



PUGET  
SOUND  
ENERGY

# **Bringing Order from Chaos**

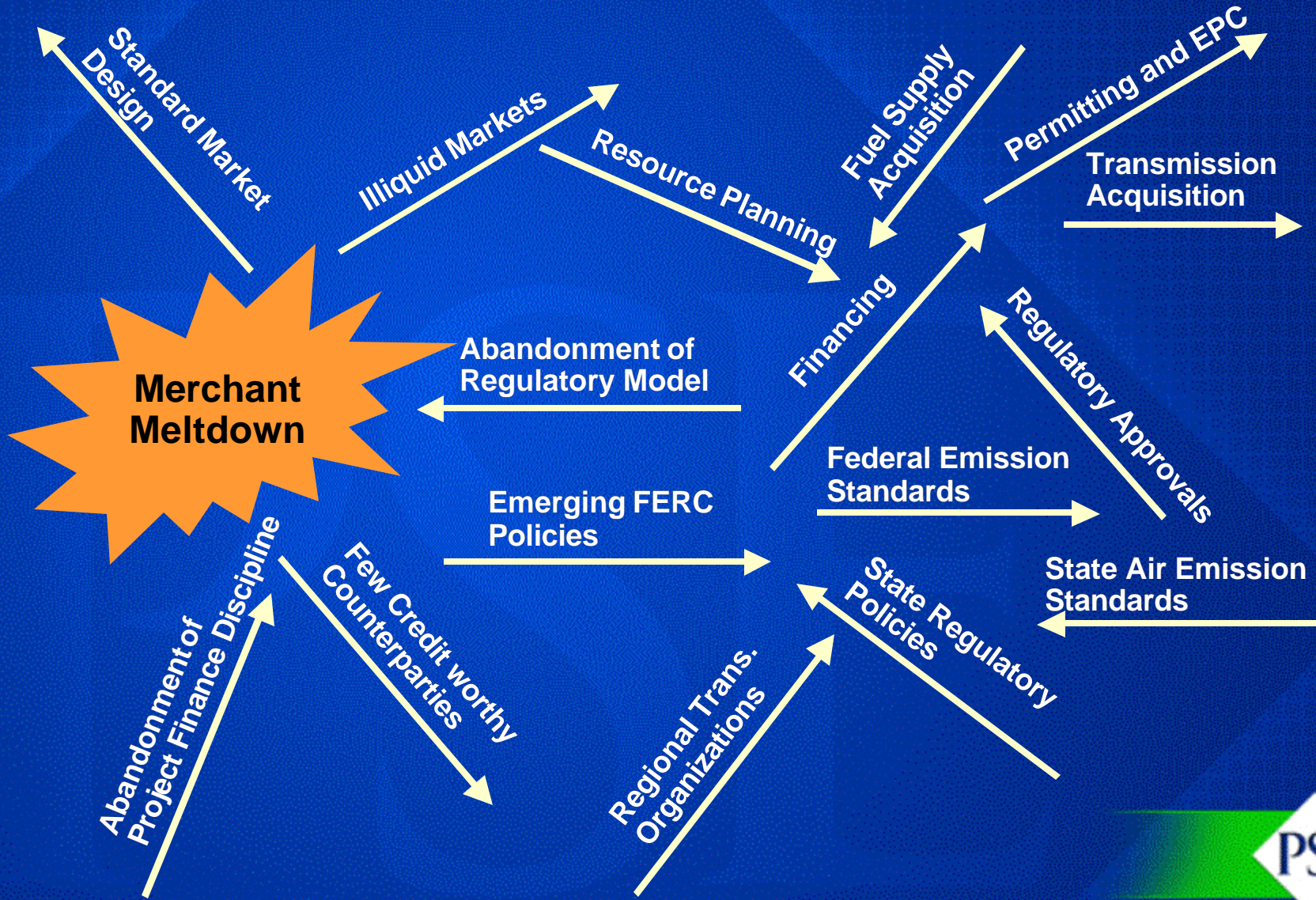
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**Puget Sound Energy**

January 27, 2004

# Asset Acquisition in the Post-Merchant World

- A. Business models are out of control**
- B. Restoring order**
- C. Defining needs**
- D. Protecting key constituent interests**
- E. Good process analysis**
- F. Key findings**

