EXHIBIT NO. ___(EMM-17HC)
DOCKET NO. _____
2005 POWER COST ONLY RATE CASE
WITNESS: ERIC M. MARKELL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	Docket No. UE-_____

SIXTEENTH EXHIBIT TO THE PREFILED DIRECT TESTIMONY OF ERIC M. MARKELL (HIGHLY CONFIDENTIAL) ON BEHALF OF PUGET SOUND ENERGY, INC.

REDACTED VERSION

JUNE 7, 2005

PUGET SOUND ENERGY, INC.

MINUTES OF THE
BOARD OF DIRECTORS' MEETING
JANUARY 11, 2005

Pursuant to notice duly given on January 5, 2005 (a copy of which is filed with these minutes), a meeting of the Board of Directors of Puget Sound Energy was held in Puget Sound Energy's Board Room on the 12th Floor of the Puget Sound Energy Building, beginning at 10:30 a.m. on Tuesday, January 11, 2005.

The following Directors were present:

D. P. Beighle
C. W. Bingham
P. J. Campbell
C. W. Cole
R. L. Dryden
S. E. Frank (by telephone)
T. Moriguchi
K. P. Mortimer
S. G. Narodick
S. P. Reynolds

being more than a quorum.

Also present were:

Puget Energy and PSE Management
J. W. Eldredge, Corporate Secretary and Chief Accounting Officer
D. E. Gaines, Vice President Finance and Treasurer
J. L. O'Connor, Vice President and General Counsel
B. A. Valdman, Senior Vice President Finance and CFO

PSE Management
K. J. Cammermeyer, Corporate Counsel
W. J. Elsea, Energy Resource Financial Analysis Manager
R. Garratt, Director of Resource Acquisition
K. J. Harris, Vice President Regulatory & Government Affairs
T. R. Heister, Senior Resource Acquisition Project Manager
L. Luebbe, Director Senior Corporate Counsel
S. S. Osborne, Corporate Counsel
E. M. Markell, Senior Vice President Energy Resources
E. R. Schild, Director Energy Production and Storage
P. M. Wiegand, Vice President Development & Contract Management

APPROVAL OF PURCHASE OF HOPKINS RIDGE WIND POWER FACILITY

Mr. Beighle then asked Mr. Elsea, Mr. Garratt, Mr. Heister, Ms. Luebbe, Mr. Osborne and Mr. Wiegand to join the meeting and for Mr. Markell to give the Board an update on PSE energy resource acquisition matters. Mr. Markell then reviewed with the Board a report he had prepared on the Hopkins Ridge Wind Project. A copy of Mr. Markell's report was furnished the Board in advance of this meeting and is filed with the minutes. After full discussion, on motion duly made and seconded, the following was unanimously approved,

> WHEREAS, this Board of Directors of Puget Sound Energy, Inc. (the "Company") has determined that it is in the best interests of the Company, its customers, shareholders and other stakeholders to add energy resources into the Company's energy resource portfolio consistent with the Company's 2003 Least Cost Plan;
>
> WHEREAS, the Company's review, analyses and evaluation of responses to its Wind Resource and All-Source Requests for Proposal have determined a wind turbine project being developed by Blue Sky Wind LLC ("Blue Sky"), an affiliate of Renewable Energy Systems Limited of the United Kingdom ("RES"), to be the least cost resource for additional energy resource generation;
>
> WHEREAS, Blue Sky's project consists of a 150 MW wind powered electric generation facility to be situated on approximately 11,400 acres of land located in Columbia County, Washington and to consist of 83 1.8 MW wind turbine generators (each, a "WTG") and associated electrical collection systems, a site substation, interconnecting transmission line, and other interconnection facilities (collectively, the "Hopkins Ridge Project");
>
> WHEREAS, the Company's management has negotiated with Blue Sky, RES and the WTG supplier the terms and conditions of a series of transactions, including the purchase of the Hopkins Ridge Project assets, the construction of the wind farm facility, and the ongoing operation and maintenance of the wind farm, pursuant to the principal definitive transaction documents (the "Principal Transaction Documents") described below:
>
> 1. Pursuant to an Asset Purchase Agreement ("APA"), PSE would acquire a 100% ownership interest in the assets owned by Blue Sky and its affiliates (including but not limited to land leases, final permits and other development assets) relating to the Hopkins Ridge Project as of the closing date (estimated

to be approximately March 31, 2005) (the "Project Development Assets"), for a purchase price of [redacted] payable half at closing and half on substantial completion. PSE is not obligated to close until after receipt by Blue Sky of all permits, consents, authorizations and approvals and satisfaction or waiver of conditions precedent specified in the APA;

2. Immediately following closing of the purchase of the Project Development Assets by PSE, RES America Construction Inc. ("RES America"), an affiliate of Blue Sky, would perform, or cause to be performed, all engineering, procurement and construction for the Hopkins Ridge Project pursuant to a fixed-price turnkey Engineering, Procurement and Construction Agreement (the "EPC Agreement"). The contract price to RES America for performing the work, commissioning and completing the Project and performing its duties under the EPC is fixed at [redacted] payable by PSE as milestones on the construction schedule are reached. RES America will, in turn, contract with Vestas-American Wind Technology Inc. ("Vestas-American") for the purchase of the 83 WTGs, and also will contract with various subcontractors for the construction of the other facets of the Hopkins Ridge Project (such as the roads, WTG foundations, the electrical collection system, the project substation, and the interconnecting transmission line); and

3. Once the WTGs are placed into service, Vestas-American would provide a power curve warranty, a five-year availability warranty, a five-year mechanical warranty and five years of maintenance, operation, spare parts and service of the WTGs under a separate Operation, Maintenance & Warranty Agreement ("OM&W Agreement") between PSE and Vestas-American;

WHEREAS, the Principal Transaction Documents are described more fully in a memorandum provided to the Board of Directors in advance of this meeting and filed with the minutes (the "Blue Sky Hopkins Ridge Proposal"); and

WHEREAS, the officers now seek Board approval of and authority to enter into the Principal Transaction Documents and all other contracts and actions described in the Blue Sky Hopkins Ridge Proposal and relating to the acquisition, construction and operation of the Hopkins Ridge Project;

IT IS, THEREFORE RESOLVED, that the Board, after full consideration and due deliberation, deems it advisable and in the best interests of the Company, its customers, shareholders and other stakeholders to approve the acquisition, construction and operation of the Hopkins Ridge Project pursuant to the Principal Transaction Documents, and any related agreements and the other transactions described in the Blue Sky Hopkins Ridge Proposal; and be it further

RESOLVED, that the Board hereby authorizes the Company's Chief Financial Officer, its Senior Vice President Energy Resources, its General Counsel, and any such other officers they deem appropriate (the "Authorized Officers") to execute the Principal Transaction Documents and all other agreements or contracts

TEXT IN BOX IS HIGHLY CONFIDENTIAL

REDACTED

described in the Blue Sky Hopkins Ridge Proposal, which may include such further additions, amendments or changes to the terms thereof as are deemed necessary and appropriate by the Authorized Officers; and

RESOLVED, that the Authorized Officers are further authorized to waive any conditions precedent to the closing of any of the Principal Transaction Documents in order to facilitate the closing of such agreement, provided that each of the Authorized Officers agree to such waiver and deem it to be in the best interest of the Company.

GENERAL AUTHORITY

RESOLVED, FURTHER, that any and all actions taken by the officers of the Company, or any of them, as deemed by such officers to be necessary or advisable to effectuate the transactions contemplated by the foregoing resolutions, including the filing of appropriate documentation with the WUTC, whether prior to or subsequent to this action by this Board of Directors, are hereby authorized, approved and ratified, and the taking of any and all such actions and the performance of any and all such things in connection with the foregoing shall conclusively establish such officers' authority therefor from the Company and the approval and ratification thereof by this Board of Directors.

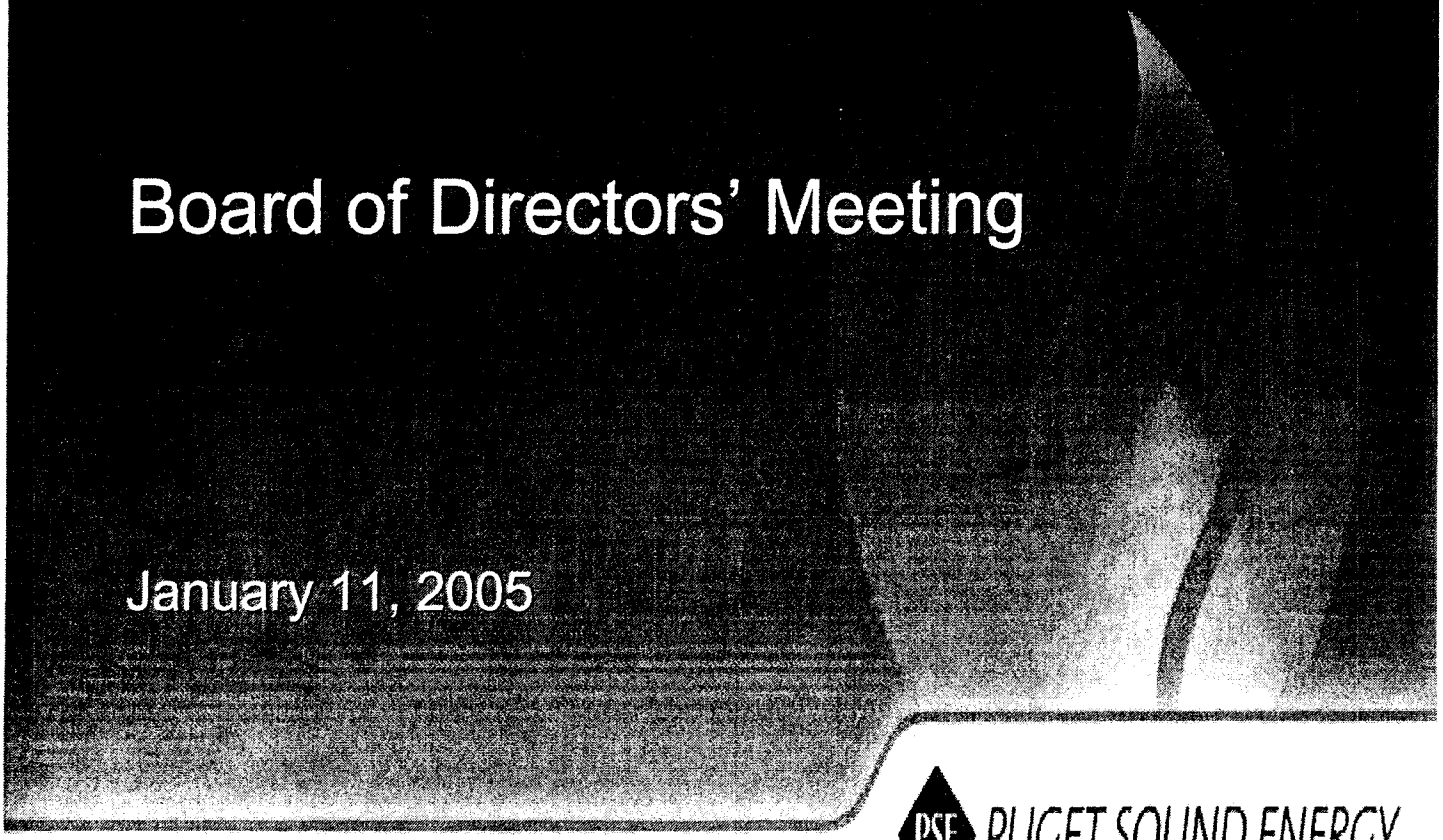
After Mr. Markell's report, Mr. Elsea, Mr. Garratt, Mr. Hiester, Ms. Luebbe, Mr. Markell, Mr. Osborne, and Mr. Wiegand, left the meeting.

EXECUTIVE SESSION TO DISCUSS PSE EXECUTIVE OFFICER DEVELOPMENT

Mr. Beighle then asked Mr. Eldredge, Mr. Gaines, Ms. O'Connor and Mr. Valdman to leave the meeting and for Mr. John M. Freud, Managing Director, and for Mr. Dean Stamoulis, PhD, consultants with Russell Reynolds Associates to join the meeting. Mr. Reynolds informed Mr. Eldredge after the meeting that the Board held a discussion concerning PSE executive officer development matters.

Hopkins Ridge Wind Project

A PSE Renewable Energy Project



Board of Directors' Meeting

January 11, 2005

PUGET SOUND ENERGY

pse.com

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APPROVAL OF PURCHASE OF HOPKINS RIDGE WIND POWER FACILITY

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WHEREAS, the Company's review, analyses and evaluation of responses to its Wind Resource and All-Source Requests for Proposal have determined a wind turbine project being developed by Blue Sky Wind LLC ("Blue Sky"), an affiliate of Renewable Energy Systems Limited of the United Kingdom ("RES"), to be the least cost resource for additional energy resource generation;

WHEREAS, Blue Sky's project consists of a 150 MW wind powered electric generation facility to be situated on approximately 11,400 acres of land located in Columbia County, Washington and to consist of 83 1.8 MW wind turbine generators (each, a "WTG") and associated electrical collection systems, a site substation, interconnecting transmission line, and other interconnection facilities (collectively, the "Hopkins Ridge Project");

WHEREAS, the Company's management has negotiated with Blue Sky, RES and the WTG supplier the terms and conditions of a series of transactions, including the purchase of the Hopkins Ridge Project assets, the construction of the wind farm facility, and the ongoing operation and maintenance of the wind farm, pursuant to the principal definitive transaction documents (the "Principal Transaction Documents") described below:

1. Pursuant to an Asset Purchase Agreement ("APA"), PSE would acquire a 100% ownership interest in the assets owned by Blue Sky and its affiliates (including but not limited to land leases, final permits and other development assets) relating to the Hopkins Ridge Project as of the closing date (estimated to be approximately March 31, 2005) (the "Project Development Assets"), for a purchase price of [redacted] payable half at closing and half on substantial completion. PSE is not obligated to close until after receipt by Blue Sky of all permits, consents, authorizations and approvals and satisfaction or waiver of conditions precedent specified in the APA;

2. Immediately following closing of the purchase of the Project Development Assets by PSE, RES America Construction Inc. ("RES America"), an affiliate of Blue Sky, would perform, or cause to be performed, all engineering, procurement and construction for the Hopkins Ridge Project pursuant to a fixed-price turnkey Engineering, Procurement and Construction Agreement (the "EPC Agreement"). The contract price to RES America for performing the work, commissioning and completing the

REDACTED

TEXT IN BOX IS HIGHLY CONFIDENTIAL

Project and performing its duties under the EPC is fixed at [redacted] payable by PSE as milestones on the construction schedule are reached. RES America will, in turn, contract with Vestas-American Wind Technology Inc. ("Vestas-American") for the purchase of the 83 WTGs, and also will contract with various subcontractors for the construction of the other facets of the Hopkins Ridge Project (such as the roads, WTG foundations, the electrical collection system, the project substation, and the interconnecting transmission line); and

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REDACTED

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RESOLVED, that the Authorized Officers are further authorized to waive any conditions precedent to the closing of any of the Principal Transaction Documents in order to facilitate the closing of such agreement, provided that each of the

Authorized Officers agree to such waiver and deem it to be in the best interest of the Company.

