Attachment A

PSE’s Form 10-Q for the Quarterly Period Ended September 30, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

[X]	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2019
OR

[ ]	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Transition period from ________ to ________

Commission File Number	Exact name of registrant as specified in its charter, state of incorporation, address of principal executive offices, telephone number	I.R.S. Employer Identification Number
1-16305	**PUGET ENERGY, INC.** A Washington Corporation 355 110th Ave NE Bellevue, Washington 98004 (425) 454-6363	91-1969407
1-4393	**PUGET SOUND ENERGY, INC.** A Washington Corporation 355 110th Ave NE Bellevue, Washington 98004 (425) 454-6363	91-0374630

Securities Registered pursuant to Section 12(b) of the Securities Exchange Act of 1934

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
N/A	N/A	N/A

Indicate by check mark whether the registrants: (1) have filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.

Puget Energy, Inc.	Yes	/X/	No	/ /	Puget Sound Energy, Inc.	Yes	/X/	No	/ /

Indicate by check mark whether the registrants have submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Puget Energy, Inc.	Yes	/X/	No	/ /	Puget Sound Energy, Inc.	Yes	/X/	No	/ /

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer", "accelerated filer," a smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Puget Energy, Inc.	Large accelerated filer	/ /	Accelerated filer	/ /	Non-accelerated filer	/X/	Smaller reporting company	/ /	Emerging growth company	/ /
Puget Sound Energy, Inc.	Large accelerated filer	/ /	Accelerated filer	/ /	Non-accelerated filer	/X/	Smaller reporting company	/ /	Emerging growth company	/ /

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. / /

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Puget Energy, Inc.	Yes	/ /	No	/X/	Puget Sound Energy, Inc.	Yes	/ /	No	/X/

All of the outstanding shares of voting stock of Puget Energy, Inc. are held by Puget Equico LLC, an indirect wholly-owned subsidiary of Puget Holdings LLC. All of the outstanding shares of voting stock of Puget Sound Energy, Inc. are held by Puget Energy, Inc.

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DEFINITIONS

ARO	Asset Retirement and Environmental Obligations
ASU	Accounting Standards Update
ASC	Accounting Standards Codification
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortization
EIM	Energy Imbalance Market
ERF	Expedited Rate Filing
FASB	Financial Accounting Standards Board
GAAP	U.S. Generally Accepted Accounting Principles
GRC	General Rate Case
ISDA	International Swaps and Derivatives Association
LIBOR	London Interbank Offered Rate
LNG	Liquefied Natural Gas
MMBtu	One Million British Thermal Units
MWh	Megawatt Hour (one MWh equals one thousand kWh)
NAESB	North American Energy Standards Board
NPNS	Normal Purchase Normal Sale
PCA	Power Cost Adjustment
PCORC	Power Cost Only Rate Case
PGA	Purchased Gas Adjustment
PTC	Production Tax Credit
PSE	Puget Sound Energy, Inc.
Puget Energy	Puget Energy, Inc.
Puget Holdings	Puget Holdings, LLC
Puget LNG	Puget Liquid Natural Gas, LLC
REP	Residential Exchange Program
SERP	Supplemental Executive Retirement Plan
TCJA	Tax Cuts and Jobs Act
Washington Commission	Washington Utilities and Transportation Commission
WSPP	WSPP, Inc.

FILING FORMAT

This report on Form 10-Q is a Quarterly Report filed separately by two registrants, Puget Energy, Inc. (Puget Energy) and Puget Sound Energy, Inc. (PSE). Any references in this report to "the Company" are to Puget Energy and PSE collectively.

FORWARD-LOOKING STATEMENTS

Puget Energy and PSE include the following cautionary statements in this Form 10-Q to make applicable and to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by or on behalf of Puget Energy or PSE. This report includes forward-looking statements, which are statements of expectations, beliefs, plans, objectives and assumptions of future events or performance. Words or phrases such as "anticipates," "believes," "continues," "could," "estimates," "expects," "future," "intends," "may," "might," "plans," "potential," "predicts," "projects," "should," "will likely result," "will continue" or similar expressions are intended to identify certain of these forward-looking statements and may be included in discussion of, among other things, our anticipated operating or financial performance, business plans and prospects, planned capital expenditures and other future expectations. In particular, these include statements relating to future actions, business plans and prospects, future performance expenses, the outcome of contingencies, such as legal proceedings, government regulation and financial results.

Forward-looking statements reflect current expectations and involve risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed. There can be no assurance that Puget Energy's and PSE's expectations, beliefs or projections will be achieved or accomplished.

In addition to other factors and matters discussed elsewhere in this report, some important risks that could cause actual results or outcomes for Puget Energy and PSE to differ materially from past results and those discussed in the forward-looking statements include:

- Governmental policies and regulatory actions, including those of the Federal Energy Regulatory Commission (FERC) and the Washington Utilities and Transportation Commission (Washington Commission), that may affect our ability to recover costs and earn a reasonable return, including but not limited to disallowance or delays in the recovery of capital investments and operating costs and discretion over allowed return on investment;
- Changes in, adoption of and compliance with laws and regulations, including decisions and policies concerning the environment, climate change, greenhouse gas or other emissions or by products of electric generation (including coal ash or other substances), natural resources, and fish and wildlife (including the Endangered Species Act) as well as the risk of litigation arising from such matters, whether involving public or private claimants or regulatory investigative or enforcement measures;
- Changes in tax law, related regulations or differing interpretation, including as a result of the TCJA, or enforcement of applicable law by the Internal Revenue Service (IRS) or other taxing jurisdiction; and PSE's ability to recover costs in a timely manner arising from such changes;
- Inability to realize deferred tax assets and use production tax credits (PTCs) due to insufficient future taxable income;
- Accidents or natural disasters, such as hurricanes, windstorms, earthquakes, floods, fires and landslides, and other acts of God, terrorism, asset-based or cyber-based attacks, pandemic or similar significant events, which can interrupt service and lead to lost revenue, cause temporary supply disruptions and/or price spikes in the cost of fuel and raw materials and impose extraordinary costs;
- Commodity price risks associated with procuring natural gas and power in wholesale markets from creditworthy counterparties;
- Wholesale market disruption, which may result in a deterioration of market liquidity, increase the risk of counterparty default, affect the regulatory and legislative process in unpredictable ways, negatively affect wholesale energy prices and/or impede PSE's ability to manage its energy portfolio risks and procure energy supply, affect the availability and access to capital and credit markets and/or impact delivery of energy to PSE from its suppliers;
- Financial difficulties of other energy companies and related events, which may affect the regulatory and legislative process in unpredictable ways, adversely affect the availability of and access to capital and credit markets and/or impact delivery of energy to PSE from its suppliers;
- The effect of wholesale market structures (including, but not limited to, regional market designs or transmission organizations) or other related federal initiatives;
- PSE electric or natural gas distribution system failure, blackouts or large curtailments of transmission systems (whether PSE's or others'), or failure of the interstate natural gas pipeline delivering to PSE's system, all of which can affect PSE's ability to deliver power or natural gas to its customers and generating facilities;
- Electric plant generation and transmission system outages, which can have an adverse impact on PSE's expenses with respect to repair costs, added costs to replace energy or higher costs associated with dispatching a more expensive generation resource;
- The ability to restart generation following a regional transmission disruption;
- The ability of a natural gas or electric plant to operate as intended;

- Changes in climate or weather conditions in the Pacific Northwest, which could have effects on customer usage and PSE's revenue and expenses;
- Regional or national weather, which could impact PSE's ability to procure adequate supplies of natural gas, fuel or purchased power to serve its customers and the cost of procuring such supplies;
- Variable hydrological conditions, which can impact streamflow and PSE's ability to generate electricity from hydroelectric facilities;
- Variable wind conditions, which can impact PSE's ability to generate electricity from wind facilities;
- The ability to renew contracts for electric and natural gas supply and the price of renewal;
- Industrial, commercial and residential growth and demographic patterns in the service territories of PSE;
- General economic conditions in the Pacific Northwest, which may impact customer consumption or affect PSE's accounts receivable;
- The loss of significant customers, changes in the business of significant customers or the condemnation of PSE's facilities as a result of municipalization or other government action or negotiated settlement, which may result in changes in demand for PSE's services;
- The failure of information systems or the failure to secure information system data, which may impact the operations and cost of PSE's customer service, generation, distribution and transmission;
- Opposition and social activism that may hinder PSE's ability to perform work or construct infrastructure;
- Capital market conditions, including changes in the availability of capital and interest rate fluctuations;
- Employee workforce factors, including strikes, work stoppages, availability of qualified employees or the loss of a key executive;
- The ability to obtain insurance coverage, the availability of insurance for certain specific losses, and the cost of such insurance;
- The ability to maintain effective internal controls over financial reporting and operational processes;
- Changes in Puget Energy's or PSE's credit ratings, which may have an adverse impact on the availability and cost of capital for Puget Energy or PSE generally; and
- Deteriorating values of the equity, fixed income and other markets which could significantly impact the value of investments of PSE's retirement plan, post-retirement medical benefit plan trusts and the funding of obligations thereunder.

Any forward-looking statement speaks only as of the date on which such statement is made, and, except as required by law, the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of any such factor on the business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. For further information, see Item 1A, “Risk Factors” in the Company's most recent Annual Report on Form 10-K for the year ended December 31, 2018.

PART I FINANCIAL INFORMATION

Item 1. **Financial Statements**

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Operating revenue:				
Electric	$ 513,926	$ 534,569	$ 1,823,596	$1,735,765
Natural gas	108,222	106,826	566,347	597,306
Other	4,859	10,069	22,833	28,253
Total operating revenue	627,007	651,464	2,412,776	2,361,324
Operating expenses:				
Energy costs:				
Purchased electricity	107,035	148,536	501,738	431,856
Electric generation fuel	93,642	71,004	208,442	143,177
Residential exchange	(15,295)	(15,401)	(56,430)	(55,436)
Purchased natural gas	27,778	30,192	168,281	211,679
Unrealized (gain) loss on derivative instruments, net	14,716	(14,046)	29,861	(21,953)
Utility operations and maintenance	142,857	139,361	450,236	440,016
Non-utility expense and other	12,436	19,338	36,813	40,587
Depreciation and amortization	138,281	149,760	483,693	486,377
Conservation amortization	17,734	21,601	71,049	82,489
Taxes other than income taxes	61,697	63,822	240,392	248,357
Total operating expenses	600,881	614,167	2,134,075	2,007,149
Operating income (loss)	26,126	37,297	278,701	354,175
Other income (expense):				
Other income	15,439	24,806	44,442	46,378
Other expense	(2,023)	(3,250)	(5,624)	(7,678)
Interest charges:				
AFUDC	3,732	3,911	10,652	10,112
Interest expense	(89,029)	(87,578)	(264,815)	(261,988)
Income (loss) before income taxes	(45,755)	(24,814)	63,356	140,999
Income tax (benefit) expense	(6,312)	(2,844)	3,597	12,428
Net income (loss)	$ (39,443)	$ (21,970)	$ 59,759	$ 128,571

The accompanying notes are an integral part of the financial statements.

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income (loss)	$ (39,443)	$(21,970)	$ 59,759	$ 128,571
Other comprehensive income (loss):				
Net unrealized gain (loss) from pension and post-retirement plans, net of tax of $(297), $(741), $(247) and $(620), respectively	(1,114)	(2,786)	(931)	(2,333)
Reclassification of stranded taxes to retained earnings due to tax reform	—	—	—	(5,230)
Other comprehensive income (loss)	(1,114)	(2,786)	(931)	(7,563)
Comprehensive income (loss)	$ (40,557)	$(24,756)	$ 58,828	$ 121,008

The accompanying notes are an integral part of the financial statements.

PUGET ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)
(Unaudited)

ASSETS

	September 30, 2019	December 31, 2018
Utility plant (at original cost, including construction work in progress of $658,261 and $550,466, respectively):		
Electric plant	$ 8,738,072	$ 8,515,482
Natural gas plant	3,824,045	3,598,732
Common plant	1,084,309	1,027,023
Less: Accumulated depreciation and amortization	(3,157,819)	(2,832,321)
Net utility plant	10,488,607	10,308,916
Other property and investments:		
Goodwill	1,656,513	1,656,513
Other property and investments	277,491	244,444
Total other property and investments	1,934,004	1,900,957
Current assets:		
Cash and cash equivalents	12,467	37,521
Restricted cash	27,659	18,041
Accounts receivable, net of allowance for doubtful accounts of $7,608 and $8,408, respectively	206,629	338,782
Unbilled revenue	145,073	205,285
Purchased gas adjustment receivable	155,711	9,921
Materials and supplies, at average cost	120,143	116,180
Fuel and natural gas inventory, at average cost	61,793	53,351
Unrealized gain on derivative instruments	14,147	46,507
Prepaid expense and other	28,502	25,674
Power contract acquisition adjustment gain	8,281	6,114
Total current assets	780,405	857,376
Other long-term and regulatory assets:		
Power cost adjustment mechanism	24,810	4,735
Regulatory assets related to power contracts	14,583	16,693
Other regulatory assets	717,596	773,552
Unrealized gain on derivative instruments	2,294	2,512
Power contract acquisition adjustment gain	149,126	156,597
Operating lease right of use asset	168,491	—
Other	86,841	77,523
Total other long-term and regulatory assets	1,163,741	1,031,612
Total assets	$ 14,366,757	$ 14,098,861

The accompanying notes are an integral part of the financial statements.

