

EXHIBIT NO. \_\_\_\_\_ (EMM-28HC/AC)  
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.**



# Due Diligence Training

April 11, 2003



LeBOEUF, LAMB, GREENE & MACRAE, L.L.P.

# Introduction

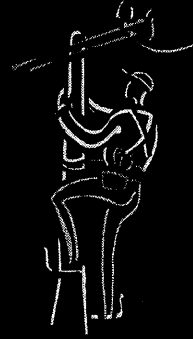
Steve St.Clair  
Puget Sound Energy

## Training Day Overview

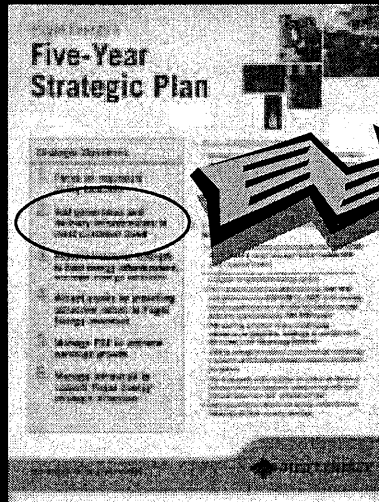
- Training Agenda
  - Overview
  - Plants
  - Activities
  - Confidentiality
  - Logistics
  - Group Time
- Handouts
- Breaks
  - 11am & 1pm
- Bathrooms
  - GO Lobby
  - By Elevators
- Box Lunch
  - Noon

## PSE Energy Resource Needs

- Energy Deficits
  - PSE: 400 MW by 2004
  - PSE: 600 MW by 2007
  - Region: 6,000 MW by 2010
- Why?
  - Load Growth
  - Contract expirations
  - Collapse of merchant sector



# PSE Five-Year Strategic Plan



**2. Add generation and delivery infrastructure to meet customer need**

Adding energy resources could include acquiring resources, developing resources, and/or contracting for power.

## Resource Acquisition Process

- “Big Picture” Acquisition Steps
  - Identify Needs / Least Cost Planning
  - Request Proposals
  - Financial Modeling
  - Short-list of Candidates
  - Negotiate Term Sheets
  - Due Diligence Review
  - Definitive Agreement
  - Closing & Transition



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### ADDITIONAL DETAIL

- Lowest Cost Alternative and the applicability of principles to the Acquisition
- Projects under consideration
- Completed Projects v. Projects under construction
- Asset v. Equity purchase
- Transaction Schedule (term sheet negotiation and execution; commencement of due diligence and negotiation of Definitive Agreements (Purchase and Sale Agreement and others)
- Diligence Process
- Relation of Diligence Process to (a) Definitive Agreements, (b) Commission review and (c) transition and integration
- Execution of Definitive Agreements
- Notices, filings, consents and approvals
- Closing
- Transition and integration of systems

## Outside Transaction Support

- Navigant Consulting
- LeBoeuf, Lamb, Green & MacRae, LLP
- Perkins-Coie
- Enpower Management
- Trinity Consulting
- Tenaska



## What is Due Diligence?

- The process of investigation into the details of a potential investment, such as an examination of operations and management, and the verification of material facts.
- A study by knowledgeable professionals to identify and assess significant factors affecting the future operation of the subject plant.
- An investigation of a potential investment, its management team, and its prospects for success.

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### ADDITIONAL DETAILS

The process whereby, in the context of a potential purchase and sale transaction, and based on document review, field and corporate observations and interviews with management and other representative of seller, the purchaser reviews and evaluates:

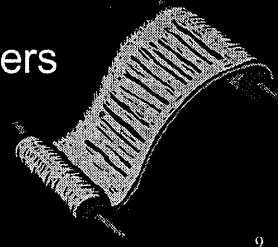
- the potential seller (and its affiliates) and its ability (financial, technical, regulatory, legal and contractual) to transfer the relevant assets and rights, make representations and warranties, and perform the promises, obligations, covenants and indemnities undertaken in the Definitive Agreements
- the quality of the relevant assets and rights
- the regulatory, permit, contractual and other obligations, responsibilities and liabilities of seller implicated in the transaction;
- the conditions and time requirements for accomplishment of the transfer of the assets and rights
- the pro forma economic performance of the Project

### PROCESS

Due Diligence activities include public records and database research and consideration of the potential seller and the financial condition of the seller and its upstream affiliates; observations of the site and facilities; review of accounts, records, permits and contracts and interviews with Seller and Seller's representatives.