GENERAL AUTHORITY

RESOLVED, FURTHER, that any and all actions taken by the officers of the Company, or any of them, as deemed by such officers to be necessary or advisable to effectuate the transactions contemplated by the foregoing resolutions, including the filing of appropriate documentation with the WUTC, whether prior to or subsequent to this action by this Board of Directors, are hereby authorized, approved and ratified, and the taking of any and all such actions and the performance of any and all such things in connection with the foregoing shall conclusively establish such officers' authority therefor from the Company and the approval and ratification thereof by this Board of Directors.

Hopkins Ridge Wind Project

A PSE Renewable Energy Project

Eric M. Markell
Senior VP, Energy Resources

January 11, 2005

PUGET SOUND ENERGY
pse.com

Project Description

Developer:
- Renewable Energy Systems

Nameplate Capacity:
- 150 MW
- capacity factor

Wind Turbine Generators:
- (83) - Vestas V80 1.8 MW

Capital Cost:
- $200 million "all in"

Energy Cost:
- 'MWh (20-yr levelized)

Location:
- Columbia County, WA

Footprint:
- 11,441 acres

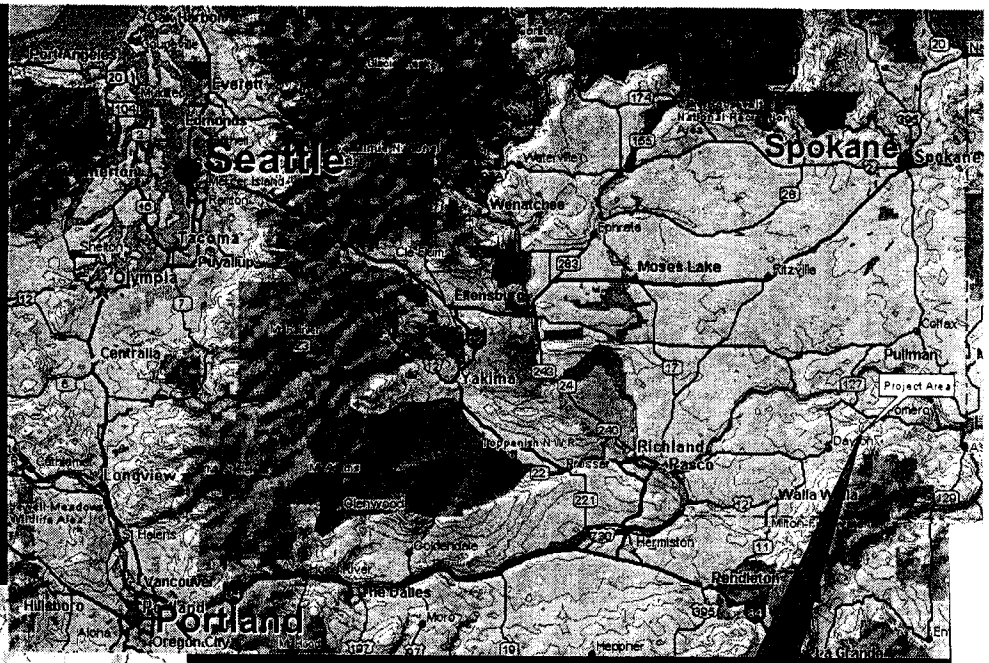
Key Dates:

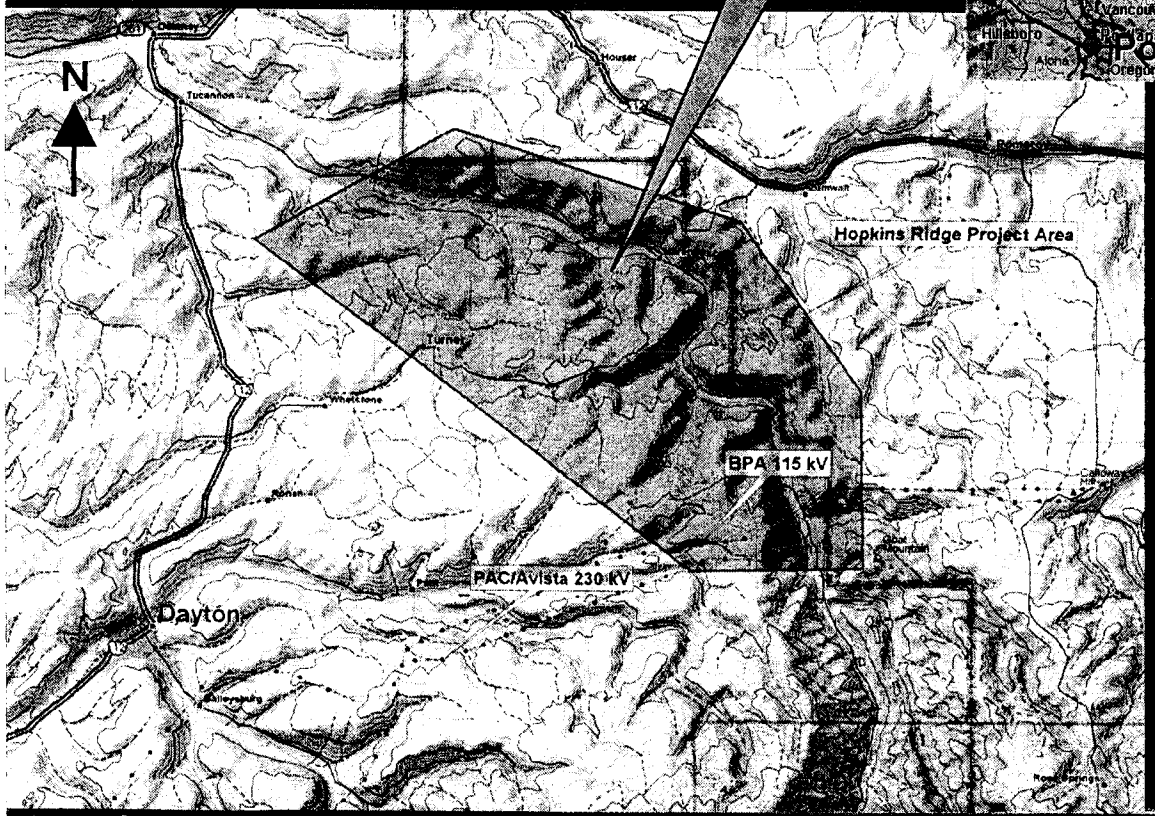
Letter of Intent:	October 29, 2004
Definitive Agreements:	December 31, 2004
Board Consideration:	January 11, 2005
Closing / Notice to Proceed*:	March 31, 2005
Commercial Operations Date:	December 31, 2005

*Assumes receipt of all necessary material non-appealable permits; Management will consider opportunities to accelerate closing, if feasible.

Site Location

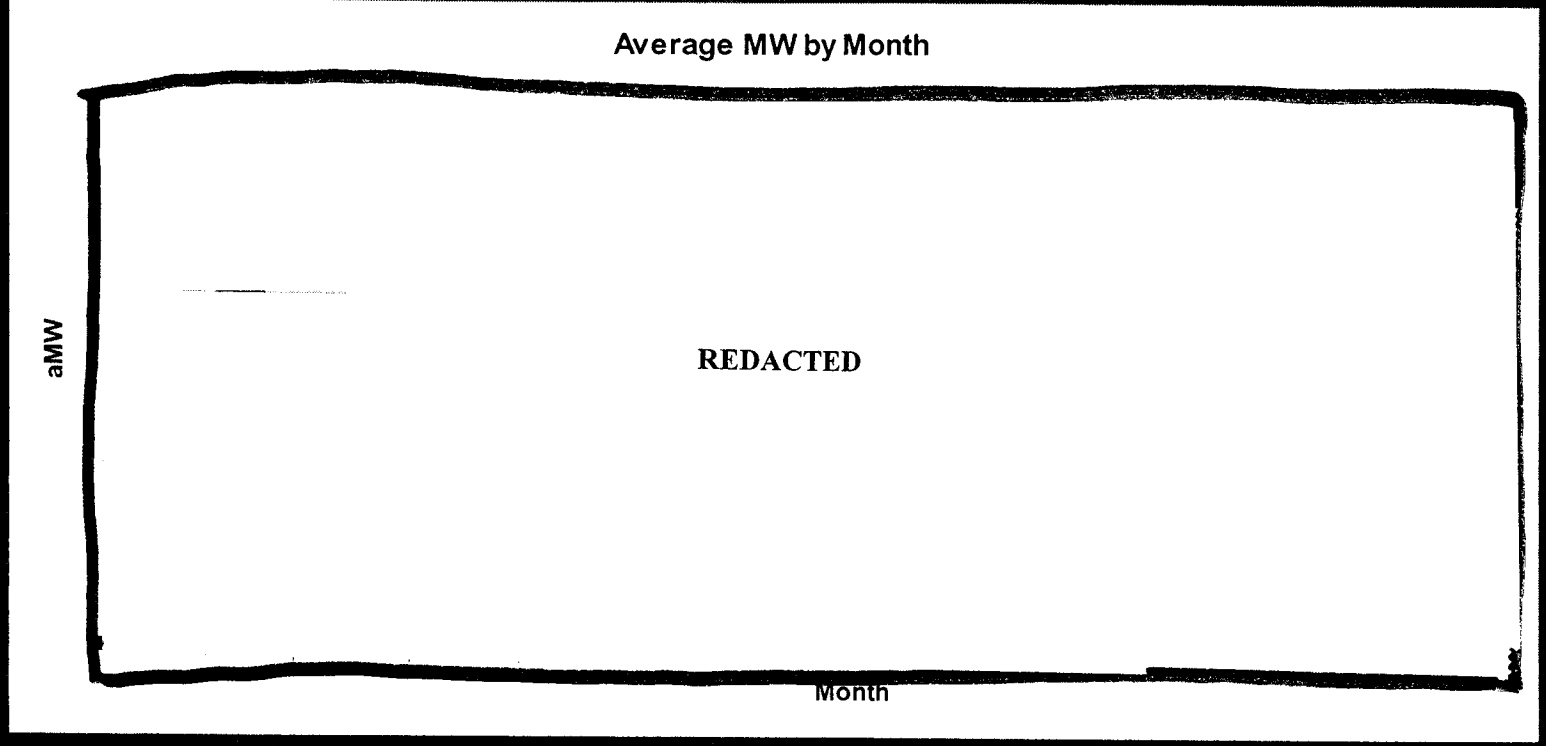
- Located 15 miles northeast of Dayton, WA, in Columbia County
- Farmed dryland wheat
- 11,441 acres of leased land
  - 11 leases
  - 35-year term





- 83 - Vestas V80 1.8 MW Wind Turbine Generators
- Eight-mile 115 kV interconnecting transmission line
- Interconnection with BPA North Lewiston-Walla Walla 115 kV transmission system

Wind Energy Resource



- Average annual wind speed is m/s (≈ mph)
- capacity factor (projection verified by Garrad Hassan)
- Facility produces power ≈ of the time
- aMW January average energy
- aMW annual average energy
- 150 MW nameplate capacity

Fits 2003 LCP Energy Need

2008 Energy Need (2003 LCP)	355 aMW
Mid-C Hydro Adjustments	27 aMW
Updated Need	382 aMW

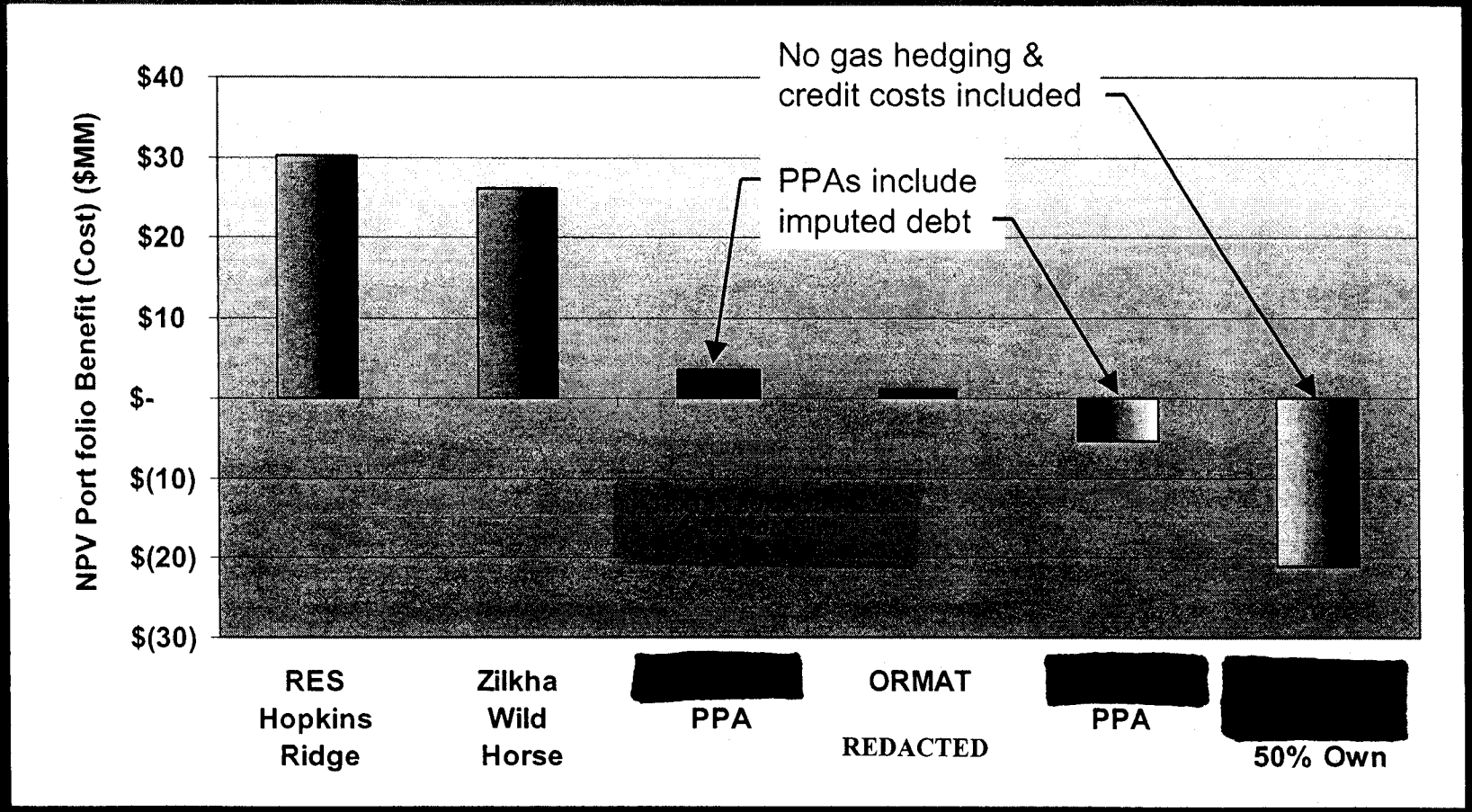
Projected Contributions from 2004 RFP Acquisitions:

Hopkins Ridge Wind Project	**aMW**
Wild Horse Wind Project	aMW
ORMAT Recovered Heat Project	aMW
Sum of Acquisitions	aMW
Remaining Need	aMW

Notes:
1. Need is based on the "B2" planning standard energy need as defined in 2003 Least Cost Plan
2. All numbers are January average energy

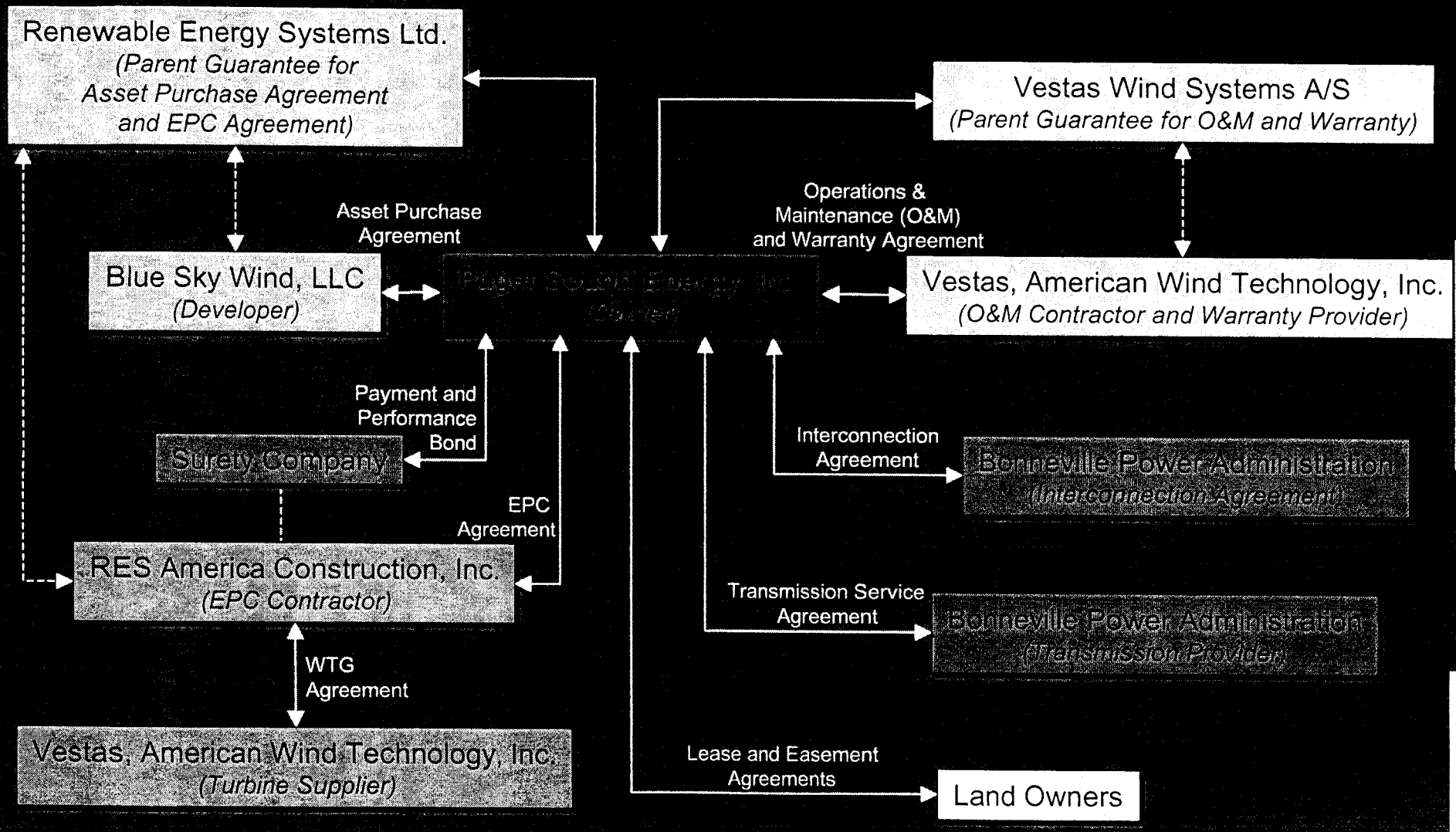
Portfolio Analysis

$30 million Net Present Value (NPV) benefit compared to PSE's generic portfolio ($2005)



Note: Generic portfolio consists of 10% wind with the balance 50% gas and 50% coal

Entity Transaction Structure



Summary Project Budget and Warranties

RES Guarantees:

- On-line date;
  delay liquidated damages
- Turbines placed in service prior to expiration of PTCs;
  liquidated damages for lost PTCs

Vestas Warranties:

- Power curve at substantial completion
- availability for 5 years
- Mechanical for 5 years
- Serial defect for 5 years

Capital Cost	Cost ($000's)	% of Total
Acquisition of Development:	REDACTED	
Engineering, Procurement, & Construction (EPC):		
Turbine Supply & Erection		
Site Substation & Overhead Line		
Civil Works (Foundations & Roads)		
Electrical Works (Supply & Installation)		
Other Items		
Total EPC		
Total Development & EPC		
Owner's Costs:		
BPA Network Upgrades		
AFUDC		
Transaction Costs (net)		
Other Items		
Start-up Power		
Owner's Contingency		
Total Owner's Costs		
Total Project Capital Costs	**199,767**	**100%**

TEXT IN BOX IS HIGHLY CONFIDENTIAL

Highly Confidential per WAC 480-07-160

Wind Integration

Interconnection:

- Interconnect to BPA North Lewiston - Walla Walla 115 kV transmission line
- BPA network upgrades - $10,100,000
  - New switching station
  - Reconductor Franklin - Nine Mile Tap 115 kV transmission line
  - Reconductor PacifiCorp Walla Walla - BPA Walla Walla 69 kV transmission line
- Network upgrade costs credited against BPA transmission charges

Transmission:

- obtain long-term firm service to Mid-C
- PSE existing transmission infrastructure and rights from Mid-C to load center
- Short-term firm, hourly firm and non-firm over BPA to Mid-C as back-up

Integration:

- Strategy
  - BPA ancillary services tariff provides hour-ahead integration
  - PSE manages its Mid-C resources to cover day-ahead firming
- Costs:

Hour-ahead firming[1]	$1.16 /MWh
Day-ahead firming[2]	$0.84 /MWh
TOTAL	$2.00 /MWh

Notes:
(1) Figure reflects both operating reserves and generating imbalance ancillary service tariff.

(2) Dav-ahead costs derived based or

Summary of Risk Factors and Mitigation Measures

Risks	Mitigation
Failure to Close a) Permits b) IRS Private Letter Ruling (PLR) c) PTC / Schedule	• No payments by PSE to RES prior to closing a) Non-controversial site; permits in hand before closing b) PLR request filed 11/17/04 (condition precedent) c) Close by 3/31/05 allows sufficient time to construct Limited force majeure events
Technology	• Garrad Hassan review affirms Vestas technology • Germanischer Lloyd design certification
Wind Resource	• Garrad Hassan review affirms energy projection
EPC Cost Overrun	• RES secured turbine price with deposit • Turnkey fixed-price EPC contract • Substantial owner's contingency • Parent guarantee from RES, Ltd. • Payment and performance bond of [redacted]
Production Tax Credit (PTC)	• Vestas / RES - PTC liquidated damages of [redacted] per turbine
Environmental / Permitting	• URS / Buck & Gordon due diligence nearly complete
Real Estate	• Buck & Gordon due diligence nearly complete
Schedule	• Delay liquidated damages of [redacted] per turbine per day
Transmission	• Acquire long-term firm transmission via [redacted] • Fall-back position: utilize short-term firm, hourly firm and non-firm • PSE existing transmission infrastructure and rights from Mid-C to load center

REDACTED

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Note: See Memo Exhibit #9 for a comprehensive risk analysis and mitigation strategy.

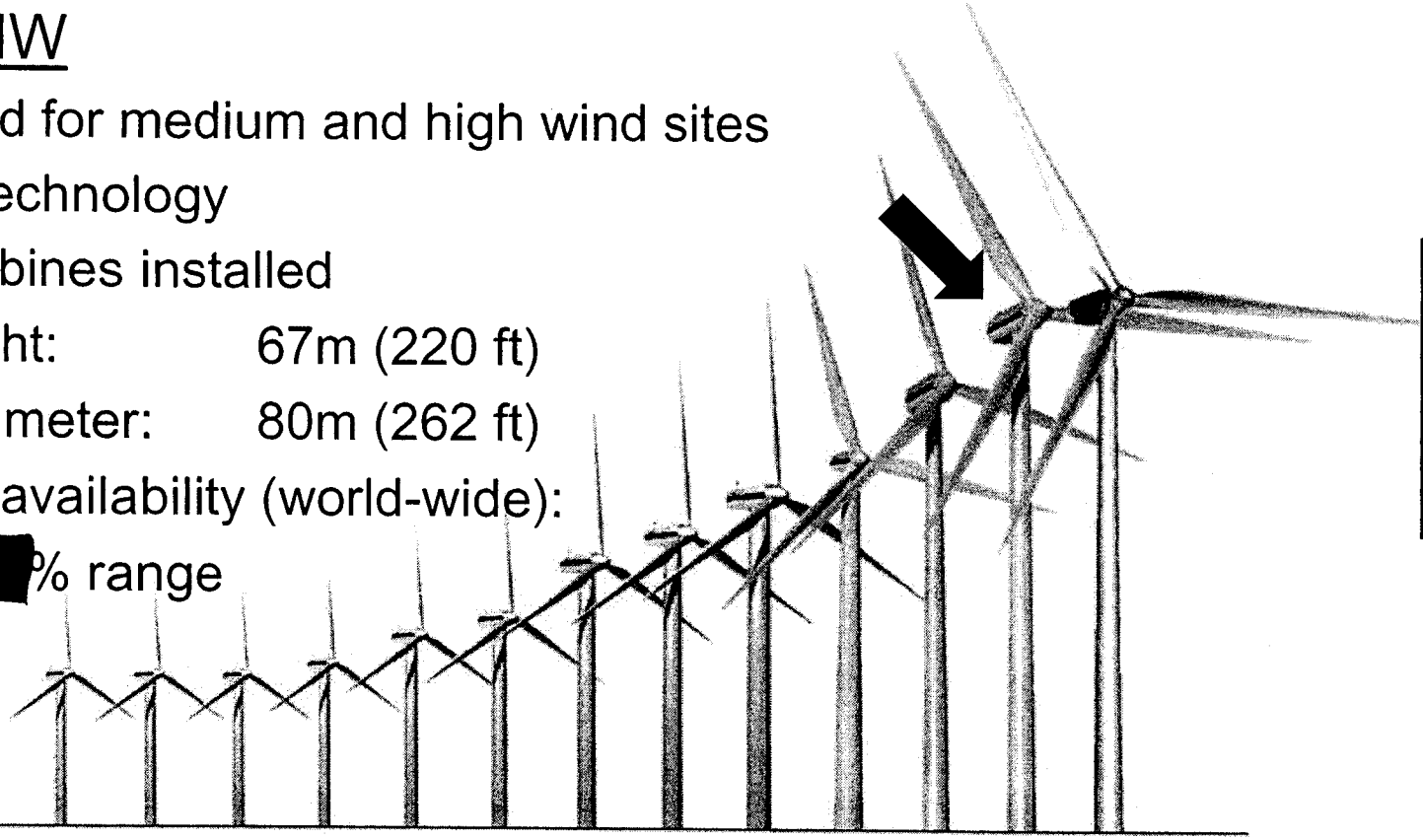
Vestas V80 Turbine Generator

V80 – 1.8MW

- Optimized for medium and high wind sites
- Proven technology
- 1,021 turbines installed
- Hub height: 67m (220 ft)
- Rotor diameter: 80m (262 ft)
- Average availability (world-wide): [redacted]% to [redacted]% range

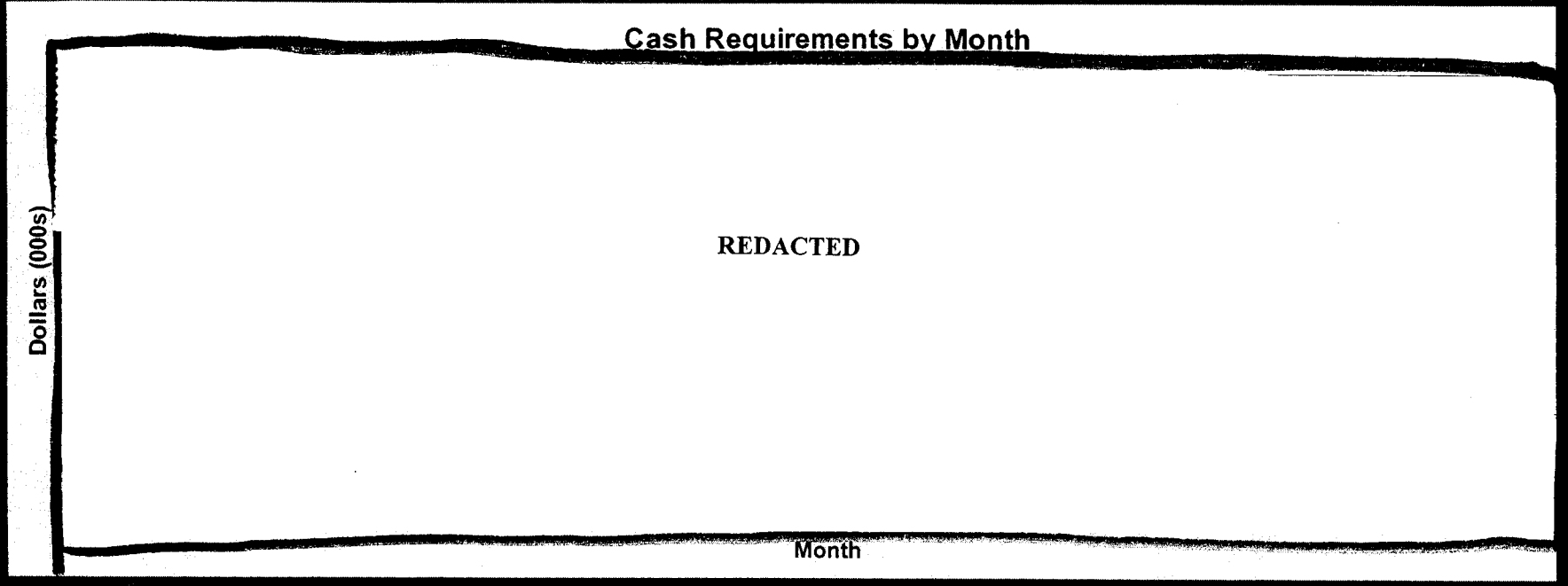
REDACTED

TEXT IN BOX IS HIGHLY CONFIDENTIAL



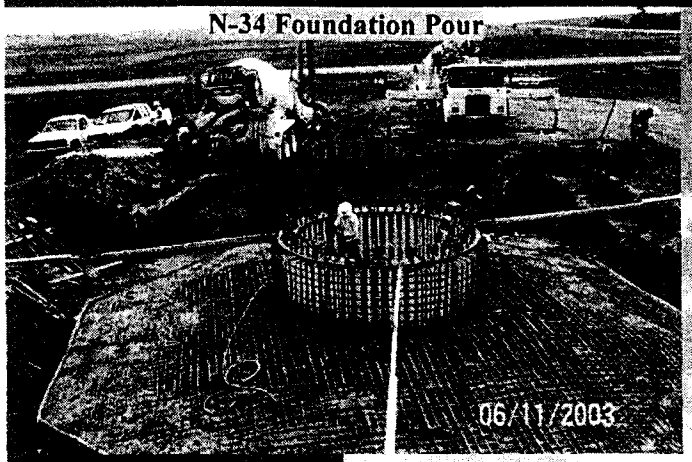
Product/Rotor diameter (m)	V15	V17	V19	V20	V25	V27	V39	V44	V47	V52	V66	V80	V90
Year of installation	1981	1984	1986	1987	1988	1989	1991	1995	1997	2000	1999	2000	2002
Capacity (kW)	55	75	90	100	200	225	500	600	660	850	1750	2000	3000
MWh/year	217	265	301	346	481	647	1304	1581	1947	2530	4705	6768	-

