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Research Update:

Puget Sound Energy Inc.'s Corp Credit Rtg Raised To 'BBB'; Puget Energy Inc.'s Corp Credit Rtg Lowered To 'BB+'

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Research Update:

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Rationale

On Jan. 16, 2009, Standard & Poor's Ratings Services raised its corporate credit rating on integrated electric and gas utility company Puget Sound Energy Inc. (PSE) to 'BBB' from 'BBB-', its secured ratings to 'A-' from 'BBB+', and its preferred stock and junior subordinated debt ratings to 'BB+' from 'BB'. At the same time, Standard & Poor's lowered its corporate credit rating on Puget Energy Inc. (Puget) to 'BB+' from 'BBB-'. Standard & Poor's removed all the ratings from CreditWatch with negative implications. The outlook is stable.

The rating actions on PSE and Puget reflect their acquisition led by Macquarie Infrastructure Partners. All federal and state regulatory and shareholder approvals required for the merger have now been obtained, and the company expects the transaction to close by Feb. 6, 2009.

Standard & Poor's placed the ratings on CreditWatch with negative implications on Oct. 26, 2007. The action followed the announcement that Puget has agreed to sell itself to a consortium of private investors led by Macquarie Infrastructure Partners, an affiliate of Macquarie Group Ltd. (A-/Negative/A-2) for \$7.4 billion. The approved transaction is expected to increase total net debt by \$850 million on consolidated basis while reducing debt at PSE.

The upgrade of PSE and its related securities reflects Standard & Poor's view that plans to place an independent director on the board of directors of the utility company, coupled with other commitments, such as dividend restrictions, provides insulation to the utility company. In addition, the utility company's stand-alone financial metrics are expected to improve post-transaction as some debt is repaid and, on a forward basis, the capital structure is expected to be managed to a more credit supportive level. The downgrade of Puget Energy reflects the additional transaction debt and our expectation that the amount of priority debt, including all operating company debt and credit facilities, in addition to the insulation of the utility company, is a disadvantage to creditors of Puget Energy.

The business risk profile is 'excellent', reflecting the combined electric and gas utility business of PSE, which is subject to regulation by the Washington Utilities and Transportation Commission (WUTC). The regulatory environment in Washington and how the company manages its relationship with the WUTC are key drivers of credit quality, especially in light of PSE's high capital needs and commodity price exposure. PSE's cost recovery mechanisms support credit quality. The company has flexibility in implementing rate changes through its power cost adjustment (PCA), but the threshold it must meet to true up under-collected rates is high and deferred costs are not

automatically collected. Each year, uncollected costs are subject to defined sharing bands, allowing the company to defer certain portions for collection from customers. However, the PCA mechanism does not trigger a rate increase until a minimum deferral balance is reached. Puget is also able to update rates for changes in projected costs by filing a power-cost-only rate case (PCORC), which gives it the flexibility to file for changes in variable and fixed costs whenever there is a projected deferral balance of \$30 million or more. The PCORC functions as a "mini" rate case that takes about five months and is especially useful for new plant additions or contracts. The use of this mechanism has allowed the company to keep deferral balances low and better match actual costs with collected costs.

Puget's financial risk profile is 'aggressive' under Standard & Poor's corporate risk matrix. Financial measures have been adequate for the rating, although cash flow coverage metrics have been mixed and are expected to weaken post-acquisition. Adjusted funds from operations (FFO) to interest coverage was approximately 3.9x, while FFO to average total debt was at about 19.8% for the 12 months ended Sept. 30, 2008. Due to the additional debt at the holding company, post-transaction coverages are expected to be run at 3.0x and no less than 12%, respectively. Adjusted debt leverage -- including debt adjustments for operating leases, purchased power, and hybrid equity -- is expected to rise slightly above 60%. Dividends to Puget may be restricted, under conditions of financial weakness at PSE.

PSE's financial risk profile is also categorized as 'aggressive' but it will reflect more robust financials metrics post-transaction due to the exclusion of holding company debt. Adjusted FFO to interest coverage is expected to average above 4x, while FFO to average total debt is expected to average above 20%. Adjusted debt leverage is expected to be balanced at 50%. Capital requirements are very high at PSE, with capital expenditures of \$2.7 billion planned for 2008 through 2010 related to system upgrade needs, customer growth, and further generation resource additions. Ongoing periodic debt and equity funds are expected to finance this growth.