## Goals of Due Diligence Review

- Eliminate Financial Uncertainties
- Verification of Resource Condition
- Find Unrecognized Limitations
- Find Fatal Flaws
- Feedback to Decisionmakers
- Documentation!!



### FATAL FLAWS

Identify and quantify technical, operational, regulatory, legal or other issues which would present material cost, finance, schedule or other risks or uncertainties that would render the particular transaction unsuitable or unachievable within established parameters.

### FINANCIAL UNCERTAINTIES

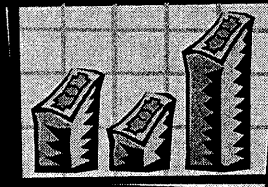
Identification and quantification of financial risks, including credit support that might be required of or by counterparties in respect of offtake and supply arrangements.

### TRANSACTION SPECIFIC

The nature, scope and focus of diligence activities will be influenced by (i) the business and purposes of the Seller (single purpose entity created for development and ownership of entity v. main entity with other businesses, assets, etc.), (ii) the structure of the transaction (equity v. asset purchase), (iii) the condition of the Project (completed v. under construction with construction work suspended) and (iv) the post-Closing co-ownership and/or sharing of certain assets, properties and services necessary for operation of the acquired generation facility.

## Due Diligence Review Tracks

- Commercial
  - Contracts Review
  - Finance & Economics
  - Human Resources
  - Fuel & Parts Inventory
  - Insurance Adequacy
  - Tax Issues
  - Documentation!

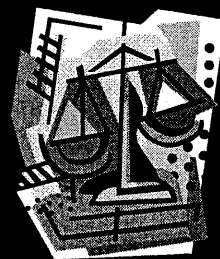


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- Existing financing (credit agreement, loans, etc.)
- General credit Support and Credit Enhancement provided to or by affiliates and others
- Credit support arrangements provided to or received from counterparties with respect to project agreements (guarantees, letters of credit, cash deposits and other collateral)
- Derivatives (hedged positions)
- AR/AP
- Indemnity Agreements
- Tax returns and filings
- Audit reports
- Opinions of Counsel

## Due Diligence Review Tracks

- Regulatory
  - Environmental Assessment
  - Permits & Agreements
  - Violations History
  - Reporting Adequacy
  - PUC Compliance
  - Stakeholder Relations
  - Documentation!



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- Governmental permits, approvals, consents, waivers, variances, licenses, filings, notices and related authorizations
- Investigations or requests for information or documents from governmental authorities
- Correspondence and communication with governmental authorities
- Employee Benefit plans
- Litigation, arbitration, mediation proceedings
- Issues, if any, presented by suspension of construction of projects under development

## Due Diligence Review Tracks

- Technical
  - Operability
  - Equipment Assessment
  - Performance Guarantees
  - Design Adequacy
  - Data Interconnection
  - Facilities & Offsite Infrastructure
  - Documentation!



