**EXHIBIT NO. ___(EMM-5CT)**
**DOCKET NO. U-072375**
**2007 MERGER PROCEEDING**
**WITNESS: ERIC M. MARKELL**

**BEFORE THE**
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

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| **In the Matter of the Joint Application of**<br><br>**PUGET HOLDINGS LLC**<br><br>**And**<br><br>**PUGET SOUND ENERGY, INC.**<br><br>**For an Order Authorizing Proposed Transaction** | **Docket No. U-072375** |

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

**REDACTED**
**VERSION**

**JULY 2, 2008**

**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF ERIC M. MARKELL**

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**PUGET SOUND ENERGY, INC.**

**PREFILED REBUTTAL TESTIMONY (CONFIDENTIAL) OF ERIC M. MARKELL**

## I. INTRODUCTION

**Q. Are you the same Eric M. Markell who provided prefiled direct testimony in this proceeding on December 17, 2007, on behalf of Puget Sound Energy, Inc. ("PSE" or "the Company")?**

A. Yes. On December 17, 2007, I filed direct testimony, Exhibit No. ___(EMM-1T), and three exhibits supporting such direct testimony, Exhibit No. ___(EMM-2) through Exhibit No. ___(EMM-4).

**Q. Please summarize the purpose of your rebuttal testimony.**

A. This rebuttal testimony responds to certain testimony submitted by the other parties to proceeding.

First, this rebuttal testimony (i) provides my views regarding the challenges of financing a stand-alone business model for PSE in light of the Company's significant capital expenditure program and (ii) explains why the financing plan of the Proposed Transaction provides important benefits to both customers and existing shareholders of PSE.

Second, this rebuttal testimony addresses recommendations of Commission Staff with respect to the treatment of (i) unamortized balances of existing credit facility transaction costs and (ii) debt redemption premiums in the event certain existing fixed rate debt is redeemed.

Third, this rebuttal testimony addresses PSE's policies, plans and commitments with respect to renewable energy, energy efficiency and carbon emissions in response to proposals made by Northwest Energy Coalition ("NWEC").

Fourth, this rebuttal testimony discusses PSE's plans and commitments for preparing and filing certain financial and operational reports with state and federal agencies after closing of the Proposed Transaction in response to issues raised by the Public Counsel Section of the Washington State Attorney General's Office ("Public Counsel"). This testimony also elaborates on the rebuttal testimony of Mr. Christopher J. Leslie regarding PSE's on-going commitment to continue certain corporate governance processes regarding the oversight and control of the business while maintaining a culture and practice of transparency.

Fifth, this rebuttal testimony addresses the proposal of Public Counsel to increase funding for Low Income Energy Efficiency Assistance programs and discusses PSE's proposal to increase bill payment assistance for our low-income gas and electric customers.

Finally, this rebuttal testimony describes PSE's recent history with short-term credit facilities and addresses the recommendation of Commission Staff that, in the event the Proposed Transaction closes, such facilities be extended to a term of ten (10) years.

## II. CHALLENGES FACING PSE AS A STANDALONE COMPANY AND BENEFITS OF THE PROPOSED TRANSACTION

**Q. Could you summarize PSE's capital expenditure needs and its related financing requirements?**

A. Yes. In mid-2007, PSE projected its capital expenditure needs and a multi-year financing plan to meet such needs over a six-year period. The details of that plan are described in PSE's October 19, 2007, Business Plan Update and Review (the "2007 Plan"), a copy of which is provided as Exhibit No. ___(EMM-6C). The 2007 Plan identifies a total six-year capital expenditure program of about $5.7 billion. (PSE is in the process of updating the 2007 Plan, but I do not expect the overall plan of expenditure and financing to be materially different.)

**Q. Commission Staff and Public Counsel assert that PSE can continue to meet its financing needs perfectly well as a stand-alone company because it has done so historically. Do you agree?**

A. No, I do not. In addition to the approximately $300 million in equity raised in December 2007, the 2007 Plan indicates, PSE will require (i) approximately $[redacted] of external equity and (ii) approximately $[redacted] of new debt and hybrid financings to fund the cash requirements of the 2007 Plan.

This need for approximately $[redacted] of external equity represents about [redacted]%

of PSE's market capitalization as of June 27, 2008.

**Q. What are the implications of raising that much new equity?**

A. Raising significant equity will be very difficult without adversely affecting the current market value of the PSE's shares and adding financial risk to PSE's business model. Under circumstances where new shares are sold at a price above book value and the property, plant and equipment purchased with those proceeds promptly placed in rates to generate cash flow, earnings per share can be increased modestly, and share values sustained or possibly increased, all other things being equal. As discussed later in my testimony, however, these circumstances will likely not be present in the case of PSE, so the necessary foundation upon which Staff and Public Counsel posit their optimistic vision of PSE's stand-alone ability to finance is absent.

**Q. Please explain the circumstances under which the ability to finance on a stand-alone basis is imperiled.**

A. If there is a significant delay in placing new plant and the associated increased operations and maintenance costs in rates, such new investment will create significant unrecovered expenses that reduce earnings and cash flow and cause returns to capital to be below authorized returns (sometimes well below authorized returns). If under earning appears to be a persistent condition (and the market forms a view that earnings growth is weak), some members of the community of equity analysts may question whether the Company will be able to maintain its growth and whether its operational environment is genuinely "supportive" or not. In such circumstances downward share price pressure is almost inevitable.

**Q. Is persistent under-earning presently a concern for PSE?**

A. Yes. Exhibit No. ___(EMM-7C) depicts a current snapshot of PSE's under-earnings.

**Q. Please elaborate on these data.**

A. The rate base and operating cost profile used to set rates for PSE lags actual rate base and current expense run rates by as much as seventeen months because of the use of an historic test year to set rates for a large portion of the Company's costs. Commission Staff and Public Counsel suggest that the Company can continue to finance under these conditions through growth in revenue. Economies of scale, however, are a thing of the past. The scenario posited by Staff and Public Counsel is based upon the premise that if new investment is not large relative to the equity capital base of the Company and expense growth is modest, sales and margin growth can sufficiently offset the lag in earnings so as not to cause undue share price pressure. Under these circumstances, the market could have a degree of tolerance for small amounts of regulatory lag. If, however, new investment is large relative to the equity capital base and such large investments persist of over time -- which is the case for PSE -- and operating expenses are driven by inflationary pressures, equity markets will assume that earnings growth will be weak, or even negative, and downward price pressure is certain to result. Mr. Justin Pettit elaborates on these points in his rebuttal discussion of PSE's equity needs relative to its market capitalization.

