BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

BELLINGHAM COLD STORAGE COMPANY and GEORGIA-PACIFIC WEST, INC., Plaintiff, v. PUGET SOUND ENERGY, INC., Defendant.;	NO. UE-001014 NO. UE-000735 AFFIDAVIT OF WILLIAM A. GAINES

STATE OF WASHINGTON)
) ss:
COUNTY OF KING)

I, WILLIAM A. GAINES, being first duly sworn on oath deposes and says:

1. I am the Vice President for Energy Supply, of Puget Sound Energy, Inc. ("Puget"). I make this affidavit in support of Puget's Answer to Complainants' "Emergency Motion For Implementation Of Optional Price Stability Provision Of Special Contracts And, If Necessary, For A Retail-Access Pilot Program" ("Motion").

2. Since at least 1997, I have been involved in various meetings with Bellingham Cold Storage Company ("BCS") and Georgia-Pacific West, Inc. ("GP") regarding the Special Contracts and their implementation. I am familiar with the markets for power in the Northwest

and with the Dow Jones indices.

3. I have reviewed the affidavit of Robert McCullough attached to the Motion. Based on my review, the statements and conclusions in his affidavit are based on incomplete, misleading or incorrect factual information and assumptions.

4. I am aware that financial swap transactions to provide price stability to BCS and GP were available since at least 1997 to and could have been purchased by entities such as BCS and GP. Indeed, the history of the Special Contracts shows that on at least three separate occasions PSE offered price stability options to BCS and GP. However, they turned down all three proposals under the Optional Price Stability provisions of the Special Contracts. If any of the three proposals had been accepted, there would be no "emergency." The alleged emergency is a result of a conscious business decision by BCS and GP to accept full market volatility. BCS and GP made it clear in a course of dealing that, up until last month, they intended to reject all hedges or other financial protections offered to them by Puget or others:

(i) In 1997, the year after the 1996 Special Contracts were signed, Puget offered BCS and GP a fixed price swap that would have provided BCS and GP with a fixed price for five years at a price below 20 mills/kWh. This would have provided GP and BCS with protection against all market price volatility from 1997 through 2001 at a price that would be substantially below the current market. Mr. McCullough does not mention this in his affidavit. BCS and GP turned down Puget's 1997 proposal for price stability.

(ii) In late 1999, Puget offered BCS and GP a fixed price of 28 mills/kWh flat for five years. Again, this would have provided BCS and GP with protection against all future market volatility for five years at a price that would have been well below current market prices. Mr. McCullough was involved in the negotiations on this proposal as an advisor to BCS and GP, but fails to mention this proposal in his affidavit. BCS and GP turned down Puget's 1999 proposal for price stability.

(iii) Earlier this year, with markets beginning to tighten and with predictions of increased price volatility, Puget offered BCS and GP a Summer price cap of 70 mills/kWh, which would have reduced price volatility to a level that has turned out to be below Summer market prices. BCS and GP turned down Puget's proposal. Mr. McCullough fails to mention this proposal in his affidavit.

(iv) At a meeting on June 29, 2000, called and attended by Bellingham Mayor Mark Asmundson, Jim Cunningham, mill manager for GP, told Puget Vice President Gary Swofford and me and others that it has been GP's corporate policy not to hedge.

This brief history of the Special Contracts shows that from 1997, not long after the Special Contracts were signed, until BCS and GP filed the Motion, neither has elected to seek or accept Optional Price Stability under the Special Contracts. Further, this course of dealing shows that the form of the Optional Price Stability contemplated and discussed under the Special Contracts was financial swap transactions and bears no resemblance to the Complainants' proposal attached to their Motion.

5. From 1997 to the Spring of this year, Puget has been open to and has made concrete

proposals that would have protected BCS and GP from market volatility. There is typically a close relationship between the cost of power under financial swap transactions and the cost of power purchases for physical delivery.

