

**EXHIBIT NO. \_\_\_(EMM-8)**  
**DOCKET NO. UE-04\_\_\_\_\_**  
**2004 PSE PCA 2 COMPLIANCE**  
**WITNESS: ERIC M. MARKELL**

**BEFORE THE**  
**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Petition of**

**PUGET SOUND ENERGY, INC.**

**For Approval of its 2004 Power Cost Adjustment  
Mechanism Report**

**Docket No. UE-04\_\_\_\_\_**

**SEVENTH EXHIBIT (NONCONFIDENTIAL) TO  
PREFILED DIRECT TESTIMONY OF ERIC M. MARKELL  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**AUGUST 31, 2004**

**REQUEST FOR PROPOSALS**  
**From**  
**All Generation Sources**

February 3, 2004

Puget Sound Energy, Inc.  
10885 N.E. Fourth Street  
Bellevue, WA 98004-5731

The Least Cost Plan examines PSE's electric and gas resource needs over the next 20 years, and through analysis and consideration of such factors as price, supply and risk, analyzes the mix of conservation programs and supply resources that might best meet electric or gas resource needs. PSE's LCP provides the strategic direction guiding the Company's long-term resource acquisition process. The LCP identifies key factors related to various resource decisions and provides a method for evaluating a resource acquisition in terms of cost, risk, and other factors at the time a decision needs to be made. It does not commit to or preclude the acquisition of a specific resource type, project or facility.

The overall strategy for least cost resource planning at PSE is to develop a diversified, balanced electric resource portfolio that meets customer needs, results in reasonable energy supply costs and mitigates market risks, such as those recently experienced in the region. PSE's resource needs (prior to recent acquisition activities) were for an estimated 400+ aMW of new electric resources in 2004 growing to over 1,700 aMW in 2013 due to growing load in its service territory, the loss of existing resources, and the expiration of power purchase and non utility generation contracts. A portion of those needs have been met through the prospective acquisition of the Frederickson 1 combined cycle generation project. Another portion will be met through conservation. PSE's planning standards call for adequate energy resources to serve each month's electric load under average hydro conditions, and having sufficient capacity resources to meet customer peak loads at 16 degrees Fahrenheit. Both energy and capacity resources will be shaped through various means to fill winter deficiencies, while minimizing summer surpluses.

The PSE LCP set forth a strategy for the acquisition of a diversified portfolio of energy resources. Thus, PSE has established a target of serving 10 percent of its customers' energy needs through renewable resources by 2013. The intent of this RFP is to solicit proposals representative of a broad set of resource technologies and fuel types.

PSE has also committed to continue, as part of its analysis, the on-going process of evaluating all new resource options through the integrated resource portfolio modeling approach used to develop its LCP.

### **3 Products Requested**

This RFP seeks electric generation proposals from a wide variety of technologies and fuel sources consistent with PSE's Least Cost Plan and Key Considerations (see Sections 1.2 and 2) and Evaluation Criteria (Section 9). PSE will consider the acquisition of generation from such proposals under two potential mechanisms: (1) long-term Power Purchase Agreements (20 + years) or 2) ownership arrangements, including co-ownership arrangements in which PSE retains adequate dispatchability and rights of control.

When submitting proposals for either a Power Purchase Agreement or ownership arrangement, PSE is interested in alternatives in which the respondent fully assumes the risk of fuel supply, fuel price, and environmental cost and which quantify the cost for assuming those risk factors. Failure to provide such an alternative will not disqualify the

respondent; however, if the respondent elects not to provide a proposal for assuming such risks, PSE requests that an explanation as to the reason be provided.

### **3.1 Power Purchase Agreements**

Any proposal for a Power Purchase Agreement must specify the generation asset underlying the agreement and provide assurances of its commercial availability within PSE's time frame requirement as defined previously in this document.

In considering Power Purchase Agreements, PSE requires proposals pursuant to which the respondent would acquire, construct, own and operate the generation asset, with PSE purchasing the output (energy and capacity) at an agreed upon delivery point and any Environmental Attributes<sup>2</sup> (see Section 6.6). A prototype Power Purchase Agreement is included as Exhibit III to this RFP.