PUGET ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)
(Unaudited)

CAPITALIZATION AND LIABILITIES

	September 30, 2019	December 31, 2018
Capitalization:		
Common shareholder’s equity:		
Common stock $0.01 par value, 1,000 shares authorized, 200 shares outstanding	$ —	$ —
Additional paid-in capital	3,308,957	3,308,957
Retained earnings	652,006	629,003
Accumulated other comprehensive income (loss), net of tax	(78,133)	(77,202)
Total common shareholder’s equity	3,882,830	3,860,758
Long-term debt:		
First mortgage bonds and senior notes	4,212,000	3,764,412
Pollution control bonds	161,860	161,860
Long-term debt	2,200,900	1,961,900
Debt discount, issuance costs and other	(214,605)	(215,681)
Total long-term debt	6,360,155	5,672,491
Total capitalization	10,242,985	9,533,249
Current liabilities:		
Accounts payable	288,126	480,069
Short-term debt	69,000	379,297
Current maturities of long-term debt	2,412	—
Accrued expenses:		
Taxes	74,971	118,112
Salaries and wages	43,488	50,785
Interest	81,038	70,099
Unrealized loss on derivative instruments	30,504	46,661
Power contract acquisition adjustment loss	2,473	2,547
Operating lease liabilities	15,173	—
Other	104,132	79,312
Total current liabilities	711,317	1,226,882
Other long-term and regulatory liabilities:		
Deferred income taxes	808,636	789,297
Unrealized loss on derivative instruments	18,222	11,095
Regulatory liabilities	710,572	747,203
Regulatory liability for deferred income taxes	952,828	975,974
Regulatory liabilities related to power contracts	157,407	162,711
Power contract acquisition adjustment loss	12,110	14,146
Operating lease liabilities	159,913	—
Other deferred credits	592,767	638,304
Total other long-term and regulatory liabilities	3,412,455	3,338,730
Commitments and contingencies (Note 8)		
Total capitalization and liabilities	$ 14,366,757	$ 14,098,861

The accompanying notes are an integral part of the financial statements.

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDER’S EQUITY
(Dollars in Thousands)
(Unaudited)

	Common Stock		Additional		Accumulated Other	
	Shares	Amount	Paid-in Capital	Retained Earnings	Comprehensive Income (Loss)	Total Equity
Balance at December 31, 2017	200	$ —	$ 3,308,957	$ 465,355	$ (24,282)	$ 3,750,030
Net income (loss)	—	—	—	146,897	—	146,897
Common stock dividend paid	—	—	—	(30,096)	—	(30,096)
Other comprehensive income (loss)	—	—	—	—	(5,003)	(5,003)
Cumulative effect of accounting change	—	—	—	5,230	—	5,230
Balance at March 31, 2018	200	$ —	$ 3,308,957	$ 587,386	$ (29,285)	$ 3,867,058
Net income (loss)	—	—	—	3,642	$ —	3,642
Common stock dividend paid	—	—	—	(25,429)	$ —	(25,429)
Other comprehensive income (loss)	—	—	—	—	226	226
Balance at June 30, 2018	200	$ —	$ 3,308,957	$ 565,599	$ (29,059)	$ 3,845,497
Net income (loss)	—	—	—	(21,970)	—	(21,970)
Common stock dividend paid	—	—	—	(21,202)	—	(21,202)
Other comprehensive income (loss)	—	—	—	—	(2,786)	(2,786)
Balance at September 30, 2018	200	$ —	$ 3,308,957	$ 522,427	$ (31,845)	$ 3,799,539
Balance at December 31, 2018	200	$ —	$ 3,308,957	$ 629,003	$ (77,202)	$ 3,860,758
Net income (loss)	—	—	—	132,154	—	132,154
Common stock dividend paid	—	—	—	(35,994)	—	(35,994)
Other comprehensive income (loss)	—	—	—	—	92	92
Balance at March 31, 2019	200	$ —	$ 3,308,957	$ 725,163	$ (77,110)	$ 3,957,010
Net income (loss)		—	—	(32,952)	—	(32,952)
Common stock dividend paid		—	—	(83)	—	(83)
Other comprehensive income (loss)		—	—	—	91	91
Balance at June 30, 2019	200	$ —	$ 3,308,957	$ 692,128	$ (77,019)	$ 3,924,066
Net income (loss)	—	—	—	(39,443)	—	(39,443)
Common stock dividend paid	—	—	—	(679)	—	(679)
Other comprehensive income (loss)	—	—	—	—	(1,114)	(1,114)
Balance at September 30, 2019	200	$ —	$ 3,308,957	$ 652,006	$ (78,133)	$ 3,882,830

The accompanying notes are an integral part of the consolidated financial statements.

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2019	2018
Operating activities:		
Net income (loss)	$ 59,759	$ 128,571
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	483,693	486,377
Conservation amortization	71,049	82,489
Deferred income taxes and tax credits, net	(3,559)	5,554
Net unrealized (gain) loss on derivative instruments	29,861	(21,953)
AFUDC – equity	(10,071)	(12,958)
Production tax credit monetization	(35,470)	(56,177)
Other non-cash	1,712	11,105
Funding of pension liability	(18,000)	(13,500)
Regulatory assets and liabilities	(46,993)	(22,545)
Other long-term assets and liabilities	(3,075)	(4,872)
Change in certain current assets and liabilities:		
Accounts receivable and unbilled revenue	192,365	214,166
Materials and supplies	(3,963)	(7,002)
Fuel and natural gas inventory	(8,442)	(7,385)
Prepayments and other	(2,283)	(15,763)
Purchased gas adjustment	(145,790)	19,911
Accounts payable	(160,792)	(38,001)
Taxes payable	(43,141)	6,695
Other	(2,727)	(12,379)
Net cash provided by (used in) operating activities	354,133	742,333
Investing activities:		
Construction expenditures – excluding equity AFUDC	(709,139)	(760,728)
Other	(5,914)	2,090
Net cash provided by (used in) investing activities	(715,053)	(758,638)
Financing activities:		
Change in short-term debt, net	(310,297)	(123,463)
Dividends paid	(36,756)	(76,728)
Proceeds from long-term debt and bonds issued	682,151	642,615
Redemption of bonds and notes	—	(450,000)
Other	10,386	6,228
Net cash provided by (used in) financing activities	345,484	(1,348)
Net increase (decrease) in cash, cash equivalents, and restricted cash	(15,436)	(17,653)
Cash, cash equivalents, and restricted cash at beginning of period	55,562	36,761
Cash, cash equivalents, and restricted cash at end of period	$ 40,126	$ 19,108
Supplemental cash flow information:		
Cash payments for interest (net of capitalized interest)	$ 236,718	$ 234,438
Cash payments (refunds) for income taxes	$ 8,990	$ 7,595
Non-cash financing and investing activities:		
Accounts payable for capital expenditures eliminated from cash flows	$ 65,023	$ 105,070
Reclassification of Colstrip from utility plant to a regulatory asset (Note 8)	$ (47,534)	$ —

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Operating revenue:				
Electric	$ 513,926	$ 534,569	$1,823,596	$1,735,765
Natural gas	108,222	106,826	566,347	597,306
Other	4,859	10,069	22,833	28,253
Total operating revenue	627,007	651,464	2,412,776	2,361,324
Operating expenses:				
Energy costs:				
Purchased electricity	107,035	148,536	501,738	431,856
Electric generation fuel	93,642	71,004	208,442	143,177
Residential exchange	(15,295)	(15,401)	(56,430)	(55,436)
Purchased natural gas	27,778	30,192	168,281	211,679
Unrealized (gain) loss on derivative instruments, net	14,716	(14,046)	29,861	(21,953)
Utility operations and maintenance	142,857	139,361	450,236	440,016
Non-utility expense and other	11,869	10,518	34,924	31,132
Depreciation and amortization	138,253	149,730	483,623	486,300
Conservation amortization	17,734	21,601	71,049	82,489
Taxes other than income taxes	61,697	63,822	240,392	248,357
Total operating expenses	600,286	605,317	2,132,116	1,997,617
Operating income (loss)	26,721	46,147	280,660	363,707
Other income (expense):				
Other income	12,373	13,596	35,334	29,352
Other expense	(2,023)	(3,250)	(5,624)	(7,678)
Interest charges:				
AFUDC	3,732	3,911	10,652	10,112
Interest expense	(61,145)	(58,278)	(181,230)	(174,853)
Income (loss) before income taxes	(20,342)	2,126	139,792	220,640
Income tax (benefit) expense	(5,085)	(1,765)	16,072	26,931
Net income (loss)	$ (15,257)	$ 3,891	$ 123,720	$ 193,709

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Thousands)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019	2018
Net income (loss)	$ (15,257)	$ 3,891	$ 123,720	$ 193,709
Other comprehensive income (loss):				
Net unrealized gain (loss) from pension and post-retirement plans, net of tax of $357, $(30), $1,692 and $1,492, respectively	1,340	(113)	6,362	5,613
Amortization of treasury interest rate swaps to earnings, net of tax of $27, $26, $78 and $77, respectively	97	96	289	289
Reclassification of stranded taxes to retained earnings due to tax reform	—	—	—	(27,333)
Other comprehensive income (loss)	1,437	(17)	6,651	(21,431)
Comprehensive income (loss)	$ (13,820)	$ 3,874	$ 130,371	$ 172,278

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)
(Unaudited)

ASSETS

	September 30, 2019	December 31, 2018
Utility plant (at original cost, including construction work in progress of $658,261 and $550,466, respectively):		
Electric plant	$ 10,797,117	$ 10,587,231
Natural gas plant	4,386,972	4,164,489
Common plant	1,109,251	1,052,544
Less: Accumulated depreciation and amortization	(5,804,733)	(5,495,348)
Net utility plant	10,488,607	10,308,916
Other property and investments:		
Other property and investments	81,013	76,986
Total other property and investments	81,013	76,986
Current assets:		
Cash and cash equivalents	10,929	35,452
Restricted cash	27,659	18,041
Accounts receivable, net of allowance for doubtful accounts of $7,608 and $8,408, respectively	209,586	346,251
Unbilled revenue	145,073	205,285
Purchased gas adjustment receivable	155,711	9,921
Materials and supplies, at average cost	120,143	116,180
Fuel and natural gas inventory, at average cost	60,470	52,028
Unrealized gain on derivative instruments	14,147	46,507
Prepaid expense and other	28,502	25,674
Total current assets	772,220	855,339
Other long-term and regulatory assets:		
Power cost adjustment mechanism	24,810	4,735
Other regulatory assets	717,596	773,552
Unrealized gain on derivative instruments	2,294	2,512
Operating lease right of use asset	168,491	—
Other	84,651	75,483
Total other long-term and regulatory assets	997,842	856,282
Total assets	$ 12,339,682	$ 12,097,523

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED BALANCE SHEETS
(Dollars in Thousands)
(Unaudited)

CAPITALIZATION AND LIABILITIES

	September 30, 2019	December 31, 2018
Capitalization:		
Common shareholder's equity:		
Common stock $0.01 par value, 150,000,000 shares authorized, 85,903,791 shares outstanding	$ 859	$ 859
Additional paid-in capital	3,485,105	3,275,105
Retained earnings	632,702	622,844
Accumulated other comprehensive income (loss), net of tax	(184,233)	(190,884)
Total common shareholder's equity	3,934,433	3,707,924
Long-term debt:		
First mortgage bonds and senior notes	4,212,000	3,764,417
Pollution control bonds	161,860	161,860
Debt discount, issuance costs and other	(38,067)	(31,417)
Total long-term debt	4,335,793	3,894,860
Total capitalization	8,270,226	7,602,784
Current liabilities:		
Accounts payable	288,194	480,195
Short-term debt	69,000	379,297
Current maturities of long-term debt	2,412	—
Accrued expenses:		
Taxes	77,815	117,993
Salaries and wages	43,488	50,785
Interest	58,410	43,951
Unrealized loss on derivative instruments	30,504	46,661
Operating lease liabilities	15,173	—
Other	104,132	79,312
Total current liabilities	689,128	1,198,194
Other long-term and regulatory liabilities:		
Deferred income taxes	949,526	926,403
Unrealized loss on derivative instruments	18,222	11,095
Regulatory liabilities	709,249	745,880
Regulatory liability for deferred income taxes	953,627	976,582
Operating lease liabilities	159,913	—
Other deferred credits	589,791	636,585
Total other long-term and regulatory liabilities	3,380,328	3,296,545
Commitments and contingencies (Note 8)		
Total capitalization and liabilities	$ 12,339,682	$ 12,097,523

The accompanying notes are an integral part of the financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDER'S EQUITY
(Dollars in Thousands)
(Unaudited)

	Common Stock		Additional		Accumulated Other	
	Shares	Amount	Paid-in Capital	Retained Earnings	Comprehensive Income (loss)	Total Equity
Balance at December 31, 2017	$ 85,903,791	$ 859	$ 3,275,105	$ 452,066	$ (126,906)	$ 3,601,124
Net income (loss)	—	—	—	163,037	—	163,037
Common stock dividend paid	—	—	—	(58,612)	—	(58,612)
Other comprehensive income (loss)	—	—	—	—	(24,374)	(24,374)
Cumulative effect of accounting change	—	—	—	27,333	—	27,333
Balance at March 31, 2018	$ 85,903,791	$ 859	$ 3,275,105	$ 583,824	$ (151,280)	$ 3,708,508
Net income (loss)	—	—	—	26,778	—	26,778
Common stock dividend paid	—	—	—	(43,844)	—	(43,844)
Other comprehensive income (loss)	—	—	—	—	2,960	2,960
Balance at June 30, 2018	$ 85,903,791	$ 859	$ 3,275,105	$ 566,758	$ (148,320)	$ 3,694,402
Net income (loss)	—	—	—	3,891	—	3,891
Common stock dividend paid	—	—	—	(48,857)	—	(48,857)
Other comprehensive income (loss)	—	—	—	—	(17)	(17)
Balance at September 30, 2018	$ 85,903,791	$ 859	$ 3,275,105	$ 521,792	$ (148,337)	$ 3,649,419
Balance at December 31, 2018	$ 85,903,791	$ 859	$ 3,275,105	$ 622,844	$ (190,884)	$ 3,707,924
Net income (loss)	—	—	—	147,302	—	147,302
Common stock dividend paid	—	—	—	(64,604)	—	(64,604)
Other comprehensive income (loss)	—	—	—	—	2,606	2,606
Balance at March 31, 2019	$ 85,903,791	$ 859	$ 3,275,105	$ 705,542	$ (188,278)	$ 3,793,228
Net income (loss)	—	—	—	(8,325)	—	(8,325)
Common stock dividend paid	—	—	—	(19,384)	—	(19,384)
Other comprehensive income (loss)	—	—	—	—	2,608	2,608
Balance at June 30, 2019	$ 85,903,791	$ 859	$ 3,275,105	$ 677,833	$ (185,670)	$ 3,768,127
Net income (loss)	—	—	—	(15,257)	—	(15,257)
Common stock dividend paid	—	—	—	(29,874)	—	(29,874)
Capital Contribution	—	—	210,000	—	—	210,000
Other comprehensive income (loss)	—	—	—	—	1,437	1,437
Balance at September 30, 2019	$ 85,903,791	$ 859	$ 3,485,105	$ 632,702	$ (184,233)	$ 3,934,433

The accompanying notes are an integral part of the consolidated financial statements.

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2019	2018
Operating activities:		
Net income (loss)	$ 123,720	$ 193,709
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	483,623	486,300
Conservation amortization	71,049	82,489
Deferred income taxes and tax credits, net	(1,600)	12,801
Net unrealized (gain) loss on derivative instruments	29,861	(21,953)
AFUDC – equity	(10,071)	(12,958)
Production tax credit monetization	(35,470)	(56,177)
Other non-cash	(6,167)	3,319
Funding of pension liability	(18,000)	(13,500)
Regulatory assets and liabilities	(46,993)	(22,545)
Other long-term assets and liabilities	4,972	5,144
Change in certain current assets and liabilities:		
Accounts receivable and unbilled revenue	196,877	208,359
Materials and supplies	(3,963)	(7,002)
Fuel and natural gas inventory	(8,442)	(7,385)
Prepayments and other	(2,283)	(15,763)
Purchased gas adjustment	(145,790)	19,911
Accounts payable	(160,850)	(37,988)
Taxes payable	(40,178)	7,580
Other	794	(9,528)
Net cash provided by (used in) operating activities	431,089	814,813
Investing activities:		
Construction expenditures – excluding equity AFUDC	(680,118)	(712,329)
Other	(5,916)	2,090
Net cash provided by (used in) investing activities	(686,034)	(710,239)
Financing activities:		
Change in short-term debt, net	(310,297)	(123,463)
Dividends paid	(113,862)	(151,315)
Long-term bonds and notes issued	443,151	594,750
Redemption of bonds and notes	—	(450,000)
Investment from parent	210,000	—
Other	11,048	6,228
Net cash provided by (used in) financing activities	240,040	(123,800)
Net increase (decrease) in cash, cash equivalents, and restricted cash	(14,905)	(19,226)
Cash, cash equivalents, and restricted cash at beginning of period	53,493	36,009
Cash, cash equivalents, and restricted cash at end of period	$ 38,588	$ 16,783
Supplemental cash flow information:		
Cash payments for interest (net of capitalized interest)	$ 152,571	$ 152,273
Cash payments (refunds) for income taxes	$ 16,540	$ 13,839
Non-cash financing and investing activities:		
Accounts payable for capital expenditures eliminated from cash flows	$ 65,023	$ 105,070
Reclassification of Colstrip from utility plant to a regulatory asset (Note 8)	$ (47,534)	$ —

The accompanying notes are an integral part of the financial statements.

(1) Summary of Consolidation and Significant Accounting Policy

Basis of Presentation

Puget Energy is an energy services holding company that owns Puget Sound Energy (PSE). PSE is a public utility incorporated in the state of Washington that furnishes electric and natural gas services in a territory covering approximately 6,000 square miles, primarily in the Puget Sound region. Puget Energy also has a wholly-owned non-regulated subsidiary, Puget LNG, LLC, which has the sole purpose of owning, developing and financing the non-regulated activity of the Tacoma LNG facility, currently under construction. PSE and Puget LNG are considered related parties with similar ownership by Puget Energy. Therefore, capital and operating costs that are incurred by PSE and allocated to Puget LNG are related party transactions by nature.

In 2009, Puget Holdings, LLC (Puget Holdings), owned by a consortium of long-term infrastructure investors, completed its merger with Puget Energy (the merger). As a result of the merger, all of Puget Energy's common stock is indirectly owned by Puget Holdings. The acquisition of Puget Energy was accounted for in accordance with FASB ASC 805, "Business Combinations", as of the date of the merger. ASC 805 requires the acquirer to recognize and measure identifiable assets acquired and liabilities assumed at fair value as of the merger date.

The consolidated financial statements of Puget Energy reflect the accounts of Puget Energy and its subsidiaries. PSE's consolidated financial statements include the accounts of PSE and its subsidiary. Puget Energy and PSE are collectively referred to herein as "the Company". The consolidated financial information furnished herein reflects all adjustments which are, in the opinion of management, necessary to fairly state the results for the interim periods presented. All such adjustments are of a normal recurring nature. All significant intercompany accounts and transactions are eliminated in consolidation. PSE's consolidated financial statements continue to be accounted for on a historical basis and do not include any ASC 805, "Business Combinations" purchase accounting adjustments. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Tacoma LNG Facility

In August 2015, PSE filed a proposal with the Washington Utilities and Transportation Commission (Washington Commission) to develop an LNG facility at the Port of Tacoma. Currently under construction at the Port of Tacoma, the facility is expected to be operational in 2021. The Tacoma LNG facility is intended to provide peak-shaving services to PSE's natural gas customers. By storing surplus natural gas, PSE is able to meet the requirements of peak consumption. LNG will also provide fuel to transportation customers, particularly in the marine market. On January 24, 2018, the Puget Sound Clean Air Agency (PSCAA) determined a Supplemental Environmental Impact Statement (SEIS) is necessary in order to rule on the air quality permit for the facility. As a result of requiring a SEIS, the Company's construction schedule may be impacted depending on the Puget Sound Clean Air Agency's timing and decision on the air quality permit. PSE received the SEIS which concluded the LNG facility would result in a net decrease in GHG emissions, provided in part that the natural gas for the facility was sourced from British Columbia or Alberta. PSE must now await the final determination by PSCAA.

If delayed, the construction schedule and costs may be adversely impacted. Pursuant to an order by the Washington Commission, PSE will be allocated approximately 43.0% of common capital and operating costs, consistent with the regulated portion of the Tacoma LNG facility. The remaining 57.0% of common capital and operating costs of the Tacoma LNG facility will be allocated to Puget LNG. Per this allocation of costs, $191.8 million of construction work in progress and $1.0 million of operating costs related to Puget LNG's portion of the Tacoma LNG facility are reported in the Puget Energy "Other property and investments" and "Non-utility expense and other" financial statement line items, respectively, as of September 30, 2019. Additionally, $156.1 million of construction work in progress related to PSE's portion of the Tacoma LNG facility is reported in the PSE "Utility plant - Natural gas plant" financial statement line item, as PSE is a regulated entity.

Leases

PSE determines if an arrangement is, or contains, a lease at inception of the contract. If the arrangement is, or contains a lease, PSE assesses whether the lease is operating or financing for income statement and balance sheet classification. Operating leases are included in operating lease right-of-use (ROU) assets, operating lease current liabilities, and operating lease liabilities in our consolidated balance sheets. Finance leases are included in utility plant, other current liabilities, and other deferred credits in our consolidated balance sheets.

ROU assets represent the right to use an underlying asset for the lease term, and consist of the amount of the initial measurement of the lease liability, any lease payments made to the lessor at or before the commencement date, minus any lease incentives received, and any initial direct costs incurred by the lessee. Lease liabilities represent our obligation to make lease payments arising from the lease and are measured at present value of the lease payments not yet paid, discounted using the discount rate for the lease at commencement. As most of PSE's leases do not provide an implicit interest rate, PSE uses the incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. For fleet, IT and wind farm leases, this rate is applied using a portfolio approach. The lease terms may include options to extend or terminate the lease when it is reasonably certain that PSE will exercise that option. On the statement of income, operating leases are generally accounted for under a straight-line expense model, while finance leases, which were previously referred to as capital leases, are generally accounted for under a financing model. Consistent with the previous lease guidance, however, the standard allows rate-regulated utilities to recognize expense consistent with the timing of recovery in rates.

PSE has lease agreements with lease and non-lease components. Non-lease components comprise common area maintenance and utilities, and are accounted for separately from lease components.

(2) New Accounting Pronouncements

Recently Adopted Accounting Guidance

Lease Accounting

In February 2016, the FASB issued ASU 2016-02, *"Leases (Topic 842)"*. The FASB issued this ASU to increase transparency and comparability among organizations by recognizing ROU lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. To meet that objective, the FASB amended the FASB ASC and created Topic 842, Leases. ASU 2016-02 requires lessees to recognize the following for all leases (with the exception of short-term leases) at the commencement date: (i) a lease liability, which is a lessee's obligation to make lease payments arising from a lease, measured on a discounted basis; and (ii) a ROU asset, which is an asset that represents the lessee's right to use, or control the use of, a specified asset for the lease term. The income statement recognition is similar to existing lease accounting and is based on lease classification. Under the new guidance, lessor accounting is largely unchanged.

In January 2018, the FASB issued ASU 2018-01, *"Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842"*. In connection with the FASB's transition support efforts, the amendments in this update provide an optional transition practical expedient to not evaluate under Topic 842 existing or expired land easements that were not previously accounted for as leases under the current guidance in Topic 840. An entity that elects this practical expedient should evaluate new or modified land easements under Topic 842 upon adoption. Land easements (also commonly referred to as rights of way) represent the right to use, access, or cross another entity's land for a specified purpose. The Company elected this practical expedient.

In July 2018, the FASB issued both ASU 2018-10 and ASU 2018-11, *"Leases (Topic 842): Codification Improvements"* and *"Leases (Topic 842): Targeted Improvements"*. These ASUs provide entities with both clarification on existing guidance issued in ASU 2016-02, as well as an additional transition method to adopt the new leasing standard. Under the new transition method, the entity initially applies the new standard at the adoption date by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements will continue to be in accordance with Topic 840. The Company has elected to adopt the standard using this new modified transition method.

In preparation for adoption of the standard, the Company assembled a project team that met bi-weekly to make key accounting assessments and perform pre-implementation controls related to the scoping and completeness of existing leases. Additionally, the Company implemented a new leasing system and drafted accounting policies including discount rate, variable pricing, power purchase agreements, and election of practical expedients. In addition to the land easement practical expedient, the Company has elected the practical expedient package.

These amendments are effective for financial statements issued for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company has adopted ASU 2016-02 as of January 1, 2019, which resulted in the recognition of ROU asset and lease liability financial statement line items that have not previously been recorded and are material to the consolidated balance sheets. Adoption of the standard did not have a material impact on the income statement. The financial impact as of the date of adoption was not materially different than what has been disclosed as of September 30, 2019, in Note 9, "Leases", to the consolidated financial statements included in Item 1 of this report.

Internal-Use Software

In August 2018, the FASB issued ASU 2018-15, *"Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract"*. These amendments align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). The accounting for the service element of a hosting arrangement that is a service contract is not affected by these amendments.

The amendments in this update are effective for public business entities for fiscal years beginning after December 15, 2019, and interim periods within those fiscal years. Early adoption of the amendments in this update is permitted, including adoption in any interim period, for all entities. The amendments in this update should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company adopted this update prospectively in 2019 for implementation costs incurred in hosting arrangements and application of the amendment has not had a material impact on the consolidated financial statements.

Accounting Standards Issued but Not Yet Adopted

Credit Losses

In June 2016, the FASB issued ASU 2016-13, "*Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments"*. The amendments in the update change how entities account for credit losses on receivables and certain other assets. The guidance requires use of a current expected loss model, which may result in earlier recognition of credit losses than under previous accounting standards. ASU 2016-13 is effective for interim and annual periods beginning on or after December 15, 2019. The Company is currently evaluating the impact of adoption of the new standard on its consolidated financial statements.

Fair Value Measurement

In August 2018, the FASB issued ASU 2018-13, *"Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement"*. The amendments in this update modify the disclosure requirements on fair value measurements in Topic 820, Fair Value Measurement, based on the concepts in the Concepts Statement, including the consideration of costs and benefits. The amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. The Company is in the process of evaluating potential impacts of these amendments to Note 5, "Fair Value Measurements", to the consolidated financial statements.

Retirement Benefits

In August 2018, the FASB issued ASU 2018-14, "*Compensation—Retirement Benefits—Defined Benefit Plans—General (Subtopic 715-20): Disclosure Framework—Changes to the Disclosure Requirements for Defined Benefit Plans"*. This update modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans through added, removed, and clarified requirements of relevant disclosures.

The amendments in this update are effective for fiscal years ending after December 15, 2020, for public business entities and for fiscal years ending after December 15, 2021, for all other entities. Early adoption is permitted for all entities. The Company is in the process of evaluating potential impacts of these amendments to Note 6, "Retirement Benefits", to the consolidated financial statements.

(3) Revenue

The following table presents disaggregated revenue from contracts with customers, and other revenue by major source:

Puget Energy and Puget Sound Energy

(Dollars in Thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
Revenue from contracts with customers:	2019	2018	2019	2018
Electric retail	$ 450,109	$ 464,210	$1,550,517	$1,563,394
Natural gas retail	101,395	101,995	569,177	594,572
Other	72,691	67,217	245,285	148,581
Total revenue from contracts with customers	624,195	633,422	2,364,979	2,306,547
Alternative revenue programs	874	(782)	(20,006)	(24,678)
Other non-customer revenue	1,938	18,824	67,803	79,455
Total operating revenue	$ 627,007	$ 651,464	$2,412,776	$2,361,324

Revenue at PSE is recognized when performance obligations under the terms of a contract or tariff with our customers are satisfied. Performance obligations are satisfied generally through performance of PSE's obligation over time or with transfer of control of electric power, natural gas, and other revenue from contracts with customers. Revenue is measured as the amount of consideration expected to be received in exchange for transferring goods and services.

Electric and Natural Gas Retail Revenue

Electric and natural gas retail revenue consists of tariff-based sales of electricity and natural gas to PSE's customers. For tariff contracts, PSE has elected the portfolio approach practical expedient model to apply the revenue from contracts with customers to groups of contracts. The Company determined that the portfolio approach will not differ from considering each contract or performance obligation separately. Electric and natural gas tariff contracts include the performance obligation of standing ready to perform electric and natural gas services. The electricity and natural gas the customer chooses to consume is considered an option and is recognized over time using the output method when the customer simultaneously consumes the electricity or natural gas. PSE has elected the right to invoice practical expedient for unbilled retail revenue. The obligation of standing ready to perform electric and natural gas services and the consumption of electricity and natural gas at market value implies a right to consideration for performance completed to date. The Company believes that tariff prices approved by the Washington Commission represent stand-alone selling prices for the performance obligations under ASC 606. PSE collects Washington State excise taxes (which are a component of general retail customer rates) and municipal taxes and presents the taxes on a gross basis, as PSE is the taxpayer for those excise and municipal taxes.

Other Revenue from Contracts with Customers

Other revenue from contracts with customers is primarily comprised of electric transmission, natural gas transportation, biogas, and wholesale revenue sold on an intra-month basis.

Electric Transmission and Natural Gas Transportation Revenue

Transmission and transportation tariff contracts include the performance obligation to transmit and transport electricity or natural gas. Transfer of control and recognition of revenue occurs over time as the customer simultaneously receives the transmission and transportation services. Measurement of satisfaction of this performance obligation is determined using the output method. Similar to retail revenue, the Company utilizes the right to invoice practical expedient as PSE's right to consideration is tied directly to the value of power and natural gas transmitted and transported each month. The price is based on the tariff rates that were approved by the Washington Commission or the FERC and, therefore, corresponds directly to the value to the customer for performance completed to date.

Biogas Revenue

Biogas is a renewable natural gas fuel that PSE purchases and sells along with the renewable green attributes derived from the renewable natural gas. Biogas contracts include the performance obligations of biogas and renewable credit delivery upon

PSE receiving produced biogas from its supplier. Transfer of control and recognition of revenue occurs at a point in time as biogas is considered a storable commodity and may not be consumed as it is delivered.

Wholesale Revenue

Wholesale revenue at PSE includes sales of electric power and non-core natural gas to other utilities or marketers. Wholesale revenue contracts include the performance obligation of physical electric power or natural gas. There are typically no added fixed or variable amounts on top of the established rate for power or natural gas and contracts always have a stated, fixed quantity of power or natural gas delivered. Transfer of control and recognition of revenue occurs at a point in time when the customer takes physical possession of electric power or natural gas. Non-core gas consists of natural gas supply in excess of natural gas used for generation, sold to third parties to mitigate the costs of firm transportation and storage capacity for its core natural gas customers. PSE reports non-core gas sold net of costs as PSE does not take control of the natural gas but is merely an agent within the market that connects a seller to a purchaser.

Other Revenue

In accordance with ASC 606, PSE separately presents revenue not collected from contracts with customers that falls under other accounting guidance.

(4) Accounting for Derivative Instruments and Hedging Activities

PSE employs various energy portfolio optimization strategies but is not in the business of assuming risk for the purpose of realizing speculative trading revenue. The nature of serving regulated electric customers with its portfolio of owned and contracted electric generation resources exposes PSE and its customers to some volumetric and commodity price risks within the sharing mechanism of the power cost adjustment (PCA). Therefore, wholesale market transactions and PSE's related hedging strategies are focused on reducing costs and risks where feasible, thus reducing volatility of costs in the portfolio. In order to manage its exposure to the variability in future cash flows for forecasted energy transactions, PSE utilizes a programmatic hedging strategy which extends out three years. PSE's hedging strategy includes a risk-responsive component for the core natural gas portfolio, which utilizes quantitative risk-based measures with defined objectives to balance both portfolio risk and hedge costs.

PSE's energy risk portfolio management function monitors and manages these risks using analytical models and tools. In order to manage risks effectively, PSE enters into forward physical electric and natural gas purchase and sale agreements, fixed-for-floating swap contracts, and commodity call/put options. Currently, the Company does not apply cash flow hedge accounting and therefore records all mark-to-market gains or losses through earnings.

The Company manages its interest rate risk through the issuance of mostly fixed-rate debt with varied maturities. The Company utilizes internal cash from operations, borrowings under its commercial paper program and its credit facilities to meet short-term funding needs. The Company may enter into swap instruments or other financial hedge instruments to manage the interest rate risk associated with these debts.

The following table presents the volumes, fair values and classification of the Company's derivative instruments recorded on the balance sheets:

Puget Energy and
Puget Sound Energy

	At September 30, 2019			December 31, 2018		
(Dollars in Thousands)	Volumes	Assets[1]	Liabilities[2]	Volumes	Assets[1]	Liabilities[2]
Electric portfolio derivatives	*	$ 9,483	$ 33,341	*	$ 33,287	$ 27,284
Natural gas derivatives (MMBtus)[3]	288.3 million	6,958	15,385	336.6 million	15,732	30,472
Total derivative contracts		$ 16,441	$ 48,726		$ 49,019	$ 57,756
Current		$ 14,147	$ 30,504		$ 46,507	$ 46,661
Long-term		2,294	18,222		2,512	11,095
Total derivative contracts		$ 16,441	$ 48,726		$ 49,019	$ 57,756

1 *Balance sheet classification: Current and Long-term Unrealized gain on derivative instruments.*

2 *Balance sheet classification: Current and Long-term Unrealized loss on derivative instruments.*

3 *All fair value adjustments on derivatives relating to the natural gas business have been deferred in accordance with ASC 980, "Regulated Operations," due to the purchased gas adjustment (PGA) mechanism. The net derivative asset or liability and offsetting regulatory liability or asset are related to contracts used to economically hedge the cost of physical gas purchased to serve natural gas customers.*

* *Electric portfolio derivatives consist of electric generation fuel of 183.6 million One Million British Thermal Units (MMBtu) and purchased electricity of 11.9 million Megawatt Hours (MWhs) at September 30, 2019, and 194.8 million MMBtus and 6.6 million MWhs at December 31, 2018.*

It is the Company's policy to record all derivative transactions on a gross basis at the contract level without offsetting assets or liabilities. The Company generally enters into transactions using the following master agreements: WSPP, Inc. (WSPP) agreements, which standardize physical power contracts; International Swaps and Derivatives Association (ISDA) agreements, which standardize financial natural gas and electric contracts; and North American Energy Standards Board (NAESB) agreements, which standardize physical natural gas contracts. The Company believes that such agreements reduce credit risk exposure because such agreements provide for the netting and offsetting of monthly payments as well as the right of set-off in the event of counterparty default. The set-off provision can be used as a final settlement of accounts which extinguishes the mutual debts owed between the parties in exchange for a new net amount. For further details regarding the fair value of derivative instruments, see Note 5, "Fair Value Measurements," to the consolidated financial statements included in Item 1 of this report.

The following tables present the potential effect of netting arrangements, including rights of set-off associated with the Company's derivative assets and liabilities:

Puget Energy and
Puget Sound Energy

	At September 30, 2019					
				Gross Amounts Not Offset in the Statement of Financial Position		
(Dollars in Thousands)	Gross Amount Recognized in the Statement of Financial Position[1]	Gross Amounts Offset in the Statement of Financial Position	Net of Amounts Presented in the Statement of Financial Position	Commodity Contracts	Cash Collateral Received/ Posted	Net Amount
Assets:						
Energy derivative contracts	$ 16,441	$ —	$ 16,441	$ (14,148)	$ —	$ 2,293
Liabilities:						
Energy derivative contracts	48,726	—	48,726	(14,148)	(5,379)	29,199

Puget Energy and Puget Sound Energy	At December 31, 2018					
				Gross Amounts Not Offset in the Statement of Financial Position		
(Dollars in Thousands)	Gross Amount Recognized in the Statement of Financial Position[1]	Gross Amounts Offset in the Statement of Financial Position	Net of Amounts Presented in the Statement of Financial Position	Commodity Contracts	Cash Collateral Received/ Posted	Net Amount
Assets:						
Energy derivative contracts	$ 49,019	$ —	$ 49,019	$ (25,388)	$ —	$ 23,631
Liabilities:						
Energy derivative contracts	57,756	—	57,756	(25,388)	—	32,368

[1] *All derivative contract deals are executed under ISDA, NAESB and WSPP master netting agreements with right of set-off.*

The following table presents the effect and classification of the realized and unrealized gains (losses) of the Company's derivatives recorded on the statements of income:

Puget Energy and Puget Sound Energy		Three Months Ended September 30,		Nine Months Ended September 30,	
(Dollars in Thousands)	Classification	2019	2018	2019	2018
Gas for Power Derivatives:					
Unrealized	Unrealized gain (loss) on derivative instruments, net	$ 8,143	$ 8,503	$ 5,914	$ 16,172
Realized	Electric generation fuel	(7,514)	(6,308)	4,481	(18,401)
Power Derivatives:					
Unrealized	Unrealized gain (loss) on derivative instruments, net	(22,859)	5,543	(35,775)	5,781
Realized	Purchased electricity	(335)	(4,803)	40,918	(10,028)
Total gain (loss) recognized in income on derivatives		$ (22,565)	$ 2,935	$ 15,538	$ (6,476)

The Company is exposed to credit risk primarily through buying and selling electricity and natural gas to serve its customers. Credit risk is the potential loss resulting from a counterparty's non-performance under an agreement. The Company manages credit risk with policies and procedures for, among other things, counterparty credit analysis, exposure measurement, and exposure monitoring and mitigation.

The Company monitors counterparties for significant swings in credit default swap rates, credit rating changes by external rating agencies, ownership changes or financial distress. Where deemed appropriate, the Company may request collateral or other security from its counterparties to mitigate potential credit default losses. Criteria employed in this decision include, among other things, the perceived creditworthiness of the counterparty and the expected credit exposure.

It is possible that volatility in energy commodity prices could cause the Company to have material credit risk exposure with one or more counterparties. If such counterparties fail to perform their obligations under one or more agreements, the Company could suffer a material financial loss. However, as of September 30, 2019, approximately 97.8% of the Company's energy portfolio exposure, excluding normal purchase normal sale (NPNS) transactions, is with counterparties that are rated investment grade by rating agencies and 2.2% are either rated below investment grade or not rated by rating agencies. The Company assesses credit risk internally for counterparties that are not rated by the major rating agencies.

The Company computes credit reserves at a master agreement level by counterparty. The Company considers external credit ratings and market factors in the determination of reserves, such as credit default swaps and bond spreads. The Company recognizes that external ratings may not always reflect how a market participant perceives a counterparty's risk of default. The Company uses both default factors published by Standard & Poor's and factors derived through analysis of market risk, which reflect the application of an industry standard recovery rate. The Company selects a default factor by counterparty at an aggregate master agreement level based on a weighted average default tenor for that counterparty's deals. The default tenor is determined by weighting the fair value and contract tenors for all deals for each counterparty to derive an average value. The default factor used is dependent upon whether the counterparty is in a net asset or a net liability position after applying the master agreement levels.

The Company applies the counterparty's default factor to compute credit reserves for counterparties that are in a net asset position. The Company calculates a non-performance risk on its derivative liabilities by using its estimated incremental borrowing rate over the risk-free rate. Credit reserves are netted against the unrealized gain (loss) positions. The majority of the Company's derivative contracts are with financial institutions and other utilities operating within the Western Electricity Coordinating Council. PSE also transacts power futures contracts on the Intercontinental Exchange (ICE), and natural gas contracts on the ICE NGX exchange platform. Execution of contracts on ICE requires the daily posting of margin calls as collateral through a futures and clearing agent. As of September 30, 2019, PSE had cash posted as collateral of $17.1 million related to contracts executed on the ICE platform. Also, as of September 30, 2019, PSE had $1.0 million in a letter of credit posted as a condition of transacting on the ICE NGX platform. PSE did not trigger any collateral requirements with any of its counterparties nor were any of PSE's counterparties required to post collateral resulting from credit rating downgrades during the nine months ended September 30, 2019.

The following table presents the aggregate fair value of all derivative instruments with credit-risk-related contingent features that are in a liability position and the amount of additional collateral the Company could be required to post:

Puget Energy and
Puget Sound Energy

(Dollars in Thousands)	At September 30, 2019			At December 31, 2018		
Contingent Feature	Fair Value[1] Liability	Posted Collateral	Contingent Collateral	Fair Value[1] Liability	Posted Collateral	Contingent Collateral
Credit rating[2]	$ 12,147	$ —	$ 12,147	$ 574	$ —	$ 574
Requested credit for adequate assurance	5,447	—	—	18,495	—	—
Forward value of contract[3]	5,379	17,117	—	—	—	—
Total	$ 22,973	$ 17,117	$ 12,147	$ 19,069	$ —	$ 574

1 *Represents the derivative fair value of contracts with contingent features for counterparties in net derivative liability positions. Excludes NPNS, accounts payable and accounts receivable.*

2 *Failure by PSE to maintain an investment grade credit rating from each of the major credit rating agencies provides counterparties a contractual right to demand collateral.*

3 *Collateral requirements may vary, based on changes in the forward value of underlying transactions relative to contractually defined collateral thresholds.*

(5) Fair Value Measurements

ASC 820 established a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy categorizes the inputs into three levels with the highest priority given to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority given to unobservable inputs (Level 3 measurement). The three levels of the fair value hierarchy are as follows:

> Level 1 - Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Level 1 primarily consists of financial instruments such as exchange-traded derivatives and listed equities. Equity securities that are also classified as cash equivalents are considered Level 1 if there are unadjusted quoted prices in active markets for identical assets or liabilities.
>
> Level 2 - Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. Instruments in this category include non-exchange-traded derivatives such as over-the-counter forwards and options.

Level 3 - Pricing inputs include significant inputs that have little or no observability as of the reporting date. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

Financial assets and liabilities measured at fair value are classified in their entirety in the appropriate fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement requires judgment and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy. The Company primarily determines fair value measurements classified as Level 2 or Level 3 using a combination of the income and market valuation approaches. The process of determining the fair values is the responsibility of the derivative accounting department which reports to the Controller and Principal Accounting Officer. Inputs used to estimate the fair value of forwards, swaps and options include market-price curves, contract terms and prices, credit-risk adjustments, and discount factors. Additionally, for options, the Black-Scholes option valuation model and implied market volatility curves are used. Inputs used to estimate fair value in industry-standard models are categorized as Level 2 inputs as substantially all assumptions and inputs are observable in active markets throughout the full term of the instruments. On a daily basis, the Company obtains quoted forward prices for the electric and natural gas markets from an independent external pricing service.

The Company considers its electric and natural gas contracts as Level 2 derivative instruments as such contracts are commonly traded as over-the-counter forwards with indirectly observable price quotes. However, certain energy derivative instruments with maturity dates falling outside the range of observable price quotes are classified as Level 3 in the fair value hierarchy. Management's assessment is based on the trading activity in real-time and forward electric and natural gas markets. Each quarter, the Company confirms the validity of pricing-service quoted prices used to value Level 2 commodity contracts with the actual prices of commodity contracts entered into during the most recent quarter.

Assets and Liabilities with Estimated Fair Value

The carrying values of cash and cash equivalents, restricted cash, and short-term debt as reported on the balance sheet are reasonable estimates of their fair value due to the short-term nature of these instruments and are classified as Level 1 in the fair value hierarchy. The carrying value of other investments totaling $51.1 million and $49.5 million at September 30, 2019 and December 31, 2018, respectively, are included in "Other property and investments" on the balance sheet. These values are also reasonable estimates of their fair value and classified as Level 2 in the fair value hierarchy as they are valued based on market rates for similar transactions.

The fair value of the junior subordinated and long-term notes was estimated using the discounted cash flow method with the U.S. Treasury yields and the Company's credit spreads as inputs, interpolating to the maturity date of each issue. The carrying values and estimated fair values were as follows:

Puget Energy		At September 30, 2019		At December 31, 2018	
(Dollars in Thousands)	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
Liabilities:					
Long-term debt (fixed-rate), net of discount[1]	2	$ 5,961,667	$ 7,544,799	$ 5,510,591	$ 6,443,742
Long-term debt (variable-rate)	2	400,900	400,900	161,900	161,900
Total liabilities		$ 6,362,567	$ 7,945,699	$ 5,672,491	$ 6,605,642

Puget Sound Energy		At September 30, 2019		At December 31, 2018	
(Dollars in Thousands)	Level	Carrying Value	Fair Value	Carrying Value	Fair Value
Liabilities:					
Long-term debt (fixed-rate), net of discount[2]	2	$ 4,338,205	$ 5,642,813	$ 3,894,860	$ 4,574,611
Total liabilities		$ 4,338,205	$ 5,642,813	$ 3,894,860	$ 4,574,611

1 *The carrying value includes debt issuances costs of $24.8 million and $26.1 million for September 30, 2019 and December 31, 2018, respectively, which are not included in fair value.*

2 *The carrying value includes debt issuances costs of $24.6 million and $24.6 million for September 30, 2019 and December 31, 2018, respectively, which are not included in fair value.*

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The following table presents the Company's financial assets and liabilities by level, within the fair value hierarchy, that were accounted for at fair value on a recurring basis:

Puget Energy and Puget Sound Energy	Fair Value At September 30. 2019			Fair Value At December 31, 2018		
(Dollars in Thousands)	Level 2	Level 3	Total	Level 2	Level 3	Total
Assets:						
Electric derivative instruments	$ 8,612	$ 871	$ 9,483	$ 28,765	$ 4,522	$ 33,287
Natural gas derivative instruments	5,279	1,679	6,958	12,247	3,485	15,732
Total assets	$ 13,891	$ 2,550	$ 16,441	$ 41,012	$ 8,007	$ 49,019
Liabilities:						
Electric derivative instruments	$ 27,942	$ 5,399	$ 33,341	$ 24,124	$ 3,160	$ 27,284
Natural gas derivative instruments	15,143	242	15,385	28,660	1,812	30,472
Total liabilities	$ 43,085	$ 5,641	$ 48,726	$ 52,784	$ 4,972	$ 57,756

The following table presents the Company's reconciliation of the changes in the fair value of Level 3 derivatives in the fair value hierarchy:

Puget Energy and Puget Sound Energy	Three Months Ended September 30,					
(Dollars in Thousands)	2019			2018		
Level 3 Roll-Forward Net Asset/(Liability)	Electric	Natural Gas	Total	Electric	Natural Gas	Total
Balance at beginning of period	$ (2,446)	$ 2,398	$ (48)	$ 2,009	$ 3,949	$ 5,958
Changes during period:						
Realized and unrealized energy derivatives:						
Included in earnings[1]	(4,611)	—	(4,611)	67	—	67
Included in regulatory assets / liabilities	—	206	206	—	930	930
Settlements	2,529	(1,167)	1,362	(945)	(2,217)	(3,162)
Transferred into Level 3	—	—	—	(150)	—	(150)
Transferred out of Level 3	—	—	—	396	514	910
Balance at end of period	$ (4,528)	$ 1,437	$ (3,091)	$ 1,377	$ 3,176	$ 4,553

Puget Energy and Puget Sound Energy

(Dollars in Thousands)	Nine Months Ended September 30,					
	2019			2018		
Level 3 Roll-Forward Net Asset/(Liability)	Electric	Natural Gas	Total	Electric	Natural Gas	Total
Balance at beginning of period	$ 1,362	$ 1,673	$ 3,035	$ 1,098	$ 1,923	$ 3,021
Changes during period:						
Realized and unrealized energy derivatives:						
Included in earnings[2]	1,524	—	1,524	2,052	—	2,052
Included in regulatory assets / liabilities	—	2,485	2,485	—	6,260	6,260
Settlements	(10,380)	(3,885)	(14,265)	(1,599)	(5,819)	(7,418)
Transferred into Level 3	4,390	(400)	3,990	(1,987)	—	(1,987)
Transferred out of Level 3	(1,424)	1,564	140	1,813	812	2,625
Balance at end of period	$ (4,528)	$ 1,437	$ (3,091)	$ 1,377	$ 3,176	$ 4,553

1. *Income Statement locations: Unrealized (gain) loss on derivative instruments, net. Amounts include unrealized gains (losses) on derivatives still held in position as of the reporting date for electric derivatives of $(4.5) million and $(0.1) million for the three months ended September 30, 2019 and 2018*, respectively.

2. *Income Statement locations: Unrealized (gain) loss on derivative instruments, net. Amounts include unrealized gains (losses) on derivatives still held in position as of the reporting date for electric derivatives of $(4.4) million and $1.4 million for the nine months ended September 30, 2019 and 2018*, respectively.

Realized gains and losses on energy derivatives for Level 3 recurring items are included in energy costs in the Company's consolidated statements of income under purchased electricity, electric generation fuel or purchased natural gas when settled. Unrealized gains and losses on energy derivatives for Level 3 recurring items are included in net unrealized (gain) loss on derivative instruments in the Company's consolidated statements of income.

In order to determine which assets and liabilities are classified as Level 3, the Company receives market data from its independent external pricing service defining the tenor of observable market quotes. To the extent any of the Company's commodity contracts extend beyond what is considered observable, as defined by its independent pricing service, the contracts are classified as Level 3. The actual tenor of what the independent pricing service defines as observable is subject to change depending on market conditions. Therefore, as the market changes, the same contract may be designated Level 3 one month and Level 2 the next and vice versa. The changes of fair value classification into or out of Level 3 are recognized each month and reported in the Level 3 Roll-Forward tables. The Company did not have any transfers between Level 1 and Level 2 during the reported periods. The Company does periodically transact at locations or market price points that are illiquid or for which no prices are available from the independent pricing service. In such circumstances, the Company uses a more liquid price point and performs a 15-month regression against the illiquid locations to serve as a proxy for forward market prices. Such transactions are classified as Level 3. The Company does not use internally developed models to make adjustments to significant unobservable pricing inputs.

The only significant unobservable input into the fair value measurement of the Company's Level 3 assets and liabilities is the forward price for electric and natural gas contracts. The following table presents the forward price ranges for the Company's Level 3 commodity contracts as of September 30, 2019:

Puget Energy and Puget Sound Energy

	Fair Value				Range		
(Dollars in Thousands)	Assets[1]	Liabilities[1]	Valuation Technique	Unobservable Input	Low	High	Weighted Average
Electric	$ 871	$ 5,399	Discounted cash flow	Power prices (per MWh)	$ 6.35	$ 40.04	$ 31.32
Natural gas	$ 1,679	$ 242	Discounted cash flow	Natural gas prices (per MMBtu)	$ 1.84	$ 2.48	$ 2.11

1 *The valuation techniques, unobservable inputs and ranges are the same for asset and liability positions.*

The following table presents the forward price ranges for the Company's Level 3 commodity contracts as of December 31, 2018:

Puget Energy and Puget Sound Energy	Fair Value				Range		
(Dollars in Thousands)	Assets[1]	Liabilities[1]	Valuation Technique	Unobservable Input	Low	High	Weighted Average
Electric	$ 4,522	$ 3,160	Discounted cash flow	Power prices (per MWh)	$ 11.35	$ 66.45	$ 29.63
Natural gas	$ 3,485	$ 1,812	Discounted cash flow	Natural gas prices (per MMBtu)	$ 1.84	$ 5.80	$ 3.18

[1] *The valuation techniques, unobservable inputs and ranges are the same for asset and liability positions.*

The significant unobservable inputs listed above would have a direct impact on the fair values of the above instruments if they were adjusted. Consequently, significant increases or decreases in the forward prices of electricity or natural gas in isolation would result in a significantly higher or lower fair value for Level 3 assets and liabilities. Generally, interrelationships exist between market prices of natural gas and power. As such, an increase in natural gas pricing would potentially have a similar impact on forward power markets. As of September 30, 2019 and December 31, 2018, a hypothetical 10.0% increase or decrease in market prices of natural gas and electricity would change the fair value of the Company's derivative portfolio, classified as Level 3 within the fair value hierarchy, by $1.9 million and $2.6 million, respectively.

Long-Lived Assets Measured at Fair Value on a Nonrecurring Basis

Puget Energy records the fair value of its intangible assets in accordance with ASC 360, “Property, Plant, and Equipment,” (ASC 360). The fair value assigned to the power contracts was determined using an income approach comparing the contract rate to the market rate for power over the remaining period of the contracts incorporating non-performance risk. Management also incorporated certain assumptions related to quantities and market presentation that it believes market participants would make in the valuation. The fair value of the power contracts is amortized as the contracts settle.

ASC 360 requires long-lived assets to be tested for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. One such triggering event is a significant decrease in the forward market prices of power.

As of September 30, 2019, Puget Energy completed valuation and impairment testing of its power purchase contracts classified as intangible assets and found no impairment. The valuations were measured using a discounted cash flow, income-based valuation methodology. Significant inputs included forward electricity prices and power contract pricing which provided future net cash flow estimates classified as Level 3 within the fair value hierarchy.

(6) Retirement Benefits

PSE has a defined benefit pension plan (Qualified Pension Benefits) covering a substantial majority of PSE employees. PSE also maintains a non-qualified supplemental executive retirement plan (SERP) for certain key senior management employees. Officers hired after January 2019 participate in an Officer Restoration Benefit as part of the Deferred Compensation Plan for Key Employees. In addition to providing pension benefits, PSE provides legacy group health care and life insurance benefits (Other Benefits) for certain retired employees. Puget Energy's retirement plans were re-measured as a result of the merger in 2009, which represents the difference between Puget Energy and PSE's retirement plans.

The following tables summarize the Company's net periodic benefit cost for the three months and nine months ended September 30, 2019 and 2018:

Puget Energy	Qualified Pension Benefits		SERP Pension Benefits		Other Benefits	
	Three Months Ended September 30,					
(Dollars in Thousands)	2019	2018	2019	2018	2019	2018
Components of net periodic benefit cost:						
Service cost	$ 6,418	$ 6,218	$ 256	$ 212	$ 13	$ 17
Interest cost	7,252	6,917	578	530	84	113
Expected return on plan assets	(12,439)	(12,533)	—	—	(100)	(119)
Amortization of prior service cost	(495)	(495)	83	11	—	—
Amortization of net loss (gain)	362	716	341	394	(156)	(80)
Net periodic benefit cost	$ 1,098	$ 823	$ 1,258	$ 1,147	$ (159)	$ (69)

Puget Energy	Qualified Pension Benefits		SERP Pension Benefits		Other Benefits	
	Nine Months Ended September 30,					
(Dollars in Thousands)	2019	2018	2019	2018	2019	2018
Components of net periodic benefit cost:						
Service cost	$ 16,992	$ 17,068	$ 768	$ 635	$ 46	$ 52
Interest cost	21,685	20,477	1,735	1,590	308	333
Expected return on plan assets	(37,686)	(37,652)	—	—	(295)	(354)
Amortization of prior service cost	(1,485)	(1,485)	249	33	—	—
Amortization of net loss (gain)	863	1,640	1,024	1,185	(281)	(252)
Net periodic benefit cost	$ 369	$ 48	$ 3,776	$ 3,443	$ (222)	$ (221)

Puget Sound Energy	Qualified Pension Benefits		SERP Pension Benefits		Other Benefits	
	Three Months Ended September 30,					
(Dollars in Thousands)	2019	2018	2019	2018	2019	2018
Components of net periodic benefit cost:						
Service cost	$ 6,418	$ 6,218	$ 256	$ 212	$ 13	$ 17
Interest cost	7,252	6,917	578	530	84	113
Expected return on plan assets	(12,443)	(12,542)	—	—	(100)	(119)
Amortization of prior service cost	(393)	(393)	83	11	—	—
Amortization of net loss (gain)	3,328	3,928	433	517	(202)	(134)
Net periodic benefit cost	$ 4,162	$ 4,128	$ 1,350	$ 1,270	$ (205)	$ (123)

Puget Sound Energy	Qualified Pension Benefits		SERP Pension Benefits		Other Benefits	
	Nine Months Ended September 30,					
(Dollars in Thousands)	2019	2018	2019	2018	2019	2018
Components of net periodic benefit cost:						
Service cost	$ 16,992	$ 17,068	$ 768	$ 635	$ 46	$ 52
Interest cost	21,685	20,477	1,735	1,590	308	333
Expected return on plan assets	(37,700)	(37,680)	—	—	(295)	(354)
Amortization of prior service cost	(1,180)	(1,180)	250	33	—	—
Amortization of net loss (gain)	9,657	11,188	1,300	1,552	(421)	(417)
Net periodic benefit cost	$ 9,454	$ 9,873	$ 4,053	$ 3,810	$ (362)	$ (386)

The following table summarizes the Company's change in benefit obligation for the periods ended September 30, 2019 and December 31, 2018:

Puget Energy and Puget Sound Energy	Qualified Pension Benefits		SERP Pension Benefits		Other Benefits	
(Dollars in Thousands)	Nine Months Ended September 30, 2019	Year Ended December 31, 2018	Nine Months Ended September 30, 2019	Year Ended December 31, 2018	Nine Months Ended September 30, 2019	Year Ended December 31, 2018
Change in benefit obligation:						
Benefit obligation at beginning of period	$ 677,643	$ 700,481	$ 55,708	$ 55,754	$ 10,636	$ 11,454
Amendments	—	—	—	1,446	—	—
Service cost	16,992	22,757	768	847	46	69
Interest cost	21,685	27,303	1,735	2,120	308	444
Actuarial loss (gain)	1,644	(29,067)	—	1,122	(909)	(379)
Benefits paid	(33,619)	(42,662)	(2,297)	(5,581)	(719)	(1,037)
Medicare part D subsidy received	—	—	—	—	226	85
Administrative Expense	—	(1,169)	—	—	—	—
Benefit obligation at end of period	$ 684,345	$ 677,643	$ 55,914	$ 55,708	$ 9,588	$ 10,636

The aggregate expected contributions by the Company to fund the qualified pension plan, SERP and the other postretirement plans for the year ending December 31, 2019 are expected to be at least $18.0 million, $6.2 million and $0.3 million, respectively. During the three months ended September 30, 2019, the Company contributed $18.0 million and $1.3 million to fund the qualified pension plan and SERP, respectively. During the nine months ended September 30, 2019, the Company contributed $18.0 million and $2.3 million to fund the qualified pension plan and SERP, respectively. The Company contributed an immaterial amount to fund the other postretirement plans.

(7) Regulation and Rates

General Rate Case

PSE filed a general rate case (GRC) with the Washington Commission on June 20, 2019 requesting an overall increase in electric and natural gas rates of 6.9% and 7.9% respectively. PSE requested a return on equity of 9.8% with an overall rate of return of 7.62%. In addition to the traditional areas of focus (revenue requirements, cost allocation, rate design and cost of capital), the Company included an attrition adjustment mechanism to address the expected regulatory lag in the rate year. Additionally, as the non-plant related excess deferred taxes that resulted from the Tax Cuts and Jobs Act (TCJA) remained outstanding from PSE's Expedited Rate Filing (ERF) as discussed below, PSE requested in its GRC to pass back the amounts over four years. On September 17, 2019, PSE filed a supplemental filing in the GRC, which provided updates as discussed in our original filing, but did not impact the requested overall electric and natural gas rate increases, return on equity or overall rate of return as originally filed.

Expedited Rate Filing

On November 7, 2018, PSE filed an ERF with the Washington Commission. The filing requested to change rates associated with PSE's delivery and fixed production costs. It did not include variable power costs, purchased gas costs or natural gas pipeline replacement program costs, which are recovered in separate mechanisms. The filing was based on historical test year costs and rate base, and followed the reporting requirements of a Commission Basis Report, as defined by the Washington Administrative Code, but used end of period rate base and certain annualizing adjustments. It did not include any forward-looking or pro-forma adjustments. Included in the filing was a reduction to the overall authorized rate of return from 7.6% to 7.49% to recognize a reduction in debt costs associated with recent debt activity. PSE requested an overall increase in electric rates of $18.9 million annually, which is a 0.9% increase, and an overall increase in natural gas rates of $21.7 million annually, which is a 2.7% increase.

On January 22, 2019, all parties in the proceeding reached an agreement on settlement terms that resolved all issues in the filing. The settlement agreement was filed on January 30, 2019. The parties agreed to a $21.5 million annual increase for natural gas and no rate increase for electric which became effective March 1, 2019. As is discussed below, these rates include the offsetting effect of passing back to customers plant related excess deferred income taxes that resulted from the TCJA, using the average rate assumption method (ARAM) amounts to arrive at the settlement rate changes.

The settlement agreement provides for the pass back of plant related excess deferred income taxes that resulted from the TCJA using the ARAM methodology based on 2018 amounts beginning March 1, 2019, in the amount of $6.1 million for natural gas and $25.9 million for electric. The settlement agreement left the determination for the regulatory treatment of the remaining items related to the TCJA, listed below, to PSE's next GRC, filed June 20, 2019:

1) excess deferred taxes for non-plant- related book/tax differences for periods prior to March 1, 2019,
2) the deferred balance associated with the over-collection of income tax expense for the period January 1 through April 30, 2018 (the time period that encompasses the effective date of the TCJA to May 1, 2018, the effective date of the TCJA rate change); and
3) the turnaround of plant related excess deferred income taxes using the ARAM method for the period from January 2018 through February 2019, the rate effective date for the ERF.

The agreement provides that PSE may defer the depreciation expense associated with PSE's ongoing investment in its advanced metering infrastructure (AMI) investment and may defer the return on the AMI investment that was included in the test year of the filing. The agreement preserves the parties' rights to argue whether or not these deferrals should be recovered in the Company's next GRC. The rate of return adopted in the settlement for reporting and deferral purposes is 7.49%. On February 21, 2019, the Washington Commission approved the settlement with one condition: PSE must pass back the deferred balance associated with the tax over-collection of $34.6 million for the period from January 1, 2018 through April 30, 2018 over a one-year period which began May 1, 2019.

Washington Commission Tax Deferral Filing

The TCJA was signed into law in December 2017. As a result of this change, PSE re-measured its deferred tax balances under the new corporate tax rate. PSE filed an accounting petition on December 29, 2017 requesting deferred accounting treatment for the impacts of tax reform. The requested deferral accounting treatment results in the tax rate change being captured in the deferred income tax balance with an offset to the regulatory liability for deferred income taxes for GAAP purposes. Additionally, on March 30, 2018, PSE filed for a rate change for electric and natural gas customers associated with TCJA to reflect the decrease in the federal corporate income tax rate from 35.0% to 21.0%. The overall impact of the rate change, based on the annual period from May 2018 through April 2019, is a revenue decrease of $72.9 million, or 3.4% for electric and $23.6 million, or 2.7% for natural gas and became effective May 1, 2018 by operation of law.

The March 30, 2018, rate change filing did not address excess deferred taxes or the deferred balance associated with the over-collection of income tax expense of $34.6 million for the period January 1 through April 30, 2018 (the time period that encompasses the effective date of the TCJA through May 1, 2018, the effective date of the rate change). The $34.6 million tax over-collection decreased PSE's revenue and increased the regulatory liability for a refund to customers.

As a result of the Washington Commission's final order in the ERF, the excess deferred taxes associated with non-plant-related book/tax differences and the treatment of the excess deferred taxes associated with plant related book/tax differences from January 1, 2018 through February 28, 2019 was addressed in PSE's GRC, which was filed June 20, 2019. The Washington Commission also required in the ERF order that PSE pass back the deferred balance associated with the tax over-collection for the period from January 1, 2018 through April 30, 2018, as discussed above, over a one-year period which began May 1, 2019.

Decoupling Filings

While fluctuations in weather conditions will continue to affect PSE's billed revenue and energy supply expenses from month to month, PSE's decoupling mechanisms assist in mitigating the impact of weather on operating revenue and net income. Since July 2013, the Washington Commission has allowed PSE to record a monthly adjustment to its electric and natural gas operating revenues related to electric transmission and distribution, natural gas operations and general administrative costs from most residential, commercial and industrial customers to mitigate the effects of abnormal weather, conservation impacts and changes in usage patterns per customer. As a result, these electric and natural gas revenues are recovered on a per customer basis regardless of actual consumption levels. PSE's energy supply costs, which are part of the PCA and PGA mechanisms, are not included in the decoupling mechanism. The revenue recorded under the decoupling mechanisms will be affected by customer growth and not actual consumption. Following each calendar year, PSE will recover from, or refund to, customers the difference between allowed decoupling revenue and the corresponding actual revenue during the following May to April time period.

On December 5, 2017, the Washington Commission approved PSE's request within the 2017 GRC to extend the decoupling mechanism with several changes to the methodology that took effect on December 19, 2017. Electric and natural gas delivery revenues continue to be recovered on a per customer basis and electric fixed production energy costs are now decoupled and recovered on the basis of a fixed monthly amount. The allowed decoupling revenue for electric and natural gas customers will no longer increase annually each January 1 as occurred prior to December 19, 2017. Approved revenue per customer costs can only be changed in a GRC or ERF. Approved electric fixed production energy costs can also be changed in a power cost only rate case (PCORC). Other changes to the decoupling methodology approved by the Washington Commission include regrouping of electric and natural gas non-residential customers and the exclusion of certain electric schedules from the decoupling mechanism going forward. The rate test, which limits the amount of revenues PSE can collect in its annual filings, increased from 3.0% to 5.0% for natural gas customers but will remain at 3.0% for electric customers. The decoupling mechanism will be reviewed again in PSE's first rate case filed in or after 2021, or in a separate proceeding, if appropriate. PSE's decoupling mechanism over- and under-collections will still be collectible or refundable after this effective date even if the decoupling mechanism is not extended.

On February 21, 2019, the Washington Commission approved the multi-party settlement agreement which was filed within PSE's ERF filing. As part of this settlement agreement, electric and natural gas allowed delivery revenue per customer was updated to reflect changes in the approved revenue requirement. For electric, there were no changes to the annual allowed fixed power cost revenue. The changes took effect on March 1, 2019.

On September 30, 2019, PSE performed an analysis to determine if electric and natural gas decoupling revenue deferrals would be collected from customers within 24 months of the annual period, per ASC 980. If not, for GAAP purposes only, PSE would need to record a reserve against the decoupling revenue and regulatory asset balance. Once the reserve is probable of collection within 24 months from the end of the annual period, the reserve can be recognized as decoupling revenue. The analysis indicated that all of electric and natural gas deferred revenue will be collected within 24 months of the annual period; therefore, no adjustment was booked to 2019 decoupling revenue.

