new credit facilities over the life
3 of the new facilities, as recorded under column “d” on Exhibit No. ___(EMM-4),
4 page 1.

5 **Q. Will any of PSE’s short-term debt be redeemed as a result of the Proposed**
6 **Transaction?**

7 A. Yes. Column “i” of Exhibit No. ___(EMM-4), page 2, shows that approximately
8 \$265 million of PSE’s estimated short-term debt outstanding will be redeemed
9 through the Proposed Transaction.

10 **Q. Are there transaction costs associated with the Proposed Transaction?**

11 A. Yes. Puget Energy and the Investor Consortium have transaction costs associated
12 with the Proposed Transaction. Such transaction costs, recorded under column
13 “j” on page 2 of Exhibit No. ___(EMM-4), relate to consultant fees, the vesting of
14 its employee stock as a result of the Proposed Transaction and the dividend
15 needed to pay the excise tax owed by shareholders on the Proposed Transaction.

16 **C. Recapitalization – Part Three**

17 **Q. What is the purpose of Recapitalization – Part Three?**

18 A. In the third stage of the plan of recapitalization, the Investor Consortium, through
19 Puget Energy, expects to invest an additional \$393 million of equity in PSE after

1 the Proposed Transaction has closed. This additional investment is reflected
2 under column “k” of Exhibit No. ____ (EMM-4), page 2 (Puget Energy), and under
3 column “e” of Exhibit No. ____ (EMM-4), page 1 (PSE).

4 **Q. Why isn’t this additional investment implemented as part of Recapitalization**
5 **– Part Two?**

6 A. This additional investment cannot be implemented as part of Recapitalization –
7 Part Two because it likely will take a few months after the closing of the
8 Proposed Transaction to exercise the “make whole” provision under the bonds
9 that PSE anticipates will be redeemed with the proceeds of the additional equity
10 investment (as indicated next in my testimony).

11 **Q. How does PSE plan to use the funds associated with this additional**
12 **investment?**

13 A. PSE anticipates that it will use the funds associated with this additional
14 investment to redeem approximately \$375 million principal amount of its long-
15 term debt (and to pay the approximately \$18.9 million in redemption premiums
16 that will be due). Column “f” of Exhibit No. ____ (EMM-4), page 1, depicts this
17 use of funds. Upon PSE’s redemption of its long-term debt, Puget Energy will
18 make a consolidating entry on its balance sheet, as shown under column “l” of
19 Exhibit No. ____ (EMM-4), page 2, along with PSE’s consolidation adjustment for
20 line of credit fees.

1 **Q. What is the plan after the closing of the Proposed Transaction with respect to**
2 **the issuance of additional long-term debt?**

3 A. The present plan is to continue to access the public debt markets for long-term
4 debt with registered debt instruments to pay down short-term debt balances from
5 time to time as market conditions warrant.

6 **D. Projected Impact of Multi-Part Plan of Recapitalization**

7 **Q. What is the expected impact of the three-part plan of recapitalization on**
8 **PSE's and Puget Energy's capital structures?**

9 A. As shown on Exhibit No. ___(EMM-4), pages 1 and 2, and in Table 1 below, the
10 three-staged plan of recapitalization is projected to produce a stronger balance
11 sheet for PSE and a comparable equity-to-debt ratio at Puget Energy.

12 **Table 1**

Company	Actual Equity / Debt Ratio (at 09/30/07)	Pro Forma Equity / Debt Ratio (at 09/30/08) (reflecting Recapitalization – Part One)	Pro Forma Equity / Debt Ratio (at 09/30/08) (reflecting Recapitalization – Parts One, Two and Three)
PSE	39.6% / 60.4%	43.7% / 56.3%	50.4% / 49.6%
Puget Energy	40.0% / 60.0%	44.1% / 55.9%	42.0% / 58.0%

1 less than 44% thereafter, unless the Commission uses a different capital structure
2 for ratemaking purposes.

3 **Q. Have the Joint Applicants made a commitment regarding PSE's return on**
4 **equity for ratemaking purposes?**

5 A. Yes. Commitment No. 25 states that the Joint Applicants will not advocate for a
6 higher return on equity as compared with what PSE's return on equity would have
7 been absent Puget Holdings' ownership.