# Many Processes Misaligned, Uncertainty Abounds, Inability to Control Destiny

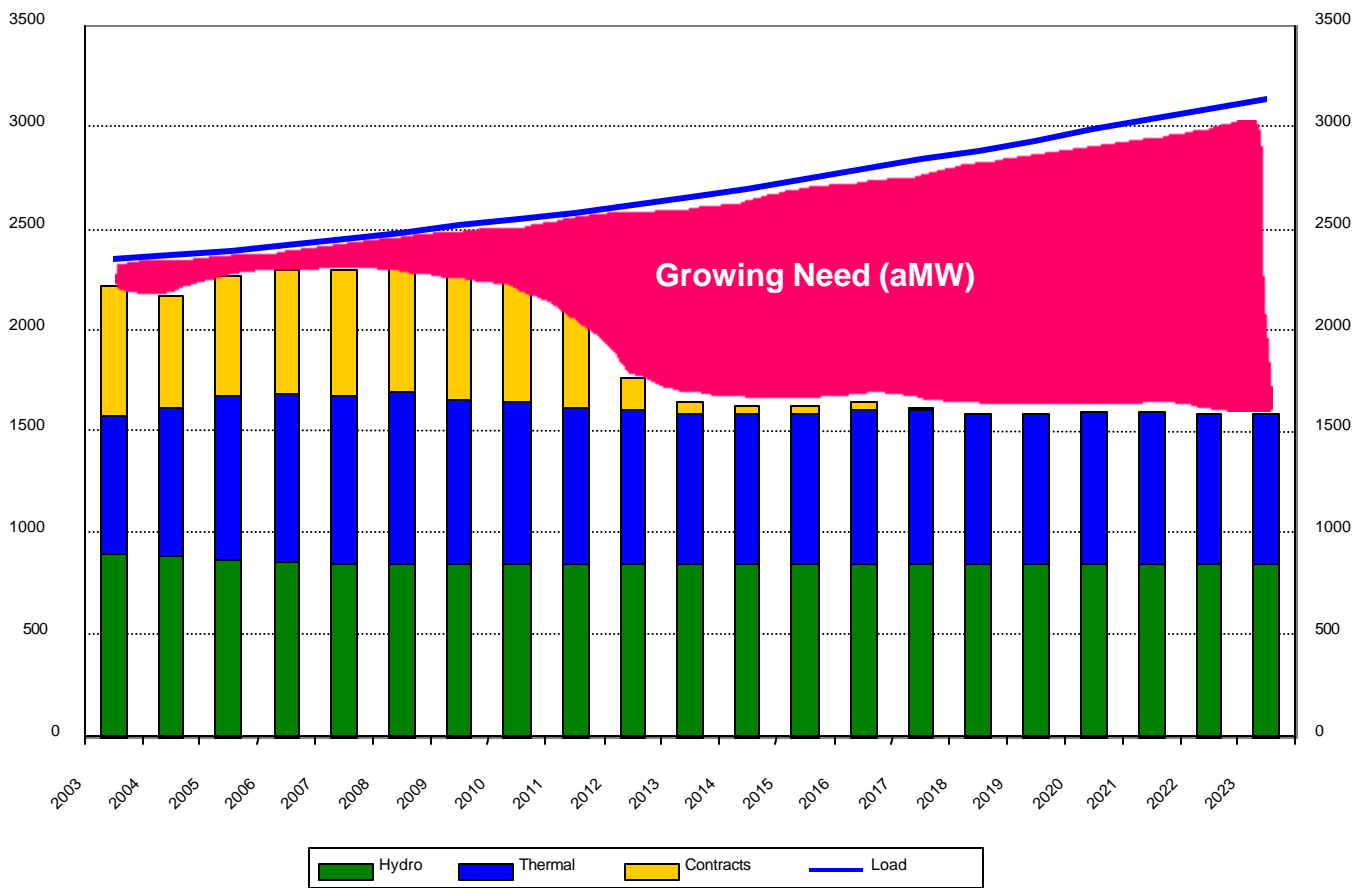


# Restoring Order

- **Integrated Resource Planning**
- **Educating parties about process alignment and sound business models**
- **Value of vertical integration and re-regulation**
- **Systematic risk reduction along the value chain**

# PSE Growing Energy Needs

PSE Energy Need by Year



# Protecting Key Constituent's Interests

## Protect Ratepayers

- Evaluate and balance risk and value
- Obtain a favorable price and terms
- Assure execution

