



Stephen P. Reynolds
Chairman, President and
Chief Executive Officer

Puget Sound Energy, Inc.
P.O. Box 97034
Bellevue WA 98009-9734

March 13, 2007

The Honorable John Dingell
Committee on Energy and Commerce
United States House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

The Honorable Rick Boucher
Subcommittee on Energy and Air Quality
United States House of Representatives
2125 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Dingell and Chairman Boucher:

Thank you for reaching out to the utility industry to request our input on how to best craft new federal regulations on the production of greenhouse gases. Puget Sound Energy appreciates the opportunity to respond to the questions you posed.

Puget Sound Energy is Washington state's oldest and largest energy utility. With a 6,000-square-mile service area stretching across 11 counties, Puget Sound Energy (PSE) serves more than 1 million electric customers and 700,000 natural gas customers, primarily in western Washington. Puget Sound Energy meets the energy needs of its growing customer base through incremental, cost-effective energy efficiency, low-cost procurement of diverse energy resources, and far-sighted investment in the energy-delivery infrastructure.

Puget Sound Energy agrees that human activity is accelerating climate change and we support efforts to craft a national program to regulate the emission of greenhouse gases. Further, we suggest that Congress address climate change by crafting an economy-wide regulatory program that caps emissions-generating entities upstream in order to balance maximum effectiveness with minimal administrative costs. We believe such an upstream regulatory system that also provides allowances to help utilities mitigate cost impacts passed through by fuel providers would provide us with the economic and regulatory certainty that we need to provide for the electricity needs of our fast growing customer base.

As you and your colleagues in the House of Representatives examine the issue of climate change, we urge you to keep in mind some additional comments. First, Puget Sound Energy is committed to increasing the portion of our power supply portfolio that comes from renewable resources. At this time, five percent of our electricity is provided by wind resources, and we believe it is critical that Congress look for predictable financial incentives that will enable us to further invest in renewable generation resources. The Renewable Energy Production Tax Credit has proven to be a useful incentive thus far. However, there are other incentive options that do not utilize the Internal Revenue Code that can and should be considered. We would be happy to meet with you to outline them.

The Honorable John Dingell
The Honorable Rick Boucher
March 13, 2007
Page 2

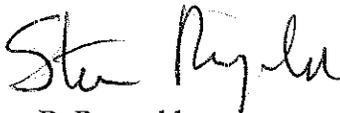
Second, a transition to a more renewable and less emission-intensive electricity future generation will take time. We believe it is important to recognize that natural gas will be the generation resource that utilities will heavily rely on in the decade ahead to bridge to less emission-intensive coal resources. For that reason, it is important to recognize that utilities will need new natural gas generation facilities to meet their obligations to serve customer load, and allowances should be provided for these resources commissioned after 2006.

Lastly, Puget Sound Energy supports the creation of a national renewable portfolio standard for utility generation that does not exceed 15 percent by 2020, provided that utility ownership of such renewable resources is placed on a level playing field with respect to access to and utilization of federal incentives. PSE is already well on its way to meeting this 15 percent goal which was also approved by Washington State voters in 2006. However, we believe that a national renewable portfolio standard must not be adopted without providing significant financial incentives to help mitigate possible financial impacts to our customers' rates.

I hope that these general thoughts and the more specific responses to your questions are helpful as you proceed toward drafting legislation. Puget Sound Energy would be pleased to work with you further on this important national issue.

If you have any questions or would like additional information, please contact me at (425) 462-3842

Sincerely,



Stephen P. Reynolds
Chairman, President and
Chief Executive Officer

cc: Washington State Congressional Delegation
Edison Electric Institute
American Gas Association

Responses to:

House Energy and Commerce Committee
Questions on Climate Change

Puget Sound Energy appreciates the opportunity to respond to the questions posed by the U.S. House of Representatives' Committee on Energy and Commerce on the issue of climate change. Puget Sound Energy is Washington state's oldest and largest energy utility, with a 6,000-square-mile service area stretching across 11 counties, Puget Sound Energy (PSE) serves more than 1 million electric customers and 700,000 natural gas customers, primarily in western Washington. PSE meets the energy needs of its growing customer base through incremental, cost-effective energy efficiency, low-cost procurement of diverse energy resources, and far-sighted investment in the energy-delivery infrastructure.