8 **Q. How will the Proposed Transaction affect PSE's access to equity capital?**

9 A. As described in detail in the testimony of Mr. Christopher Leslie, the Investor
10 Consortium has indicated its understanding of and commitment to the business
11 model and capital needs of PSE. As described earlier in my testimony and as
12 presented in Exhibit No. ___(EMM-4), the Investor Consortium will invest about
13 \$700 million of equity in PSE by the time PSE redeems certain term debt shortly
14 after closing. Thereafter, the Investor Consortium has committed to maintaining
15 PSE's common equity ratio at not less than 44%, provided not less than such
16 amount is reflected in rates (Commitment No. 11).

17 **Q. How will the Proposed Transaction affect PSE's access to the debt markets?**

18 A. PSE will still access the capital markets for long-term fixed income securities,
19 such as senior secured notes, mortgage bonds (after the "substitution date" of the
20 fall away mortgage structure), unsecured debt and hybrid securities such as the

1 junior subordinated notes. PSE may or may not enter into commercial paper
2 agent agreements -- if so, the credit facilities will be used as a back stop to
3 commercial paper; if not, PSE will have access to short-term funds directly
4 through the credit facilities. Equity investments into PSE will be made by Puget
5 Energy.

6 **Q. Will the basis of presentation of PSE's financial statements change as a result**
7 **of the consummation of the Proposed Transaction?**

8 A. No. PSE's financial statements will continue to be maintained and presented in
9 accordance with Generally Acceptable Accounting Principles and FERC
10 accounting rules.

11 **B. Corporate and Debt Credit Rating**

12 **Q. Will PSE maintain its own corporate and debt credit ratings after the**
13 **Proposed Transaction is closed?**

14 A. Yes. Commitment No. 10 states that PSE will maintain its own corporate and
15 debt credit ratings, as well as ratings for long-term debt and preferred stock.

1 **Q. What are the corporate and debt credit ratings currently assigned to Puget**
2 **Energy and PSE?**

3 A. The Puget Energy and PSE credit ratings are as follows:

4 **PUGET ENERGY / PSE CREDIT RATINGS**

Security	S&P	Moody's
Corporate credit/issuer rating	BBB- / BBB-	Ba1 / Baa3
Senior Secured Debt	N/A / BBB+	N/A / Baa2
Junior Subordinated Notes	N/A / BB	N/A / Ba1
Preferred Stock	N/A / BB	N/A / Ba2
Commercial Paper	N/A / A-3	N/A / P-2

5 **Q. Will the Proposed Transaction affect the corporate and debt credit ratings of**
6 **PSE?**

7 A. The credit ratings of PSE are not expected to change immediately as a result of
8 the Proposed Transaction. For example, Moody's affirmed PSE's long-term
9 ratings upon the announcement of the Proposed Transaction. However, over the
10 longer term, PSE's stronger capital structure, when combined with gradually
11 improving earnings, will support a case for improved credit ratings at PSE.

1 **C. Accounting**

2 **Q. Do the Joint Applicants make any commitment relating to recovery of the**
3 **acquisition premium associated with the Proposed Transaction?**

4 A. Yes. PSE and Puget Holdings agree in Commitment No. 22 that they will not
5 seek recovery of the acquisition premium in PSE's rates.

6 **Q. Do the Joint Applicants make any commitment concerning the recovery of**
7 **legal and financial advisory fees associated with the Proposed Transaction?**

8 A. Yes. PSE and Puget Holdings also agree in Commitment No. 22 that they will
9 not request recovery of legal and financial advisory fees associated with the
10 Proposed Transaction in PSE's rates.

11 **D. Commission Oversight**

12 **Q. Does the Merger Agreement require Commission approval before PSE can**
13 **encumber itself in favor of Puget Energy or Puget Holdings?**

14 A. Yes. Commitment No. 9(ii) prohibits PSE from loaning or pledging utility assets
15 to Puget Energy or Puget Holdings without Commission approval.