## Protect Shareholders

- Identify and examine all relevant opportunities
- Ensure acceptable return of, and on, investment
- Assure execution

# Good Process and Analysis Requires Managing Several Steps

**Step I:  
Determination Of  
Need For Resources**

**Step II:  
Assessing Available  
Opportunities**

**Step III:  
Acquiring Resources**

**Step IV:  
Integration and  
Transition Support**

## Regulatory

- |  |  |  |   |
|--|--|--|---|
| <ul style="list-style-type: none"> <li>• Integration with regulatory environment</li> <li>• Decision analysis/documentation</li> <li>• Process management</li> </ul> | <ul style="list-style-type: none"> <li>• Development of fast-track process to act on current market opportunities</li> <li>• Coordination of solicitation/RFP</li> <li>• Acq., build, PPA, renewables</li> </ul> | <ul style="list-style-type: none"> <li>• Coordination with state regulatory requirements</li> <li>• Integration with IRP/LCP program</li> <li>• Ensure all options are assessed</li> </ul> | <ul style="list-style-type: none"> <li>• Direct/indirect testimony support</li> <li>• Provide support across numerous regulatory agency filings &amp; sessions</li> </ul> |
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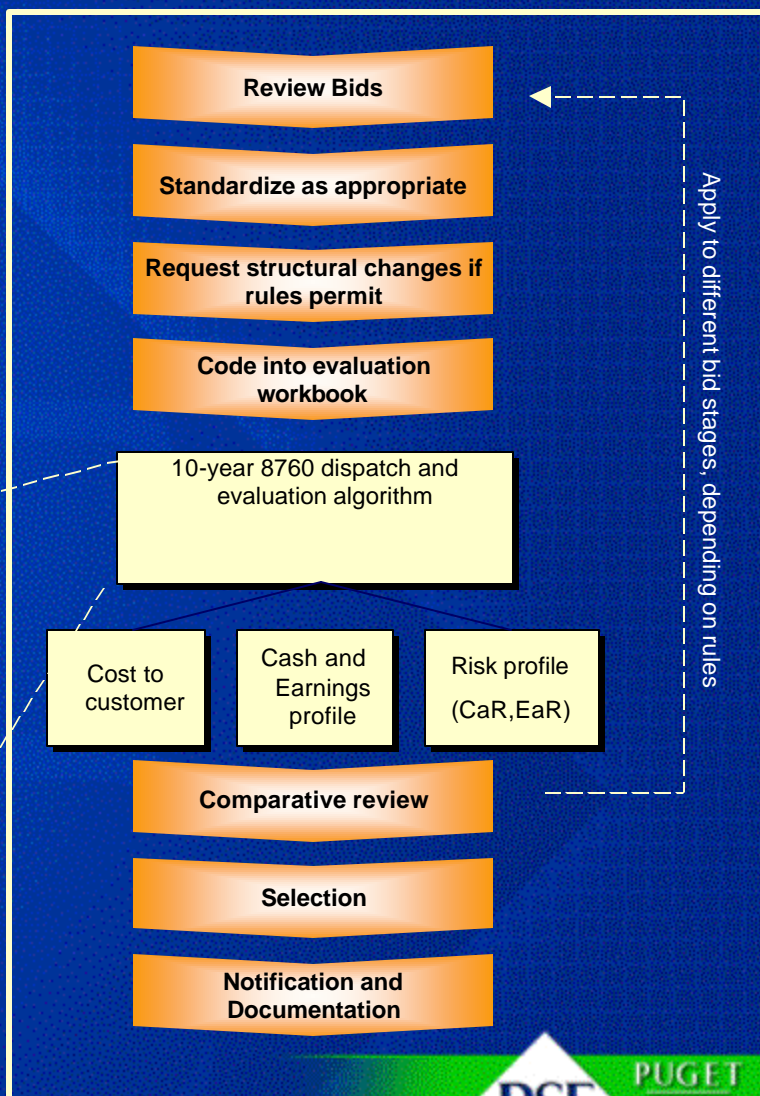
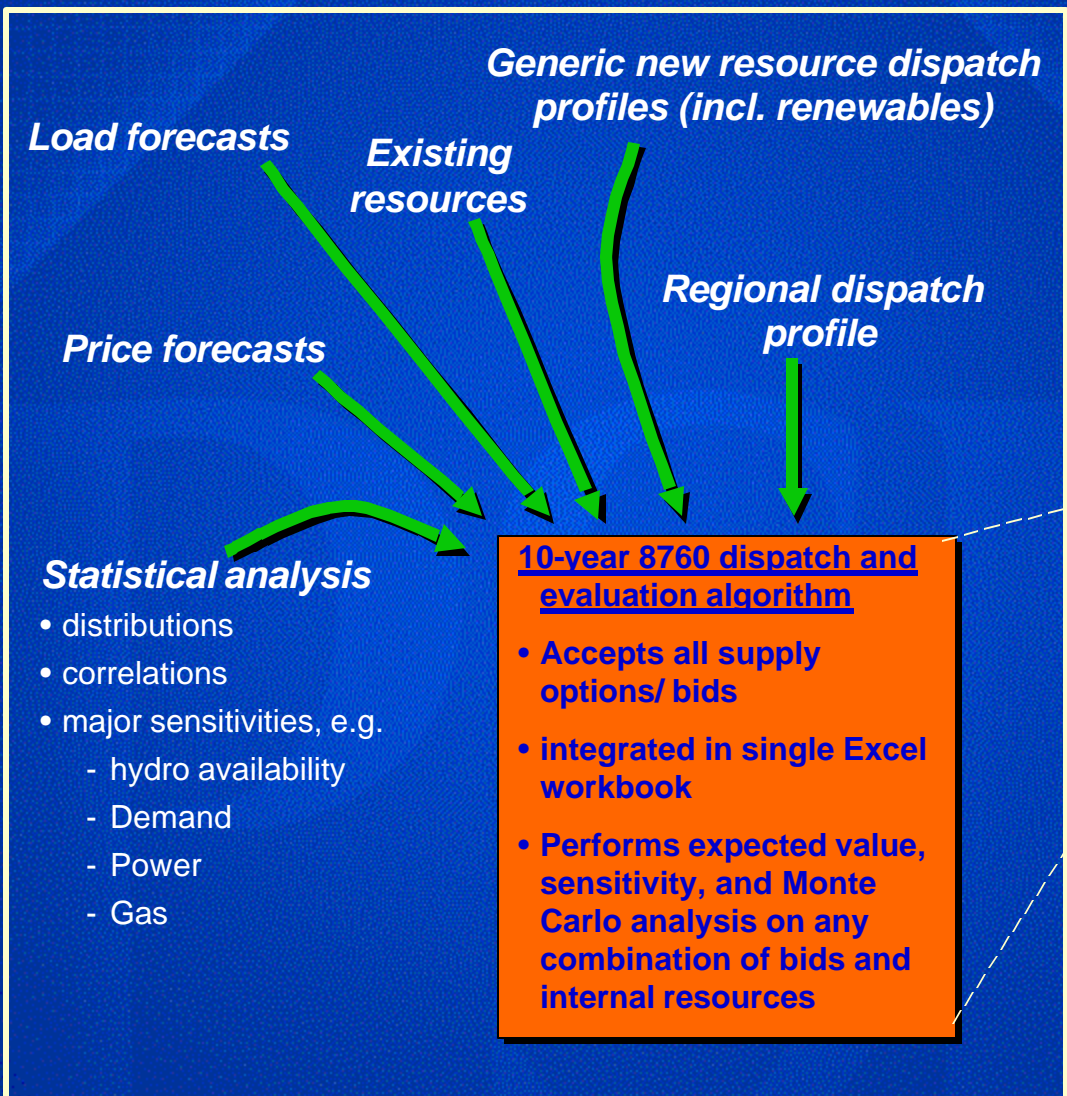
## Strategy