### **3.2 PSE Ownership**

The PSE ownership mechanism anticipates a proposal pursuant to which PSE would ultimately own the resource or a significant interest in the resource. This may be accomplished at various stages of development and using a variety of approaches such as joint development by the respondent and PSE, development by the respondent and then transfer to PSE, initial purchase of power by PSE with transfer of ownership later, or other approaches which may be mutually beneficial. Although PSE is willing to consider a wide range of arrangements, the term sheet included as Exhibit IV to this RFP presumes that PSE would acquire its ownership interest in the project prior to the commencement of construction and would fund its ownership share on a pro rata basis.

### **3.3 Shaping**

PSE will also consider contractual or other proposals for shaping resource output to meet PSE seasonality requirements. If the respondent includes a shaping proposal, such proposal must be in conjunction with a proposal for an underlying generation asset. PSE is interested in shaping proposals that provide a stable price (e.g., are not tied to a market price index), are associated with an underlying resource proposal and are for arrangements for a term of 3 or more years. Any proposal to shape resource output contractually must be made in conjunction with a specific proposal that satisfies the criteria of this RFP (i.e., stand-alone or separate shaping proposals do not meet such criteria). Also, any such shaping provisions should be optional, to be included at PSE's election.

### **3.4 Fuel Supply**

For proposals that are dependent upon a fuel source such as natural gas, coal, biomass or others, respondents are requested to propose, as an alternative, a long-term stable price (e.g., not tied to a market price index) and firm supply of fuel. Any proposal for fuel supply must be made in conjunction with a specific proposal that satisfies the criteria of this RFP (i.e., stand-alone or independent fuel supply proposals do not meet such

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<sup>2</sup> "Environmental Attributes" means generally credits, benefits, reductions, offsets and other beneficial allowances with respect to fuel, emissions, air quality, or other environmental characteristics, resulting from the use of certain resource generation or the avoidance of emissions.

criteria). Failure to provide such an alternative will not disqualify the respondent; however, if the respondent elects not to provide a proposal for assuming such risks, PSE requests that an explanation as to the reason be provided. Also, any such fuel supply provisions should be optional, to be included at PSE's election.

### **3.5 Environmental Costs**

Respondents are requested, as an alternative, to provide a proposal which fully assumes the present and future costs of environmental mitigation required under existing or future local, state, or federal law. If provided, such proposal should specify the environmental risks which the respondent is assuming and the cost for assuming each one. Failure to provide such an alternative will not disqualify the respondent; however, if the respondent elects not to provide a proposal for assuming such risks, PSE requests that an explanation as to the reason be provided. Also, any such environmental risk provisions should be optional, to be included at PSE's election.

## **4 Eligible Respondents**

This RFP will accept proposals from all third party project developers or owners that meet the project requirements and comply with the process guidelines described herein. Affiliated generating companies of PSE are not eligible to respond to this RFP. However, PSE will consider proposals from other utilities or utility subsidiaries. PSE believes that consideration of proposals from other utilities and/or their affiliates may increase the number of qualified respondents and thus increase the overall creativity and competitiveness of responses to this RFP.

## **5 Proposal Requirements**

PSE is requesting that respondents conform to the following format for presenting their bid information:

- Summary Data (Summary material to be provided as per Exhibit X of this RFP)
- Project Summary
- Resource Description
- Fuel Supply
- Legal and Financial Information
- Price
- Transmission
- Experience and Qualifications of the Project Team
- Development Status and Schedule
- Response to RFP Section 6 Requirements
- Completed RFP Exhibits or proposed modifications to RFP Exhibits, as applicable (see Section 13 of this RFP).

Information requirements for each of the above subjects is further detailed below. It is expected that respondents will provide complete information in their original submittals. Failure to provide all of the requested information will not disqualify the respondent. However, if the respondent elects not to provide the requested information, PSE requests that an explanation as to the reason be provided. (Please see Section 10 and Exhibit VII

rate base, such approvals and/or orders to be in form and substance satisfactory to PSE in its sole discretion. In this regard, any proposed price may not be unilaterally changed by the respondent prior to the finalization of such agreements and approvals. It is preferred that the respondent provide proposals that remain valid for a period that allows for negotiation of Definitive Agreements and applicable management and regulatory approvals.

## **6.6 Environmental Attributes**

All proposals must state that all Environmental Attributes associated with the project, if any, will accrue to the ownership and beneficial use of PSE.