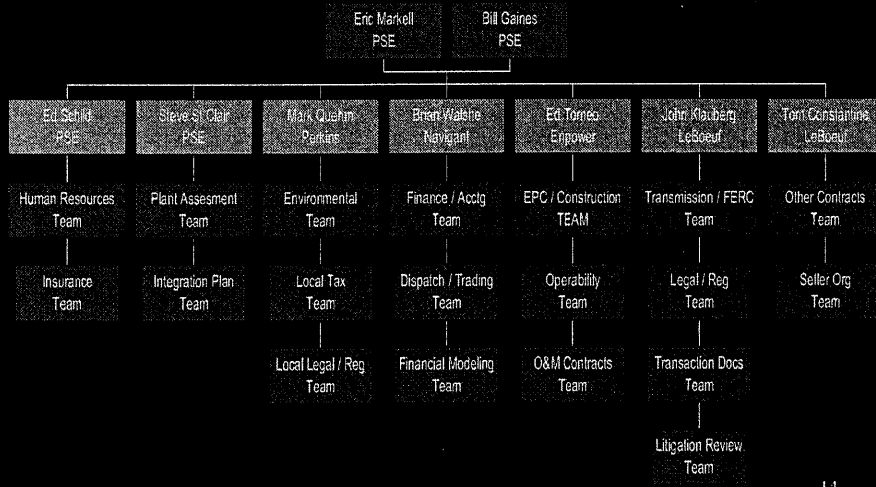
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- Contracts and Counterparties
- QA/QC
- Health, safety and environmental
- Operations and capital budgets
- Maintenance Schedules
- Equipment Overhauls
- Outage records
- Cost, schedule, warranty, and other issues associated with completion of projects under development

## Process Organizational Structure

- Due Diligence Organization
  - Executive Sponsors
  - Steering Committee
    - PSE Personnel
    - Outside Consultants
  - Due Diligence Teams
    - PSE Internal Experts
    - Outside Consultants

# Due Diligence Team Organization



# Due Diligence Steps

Brian Walshe  
Navigant Consultants

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Goal of on-site due diligence is data gathering for further analysis – do not focus on information that is publicly available

Designate responsibility for interviews & document reviews prior to due diligence visit

Identify areas where creative solutions/opportunities may address existing problems to enhance value

Team meeting should be held at lunch time to share any issues & identify areas where additional evaluation may be necessary

Team members should record data received, interviews conducted & items of significance



## Due Diligence Steps

- Phase One – Preparation Stage
- Phase Two – Information Gathering
- Phase Three – Analysis & Review
- Phase Four – Documentation!!

## Phase I - Preparation

*Goal : Gather as much publicly available data before performing on-site due diligence*

- Determine size & composition of due diligence team
- Due diligence team collects publicly available information regarding plant
- Review any data available from company, including Offering Memorandum, draft PSA, etc.

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## Phase I - Preparation

- Determine on-site schedule, interview list & specific interview topics
- Determine specific input required for the financial model
- Before going on-site, assign specific data review to due diligence team

## Phase II - Data Gathering

*Goal : Gather data & information specific to plant & not available through public means*

- Document Review
  - If possible, get list of documents before visit & make assignments among team members
  - Review available documents & request necessary follow-up documents

## Phase II - Data Gathering

- Plant Tours
  - Perform high-level tour to get a sense of plant layout
  - Request specialized tours to evaluate attributes of assigned categories (i.e., fuel handling, environmental)

## Phase II - Data Gathering

- Due Diligence Interviews
  - Meet with scheduled interviewees to ask specific topic-related questions
  - Arrange additional interviews as needed to follow up on items of interest from document review or plant tour

## Phase III - Analysis & Review

*Goal* : Analyze data received during on-site due diligence to provide input into the financial model

- Complete review of data received from on-site visit & submit follow-up questions as necessary
- Estimate future staffing needs, & O&M costs
- Develop necessary operation, maintenance, capital & regulatory inputs for the financial model

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## Phase III - Analysis & Review

- Determine areas for cost reductions or synergies with PSE's existing portfolio
- Review & assess appropriateness of all scheduled capital expenses
- For any identified issues/problems, assess the associated risks & costs



## Phase IV - Documentation

- Decision Support
- Prudence Consideration
- Contemporaneous Documentation
- Notes vs. Final Reports
  - Transcribe Notes into Report Format
    - Spreadsheets
    - Word Documents
    - Charts, etc.