Construction Cash Flow



Highly Confidential per WAC 480-07-160

Facility Construction Overview



WTG Erection
(Timelapse)

Findings & Recommended Action

Findings:

- Least-cost alternative on levelized-cost basis and largest portfolio benefit
- Best wind resource, including winter winds
- Experienced wind developer and construction contractor with proven track record
- Vestas - proven technology from world's leading wind turbine supplier
- Most viable opportunity for 2005 project, taking advantage of current PTC
- Strong local community support for project

Recommended Action:

- Management recommends approval of the proposed transaction

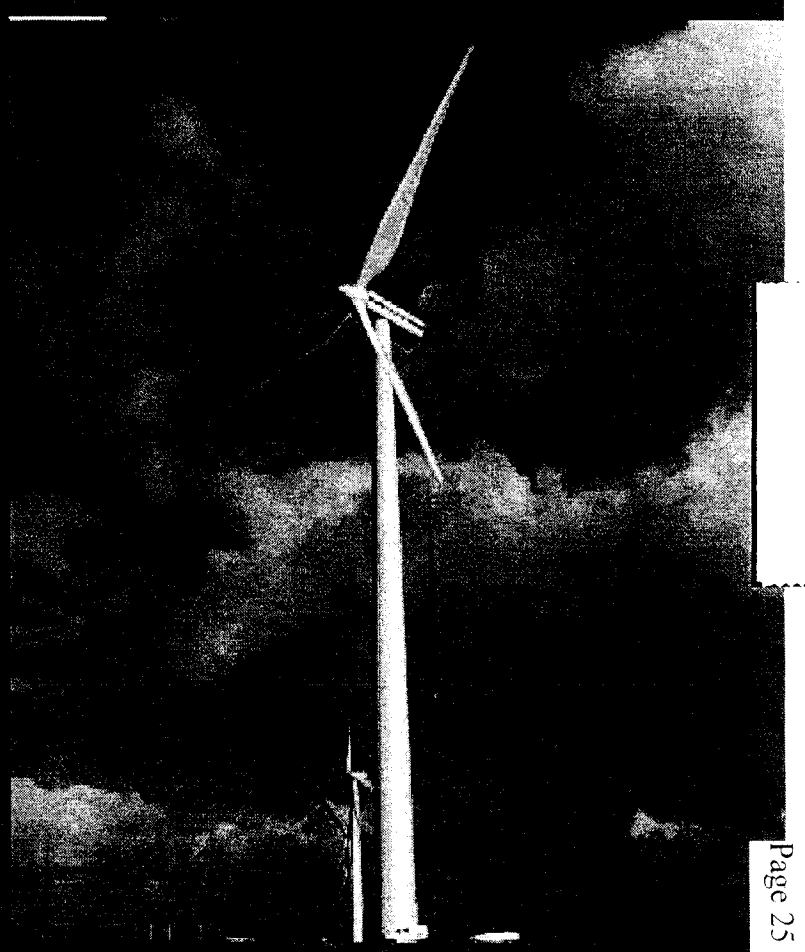
Hopkins Ridge

Presentation Appendix

PUGET SOUND ENERGY

Key Attributes

- Least-cost alternative on levelized-cost basis and largest portfolio benefit
- Best wind resource, including winter winds
- Experienced wind developer and construction contractor with proven track record
- Vestas - proven technology from world's leading wind turbine supplier
- Most viable opportunity for 2005 project, taking advantage of current Production Tax Credit (PTC)
- Strong local community support for project



Application of RFP Criteria

RFP Criteria	Benefits
Compatibility with Need	• Provides [redacted] aMW of January energy • Attractive energy shape
Cost Minimization	• Lowest cost wind project • Lowers portfolio cost by $30 million verses generic portfolio
Risk Management REDACTED	• Experienced developer and construction contractor with 6 projects in the U.S. (609 MW); developed and constructed the Nine Canyon project in Kennewick, WA • Land rights acquired • Conditional Use Permit (CUP) issued and progressing well towards other major permits
Public Benefits	• Strong community support • Project consistent with existing land uses
Strategic & Financial	• PSE ownership of rate-based asset • Parent guarantees from RES Ltd. and Vestas A/S • Payment and performance bond to backstop Engineering, Procurement and Construction (EPC) performance

TEXT IN BOX IS HIGHLY CONFIDENTIAL

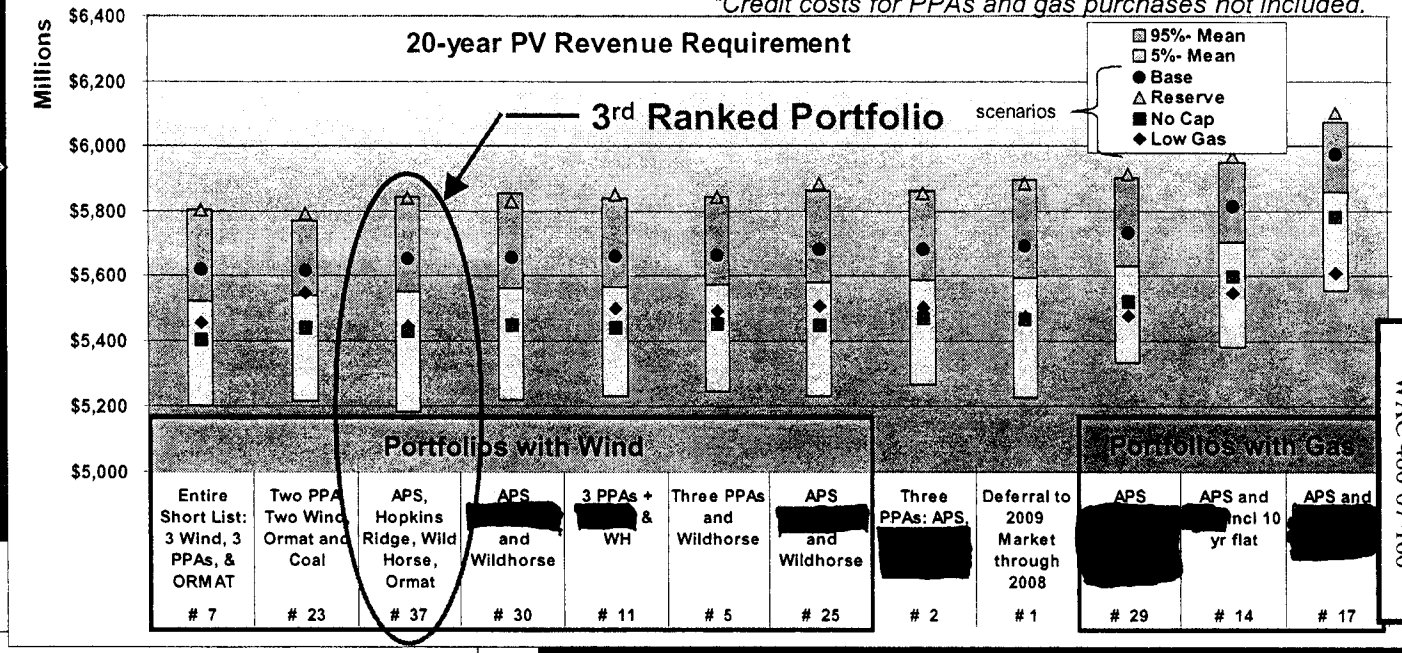
Highly Confidential per WAC 480-07-160

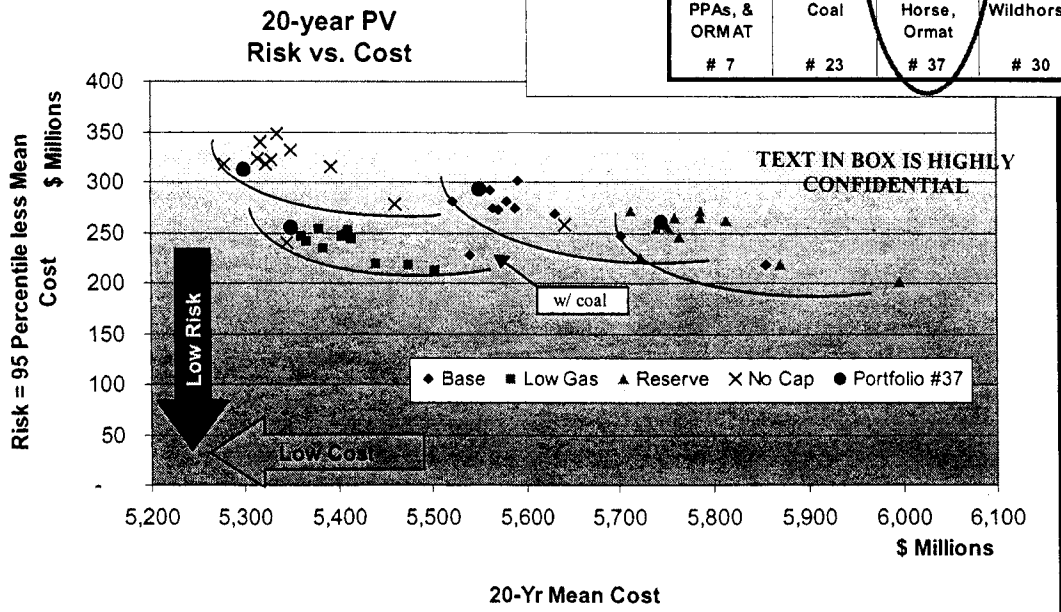
Portfolio Analysis

Present value of portfolio costs were calculated for 12 portfolios

The graph shows the present value of portfolio cost ranked from lowest cost on the left to highest cost on the right

*Credit costs for PPAs and gas purchases not included.





Proposed portfolio has low cost and reasonable risk in each of the four price scenarios

Portfolio #37:

- Hopkins Ridge Wind
- Wild Horse Wind
- Ormat Heat Recovery
- APS 2-yr PPA

REDACTED

Highly Confidential per WAC 480-07-160

Key Commercial Terms

Acquisition of development rights:

- 50% at closing; 50% at substantial completion
- Assets include land leases, transmission ROWs, permits, BPA Interconnection Agreement, other contracts, environmental studies, wind studies, and other tangible property

Engineering, Procurement and Construction (EPC):

- Fixed-price turnkey contract
- 9-month construction period

RES contribution to PSE transaction expenses:

- 50% at closing; 50% at substantial completion

BPA Interconnection / Network Upgrades

- $10,100,000
- Credited back with interest against transmission tariffs

Payment and Performance Bond

- (balance of plant)
- one-time premium

Capital Cost	Cost ($000's)	% of Total
Acquisition of Development:		
Engineering, Procurement, & Construction (EPC):		
Turbine Supply & Erection		
Site Substation & Overhead Line		
Civil Works (Foundations & Roads)		
Electrical Works (Supply & Installation)		
Other Items		
Total EPC		
Total Development & EPC		
Owner's Costs:		
BPA Network Upgrades		
AFUDC		
Transaction Costs (net)		
Other Items		
Start-up Power		
Owner's Contingency		
Total Owner's Costs		
Total Project Capital Costs	**199,767**	**100%**

REDACTED

Highly Confidential per WAC 480-07-160

Guarantees:

- Turbine performance and availability (Vestas)
- On-line date; delay liquidated damages (RES)
- Turbines placed in service prior to expiration of PTCs; liquidated damages for lost PTCs (RES)

Operations, Maintenance & Warranties

Turbine Generator O&M:

- Vestas for first 5 years
- per turbine per year,

Balance of Plant O&M:

- PSE

Site Management:

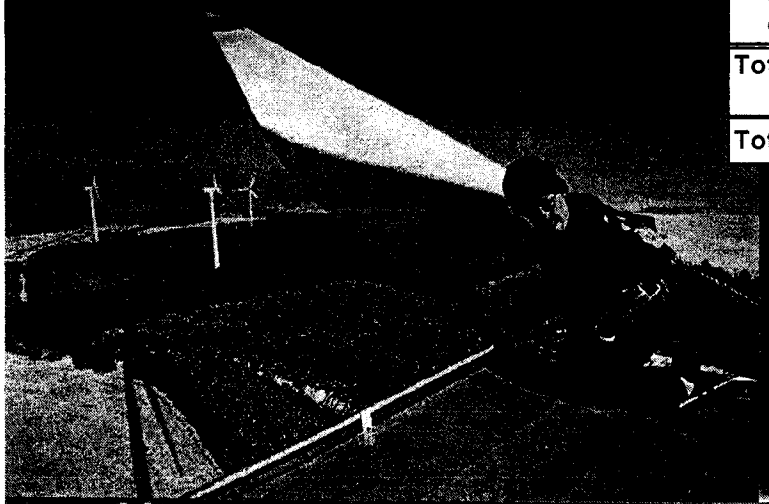
- PSE

Operating Expenses ($000's)	2007	2010	2015	2020	2023
Operations & Maintenance (O&M):					
PSE Labor					
Consumables					
Parts Replacement					
Site, Tool & Vehicle Expenses					
Outside Services					
Vestas O&M Contract					
Parasitic Power					
Total O&M					
Other Expenses:					
Property Tax					
Insurance					
Property Lease					
PSE Asset Management					
Professional Services					
BPA Transmission Expenses					
BPA Transmission CREDIT(1)					
Contingency					
Total Other Expenses					
Total Operating Expenses	7,544	8,288	12,053	13,620	14,937

