EXHIBIT NO. ___(BAV-4)
DOCKET NO. UE-06___/UG-06___
2006 PSE GENERAL RATE CASE
WITNESS: BERTRAND A. VALDMAN

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UE-06____** **Docket No. UG-06____**

THIRD EXHIBIT (NONCONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF
BERTRAND A. VALDMAN
ON BEHALF OF PUGET SOUND ENERGY, INC.

FEBRUARY 15, 2006

their generation, and these plants were often put into affiliated supply companies under a common parent holding company, but continue to sell a large portion of their output to the affiliated regulated utility.

Medium-risk unregulated generation is likely to have significant exposure to fluctuations in the price of fuel, or capital spending needs to maintain competitiveness or to meet environmental requirements.

Lower-Business-Risk Unregulated Activities

This category includes unregulated generation of electricity that is sold under long-term contract to highly creditworthy counterparties, with the purchaser bearing the risk of any change in the market price of fuel and wholesale power.

Unregulated electricity generation may also be low-risk if there is little competition due to the structure of the market or the generators' exclusive control over critical production and transmission infrastructure that is needed to reach customers.

Below-average costs are not necessarily sufficient for unregulated generation to be classified in the low-risk category. Without other mitigating factors being present, low-cost merchant generation is likely to be classified as medium-risk due to the potential for changes in relative cost competitiveness as market conditions change.

Conclusion on Qualitative factors

This analysis of qualitative factors – the split of regulated versus non regulated activities and the respective risk analysis of those businesses – allows us to determine how stable and predictable we feel the cashflows of the company should be. The lowest business risk will be a company with wholly regulated activities in a supportive regulatory framework. The highest business risk will be a company with a high degree of exposure to non-regulated businesses when those businesses are viewed to be relatively high-risk.

Companies with a lower business risk can have weaker financial metrics than one with higher business risk for the same rating category.

QUANTITATIVE FACTORS

Key ratios

Moody's uses financial ratio analysis as part of our quantitative analysis of all corporates, including electric utilities. Ratio analysis is a helpful way of comparing one company's performance to that of another and the performance in one year to that in another.

However, the importance of ratio analysis can be overstated. No two companies look exactly alike from a qualitative assessment standpoint and each company we rate is constantly changing. It is impossible to assign an accurate credit rating on the basis of financial ratio analysis alone, even less so on the basis of any one ratio. Therefore, Moody's does not have any specific "hurdle rate" to explain which ratio will make the difference between any two rating categories.

Nonetheless, we have identified six core ratios which we consider to be the most useful when looking at an electric utility company. These are supplemented by other ratios which are particularly useful for various local regulatory frameworks.

The six core ratios[1] are as follows:

Primary:

1. Retained Cashflow[2] / Adjusted gross debt[3]
2. FFO / Adjusted gross debt
3. FFO / Interest
4. Adjusted gross debt / Regulated Asset Value[4], or Capitalization

Secondary:

5. EBITDA Margin
6. Retained Cashflow / Capex

While other factors considered in this report may outweigh pure quantitative analysis, it is possible to provide broad guidance on the ratio ranges that may generally be seen at different rating levels.

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1. *Please see Appendix 2 for definitions.*
2. *Retained Cashflow (RCF) is FFO less dividends*
3. *Moody's concentrates on gross debt but will also consider net debt ratios if the cash is clearly being held for future debt maturities or for reasons such as hedging. A good example of this would be a company that has hedged the exchange risk of an overseas investment with the local currency debt despite having surplus cash at the parent level. In such cases, the net ratio will take predominance over the gross ratio.*
4. *The Regulated Asset Value (RAV) or Regulated Asset Base (RAB)*