STANDARD & POOR'S

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Research Update:

Puget Energy Inc.'s, Puget Sound Energy Inc.'s Corp Credit Ratings Remain On Watch Neg

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Rationale

On Nov. 19, 2008, Standard & Poor's Ratings Services said that its 'BBB-' corporate credit rating on Puget Energy Inc. (Puget) and Puget Sound Energy Inc. (PSE) remains on CreditWatch with negative implications, pending final regulatory approval proceedings related to the proposed merger with Macquarie Infrastructure Partners. The rating reflects the 'excellent' business profile of PSE, a regulated, vertically integrated electric and gas utility, and the 'aggressive' consolidated financial risk profile of Puget.

Puget's 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. On Oct. 8, 2008, the WUTC issued its Final Order in PSE's 2007 general rate filing. The order approved the settlement agreement and granted a 46% equity ratio and a return on equity of 10.15%, resulting in a 7% increase in revenue requirements for electric customers and 4.6% for gas.

Puget's cost recovery mechanisms also support credit quality. The company has a great degree of flexibility in implementing rate changes through its power cost adjustment (PCA), but the threshold it must meet to true-up undercollected 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 if the pending acquisition by Macquarie is completed. 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. Adjusted debt leverage -- including debt adjustments for operating leases, purchased power, and hybrid equity -- was approximately 58.5% as of Sept. 30, 2008, but is expected to rise slightly above 60%, on a consolidated basis, if the merger is completed as proposed.

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-3'. 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 Puget 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.

CreditWatch

Standard & Poor's expects to resolve the CreditWatch listing shortly after the Washington Utilities and Transportation Commission's final decision.

Ratings List

Ratings Remaining On CreditWatch

Puget Energy Inc.	
Corporate credit rating	BBB-/Watch Neg/--
Puget Sound Energy Inc.	
Corporate credit rating	BBB-/Watch Neg/A-3
Commercial Paper	
Local Currency	A-3/Watch Neg
Junior Subordinated	
Local Currency	BB/Watch Neg
Preferred Stock	
Local Currency	BB/Watch Neg
Washington Natural Gas Co.	
Corporate credit rating	BBB-/Watch Neg/--
Senior Secured	BBB+/Watch Neg

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