**Q. Is there a relationship between PSE's mechanism for recovering power costs and the issue of large equity requirements?**

A. Yes. The Power Cost Only Rate Case (PCORC) and PCA mechanisms work in concert to minimize the earnings lag that arises from large, recurring increases in power costs and generation plant investment. Although Mr. Gorman proposes to eliminate PSE's PCORC mechanism, it remains essential for PSE to continue to be a viable company. Even assuming the PCORC remains in place, PSE will experience serious earnings pressure due to increasing delivery system investment and increasing delivery system operating costs. In PSE's case, the delivery system investment over the period covered by the 2007 Plan will be even larger than the generation plant investment. PSE has no mechanism similar to the PCA or PCORC to mitigate persistent delivery system related earnings lag. Accordingly, as the Company's delivery system investment needs and operating cost pressures become better understood, the public equity markets will compensate by keeping downward pressure on the PSE's share price. In periods of falling market multiples, this negative effect on share price is magnified considerably. Mr. Justin Pettit elaborates in greater detail on these market dynamics in his rebuttal testimony.

**Q. Why is this inability to earn a fair return such an important financing and share valuation issue now?**

A. In an environment where the magnitude of new investment tracks at or about the rates of cash flow derived from depreciation, earnings growth may not be a material issue to share valuation and may allow for the raising new capital on reasonable terms. As discussed above, however, the use of an historic test year to fix rates in an era when (1) a utility's capital expenditures far exceed its internally generated funds for extended periods of time, ***and*** (2) the business is experiencing significant operations and maintenance cost pressures, the resultant earnings lag contributes to downward pressure on share prices and a downward spiral of the market value of the enterprise.

In other words, the more shares that need to be issued to fund growth, the more dilutive such issuances are. As issuances become more dilutive, more shares are necessary to be issued to raise the needed funds. Please see the rebuttal testimony of Mr. Justin Pettit for additional data and analysis to illustrate this point.

**Q. Have these fundamental industry characteristics and capital market dynamics existed before?**

A. Yes. Although no two eras are exactly alike and comparisons are often imperfect, the period from about 1974 to about 1984 had many characteristics in common with the utility era we are now entering. Despite the much higher market returns to debt and equity in that era, industry share prices were driven substantially below book value. *See* Exhibit No. ___(EMM-8). In such circumstances as Mr. Justin Pettit describes in his rebuttal testimony, capital programs that are large relative to a company's market capitalization can result in a significant dilution of the value of existing shares and a decline in the value of shareholders' current holdings. At some point, these consequences become so great that they adversely affect the ability of the utility to attract capital on reasonable terms, and thus make exceptionally difficult the ability of the utility to carry out the business plan necessary to fulfill its public service obligations.

**Q. Are there any market conditions that may serve to exacerbate this spiral of share value loss and declining market capitalization valuation?**

A. Yes. In periods of a steepening yield curve (rising long-term rates relative to short-term rates) and falling market multiples (the multiple that new shareholders are willing to pay to buy a projected earnings and cash flow stream is falling), the downward price pressure on shares can intensify. In such circumstances, buyers of utility equities signal that they are willing to pay less and less per share for a constant stream of earnings and cash flow.

**Q. Have market multiples declined in the last year?**

A. Yes. Market multiples described by Morgan Stanley in mid-2007 were in the 14.5 to 16.5 times range. More recent market multiples are approximately 13.0 times.

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**Q. What do such developments imply for the next round of share issuances of PSE as a standalone company?**

A. There are several metrics useful in estimating a company's valuation and several methods should be considered before reaching a view about valuation. However, a simplistic price/earnings ratio is one such metric and is readily calculated. PSE's current earnings outlook for 2008 is about $[redacted] per share. If a market multiple of 13.0 times is applied by the market to current year earnings, shares would be issued at about $[redacted] per share, before underwriters' discount. If the 2007 Plan projection for 2009 earnings per share of $[redacted] is used, and the same market multiple were used, the implied share price would be about $[redacted], before underwriters' discount.

**Q. How does this range of share value compare to current book value?**

A. Book value per share was $19.87 at March 31, 2008.

**Q. How are these observations relevant to the assertions of Commission Staff and Public Counsel about the merits of financing a stand-alone company?**

A. These observations are directly relevant, for they address the issue of whether the "model" upon which Staff and Public Counsel base their claim regarding PSE's "stand-alone ability to finance" is fiction or reality. In questioning whether the Proposed Transaction is better than PSE's stand-alone business model, Staff and Public Counsel are, in effect, asserting that continued reliance as a public company on conventional Wall Street capital sources presents few risks to PSE or its customers.

**Q. What is your reaction to the assertion that continued reliance as a public company on conventional Wall Street capital sources presents few risks to PSE or its customers?**

A. I strongly disagree. PSE may indeed be able to raise the funds it requires, but at what cost to its shareholders? And at what risk to its customers? As discussed above, it is obvious that shareholders are harmed by a significant dilution of the value of existing shares and a decline in the value of shareholders' current holdings. While this undeniable harm to the interests of shareholders may not be of great concern to Staff or Public Counsel, at some point the impact grows to a level that imperils the ability of the utility to access capital, and thereby imposes great risks to customers as well.

**Q. Was this risk acknowledged by PSE as a factor in the events that led to the Proposed Transaction?**

A. Yes. In assessing the merits of various strategic alternatives in 2007, the Board of Directors was advised by management and its own financial advisors (Morgan Stanley & Co.) that shares of the utility industry, including PSE, had been trading for several years at earnings per share market multiples that were at, or near, all-time historic levels and generously valued against other market indices, such as the S&P 500 Index. The Board of Directors was also advised that the consensus by equity analysts for Puget Energy's and PSE's future earnings was generous and that then-prevailing valuations might not be sustained. In other words, new equity could then (mid 2007) be acquired on favorable terms relative to historic valuations, but that such favorable market situation could well deteriorate, perhaps dramatically, as the market gained a better appreciation of PSE's business needs and inherent earnings capability.

