

EXHIBIT NO. _____ (EMM-7)
DOCKET NO. _____
2003 POWER COST ONLY RATE CASE
WITNESS: ERIC M. MARKELL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

Docket No. _____

v.

PUGET SOUND ENERGY, INC.,

Respondent.

DIRECT TESTIMONY OF
ERIC M. MARKELL
ON BEHALF OF PUGET SOUND ENERGY, INC.

LOAD & RESOURCE OUTLOOK

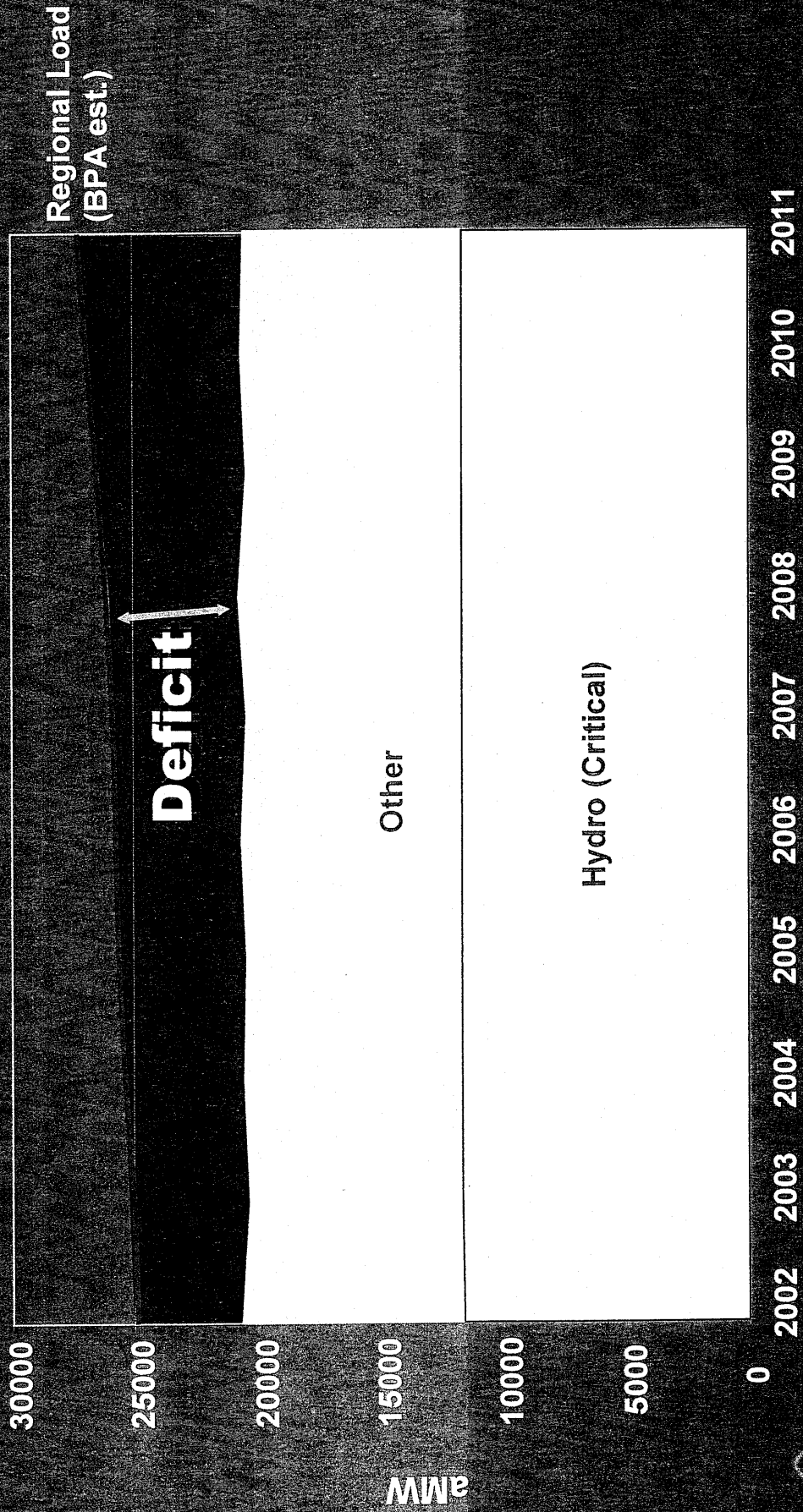
Bill Gaines
Vice President
Energy Supply



