

EXHIBIT NO. _____ (EMM-13C/HC)
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.

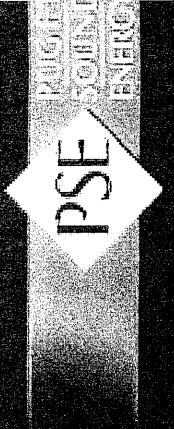
PUGET SOUND ENERGY, INC.,

Respondent.

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

Resource Acquisition Team Report

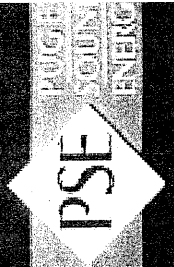
Eric Markell - Vice President, Corporate Development



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- **Discussion of Resource Options**
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- **Key Findings and Next Steps**

The following material represents only a partial summary of the discussions held by the Power Resource Acquisition Team. It does not constitute the entire range of discussion held or alternatives reviewed. The information contained in this document has been obtained under Confidentiality Agreement and should not be copied or reproduced.



Today's discussion will review four potential options available to the Company.

Potential Option

1. Purchase an existing power plant or development project
2. Enter into a longer-term PPA to meet baseload requirements
3. Have PSE construct a new greenfield generation facility itself
4. Hybrid combination of above options (e.g. purchase an existing plant in conjunction with a long term PPA and a sale of a summer off-take agreement)

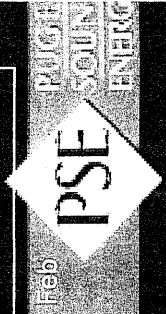
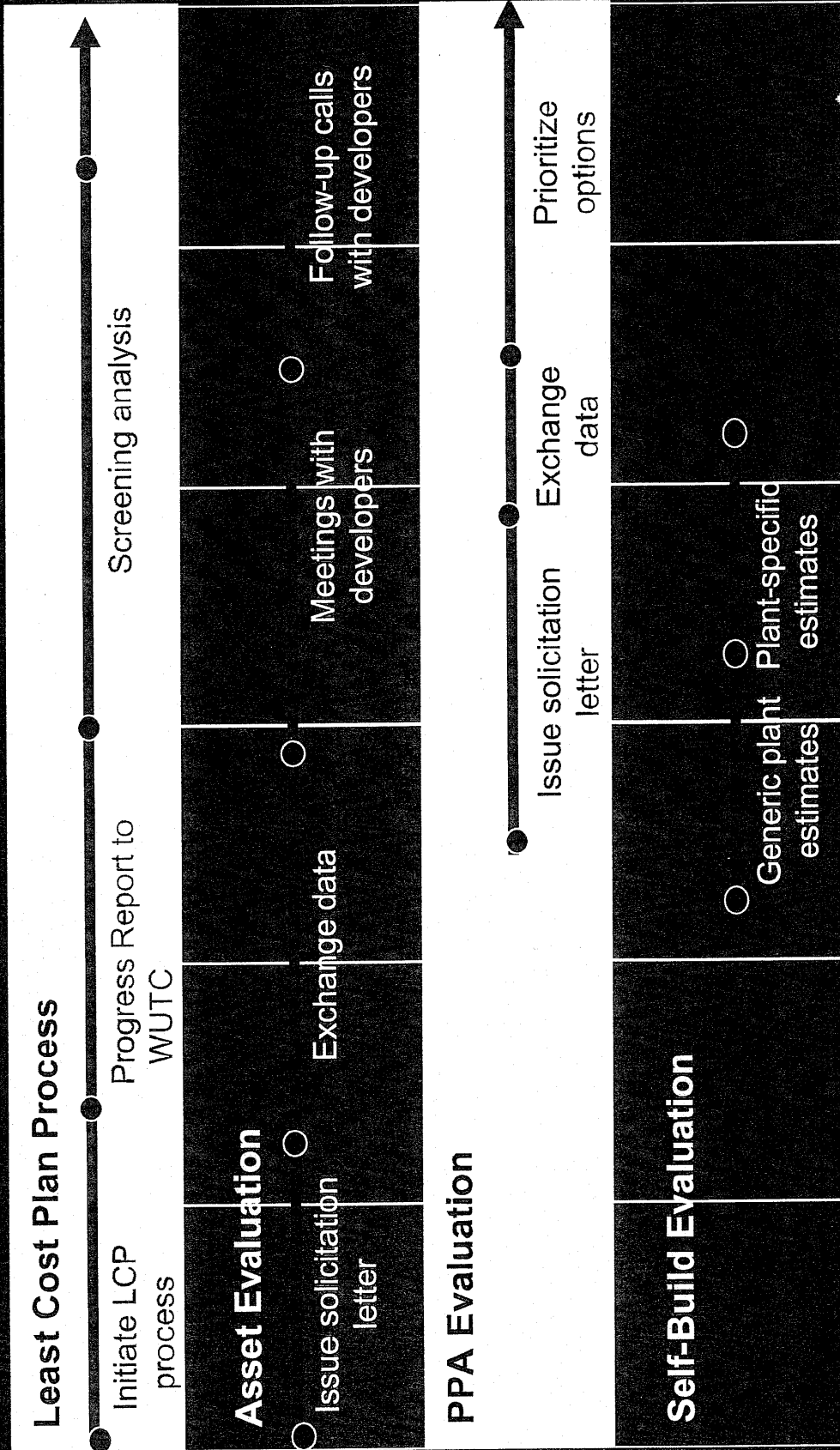
What We Are Asking Of The Board

1. Review updated information since last Board meeting
2. Review decision process prioritizing the leading candidate options for PSE
3. Review how resource acquisition solutions are compatible with the Company's LCP
4. Authorize proceeding to next due diligence steps to obtain further specificity on costs and elements of a potential transaction

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Considerable progress was made over the last six months.



Five primary decision variables have guided our evaluation of alternatives.

Compatibility with Need

- Meet short and long term energy and capacity requirements
- Balance capacity and energy needs without risk of excess capacity
- Provide shaped resource to balance seasonality of load

Cost Minimization

- Provide lowest cost alternative to meet energy and capacity needs
- Balance potential future exposure to power sales risk

Risk Management

- Balance potential future exposure to power purchase risk
- Balance potential future exposure to power sales risk
- Reasonable exposure to counter party risk

Public Benefits

- Lower portfolio emission levels
- Contribute to regional energy adequacy
- Support renewable energy development objectives
- Promote energy efficiency (conservation and demand response)

Strategic and Financial

- Reasonable exposure to future environmental regulations
- Reasonable exposure to future state wholesale market restructuring trends
- Contribute to regional energy need
- Limits balance sheet impact of imputed debt from PPA contract

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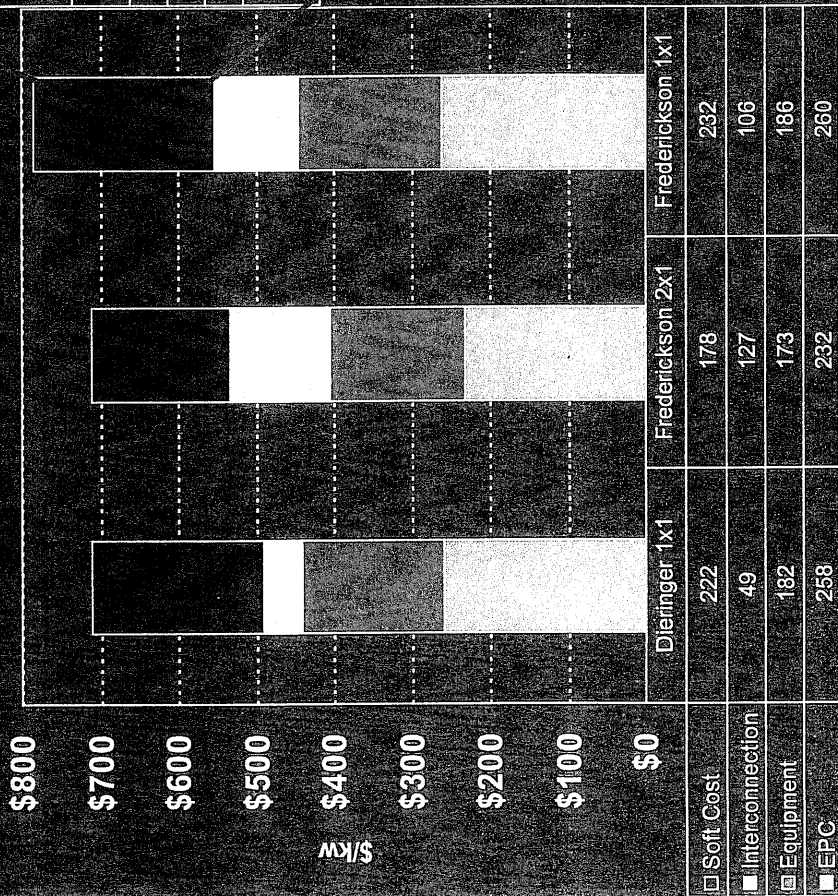
Note: Consistent decision criteria applied to resource acquisition, PPA evaluation, self-build evaluation, and LCP portfolio screening

The estimated costs and schedule for the self-build option varies for each plant.

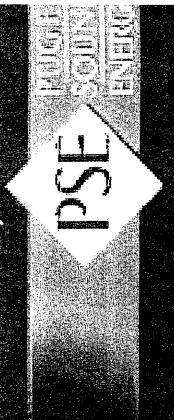
Conclusions

- Developing project-specific cost estimates requires a detailed assessment of specific design & construction variables
- Development, permitting, scheduling or construction risks have a considerable impact on the actual cost-to-build and project schedule
- Executing a self-build option at an existing PSE site would require 40-60 months
- Leading candidates appear available at more favorable price than self-build option, without the associated development, construction, or schedule risks

Site Specific Cost Drivers (\$/kw)

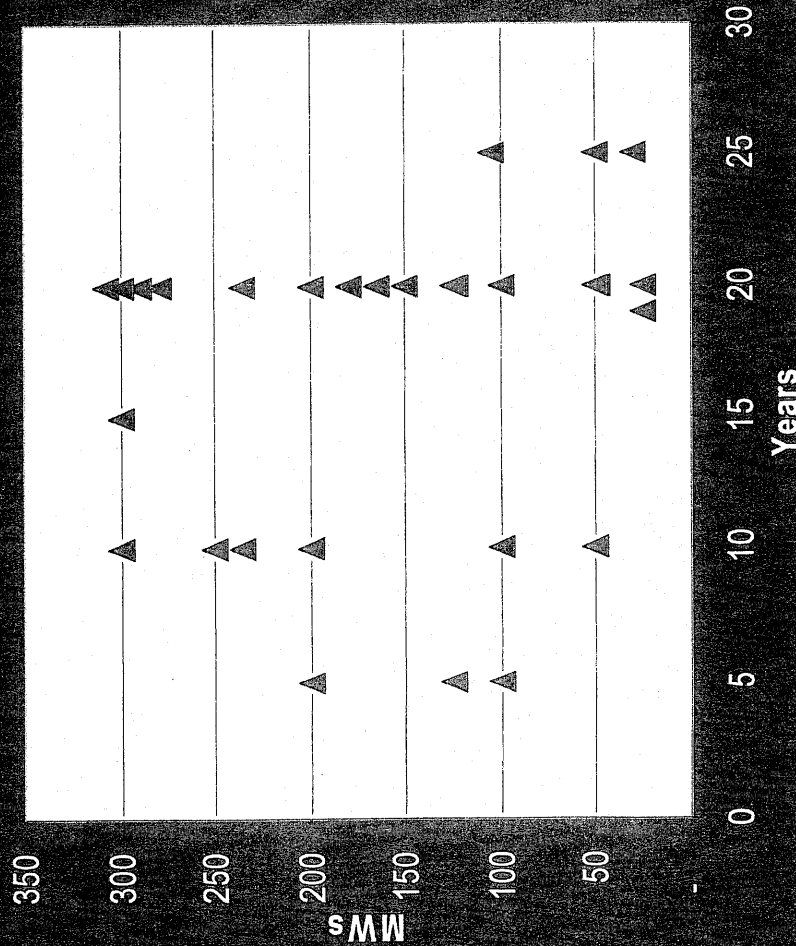


IDC (\$11.5)
Contingency (\$10.2)
Sales Tax (\$9.5)
Develop. Costs (\$7)
LTSA & Spares (\$5.8)
Startup (\$5.6)
Project Mgmt (\$5.5)
Other (\$12.6)



46 PPA proposals containing a variety of terms and attributes were received.

Profile of Product Offers - MWs by Term



Preliminary Observations

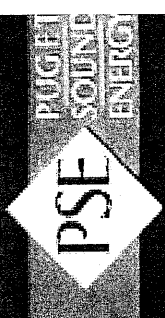
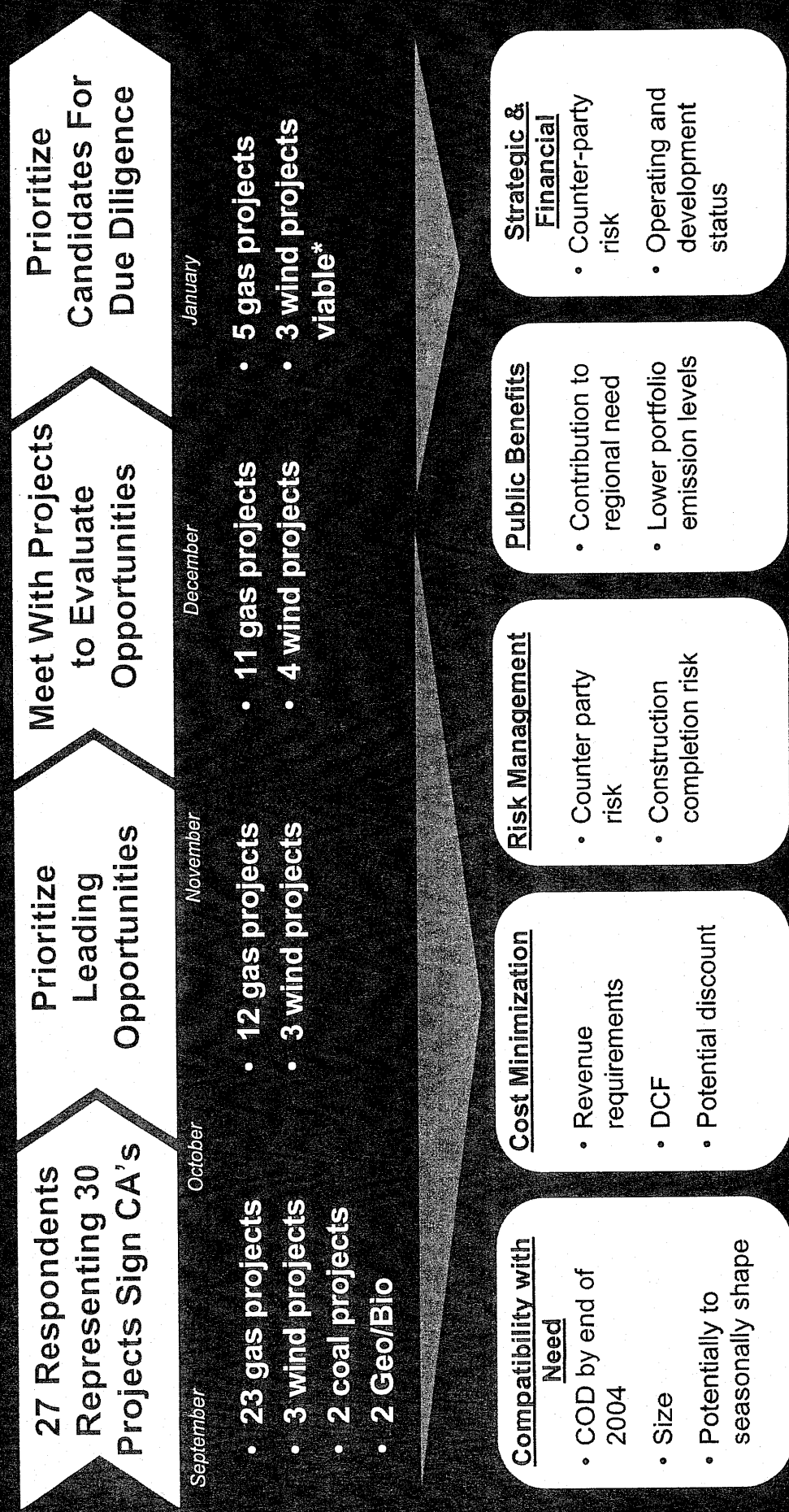
- Comparability of PPA options involves normalizing for differences in size, duration, or other factors, and is a complex evaluation
- Different PPA options could have a considerable effect on the PSE portfolio's price and volatility profile
- Strategic and financial implications of a PPA counter-party are a significant decision driver
- A number of PPA proposals offer potential opportunities to mitigate PSE's fuel and price risk exposure

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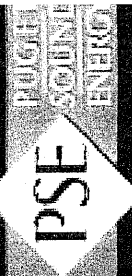
The evaluative criteria were applied to funnel down the leading candidates.