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|---|---|---|---|
| <ul style="list-style-type: none"> <li>• Regional power market modeling and assessment</li> <li>• Review of trading &amp; contracting activities</li> <li>• Portfolio optimization</li> </ul> | <ul style="list-style-type: none"> <li>• Assessment of “target” and “market” opportunities</li> <li>• Review of options (build, buy, PPA, DSM) and technologies (Gas, coal, renewables)</li> <li>• Assessment of counter-parties and alignment with strategic objectives</li> </ul> | <ul style="list-style-type: none"> <li>• Incorporation of strategic insight of counter-parties into negotiation</li> <li>• Scenario-based simulation of existing portfolio (VAR/EAR)</li> <li>• Assessment of PPA vs. owned-asset trade-offs</li> </ul> | <ul style="list-style-type: none"> <li>• Development of transition plans (HR, IS/IT)</li> <li>• Integration planning and assignment of team roles and responsibilities</li> <li>• Development of new entities strategy</li> </ul> |
|---|---|---|---|

## Market Engagement

- |   |   |  |   |
|---|---|--|---|
| <ul style="list-style-type: none"> <li>• Access to expanded deal-flow of potential opportunities</li> </ul> | <ul style="list-style-type: none"> <li>• Facilitation of discussion with counter-parties</li> <li>• Review of alternative project structures and approaches</li> <li>• Valuation of alternatives</li> </ul> | <ul style="list-style-type: none"> <li>• Due diligence</li> <li>• Preparation of offer (s)</li> <li>• Negotiation of transaction</li> <li>• Executing P&amp;S agreement</li> </ul> | <ul style="list-style-type: none"> <li>• Market power monitoring</li> <li>• Revenue enhancement measures (M&amp;T, etc.)</li> </ul> |
|---|---|--|---|