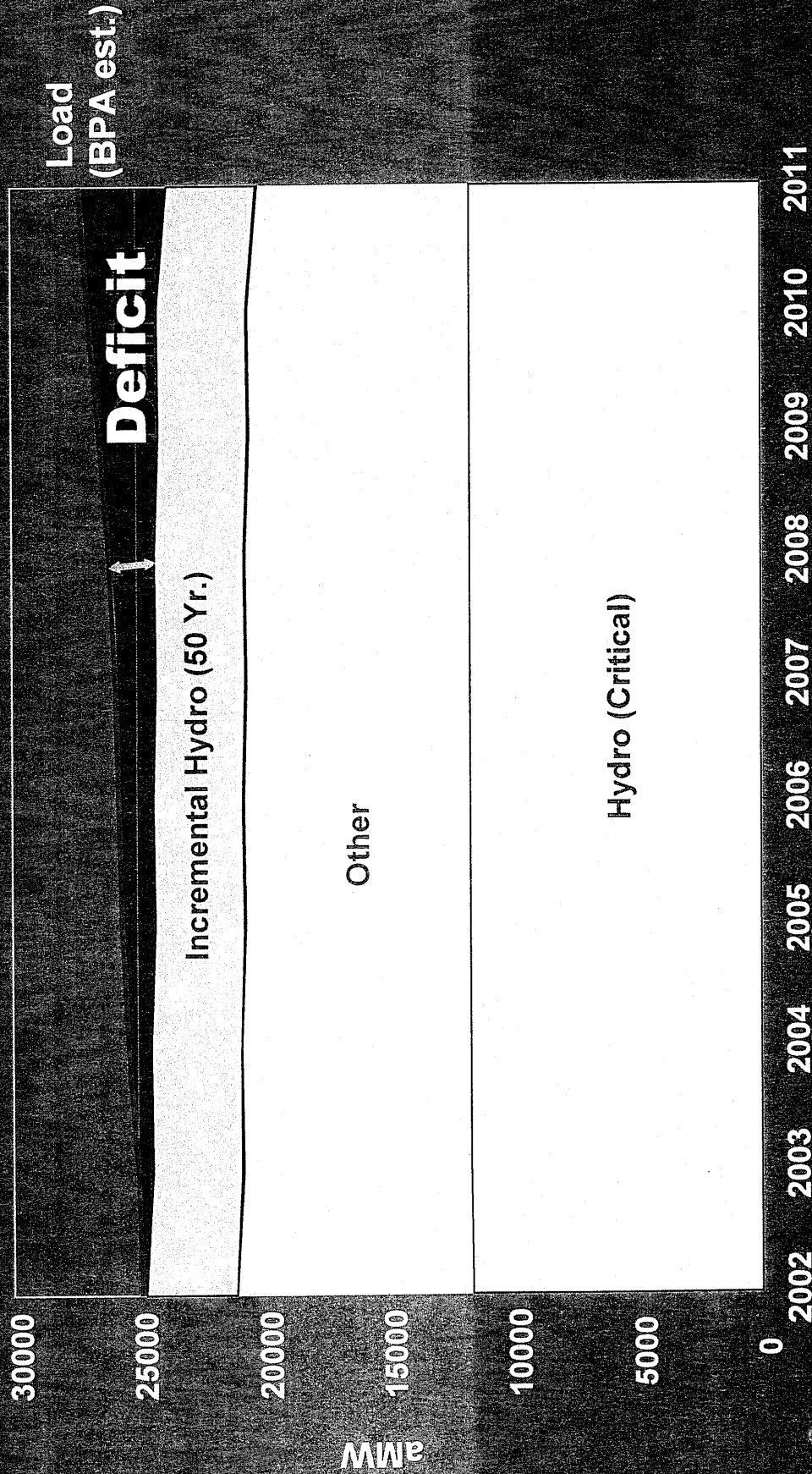
NW POWER SUPPLY

- *NW is energy deficient for 2002-2010 under both “critical” and “average” water conditions*
- *Regional supply deficits increase materially with load growth and resource decline*
- *Deficiency reaches about 3,000 MW by 2010 with “average” hydro, 6,600 MW with “critical”*
- *Proposed merchant plants likely insufficient to fill the deficit – portends a “tight” supply market*

REGIONAL L/R-“CRITICAL”