## **7 Credit Requirements**

PSE reserves the right to require adequate credit assurances which may include, but not be limited to, a corporate parental guaranty and/or a letter of credit in a form and amount, for a term and from a corporate parent or a financial institution acceptable to PSE. In the event PSE anticipates that additional credit assurances may be required from a respondent, PSE reserves the right to request that the respondent reply in writing regarding its intent to provide such credit assurances prior to the beginning of negotiations on any Definitive Agreement. "Adequate credit assurances" shall include, but not be limited to, security for the value associated with market-based damages for failure to perform, delays in construction, failure to meet minimum availability levels and/or other forms of default or non-performance.

The respondent should be aware that PSE may require negative control provisions (covenants restricting respondent business practices that could jeopardize respondent's ability to perform its obligations) in the Definitive Agreements that respondent and PSE might execute in connection with respondent's proposal, in addition to any that may be included in the prototype Power Purchase Agreement (Exhibit III) or prototype ownership term sheet (Exhibit IV). Examples of such negative control provisions are included in the prototype term sheet (Exhibit IV) under the heading "Transaction Covenants."

PSE prefers acquisitions that do not impose credit support requirements on PSE. If any respondent intends to propose that PSE provide credit support (e.g., in the form of a letter of credit or otherwise), the respondent must describe in its proposal all desired terms and conditions regarding such credit support.

## **8 Evaluation Process**

PSE will follow a structured evaluation process in evaluating the merits of proposals with regard to meeting PSE's LCP requirements and the Key Considerations previously stated. This will be accomplished through a two stage process.

### **8.1 Stage I Evaluation**

Stage I of the evaluation process is intended to screen and rank proposals which will then be further evaluated in Stage II which will examine individual proposals in more detail

and in the context of PSE's overall loads and resources. PSE will evaluate proposals for individual resources based on compliance of the proposal with this RFP (including term sheet and contractual provisions contained in this RFP) and according to the following set of primary criteria:

- Compatibility with Resource Need
- Cost
- Risk Management
- Public Benefits
- Strategic and Financial

Each of these primary criteria is further delineated with sub-criteria as detailed in Exhibit I to this RFP.

## **8.2 Stage II Evaluation**

In Stage II, PSE will further evaluate the most attractive proposals, as identified in Stage I, based on compliance of the proposals with this RFP (including term sheet and contractual provisions contained in this RFP) and using the same primary criteria as in Stage I, analyzed at a more detailed level. In Stage II, a primary focus will be to examine the interaction of the most promising resources and combinations of resources within PSE's existing portfolio of generation.

Further elaboration of the Stage II evaluation criteria are presented in more detail in Exhibit II to this RFP. Stage I evaluation criteria continue to apply in Stage II.

As part of the evaluation of proposals, PSE may require the "short-listed" respondents to fund the fees and cost of a third party selected by PSE to perform "fatal flaw" analyses and initial due diligence of the selected projects. The maximum level of funding will be specified at the time of any such request.

At the completion of the Stage II evaluation, PSE will select proposals for further discussion with the respondent(s) and potentially move forward with negotiations of the terms and conditions of Definitive Agreements.

## **9 Post-Proposal Negotiations and Awarding of Contracts**

It is PSE's intent to negotiate both price and non-price factors during any post-proposal negotiations with a respondent whose proposal is selected for further discussions at the completion of the Stage II evaluation. It is also PSE's intent to include any additional factors that may impact the total cost of a project and to continually update its economic and risk evaluation until such time as PSE and respondent might execute Definitive Agreements.

Definitive Agreements, if any, would be based on the outcome of these continuing evaluations and negotiations. PSE has no obligation to enter into a Definitive Agreement with any respondent to this RFP and may terminate or modify this RFP at any time without liability or obligation to any respondent. This RFP shall not be construed as preventing PSE from entering into any agreement that it deems appropriate at any time

**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

<b>Evaluation Criteria</b>	<b>Explanation of Criteria</b>	<b>Summary Evaluation</b>
<b>Compatibility with PSE Resource Need</b> 1) Timing  2) Resource match to monthly need  3) Match to monthly need through contract	<p>Proposals which are available early in the acquisition time period (2005 through winter '07/'08) are preferred. Proposals which provide substantial assurances of being commercially available in 2005 are preferred.</p> <p>Proposals where generation from the underlying generation asset closely match PSE's monthly energy requirements or whose output can be controlled by PSE are preferred over those which rely on shaping through short- or long-term arrangements.</p> <p>Proposals that provide a fixed annual price to shape the underlying generation asset output to PSE monthly energy requirements are preferred. PSE will not consider proposals for contractual shaping that are tied to an energy price index. Contracts for a term of 3 or more years are preferred.</p>	