# Understanding the regional market environment defines what price to pay

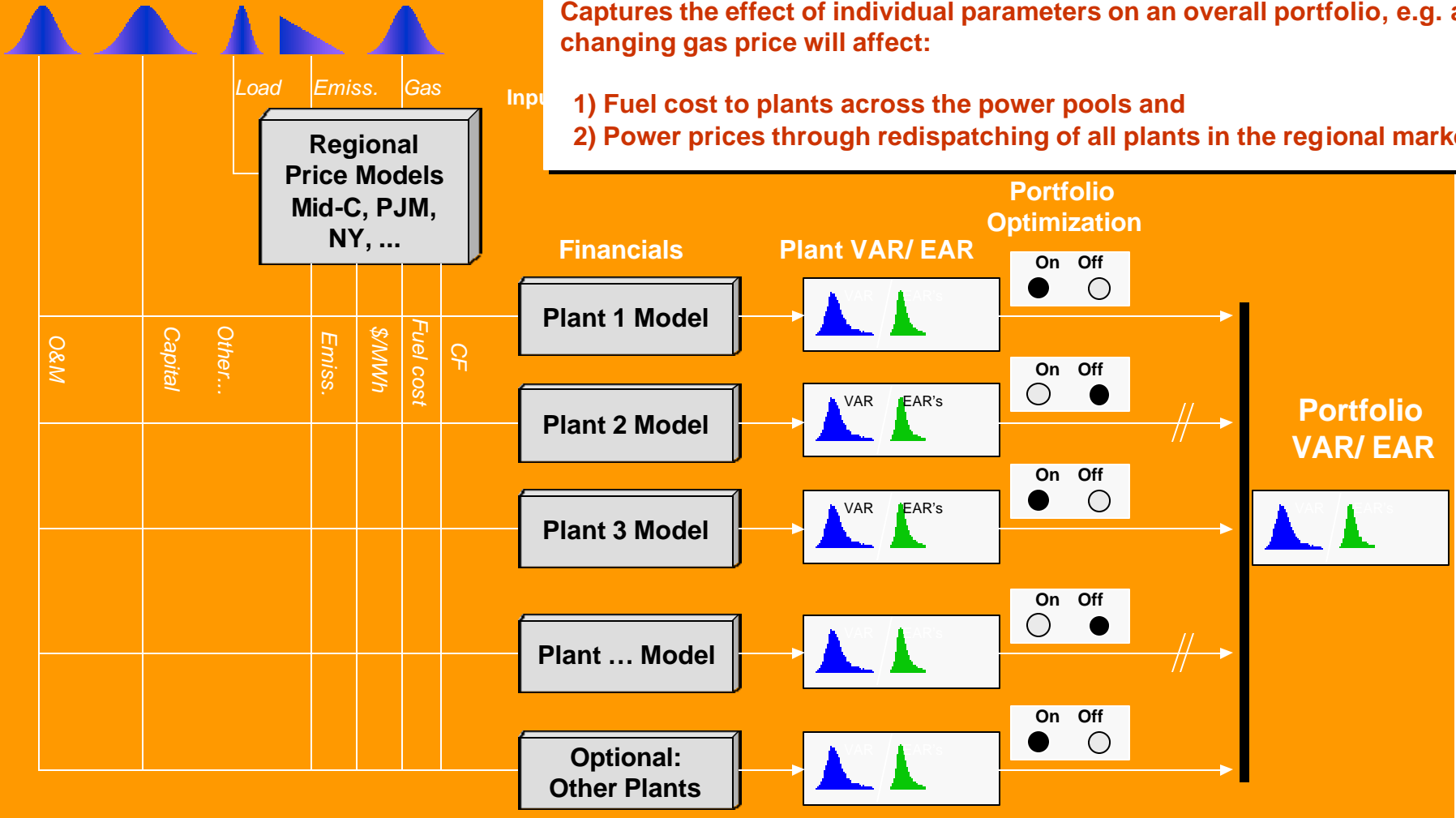




# Point Estimates are No Longer Acceptable, Uncertainty and Risk must be Integrated

Captures the effect of individual parameters on an overall portfolio, e.g. a changing gas price will affect:

- 1) Fuel cost to plants across the power pools and
- 2) Power prices through redispatching of all plants in the regional markets



# Financial Metrics

Financial Metric	Rationale	Limitations
Revenue Requirements	<ul style="list-style-type: none"> <li>● Best indicator of the cost to PSE customers</li> </ul>	<ul style="list-style-type: none"> <li>● Complexity of comparing opportunities of different size, terms, and composition (e.g. assets vs. PPA's)</li> </ul>
DCF Valuation	<ul style="list-style-type: none"> <li>● Best estimate of market value based upon today's best information</li> <li>● How the counter-parties values the transaction. Provides basis to evaluate synergies and trade-offs</li> </ul>	<ul style="list-style-type: none"> <li>● Dependent upon each parties respective view of forward prices and spark spreads</li> <li>● A "modeled" value that doesn't reflect actual costs to ratepayers</li> <li>● Doesn't lead directly to transaction price</li> </ul>