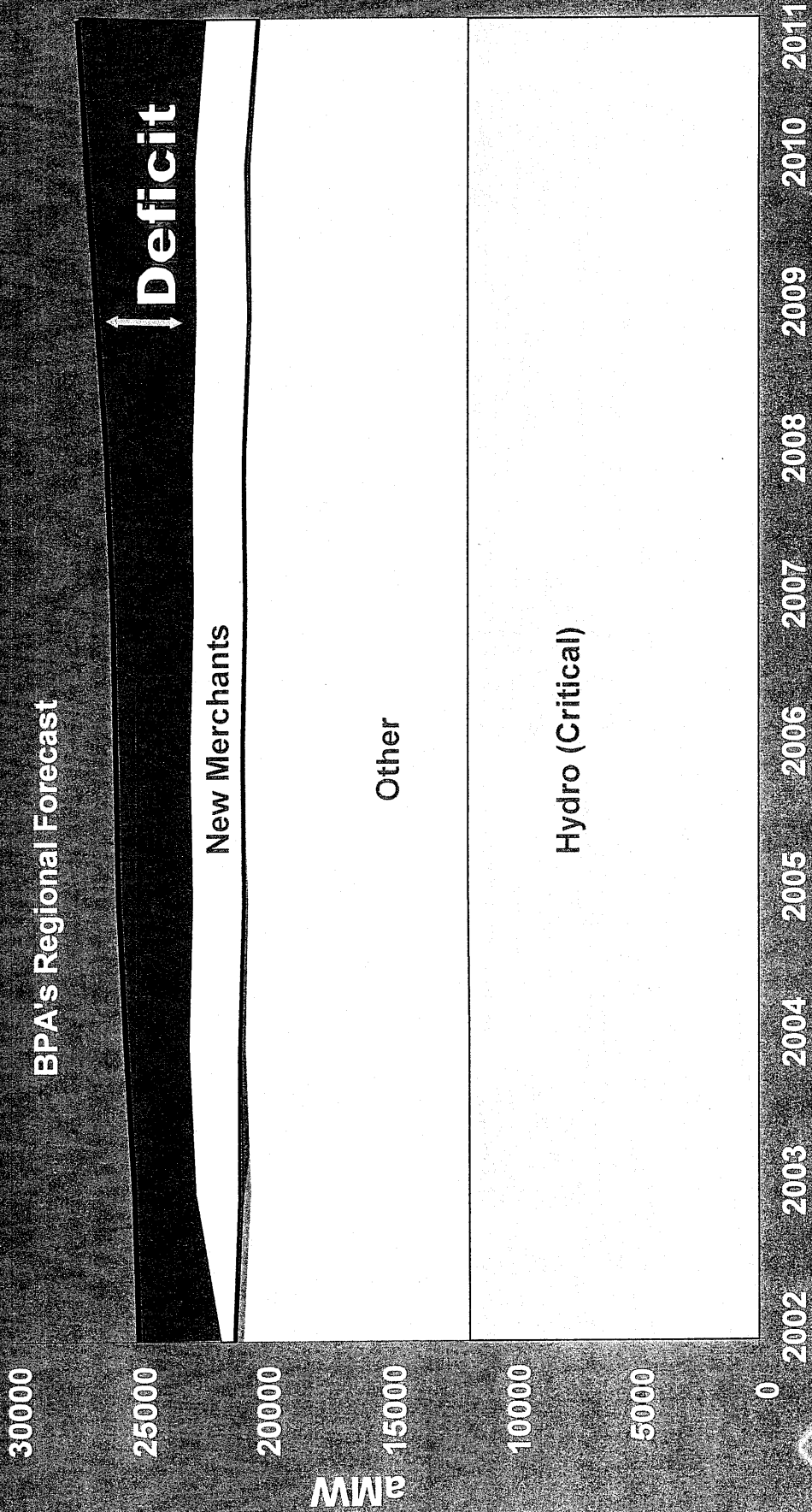
REGIONAL L/R- 'AVERAGE'