6. In sharp contrast to Complainants' proposal, Optional Price Stability of the type intended by the Special Contracts has been implemented by PSE for at least one other customer facing market-based pricing. A copy of one example of an appropriate implementation of Optional Price Stability is attached to this Affidavit as Attachment A, entitled "Swap Transaction Fixed/Floating." This is an example of a type of transaction actually entered into by PSE to provide price stability to a retail customer facing prices based on a Mid-Columbia index. Such a transaction does not entail buy-sell arrangements (e.g., retail customer selection of a power purchaser or price for power purchases by PSE) and is the type of transaction contemplated under the Optional Price Stability provisions of the Special Contracts. Such financial swap arrangements would (i) implement the Optional Price Stability provision of the Special Contracts and (ii) provide price stability at very competitive prices (in many circumstances, at a savings as compared with arranging for a fixed price physical delivery of power).

7. In short, the "emergency" BCS and GP claim is a financial situation of their own making. Market volatility was a risk BCS and GP voluntarily undertook, and they have elected not to hedge when they could readily do so. Their complaint boils down to a statement that the power price volatility was greater than they hoped it would be based on past power market price and based on their own expectations.

8. Having refused three proposals under the Optional Price Stability provisions of the Special Contracts while the Complainants perceived market prices to be relatively low, they now seek to have the Commission force a buy-sell arrangement. The Special Contracts contemplate that Optional Price Stability will be negotiated, not imposed. The proposal by GP and BCS is not acceptable to PSE and was not contemplated by the Special Contracts. (Moreover, the three refusals of GP and BCS constitute a pattern of conduct or course of dealing that shows neither party can impose a proposal on the other.) Indeed, the Special Contracts specifically state that the price of such services is to be "Negotiated".

9. Mr. McCullough alleges an historical relationship between the price of natural gas and the price of electricity in the Northwest. Regardless of what, if any, calculations or models he used, he has made a fundamental error in his basic assumptions: Market prices of power are set by a variety of factors, including particularly, supply and demand. The price and supply of natural gas are only two of many factors that influence from time to time, but do not determine, the market price of power.

10. Mr. McCullough acknowledges the importance of supply and demand factors when he mentions loads, hydro generating conditions and scheduled thermal plant outages. He asserts that these conditions have been normal, and that there have been no unusual supply or demand events since May 22, 2000. These statements are incomplete, misleading and wrong.

11. For the four years 1996-99, the West Coast has enjoyed exceptionally good hydro conditions. This year, hydro has dropped to average levels. Mr. McCullough fails to place this

year's hydro in the context of the preceding four years of exceptionally good hydro, and he thus seeks to make it appear that this year is no different for hydro than the past four years. Mr. McCullough's affidavit fails to address the effect of these different hydro conditions in his discussion of historical and present power market prices.

12. In a panel presentation to the Northwest Power Planning Council Power Committee work session on July 18, 2000, in Spokane on West Coast power market issues, Mr. Tim Belden, a Vice President of Enron North America, presented a chart with the title: "Have We Been Fooled by Good Hydro?" (See Attachment B) His point was that for the last four years the West Coast has had exceptionally good hydro, so that the drop back to normal conditions is the equivalent of a loss of 5,000 average MW of power in June of 2000 as compared with June 1999.

13. Similarly, although Mr. McCullough presents statistics on cumulative Columbia River natural stream flows, he fails to mention increased reservoir fill and spill issues. In June 2000, BPA has had to use Columbia River flow to fill the Grand Coulee Dam reservoir, due to recreational and future fish flow requirements. In order to meet a June 30, 2000 fill deadline, BPA took substantial flow out of the hydro supply system. This significantly reduced the supply of power, and undoubtedly increased power prices.

14. Similarly, Mr. McCullough produces no information on fish spill. Columbia River flow does not contribute to the supply of power if the flow spills over dams instead of running through turbines. Although we have not had time to assemble the spill information, fish spill

has become an increasing use of flow--thus reducing hydro supply. For example, Grant County PUD, which operates the Priest Rapids and Wanapum hydro electric dams with a combined 2,000 MW capacity, recently announced an intent to spill more water for fish. Each spring, significant amounts of hydro are now lost due to fish spill.

15. Hydro generation and thermal generation are the supply in the supply and demand factors that significantly affect price. As discussed above, hydro generation is significantly lower this year than it has been in the last four years. Spill and fill issues have further reduced hydro supply. In addition, several thermal plants throughout the West have been out of service for forced and planned maintenance outages in the past two months, including in the Northwest WNP-2, Jim Bridger and Colstrip 3 and 4. This combination of forced and planned maintenance outages reduced supplies in the Northwest at critical times, and undoubtedly increased power prices. Mr. McCullough does not even acknowledge the significant forced plant outages that have occurred in recent months. Similarly, Mr. McCullough does not address the very high temperatures experienced in recent months in the West.