Distribution of financial results	<ul style="list-style-type: none"> <li>● Monte Carlo analysis tests the "robustness" of the answer</li> </ul>	<ul style="list-style-type: none"> <li>● Uncertain regulatory environment difficult to model</li> </ul>
BV And Potential Discount To BV	<ul style="list-style-type: none"> <li>● Provides an estimate of the "value captured" from current market downturn</li> </ul>	<ul style="list-style-type: none"> <li>● An accounting perspective that could mask true value</li> </ul>

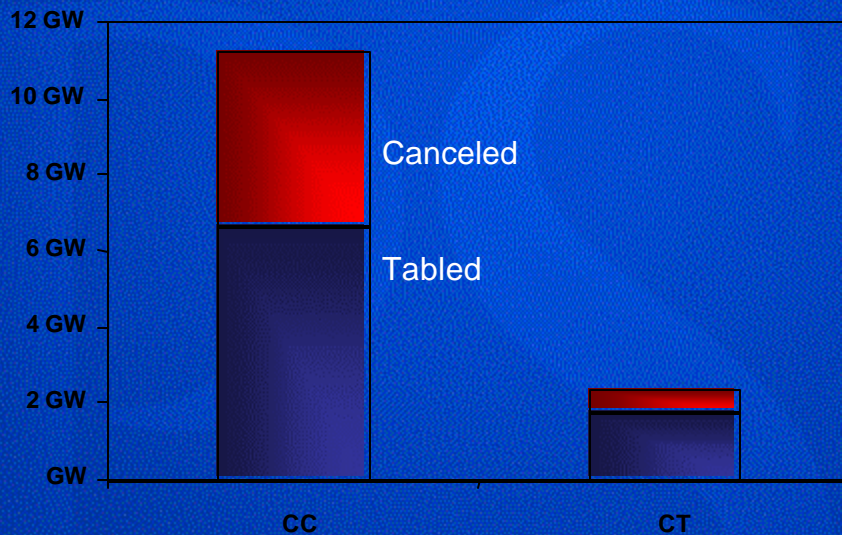
# Examination of All Alternatives

	Why Attractive	Why a Concern
Asset Purchase	<ul style="list-style-type: none"><li>● Hedges long term exposure to spot market</li><li>● Helps bound future costs to customers</li></ul>	<ul style="list-style-type: none"><li>● What price is fair?</li><li>● What risks or other concerns does plant bring to table?</li><li>● Integration challenges?</li></ul>
PPA	<ul style="list-style-type: none"><li>● Potential to get attractive deal in today's market environment</li></ul>	<ul style="list-style-type: none"><li>● Counter-party exposure</li><li>● What changes could develop in future?</li></ul>
Self-Build	<ul style="list-style-type: none"><li>● Controls utility's own destiny</li></ul>	<ul style="list-style-type: none"><li>● Potential cost overruns</li><li>● Potential schedule overruns</li></ul>