# Candidate Plants

Ed Tomeo  
Enpower Management

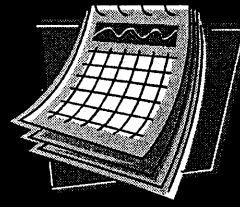
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# Due Diligence Activities

Steering Committee

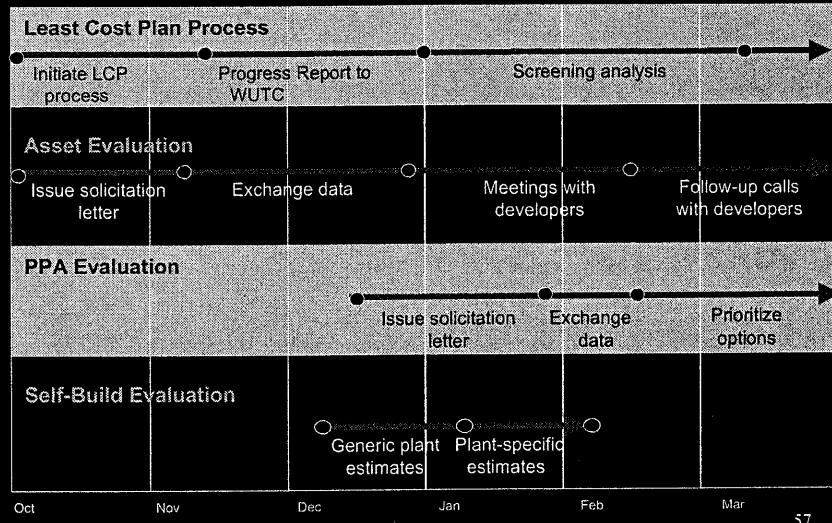
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# Schedule

Brian Walshe  
Navigant Consulting

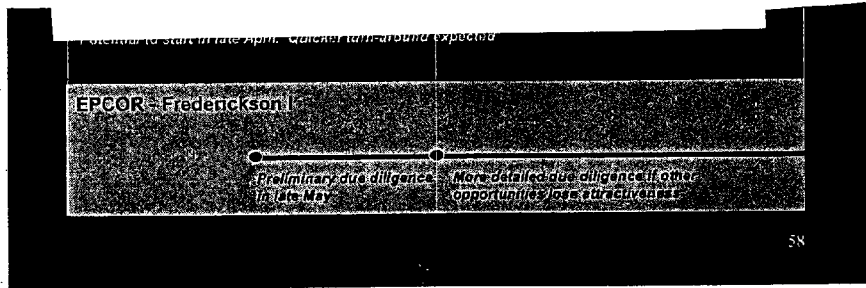
# Progress over the last six months.



Projected schedule of due diligence activities over next two months (always subject to revision)

May	June
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# Reporting & Documentation

Ed Tomeo  
Enpower Management

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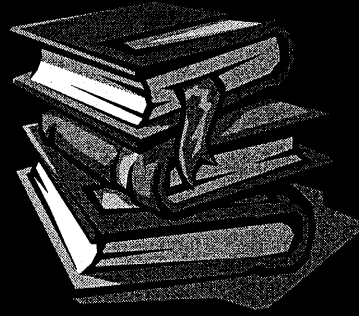
## Report Format & Documentation

- Exception Philosophy
  - Simple Narrative
  - Findings & Exceptions
- Data Forms
  - Nameplate Data
  - Operating History
  - Permit Lists
  - Compliance History
  - Reviewed Documents



## Report Format & Documentation

- “Red Flag” Lists
  - Issue
  - Analysis
  - Conclusion
  - Action
- Final Documentation
  - Support Business Decision
  - Prudence Review Record



# Logistics

Steve St.Clair

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## Logistics

- Due Diligence “Office Space”
  - OBC-05E
  - Telephones
  - Computer / Network
  - File Cabinets
  - Printer / Copier
  - **Coffee!**



## Logistics

- Plant Site Attire
  - Work Clothes
  - Sturdy Shoes
  - Hardhats
  - Safety Eyewear
  - Hearing Protection
- Spiral Notebook
- Overnight Stays
- Meals
- Transportation
- ??



## Breakout Discussion

- Exchange Contact Information
- Discuss Role of Team Lead
- Review Task List in Detail
  - Go through sub-tasks
  - Add / Revise as needed
  - Tie names to each sub-task
  - Discuss common reporting format (Forms)
- Review Confidentiality Concerns
- Set Time for Future Calls or Meetings