EXHIBIT NO. ___(DEG-5)
DOCKET NO. UE-11___/UG-11___
2011 PSE GENERAL RATE CASE
WITNESS: DONALD E. GAINES

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-11____** **Docket No. UG-11____**

FOURTH EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF
DONALD E. GAINES
ON BEHALF OF PUGET SOUND ENERGY, INC.

JUNE 13, 2011

MOODY'S
INVESTORS SERVICE

Credit Opinion: Puget Sound Energy, Inc.

Global Credit Research - 17 Mar 2011

Bellevue, Washington, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
First Mortgage Bonds	A3
Senior Secured	A3
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured Shelf	(P)Baa2
Commercial Paper	P-2
Parent: Puget Energy, Inc.	
Outlook	Stable
Issuer Rating	Ba1
Sr Sec Bank Credit Facility	Ba1
Senior Secured	Ba1
Puget Sound Energy, Inc. (Old)	
Outlook	No Outlook
First Mortgage Bonds	Baa1
Bkd Senior Secured	A3
Bkd Jr Subordinate	Baa3
Washington Natural Gas Company	
Outlook	No Outlook
Bkd First Mortgage Bonds	A3

Contacts

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Key Indicators

Puget Sound Energy, Inc. (The)

	31-Dec-2008	31-Dec-2009	31-Dec-2010
Adj CFO (pre w/c) / Debt	17.2%	21.8%	16.4%
Adj CFO (pre w/c) + Interest / Interest	4.1x	4.2x	3.6x
Adj CFO (pre w/c) - Dividends / Debt	13.4%	16.4%	11.5%
Debt / Capitalization	54.5%	44.4%	47.8%
Adj Net Income / Avg Equity	6.8%	5.7%	6.1%
Common Dividends / Adj Net Income	85.7%	115.9%	96.7%

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

Sole focus on relatively low risk regulated electric and gas utility operations

Collaborative regulatory relationships and credit supportive regulatory practices

Negative free cash flow that creates external financing needs

Ring-fence-like mechanisms afford protection from risk of excess dividends to the parent

Corporate Profile

Puget Sound Energy, Inc. (PSE), a subsidiary of Puget Energy, Inc. (PE), is an electric and natural gas utility serving about 1.1 million electric and 750,000 natural gas customers in the State of Washington (primarily in the Puget Sound region). In 2010, the company's electric operations accounted for 67% of revenue and gas 33%.

On February 6, 2009, PE was acquired by Puget Holdings LLC, a consortium of private equity investors led by Macquarie Infrastructure Partners, and PE became a direct wholly-owned subsidiary of Puget Equico LLC, which is an indirect wholly owned subsidiary of Puget Holdings. PSE continues to be regulated by the Washington Utilities and Transportation Commission (WUTC) and the Federal Energy Regulatory Commission.

Recent Events

On March 16, 2011, Moody's upgraded all long-term ratings of PE and PSE by one notch and assigned a stable outlook. At the same time we upgraded PSE's short-term rating to P-2 from P-3. The rating action was reflective of a number of considerations including the relative stability in operations observed following the company's buyout in February 2009, as well as the progress being made to extend the maturity profile, at the PE level, of debt that was used to help finance the acquisition. Prospectively, we believe the utility's capital spending will peak in 2011 resulting in a higher level of retained cash flow in 2012. Additionally, we expect the company will seek authorization from the Washington Commission for rate increases at both the electric and gas businesses sometime in 2011 (effective 2012), providing an opportunity for stronger positioning at its current rating category.

SUMMARY RATING RATIONALE

PSE's Baa2 senior unsecured rating reflects its relatively low risk utility operations, collaborative regulatory relationships and recent credit supportive rate case outcomes, efficient handling of electric and gas supply needs, solid credit metrics, and access to its own committed bank credit facilities plus indirect access to the parent's committed capital expenditure facility to supplement internal cash flow.

PSE's primary near-term challenge includes our expectations for considerable negative free cash flow through 2011 given capital spending plans. Careful management of its significant power and gas supply contracts will continue to be a longer-term rating consideration. PSE's ratings also take into account the 2009 ownership change. At year-end 2010 the parent reported $1.5 billion of debt above PSE (25% of consolidated debt). PE relies solely on the utility to service those obligations. Although ring-fencing-like mechanisms exist to protect PSE from undue cash demands by the parent, we believe the Baa2 rating captures the increase in financial risk at the holding company.

DETAILED RATING CONSIDERATIONS

CONSERVATIVE REGULATED UTILITY FOCUS

PSE's electric utility operations include its regulated generation, transmission and distribution operations in the State of Washington. By customer count, approximately 88% of electric and 92% of PSE's gas customers are residential. Measured by sales, residential customers accounted for 41% and 51% of electric and gas revenues, respectively. In 2010, PSE's average retail electric cost per residential customer was 10 cents/kWh, a 5.6% increase from the previous year and below the US average; not surprising given the hydro availability.