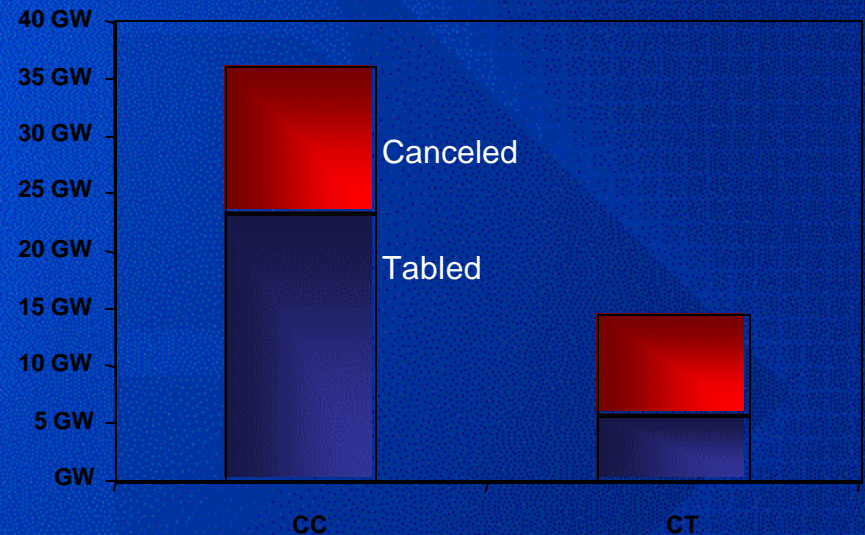
# There are a number of distressed projects to sort through

- In addition to “officially” tabled projects, many still in “construction” status have actually been suspended