REDACTED

Highly Confidential per WAC 480-07-160

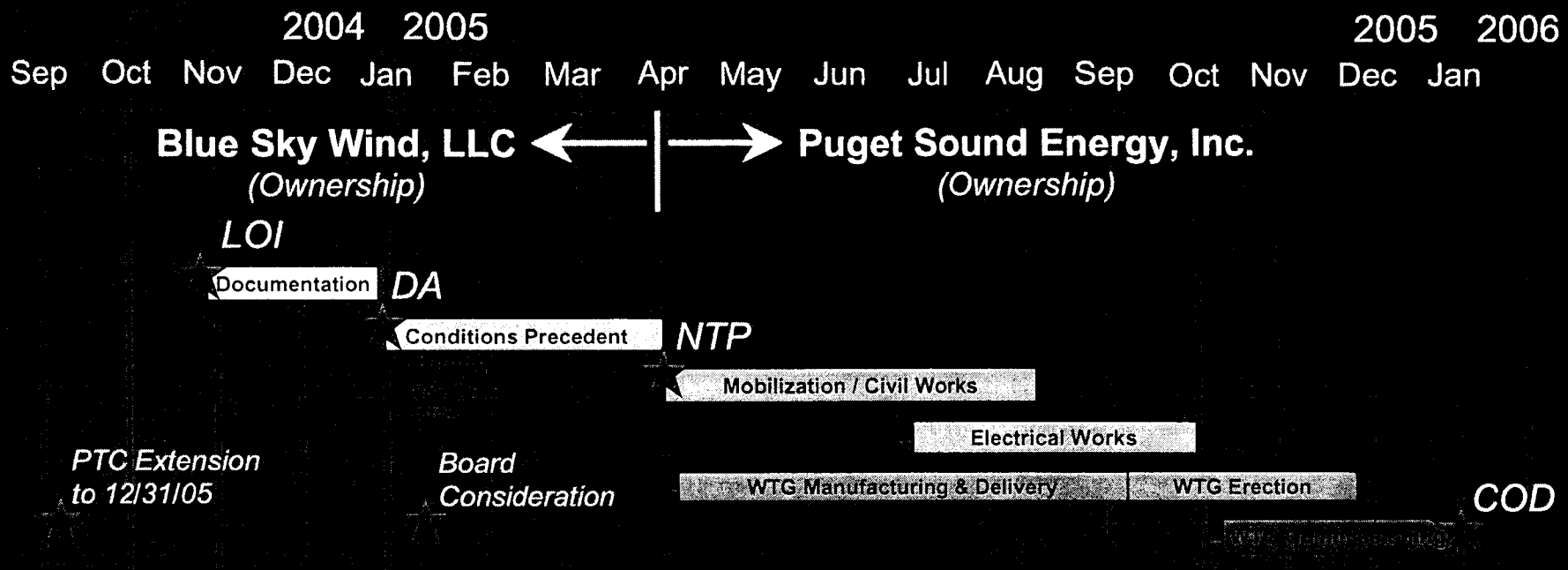
(1) Total BPA credits = $10,100,000 plus interest



Vestas Warranties:

- Power curve at substantial completion
- availability for 5 years
- Mechanical for 5 years
- Serial defect for 5 years

Project Schedule



- Non-binding Letter of Intent (LOI) — Oct 29, 2004
- Negotiate Definitive Agreements (DA) — Dec 31,2004
- PSE Board Consideration — Jan 11, 2005
- Closing / Notice to Proceed[1] (NTP) — Mar 31, 2005
- Commercial Operations Date (COD) — Dec 31, 2005

Note:
(1) Assumes receipt of all, necessary material non-appealable permits; Management will consider opportunities to accelerate closing, if feasible.

Site Layout

REDACTED

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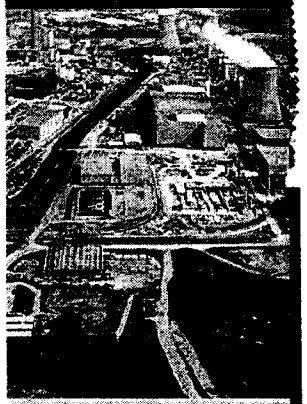
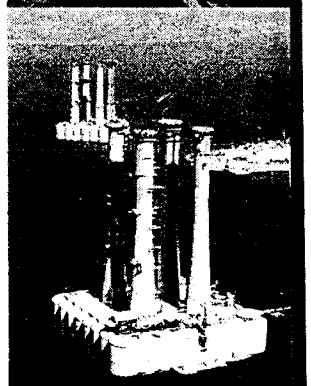
Visual Simulations

RES Corporate Structure

RES, Ltd. was formed in 1981 and is a member of the Sir Robert McAlpine Group, one of the UK's major engineering and construction companies.





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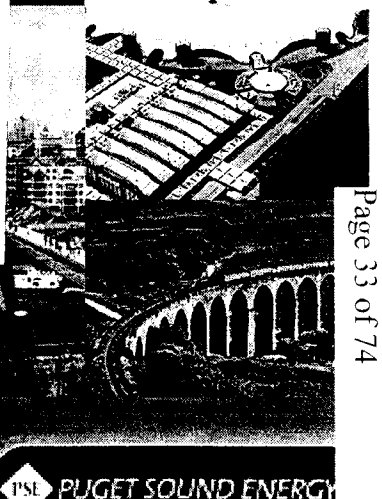

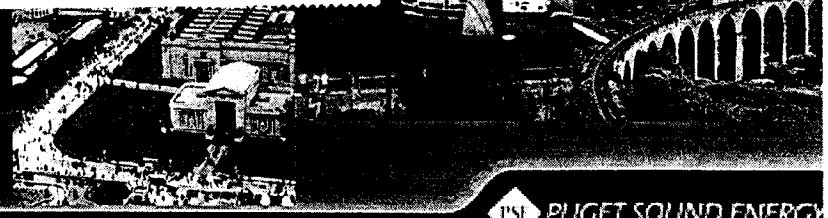

Notes:
* Respective ownership percentage
(a) Name changed during 2004 from RES (USA) Holdings Inc
(b) Name changed during 2004 from RES (Developments) Inc
(c) Name changed during 2004 from Renewable Energy Systems (USA) Inc

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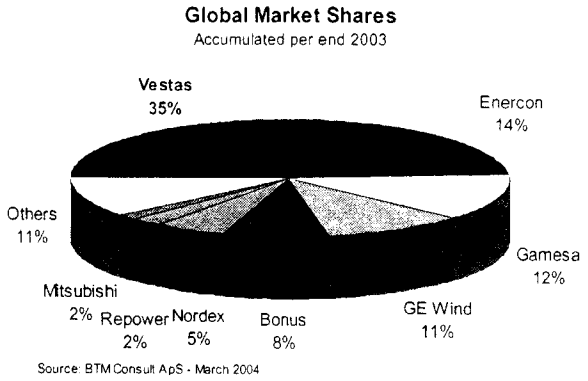
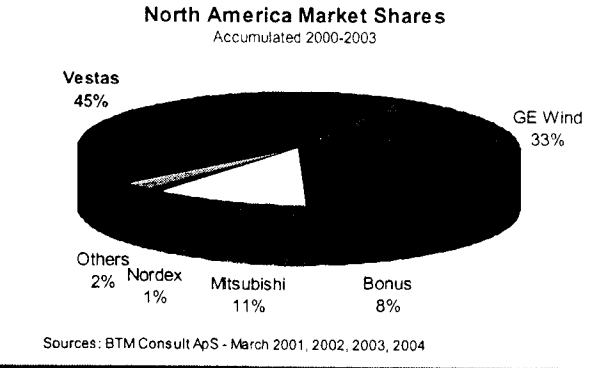
HIGHLY CONFIDENTIAL PER WAC 480-07-160

Vestas Wind Systems A/S

Vestas is the world's largest supplier of wind power systems

- 2,667 MW 2003 total installed
- $2.9 Billion 2003 sales
- 14,500+ MW installed worldwide
- Active in 40 countries
- Vestas has installed 35% of global wind turbine capacity
- 30 manufacturing facilities in 10 countries world wide
- 9,300 employees world wide
- 450 R&D engineers
- 200+ personnel in North America
- 26 service locations in North America
- 24/7 Monitoring Center
- Technical Specialists located in Portland
- After market parts support based in Portland





Garrad Hassan

GARRAD HASSAN

- Garrad Hassan and Partners Limited (GH) was established in 1984 by founding partners, Dr. Andrew Garrad and Dr. Unsal Hassan
- GH is recognized internationally as a leading authority on all aspects of wind energy
- GH has acted as bank's and owners engineer for over 5,000 MW of wind energy projects in 14 countries; other activities includes:
  - Due diligence for banks and insurance companies
  - Project managers and owners' engineers
  - Concept developments and detailed design analyses for manufacturers
  - Site resource and environmental assessments
  - Wind farm design, technical specification and economic modeling
  - Short to long-term RD+D for the European Commission and the UK government
  - Regional resource modeling, GIS analysis and strategic studies
  - Grid integration and autonomous networks
- GH maintains its independence by taking no equity stake in any development or technology and works purely on a consultancy basis
- GH was awarded the Queen's Award for Export Enterprise - a prestigious national award reflecting the company's outstanding export work over many years

Regulatory Strategy
Cost Recovery & Accounting

Project Key Schedule Dates

- Closing / Notice to Proceed[1] — March 31, 2005
- Commercial Operations Date — December 31, 2005

Rate Case Type -- Power Cost Only (PCORC)

- PCORC Filing Date[2] — June 1, 2005
- Ruling Complete — January 1, 2006
- Rates in Effect[3] — Commercial Operations Date

Accounting Petitions:

- Hopkins Ridge pre-paid transmission expense
- Production Tax Credits

Notes:

(1) Assumes receipt of all necessary material non-appealable permits; Management will consider opportunities to accelerate Closing, if feasible.

(2) The filing date is targeted so that rate case order will coincide with the COD of the Project and with the assumption that PSE will not file a GRC until after 1/1/06. If the Company decides to file a GRC earlier, then proposed rate-recovery schedule would be revised.

(3) If PCORC Rates implemented before Project COD, then PCORC Baseline Rate would be adjusted to exclude Hopkins Ridge costs until plant is in service.

Regulatory Strategy
Accounting

PCORC

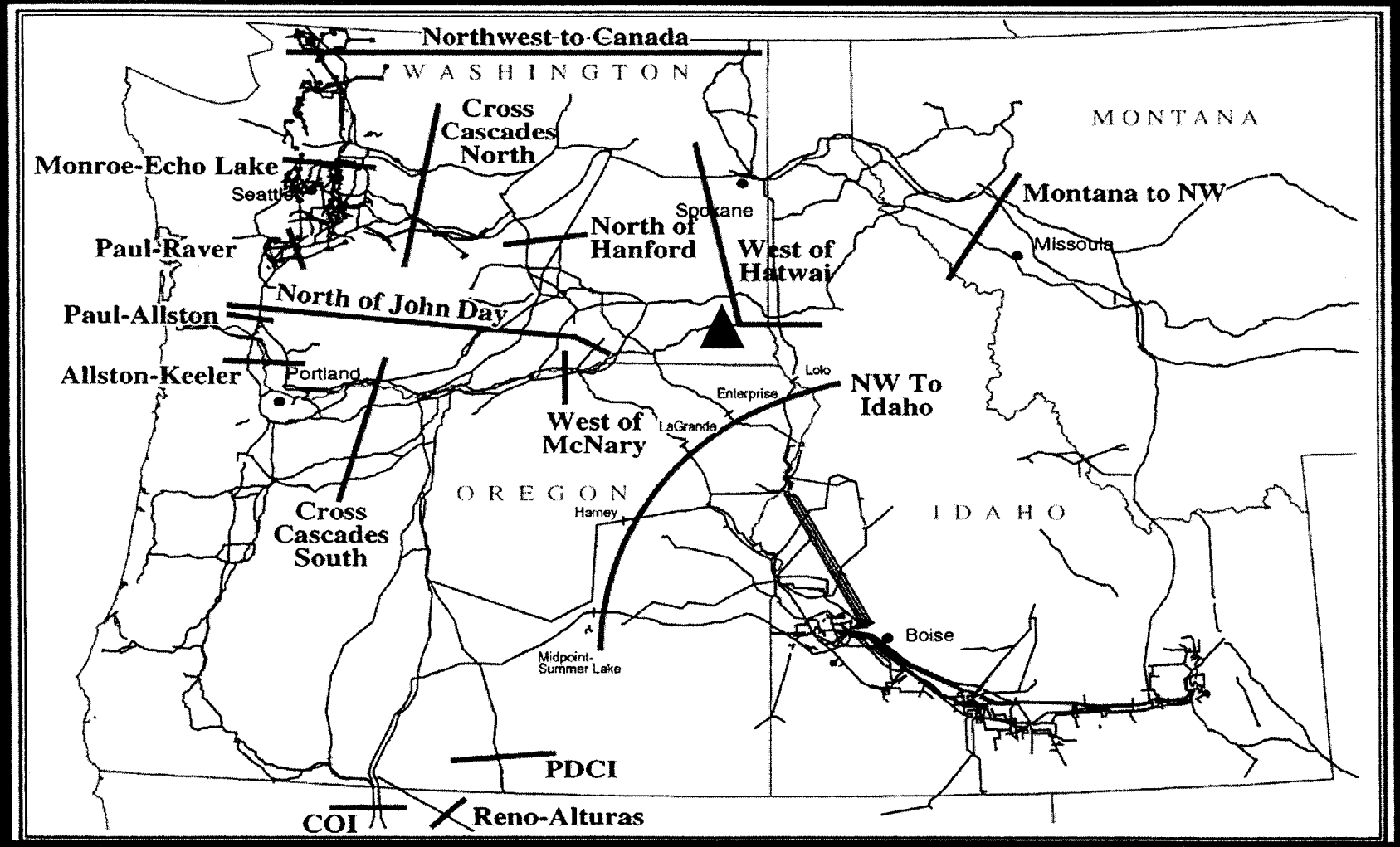
WUTC Accounting Petition

Ongoing Cost Recovery

Issues:

- Hopkins Ridge pre-paid transmission expense
  - PSE will petition to earn an allowed return on the pre-payment to BPA for the interconnection switching station and transmission network upgrades. PSE receives a credit from BPA on wheeling charges that reduce this pre-paid account.
- Production Tax Credits
  - PSE will petition to include the PTC in the monthly PCA calculation, allowing these credits to flow through to customers. Tax accounts are not currently part of PCA.
  - A deferred tax account will record the timing difference between the PTC used to reduce tax payments and PTC passed through to customers through the PCA. PSE will petition to include this deferred tax balance in the PCA in a manner similar to that used for regulatory assets receiving a monthly true-up of return and amortization.