- 1. Please outline which issues should be addressed in the Committee's legislation, how you think they should be resolved, and your recommended timetable for Congressional consideration and enactment. For any policy recommendations, please address the impacts you believe the relevant policy would have on:**
 - a. Emissions of greenhouse gases and the rate and consequences of climate change; and**
 - b. The effects on the U.S. economy, consumer prices, and jobs**

Puget Sound Energy requests federal guidance on this important matter through appropriate legislative solutions. The sooner the promulgation, the sooner that utilities like PSE will receive the needed guidance and certainty for management of future energy needs for our customers. While laudable efforts are being undertaken at local, state, and regional levels, the management of climate change and corresponding adoption of solutions should be adopted at the federal level. If the United States Congress adopts greenhouse gas legislation during the 110th Congress, that legislation should include the following three elements.

First, any greenhouse gas regulation should be crafted as a market-based approach (i.e. cap and trade or carbon tax) that covers all sectors of the economy. An economy-wide approach will ensure that no particular industrial sector is expected to carry more than its appropriate share of the burden of reducing greenhouse gas production which will spread and possibly limit the effects on the US economy. Further, inclusion of a safety valve as outlined by the National Commission on Energy Policy will also minimize the initial and possible long-term economic shocks that could arise from the introduction of the cost of reducing greenhouse gases. It will also mitigate opportunities for "gaming" by traders and brokers.

Second, any legislation must provide utilities (particularly those serving fast growing areas of the United States) with the cost certainty that is needed to effectively plan for the addition of new generation resources to serve utility customers.

Third, as is outlined below, Puget Sound Energy believes that any climate change legislation adopted by Congress should also include meaningful financial incentives that will increase the use and deployment of renewable electricity generation resources particularly for utilities. These incentives should include but are not limited to a permanent or long-term extension (5 years or more) of the Renewable Energy Production Tax Credit, amendments to the Renewable Energy Production Tax Credit and the Investment Tax Credit for Solar to make them more applicable for utilities, and any other direct financial incentives that could advance the goal of increasing sources of renewable electricity generation. It would also greatly aid utilities if mechanisms to alleviate transmission constraints were addressed to ensure timely and cost-effective transportation of the renewable generation to appropriate utility service territories

To comment briefly on the appropriate timing for the adoption of climate change legislation, Puget Sound Energy would prefer that Congress adopt climate change legislation within the next 1-2 years to allow for the energy industry and other sectors of the economy to incorporate the new regulatory environment and associated costs into future business planning.

2. One particular policy option that has received a substantial amount of attention and analysis is “cap-and-trade.” Please answer the following questions regarding the potential enactment of a cap-and-trade policy:

a. Which sectors should it cover? Should some sectors be phased-in over time?

Puget Sound Energy believes that any cap-and-trade program should apply to all sectors of the economy. Many different industries and economic sectors contribute to the total amount of greenhouse gases produced every year in the United States and all of these sectors should be included in a solution. For instance, it is estimated that transportation accounts for at least 50% of all greenhouse gases emitted in the Pacific Northwest.¹

b. To what degree should the details be set in statute by Congress or delegated to another entity?

Puget Sound Energy believes that Congress should set forth in law the major components of any cap-and-trade program including allowance methodology, allocation, the basic regulatory structure, timetables, and benchmarks. Only the purely administrative aspects of such a program should be left to the applicable Federal agencies for interpretation. We also believe that a nation-wide program for the regulation of greenhouse gas emissions would be the most productive. So, to the extent that state or regional bodies enact area specific climate change regulations prior to the creation of a nation-wide climate change regulatory system, we urge

¹ "Roadmap for Climate Protection: Reducing Greenhouse Gas Emissions in Puget Sound", Puget Sound Clean Air Agency Climate Protection Advisory Committee, December 29, 2004.

Congress to establish that any Federal climate change program supercede and preempt any state or regional greenhouse gas regulation programs.

c. Should the program's requirements be imposed upstream, downstream, or some combination thereof?

Puget Sound Energy supports the upstream regulation of greenhouse gas emissions by the transportation and energy sectors as long as utilities are provided allowances to off-set some or all of the initial costs passed down to utilities by upstream fossil fuel providers.

d. How should allowances be allocated? By whom? What percentage of the allowances, if any, should be auctioned? Should non-emitting sources, such as nuclear plants, be given allowances?

Puget Sound Energy believes that allowances should be distributed to fossil fuel users only and that distribution should be freely assigned based on a uniform allocation scheme similar to the one used in the acid rain program administered by the US Environmental Protection Agency. Allocations provided to the utility sector should be based on CO₂ production during a five year baseline period average (such as a 2000-2004). The allocation methodology should also take into account power plant ownership so that public utilities, investor-owned utilities and independent power producers are all treated fairly. Allocation formulas should not be based on electricity generation output since hydro facilities are already exempted as they do not produce CO₂.

e. How should the cap be set (e.g., tons of greenhouse gases emitted, CO₂ intensity)?