Electric Regulation and Rates

Storm Damage Deferral Accounting

The Washington Commission issued a GRC order that defined deferrable storm events and provided that costs in excess of the annual cost threshold may be deferred for qualifying storm damage costs that meet the modified Institute of Electrical and Electronics Engineers outage criteria for system average interruption duration index. For the nine months ended September 30, 2019, PSE incurred $39.3 million in storm-related electric transmission and distribution system restoration costs, of which the Company deferred $28.5 million and $0.4 million as regulatory assets related to storms that occurred in 2019 and 2018, respectively. This compares to $8.9 million incurred in storm-related electric transmission and distribution system restoration costs for the nine months ended September 30, 2018, of which no amount was deferred to a regulatory asset. Under the December 5, 2017 Washington Commission order regarding PSE's GRC, the following changes to PSE's storm deferral mechanism were approved: (i) the cumulative annual cost threshold for deferral of storms under the mechanism increased from $8.0 million to $10.0 million effective January 1, 2018; and (ii) qualifying events where the total qualifying cost is less than $0.5 million will not qualify for deferral and these costs will also not count toward the $10.0 million annual cost threshold.

(8) Commitments and Contingencies

Colstrip

PSE has a 50% ownership interest in Colstrip Units 1 and 2 and a 25% interest in Colstrip Units 3 and 4. In March 2013, the Sierra Club and the Montana Environmental Information Center filed a Clean Air Act citizen suit against all Colstrip owners in the U.S. District Court, District of Montana. In July 2016, PSE reached a settlement with the Sierra Club to dismiss all of the Clean Air Act allegations against the Colstrip Generating Station, which was approved by the court in September 2016. As part of the settlement that was signed by all Colstrip owners, Colstrip 1 and 2 owners, PSE and Talen Energy, agreed to retire the two oldest units (Units 1 and 2) at Colstrip in eastern Montana no later than July 1, 2022. Depreciation rates were updated in the GRC effective December 19, 2017, where PSE's depreciation increased for Colstrip Units 1 and 2 to recover plant costs to the expected shutdown date. Additionally, PSE has accelerated the depreciation of Colstrip Units 3 and 4, per the terms of the GRC settlement, to December 31, 2027. The GRC also repurposed PTCs and hydro-related treasury grants to recover unrecovered plant costs and to fund and recover decommissioning and remediation costs for Colstrip Units 1 through 4.

On June 11, 2019, Talen made a public announcement that Colstrip 1 and 2 will be shut down at the end of the year due to operational losses associated with the Units. The regulatory asset associated with early retirement of Colstrip Units 1 and 2 increased from $130.7 million as of December 31, 2018, to $178.2 million as of September 30, 2019. The Washington Clean Energy Transition Act requires the Washington Commission to provide recovery of the investment, decommissioning, and remediation costs associated with the facilities that are not recovered through the repurposed PTC's and hydro-related treasury grants. The full scope of decommissioning activities and costs may vary from the estimates that are available at this time.

Other Commitments and Contingencies

There have been no material changes to the contractual obligations and consolidated commercial commitments disclosed in Note 16, "Commitments and Contingencies" to the consolidated financial statements included in Item 8 of the Company's Form 10-K for the period ended December 31, 2018.

(9) Leases

PSE has operating leases for buildings for corporate offices and operations, real estate for operating facilities and the PSE and PLNG LNG facility, land for our wind farms, and vehicles for PSE’s fleet. The finance leases are for office printers. The leases have remaining lease terms of less than a year to 26 years, some of which include options to extend the leases for up to 25 years.

The components of lease expense were as follows:

Puget Energy and Puget Sound Energy	Three Months Ended September 30,	Nine Months Ended September 30,
(Dollars in Thousands)	2019	2019
Finance lease cost:		
Amortization of right-of-use asset	$ 128	$ 410
Interest on lease liabilities	10	29
Total finance lease cost	$ 138	$ 439
Operating lease cost[1]	$ 5,311	$ 15,318

[1] *Includes $0.3 million and $0.8 million allocated to PLNG at PE related to the Tacoma land lease at three and nine months ended September 30, 2019, respectively.*

Supplemental cash flow information related to leases was as follows:

Puget Energy and Puget Sound Energy (Dollars in Thousands)	Three Months Ended September 30, 2019	Nine Months Ended September 30, 2019
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows for operating leases	$ (3,678)	$ (10,437)
Investing cash flow for operating leases[1]	(1,633)	(4,881)
Operating cash flow for finance leases	(10)	(29)
Financing cash flows for finances leases	(129)	(410)

[1] *Includes $0.3 million and $0.8 million allocated to PLNG at PE related to the Tacoma land lease at three and nine months ended September 30, 2019, respectively.*

Supplemental balance sheet information related to leases was as follows:

Puget Sound Energy (Dollars in Thousands)	At September 30, 2019
Operating Leases	
Operating lease right-of-use asset	$ 168,491
Operating leases liabilities current	$ (15,173)
Operating lease liabilities long-term	(159,913)
Total Operating lease liabilities:	$ (175,086)
Finance Leases	
Common Plant	$ 1,268
Other current liabilities	$ (585)
Other deferred credits	(682)
Total finance lease liabilities	$ (1,267)
Weighted Average Remaining Lease Term	
Operating leases	13.15 years
Finance leases	2.96 years
Weighted Average Discount Rate	
Operating leases	3.77%
Finance leases	2.98%
Supplemental Non-cash Information on Lease Liabilities Arising from Obtaining New Right-of-Use Assets	
Operating leases	$ 2,032
Finance leases	$ 373

The following tables summarize the Company's estimated future minimum lease payments as of September 30, 2019, and December 31, 2018, respectively:

Maturities of lease liabilities (Dollars in Thousands)	Future Minimum Lease Payments	
At September 30,	Operating Leases	Finance Leases
2019 (remaining three months)	$ 4,968	$ 133
2020	21,514	554
2021	21,791	416
2022	21,375	184
2023	20,935	25
Thereafter	135,492	—
Total lease payments	226,075	1,312
Less imputed interest	(50,989)	(45)
Total	$ 175,086	$ 1,267

Maturities of lease liabilities (Dollars in Thousands)	Future Minimum Lease Payments	
At December 31,	Operating Leases	Finance Leases
2019	$ 20,635	$ 495
2020	20,704	446
2021	20,630	311
2022	20,202	82
2023	19,223	—
Thereafter	132,889	—
Total minimum lease payments	$ 234,283	$ 1,334

(10) Other

Long-Term Debt

In April 2019, Puget Energy entered into an additional $24.0 million of supplemental loans under the expansion feature of the term loan agreement with the existing lenders. All other terms and conditions of the agreement remain unchanged. The proceeds from the term loan and supplemental loans will be used to repay borrowings under the revolving credit facility, which carries a higher interest rate.

On August 30, 2019, PSE issued $450.0 million of senior notes at an interest rate of 3.25%. The notes pay interest semi-annually and are due to mature on September 15, 2049. Proceeds from the sale of the notes were used to repay outstanding short-term debt under the Company's commercial paper program.

On September 26, 2019, Puget Energy entered into a separate $210.0 million, 3 years term loan agreement with a small group of banks. The agreement allows Puget Energy to borrow at either the banks' prime rate or LIBOR plus a spread, which will vary as those base rates fluctuate over the loan period. The Term Loan Agreement also includes an expansion feature, pursuant to which Puget Energy may request to increase the aggregate amount of the Term Loan Agreement, obtain incremental term loans or any combination of increases and incremental term loans in an amount up to $100.0 million. The proceeds from the term loan were contributed as equity to PSE and used to repay outstanding short term debt under the Company's commercial paper program.

For further information, see Note 7, "Long-Term Debt" and Note 8, "Liquidity Facilities and Other Financing Arrangements" in the Company's most recent Annual Report on Form 10K for the year ended December 31, 2018.

Item 2. **Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the financial statements and related notes thereto included elsewhere in this report on Form 10-Q. The discussion contains forward-looking statements that involve risks and uncertainties, such as Puget Energy, Inc. (Puget Energy) and Puget Sound Energy, Inc. (PSE) objectives, expectations and intentions. Words or phrases such as "anticipates," "believes," "continues," "could," "estimates," "expects," "future," "intends," "may," "might," "plans," "potential," "predicts," "projects," "should," "will likely result," "will continue" and similar expressions are intended to identify certain of these forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. Puget Energy's and PSE's actual results could differ materially from results that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Forward-Looking Statements" included elsewhere in this report and in the section entitled "Risk Factors" included in Part I, Item 1A in Puget Energy's and Puget Sound Energy's Form 10-K for the period ended December 31, 2018. Except as required by law, neither Puget Energy nor PSE undertakes any obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made in this report and in Puget Energy's and PSE's other reports filed with the U.S. Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect Puget Energy's and PSE's business, prospects and results of operations.

Overview

Puget Energy is an energy services holding company and substantially all of its operations are conducted through its subsidiary PSE, a regulated electric and natural gas utility company. PSE is the largest electric and natural gas utility in the state of Washington, primarily engaged in the business of electric transmission, distribution and generation and natural gas distribution. Puget Energy's business strategy is to generate stable cash flows by offering reliable electric and natural gas service in a cost-effective manner through PSE. Puget Energy also has a wholly-owned non-regulated subsidiary, Puget LNG, LLC (Puget LNG), which has the sole purpose of owning, developing and financing the non-regulated activity of the Tacoma liquefied natural gas (LNG) facility, currently under construction. All of Puget Energy's common stock is indirectly owned by Puget Holdings, LLC (Puget Holdings). Puget Holdings is owned by a consortium of long-term infrastructure investors including the Canada Pension Plan Investment Board, the British Columbia Investment Management Corporation (BCIMC), the Alberta Investment Management Corporation (AIMCo), Ontario Municipal Employee Retirement System (OMERS) and PGGM Vermogensbeheer B.V. The sale of previous owners', Macquarie Infrastructure Partners and Macquarie Capital Group Limited, shares to OMERS, PGGM Vermogensbeheer B.V., AIMCo and BCIMC was approved by various federal and state agencies, including that of the Washington Utilities and Transportation Commission (Washington Commission), and closed on April 17th, 2019. Puget Energy and PSE are collectively referred to herein as "the Company."

PSE generates revenue and cash flow primarily from the sale of electric and natural gas services to residential and commercial customers within a service territory covering approximately 6,000 square miles, principally in the Puget Sound region of the state of Washington. PSE continually balances its load requirements, generation resources, purchase power agreements, and market purchases to meet customer demand. The Company's external financing requirements principally reflect the cash needs of its construction program, its schedule of maturing debt and certain operational needs. PSE requires access to bank and capital markets to meet its financing needs.

Further detail regarding the factors and trends affecting performance of the Company during the fiscal quarter ended September 30, 2019 is set forth below in this "Overview" section as well as in other sections of Management's Discussion and Analysis.

Factors and Trends Affecting PSE's Performance

The principal business, economic and other factors that affect PSE's operations and financial performance include:

- The rates PSE is allowed to charge for its services;
- PSE's ability to recover power costs that are included in rates which are based on volume;
- Weather conditions, including the impact of temperature on customer load; the impact of extreme weather events on budgeted maintenance costs; meteorological conditions such as snow-pack, stream-flow and wind-speed which affect power generation, supply and price;
- Regulatory decisions allowing PSE to recover purchased power and fuel costs, on a timely basis;
- PSE's ability to supply electricity and natural gas, either through company-owned generation, purchase power contracts or by procuring natural gas or electricity in wholesale markets;
- Equal sharing between PSE and its customers of earnings which exceed PSE's authorized rate of return (ROR);
- Availability and access to capital and the cost of capital;
- Regulatory compliance costs, including those related to new and developing federal regulations of electric system reliability, state regulations of natural gas pipelines and federal, state and local environmental laws and regulations;
- Wholesale commodity prices of electricity and natural gas;
- Increasing capital expenditures with additional depreciation and amortization;
- Tax reform, the effect of lower tax rates, and regulatory treatment of excess deferred tax balances on rate base and customer rates;
- General economic conditions in PSE's service territory and its effects on customer growth and use-per-customer; and
- Federal, state, and local taxes.

Regulation of PSE Rates and Recovery of PSE Costs

PSE's regulatory requirements and operational needs require the investment of substantial capital in 2019 and future years. As PSE intends to seek recovery of these investments through the regulatory process, its financial results depend heavily upon outcomes from that process. The rates that PSE is allowed to charge for its services influence its financial condition, results of operations and liquidity. PSE is highly regulated and the rates that it charges its retail customers are approved by the Washington Commission. The Washington Commission has traditionally required these rates be determined based, to a large extent, on historic test year costs plus weather normalized assumptions about hydroelectric conditions and power costs in the relevant rate year. Incremental customer growth and sales typically have not provided sufficient revenue to cover general cost increases over time due to the combined effects of regulatory lag and attrition. Accordingly, under existing modified historical ratemaking, the Company will need to seek rate relief through a rate case on a regular and frequent basis in the foreseeable future after the investment is made. In addition, the Washington Commission determines whether the Company's expenses and capital investments are reasonable and prudent for the provision of cost-effective, reliable and safe electric and natural gas service. If the Washington Commission determines that an expense or capital investment is not reasonable or prudent, the costs (including return on any resulting rate base) may be disallowed, partially or entirely, and not recovered in rates.

Washington state law also requires PSE to pursue electric conservation that is cost-effective, reliable and feasible. PSE's mandate to pursue electric conservation initiatives may have a negative impact on the electric business financial performance due to lost margins from lower sales volumes as variable power costs are not part of the decoupling mechanism. Although not specified by Washington state law, the Washington Commission also sets natural gas conservation achievement standards for PSE. The effects of achieving these standards will, however, have only a slight negative impact on natural gas business financial performance due to the natural gas business being almost fully decoupled.