PUGET ENERGY

'CRITICAL' w/MERCHANTS

BPA's Regional Forecast

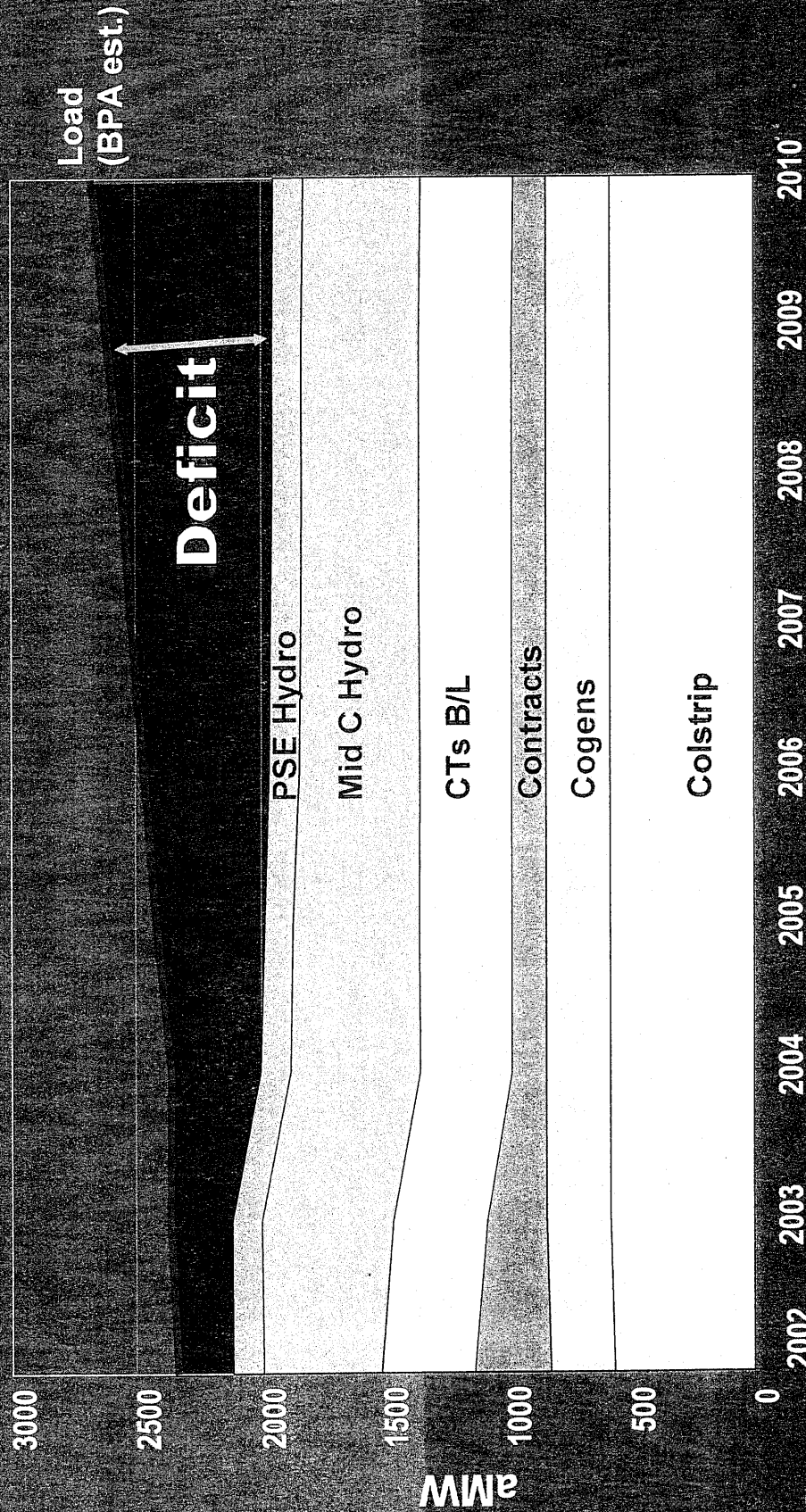


PSE POWER SUPPLY

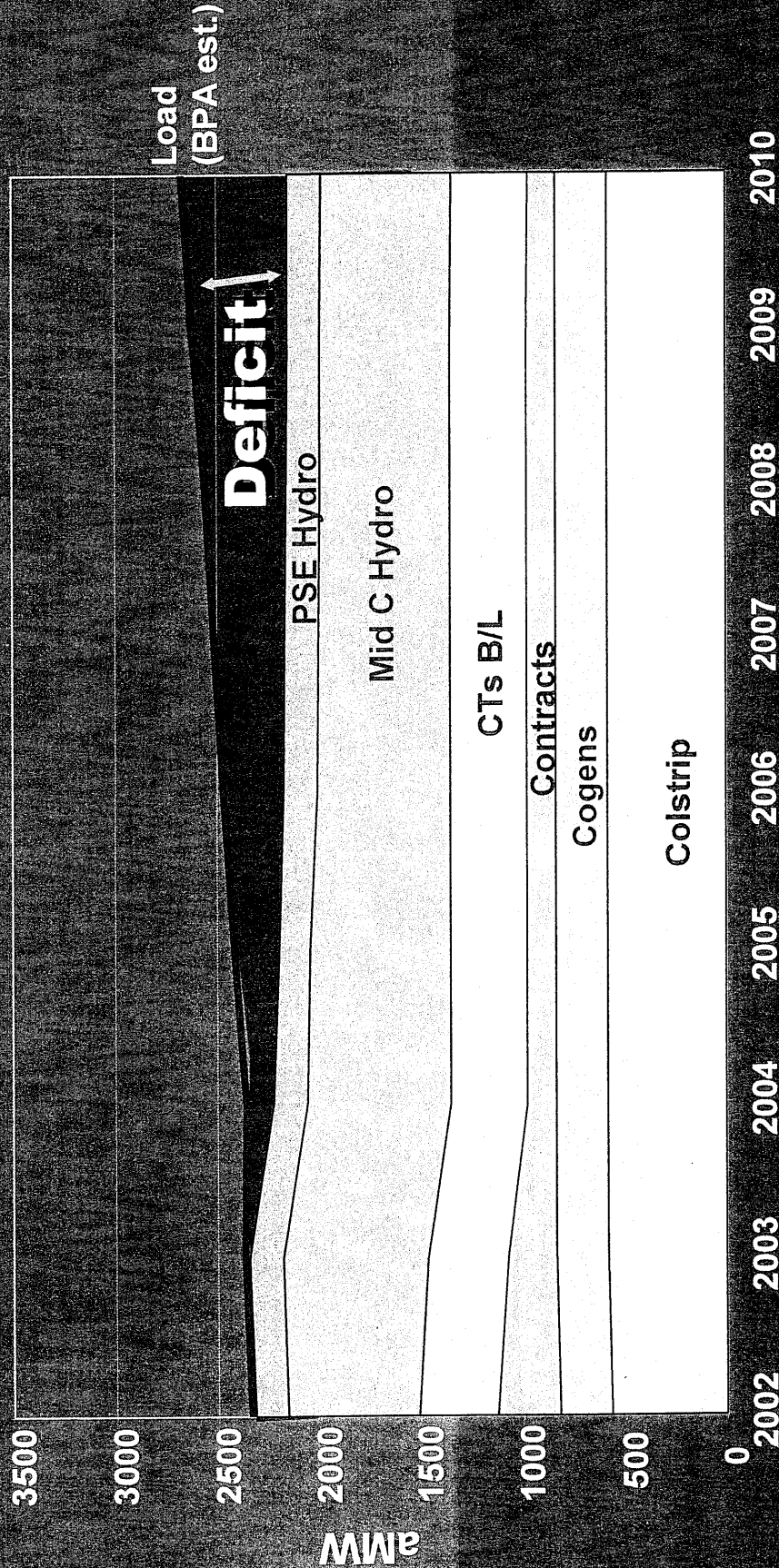
- *PSE is becoming both energy and capacity deficient due to supply contract expirations and load growth*
- *Energy deficit begins at about 250 MW in 2003, about 1 power plant, grows to 750 MW by 2010, about 3 power plants, assuming critical hydro*
- *Energy deficits under average hydro conditions are about 200 MW smaller*
- *After 2010, expiration of PURPA Cogeneration contracts and relicensing/renewal of Mid-Columbia contracts are important*



PSE L/R - 'CRITICAL'



PSE L/R - 'AVERAGE'



CONTRACT EXPIRATIONS DRIVE 2002-10 DEFICITS

- *By end of 2003, PSE will lose 265 MW capacity; 160 aMW energy (expiration of Avista+PacifiCorp contracts)*
- *By end of 2006, PSE will lose 300 MW of winter capacity (termination of PG&E exchange)*
- *By end of 2010, PSE will lose 107 MW capacity; 94 aMW energy (expiration of Montana Power contract)*



TREND: LOSS OF SUPPLY CONTRACTS THRU 2010

Expiring Resources, by source	Capacity MW	Energy aMW	Resource Type	Expiration
PacifiCorp	200	120	Thermal	10/31/03
PG&E Seasonal Exchange-PSE	300	0	Thermal	12/31/06
Montana Power	97	84	Colstrip	12/29/10
Other	91.3	250		
Total	688.3	264.3		