**Q. How did such situation influence management's consideration of its financing plans?**

A. First, PSE's management reaffirmed its recommendation that the Company remain committed to the fundamental direction of 2007 Plan provided as Exhibit No. ___(EMM-6C). PSE's management also advised the Board of Directors that implementation of the 2007 Plan was the right thing to do to meet the needs of PSE's customers, regardless of PSE's ownership structure.

**Q. What was determined with respect to an equity-financing plan to meet the cash requirements of the 2007 Plan?**

A. PSE's management recommended that the Company keep it options open, but continue on the course set in 2002 to rebuild PSE's equity capital by (i) constraining the cash dividend to generate internal cash flow, (ii) selling additional equity on market terms in 2007, and (iii) continuing to consider the strategic alternatives under review by the Board of Directors. In other words, PSE's management recommended that the Company meet its customers' needs and explore financing alternatives that would result in obtaining the needed funds, but not unduly detrimental to shareholders.

**Q. Did you express a view about the Proposed Transaction after you became aware of it?**

A. Yes. The opportunity to transact with a firm with a proven track record willing to commit to PSE's many capital needs while remaining autonomous, and receiving a share price that was about 25% in excess of historically high market values, was an opportunity that merited serious consideration by the Board of Directors, and I recommended as such to the Board.

**Q. Do the Company's customers benefit if PSE can raise cash from infrastructure investors like the Investor Consortium on a reliable basis without the adverse effects on share price that will accompany continued reliance on the public capital markets?**

A. Most certainly. Customers always benefit from a utility that can access equity capital on reasonable terms and in a reliable fashion. Well-established law speaks to the public good achieved when the interests of capital providers and customers are well balanced and reasonable levels of service are delivered. In essence, these established legal standards instruct that it is in the public interest for a utility to have access to capital on reasonable terms, in both good and bad capital markets. Such access to capital ensures that customers can rely on the utility for safe, adequate and reliable service because such utility can invest in the business and render service. This is the essence of the so-called “regulatory compact” between capital providers and customers.

**Q. Can you recall any conditions or circumstances that have given rise to the financial distress of publicly traded utilities to the detriment of customers?**

A. Yes, there are several. Risky and costly nuclear programs, failure to be able to recover power and fuel costs, failure to receive construction work in process (“CWIP”) in rate base to generate cash flow, rate caps and rate freezes that cap revenues but leave unlimited expense risk are examples of causes that contributed to the financial duress of some publicly traded utilities.

Some examples of utilities that experienced various degrees of financial distress include Public Service of New Hampshire, Long Island Lighting Company, Pacific Gas & Electric Co., and Southern California Edison. These utilities each suffered financial distress to the extent that customers and service levels were reportedly adversely affected. In the event financial duress is sever enough impacts may include deferral of capital programs, construction delays, employee layoffs, deferred vegetation management, deferred generation plant maintenance, deferred substation modernization, and general impairment of service quality.

Customers may also suffer when financially weak companies are compelled to forego opportunistic investments or transactions that could serve customers well. Utilities that are in financial distress and whose commercial reputations are impaired can have difficulty recruiting and retaining the best employees and can have difficulty obtaining terms of trade from vendors. In addition to these customer effects, the communities served by a utility in distress may also be adversely affected. For example, company employees may step back from their community service activity, and the utility's financial support of community affairs may be decreased or omitted entirely as a cost control measure.

**Q. Can you cite any conditions or circumstances from the 1974-1984 periods that you refer to that may also be present today?**

A. Yes. As described in greater detail in the article entitled, "The CAPEX Cycle," a copy of which is provided as Exhibit No. ___(EMM-8), many conditions that were present in the utility sector then are now recurring. These include inflation throughout the business model for fuel, construction costs and operations expenses; rising long term debt costs; renewed customer conservation efforts which lower per customer sales; electric reliability concerns that are driving spending on system upgrades and increased maintenance costs; significant new environmental requirements that are driving generation construction and targeted power purchase agreements; new emissions regulations requiring additional emission controls investments and operating costs in power plants, and of course, dramatically rising fuel costs and the associated cost of market power purchases. At present, the Company is also facing tightening credit markets, numerous regulatory filings, rising rates, rate push back and proposals to shift more risk to the Company, such as elimination of the PCA and PCORC mechanisms, and finally, perpetual under earnings.

**Q. Do you believe that the Proposed Transaction is in PSE's best long-term interests?**

A. Yes, I certainly do. Although PSE's financial planning horizon is presently only about five years, the Company's resource planning horizon is twenty years. This twenty-year resource plan demonstrates an enormous need for supply resources, and this need will demand large amounts of capital for many years to come. Similarly, PSE will need to grow and strengthen its delivery system to satisfy the growth in the region. As discussed in the testimony of Messrs. Leslie, McKenzie, Webb, and Wiseman, each member of the Investor Consortium well positioned to help fund such capital requirements.

## III. FINANCING MATTERS

### A. <u>Credit Facility Terms and Availability</u>

**Q. Commission Staff suggests that the term of the short-term credit facilities obtained for Puget Energy and PSE from a consortium of banks led by Barclays Capital and Dresdner Kleinwort be extended to a term of ten years from 5 years. Do the Joint Applicants have a response to such proposal?**

A. Yes. I have been involved in obtaining and re-negotiating bank credit facilities for a large part of my career. I have never encountered a bank or insurance company willing to offer a revolving credit facility for a ten-year term. Indeed, a three-year revolving credit/term loan facility was the norm for a large part of my career. Occasionally, markets "soften," and a borrower may be able to obtain an "evergreen" feature that would allow such borrower to roll the terminal date of the facility one year.

In my experience, the advent of the five-year credit facility is a recent development (within the last decade or so). As indicated in Exhibit No. ___(EMM-9), a few six-year facilities have been obtained in very recent times, but the Company is unaware of facilities of a greater term. In any event, the advent of credit facility pricing that has very low carrying costs and few, if any, restrictive covenants (so-called "covenant light" facilities) was unheard of until the credit bubble that has characterized the last several years.