The company has a conservative utility focus but also some unique attributes. For example, while viewed as a mid-size utility business, PSE is short internally-generated power and has extensive supply agreements to meet its total load requirements. In 2010, approximately 50% of the company's energy production was purchased. These large short-term and long-term purchase agreements need to be managed carefully and as such, liquidity is a heightened area of focus for PSE. Nevertheless, despite a $398 million gross liability position (61% electric / 39% gas) related to hedging activity at December 31, 2010, the company reported that it was not required to post collateral with counterparties.

Additionally, we note the company elects to classify their hedging activity as fair-value and as such, unrealized non-cash changes in the derivative positions impact the income statement directly. While this increases the "noise" in earnings we look through the accounting convention and focus on cash flow which should be unaffected. Long-term, PSE's electric supply strategy focuses on increasing energy efficiency, while also adding renewable (mostly wind) and natural gas supply sources. These additions are aimed at reducing PSE's dependence on hydro, which we see as beneficial given past supply cost issues due to persistent drought conditions.

COLLABORATIVE REGULATORY RELATIONSHIPS AND CREDIT SUPPORTIVE REGULATORY PRACTICES

As noted above, among the most significant risks that PSE faces are hydro-electric generation variability and the wholesale market prices of natural gas and power. PSE embraces a collaborative regulatory approach in Washington that has been allowing more reasonable rate increases and providing risk-mitigating cost-recovery mechanisms (i.e., the power cost adjustment (PCA) and purchased gas adjustment (PGA) mechanisms). In our view the PCA and PGA are critical underpinnings of the rating given the potential variability in power supply and natural gas costs.

The regulatory framework in Washington also allows for power cost only rate cases (PCORC). A PCORC allows PSE to revise electric rates after an expedited 5-month review of the company's power costs and new resources, instead of filing a traditional general rate case, which entails a comprehensive 11-month review of all utility costs. PSE's use of the PCORC process has helped minimize regulatory lag.

In its most recent electric rate case, the company was authorized a $74 million, or 3.7%, rate increase in April 2010 (74% of requested amount, 48% equity, and 10.1% ROE). On the gas side, the company recently received an appproval to settle with the WUTC for authorization to implement a $19 million, or 1.8%, rate increase.

Although we focus on cash flow, one area of concern has been the under-earning of ROE relative to authorized levels. For example, from 2008-2010 the average achieved ROE was 6.2% (Moody's calculation), well below the recent authorized level. Going forward we expect the company will seek additional rate increases for both gas and electric operations in mid-2011, providing at least the opportunity to achieve its allowed ROE through revenue growth. We note the most recent electric rate case in 2010 used a 2008 test year and authorized a 46% equity component, below the actual 48% reported by the company. We believe these two items, in part, explain some of the under-earning of ROE noted above.

WHAT IS PSE SPENDING CAPITAL ON?

Combining maintenance and growth capex, PSE could spend close to $2.5 billion over the next three years to support supply and delivery infrastructure needs. This is relative to cash from operations of $1.8 billion from 2008-2010. Although the future amounts remain subject to review and may change based on economic, regulatory, and other factors, we still expect the trend of higher than historical average capital expenditures to continue for a few more years. Accordingly, we expect periodic rate cases for PSE to minimize the effects of regulatory lag given the use of historical test years under Washington's regulatory practice. Notable projects include:

- Completion of the first phase of the Lower Snake River Wind Project. Originally a five-phase project (250 megawatts each), the plan is now revised with phase one being increased to 343MW's and the deferral of the following phases to future periods. The company expects that Treasury grants will help reduce the cost of the new generation and this was a consideration in the revised capex strategy. Target completion date is 2012 and total project cost is approximately $840 million.

- Snoqualmie Falls Redevelopment - Scope of project includes the re-licensing of this existing asset and upgrade MW capacity. The $240 million project has a 2013 target completion date.

- Baker River Redevelopment - Increasing hydro-electric capacity at an existing asset from 170MW to 200MW. Target completion is 2014 and cost is $250 million.

The anticipated financing for the capex program is likely to be met from a combination of internal cash flow and utility issued debt, while targeting a capital structure that includes common equity equal to the level that regulators use in setting rates. PSE has committed to keep a minimum common equity of 44% as calculated by the state regulators, unless the WUTC establishes some lower level as the basis for setting rates.

The Investor consortium has now owned PSE for two years and has generally operated the company with no change of strategy from what was contemplated at the time of the acquisition. However, we note the ownership group has contributed no "new" equity since the initial acquisition. We expect that going forward managing the dividend will be a tool to adjust equity rather than new contributions. However, given the large size of the current capital investment program new equity would be viewed as credit supportive. Conversely, large dividend payments at the PSE or PE level would be viewed negatively.