Short-term credit factors

PSE's short-term rating is 'A-2'. Overall liquidity at PSE is adequate, with \$147 million in available capacity as of Sept. 30, 2008, under its \$500 million committed unsecured bank credit agreement that expires April 15, 2012, and a fully available \$350 million facility to support hedging activities, less \$35 million allocated to Lehman. In August 2008, PSE entered into a nine-month, \$375 million credit agreement with \$300 remaining available under the agreement. Additional liquidity resources at PSE include a \$200 million receivables securitization facility with \$29 million available and a cash balance of \$158 million as of Sept. 30, 2008. Liquidity requirements will remain high at PSE due to a high level of planned capital spending and potential collateral requirements related to the company's electric and gas supply arrangements. Debt maturities are manageable, with about \$158 million due in 2009 and \$232 million due in 2010. We expect PSE to internally fund at least 40% of capital expenditures in order to maintain a stable capital structure. Post-transaction, Puget is expected to have ample liquidity due to the addition of new credit facilities.

Outlook

The stable outlook on Puget reflects our expectation that it will be able to refinance term loans and credit facilities that come due in five years and that financial risks are prudently managed such that they remain within our 'aggressive' financial category. Consolidated adjusted FFO to debt will remain above 12% on an ongoing basis and that adjusted debt to capital will remain near 60%. The stable outlook on PSE reflects reasonable and timely rate relief related to resource additions and changes in power costs. Factors that could lead to a negative outlook on both entities include commodity cost disallowances, excessive power cost deferrals that stretch liquidity, regulatory lag or insufficiency, or a disproportionate reliance on debt financing to meet its capital needs. Consideration of a positive rating outlook is unlikely at this time.

Ratings List

Downgraded; CreditWatch/Outlook Action

	To	From
Puget Energy Inc. Corporate Credit Rating	BB+/Stable/--	BBB-/Watch Neg/--

Upgraded; CreditWatch/Outlook Action

	To	From
Puget Sound Energy Inc. Corporate Credit Rating	BBB/Stable/A-2	BBB-/Watch Neg/A-3
Commercial Paper Local Currency	A-2	A-3/Watch Neg

Washington Natural Gas Co.

Corporate Credit Rating	BBB/Stable/--	BBB-/Watch Neg/--
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Puget Sound Energy Capital Trust I

Preferred Stock (1 issue)	BB+	BB/Watch Neg
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Puget Sound Energy Inc.

Senior Secured (18 issues)	A-	BBB+/Watch Neg
Senior Unsecured (2 issues)	BBB	BBB-/Watch Neg
Junior Subordinated (1 issue)	BB+	BB/Watch Neg
Preferred Stock (2 issues)	BB+	BB/Watch Neg
Commercial Paper (1 issue)	A-2	A-3/Watch Neg

Upgraded; CreditWatch/Outlook Action; Ratings Affirmed

	To	From
Puget Sound Power & Light Co. Corporate Credit Rating	BBB/Stable--	BBB-/Watch Neg/--

Research Update: Puget Sound Energy Inc.'s Corp Credit Rtg Raised To 'BBB'; Puget Energy Inc.'s Corp Credit Rtg Lowered To 'BB+'

Upgraded; CreditWatch/Outlook Action

	To	From
Puget Sound Energy Inc.		
Senior Secured		
US\$300 mil 7.02% 1st mtg bnd ser A due 12/01/2027	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$200 mil 6.74% sr med-term nts due 06/15/2018	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$150 mil 6.46% fallaway 1st mtg bnd due 03/09/2009	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$100 mil 7% fallaway 1st mtg bnd ser B due 03/09/2029	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$225 mil 7.96% 1st mtg bnd due 02/22/2010	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$260 mil 7.69% 1st mtg bnd ser C due 02/01/2011	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$250 mil 5.483% 1st mtg bnd due 06/01/2035	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$150 mil 5.197% sr nts 1st mtg bnd due 10/01/2015	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$250 mil 6.724% fallaway sr nts 1st mtg bnd due 06/15/2036	A-	BBB+/Watch Neg
Recovery Rating	1+	1+
US\$300 mil 6.274% fallaway 1st mtg bnd due 03/15/2037	A-	BBB+/Watch Neg
Recovery Rating	1+	1+

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