Now, that credit bubble has burst with the implosion of sub-prime lending and a weak economy. Major banks and brokerage firms are seeking huge equity infusions from sovereign funds. Bear Stearns has been liquidated, and the largest mortgage broker, Countrywide, was sold under duress. Washington Mutual, based here in the State of Washington, has been forced to sell a controlling interest in itself at fire sale values. Clearly, the days of easy, cheap credit are over, and reliable access to capital on good terms has never been more important.

In the last year, credit availability has declined, and credit spreads have widened to compensate risk more appropriately. Facility fees have risen, and lenders have narrowed the spectrum of target credits to whom they are willing to extend credit. In short, obtaining a ten-year revolving credit facility (admittedly, an attractive concept) is not commercially feasible.

**Q. Could you summarize the credit facilities that PSE has been able to obtain since 2002 and the maturities of PSE debt of three years or less?**

A. Yes. Exhibit No. ___(EMM-10) summarizes the terms and history of PSE's credit facilities since 2002 and the schedule of debt maturing within three years.

**Q. What do these data demonstrate?**

A. Exhibit No. ___(EMM-10) demonstrates that PSE was able to obtain short-term credit facilities ranging in term from 364 days to five years. As noted above, however, neither of the Joint Applicants believes that a ten-year credit facility is commercially available to either of the Joint Applicants.

## B. Treatment of Prospective Debt Redemption Premiums and Existing Deferred Debt Cost Balances

**Q. Does Commission Staff propose a certain treatment of prospective debt redemption costs and existing deferred debt cost balances?**

A. Yes. Commission Staff proposes that existing deferred debt cost balances associated with existing credit facilities be removed from PSE's balance sheets in a future rate proceeding and written off (to expense) if such facilities are extinguished as a result of the Proposed Transaction. Each of the Joint Applicants agrees that such proposal is reasonable and will agree that such deferred balances continue to be carried on PSE's balance sheets until such time as the Commission addresses their disposition in a future rate proceeding.

Commission Staff also recommends that premiums incurred in the future to redeem outstanding term debt as part of the plan to de-lever the balance sheets of PSE be examined by the Commission for prudence and rate treatment in a future rate proceeding. It is important to note that neither of the Joint Applicants have finalized any plans regarding optional debt redemption and de-leveraging of PSE shortly after closing of the Proposed Transaction. Accordingly, each of the Joint Applicants agrees with Commission Staff's recommendation.

## IV. REBUTTAL TO VARIOUS SPECIFIC OBJECTIONS RAISED BY OTHER PARTIES

### A. Environmental Commitments

#### 1. Energy Efficiency

**Q. Does NWEC suggest that the Joint Applicants add more specific elements to the energy efficiency commitment (Commitment No. 7)?**

A. Yes. The Joint Applicants can agree with two proposals made by NWEC with respect to Commitment No. 7.

**Q. What is the response of the Joint Applicants to the first element of NWEC's suggested additions to Commitment No. 7?**

A. NWEC proposes that PSE should commit to specific energy efficiency improvements in its distribution, transmission and generation assets. PSE has participated in a Northwest Energy Efficiency Alliance project to investigate conservation voltage reduction. PSE monitors smart grid opportunities and high efficiency transformers.

Each of the Joint Applicants agrees that PSE can commit in this proceeding to (i) undertake a study, in collaboration with NWEC, to identify specific energy efficiency improvements in its distribution, transmission and generation assets (in addition to any analysis required as part of the IRP process) and (ii) implement all cost-effective and prudent efficiency improvements to PSE's energy generation and delivery systems identified in such study, provided that such improvements are consistent with the IRP, subject to the CRAG approval process, and ultimately accepted by the Commission.

**Q. What is the response of the Joint Applicants to the second element of NWEC's suggested additions to Commitment No. 7?**

A. NWEC proposes that the Joint Applicants support increased funding for Northwest Energy Efficiency Alliance in the next budget cycle, if the outcome of the strategic planning process finds expanded opportunities.

PSE is supportive of Northwest Energy Efficiency Alliance and provides financial support, via conservation rider/tracker funds, and participation in many projects. PSE also provides direction through the Board of Directors of the Northwest Energy Efficiency Alliance and various advisory groups. Indeed, Calvin E.

Shirley, Vice President, Energy Efficiency Services for PSE, serves as the Chair of Northwest Energy Efficiency Alliance Board committee directing the strategic planning process.

Each of the Joint Applicants agrees that PSE can commit to support increased funding in the next Northwest Energy Efficiency Alliance budget cycle, if such funding is determined to have merit as an outcome of the strategic planning process and contingent on availability of sufficient rider/tracker funds,

**2. <u>Renewable Energy Resources</u>**

**Q. Does NWEC make any suggestions that the Joint Applicants add more specific action items to the renewable energy resources commitments (Commitment Nos. 4 and 5)?**

A. Yes. NWEC proposes five action items be included in Commitment Nos. 4 and 5.

**Q. What is the response of the Joint Applicants to the first element of NWEC's suggested additions to Commitment Nos. 4 and 5?**

A. NWEC proposes that the Joint Applicants commit specific and quantified resources that will enable PSE to meet its internal objective of serving 10% of load with renewable energy resources by 2013.

Each of the Joint Applicants agrees that PSE can commit to acquire renewable resources, to the extent such resources are reasonably commercially available and cost-effective, that will enable PSE to meet its internal objective of serving 10% of load with renewable energy resources by 2013, provided that nothing in such commitment would prohibit PSE from selling renewable energy credits associated with such resources that are surplus to PSE's needs to meet Washington Renewable Portfolio Standards targets. In return, NWEC will agree to support PSE's efforts to recover the costs of such resources in rates.

**Q. What is the response of the Joint Applicants to the second element of NWEC's suggested additions to Commitment Nos. 4 and 5?**

A. NWEC proposes that the Joint Applicants commit to increased penetration of the Green Power Program to at least 2% of PSE's annual load and at least 5% of electric customers subscribed within five years of the close of the Proposed Transaction.