Puget Sound Energy would prefer that any federal greenhouse gas regulatory program establish a cap based on carbon intensity because it allows for economic growth while supporting the development of new resources with lower emissions profiles.

f. Where should the cap be set for different years?

Puget Sound Energy believes that the baseline for establishing any cap should be calculated on a long enough period of time to reflect variances in emission from year to year due to factors like changes in weather and water conditions as well as plant maintenance. Based on this, we would recommend a five-year base-line period from 2002-2006.

As for setting the initial program implementation date, we agree with several other proposals that program implementation should begin in 2012. Beyond that date, the next major greenhouse gas reduction target should be set at 2020 to allow for advancements in technology, planning, permitting and financing with subsequent target reductions set at every 10 years from there.

g. Which greenhouse gases should be covered?

All greenhouse gases should be covered. However, they should be measured in the equivalent amount of CO₂ created by that gas so as to minimize confusion in the caps and markets. A simple regulation system will be the most effective to implement.

h. Should early reductions be credited? If so, what criteria should be used to determine what is an early reduction?

Yes, early reductions should be rewarded. Measures, including energy efficiency, to reduce emissions that have been undertaken in the absence of specific regulatory or legislative requirements should receive credit both in the determination of any specific baseline and as an indicator of success in achieving statutory reduction or mitigation requirements.

i. Should the program employ a safety valve? If so, at what level?

A cap and trade program should include a safety valve. Puget Sound Energy prefers the model proposed by the National Commission on Energy Policy which is included in many of the proposals circulated by Senate Energy Committee Chairman Jeff Bingaman. Currently, this proposal would set the safety valve at a starting price of \$7 with an inflation factor to adjust the future years. We believe the safety valve approach will minimize the economic impact that Federal greenhouse gas regulation could have on utilities and their customers, particularly in fast growing regions of our country.

j. Should offsets be allowed? If so, what types of offsets? What criteria should govern the types of offsets that would be allowed?

Offsets should be allowed for carbon sequestration in all sectors whether the sequestration is geologic or terrestrial in nature. The sequestration needs to be measured, monitored and verified (MMV) within that sector. It is important to note that the US Department of Energy has a number of sequestration demonstration projects underway. PSE is participating in the Big Sky Carbon Sequestration Partnership.

k. If an auction or a safety valve is used, what should be done with the revenue from those features?

Puget Sound Energy believes that the revenue from the auction of any emissions credits should be dedicated to three causes – new and additional incentives for the generation of renewable electricity generation resources, the advancement of carbon sequestration technologies, and the advancement of other technologies that reduce our nation's overall production of greenhouse gases.

l. Are there special features that should be added to encourage technological development?

Please see responses to Question K.

m. Are there design features that would encourage high-emitting developing countries to agree to limits on their greenhouse gas emissions?

Puget Sound Energy does not have a position on this question.

3. How well do you believe the existing authorities permitting or compelling voluntary or mandatory actions are functioning? What lessons do you think can be learned from existing voluntary or mandatory programs?

Puget Sound Energy makes the following observations about lessons that can be learned from ongoing work around the country to expand renewable electricity generation, create markets for trading credits and the financing and regulation of new utility generation projects.

Permitting Process for Renewables - Expediting the Process and Removing Barriers

Clean energy development could be accelerated by pointing developers to good sites and expediting the permitting and approval process. Public authorities should identify good areas for clean energy installations, undertake necessary environmental studies, and include them in comprehensive plans and zoning ordinances as "allowed uses" which do not require conditional use permits. State and regional institutions can build on these models to develop statewide and regional non-project environmental impact statements that clear the way for clean energy projects on suitable sites.

Transparency in the Markets & the Need for Government Sanctioned Rules

We are beginning to see the emergence of new green trading markets in the United States, some voluntary and some compliance driven. Green trading provides a market-driven solution to reduce pollution, but it needs mandatory government sanctions to get the rules in place. We are also beginning to see Renewable Energy Credit (REC) and carbon markets emerge with rules that are often inconsistent, vague and lacking transparency. Trading rules need to be consistent, harmonized and easily verified. For example, REC markets, both voluntary and compliance, often won't acknowledge a REC as eligible in cases where an equivalent number of carbon credits were sold by the producer. While many will argue these are two separate commodities, at the end of the day what is at issue is the lack of consistency between markets. It will become an even bigger issue as the US enters markets internationally. The US energy industry and the emerging green markets cannot have dual environmental standards in disharmony with the rest of the world.

