EXHIBIT NO. ___(WJE-9)
DOCKET NO. _____________
2005 POWER COST ONLY RATE CASE
WITNESS: W. JAMES ELSEA

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

EIGHTH EXHIBIT TO THE PREFILED DIRECT TESTIMONY OF
W. JAMES ELSEA (NONCONFIDENTIAL)
ON BEHALF OF PUGET SOUND ENERGY, INC.

JUNE 7, 2005

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Research:
Puget Sound Energy Inc.

Publication date: 13-May-2005
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Corporate Credit Rating	
	BBB-/Stable/A-3

Business Profile

1 2 3 $\boxed{4}$ 5 6 7 8 9 10

Financial policy:
Moderate
Debt maturities:
Puget Sound Energy, as of Dec. 31, 2004
Year Amount ($ in millions)
2005 31.0
2006 281.0
2007 125.0
2008 179.5
2009 158.0
Bank lines/Liquid assets:
As of March 31, 2005, subsidiary Puget Sound Energy Inc. (PSE) had $402.4 million in borrowing capacity on its five-year, $500 million credit agreement, which expires in 2010.
Collateralization:
As of March 31, 2005, PSE had approximately $2.2 billion in total debt and $280.3 million in trust preferred securities. First mortgage bonds and senior secured notes totaled $1.9 billion, versus $4.3 billion in net property, plant, and equipment.

Outstanding Rating(s)	
Puget Sound Energy Inc.	
Sr secd debt	
Local currency	BBB
CP	
Local currency	A-3
Pfd stk	
Local currency	BB
Puget Energy Inc.	
Corporate Credit Rating	BBB-/Stable/--
Puget Sound Power & Light Co.	
Corporate Credit Rating	BBB-/Stable/NR
Sr secd debt	
Local currency	BBB
Pfd stk	
Local currency	NR
Washington Natural Gas Co.	
Corporate Credit Rating	BBB-/Stable/--
Sr secd debt	
Local currency	BBB

Corporate Credit Rating History	
Oct. 8, 2001	BBB/A-2

Major Rating Factors

Strengths:

- The strong business profile of regulated utility subsidiary PSE
- A growing base of electric and gas customers in the Puget Sound region, which is exhibiting signs of gradual economic recovery
- Strong competitive position of both its gas and electric operations, despite recent rate increases
- Parent company Puget Energy's stated commitment to monetize its investment in nonregulated subsidiary InfrastruX and to improve PSE's equity capitalization to 43%
- Strong cash flow coverage in 2004, with funds from operations (FFO) to interest coverage of 3.1x and FFO to average total debt of 15%

Weaknesses:

- Above-average debt leverage, with adjusted debt to total capital at 64% as of Dec. 31, 2004
- Heavy capital requirements driven by system upgrade and resource requirements, with approximately $1.4 billion in capital spending planned in 2005 and 2006
- Variability in retail sales due to weather variations and changes in regional economic conditions
- Moderate price and commodity risk related to PSE's reliance on hydroelectric resources and short-term contracts for 53% of energy supplies in 2004

Rationale

The 'BBB-' corporate credit rating on PSE reflects the credit profile of parent company Puget Energy (Puget), which owns PSE, a regulated electric and gas utility, and InfrastruX, a nonregulated construction subsidiary. Puget's nonregulated construction subsidiary, InfrastruX, is not a primary credit factor, given Puget's plans to monetize the unit and focus on PSE as its sole major investment.

Regulatory support has tempered somewhat since the 2002 general rate case. On March 1, 2005, the WUTC issued its final ruling on PSE's 2004 general rate case, approving a ROE of 10.3%, versus the 11% it granted on the 2002 general rate case. On a positive note, the commission agreed to increase PSE's hypothetical equity layer to 43%, which is higher than the previously approved target of 39%, but still short of the PSE's request for 45%. In May 2004, the WUTC denied PSE recovery of $25.6 million of gas costs associated with the company's Tenaska generating facility and reduced by as much as 50%, under certain conditions, the approved return on the Tenaska regulatory asset created in the late 1990s. The company recorded a $43.4 million charge, reflecting the estimated cost disallowance from June 2002 through Dec. 31, 2004.