Each of the Joint Applicants agrees that PSE can commit to increased penetration of the Green Power Program to at least 2% of PSE's annual load or at least 5% of electric customers subscribed within five years of the close of the Proposed Transaction, provided that (i) NWEC agrees to support PSE's requests for increased program expenses and (ii) the Commission approves the program and related program costs. To meet such a commitment, PSE will enlist the services of a third-party marketer experienced with the Northwest marketplace.

**Q. What is the response of the Joint Applicants to the third element of NWEC's suggested additions to Commitment Nos. 4 and 5?**

A. NWEC proposes that the Joint Applicants commit to offer customers the investment cost recovery incentive authorized by RCW 82.16.120 each year for as long as the law is in effect. Additionally, NWEC proposes that the Joint Applicants should commit specific resources to market and promote net metering.

PSE currently dedicates resources to market and promote net metering through Schedules 150, 151 and 248, as part of Energy Efficiency Services. Each of the Joint Applicants agrees that PSE can commit to (i) offer customers the investment cost recovery incentive authorized by RCW 82.16.120 each year for as long as the law is in effect and (ii) dedicate resources to market and promote net metering. Such a commitment, however, would require the WUTC to approve an appropriate cost recovery mechanism.

**Q. What is the response of the Joint Applicants to the fourth element of NWEC's suggested additions to Commitment Nos. 4 and 5?**

A. NWEC proposes that the Joint Applicants commit to advance solutions and provide analyses and resources on transmission issues, pricing policies, siting requirements, and interconnection and integration policies.

PSE has participated in regional forums regarding these types of transmission and renewable integration issues. Each of the Joint Applicants agrees that PSE can commit to advance solutions and provide analyses and resources on transmission issues, pricing policies, siting requirements, and interconnection and integration policies.

**Q. What is the response of the Joint Applicants to the fifth element of NWEC's suggested additions to Commitment Nos. 4 and 5?**

A. NWEC proposes that the Joint Applicants commit to advocate in the 2009 legislative session to maintain the integrity of the Energy Independence Act (RCW 19.285) and oppose amendments that would have the overall effect of weakening the Act.

Given PSE has committed to an internal objective of serving 10% of load with renewable energy resources by 2013 (see above), PSE projects that it will be in full compliance with the targets contained in the Renewable Portfolio Standard and supports these annual targets.

### 3. <u>Greenhouse Gas Emissions</u>

**Q. Does NWEC make any suggestions that the Joint Applicants add more specific action items to the greenhouse gas emissions reductions commitment (Commitment No. 6)?**

A. Yes. NWEC proposes five action items that it suggests should be included in Commitment No. 6.

**Q. What is the response of the Joint Applicants to the first element of NWEC's suggested additions to Commitment No. 6?**

A. NWEC proposes that the Joint Applicants commit to (i) adhere to the intent of RCW 80.80 rather than the rules (WAC 173-407) that allow blending of renewable resources and coal-fired market purchases in long-term power contracts and (ii) support legislative changes to RCW 80.80 that close this loophole.

Neither of the Joint Applicants can agree with this suggested addition to Commitment No. 6. As a public utility subject to state law and the rules of the Commission, PSE must procure the least cost resource to serve its customers. Given this limitation, PSE is not in the position to agree to NWEC's suggested addition to Commitment No. 6 but can agree to participate in any discussion to change the statute or rule.

**Q. What is the response of the Joint Applicants to the second element of NWEC's suggested additions to Commitment No. 6?**

A. NWEC proposes that the Joint Applicants (i) commit to become carbon neutral, (ii) contract with an independent third party to evaluate PSE's carbon footprint, and (iii) establish a timeline for internal emissions reductions and/or offsets to reduce that carbon footprint.

To become carbon neutral, PSE would need to offset approximately 14 million tons of $CO_2$ per year. Each of the Joint Applicants agree that PSE can commit to

(i) evaluate and publish its carbon footprint;

(ii) integrate carbon analysis into its IRP studies; and

(iii) support federal legislation that will (a) achieve necessary reductions in greenhouse gas emissions, (b) support significant increases in research of new technologies (such as carbon sequestration), and (c) establish improved energy efficiency standards for transportation, appliances and buildings

In addition, PSE is willing to set a goal to be carbon neutral by 2050.

**Q. What is the response of the Joint Applicants to the third element of NWEC's suggested additions to Commitment No. 6?**

A. NWEC proposes that the Joint Applicants commit to develop, within two years of closing of the Proposed Transaction, a voluntary program for all natural gas customers that will enable such customers to offset greenhouse gas emissions associated with their direct use of natural gas.

Each of the Joint Applicants agrees that PSE can commit to file a carbon-offset program for PSE's natural gas customers with the Commission within the two-year period suggested by NWEC.

**Q. What is the response of the Joint Applicants to the fourth element of NWEC's suggested additions to Commitment No. 6?**

A. NWEC proposes that the Joint Applicants commit to review and consider adoption of the final staff recommendations in Oregon Public Utilities

Commission docket UM1302 regarding a framework for incorporating carbon risk into utility integrated resource planning. NWEC also proposes that PSE, within twelve months of the close of the Proposed Transaction, report to the Commission and the parties to this proceeding the results of PSE's assessment of these recommendations and their applicability to PSE's IRP process.

Each of the Joint Applicants agrees that PSE can commit to

(i) assess carbon risk in its IRP process;

(ii) consider the final recommendations of the Oregon Public Utility Commission within the context of the IRP; and

(iii) report to the Commission and the parties to this proceeding the results of PSE's assessment of the final recommendations of the Oregon Public Utility Commission and their applicability to PSE's IRP process within twelve months of the close of the Proposed Transaction.

**Q. What is the response of the Joint Applicants to the fifth element of NWEC's suggested additions to Commitment No. 6?**

A. NWEC proposes that the Joint Applicants commit to develop and implement a fuel-switching program that captures the economic and greenhouse gas emissions benefits identified in the recent study of PSE's electric and gas customers. NWEC also proposes that the Joint Applicants work with electric utilities in PSE's gas service territory to determine if a joint fuel-switching program offers similar economic and environmental benefits and report to the Commission and the interveners in this proceeding within twelve months of the closing of the proposed transaction, the results of these efforts.