Financing New Projects and Regulatory Scrutiny

Regulated utilities need both cost certainty and regulatory approval if they are to finance new generation projects, especially with regard to new technologies and renewables. In Washington, the Washington Utilities Trade Commission (WUTC), through their policies and ratemaking treatment of capital expenditures, has a decisive impact on the development of new technologies that would promote fuel diversity and renewable development, and they have the authority to encourage the investment in renewable resources. The WUTC requires PSE to make quantitative and qualitative analysis of future demand and make resource decisions based on this analysis at the "lowest reasonable cost". This poses a significant challenge to utilities like ours that are considering future risk, particularly with respect to projects that have inherent environmental risk like carbon. The "lowest reasonable cost" today may prove to be a significant cost in the future as requirements to abate greenhouse gases and emissions continue to take hold. It is also important to note that the reasonableness and prudence of a utility's purchase of resources is constantly under WUTC review, and WUTC regulations allow for a "look-back" of business decisions to determine if prudent decisions were made. If the WUTC determines that these decisions were not just and reasonable, then PSE shareholders are left with the burden of paying those costs.

- 4. How should potential mandatory domestic requirements be integrated with future obligations the United States may assume under the 1992 United Nations Framework Convention on Climate Change? In particular, how should any U.S. domestic regime be timed relative to any international obligations? Should adoption of mandatory domestic requirements be conditioned upon assumption of specific responsibilities by developing nations?**

Puget Sound Energy does not have a position on this question.

- 5. What, if any, steps have your organization's members or its individual members taken to reduce their greenhouse gas emissions? Which of these have been voluntary in nature? If any actions have been taken in response to mandatory requirements, please explain which authority (State, Federal, or international) compelled them?**

Over the last several years, Puget Sound Energy has made substantial investments in renewable resources, energy efficiency and greenhouse gas reduction efforts. The highlights of our work are outlined below.

PSE's Renewable Efforts

In late 2005, PSE became the first and so far the only Northwest utility to solely build and operate a large wind farm. PSE's Hopkins Ridge Wind Project in southeast Washington's Columbia County is now generating renewable power for PSE customers. Since late December 2006, a second, even larger PSE wind farm, Wild Horse Wind Project, in central Kittitas County has been generating power for PSE customers. PSE remains committed to the development of additional renewable-energy resources. PSE is involved in a variety of studies, pilot projects, and small-scale renewable-power initiatives. These projects include

the development of a 500 kilowatt solar facility, a facility that generates electricity from dairy-cow waste and research into producing power from Puget Sound tidal action. PSE also promotes the development of renewable energy through its Green Power Program, which since 2001 has offered customers the option to purchase electricity from renewable energy resources, primarily in the form of "green tag" credits from suppliers of renewable energy.

Chicago Climate Exchange

In February 2007, PSE joined the Chicago Climate Exchange (CCX), the world's first and North America's only voluntary, legally binding greenhouse gas emissions reduction, registry and trading program. PSE's agreement to work with CCX on greenhouse gas emissions is consistent with its commitment to reduce the impact of its energy production activities on the environment while meeting the energy demands of its growing customer base. As part of our membership in the CCX, PSE is committed to reducing its emissions by 4% from the CCX's (1998 to 2001) baseline. As stated in our policy on greenhouse gases and global warming, PSE is committed to meaningful achievements to lessen the threat of climate change. PSE's long-range goal is to continue pursuing resource policies and strategies (e.g., energy efficiency, renewable power generation) that cuts our emissions even further.

Washington's Clean Energy Initiative

On November 7, 2006, Washington voters narrowly approved a ballot measure that mandates an increase in the investment in and production of renewable energy resources. Initiative 937, the Clean Energy Initiative (I-937), requires that by 2020, large public and private utilities obtain 15% of their electricity from renewable resources such as wind, solar, and biomass. The first requirement will be 3% in 2012, increasing to 9% by 2016 and reaching its final target of 15% by 2020. With the acquisition of Hopkins Ridge and Wild Horse, PSE comfortably meets the first renewable portfolio standard target in 2012 and would likely meet the 2016 target based on its internal goal of meeting 10% of its load with renewable energy by 2013. PSE will need to continue to acquire renewable resources to meet the 2020 target.

Energy Efficiency

PSE has long supported cost-effective energy conservation. Between 1985 and 2006, these measures produced electricity savings that saved approximately over 2,860,000 MWH (an amount roughly equal to the electricity used by about 244,000 homes) on an investment of \$462 million. PSE's conservation program has resulted in over 1,600,000 tons of CO₂ avoided, based on western regional average emissions.