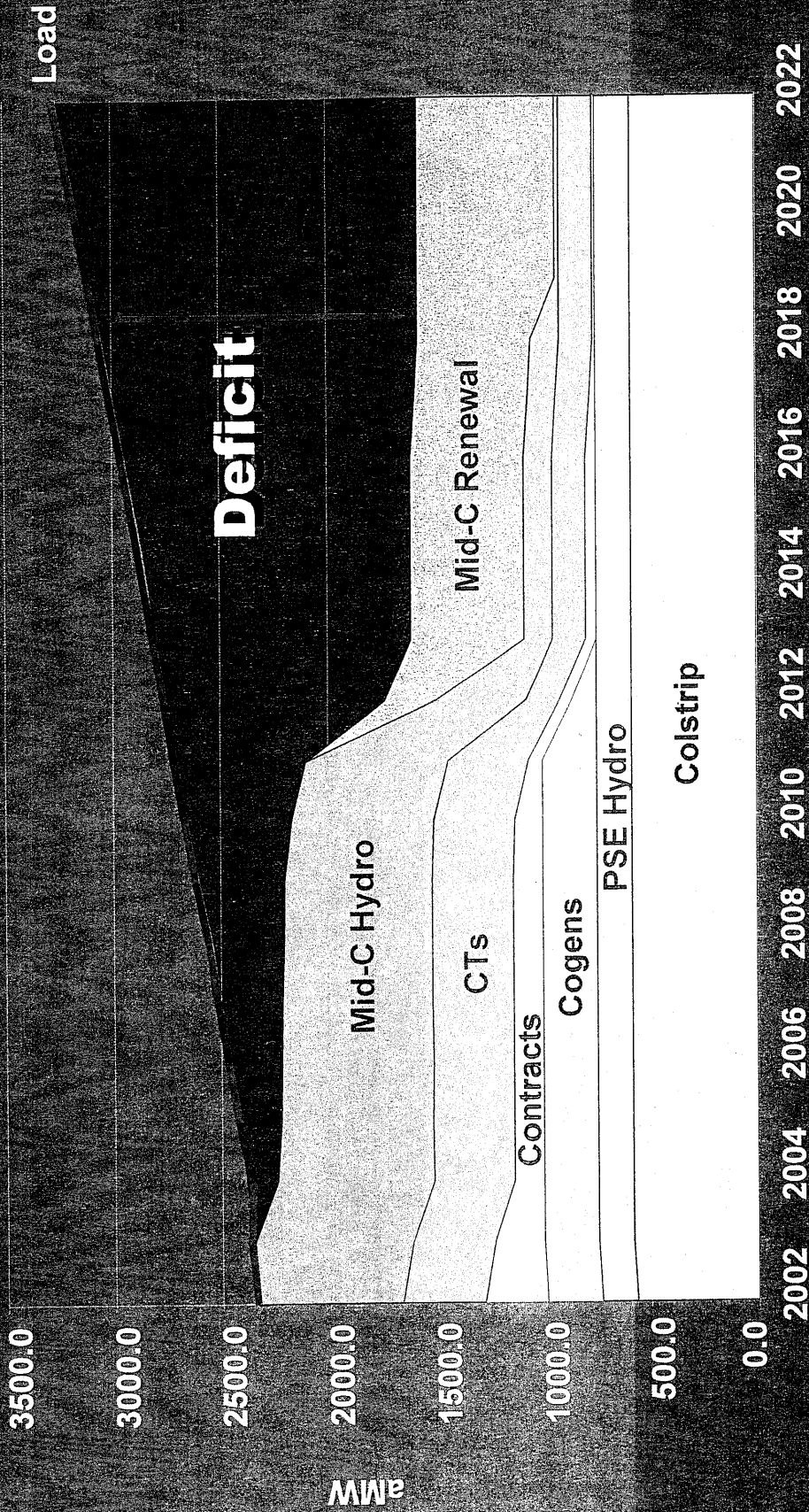


LONG-TERM, CONTRACT EXPIRATIONS CONTINUE

- *Post-2010, many of PSE's large PURPA cogeneration contracts and Mid-Columbia hydro contracts expire.*
- *By end of 2012, PSE will lose an additional 530 MW capacity and 495 aMW energy (termination of Spokane, March Point, Tenaska and Sumas cogeneration contracts).*
- *PSE's large low-cost purchases of hydroelectric supply from Chelan PUD and Douglas PUD expire in 2012 and 2018, respectively.*



L-T SUPPLY DECLINES



LOAD / RESOURCE BALANCE

- *PSE's 650 MW of simple-cycle combustion turbines provide capacity, but are uneconomic for baseload energy operation*
- *PSE must secure new supply resources to meet its capacity and energy deficits and its obligation to serve core customers*

NEW SUPPLY CONSIDERATIONS

- *Gas-fired combined-cycle generators have become increasingly efficient, and are the resource of choice in most regions*
- *Proximity of new resources to PSE's service area can save transmission costs and reduce uncertainty associated with RTO, SMD, etc.*
- *Requires aggregation and management of additional gas supply and transport; provides opportunity for integration and synergy with PSE's gas distribution portfolio*



NEW SUPPLY CONSIDERATIONS, CONT'D

- *Resumed retail rate pressure from publicly owned utilities post-2006 makes economic resource choices important.*
- *Proposed long-term allocation of BPA benefits will mitigate this.*
- *Prudence of resource acquisition process is critical for regulatory approval.*
- *Inclusion of new supply resources in PSE rate base creates earnings growth opportunity.*