KEY FINANCIAL METRICS IN LINE WITH EXPECTATIONS

PSE's results in 2010 generated CFO (pre-w/c) plus interest to interest and CFO (pre-w/c) to debt of 3.6x and 16.4%, respectively. These results compare well to the mid-range of the "Baa" category for utilities of 2.7-4.5x and 13-22%, for the same metrics. They are also slightly below the 3-year average on both measures as this was partly attributable to weather-related weakness in the early part of 2010 (2010 electric usage was down 4.4% and gas 9%) but also as 2009 results were positively impacted by movements in deferred taxes that positively impacted cash flow.

At the parent level PE's results were also in line with expectations and the rating category. For example, CFO (pre w/c) to debt was 10%, approximate to the mid-point of the 5-13% range for the "Ba" category. We note as well that in addition to Moody's standard adjustments (pension, lease, and capitalized interest) we make an additional adjustment in the case of PE to remove the effect of re-classified derivative contracts at the time of acquisition.

PSE should have ample flexibility to comply with key financial covenants in its bank revolvers and regulatory mandates that govern its dividend distributions to the parent. The regulatory protections have become an increasingly important aspect of the analysis of PSE as substantial debt was introduced above the operating company for the first time when the ownership change occurred.\

Key among the ring-fence-like mechanisms established when the WUTC approved the change in ownership are: a required "golden share" vote to address concern about potential substantive consolidation of PSE in any parent bankruptcy and any voluntary filing by PSE; minimum required levels of PSE common equity to be maintained and limits on PSE and parent distributions under certain circumstances.

Liquidity

To supplement internal cash flow, PSE relies on three five-year committed credit facilities aggregating $1.150 billion (i.e. $400 million to support working capital and act as backup to the commercial paper program, $350 million to support its energy hedging program, and $400 million to provide another source of funding for utility capex), all of which expire in February 2014. Puget Energy's $1.0 billion committed capex facility is available through February 2014 to support the planned utility investments as well. As of December 31, 2010 there was $742 million of unused capacity under the parent's capex facility. All PSE facilities have (4) day borrowing notice requirement with same day borrowing ability in an amount up to $50 million and no material adverse event language for ongoing drawdowns. Although PSE's liquidity should remain sufficient to meet its short-term working capital needs, liquidity will likely be stretched as external borrowings are made to fund anticipated negative free cash flow due to the large capex program.

The quality of the alternate liquidity provided by PSE's bank facilities benefits from not having any ongoing material adverse change clause or any onerous financial covenant requirements (i.e. fairly low cash flow coverage tests as defined, which replace the former maximum allowed debt covenant in the prior facilities). We expect that PSE should maintain adequate headroom against the covenants given expected financial performance.

Rating Outlook

PSE's rating outlook is stable, and reflects our view that the utility can sustain its current financial performance.

What Could Change the Rating - Up

Positive pressure could develop if PSE achieves stronger financial results, while coping with the challenges of executing a large capital program and helping service the parent's standalone debt. In particular, producing CFO (pre-w/c) plus interest to interest and CFO (pre-w/c) to debt above 4x and 20%, respectively, on a sustainable basis could overcome the existing constraints in the rating and provide impetus for positive rating action. This improvement would also need to be accompanied by improvement at PE such that CFO (pre w/c) / debt reached the low teens.

What Could Change the Rating - Down

Adding more debt above PSE that creates undue pressure for higher dividends could lead to a downgrade, especially if there are any unexpected changes that weaken the ring-fencing like measures established by the WUTC. Moreover, shortfalls in PSE's performance that reduce CFO (pre-w/c) plus interest to interest and CFO (pre-w/c) to debt below 3.5x and the mid teens, respectively, for an extended period of time, could lead to a downgrade.

Rating Factors

Puget Sound Energy, Inc.

Regulated Electric and Gas Utilities [1][2]	**Dec-31-2010**			**Moody's 12-18 month Forward View As of March 16, 2011***	
Factor 1: Regulatory Framework (25%)	**Measure**	**Score**		**Measure**	**Score**
a) Regulatory framework		Baa			Baa
Factor 2: Ability to Recover Cost and Earn Returns (25%)					
a) Ability to recover Cost and Earn Returns		Baa			Baa
Factor 3: Diversification (10%)					
a) Market Position		Baa			Baa
b) Generation and Fuel Diversity		Ba			Ba
Factor 4: Financial Strength, Liquidity, & Metrics (40%)					
a) Liquidity		Baa			Baa
b) CFO (pre w/c) + Interest / Interest	3.6%	Baa		2.7 - 4.5X	Baa
c) CFO (pre w/c) / Debt	0.2x	Baa		13 - 22%	Baa
d) CFO (pre w/c) - Dividends / Debt	11.5%	Baa		9 - 17%	Baa
e) Debt / Capitalization	47.8%	Baa		45 - 55%	Baa
Rating:					
Indicated Rating from Grid		Baa2			Baa2
Actual Rating Assigned		Baa3			Baa3

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010; Source: Moody's Financial Metrics

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