16. Mr. McCullough erroneously points to projected reserve margins for peaking capacity for June to September to demonstrate that there is not a "shortage of generation," and he concludes without elaboration that "the overall level of prices cannot be explained using fundamental tools like . . . the balance between loads and resources." However, this unsupported conclusion does not address the factors, discussed above, that have affected supply and demand. Moreover, projected reserve margins do not account for temperatures that may be

higher than projected, or plant outages that may be greater than projected, and do not account for the energy (as opposed to capacity) restrictions inherent in hydroelectric generation.

17. Although Mr. McCullough speculates that someone, somewhere, somehow may be manipulating power markets, he presents no credible factual evidence of any market manipulation.

18. At the July 18, 2000, the Northwest Power Planning Council Power Committee work session, Mr. Steve Oliver of BPA concluded that the Northwest has moved from a situation of over supply to under supply, and as we experience scarcity, prices will go up. Mr. Jim Harding of Seattle City Light said the May/June prices were like a "speed bump" and were "an expected occurrence and necessary to incent new generation, and that elsewhere (U.K., U.S. Mid West and East) price spikes have been higher than we've seen yet." Mr. Belden presented several charts regarding the power supply/demand/price situation. He concluded that the scarcity is real and that the Northwest needs the price signals it received in June in order to build more generation.

19. Mr. McCullough also alleges or suggests that, since June 1, 1998, the Dow Jones Mid-Columbia firm and non-firm indices do not "consistently report the true market for spot power." However, by Amendment to the Special Contracts dated as of April 28, 2000, Complainants agreed to prices under the Special Contracts based upon the Dow Jones Mid-Columbia firm index.

20. In addition, to the best of my knowledge, the Dow-Jones indices are the only indices in

the West based on actual audited and verifiable transaction data. Unlike other indices which rely on unaudited self-reporting by traders, the Dow Jones indices are the product of a 1995 process that established independent, objective, verifiable indices.

21. I have also reviewed the affidavits of James W. Cunningham and Douglas G. Thomas. Based upon my review, the following statements, inferences and conclusions contained therein are among the incomplete, misleading or incorrect factual information and assumptions contained therein.

22. Both of these affidavits erroneously conclude that Complainants' proposal (i) is contemplated by the Optional Price Stability provisions of the Special Contracts, (ii) is necessary and appropriate in order to implement those provisions and (iii) can be imposed. Rather, the Optional Price Stability provisions of the Special Contracts are to be implemented by mutual agreement and can be implemented by the financial swap transaction discussed above, without resort to buy-sell transactions or other retail wheeling as proposed by Complainants.

23. Similarly, Mr. Cunningham asserts that GP's "potential liabilities for energy costs are not only large but also unpredictable." This is true only if and to the extent GP has elected not to hedge its risk. See, for example, the swap transactions discussed above which would have provided a fixed rate for power purchased under the Special Contracts.

24. Mr. Cunningham also asserts that "[v]olatility is as bad as high prices." This is misleading, and overlooks the fact that volatility has also afforded Complainants low prices, and a substantial benefit of approximately $8 million, from the inception of the Special Contracts

through the end of April 2000.

25. Mr. Thomas asserts that Complainants' "implementation proposal" is fair to PSE. This is not true. Their proposal would shift risks, and potential penalties, to PSE that are neither fair nor reasonable. The proposal does not comport with the financial swap transactions, discussed above, through which price stability can be provided, without resort to buy-sell transactions or other retail wheeling.

DATED: July 26, 2000.

William A. Gaines

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

On this _____ day of __________________, 2000, before me, a Notary Public in and for the State of Washington, duly commissioned and sworn, personally appeared William A. Gaines, to me known to be the individual who executed foregoing Affidavit, and acknowledged that he signed the same as his free and voluntary act and deed, for the uses and purposes therein mentioned.

GIVEN UNDER my hand and official seal hereto affixed the day and year in this certificate first above written.

Print Name:
Notary Public in and for the State of Washington,
residing at
My commission expires: