

EXHIBIT NO. \_\_\_\_\_ (EMM-16HC)  
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,

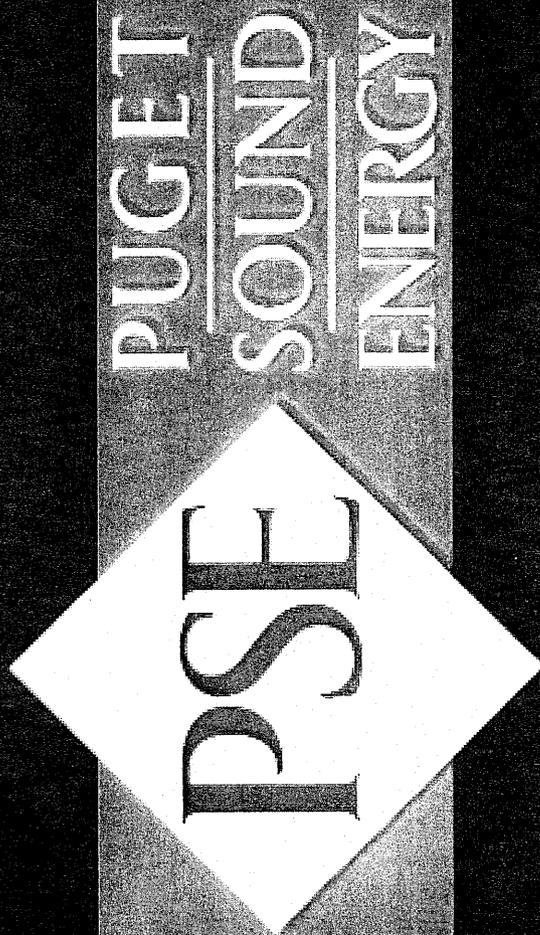
Docket No. \_\_\_\_\_

v.

PUGET SOUND ENERGY, INC.,

Respondent.

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



**Presentation to Board of Directors  
Resource Planning and  
Acquisition Update**

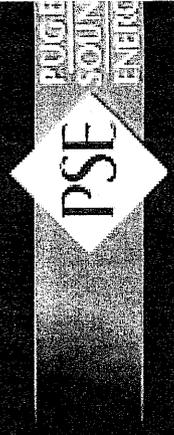
**Eric Markell  
Senior Vice President Energy Resources**

**July 8, 2003**

# Agenda

○ Progress Report

● LCP Context and Energy Market Developments



PEOPLE  
SOUND  
ENERGY



# Progress Overview

- Negotiations and due-diligence have continued on:

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▲  
▲  
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- Letters of Intent for assets have advanced:

▲  
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- Tolling agreements to shape PSE's prospective interest in  
are well advanced, but not final

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# Frederickson | Observations

- Well-prepared and knowledgeable seller
- Due-diligence expected to proceed with only "normal" issues
- Plant size, 125 MW + 12 MW expansion, is only about 1/2 of PSE's desired supply addition
- Smaller acquisition leaves ample room for conservation and other diverse supply solutions, e.g. renewable and follow-on thermal plants

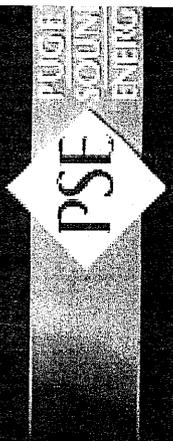
[REDACTED]

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[REDACTED]

[REDACTED] PSE's gas LDC

may be able to provide some gas transportation for 5 to 10 years



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**Total present value of revenue requirement per kw for  
candidate projects (including wheeling costs)**

**CONFIDENTIAL  
HIGHLY CONFIDENTIAL  
INFORMATION READING**

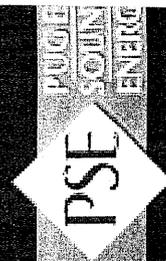
**Annual revenue requirement for candidate projects compared to power costs in PSE rates**

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# **We recommend pursuing all three viable candidates to ensure an optimal deal**

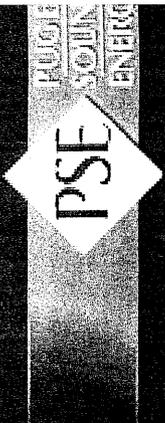
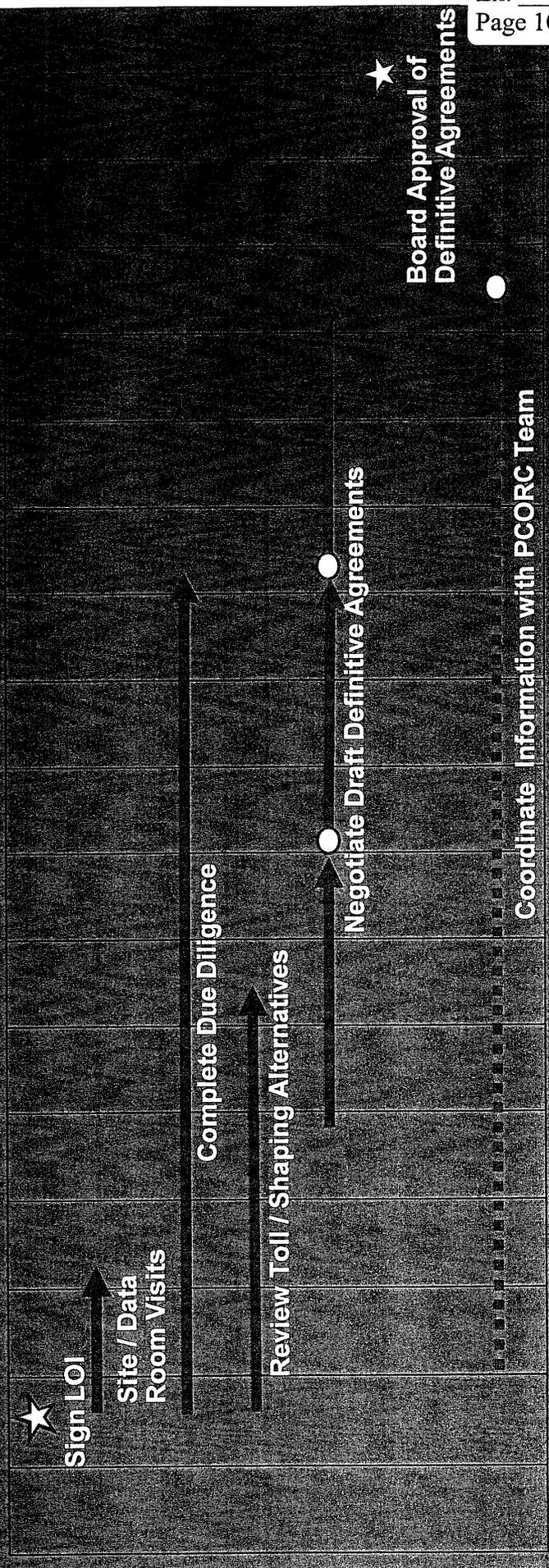
## **Additional supporting elements of the recommended strategy**

- **Assure consistency with LCP updates**
- **Monitor and assess contract extensions or other opportunities that might emerge from existing portfolio**
- **Proceed with Phase II solicitation of ~150 MW capacity wind project development in 4th Quarter 2003**
- **Prepare for additional Phase III and IV solicitations for unspecified technology resources**
- **Detailed discussions of Toll and PPA alternatives with potential counterparties**
- **Will soon file request for waiver of WUTC requirement for filing of RFP**



# Final recommendation for Board action in late October

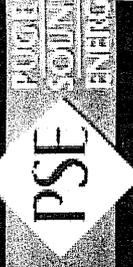
- We expect a need to go forward with somewhat parallel efforts
  - LOI's
  - Due diligence
  - Toll negotiations
  - Definitive agreements



# Agenda

- **Progress Report**

- **LCP Context and Energy Market Developments**



# The LCP strategy in our April report was a result of direction from the PSE Board of Directors

## Board Direction

### Energy:

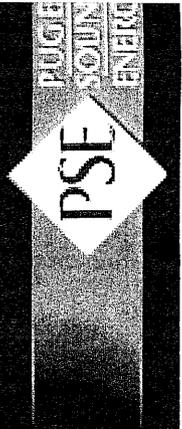
Meet every month's energy need (assuming an average hydro year)

### Capacity:

Meet 16° F. hour at SEATAC airport

## Strategy resulting from LCP

- Diverse mix of technologies
- 5%/10% renewable goals
- Conservation of 15 aMW/year (to be revisited in August update)
- Seasonal shaping to meet planning levels



# We are committed to monitoring market developments and keeping you apprised of relevant changes

## What has changed

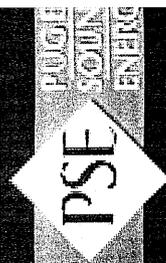
- Gas prices have risen dramatically
- Gas supply adequacy is being called into question

## What has not changed

- Market volatility
- PSE still needs committed resources to meet its planning standards

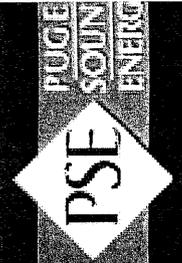
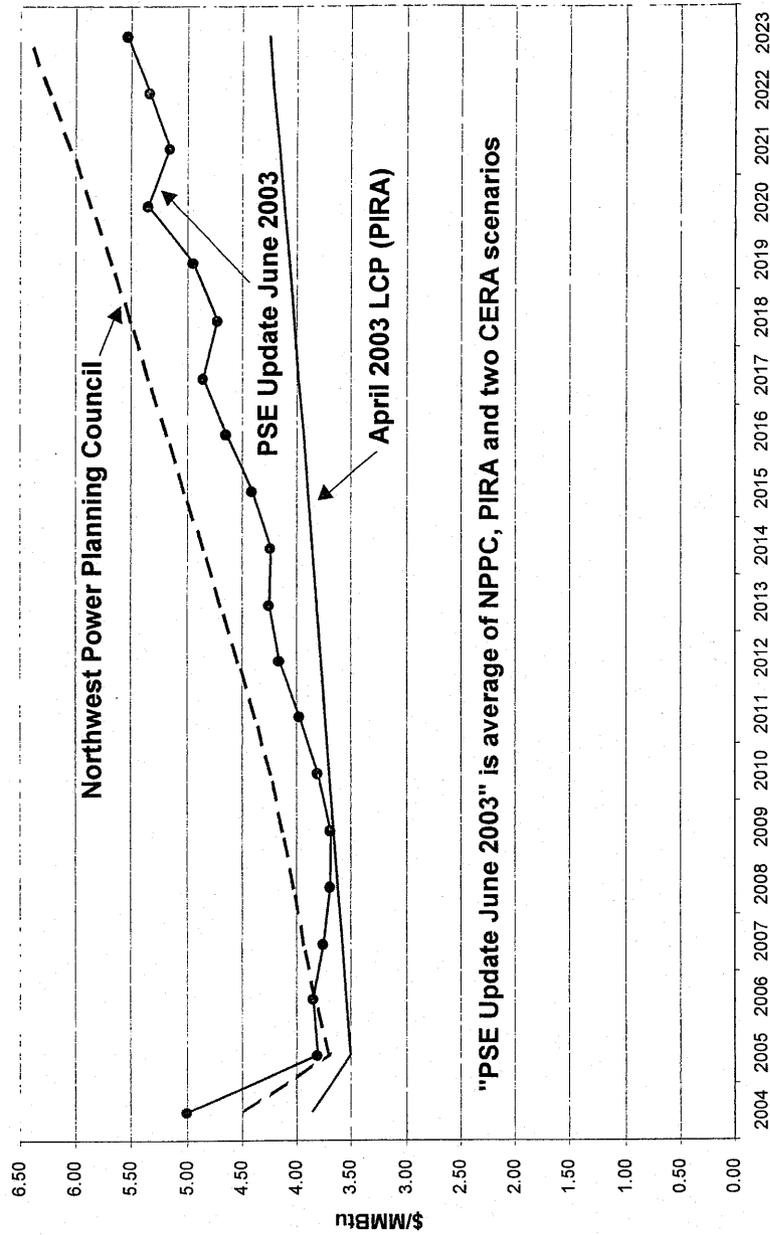
Market changes have affected the perceived value and risks in today's market place

- Current price forecast lowers the modeled valuation for gas-fired assets and increases relative valuation of coal and wind
- If and when market heat rates rebound, valuations will have already increased accordingly, which reduces potential attraction of "deferral strategy"



# Natural gas prices and supply outlook have risen to the national stage

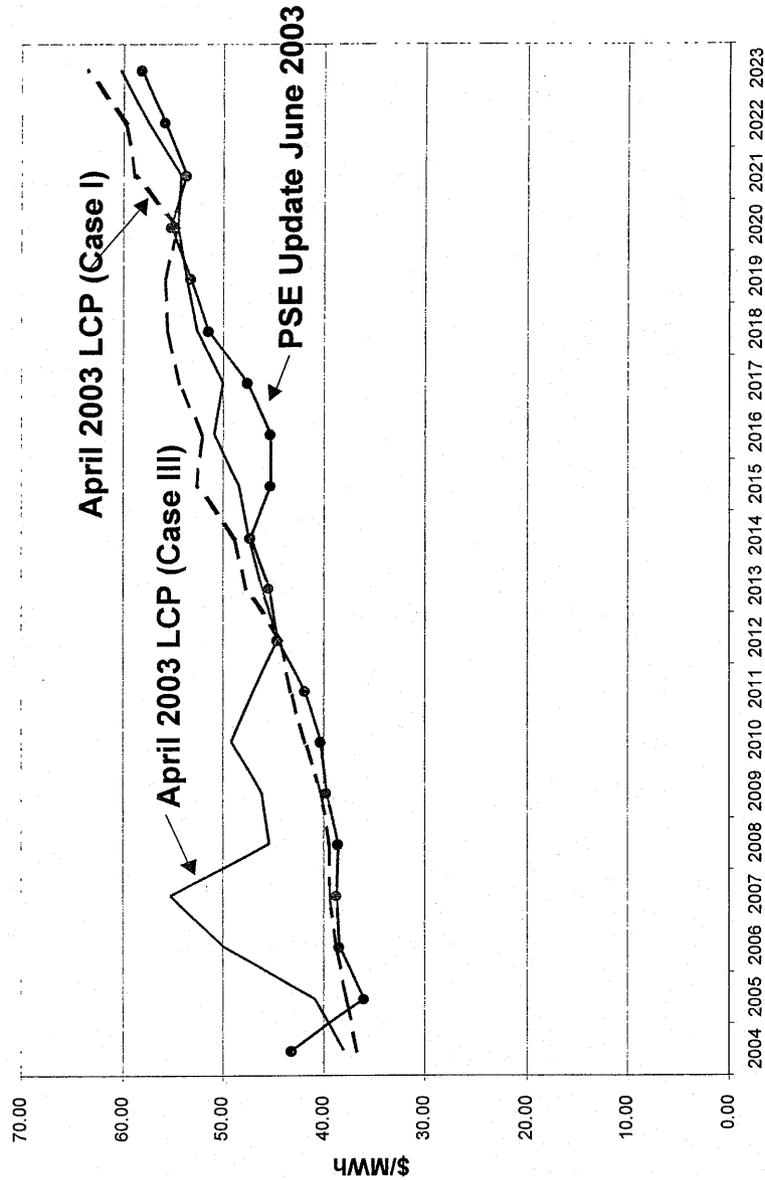
- Recent Federal Reserve Board testimony cited concerns over increased gas prices
- Sources of supply are being depleted and adequate replacement fields not being developed
- Extent of national reliance on gas-fired electric generation being questioned