Transmission Constraints



Hopkins Ridge Wind Project

PUGET SOUND ENERGY

MEMORANDUM

January 4, 2005

Privileged and Confidential Attorney - Client Communication

To: PSE Board of Directors

cc: LeBoeuf, Lamb, Greene and MacRae, L.L.P.

From: Eric M. Markell

Subject: Proposed Acquisition of 100% of Blue Sky Wind LLC's Interests in, and the Construction and Operation of, a 150 MW (Nominal) 83 Turbine Wind Generating Facility to be Located in Unincorporated Columbia County, WA

The purpose of this Memorandum is to describe:

- The proposed transactional program by which PSE would acquire a 100% interest in a proposed 150 MW (nominal) wind turbine project (the "Hopkins Ridge Wind Project" or "Project") being developed, and which presently is owned, by Blue Sky Wind LLC ("Blue Sky"), an indirect wholly-owned subsidiary of Renewable Energy Systems, Ltd. ("RES"), which, in turn, is an affiliate of the Sir Robert McAlpine Group, a leading UK building and civil engineering contractor. (See **Exhibit 1,** "RES Corporate Structure")
- The need for, and benefits of, such proposed resource acquisition.

- The analyses supporting the selection by PSE of the proposed transaction.
- The principal commercial terms and conditions of the proposed transaction.
- Key risk factors related to the proposed transaction.
- The development, construction and operation plans for the Project.
- The expected tax, accounting and ratemaking treatments for the proposed transaction.
- The projected "stand-alone" financial pro forma[1] for the Project (income statement, cash flows and balance sheet) and the Project's estimated impact on PSE's gross revenue requirements (See **Exhibit 5**).
- The estimated costs of the Project's acquisition, development and construction.
- The estimated costs of operating the Project, inclusive of annual operations and maintenance and asset management costs.
- The plan to finance the asset acquisition and construction costs.
- Management's recommendation to PSE's Board of Directors for approval to complete due diligence and contract documentation, to execute the definitive agreements and to close the proposed transaction.

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[1] The Project will be wholly owned by PSE and consolidated within PSE's financial statements. For clarity of interpretation, the stand-alone pro forma illustrates the financial impacts of the Project separate and apart from PSE's financial statements, similar to the presentation were the Project held by a wholly owned subsidiary of PSE.

Summary Project Description

When completed, the Project will be a 150 MW (nominal) wind-powered generation facility located on an 11,441-acre site in unincorporated Columbia County, approximately fifteen miles northeast of Dayton, Washington. It will incorporate 83 Vestas V80 1.8 MW wind turbine generators (the "WTGs"). The Project site is virtually uninhabited dryland wheat fields owned by ten landowners, mostly farmers or ranchers.[2]

The Project has been developed by Blue Sky.[3] Blue Sky's affiliate, RES, is a leading worldwide developer, constructor, and operator of wind energy projects with over 20 years experience in the industry. Blue Sky commenced development of the Project in 2001 and, subsequently, secured leases and easements with landowners to construct the Project and conducted all required environmental studies necessary to obtain the required permits. In addition, Blue Sky erected over eight meteorological towers to monitor the wind resource and collected over three years of data. Blue Sky submitted an application for a Conditional Use Permit ("CUP") with Columbia County, Washington, along with a State Environmental Policy Act ("SEPA") checklist. Columbia County reviewed the SEPA checklist and issued a mitigated determination of non-significance. On December 14, 2004, the County approved the CUP and issued it on December 23,

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[2] **REDACTED**

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[3] Blue Sky is a special purpose entity created to own the development assets of the Hopkins Ridge facility. Blue Sky has no employees; the management responsibility for the development of the Facility is being performed under the direction of RES's U.S.-based subsidiary, RES North America, LLC and its subcontractors.

2004. Blue Sky has applied for other necessary, material project permits and is well en route to receiving them. Finally, Blue Sky has applied for an interconnection of the Project with the Bonneville Power Administration ("BPA") transmission system and expects to enter into an interconnection agreement with BPA prior to March 31, 2004.

As soon as Blue Sky has obtained all required permits and the final applicable appeal periods have expired[4] and has obtained all other required development rights to construct and operate the Project, PSE will purchase all such rights and will then contract with RES America Construction Inc. ("RES America") to have the Project constructed under a fixed price, turnkey contract. Upon substantial completion of the Project, PSE will assume responsibility for operating the Project. PSE will contract with the WTG supplier, Vestas-American Wind Technology, Inc. ("Vestas American"), a subsidiary of Vestas Wind Systems A/S ("Vestas"), to operate and maintain the WTGs during their five-year warranty period. Vestas American will manufacture, deliver, and commission the WTGs (with such WTGs being erected by RES America), guarantee their performance, and warrant their availability and mechanical performance. RES America will further deliver at the closing, for the benefit of PSE, a payment and performance bond to be issued by a surety meeting specified standards as set forth in the definitive agreements to guaranty RES America's construction obligations. Assuming closing occurs on or before March 31, 2005, then substantial completion (i.e., commercial operation) will occur before the end of 2005.

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[4] PSE has the right to waive this condition precedent and should it determine that the risk of any appeals is minimal, PSE may proceed toward closing earlier.

Summary of the Program of Acquisition, Construction and Operation

A non-binding Letter of Intent and Term Sheet was executed on October 29, 2004 with Blue Sky and formed the commercial basis for the definitive agreements. A detailed summary of these agreements is attached as **Exhibit 11**. The principal commercial terms of the proposed transaction are briefly summarized below:

- Pursuant to an ***Asset Purchase Agreement ("APA")***, PSE will acquire a 100% ownership interest in the assets owned by Blue Sky and its affiliates (including but not limited to land leases and easements, final permits, environmental studies, surveys, wind resource data and analysis and other development assets) relating to the Project as of the closing date (estimated to be approximately March 31, 2005) (the "Project Development Assets"). PSE's purchase price for the Project Development Assets is [redacted] payable in two equal installments as follows: (i) on the closing and (ii) on substantial completion of the Project. The closing will occur after receipt by Blue Sky of all permits, consents, authorizations and approvals and satisfaction or waiver of conditions precedent specified in the APA.

- Also pursuant to the APA, RES will pay [redacted] toward PSE's third-party costs of documenting and implementing the transaction, payable one-half at closing and one-half on substantial completion of the Project.

- Immediately following closing of the purchase of the Project Development Assets by PSE, RES America, an affiliate of Blue Sky, will perform, or cause to be performed, all engineering, procurement and construction for the Project pursuant to a fixed-price turnkey ***Engineering, Procurement and Construction Agreement*** with PSE ***(the "EPC Agreement")***. RES America will, in turn, contract (via a turbine supply agreement) with Vestas American for the purchase of the 83 WTGs, and also will contract with various subcontractors for the construction of the other facets of the

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Project (such as the roads, WTG foundations, the electrical collection system, the site substation, and the interconnecting transmission line).

- The EPC Agreement price will be fixed at [redacted] provided that the closing occurs on or before March 31, 2005. The closing date will depend upon, among other things, the time needed to obtain all necessary, final permits and to satisfy other conditions precedent for the closing. Management will consider opportunities to accelerate closing, if feasible. Should the necessary conditions precedent not be satisfied such that closing cannot occur prior to March 31, 2005, the APA will terminate unless extended by mutual agreement.

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- To guarantee the performance of its affiliates under the APA and the EPC Agreement, RES will provide a ***parent guarantee*** of the obligations of both Blue Sky and RES America. In addition to the parent guarantee, a ***payment and***

[redacted]

performance bond in the amount of [redacted] will be issued in favor of PSE as partial security for the performance and payment of RES America's obligations. The amount of the bond equates to [redacted]

- Vestas American's contractual obligations under its turbine supply agreement with RES America will be guaranteed by Vestas. In addition, once the WTGs are placed into service, Vestas American will provide a power curve warranty, a five-year availability warranty, a five-year mechanical warranty and five years of maintenance, operation, spares parts and service of the WTGs under a separate ***Operation, Maintenance, & Warranty Agreement ("OM&W Agreement")*** between PSE and Vestas American. Under the power curve warranty, Vestas American will guarantee that the measured power curve is at least [redacted] of the warranted power curve. Similarly, under the availability guarantee, Vestas American will guarantee that measured average availability is at least [redacted] during the first six months of operation and [redacted] during the remainder of the five-year warranty period. The OM&W Agreement provides for financial compensation to PSE in the event that there are shortfalls in the power curve or the availability.[6]

- Pursuant to the terms of the ***Wind Energy Ground Leases and Transmission and Access Easements*** (the ***"Wind Leases and Easements"***) assigned to PSE by Blue Sky on the closing of the APA, PSE will make payments during construction and afterwards to the ten landowners upon whose property the Project will be placed. During the estimated nine-month construction period of the Project, PSE will be obligated to pay each private landowner [redacted] per megawatt of installed rated

REDACTED

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[6] Financial compensation is calculated per defined formulae contained within the OM&W agreement.

capacity on their land, one-half of which shall be due on the commencement of construction, and the balance of which shall be due upon the commercial operation date for such WTG. Once the WTGs are placed into service and for the remainder of the leases' terms, PSE will be obligated to pay royalties to the lessors at a rate of approximately [redacted] MWh actually produced, escalating annually from the date on which each lease began. Royalties for the Project are estimated, in the aggregate, to be approximately [redacted] per year, in 2005 dollars. Based on advice PSE has received from its wind consultant, Garrad Hassan Americas, Inc. ("Garrad Hassan"), such terms are "market" in the industry. Additionally, approximately [redacted] per year in aggregate will be paid to landowners that have granted transmission easements for the Project.

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Need for Additional Supply Resources, Analytical Updates, and Resource Solicitation Process

PSE's 2003 Least Cost Plan ("LCP") was published in April 2003 and updated in August 2003 as part of PSE's efforts to analyze and document its projected load and resource needs. The August 2003 update incorporated a comprehensive assessment of available conservation resources and a fully-integrated portfolio analysis that evaluated both conservation and supply resources. The updated LCP identified need for additional electric energy resources based upon the "B2" planning standard as adopted by PSE's Board of Directors. That standard requires that energy be added to meet PSE's highest deficit month. For the time period 2005 - 2008 that deficit was estimated to be 592 aMW. This 592 aMW need was reduced in early 2004 due to PSE's acquisition of a 125 MW interest in the Frederickson 1 generation facility.[7] PSE's

[7] The nominal capacity of PSE's interest in the Frederickson 1 facility is 125 MW. The Frederickson facility provides approximately 120 aMW of winter energy.

conservation efforts are expected to reduce the remaining deficit by an additional 117 aMW. This leaves 355 aMW of additional supply resources to be acquired (via outright ownership or power purchase agreements) in order for PSE to meet its planning standard through the 2005 - 2008 time period. In 2004, PSE adjusted this need upward by 27 aMW to reflect certain changes in its contracted Mid-Columbia ("Mid-C") hydro resources.[8] This increased PSE's estimated need to 382 aMW from 355 aMW.

PSE has updated certain key assumptions, as summarized in the Documentation Appendix, Summary of Resource Acquisition Process and Update dated December 15, 2004 and provided to the Board of Directors.

PSE's described its resource needs in the Wind Resource and All-Generation Sources Requests for Proposals dated November 17, 2003, and February 3, 2004 (respectively the "Wind RFP" and the "All-Source RFP", and collectively the "RFPs"). These RFPs were reviewed and approved by the Washington Utility and Transportation Commission ("WUTC") in orders issued on November 13, 2003 and on January 28, 2004. PSE then issued the RFPs and evaluated the responses it received. In the case of the proposed transaction, PSE evaluated the transaction relative to the other responses it received to the RFPs, including the non-wind proposals. Washington State does not presently have a mandated renewable resources portfolio standard ("RPS") that would provide an evaluation advantage to qualified renewable projects. However, several RPS bills are expected to be introduced in the Washington legislature and efforts are stirring to organize a voter initiative on RPS.

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[8] The change in need was created by three factors: (1) a new contract with Grant Co. PUD for Priest Rapids and Wanapum energy; (2) an update of the hydro shape provided by consultant Avo Chillegerian and based on the latest Biological Opinion on the operation of the Federal Columbia River Power System prepared by the National Marine Fisheries Service; and (3) an update in the shape of the seasonal energy received from PG&E.

The Cost of Wind Generation is Competitive

The Project ranked highly when considering an integration of all evaluation criteria. In addition the proposed transaction's commercial terms cause the Project to be the top-ranked resource with the lowest 20-year project levelized costs among the group of seven short-listed proposals[9], assuming PTCs of approximately $18/MWh escalated and qualification of the Project for such PTCs. As presently configured, but subject to certain contingencies (including the length of time to closing), the Project's 20-year levelized cost delivered to, and integrated into, the PSE supply portfolio is estimated to be approximately $48/MWh, including PTCs. Such costs compare favorably to the July 2004 Aurora 6 long-term forecast of Mid-C spot power prices of approximately $49/MWh. (Mid-C prices reflect generally only the variable cost of energy production for the marginal generating resource and not a full return of or on capital for that resource.) While a favorable comparison of cost with projected market is a bonus, this comparison does not reflect the fact that reliance on market priced supply creates a highly uncertain power cost outlook. The portfolio evaluation indicated that in a variety of price scenarios the addition of wind generation to the portfolio both reduced cost and lowered the expected variability of portfolio costs.

REDACTED

Finally, in addition to its attractive cost profile, the Project would further diversify PSE's supply portfolio.

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[9] Of the seven short-listed proposals, PSE has entered into a two-year power purchase agreement ("PPA") with Arizona Public Service for 85 MW flat with delivery commencing January 1, 2005. Two other proposals are in active negotiation: (1) a purchase of 100% of the ownership interest from Zilkha Renewable Resources in the approximate 230 MW Wild Horse wind generating facility in Kittitas County, Washington, and (2) a purchase of 100% of the ownership interests from ORMAT in the approximate 5

In connection with the proposed transaction, PSE has requested a private letter ruling ("PLR") from the Internal Revenue Service ("IRS") confirming that PSE, as a regulated utility and under the specific facts of the proposed transaction, may utilize PTCs to shelter its taxable income. The receipt of a favorable IRS ruling is a condition precedent to the closing of the transaction. Should the PLR not be issued in a timely manner, PSE may waive this condition precedent and proceed with the Project, but PSE presently believes that such a ruling from the IRS should be received and on a time line that will not result in a delay in the closing.

At the present time, PTCs apply to the energy produced from a wind generation facility for a 10-year period, commencing with the date each WTG is placed into service.

Development of the Project

Blue Sky, a wholly owned subsidiary of RES, was formed to develop the Project. Blue Sky has developed the Project to date and will continue to develop and permit the Project at its cost and risk. The proposed transaction is structured so that PSE will not be required to purchase the Project Development Assets until final non-appealable permits are in place and the Project's development phase has been completed.