**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

<b>Compatibility with PSE Resource Need (Cont'd)</b>	
<p>4) Operational Flexibility</p>	<p>Proposals which provide PSE control of project output acceptable to PSE to respond to seasonal &amp; real-time fluctuations in load/resource balance and system reliability events are preferred. This includes, for example, dispatch or displacement of the project in real-time and, for jointly-owned projects, the ability for PSE to elect to use for reliability purposes generation output that would otherwise have been displaced by the other owner.</p>

**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

Evaluation Criteria	Explanation of Criteria	Summary Evaluation
<p><b>Cost Minimization</b></p> <p>1) Resource price</p>	<p>PSE prefers those proposals which satisfy its other evaluation criteria at the lowest cost throughout the project life.</p>	
<p>2) Transmission</p>	<p>PSE prefers firm delivery of energy to its service area (particularly at points on its system at which the deliveries may be effected and used to serve load with no or limited transmission congestion). In the absence of assurance at the time of proposal of such firm delivery, PSE prefers proposals that provide a high likelihood of acquiring adequate transmission rights to such points. Proposals that do not include firm transmission to such points, that would produce congestion or that would increase PSE's transmission costs will be compared unfavorably with other proposals and/or will be assessed the additional cost to PSE.</p>	

**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

Evaluation Criteria	Explanation of Criteria	Summary Evaluation
<p><b>Risk Management</b></p> <p>1) Status &amp; Schedule</p>	<p>All other things being equal, PSE prefers operating projects first, projects under construction second, and development projects third. With respect to development projects, respondent proposals that are able to demonstrate they have the experience and financial resources to complete the project and have made significant progress in securing necessary permits, property rights, equipment, regulatory approvals, water rights, wastewater and disposal rights, project agreements and all other rights or arrangements necessary for a completely commercially operational project within the time proposed for commercial operation are preferred.</p>	
<p>2) Price Volatility</p>	<p>Proposals that provide significant long-term control of fixed and variable costs are preferred.</p>	
<p>3) Resource Flexibility and Stability</p>	<p>Proposals that provide flexibility to expand to meet PSE's growing needs or to be deferred as required are preferred. Proposals that include project agreements and all other rights and arrangements coterminous with power purchase delivery periods or project life are preferred.</p>	

**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

Evaluation Criteria	Explanation of Criteria	Summary Evaluation
<b>Risk Management (Cont'd)</b> 4) Resource Technology	Proposals that are based on commercially proven technology with demonstrated long-term reliability and performance history are preferred. Proposals that are based on technologies whose output may be controlled are preferred.	
5) Long-term Flexibility	Proposals that provide PSE the flexibility to adjust its position in a resource long-term up to and including termination are preferred.	
6) Project Risk	Proposals that involve minimal risk for timely plant completion within cost projections are preferred. Proposals that minimize exposure to environmental risk or other potential liability are preferred.	

**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

<b>Evaluation Criteria</b>	<b>Explanation of Criteria</b>	<b>Summary Evaluation</b>
<p><b>Public Benefits</b></p>		
<p>1) Environmental Impacts</p>	<p>Proposals with lower environmental impacts are preferred. Environmental impacts refer to the full range of issues evaluated in an environmental impact statement (EIS) or environmental assessment (EA).</p>	
<p>2) Resource Location</p>	<p>Proposals that are located such that they provide benefits to the regional and PSE transmission system or require minimal or no transmission upgrades are preferred. Proposals that are not dependent upon constrained transmission or fuel transportation paths are preferred. Proposals that are located such that they are within PSE's control area are preferred.</p>	
<p>3) Community Impacts</p>	<p>Proposals that demonstrate support from public, local, state and federal government entities and Native American nations, if applicable, are preferred.</p>	

**Exhibit I, All Generation Source RFP – Stage I Evaluation Criteria**

Evaluation Criteria	Explanation of Criteria	Summary Evaluation
<p><b>Strategic &amp; Financial</b></p>		
<p>1) Capital Structure Impacts</p>	<p>Proposals are preferred that do not increase PSE's exposure to adverse impact on its financial position (e.g., by requiring PSE to impute debt, by otherwise adversely affecting PSE's financial leverage, operating leverage, credit rating, cash flow, income statement or balance sheet, or by imposing credit requirements).</p>	
<p>2) Future exposure to environmental regulations and/or taxes.</p>	<p>Proposals for resources with lower potential exposure to future environmental regulations and/or taxes are preferred.</p>	