* Economic viability of wind projects totally dependent upon extension of Production Tax Credits

Prioritizing opportunities utilized a number of different financial metrics.

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



**A range of levelized revenue requirements
are evident for available options.**

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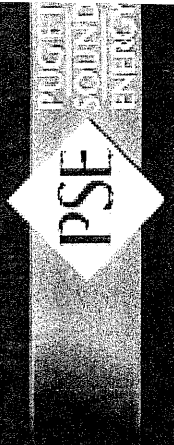
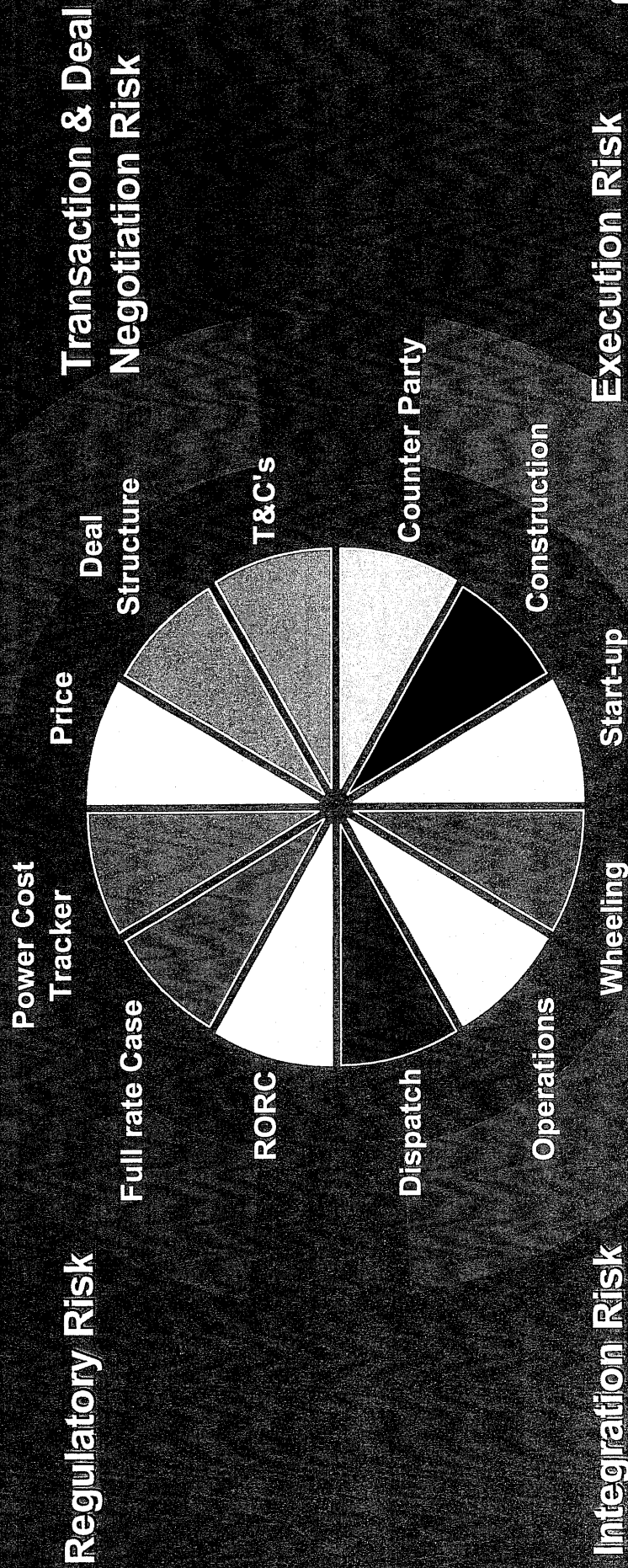
**Indicative offers from leading candidates
have converged in recent days.**

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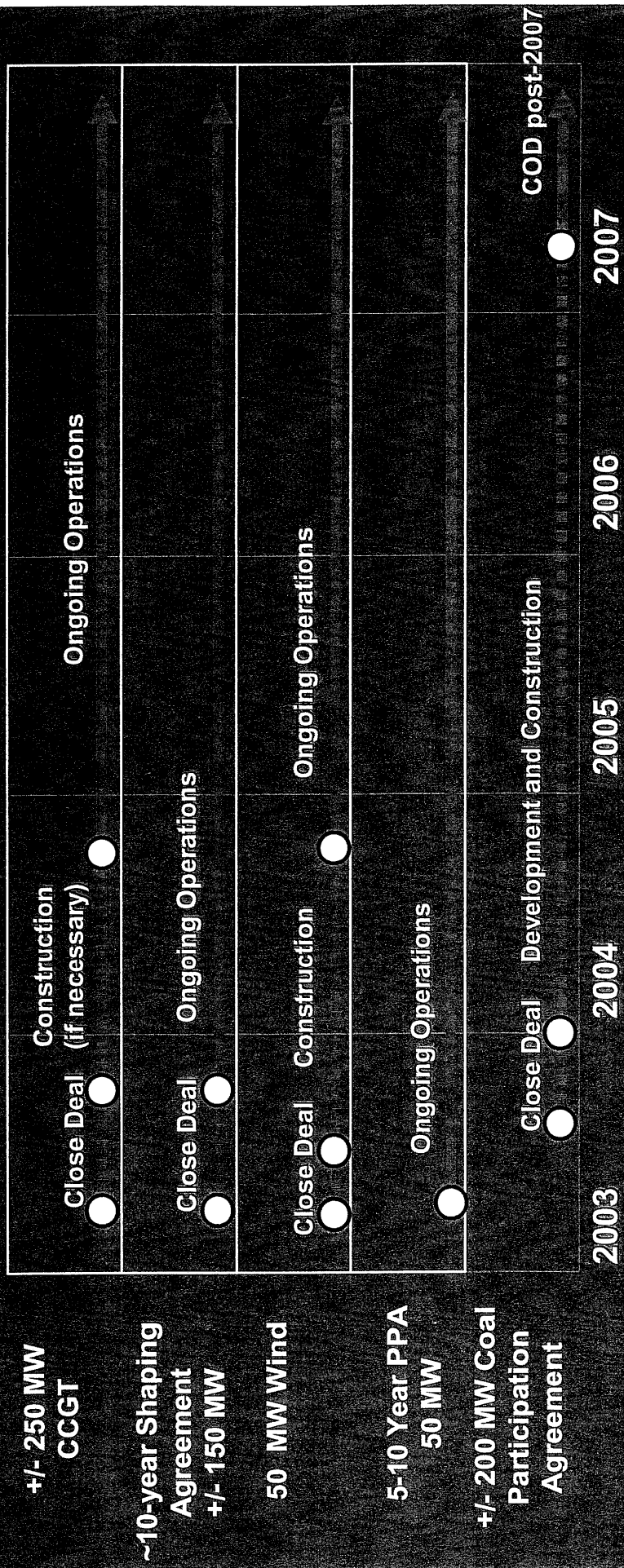
Each of the leading candidates offer some pros and some cons.

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Risk identification and management is important.



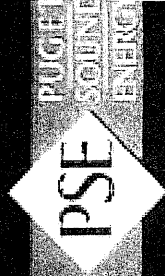
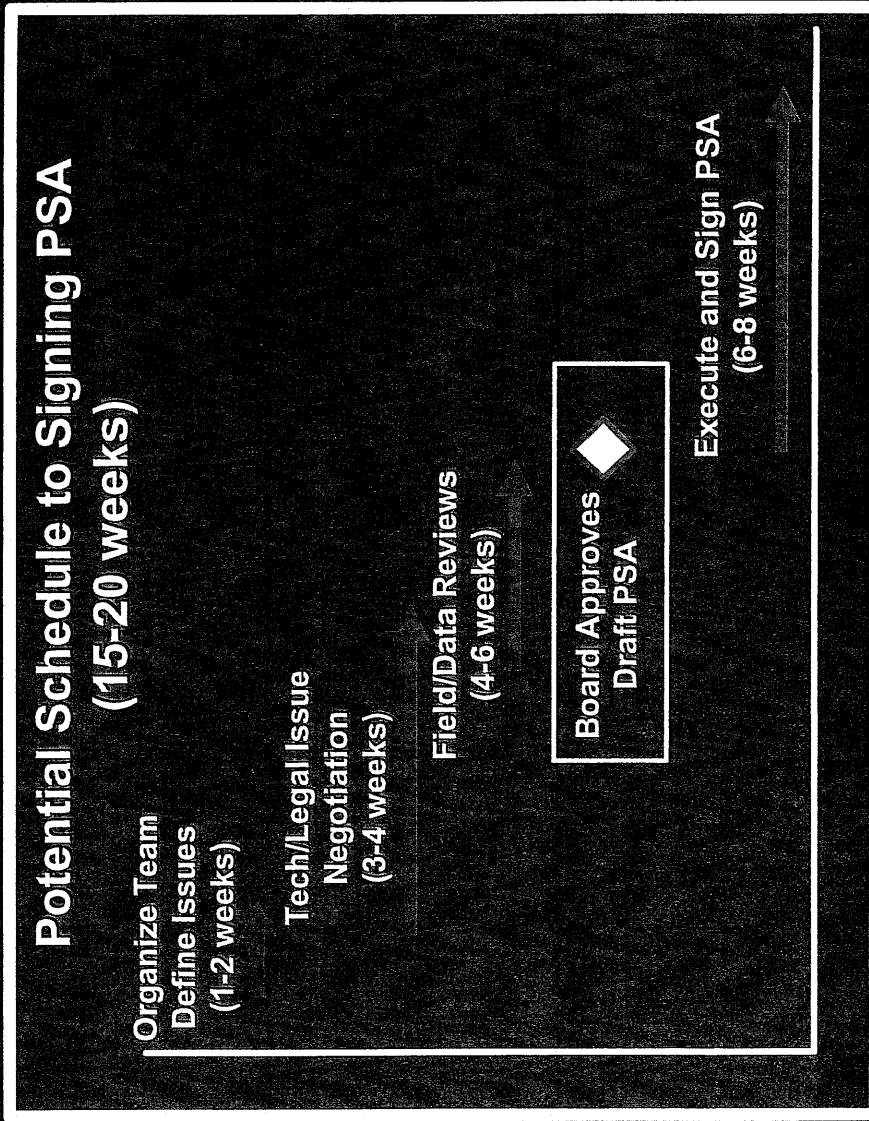
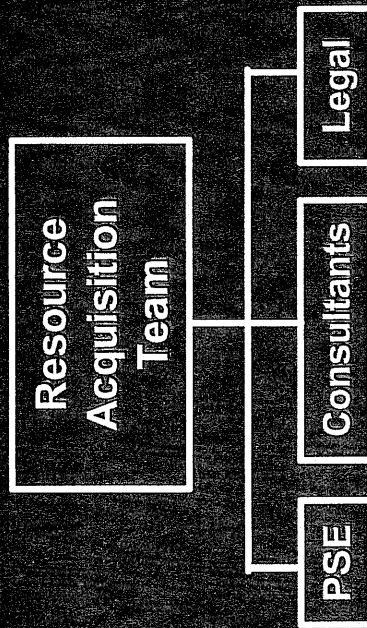
One possible implementation of a hybrid solution illustrates the interaction between resources.



A hybrid solution would have resource addition and capital expenditure implications.

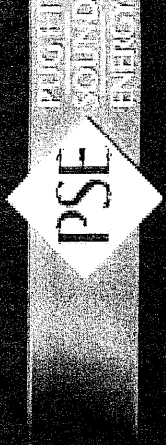
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Due diligence activities will require close coordination among team members.



A hybrid solution will require examination of a wide range of other issues.

- Organization Design & Development**
- Operations**
- Portfolio Management**
- Financing**
- Regulatory and Rate Making**



Key findings.

- 1. Self-build option is not currently justified on cost or risk basis**
 - Prices from leading candidate appear same or better
 - Leading candidates off more attractive risk profile related to schedule, development, and construction risk
- 2. Still evaluating trade-offs between assets and PPAs**
- 3. A multiple transaction, hybrid solution may be most attractive considering cost and risk**
 - Each of the leading candidate assets is a potential component of a hybrid strategy
- 4. Need to conduct further due diligence to validate asset attractiveness**



Next steps.

Least Cost Plan

1. Complete draft resource strategy
2. Issue draft LCP for public comment
3. Submit final LCP to WUTC
4. Update load-resource analysis to reflect conservation potential assessment
5. Request for proposals as needed

Resource Acquisition

1. Pursue term sheets with targeted transactions
2. Organize due diligence team
3. Perform due diligence on leading alternatives; +/- \$ 3 million.
4. Negotiate shaping contract terms with sellers or other qualified 3rd parties
5. Test leading transactions in Aurora model to determine specific resource requirements
6. Bring recommended transaction(s) to Board for final approval

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