PSE's service territory is large and diverse, with low industrial and customer concentration. The utility's reliance on hydroelectric supplies and short-term market purchases results in above-average market risk, but gas and electric distribution operations are stable. Competition is limited given the absence of mandatory retail choice for electricity users and residential gas users, which comprise most of PSE's retail base. Electric and gas rates are competitive.

Capital requirements are very high, with capital expenditures of about $1.4 billion at PSE budgeted for 2005 through 2006 due to system upgrade needs, customer growth, and resource additions. PSE commenced construction on a 150-MW wind project and has signed an agreement to start construction on a second 220-MW wind project later in 2005. PSE has yet to file for cost recovery of the projects, but is able to do so under an expedited "power cost only" rate case. Puget plans to cash fund about 50% of capital expenditures, with the balance funded with proceeds from equity and debt issuances.

Cash flow coverage metrics are within benchmark levels for the rating, but debt leverage remains above average. Adjusted FFO to interest coverage was a strong 3.1x, while FFO to average debt equaled an adequate 15% for the 12-month period ended March 31, 2005. Adjusted debt leverage was high at 64% as of March 31, 2005.

Short-term credit factors.

Liquidity resources consisted primarily of $402.4 million in borrowing capacity under a $500 million committed credit facility at PSE. PSE does not rely on liquidity support from its parent Puget Energy, which had no undrawn capacity under its $5 million credit agreement. In comparison, PSE's debt maturities are about $35 million in 2005, while capital requirements are significantly higher at about $380 million for system upgrades and $200 million for new resources. Liquidity requirements will remain high through 2007 due to more than $1.5 billion in planned capital spending and to the refinancing requirements of both short and long-term debt. Debt maturities from 2005 to 2007 total $437 million.

Outlook

The stable outlook reflects Standard & Poor's expectation of moderate rate relief for PSE consistent with the WUTC's latest general rate case decision. Credit stability will also depend on adequate and timely equity infusions to support capital investment needs and PSE's 43% equity target. The outlook assumes that PSE's power cost cap will remain in effect through mid-2006 and that resource acquisitions by PSE will be financed in a prudent manner. The outlook also assumes that Puget Energy will monetize in a timely fashion its unregulated subsidiary InfrastruX.

Consideration of a positive rating outlook will depend on more favorable rate relief in future years, consistently strong cash flow coverage metrics, and Puget's ability to improve its equity capitalization. Alternatively, a negative outlook could result due to several factors, including additional commodity cost disallowances, inadequate regulatory treatment of capital additions, or a disproportionate reliance on financing to meet its capital needs.

Rating Methodology

The corporate credit ratings on Puget and PSE reflect the consolidated creditworthiness of its two regulated business units, the electric and gas utilities. Puget Sound Energy accounts for nearly all cash flow and profit at Puget Energy.

Puget Sound Energy's first mortgage bonds are rated 'BBB', one notch above the corporate credit rating of 'BBB-', based on Standard & Poor's ultimate recovery analysis. This analysis has determined that the first mortgage bonds are over-collateralized since the company's total assets exceed the maximum amount of mortgage bonds that could be outstanding under the terms of the indenture. Therefore, Standard & Poor's has a higher degree of confidence that first mortgage bondholders would recover their principal, albeit delayed, under a bankruptcy scenario. The company's preferred stock, rated 'BB', is two notches below the corporate credit rating based on the subordinated characteristics of the preferred securities.

Business Profile

PSE is a vertically integrated electric and gas utility that provides service to about 1 million electric customers and about 672,000 customers in the Puget Sound region, including portions of Seattle. PSE has a business profile of '4' on Standard and Poor's 10-point scale, with '1' being the highest. PSE's strong business profile reflects the respective business positions of its electric and gas divisions, which are characterized by an average regulatory environment, diverse markets, capital-intensive operations, and above-average competitive position.