Through and until the closing of the APA, Blue Sky will continue to develop the Project and obtain all development rights necessary to permit construction and operation of the Project. After the closing date under the APA and the issuance of the "notice to proceed" ("NTP") under the EPC Agreement, RES America will construct the Project so as to achieve commercial operation within the prescribed deadlines. Key development assets include, but are not limited to:

MW heat recovery project in Whatcom County, Washington. Consideration of the other three proposals has been discontinued for commercial and economic reasons.

- Real estate rights, including rights to access, install, operate, and move power from the WTGs to the Project interconnection with the BPA's transmission system;

- Environmental permits and licenses granting authority to construct and operate the Project subject to specified conditions;

- An interconnection agreement and a design and procurement agreement with BPA detailing the specifications, construction, and payment requirements for interconnection facilities, including network upgrades, required to deliver the Project power;

- EPC Agreement wherein RES America will undertake the turnkey construction of the Project incorporating, among other things, a turbine supply agreement with Vestas American for the WTGs, and other subcontracts as appropriate to construct the balance of plant ("BOP") infrastructure and erect the WTGs;

- Warranty agreements wherein the Project is constructed according to specifications and warranted to meet specified performance criteria;

- OM&W Agreement wherein Vestas American will provide long term operations and maintenance of the WTGs during the five-year warranty period pursuant to specified standards of performance;

- Consents and agreements to transfer all Project assets to PSE.

The Project's development will generally be concluded once these assets are in place and the Project can enter the construction phase. The parties could, however, agree to waive certain minor development conditions, in which case, Blue Sky could have some ongoing development responsibility during the construction period.

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Material Project permits include:

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- A conditional use permit issued by Columbia County, Washington and applicable solely to the Project site and not including any adjacent site indicating the Project's compliance with Columbia County's zoning ordinance. A conditional use permit for the Project site was approved on December 14, 2004 and was issued on December 23, 2004. The statutory appeal period expires on January 18, 2005.

- A mitigated determination of non-significance ("MDNS") issued by Columbia County, Washington, indicating the Project's compliance with the Washington State Environmental Policy Act ("SEPA"). The MDNS was issued on November 9, 2004. A 15-day comment period followed in which six parties submitted comments. All submitted comments were incorporated into the final conditions of the conditional use permit approval.

- A Record of Decision ("ROD") issued by BPA indicating the Project's compliance with the National Environmental Policy Act ("NEPA"). The ROD was issued on December

20, 2004 and was published in the Federal Register on December 23, 2004. The 90-day appeal period will expire on March 23, 2005.

- A US Army Corps of Engineers Section 404 Wetland Permit, including any related NEPA compliance and Endangered Species Act review. Authorization under this nationwide permit was applied for under a Joint Aquatic Resource Permits Application ("JARPA") and the application was deemed complete on November 23, 2004. The Corp is expected to issue its authorization the week of January 3, 2005.

- A Washington Department of Fish and Wildlife ("WDFW") Hydraulic Project Approval. This permit was also applied for under JARPA and issued on December 28, 2004. The 30-day appeal period will expire on January 27, 2005.

A number of real estate matters must be completed before closing under the APA can occur. These fall into two broad categories: (1) securing certain remaining real estate interests required for the construction, ownership, interconnection and operation of the Project by PSE and (2) completing the necessary real estate due diligence review.

The Project site will not be owned in fee. The primary real estate interests to be acquired by PSE are the Wind Leases and Easements obtained by Blue Sky that allow the construction, maintenance and operation of the WTGs and related transmission improvements on the site. Although Blue Sky has secured the necessary Wind Leases and Easements for the Project, a few critical terms need to be modified in order to be acceptable to PSE.

REDACTED

Consequently, prior to closing, Blue Sky is required to obtain from the landowners an executed package of documents, including:

Additional property interests must also be secured from parties other than the underlying landowners. The Project transmission lines will cross existing rights-of-way held by Columbia County for roads and by PacifiCorp for an electrical transmission line, so the rights to cross these existing rights-of-way must be obtained. Also, as an element of the required BPA interconnection agreement, a substation site must be obtained and conveyed to BPA prior to closing. In addition, ***Non-Disturbance Agreements*** must be obtained from all holders of mortgages or other pre-existing real estate interests in the Project site, recognizing and consenting to PSE's rights under the Wind Leases and Easements. Blue Sky is in the process of obtaining these consents and other items.

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Construction of the Project

The notice to proceed under the EPC Agreement would be issued at the closing of the APA. RES America will commence its performance immediately thereafter. Pursuant to

the EPC Agreement, PSE will pay to RES America a fixed turnkey price for the construction of the Project, subject to adjustment if RES America and PSE agree to changes in the Project's scope. The EPC Agreement Price is [redacted] assuming the closing occurs by March 31, 2005. As noted above, any delay in closing may cause a material increase in the cost of turbines. See **Exhibit 2,** "Diagram of Transaction and Principal Contractual Relationships."

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Management and Operations of the Project

Effective as of the date on which Project "substantial completion" (as defined in the EPC Agreement) has been achieved, Vestas American will provide the day-to-day operations and maintenance ("O&M"), including warranty coverage, for the WTGs pursuant to the OM&W Agreement. The OM&W Agreement will be for a five-year term and will contain terms customary for such agreements in the electric industry for wind energy facilities. The scope of services under this agreement includes supply of consumables and parts replacement of the WTGs, in addition to O&M services. The annual cost payable to Vestas American under this contract is [redacted] per turbine, escalated with inflation starting in 2006, or slightly more than [redacted] per year. During the term of the OM&W Agreement, PSE will be responsible for site management and the O&M of the BOP systems (i.e., the portion of the facility excluding the WTGs), including the collection system, Project roads, the site substation, and the interconnecting transmission line. Other than site management, PSE will provide those O&M services via subcontract. The Project will include an on-site O&M building that will house the PSE project manager and the Vestas American employees as well as the parts and consumable supplies stored on site. In addition, PSE will rent an off-site business office in downtown Dayton, Washington from which asset management activities and community and tourism-related events would be managed. Such office will have space available to host meetings for community briefings and provide PSE with visibility in the

local area that is served electrically by Columbia REA and PacifiCorp. The community is highly desirous that PSE establish such a local presence.

The OM&W agreement provides for both penalties and incentives for Vestas American. The principal penalty would be with respect to any shortfall of performance of the WTGs below a level of [redacted] of the warranted power curve. Three WTGs will be tested over a period that may take several months to accumulate data to create a measured power curve. If these curves, when applied to the projected site wind speed distribution, indicates a shortfall in performance, Vestas American will be able to repeat the test one time. If after a retest, a shortfall persists, liquidated damages will be assessed on all of the WTGs in the wind farm. The amount of the liquidated damages is determined such that with reduced energy capture over the twenty-year design life, PSE is made economically whole for lost power.[10]

During the five-year operating period, there will also be an availability warranty. During the first six months of operation, the warranted average availability is [redacted] and for the remainder of the five-year warranty period, the warranted average availability is [redacted] Should the actual availability fall below this level, liquidated damages will be paid to PSE, calculated based on a defined formula within the OM&W Agreement. Likewise, Vestas American is paid an incentive if availability exceeds [redacted] during any six-month period.

Subsequent to the five-year term of the OM&W Agreement, it is likely that PSE will assume responsibility for the O&M of the entire Project, including the WTGs. At the time of transition from the OM&W Agreement to PSE-provided O&M, PSE will staff the facility, possibly by hiring staff trained by Vestas American. During that initial period of

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[10] Financial compensation is calculated per defined formulae contained within the OM&W agreement using an assuming electricity price of [redacted] MWh, escalating at CPI.

PSE-provided O&M, it is estimated that the staff will include

Likewise, subsequent to the five-year term of the OM&W Agreement, PSE will assume responsibility for replacement parts as necessary.

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Estimates of future Project expenses are reflected in the Financial Pro Forma in **Exhibit 5**.

Interconnection, Transmission and Integration Arrangements

The Project will be interconnected directly with the BPA North Lewiston-Walla Walla 115 kV transmission system at the Project site at a new interconnection switching station to be owned and constructed by BPA at PSE's cost. As part of the Project, there will be a 34.5 kV/115 kV site substation and an eight-mile 115 kV interconnecting transmission line between the site substation and the BPA switching station. The site substation and interconnecting transmission line will be constructed by RES America as part of its scope of work under the EPC Agreement. In addition, RES America will act as PSE's agent in overseeing BPA's construction of the switching station.

In addition to the interconnection switching station, BPA has identified other network upgrades required to interconnect the Project to the BPA transmission system. These upgrades include a reconductoring and pole replacement of the BPA Franklin-Nine Mile Tap 115 kV transmission line, a reconductoring of PacifiCorp's Walla Walla (BPA) to Walla Walla (PacifiCorp) 69 kV transmission line as well as a transfer trip scheme to protect the Avista system. The total cost for the interconnecting switching station and these network upgrades is estimated to be $10,100,000. This scope is set forth in the Generation Interconnection Agreement ("GIA") and a separate, design and procurement agreement, both agreements between BPA and Blue Sky. Both the GIA and the design and procurement agreement will be assigned to PSE by Blue Sky at closing and PSE will be responsible for these costs.[11] Under FERC policy with respect to large generator interconnections, interconnection customers are entitled to receive credit for network upgrades against future transmission service costs. For purposes of applying such a credit, the transmission provider also credits the interconnection customer interest, assumed at a rate of 4.2% per year, on the unused balance, based on the FERC variable rate. BPA expects to adopt this credit mechanism as part of its 2005 transmission rate case (expected to be finalized in January 2005). To date, there has been no opposition to this provision in the draft settlement. The Financial Pro Forma (See **Exhibit 5**) assumes this treatment and, as a result, amortizes this credit over the first five years of operation. In the unlikely event that PSE was not provided transmission credits in exchange for funding these upgrades, the 20-year levelized cost of power from the Project would increase by approximately [redacted] MWh to a total of [redacted] MWh.

Long-term, firm transmission from the Project to PSE's load center is not generally available for moving power from the Project location to the west. However, [redacted]

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[11] PSE will front the payments to BPA under the design and procurement agreement.

[redacted] firm transmission service will be available effective as of January 1, 2006 for the Project. [redacted]

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[redacted] If PSE is unable to consummate the necessary commercial arrangements [redacted] PSE will rely upon short-term firm, hourly firm, and non-firm transmission from BPA until long-term firm service is available. Extensive analysis confirms that curtailments should be extremely unlikely. Should transmission curtailments occur, PSE will mitigate by selling the energy in the wholesale market east of the constraints.

A more detailed discussion on transmission and a map showing the location of the Project relative to the regional transmission system is attached as **Exhibit 12.**

As part of PSE's overall effort to evaluate wind resources, Golden Energy Services was retained to assist PSE personnel in evaluating the short-term operating impacts of integrating wind generation into the PSE system. An initial study was completed in August 2003, a Phase II study was completed in January 2004, and a Phase III study was completed in November 2004. These studies estimated integration costs based on using PSE's contracted Mid-C hydro resources and related transmission assets. Such costs are estimated to be approximately $3.80/MWh for hour-ahead and day-ahead integration.

However, as previously described, the energy produced from the Project will be delivered to the PSE load center via the BPA transmission system. Accordingly, the power will be scheduled on an hour-ahead basis and BPA will deliver the scheduled quantity to PSE. For each scheduled hour, PSE will be charged for the difference between the power scheduled and the power actually produced at BPA's published ancillary service tariff rate for generation imbalance. This imbalance charge will have the effect of firming the power on the hour. PSE estimates the imbalance charge plus the ancillary service charge for operating reserves to total $1.03/MWh, assuming persistence forecasting[12] from hour-to-hour and not reflecting any improvements over persistence forecasting that would result from utilizing forecast technology. PSE will use its existing Mid-C resources to firm the power on a day-ahead basis; this cost is estimated to add another $0.84/MWh. Both the hour-ahead and day-ahead costs have been included in the estimates of 20-year project levelized costs cited previously. See **Exhibit 13** for a summary of wind integration matters. Additional staffing costs on the operations floor to provide real-time management for such resources are estimated at the equivalent of one FTE, once the Project enters commercial service.

Summary of Project Benefits

Together with the acquisition of conservation resources and the recently-acquired interest in the Frederickson 1 facility, PSE's acquisition of its first wind energy resource would be a valuable step in acquiring the necessary electric supply resources to meet the planning standard for supply adequacy. This initial acquisition of approximately 150 MW of wind resources would reduce the projected energy shortfall of 382 aMW in 2008 by about [redacted] aMW. The principal benefits of this new resource would be as follows:

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[12] Persistence forecasting is the practice of forecasting the wind generation for the next "scheduled" hour based on the actual production of the wind farm during the current hour.

- Incremental addition that leaves open options for additional renewable and thermal resources;

- State-of-the-art WTGs and control technology provided by a world-class manufacturer (Vestas) with substantial experience and a worldwide commitment to wind energy resources;

- Avoids the liquidity and credit requirements that accompany many long-term power purchase agreements, market power purchases, and natural gas supply arrangements;

- Zero emission technology with minimum impacts on the natural environment;

- Engages the largest world-wide manufacturer of WTGs as the O&M contractor for the first five years of operation, coupled with the manufacturer's extensive West Coast support and parts inventory capability;

- Project power costs less than the 20-year Mid-C power price forecasts as indicated by the Aurora 6 Forecast and below other competing resources proposed to PSE;

- Construction and completion risks guaranteed by financially-responsible and proven entities and adequately secured by a payment and performance bond;

- Proven and improving technology to monitor real-time wind resource conditions and to estimate hour-ahead and day-ahead Project output to make integration both manageable and economical.

Wind Resource Assessment

The Project is an excellent wind resource with strong winds in every month of the year. RES began wind resource measurements on the site in 2001 and accumulated over three years of on-site wind data at over eight meteorological tower sites. RES analyzed these data, as did PSE's independent consultant, Garrad Hassan. Garrad Hassan is a world-renowned expert in wind energy resource and technology assessment. Garrad Hassan independently estimated that the expected long-term energy output from the proposed project is [redacted] MWh per year. This is an annual capacity factor of [redacted] making it one of the best wind resources in Washington State. The analysis includes consideration of topographical effects on the wind field, interference of WTGs upon another, electrical system losses, and other effects. Wind varies from year-to-year and the standard deviation of such variations is estimated to be approximately 40,000 MWh per year. To better understand the seasonal and inter-annual volatility of the wind resource, PSE has also retained 3Tier Environmental Forecast Group, Inc. ("3Tier"), a Seattle-based firm with expertise in wind energy and atmospheric analysis. 3Tier provided an analysis of what the energy production of the Project would have been over the last several decades, based on historical weather data and the most modern numerical modeling techniques. This volatility can be correlated to historical hydroelectric production, load patterns, and climate cycles (such as El Nino) to get a view on how the energy production will fit into future operations.