# Mid-Columbia Power Price Forecasts are Lower Since April 30<sup>th</sup> LCP

## Revised Forecast Assumptions

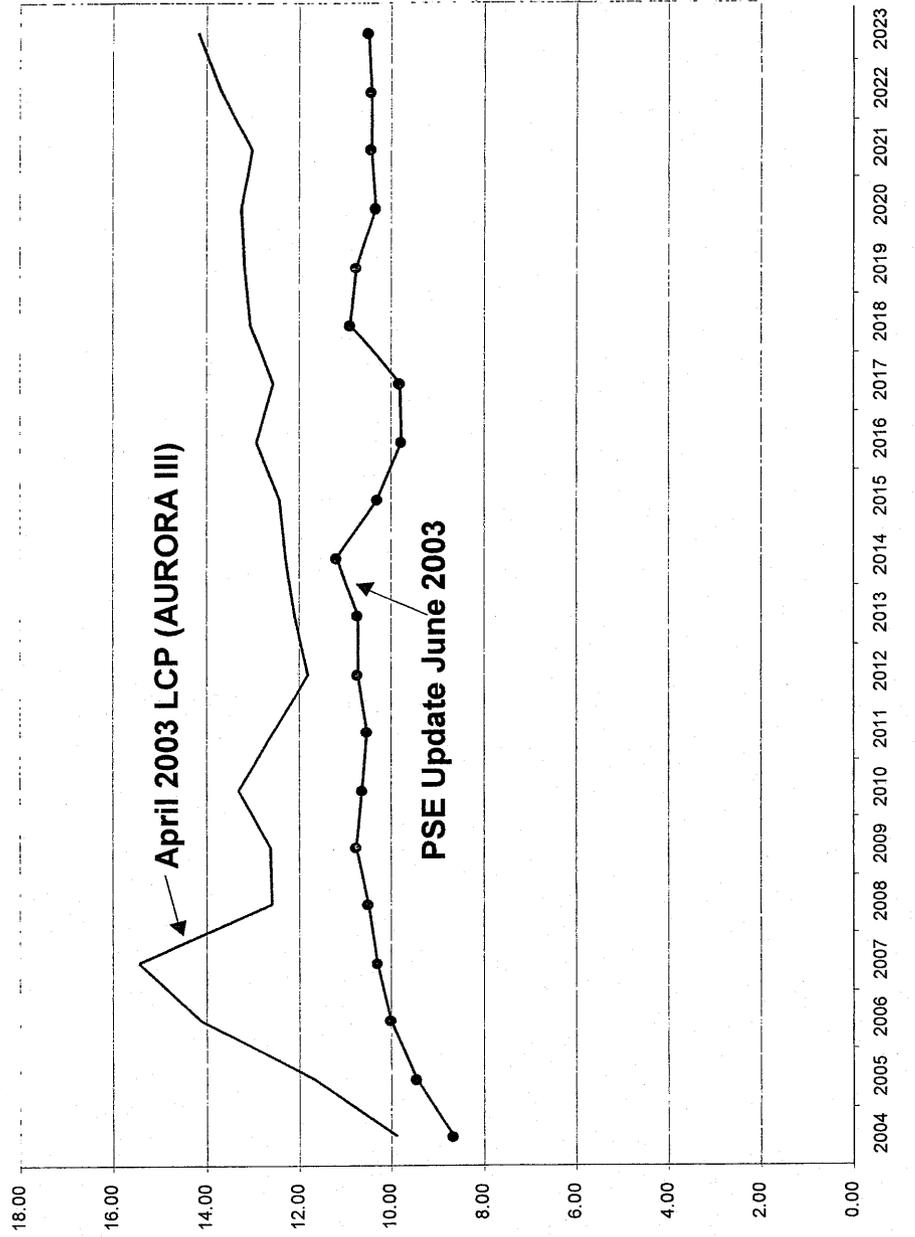
- Natural gas price forecast (higher)
- Cost of capital for generation development (lower)
- Northwest hydro regulation (monthly generation reshaped into July and August)
- Recent and impending new generation in WECC (increased)
- Limits on coal and wind resource development (lower ceiling)
- Transmission costs for coal, wind (higher)



# Higher Gas Prices Plus Lower Power Prices Result In Lower Implied Market Heat Rates

## Implications of Updated Forecast

- Consistent with current market conditions and public/political/regulatory focus on gas supply, gas prices and dependence on gas-fired generation
- Lower implied market heat rates drive the apparent market value of gas-fired generation assets lower
- Renewable resources/wind now will look better
- Coal also begins to look more attractive, subject to environmental concerns



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