Regulated electric and gas utility operations at PSE are under the jurisdiction of the WUTC. The commission establishes rates based on a historical test year, resulting in a regulatory lag for recovering expenses such as operating and maintenance costs and depreciation and amortization. PSE's rate structure features both power and purchased gas adjustment mechanisms (PCA and PGA, respectively) that require commission approval. The electric PCA provides for only partial cost recovery, albeit at levels that improve as excess power costs increase. A temporary power cost cap limits PSE's cumulative exposure to excess power costs to $40 million from July 1, 2002, to July 1, 2006.

PSE will require an adequate and timely rate relief from the WUTC as it pursues its aggressive capital plan to build 370 MW of wind capacity by 2007 at a cost of about $500 million. The company worked extensively with the WUTC to create the "power cost only" rate case process, through which the commission has agreed to review all of PSE's new generation investments and power-supply costs within five months of the filing date. PSE successfully utilized the fast-track process for its Frederickson acquisition and may do so again for its two latest wind acquisitions.

PSE's market position reflects its favorable customer base and the performance of the Puget Sound economy, which is showing signs of recovery after struggling during the last economic downturn. Puget's customer base is primarily residential and commercial. In 2004, residential customers accounted for 44% of electric revenues and 62% of gas revenues. Commercial customers accounted for 41% and 29%, respectively, of revenues. Customer concentration is low, with the top 10 customers accounting for only 5% of total electric and gas revenues. Both the gas and the electric systems have exhibited high rates of customer growth, but sales have been weak due to conservation, mild weather and the region's slow economic recovery. From 2002 to 2004, the number of gas customers increased at an annual average rate of 3.4%, but sales declined 1.8% on average. Over the same period, the electric system saw growth in both its customers (2.1% on average) and sales (0.7%) on average.

PSE is restructuring its power supply to increase the share of owned generation and improve fuel diversity with the acquisition of wind and gas resources. Currently, PSE purchases a substantial portion of its power, about 27% of its energy supply, from the wholesale market through short-term purchases. Market purchases have remained elevated, in part due to below-average production from PSE's purchased and owned hydroelectric resources, which accounted for 31% of energy in 2004. PSE's hydro supplies, while very low in cost, are highly variable in production due to river stream flow variability. Poor hydrology conditions in the Pacific Northwest have reduced hydropower supplies in the region, forcing PSE and many others to make do with lower wholesale sales margins and others to procure higher cost replacement power. PSE's power supply also includes coal (23% of supply) and gas (19%) resources. With the addition of 370 MW of wind capacity, PSE hopes to derive about 5% of its power from wind turbines by 2007.

The combined utility's competitive position is strong due to its competitive rates and insulation from retail competition with regards to its electric business. Washington has not adopted retail choice for its electricity customers, although PSE has agreements with several of its larger customers to procure power from retail electricity marketers. PSE's exposure to competition on its gas business is limited due to the absence of retail competition for residential customers, which make up the bulk of PSE's gas sales and revenues, and PSE's ability to charge system connection fees to large commercial and industrial customers, which are permitted to purchase gas from third parties. Its electrical rates are below the regional average and compare favorably with those of its peers, such as Avista and Portland General Electric. Its gas rates are also competitive with peers Cascade Natural Gas and Northwest Natural Gas.

Financial Policy: Moderate

Puget Sound Energy's financial policy is moderately supportive of credit quality. Management plans to achieve a 43% equity ratio target over the next few years. PSE's approach to interest rate risk is somewhat conservative given its limited historical appetite for floating rate debt, but Puget may end up relying heavily on short-term debt to fund plant construction. The company also targets dividend payout ratio of 60% of normalized utility earnings. Despite several years of unseasonable weather and poor stream flow, PSE continues to rely on assumptions of normal weather and stream flow for its financial planning, which Standard & Poor's considers to be somewhat aggressive.

Financial Profile

Cash flow coverage metrics are within benchmark levels for the rating, but debt leverage remains above average. Adjusted FFO to interest coverage was a strong 3.1x, while FFO to average debt equaled an adequate 16% for the 12-month period ended March 31, 2005. Profitability measures since 2001 have been below the company's allowed ROE, although PSE's 2004 results would have shown improvement if not for the impact on earnings of the $43.4 million Tenaska charge.