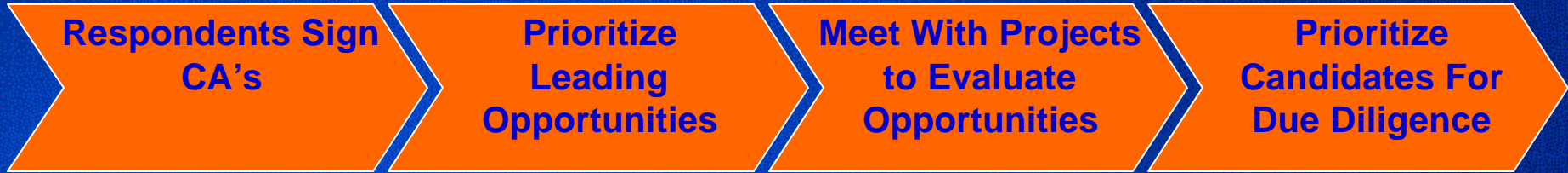
*WSCC: Northwest only/ NWPA*



*WSCC Capacity*



# Pre-defined Valuation Criteria can Winnow Down the Leading Candidates



## Compatibility with Need

- COD by end of 2004
- Size
- Potentially to seasonally shape

## Cost Minimization

- Revenue requirements
- DCF
- Potential discount

## Risk Management

- Counter party risk
- Construction completion risk

## Public Benefits

- Contribution to regional need
- Lower portfolio emission levels

## Strategic & Financial

- Counter-party risk
- Operating and development status

# Key Findings - What we saw

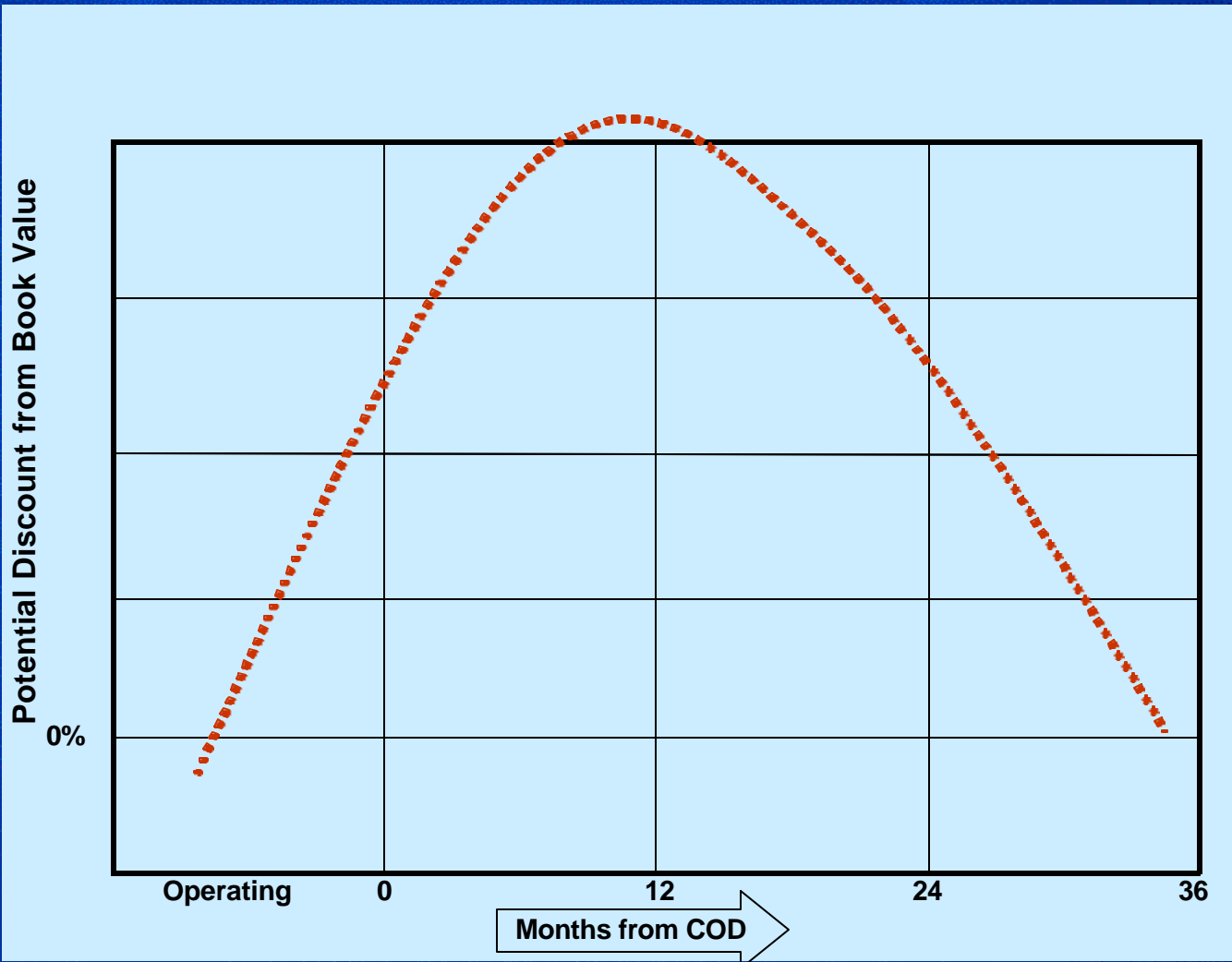
## Expected

1. Considerable influence of lenders limiting what the counter-parties are willing or able to disclose about declining valuations
2. Seller's concern about a lengthy decision cycle at an IOU, commitment to actually close a transaction and in particular, the regulatory risks involved
3. Seller's expressions of interest and early posturing on prices designed at making the short list, but preserving options to try to increase prices during negotiations

## Less Expected

1. Lenders not a factor. Most projects financed with equity from intermediate holding companies
2. Actual construction costs have been higher than generic self-build option might indicate
  - Generally in the high \$700/kw range as opposed to the expected mid \$600/kw range
  - Some differences attributable to developer's rush to get a project on-line ASAP, but also indicative of the difficulty of projecting generic costs to build without having a specific project estimate defined
3. Some counter-parties believe in eventual market recovery, and express no interest in negotiating an attractive price – taking the “long-term perspective”

# Value potential is a function of where the project is on its development cycle, and how distressed the parent is



➤ Operating plants aren't under same degree of distress and tend to feel they can ride out the storm – long option

➤ Farther out development projects expect to share equally in to-go development costs

# Fuel Type and Transmission are Big Value Drivers

- Wheeling costs a large value detraction
- Transmission service difficult to obtain
- Coal's low costs and low volatility are a significant value adder
- Coal's relatively high capital cost, construction cycle, and GHG risks are holding it back despite large and growing uncertainty with the gas supplies and costs



# Recognition and Management of Risk is Critical