NEW RESOURCE OPPORTUNITIES

Eric Markell

Vice President

Corporate Development

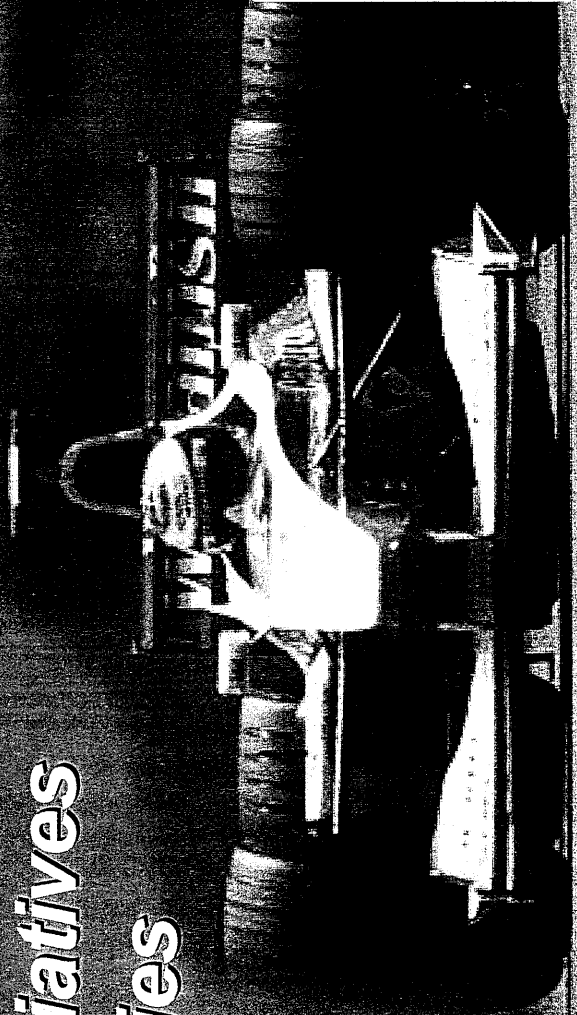


GENERATION PLANNING

- *The Drivers*
- *Our Principles & Goals*
- *Market Situation*
- *Our Plan to Serve Load*

THE DRIVERS

- *Regional supply shortage*
- *PSE supply shortage*
- *“Market-only” supply is too uncertain*
- *Regulatory initiatives and uncertainties*



PLANNING PRINCIPLES

- *Assure security of, and control over, supply*
- *Use least-cost planning process to make wise choices*
- *Maintain and improve creditworthiness of company*
- *Improve earnings per share*
- *Be opportunistic*



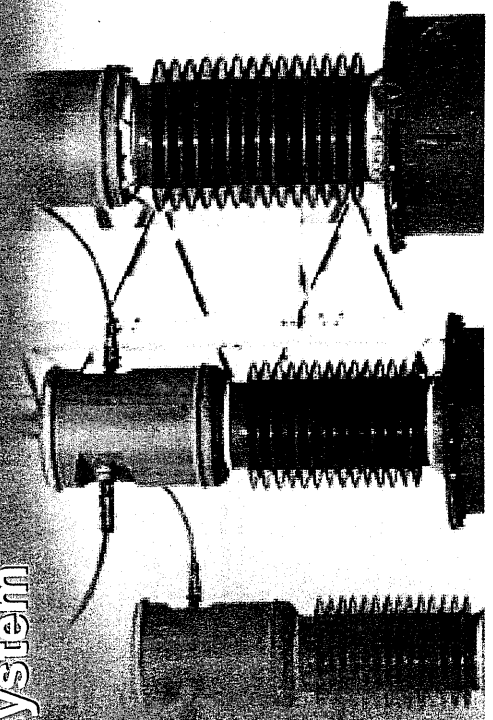
RATEMAKING GOALS

- *Obtain WUTC approval for return of, and on, investment*
- *Keep revenue requirements modest*
- *Be creative and collaborative in approach to electric and gas ratemaking*
- *Look for “win-win” opportunities*



REGIONAL GENERATION PROPOSALS

- *36 projects totaling about 19,000 MW being permitted for the Northwest*
- *7 of the plants may be on line by end of 2003*
 - 3 on the west side of Cascades
 - 4 on the east side of Cascades
 - 2 could direct connect to PSE system



MERCHANT GENERATION

Projects In Service by 2003

Developer	Project	MW	Date	Credit	Location
Calpine	Hermiston	536	In-service	B1	E Hermiston, OR
Trans Alta	Big Hanaford	248	Q3 - 02	Baa1	W* Centralia, WA
EPCOR	Frederickson LPI	249	In-service	A1	W* Frederickson, WA
Avista/Mirant	Coyote Springs II	280	Q4 - 02	Ba1/Ba1	E Boardman, OR
Calpine	Goldendale	248	Q1 - 03	B1	E Goldendale, OR
Northwestern	Montana First	260	Q2 - 03	Baa2	E Great Falls, MT
Duke	Grays Harbor	650	Suspended	A1	W Satsop, WA
Mirant	Mint Farm	286	Suspended	Ba1	W Longview, WA
Tractebel	Chehalis Pwr.	520	Q4 - 03		W Chehalis, WA