16 **Q. Will PSE keep its books and records separate from the books and records of**
17 **Puget Holdings, Puget Energy and their affiliates?**

18 A. Yes. Commitment No. 9(i) states that PSE will maintain separate books and
19 records.

1 **Q. In the Merger Agreement, did the Joint Applicants make any commitments**
2 **regarding Commission access to books, records and other documentation?**

3 A. Yes. Commitment No. 20 states that Puget Holdings and PSE will make
4 reasonable commitments, consistent with recent Commission orders, to provide:
5 (1) access to PSE's books and records; (2) access to financial information and
6 filings that relate to PSE; (3) audit rights with respect to the documents
7 supporting any costs that may be allocable to PSE; and (4) access to PSE's board
8 minutes, audit reports and information provided to credit rating agencies
9 pertaining to PSE. Moreover, Commitment No. 21(i) requires PSE to file cost
10 allocation methodologies for apportioning PSE's costs related to Puget Energy or
11 Puget Holdings.

12 **Q. Have the Joint Applicants, in fact, agreed to the requirements referenced in**
13 **Commitment Nos. 20 and 21?**

14 A. Yes. Following execution of the Merger Agreement, the Joint Applicants have
15 made extensive commitments regarding Commission access to books, records and
16 other documentation. The commitments address, among other topics:

- 17 • Maintenance of separate books and records (Commitment
18 Nos. 27(a), 28(a));
- 19 • Access to books and records (Commitment No. 28(b)), accounts,
20 books, papers and documents (Commitment No. 28(c)) and credit
21 rating documentation (Commitment No. 28(d));
- 22 • Documentation regarding cost allocation methodologies
23 (Commitment Nos. 29(a) and 29(b));
- 24 • Compliance with all applicable provisions of Title 80 RCW,
25 including those pertaining to transfers of property under Chapter

1 80.12 RCW, affiliated interests under Chapter 80.16 RCW, and
2 securities and the assumption of obligations and liabilities under
3 Chapter 80.08 RCW (Commitment No. 29(c));

- 4 • Compliance with the Commission's then-existing practice with
5 respect to the ratemaking treatment of affiliate transactions;
6 provided that PSE would not be prohibited from proposing a
7 different ratemaking treatment for the Commission's consideration
8 (Commitment No. 29(d)); and
- 9 • Bear the burden of proof in any general rate case that any
10 corporate and affiliate cost allocation methodology it proposes is
11 reasonable for ratemaking purposes (Commitment No. 29(e)).

12 **Q. Have the Joint Applicants committed to notify the Commission of certain**
13 **transactions as soon as those transactions are publicized?**

14 A. Yes. Following approval of Puget Holdings' Board of Managers and any public
15 announcement, the Joint Applicants will notify the Commission as soon as
16 practicable (pursuant to Commitment No. 27(b)) of: (1) any acquisition of a
17 regulated or unregulated business representing 5 percent or more of the
18 capitalization of Puget Holdings; or (2) the change in effective control or
19 acquisition of any material part or an of PSE by any other firm, whether by
20 merger, combination, transfer of stock or assets.

21 **Q. Has PSE committed to file a periodic report with the Commission regarding**
22 **the implementation of these and the other numbered commitments?**

23 A. Yes. Commitment No. 33 requires PSE to file annually, by June 1 (between 2009
24 and 2013), a compliance report describing how Commitments Nos. 1-34 have
25 been implemented. If any of the Commitment Nos. 1-34 is not being met, the
26 report is required to provide proposed corrective measures and target dates for

1 completion of such measures.

2 **E. Ring-Fencing Provisions**

3 **Q. What does the term “ring-fencing” mean?**

4 A. Generally speaking, the term “ring-fencing” means the act of insulating a
5 company, in this case a regulated utility (*i.e.*, PSE), and its customers from any
6 impact of the financial activities of its corporate affiliates and other potential
7 implications associated with the utility being or becoming a part of a holding
8 company structure.

9 **Q. Has the Commission approved ring-fencing provisions in connection with**
10 **recent transactions?**

11 A. Yes. Most recently, the Commission has approved ring-fencing provisions in its
12 orders approving the acquisition of PacifiCorp by MidAmerican Energy Holding
13 Company (2006) (“MEHC/PacifiCorp Transaction”),⁶ the reorganization of
14 Avista Corporation (2007) (“Avista Transaction”)⁷ and the acquisition of Cascade
15 Natural Gas Corporation by MDU Resources Group, Inc. (2007) (“MDU/Cascade
16 Transaction”).⁸

⁶ Docket No. UE-051090, *Order No. 7* (issued February 22, 2006) (“MEHC/PacifiCorp Order”), at 16.