PSE's capital structure is characterized by high debt leverage, and low but increasing reliance on short-term debt. Adjusted debt leverage was high at 65% as of March 31, 2005. Interest rate exposure is expected to be moderate during the company's capital expansion through 2007, due to its anticipated reliance on short-term debt for construction financing and sizable debt maturities beginning in 2006 at $290 million. Floating rate and short-term debt (excluding current maturities) accounted for a low 13% of total debt as of Dec. 31, 2004. PSE's contingent liabilities are driven primarily by its bilateral power contracts, which call for collateral calls in the event that credit thresholds are exceeded either due to market movements or a ratings downgrade of Puget.

All ratios are adjusted to reflect the imputation of a purchased power debt equivalent based on Standard & Poor's debt imputation methodology, including a 30% risk factor, reflecting the existence of a purchased power adjustment clause.

Table 1 Puget Sound Energy Inc. Peer Comparison

Industry Sector: Integrated - Electric

	Average of past three fiscal years		
($ in millions)	**Puget Sound Energy Inc.**	**Portland General Electric Co.**	**Idaho Power Co.**
Rating	BBB-/Stable/A-3	BBB+/Developing/A-2	BBB+/Stable/A-2
Sales	2,140.5	1,687.0	822.3
Net income from continuing operations	118.3	71.3	72.7
Funds from operations (FFO)	424.5	296.3	233.8
Capital expenditures	290.7	175.3	145.9
Cash and equivalents	63.6	121.3	11.5
Total debt	2,413.3	974.7	958.7
Preferred stock	0.6	9.0	35.3
Common equity	1,524.6	1,195.0	835.6
Total capital	3,938.6	2,178.7	1,829.6
Ratios			
Adjusted EBIT interest coverage (x)	1.8	2.4	2.3
Adjusted FFO interest coverage (x)	2.9	4.1	4.9
Adjusted FFO/average total debt (%)	14.5	24.5	23.4
Net cash flow/capital expenditures (%)	109.1	162.5	115.8
Adjusted total debt/capital (%)	65.6	49.8	52.9
Return on common equity (%)	7.8	6.0	7.9
Common dividend payout (%)	76.5	0.0	88.3

Table 2 Puget Sound Energy Inc. Financial Summary

Industry Sector: Integrated - Electric

	Fiscal year ended Dec. 31				
($ in millions)	**2004**	**2003**	**2002**	**2001**	**2000**
Rating history	BBB-/Positive/A-3	BBB-/Positive/A-3	BBB-/Stable/A-3	BBB-/Negative/--	BBB+/Negative/--
Sales	2,198.9	2,149.7	2,072.8	3,200.2	3,441.7
Net income from continuing operations	126.2	119.9	108.9	119.1	193.8
Funds from operations (funds from operations)	450.1	328.7	491.2	339.8	359.8
Capital expenditures	388.5	261.6	222.0	258.6	294.1
Cash and equivalents	14.6	14.8	161.5	82.7	36.4
Total debt	2,377.5	2,335.1	2,527.3	2,919.7	2,786.3
Preferred stock	1.9	0.0	0.0	0.0	0.0

Common equity	1,592.4	1,555.4	1,426.1	1,267.7	1,426.6
Total capital	3,971.8	3,890.5	3,953.4	4,187.4	4,212.9
Ratios					
Adjusted EBIT interest coverage (x)	1.9	1.8	1.7	1.8	2.3
Adjusted funds from operations interest coverage (x)	3.1	2.5	3.0	2.5	2.5
Adjusted funds from operations/average total debt (%)	16.1	11.5	15.7	10.7	11.6
Net cash flow/capital expenditures (%)	93.3	92.5	177.5	76.6	73.8
Adjusted total debt/capital (%)	64.2	64.4	68.1	72.3	69.6
Return on common equity (%)	7.7	7.8	7.9	8.5	13.2
Common dividend payout (%)	69.5	72.3	89.3	119.0	73.7