Each of the Joint Applicants agrees that PSE can commit to work with the CRAG to propose programs that accomplish electrical load reduction through the direct use of natural gas as identified in PSE's IRP. In addition to the economic and emissions benefit study for its own customers, PSE recently completed a joint study with Public Utility District No. 1 of Snohomish County, Washington. Each of the Joint Applicants agrees that PSE can commit to similar efforts of appropriate scale and scope with all neighboring utilities subject to their willingness and interest to participate. PSE agrees to report back the results to the Commission and intervenors.

## B. Financial Reporting, Governance, and Transparency

**Q. Will PSE remain subject to the jurisdiction, rules and oversight of the Commission after the Proposed Transaction closes, and will its rates, tariffs and operations remain subject to Commission jurisdiction?**

A. Yes, it will.

**Q. Please describe PSE's plans with respect to filing financial and operational information to the Commission after closing of the Proposed Transaction?**

A. PSE will continue to file all of the same reports it presently files with the Commission and any new reports that may be required in the future. The Proposed Transaction neither eliminates nor reduces the current reporting and compliance obligations of PSE under Washington law and, in no way, alters

PSE's commitment to be as transparent as practical in the conduct of the business.

**Q. Please describe the Joint Applicants' commitments regarding compliance with applicable rules of the New York Stock Exchange after closing of the Proposed Transaction?**

A. Post-closing, Puget Energy, Inc. ("Puget Energy"), the parent of PSE, will no longer have publicly listed common stock. PSE, however, will have outstanding preferred stock registered under the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a *et seq*.) and will have publicly traded bonds outstanding, the covenants of which require compliance with certain New York Stock exchange ("NYSE") reporting standards.

After closing of the Proposed Transaction, PSE intends, and will commit to the extent practical, comply with the rules applicable to a registrant under NYSE rules. Please see Exhibit No. ___(EMM-11) at pages 1-4 for an analysis of PSE's present reporting and governance obligations under NYSE Corporate Governance Standards. Such analysis identifies the applicable NYSE rule, describes the current requirement, describes the post-closing requirement, and sets forth PSE's post-closing commitment with respect to each requirement in the event a current requirement is not a continuing obligation. Such analysis also details the requirements of the NYSE with respect to the following:

(i) annual report availability,

(ii) interim financial statements,

(iii) independent directors,

(iv) director executive sessions,

(v) communication with non-management directors,

(vi) nominating and governance committee matters,

(vi) compensation committee matters,

(vii) the audit committee and committee membership,

(viii) the internal audit function,

(ix) corporate governance guidelines,

(x) disclosure of corporate governance guidelines,

(xi) code of business conduct and ethics, and

(xii) officer certification.

**Q. Please describe the Joint Applicants' commitments regarding compliance with applicable disclosure requirements of the Securities Exchange Commission after closing of the Proposed Transaction?**

A. Exhibit No. ___( EMM-11) at pages 5-6 provides an analysis of (i) applicable disclosures rules of the Securities Exchange Commission ("SEC"), (ii) describes the current disclosure requirements, (iii) describes the post-closing disclosure requirements, and (iv) sets forth the Joint Applicants' post-closing commitment with respect to each existing requirement in the event a current requirement is not a continuing obligation.

The Joint Applicants note that the proposed post-closing commitments with respect to applicable disclosure rules of the SEC reflected in Exhibit No. ___(

EMM-11) at pages 5-6 applies to both PSE (the entity subject to Commission jurisdiction) and Puget Energy (the parent company of PSE not subject to Commission jurisdiction).

**Q. Why do the Joint Applicants propose that the proposed post-closing commitments with respect to applicable disclosure rules of the SEC also apply to Puget Energy?**

A. Certain parties to this proceeding have raised concerns about the post-closing transparency of the financial condition of Puget Energy, Puget Energy's use of debt that is *non-recourse* to PSE, and the potential of such non-recourse Puget Energy debt to harm PSE. Exhibit No. ___(EMM-11) at pages 5-6 describes SEC requirements with respect to the following:

i) Section 13(a) disclosure requirements,

ii) Section 15(d) disclosure requirements, and

iii) indenture covenants disclosure requirements.

As illustrated in Exhibit No. ___(EMM-11) at pages 5-6, Puget Energy and PSE will continue to make the same SEC financial reporting requirements after closing of the Proposed Transaction.

**Q. Please describe the Joint Applicants' commitments regarding compliance with applicable Sarbanes-Oxley and Governance Reporting Obligations after closing of the Proposed Transaction?**

A. Exhibit No. ___(EMM-11) at pages 7-10 provides an analysis of (i) the applicable title of the Sarbanes-Oxley Act of 2002 (Pub.L. 107-204, 116 Stat. 745), also known as the Public Company Accounting Reform and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act"), (ii) the applicable sections of the Sarbanes-Oxley Act, (iii) the SEC and NYSE rule and requirements of the Sarbanes-Oxley Act, (iv) the post-closing requirement of the Sarbanes-Oxley Act, and (iv) the Joint Applicants' proposed post-closing commitments with respect to the Sarbanes-Oxley Act for both PSE *and* Puget Energy.

Exhibit No. ___(EMM-11) at pages 7-10 identifies the following post-closing commitments with respect to the Sarbanes-Oxley Act for both PSE *and* Puget Energy:

(i) Section 201 guidance on the use of outside auditors,

(ii) Section 202 pre-approval requirements with respect to the engagement and compensation of auditors,

(iii) Section 203 requirements with respect to audit partner rotation,

(iv) Section 204 guidance with respect to the requirements of auditor reports to audit committees,

(v) Section 206 guidance with respect to auditor conflicts of interest,

(vi) Section 301 requirements with respect to audit committee requirements,

(v) Section 302 requirements with respect to corporate responsibility for financial reports,

(vi) Section 401 requirements with respect to the form and content of periodic and annual reports,

(vii) Section 403 requirements with respect to disclosures of certain transactions involving management and shareholders,

(viii) Section 404 requirements with respect to management assessment of internal controls,

(ix) Section 406 requirements with respect to the code of ethics for senior financial officers,

(x) Section 407 requirements with respect to disclosure of audit committee financial expert, and

(xi) Section 906 requirements with respect to corporate responsibility for financial statements.