⁷ Docket No. U-060273, *Order 03* (issued February 28, 2007) (“Avista Order”), at 21-22.

⁸ Docket No. UG-061721, *Order 06* (issued June 27, 2007) (“MDU/Cascade Order”), at 17.

1 **Q. Has the Commission identified specific goals of ring-fencing provisions?**

2 A. Yes. The Avista Order (at ¶ 21) states that:

3 Ring-fencing provisions are intended to isolate utility operations
4 from any negative financial impacts flowing from unregulated
5 units: (1) to ensure that the utility maintains a strong credit rating
6 and can attract capital; (2) to prevent cross-subsidization of non-
7 regulated ventures; and (3) to ensure regulators' access to timely
8 and accurate information.

9 **Q. Have the Joint Applicants committed to implement ring-fencing provisions**
10 **through the Merger Agreement and the Joint Application?**

11 A. Yes. As described more fully in Mr. Leslie's testimony, the Merger Agreement
12 and the Joint Application contain an extensive list of ring-fencing provisions
13 intended to isolate PSE and its customers from the financial activities of other
14 entities in the Puget Holdings group. I have already discussed in my testimony
15 many of the ring-fencing provisions to which the Joint Applicants have
16 committed.

17 **Q. Do the ring-fencing provisions to which the Joint Applicants have committed**
18 **fulfill all three Commission goals of such provisions?**

19 A. Yes. The Joint Applicants have committed to ring-fencing provisions that will:
20 (1) ensure that PSE maintains a strong credit rating and can attract capital; (2)
21 prevent cross-subsidization of non-regulated ventures; and (3) ensure the
22 Commission's access to timely and accurate information.

1 **Q. How will the Joint Applicants’ ring-fencing provisions ensure that PSE**
2 **maintains a strong credit rating and can attract capital?**

3 A. The Joint Applicants have made an overarching commitment that recognizes
4 “PSE’s need for significant amounts of capital to invest in its energy supply and
5 delivery infrastructure and commits that meeting these capital requirements will
6 be considered a high priority by the Boards of Puget Holdings and PSE.”
7 (Commitment No. 2). Other key ring-fencing provisions proposed by the Joint
8 Applicants demonstrate the conviction to this overarching commitment. For
9 example, PSE will have its own credit rating (Commitment No. 10), capital
10 structure (Commitment Nos. 10 and 11) and books and records (Commitment
11 No. 9). In addition, PSE will be prohibited from having any diversified holdings
12 and investments following Commission approval of the Proposed Transaction
13 (Commitment No. 27(a)). Moreover, PSE generally will hold PSE customers
14 harmless from any business and financial risk exposures associated with Puget
15 Energy, Puget Holdings and its other affiliates (Commitment No. 9(iii)). Finally,
16 PSE commits to a common equity ratio for PSE of not less than 50% at closing or
17 shortly thereafter, and not less than 44% thereafter except to the extent a lower
18 equity ratio is established for ratemaking purposes by the Commission
19 (Commitment No. 9(iii)).

20 **Q. Please identify the ring-fencing provisions that will prevent cross-**
21 **subsidization of non-regulated ventures.**

22 A. The Joint Applicants have proposed a variety of ring-fencing provisions that will

1 ensure the implementation of appropriate cost allocation principles and standards
2 and will shield PSE from being subject to cross-subsidization (Commitment Nos.
3 21, 27(a)).

4 **Q. Will the Joint Applicants' proposed ring-fencing provisions ensure the**
5 **Commission's access to timely and accurate information?**

6 A. Yes (Commitment Nos. 20, 21, 28, and 29). Earlier in my testimony, I discussed
7 at length the Joint Applicants' commitment to these ring-fencing provisions.

8 **Q. Please describe the term "non-consolidation opinion."**

9 A. A non-consolidation opinion is a legal document from outside counsel concluding
10 that certain ring-fencing provisions are sufficient that a bankruptcy court would
11 not order the substantive consolidation of the assets and liabilities of a utility with
12 those of the utility's parent company or the parent company's affiliates or
13 subsidiaries.