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Environmental Matters

An environmental due diligence review was conducted of all required local, state and federal government notices, authorizations, approvals, licenses, and permits required for construction and operation of the Project, and corresponding applications, notices, studies and other information, as provided by Blue Sky. The major documents reviewed include the Hopkins Ridge (Blue Sky) Wind Energy Project SEPA Checklist, the

application for a Conditional Use Permit, the Site Plan Application, the Traditional Cultural Property Assessment, the Biological Study Report (also called Baseline Avian Studies Report), the Wetland Delineation Report, and the Joint Aquatic Resources Permit Application (JARPA). A detailed explanation of the environmental regulatory requirements is provided in **Exhibit 7**. Of these, the major environmental requirements were made conditions precedent to the APA as described above.

Other Due Diligence

Real Estate

The real estate due diligence to be completed prior to closing will include title review and a survey of the entire site to confirm the site is contiguous, without significant encroachments, and that there are not any additional real property interests needed for the Project. In addition, Phase I environmental site assessments[13], subject to PSE's review and approval, will be obtained for the entire Project site [redacted]

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Wind Turbine Generators

PSE retained Garrad Hassan to provide a due diligence review of the Vestas V80 wind turbine generator, and of Vestas. Garrad Hassan confirmed that Vestas is the world's leader in wind turbine market share and is considered the leader in technology as well. The V80 WTG began production in 2001. Like most wind turbines, the first machines experienced some performance problems. These problems included some mechanical

[13] Phase I environmental site assessments are performed by a qualified environmental professional and are intended to provide a review of known and observable conditions that allow for an evaluation of the environmental conditions on a site.

and electrical systems issues, which Vestas has addressed through warranty programs. Vestas has a program to incorporate lessons learned into future editions of their machines, and the PSE turbines will benefit from these lessons implemented on a more robust platform. The V80 wind turbine has earned a "Type Certificate" from Germanischer Lloyd ("GL"), an industry recognized certification agency, that certifies the V80 to have a design life of at least 20 years. The V80 fleet has achieved over availability, and thus Garrad Hassan concluded PSE should expect to achieve its operational and financial goals with this WTG. Nevertheless, Garrad Hassan recommends PSE take advantage of the five-year warranty offered by Vestas as protection against any serial defects which might show up after the expiration of the standard two-year warranty. In addition to the Garrad Hassan due diligence, PSE also made an inspection of the Vestas factories in Denmark, including the machine shops that manufacture major components, the nacelle assembly factory, the blade production factory, and the executive offices and found Vestas to be substantial and smooth functioning.

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Technical Due Diligence

PSE retained Garrad Hassan to provide engineering services during the development and construction phases of the Project. Garrad Hassan has provided review and comment during the negotiation of the EPC and OM&W Agreements to assure PSE that it is entering industry-conforming contracts with appropriate risk mitigation. In addition, Garrad Hassan will provide critical review of certain preliminary engineering, such as the design of the Project electrical collection system, to assure maximum availability of the wind turbines at minimum electrical or other losses. During the construction phase of the project, Garrad Hassan will provide owner's engineering services by providing

critical design reviews, for example with respect to wind turbine foundations. In addition, PSE staff engineers have reviewed, negotiated and accepted the technical specifications included in the EPC contract.

The principal findings of PSE's due diligence investigations are summarized in **Exhibit 7**.

Tax Benefits/Considerations

The proposed transaction has been structured to reduce revenue requirements of customers by minimizing PSE's income tax costs. PSE will claim the PTCs and flow-through the PTCs on energy actually produced during the ten-year period following the tax in-service date resulting in reduced customer revenue requirements. In addition, a significant portion of the investment in the Project will qualify for accelerated depreciation benefits over a five-year recovery period, thereby resulting in a significant reduction in PSE's otherwise-applicable federal income tax liabilities. A substantial portion of the equipment and services acquired by PSE pursuant to the EPC Agreement will not be subject to Washington sales tax, thus lowering the all-in cost of the Project. Also, PSE has applied for an IRS ruling with respect to PSE's qualification to claim the PTCs for the output of the Project.

Renewable PTCs cannot be used by a company to reduce its corporate income taxes below a floor of 75% of the company's regular tax liability or the amount it would owe under the alternative minimum tax. PSE is estimated to have federal income tax payable that will allow it to take full advantage of the PTCs from the Project. Any credits that go unused because of this limitation can be carried back one year and forward for 20 years. The average amount of the PTCs expected from the Project is approximately [redacted] million per year. To use this credit requires an annual amount of income taxes payable of approximately [redacted] million.

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On October 4, 2004, a two-year extension (through December 31, 2005) of PTCs for wind projects was signed into law by President Bush.[14] The credit was first created by the passage of the Energy Policy Act of 1992 and applied to electricity produced by a qualified wind facility placed in service after December 31, 1992. The PTCs represents a 1.5 cent per kilowatt-hour federal income tax credit that is adjusted annually for inflation. The current value of the credit is 1.8 cents per kilowatt-hour (or $18.00/MWh).

Assets acquired and/or constructed as part of the proposed transaction will have book lives and tax lives that will differ, in certain cases significantly. Such differences will give rise to a deferred tax liability and a Schedule M adjustment on PSE's corporate income tax return. For rate-making purposes, such deferred tax liability will cause PSE to have a somewhat lower earnings base than book basis in the acquired assets as the accelerated cash flow benefit of the shorter tax lives of the acquired assets reduce PSE's earnings base for rate-making purposes. Such difference will reverse by the end of the book life of the assets. The revenue requirement effects of such book/tax differences over the Project's life are reflected in PSE's estimate of the Project's 20-year levelized costs.

Accounting Treatment

The proposed transaction will be accounted for pursuant to the applicable accounting rules of the FERC and WUTC. For modeling purposes the overall useful life of the Project is estimated to be 20 years. PSE is working with its engineering and wind

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[14] The tax bill also provided that income from the production and sale of power, whether by IPPs or regulated utilities, qualifies for a newly enacted manufacturing tax deduction. This tax deduction has not been taken into account in the financial pro forma or in the levelized cost of power figures cited in this memo. PSE is awaiting further definition as to the proper treatment of this deduction.

consultant, Garrad Hassan, and with Vestas American to confirm this useful life or, alternatively, to decide whether a longer useful life is appropriate.

Rate-Making Treatment

PSE anticipates that, shortly after closing, it would request recovery of its investment costs in a Power Cost Only Rate Case ("PCORC") timed such that the case would be completed shortly before the Project achieves substantial completion and with the rates for the Project going into effect upon substantial completion[15].

PSE would likely seek to have the Project's asset acquisition costs, development costs, due diligence costs, start-up costs, construction costs, AFUDC and all related transactions costs capitalized and recovered in rates over a 20-year period (or longer if appropriate) together with an authorized return on rate base. The authorized rate of return in a PCORC would be the rate currently approved. PSE would request that all projected costs associated with the operation and maintenance of the Project be recovered in rates.

PSE would also request an accounting order to accrue a return on 1) the regulatory asset created by the difference in timing between when PTCs are earned and when PTCs are booked as tax credits; plus 2) the balance of deferred tax created by the timing difference between when deferred tax credits are booked and when they can be used to reduce actual tax payments; plus 3) the pre-payments to BPA for the network upgrades that PSE receives as a credit from BPA against future wheeling charges that reduce this pre-paid expense.

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[15] The rate-recovery schedule assumes that PSE will not file a General Rate Case ("GRC") until after January 1, 2006. If the Company decides to file a GRC earlier, then the proposed rate-recovery schedule would be revised.

The levelized cost of the Project is approximately $48/MWh. The current baseline rate approved in PSE's PCORC in May 2004, is $46.303/MWh. It is expected that the power cost baseline rate will increase in late February 2005, as a result of the increased fuel and operation costs included in the 2004 GRC. The levelized cost of the Project is approximately equal to the average power costs embedded in rates. The actual impact on customer rates at the end of 2005 is expected to be an increase that depends upon: (1) the outcome of the GRC, (2) the market price of power in 2006 that is replaced by Project generation, and (3) the first year cost of the Project compared to the levelized Project cost. A preliminary estimate of the net effect on electric rates would be an increase of less than 1%.

Discussions of rates and accounting issues are discussed in **Exhibit 8**.

Financing Program

The cash requirements will be included in PSE's capital budget and will be funded as a component of the Company's overall financing strategy. It is expected that the Company will fund the initial cash requirements with its existing short-term credit facilities and then refund those borrowings using the proceeds of permanent long-term financing when conditions for issuing such financing are favorable in the capital markets. The permanent financing will most likely consist of senior secured notes (secured by a mortgage on electric and/or gas property) and/or common equity.

Insurance Program

Construction Period Insurance Program

During the construction period, builder's risk coverage (physical damage to the plant during construction) can be provided in one of three ways: (1) PSE can endorse

coverage on its existing property insurance policy, (2) PSE can purchase a separate policy, or (3) RES America can purchase a policy. Once PSE has obtained construction period insurance premium estimates, the following factors will be considered:

(1)

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(2)

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Operating Period Insurance Program

Once construction is complete and the Project commences operation, it will be added to PSE's existing (1) general liability insurance coverage – [redacted] and (2) all risk property insurance program for replacement value [redacted] In addition, the OM&W Agreement will require that Vestas American obtain the following insurance coverage:

(1) Workers' Compensation;

(2) Comprehensive General Liability;

(3) Automobile Liability; and

(4) Excess Liability.

Risk Factors

PSE's risks associated with the Project vary in nature and extent based on the phase of the Project. The phases are:

- Pre-Closing
- Construction
- Operation

PSE has identified a detailed description of the principal risks and identified mitigation plans (See **Exhibit 9**). A summary description of these risks follows:

- The Pre-Closing Phase extends from now until the closing of the proposed transaction. Principal risks are that the proposed transaction will not come together and, to a lesser extent, that various stakeholders, including community members, Wall Street, and the WUTC exhibit an adverse reaction to the Project or the proposed transaction. The financial exposure to PSE is principally in the previously-incurred transaction costs that would be expensed in the event the proposed transaction does not go forward or is not completed. The principal mitigation against these risks is PSE's careful negotiation of the definitive agreements, due diligence and communications plans. The most significant conditions precedent include Blue Sky obtaining final, non-appealable permits necessary to construct the Project. As PSE will not pay Blue Sky prior to closing, the financial risk to PSE is the loss of previously-incurred transaction and due diligence costs. The principal mitigation will be the inclusion of "off-ramps" in which the definitive agreements will terminate if the proposed transaction does not close on or before March 31, 2005 because one or more of the condition precedents have not been satisfied.

- The Construction Phase commences at the closing of the APA and the issuance of the NTP under the EPC Agreement. At closing, PSE will purchase the development assets of the Project for [redacted] half payable at closing and half payable when the Project reaches substantial completion. The primary responsibility during this phase is RES America's obligation to build the Project according to a guaranteed price, guaranteed schedule, and such that the Project meets certain performance guarantees. The financial risks may be substantial in the event of delay that results, for example, in some or all of the WTGs not qualifying for PTCs because of the failure to meet the tax law imposed placed in-service deadlines. The principal mitigation to be implemented include careful management of the construction design and execution, including PSE's rights for owner's engineer review and oversight, coupled with rights to compel acceleration of the construction (by adding additional cranes and crew for example) or assess liquidated damages on the responsible parties. In addition to parent guarantees from RES and Vestas, PSE will obtain a payment and performance bond to secure RES America's performance of the BOP scope of the EPC Agreement.

- The Project enters the Operating Phase once substantial completion is achieved. The principal risks in this phase relate to the Project not meeting performance expectations. The reasons the Project might fall short include poor wind conditions or initial projections, the Project not being capable of meeting initial performance projections, or mechanical availability problems with the equipment. The risks are proportional to the loss of production. Performance of the equipment, both initial and ongoing, is subject to warranty by Vestas American during the defined, five-year warranty period, and subject to incentives and penalties in the OM&W Agreement. With respect to the wind resource, PSE's mitigation is thorough due diligence on the wind resource projection by independent industry experts.

Closing and Schedule

PSE and Blue Sky desire to execute definitive agreements and close this transaction as soon as possible. Execution of three key definitive agreements (the APA, the EPC Agreement, and the OM&W Agreement) is currently targeted to occur by January 15, 2005 or shortly thereafter, following Board consideration.

Closing is expected to occur by March 31, 2005. Management will consider opportunities to accelerate closing, if feasible.

At closing, PSE would issue a NTP to RES America (and RES America would, in turn, issue a similar notice to Vestas American for the WTGs). Construction is expected to take slightly less than nine (9) months, which would (i) permit the Project to achieve substantial completion by December 31, 2005 and (ii) allow PSE to take advantage of the current PTCs. Should the necessary condition precedents not be satisfied by March 31, 2005, then the APA will terminate; however,

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See **Exhibit 10** for the Project Schedule.

Recommendation

Based on the described benefits of the proposed transaction, management recommends that the Board of Directors approve the transaction as proposed.

GUIDE TO ACRONYMS AND SHORTENED TERMS

Abbreviation/Term	Meaning
£	Pound sterling
APA	Asset Purchase Agreement
BOP	Balance of Plant
BPA	Bonneville Power Administration
CUP	Conditional Use Permit
DNR	Washington State Department of Natural Resources
EPC Agreement	Engineering, Procurement and Construction Agreement
Garrad Hassan	Garrad Hassan Americas, Inc.
GIA	Generation Interconnection Agreement
GBP	United Kingdom pound sterling
GL	Germanischer Lloyd AG
GL Wind	Germanischer Lloyd WindEnergie GmbH
GRC	General Rate Case
IRS	Internal Revenue Service
JARPA	Joint Aquatic Resource Permits Application
LCP	Least Cost Plan
MDNS	Mitigated Determination of Non-Significance
Mid-C	Mid-Columbia
NEPA	National Environmental Policy Act
NTP	Notice to proceed
O&M	Operation and maintenance
OM&W Agreement	Operation, Maintenance, & Warranty Agreement
PCORC	Power Cost Only Rate Case
PLR	Private letter ruling
PTCs	Production Tax Credits
RES	Renewable Energy Systems, Ltd.
RES America	RES America Construction Inc.
ROD	Record of Decision

GUIDE TO ACRONYMS AND SHORTENED TERMS

Abbreviation/Term	Meaning
RPS	Renewable portfolio standard
SEPA	State Environmental Policy Act
Vestas	Vestas Wind Systems A/S
Vestas American	Vestas-American Wind Technology, Inc.
WDFW	Washington Department of Fish and Wildlife
Wind Leases and Easements	Wind Energy Ground Leases and Transmission and Access Easements
WTG	Wind turbine generator
WUTC	Washington Utility and Transportation Commission
3Tier	3Tier Environmental Forecast Group, Inc.

List of Exhibits

1. RES Corporate Structure
2. Diagram of Transaction and Principal Contractual Relationships
3. Overview of RES
4. Project Description
5. Project Stand Alone Financial Pro Forma
6. Discussion of Wind Resource and GH Findings
7. Key Due Diligence Findings
8. Rates and Accounting Issues
9. Risk Analysis
10. Project Schedule
11. Summary of Project Definitive Agreements
12. Transmission
13. Summary of Wind Integration Studies
14. Overview of Technical Data
15. Description of Principal Project Components