**Q. Please describe the Joint Applicants' commitments regarding compliance with applicable reporting obligations to the Federal Energy Regulatory Commission after closing of the Proposed Transaction?**

A. Exhibit No. ___(EMM-11) at page 11 provides an analysis of (i) the applicable reporting requirements of the Federal Energy Regulatory Commission ("FERC"), (ii) a description of the current reporting requirements of PSE, (iii) a description of the post-closing reporting requirements of PSE, and (iv) the Joint Applicants' proposed post-closing commitments for FERC reporting requirements of PSE. As detailed in Exhibit No. ___(EMM-11) page 11, PSE will continue to meet all the applicable FERC reporting requirements with respect to annual reports (FERC

Form 1) and quarterly reports (FERC Form 3) after closing of the Proposed Transaction.

**Q. Do you have any observations to make regarding the on-going availability of financial reports that Puget Energy and PSE have traditionally filed in compliance with the rules and regulations of the SEC, NYSE, and FERC?**

A. Yes. After closing of the Proposed Transaction, PSE's customers, PSE's regulators, and the general public will have access to the same operational and financial materials to which they now have access. Exhibit No. ___(EMM-11) demonstrates there will be no diminution in the quality or quantity of data readily available to any party interested in the affairs of PSE.

## C. <u>Low-Income Energy Efficiency Program Funding</u>

**Q. What is the response of the Joint Applicants to the recommendation of Public Counsel and the Energy Project that PSE increase funding for low-income energy efficiency programs by a minimum of $1,500,000 per year for the 2008-2009 biennium?**

A. PSE is, and will continue to be, a strong advocate for energy efficiency programs. Each of the Joint Applicants would likely be in favor of increased funding if there were evidence supporting the amount of funds needed and demonstrating the reasonable ability of the implementing agencies to spend additional funds in a cost-effective manner. Neither Public Counsel nor the Energy Project has addressed these issues. It is not at all clear that additional residences would be reached if funding were increased. Thus, each of the Joint Applicants opposes any order by the Commission in *this* proceeding to increase funding for low-income energy efficiency.

**Q. Is PSE aware whether low-income agencies spent the energy efficiency funds that are budgeted under the current level of funding?**

A. Yes, low-income agencies have recently failed to spend the funds budgeted to them for energy efficiency. During the 2006-2007 biennium, the participating low-income agencies deployed, on average, only about 85% of the budgeted funds available from PSE.

**Q. Where should these issues be addressed if not in this proceeding?**

A. Each of the Joint Applicants believes that this issue is best addressed by the knowledgeable participants in the Conservation Resource Advisory Group ("CRAG") process. It is within the context of that process that issues not addressed by Public Counsel and the Energy Project (such as need, cost trends, additional residences that would be reached, and the cost-effectiveness of the increased funding) could be thoughtfully addressed.

**Q. Why do the Joint Applicants believe that the CRAG is the appropriate body to consider the issue of increased energy efficiency funding?**

A. PSE establishes its energy efficiency savings targets and budgets by working collaboratively with a group of stakeholders who participate in the CRAG. One of the primary purposes of the CRAG is to "review issues related to limited income participation in energy efficiency programs."[1] Each of the Joint Applicants believes that the CRAG process is the proper forum for considering low-income energy efficiency issues. PSE is willing to work with the CRAG and the low-income agencies to identify appropriate, cost-effective energy efficiency funding levels based on more thorough analysis of the agencies' specific needs.

**Q. Are Public Counsel and the Energy Project members of the CRAG?**

A. Yes.

**Q. Have Public Counsel or the Energy Project presented their low-income energy efficiency proposal to the CRAG?**

A. No. CRAG meetings were held in July and September 2007 to discuss energy efficiency program targets and budgets for the 2008-2009 biennium. Draft tariffs were sent to the CRAG for review in October 2007, prior to filing with the Commission in November 2007. Neither the recommended funding increase proposed by Public Counsel and the Energy Project nor any other 2008-2009 low-income energy efficiency budget proposal from Public Counsel or the Energy Project has been presented, reviewed, or endorsed by the CRAG to date.

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[1] Settlement Terms for Conservation, Twelfth Supplemental order of Docket Nos. UE-011570 and UG-011571.

**Q. Is there anything the Commission should do in this case related to the low-income energy efficiency issue?**

A. Each of the Joint Applicants asks the Commission to allow PSE to invite the CRAG participants to consider the issues raised by Public Counsel and the Energy Project and to present a report to PSE on these issues not later than December 1, 2008. This would be an adequate time for PSE to consider such recommendations in advance of filing its next general rate proceeding.

## D. <u>Expanded Benefits for Low-Income Customers</u>

**Q. Please describe PSE's proposal to increase bill assistance benefits for qualifying low-income customers.**

A. PSE has considered the testimony of the participating parties in Docket Nos. UE-072300 & UG-72301, on-going developments in the global energy market, the June 6, 2008 report entitled, "2008 Energy Cost Survey" authored by the Energy Programs Consortium ("EPC") and the National Energy Assistance Directors' Association ("NEADA") and updated projections of all-in delivered natural gas costs for the next several years. As a result of such considerations, PSE proposes that it make the appropriate tariff filings to:

(i) increase the total aggregate funding cap for its low income customer bill assistance program to approximately $15 million per year from approximately $10.25 million per year, and

(ii) permit benefit funds not distributed to qualifying customers in any single program year be able to be carried over to provide supplemental benefit funding to be available in the next program year.

PSE also proposes clarification of the program accounting rules to define the program caps to include benefits and administrative costs. Amounts to be set in rates would include a gross-up over and above the program caps sufficient to cover PSE's revenue sensitive items.

**Q. Is there an overarching reason for PSE's updated bill assistance proposal?**

A. Yes. PSE is highly sensitive to energy cost trends and to the special needs of its less fortunate customers. Furthermore, I know, from my engagement as a member of the Board of Directors of King County United Way and its endeavors to end homelessness, that failure to be able to meet energy bills can be become a rolling stone on the way to homelessness. As explained throughout PSE's testimony, the forces of global energy markets, federal and state energy policy and general inflationary trends in the Company's value chain have created a significant and continuing need for rate relief over the next several years. PSE knows from dialogue with its twelve low-income service provider partners, the advocates for the interests of low income families, and our the Company's own customer service staff that increases in bill assistance funding made in the past, while helpful, are simply not adequate to serve all those who currently apply for bill assistance.

Unlike other private corporations, a regulated utility has unique responsibilities not only to render reliable gas and electric service but to discharge the social responsibilities it implicitly assumes when it accepts the public trust to place its works in the public rights of way.

**Q. How would the increased funding benefit low-income customers?**

A. The increased funding levels PSE proposes will permit the bill assistance program to increase service to more customers who qualify for bill assistance. PSE estimates that approximately 16,400 low-income electric customers and approximately 8,700 low-income natural gas customers will be able to be served by the program, and that the program will be able to provide increased levels of assistance per customer.

**Q. Please describe the impact of PSE's proposal on the monthly bill of a typical, or average, residential customer?**

A. PSE currently estimates that PSE's low-income proposal would increase the typical residential electric customer's bill by only 19 cents per month and the average residential gas customer's bill by only 18 cents per month.

**Q. When would the increased caps for this funding go into effect?**

A. PSE will be filing proposed changes to the caps in Schedules 129 to implement this proposal no later than September 2, 2008, with a requested effective date of October 1, 2008. Cost recovery to provide funds for the increased caps would start coincident with the effective date of the tariffs, October 1, 2008, so that the increased funds are available for the upcoming heating season.

### E. Accountability Metrics

**Q. Have the Joint Applicants agreed to provide benchmarks or specific measurable criteria to measure compliance with the commitments offered in this proceeding?**

A. Yes. NWEC erroneously suggests that the Joint Application is deficient because the Joint Applicants allegedly failed to propose "any benchmarks or specific measurable criteria to measure compliance with the Commitments." Exhibit No. ___(NEH-1T) at page 33, lines 19-20. NWEC specifically proposes that "the Joint Applicants at a minimum should agree to provide the Commission with an annual status report detailing actions associated with each commitment." Exhibit No. ___(NEH-1T) at page 34, lines 2-4. Additionally, NWEC proposes that "[s]hould the Joint Applicants fail to achieve a commitment, they should agree to make amends within a specified trimeframe or accept appropriate penalties." Exhibit No. ___(NEH-1T) at page 34, lines 7-9.

**Q. Have the Joint Applicants committed to "provide the Commission with an annual status report detailing actions associated with each commitment."**

A. Yes. Commitment No. 33 commits the Joint Applicants to provide the Commission with an annual report regarding the commitments offered by the Joint Applicants in this proceeding:

> By June 1, 2009 and each June 1 thereafter through June 1, 2013, PSE will file a report with the Commission regarding the implementation of the Commitments. The report will, at a

> minimum, provide a description of the performance of each of the Commitments that have quantifiable results. If any of the Commitments is not being met, relative to the specific terms of the Commitment, the report shall provide proposed corrective measures and target dates for completion of such measures. PSE will make publicly available at the Commission non-confidential portions of the report.

Appendix C to the Joint Application at page 6.

**Q. Have the Joint Applicants committed to "make amends within a specified trimeframe or accept appropriate penalties" if they fail to achieve a commitment?**

A. Yes. Commitment No. 32 commits the Joint Applicants to "make amends within a specified trimeframe or accept appropriate penalties" if they fail to achieve a commitment:

> Unless otherwise specified by Commission regulations or applicable statute, the Commission shall give Puget Holdings and PSE written notification of any violation by either company of the Commitments made in this application. If such failure is corrected within thirty (30) calendar days, the Commission shall take no action. Puget Holdings or PSE may request, for cause, an extension of these time periods. If Puget Holdings or PSE fails to correct such violations within the specified time frames, as modified by any Commission-approved extensions, the Commission may seek to assess penalties for violation of a Commission order, against either Puget Holdings or PSE, but not both, as allowed under state laws and regulations.

Appendix C to the Joint Application at page 6.

## V. CONCLUSION

**Q. Please summarize your rebuttal testimony.**

A. The Proposed Transaction removes the challenges of the public capital marketplace and the risks to customers discussed above. Importantly, the Investor Consortium represents PSE's capital partner of choice. The Proposed Transaction is neither a forced marriage nor an unwelcome overture. The Proposed Transaction is not a "bear hug" from a private equity firm or strategic player.

PSE has vetted the management, intent, and record of accomplishment of the Investor Consortium and each of its members. The Investor Consortium understands PSE's challenges and endorses the Company's plans to meet those challenges.

The Investor Consortium and its members provide access to long-term capital and a proven record of being able to access the global capital markets, even during the historically formidable markets faced today. Indeed, the members of the Investor Consortium have already demonstrated their commitment to PSE by infusing $300 million in capital in late 2007, without any special consideration.

PSE's long-term need for funds is a perfect fit for the investment goals of the members of the Investor Consortium. The Investor Consortium seeks to exact no synergies, eliminate no valuable "overhead" functions, such as environmental and regulatory compliance. The Investor Consortium is supportive of PSE's management team, the history of the Company, and the plans for the future of PSE and the region.

The members of the Investor Consortium have proven to be attentive listeners. They understand PSE's commitment to the environment, compliance, and community service. The Investor Consortium has worked diligently to structure effective ring-fencing provisions, offered additional dividend restrictions and certain financial controls described in the rebuttal testimony of Mr. Christopher Leslie to protect PSE from any adverse upstream financial developments, however remote they may be.

The Joint Applicants have made a commitment to be transparent in financial reporting, including committing to public reporting requirements for Puget Energy, the unregulated parent of PSE. The Investor Consortium has even offered to provide notice to the Commission if, at some future time, the Investor Consortium plans to incur any public debt at the Puget Intermediate Holdings Inc. or Puget Holdings LLC level.

Critically, the Investor Consortium has committed to a series of actions, including significant rate credits, that provide PSE's customers meaningful incremental benefits that the Company, as a standalone utility, cannot provide.

In short, the Proposed Transaction brings certainty of capital and stability in the business model for PSE and its customers.

**Q. Does that conclude your prefiled rebuttal testimony?**

A. Yes.