Total 3,277

MERCHANT GENERATION

Westside Merchant Projects – In Service Post-2003

Developer	Project	MW	Date	Location
EPCOR	Frederickson LP II	250	Q3 - 04	Frederickson, WA
FPL	Everett Delta I	248	2005	Everett, WA
Enron	Longview EDP	290	2005	Longview, WA
Ida-Corp	SnoPUD-Ida-Corp	250	2005	Near Everett, WA
BP	Cherry Pt. Cogen	720	2006	Whatcom Co., WA
Calpine	Tahoma	250	2006	Frederickson, WA
NESCO	Sumas II	660	2006	Sumas, WA
NESCO	Rainier Energy	300		Tumwater, WA

Total **2,968**

MERCHANT GENERATION

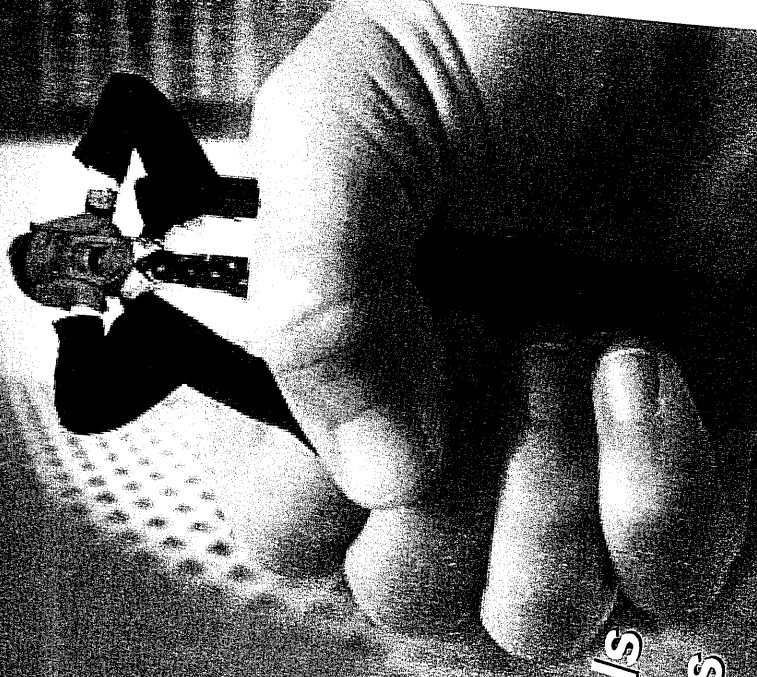
Markets are:

- *More complex*
- *More volatile*
- *Less transparent*
- *Less accountable*
- *“Suffering” moderate gas & low electric prices*
- *Capital starved*
- *Forcing consolidation*

MERCHANT GENERATION

Participants are:

- *Fewer in number*
- *Under-capitalized*
- *Fighting to remain liquid*
 - *Asset sales*
 - *Distressed security sales*
- *Canceling or delaying projects*
- *Uncertain of their business models*
- *Uncertain of their financial models*



FOUR-POINT LOAD SERVING PLAN

- *Invest in wise conservation programs*
- *Acquire renewables as appropriate*
- *Preserve legacy hydro assets & contracts*
- *Acquire and/or build efficient thermal assets*



GENERATION ASSET ACQUISITION

- *Organize the team*
- *Establish clear roles and responsibilities*
- *Establish process and criteria*
- *Identify and prioritize opportunities*
- *Pursue prioritized opportunities*
- *Obtain regulatory treatment of asset*
- *Finance and close the transaction*



ACQUISITION CRITERIA

- *Consistent with least-cost plan principles*
- *Size and timing*
- *Security and control*
- *Technology / environment*
- *Locational advantages*
- *Reliable fuel supply*
- *Appropriate investment*
- *Improve PSE's capital structure/creditworthiness*
- *Reduce reliance on short-term market and third-party suppliers*

THE TEAM

- **Treasury**
 - Equity / Debt
 - Credit Ratings
 - Capital Structure
 - Financial Modeling
- **Controllership**
 - Accounting
 - Financial Reporting
 - Budgeting
 - Tax
 - Earnings Effects
 - Insurance
- **Communications**
 - Internal / External
- **Operations**
 - Plant O&M
 - Wholesale Power Operations
 - Portfolio Management
 - Human Resources
 - Fuel Management
 - Transmission Planning
 - Environmental
- **Regulatory Affairs**
 - Power Cost Only Proceeding
 - Least Cost Planning Proceeding
 - Prudence Reviews
 - Tariff Design
 - Price Effects
- **Legal/Consultants**