14 **Q. Are the Joint Applicants committed to obtaining a non-consolidation opinion**
15 **regarding the ring-fencing provisions being proposed?**

16 A. Yes. Commitment No. 8 states that PSE and Puget Holdings will file a non-
17 consolidation opinion with the Commission within 90 days of completing the
18 Proposed Transaction. The non-consolidation opinion will conclude that the ring-
19 fencing provisions proposed by the Joint Applicants are sufficient that a
20 bankruptcy court would not order the substantive consolidation of the assets and

1 liabilities of PSE with those of Puget Energy or Puget Energy's affiliates or
2 subsidiaries.

3 **Q. Do you believe that the ring-fencing provisions being proposed are sufficient**
4 **to obtain such a non-consolidation opinion?**

5 A. Yes.

6 **Q. If the proposed ring-fencing provisions were insufficient to obtain such a**
7 **non-consolidation opinion, what course of action would the Joint Applicants**
8 **take?**

9 A. Assuming, solely for the sake of argument, that the proposed ring-fencing
10 provisions were not sufficient to obtain such a non-consolidation opinion, the
11 Joint Applicants have agreed to cure that situation (Commitment No. 26(a)). In
12 such an event, PSE and Puget Holdings would: (1) promptly notify the
13 Commission of their inability to obtain a non-consolidation opinion; (2) propose
14 and, upon Commission approval, implement such ring-fencing provisions that
15 would be sufficient that a bankruptcy court would not so order such substantive
16 consolidation; and (3) obtain a non-consolidation opinion.

17 **Q. Will PSE's Board of Directors have an independent director?**

18 A. Yes. Commitment No. 17 provides that

19 at least one director of PSE will be an independent Independent
20 director Director who is not a member, stockholder, director
21 (except as such Independent Director of PSE), officer, or employee
22 of Puget Holdings or its affiliates. The organizational documents

1 for PSE will not permit PSE, without the unanimous consent of all
2 its directors including the Independent Director, to consent to the
3 institution of bankruptcy proceedings or the inclusion of PSE in
4 bankruptcy proceedings. The Chief Executive Officer of PSE will
5 be a member of the board of PSE.

6 Exhibit No. ____ (CJL-7) at 2.

7 **Q. Will PSE's Independent Director serve a special function?**

8 A. Yes. In connection with the Joint Applicants' ring-fencing commitments, PSE's
9 "consent to the institution of bankruptcy proceedings or the inclusion of PSE in
10 bankruptcy proceedings" will be contingent upon PSE's Independent Director,
11 along with all of the other members of PSE's Board of Directors, voting in favor
12 of such action (Commitment No. 17). Thus, even if all of PSE's Board members
13 (exclusive of the Independent Director) were to affirmatively vote in favor of PSE
14 commencing or including PSE in bankruptcy proceedings, PSE could not do so if
15 PSE's Independent Director did not concur.

16 **Q. Why will the Independent Director serve on the Board of Directors of PSE**
17 **instead of Puget Energy?**

18 A. Commitment No. 17 in Exhibit B to the Merger Agreement placed this
19 Independent Director at Puget Energy. Subsequent to the execution of that
20 agreement, however, the Joint Applicants agreed to place this Independent
21 Director at the operating utility to better protect the utility from any nonregulated
22 activities of any affiliates.

1 **Q. Is the rationale for the Independent Director serving this special function**
2 **well chronicled?**

3 A. Yes. For example, a frequently-quoted article entitled “Ring-Fencing a
4 Subsidiary,” written by Standard & Poor’s (“S&P”) Credit Analyst James Penrose
5 in October 1999, explained why the independent director was the “operative
6 feature” in the context of a “ring-fenced” transaction:

7 Absent any stipulation to the contrary, a company’s directors have
8 a fiduciary duty to its shareholders. The fiduciary duties of the
9 subsidiary’s directors are understood to include the execution of
10 the parent’s instructions, including an order to file the subsidiary
11 into bankruptcy voluntarily.... To ensure that this duty is fulfilled
12 properly, ... the affirmative vote of the independent director, an
13 individual with no tie or relationship to the parent [is required]....
14 [T]he independent director [is required] to take into account the
15 interests of the creditors of the subsidiary (including the holders of
16 the rated debt), in addition to the interests of the shareholding
17 parent, when deciding to file.

18 Another example is an August 2003 article in The National Law Journal, entitled
19 “Brave new world of big defaults” and written by Gary Saunders. The article
20 explained that the independent director is a common method to address the risk of
21 a parent company causing its utility subsidiary to file for bankruptcy.

22 [S]tructural safeguards are usually implemented that effectively
23 give the subsidiary and its creditors a voice independent from the
24 directives of the parent. The most common structural safeguard is
25 a provision in the subsidiary’s charter that requires that the
26 subsidiary’s board of directors include one independent director,
27 an individual who is not affiliated with the parent. The charter will
28 provide that an affirmative vote of the independent director is
29 required for the subsidiary to file a voluntary petition for
30 bankruptcy. Moreover, [S&P] recommends that the charter also
31 provide that the independent director must consider the interests of
32 the creditors of the subsidiary in determining whether to file for
33 bankruptcy protection.

1 **Q. Please summarize the primary purpose of the independent director's special**
2 **function.**

3 A. The independent director, an individual unaffiliated with the parent company, is
4 meant to protect the interests of the subsidiary's creditors (as opposed to the
5 shareholders of the subsidiary and/or its parent company) when the subsidiary
6 and/or its parent company are deciding whether to place the subsidiary into
7 bankruptcy proceedings.

8 **Q. Has the Commission recently approved any transactions including a ring-**
9 **fencing commitment that an independent director will serve this special**
10 **function?**

11 A. Yes. The MEHC/PacifiCorp Order and the MDU/Cascade Order both approved
12 transactions including a ring-fencing commitment that an independent director's
13 affirmative vote was required before certain corporate actions could take place.

14 **Q. Are the ring-fencing provisions proposed by the Joint Applicants generally**
15 **consistent with the ring-fencing provisions offered by the applicants in**
16 **connection with the MEHC/PacifiCorp Transaction, Avista Transaction and**
17 **MDU/Cascade Transaction?**

18 A. Yes. The Joint Applicants believe that their proposed ring-fencing provisions
19 generally are consistent with those that the applicants offered in connection with
20 the MEHC/PacifiCorp Transaction, Avista Transaction and MDU/Cascade
21 Transaction. The ultimate measure of the adequacy of the ring-fencing provisions

1 is the ability to secure a non-consolidation opinion and, as noted above, we are
2 confident that the ring-fencing provisions being proposed are sufficient in this
3 regard.

4 **VII. THE PROPOSED TRANSACTION**
5 **IS CONSISTENT WITH THE PUBLIC INTEREST**

6 **Q. Please describe your understanding of the Commission's standard for**
7 **reviewing the Proposed Transaction.**

8 A. I understand that the Commission must find that the Proposed Transaction is
9 consistent with the public interest.

10 **Q. Does the Proposed Transaction present any risk of harm to PSE's customers**
11 **or the public generally?**

12 A. I am not aware of any risks that the Proposed Transaction presents either to PSE's
13 customers or to the public generally. To the contrary, PSE's customers will
14 benefit from the Proposed Transaction, for the reasons mentioned throughout my
15 testimony.

16 **Q. Do you believe the Proposed Transaction is consistent with the public**
17 **interest?**

18 A. Yes. For the reasons demonstrated in my testimony, along with the extensive
19 commitments being proposed by the Joint Applicants, the Proposed Transaction
20 serves the interests of PSE's customers and the public in general. The Proposed

1 Transaction provides the best means for Puget Energy and PSE to meet the
2 financial challenges facing PSE because it resolves PSE's current and future need
3 for significant and secure capital investment on reasonable terms through a multi-
4 part plan of recapitalization funded by a consortium of entities that have a proven
5 track record of acquiring utility assets and holding and operating such
6 investments on a long-term basis. The Investor Consortium also has agreed to the
7 full spectrum of financial and associated commitments typically expected by the
8 Commission when reviewing an acquisition of this nature. The Joint Application
9 and supporting testimony provide a strong basis for the Commission to make a
10 finding that the transaction is consistent with the public interest, and therefore
11 warrants approval.

12 VIII. CONCLUSION

13 **Q. Does that conclude your direct testimony?**

14 **A. Yes, it does.**