General Rate Case Filing

PSE filed a general rate case (GRC) with the Washington Commission on June 20, 2019 requesting an overall increase in electric and natural gas rates of 6.9% and 7.9% respectively. PSE requested a return on equity of 9.8% with an overall rate of return of 7.62%. In addition to the traditional areas of focus (revenue requirements, cost allocation, rate design and cost of capital), the Company included an attrition adjustment mechanism to address the expected regulatory lag in the rate year. Additionally, as the non-plant related excess deferred taxes that resulted from the Tax Cuts and Jobs Act (TCJA) remained outstanding from PSE's Expedited Rate Filing (ERF) as discussed below, PSE requested in its GRC to pass back the amounts over four years. On September 17, 2019, PSE filed a supplemental filing in the GRC, which provided updates as discussed in our original filing, but did not impact the requested overall electric and natural gas rate increases, return on equity or overall rate of return as originally filed.

Expedited Rate Filing

On November 7, 2018, PSE filed an ERF with the Washington Commission. On January 22, 2019, all parties in the proceeding reached an agreement on settlement terms. The settlement agreement was filed on January 30, 2019. On February 21, 2019, the Washington Commission approved the settlement with one condition: PSE must pass back the deferred balance associated with the tax over-collection of $34.6 million from January 1, 2018, through April 30, 2018, over a one-year period which began May 1, 2019.

Washington Commission Tax Deferral Filing

The TCJA was signed into law in December 2017. As a result of this change, PSE re-measured its deferred tax balances under the new corporate tax rate. PSE filed an accounting petition on December 29, 2017 requesting deferred accounting treatment for the impacts of tax reform. The deferred accounting treatment results in the tax rate change being captured in the deferred income tax balance with an offset to the regulatory liability for deferred income taxes. Additionally, on March 30, 2018, PSE filed for a rate change for electric and natural gas customers associated with TCJA to reflect the decrease in the federal corporate income tax rate from 35% to 21%. Other outcomes associated with PSE's tax deferral filing are discussed in the ERF and GRC disclosures.

The Washington Commission approved the following PSE requests to change rates to reflect the new corporate tax rates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
Electric:		
May 1, 2018	(3.4)%	$(72.9)
Natural Gas:		
May 1, 2018	(2.7)	(23.6)

Decoupling Filings

On December 5, 2017, the Washington Commission approved PSE's request within the 2017 GRC to extend the decoupling mechanism with some changes to the methodology that took effect on December 19, 2017. Electric and natural gas delivery revenues will continue to be recovered on a per customer basis and electric fixed production energy costs will now be decoupled and recovered on the basis of a fixed monthly amount. Approved revenue per customer costs can only be changed in a GRC or ERF. Approved electric fixed production energy costs can also be changed in a power cost only rate case (PCORC). Other changes to the decoupling methodology approved by the Washington Commission include regrouping of electric and natural gas non-residential customers and the exclusion of certain electric schedules from the decoupling mechanism going forward. The rate cap which limits the amount of previously deferred revenues PSE can collect in its annual filings increased from 3.0% to 5.0% for natural gas customers but will remain at 3.0% for electric customers. The decoupling mechanism is to be reviewed again in PSE's first GRC filed in or after 2021, or in a separate proceeding, if appropriate. PSE's decoupling mechanism over- and under- collections will still be collectible or refundable after this effective date even if the decoupling mechanism is not extended.

On February 21, 2019, the Washington Commission approved the multi-party settlement agreement which was filed within PSE's ERF filing. As part of this settlement agreement, electric and natural gas allowed delivery revenue per customer was updated to reflect changes in the approved revenue requirement. For electric, there were no changes to the annual allowed fixed power cost revenue. The changes took effect on March 1, 2019.

On September 30, 2019, PSE performed an analysis to determine if electric and natural gas decoupling revenue deferrals would be collected from customers within 24 months of the annual period, per ASC 980. If not, for GAAP purposes only, PSE would need to record a reserve against the decoupling revenue and regulatory asset balance. Once the reserve is probable of collection within 24 months from the end of the annual period, the reserve can be recognized as decoupling revenue. The analysis indicated that all of electric and natural gas deferred revenue will be collected within 24 months of the annual period; therefore, no adjustment was booked to 2019 decoupling revenue.

The Washington Commission approved the following PSE requests to change rates for prior deferrals under its electric and natural gas decoupling mechanisms:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)[1]
Electric:		
May 1, 2019	0.9%	$20.6
May 1, 2018	(1.1)	(25.2)
Natural Gas:		
May 1, 2019	(5.3)%	$(45.9)
May 1, 2018	1.7	15.9

[1] *There were no excess earnings for either electric or natural for the rates effective May 1, 2019. The increase in revenue is net of reductions from excess earnings of $10.0 million for electric and $4.9 million for natural gas effective May 1, 2018.*

Electric Rates

Power Cost Adjustment Mechanism

PSE currently has a power cost adjustment (PCA) mechanism that provides for the deferral of power costs that vary from the "power cost baseline" level of power costs. The "power cost baseline" levels are set, in part, based on normalized assumptions about weather and hydroelectric conditions. Excess power costs or savings are apportioned between PSE and its customers pursuant to the graduated scale set forth in the PCA mechanism and will trigger a surcharge or refund when the cumulative deferral trigger is reached.

Effective January 1, 2017 the following graduated scale is used in the PCA mechanism:

	Company's Share		Customers' Share	
Annual Power Cost Variability	Over	Under	Over	Under
Over or Under Collected by up to $17 million	100%	100%	—%	—%
Over or Under Collected by between $17 million - $40 million	35	50	65	50
Over or Under Collected beyond $40 + million	10	10	90	90

In September 2016, PSE filed an accounting petition with the Washington Commission which requested deferral of the variances, either positive or negative, between the fixed costs previously recovered in the PCA and the revenue received to cover the allowed fixed costs. The deferral period requested was January 1, 2017, through December 31, 2017, when rates went into effect from PSE's 2017 GRC. In November 2016, the Washington Commission issued Order No. 01 approving PSE's accounting petition. With the final determination in PSE's GRC, this deferral ceased with the rate effective date of December 19, 2017.

For the nine months ended September 30, 2019, in its PCA mechanism, PSE under-recovered its power costs by $48.9 million of which $19.5 million amount was apportioned to customers. This compares to an under-recovery of power costs of $7.7 million for the nine months ended September 30, 2018 of which no amounts were apportioned to customers. Power costs have been higher than the allowed base line in 2019 which has led to an increase in the PCA deferral causing an under-collection compared to the prior year. Actual power costs were less than baseline rates in 2018 which caused an over-collection. Load increased 4.2% year over year which is one driver of increased power cost. This was driven by colder temperatures in February and early March. Additionally, power prices increased during the period as compared to the prior year. Increase in prices are due to: (i) Cold weather in February and early March which drove regional loads up; (ii) Westcoast pipeline capacity limitations contributed to higher natural gas and power prices; (iii) An outage on a transmission line contributed to a liquidity crisis at Mid-C, resulting in high market power prices; and (iv)) The relative prices of natural gas and power reduced the supply of natural gas-fired generation and increased the demand for market power, increasing prices.

Power Cost Adjustment Clause Filing

PSE updated its rates under Schedule 95 its Power Cost Adjustment Clause tariff to reflect the transition fee as required by Section 12 of the Microsoft Special Contract.

The following table sets forth the rate change approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
July 1, 2019	(1.2)%	$(24.9)

Electric Conservation Rider

The electric conservation rider collects revenue to cover the costs incurred in providing services and programs for conservation. Rates change annually on May 1 to collect the annual budget that started the prior January and to true-up for actual compared to forecast conservation expenditures from the prior year, as well as actual compared to the forecasted load set in rates.

The following table sets forth conservation rider rate adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2019	(0.9)%	$(17.5)
May 1, 2018	(0.8)	(18.0)

Electric Property Tax Tracker Mechanism

The purpose of the property tax tracker mechanism is to pass through the cost of all property taxes incurred by the Company. The mechanism was implemented in 2013 and removed property taxes from general rates and included those costs for recovery in an adjusting tariff rate. After the implementation, the mechanism acts as a tracker rate schedule and collects the total amount of property taxes assessed. The tracker is adjusted each year in May based on that year's assessed property taxes and true-up from the prior year.

The following table sets forth property tax tracker mechanism rate adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2019	(0.2)%	$(5.1)
May 1, 2018	(0.1)	(1.3)

Federal Incentive Tracker Tariff

The Federal Incentive Tracker Tariff passes through to customers the benefits associated with the wind-related treasury grants. The filing results in a credit back to customers for pass-back of treasury grant amortization and pass-through of interest and any related true-ups. The filing is adjusted annually for new Federal benefits, actual versus forecast interest and to true-up for actual load being different than the forecasted load set in rates. Rates change annually on January 1. Additionally, this tracker is impacted by the TCJA previously discussed. Accordingly, PSE filed for a one-time rate change to be effective May 1, 2018 to recognize the decrease in the federal corporate income tax rate from 35% to 21%.

The following table sets forth the federal incentive tracker tariff revenue requirement proposed and approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates from prior year	Total credit to be passed back to eligible customers (Dollars in Millions)
January 1, 2020 - proposed	—%	$(37.8)
January 1, 2019	0.1	(38.7)
May 1, 2018	0.4	(40.1)
January 1, 2018	0.2	(48.2)

Residential Exchange Benefit

The residential exchange program passes through the residential exchange program benefits that PSE receives from the Bonneville Power Administration. Rates change biennially on October 1.

The following table sets forth residential exchange benefit adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Total credit to be passed back to eligible customers (Dollars in Millions)
October 12, 2019	—%	$(81.8)
October 1, 2017	(0.6)	(80.8)

Natural Gas Rates

Natural Gas Conservation Rider

The natural gas conservation rider collects revenue to cover the costs incurred in providing services and programs for conservation. Rates change annually on May 1 to collect the annual budget that started the prior January and to true-up for actual compared to forecast conservation expenditures from the prior year, as well as actual compared to the forecasted load set in rates.

The following table sets forth conservation rider rate adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2019	0.1%	$1.1

Natural Gas Property Tax Tracker Mechanism

The purpose of the property tax tracker mechanism is to pass through the cost of all property taxes incurred by the Company. The mechanism was implemented in 2013 and removed property taxes from general rates and included those costs for recovery in an adjusting tariff rate. After the implementation, the mechanism acts as a tracker rate schedule and collects the total amount of property taxes assessed. The tracker is adjusted each year in May based on that year's assessed property taxes and adjustments to the rate from the prior year.

The following table sets forth property tax tracker mechanism rate adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE’s revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2019	(0.2)%	$(1.6)
May 1, 2018	(0.2)	(2.2)

Natural Gas Cost Recovery Mechanism

The purpose of the cost recovery mechanism (CRM) is to recover capital costs related to projects included in PSE's pipe replacement program plan on file with the Washington Commission with the intended effect of enhancing the safety of the natural gas distribution system. Rates change annually on November 1.

The following table sets forth CRM rate adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE’s revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
November 1, 2019	0.8%	$7.0
November 1, 2018	0.5	5.0

Purchased Gas Adjustment

PSE has a PGA mechanism that allows PSE to recover expected natural gas supply and transportation costs and defer, as a receivable or liability, any natural gas supply and transportation costs that exceed or fall short of this expected natural gas cost amount in PGA mechanism rates, including accrued interest. PSE is authorized by the Washington Commission to accrue carrying costs on PGA receivable and payable balances. A receivable or payable balance in the PGA mechanism reflects an under recovery or over recovery, respectively, of natural gas cost through the PGA mechanism. Rates typically change annually on November 1st although out-of-cycle rate changes are allowed at other times of the year if needed.

On April 25, 2019, the Washington Commission approved PSE’s request for an out-of-cycle change to PGA rates with the rate change taking effect May 1, 2019. The out-of-cycle PGA filing was needed to begin amortizing a large PGA commodity deferral balance that had grown due to higher than projected commodity costs during the 2018/19 winter. These higher than projected commodity costs were primarily due to an October 9, 2018 rupture and subsequent explosion on Westcoast Pipeline which is one of the major pipelines feeding PSE’s distribution system. The pipeline was repaired in October 2018, however supply capacity on the pipeline was limited over the 2018/19 winter leading to higher prices. February weather was also much colder than normal which also increased the demand for natural gas. The amortization period will be from May 2019 through April 2020.

On October 24, 2019, the Washington Commission approved PSE’s request for November 2019 PGA rates with the rate change taking effect November 1, 2019. As part of that filing, PSE have requested PGA rates increase annual revenue by $17.8 million, while the new tracker rates increased by annual revenue of $100.6 million; this was in addition of continuing the collection on the remaining balance of $54.0 million from the out-of-cycle PGA. The tracker rates include deferral balances for the three separate amounts: (i) $114.4 million of under collected commodity balances deferred in February and March; (ii) a $10.8 million balance of over-collected commodity costs for the 2018 PGA, and (iii) a $4.1 million remaining balance from the $54.7 million credit to customers, caused by the 2017 over-collection, established in the 2018 tracker. The high commodity deferral balances for winter months through March 2019 were the result of three noteworthy events last winter experienced by PSE: the Enbridge pipeline rupture, unusually low temperatures in February and March, and a compressor failure in February at the Jackson Prairie storage facility. Additionally, to reduce customer impact, as part of the approved PGA filing, PSE will be collecting $114.4 million commodity deferrals and related interest over two years period instead of historic one year from November 2019 through October 2021.

The following table sets forth the PGA rate adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective date:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
November 1, 2019	13.4%	$118.3
May 1, 2019	6.3	54.0
November 1, 2018	(10.9)	(98.4)

Other Proceedings

Microsoft Special Contract

Following discussions between PSE, the Microsoft Corporation, and others, and after completing a negotiated regulatory process, in July 2017, the Washington Commission issued an order approving a special contract between PSE and Microsoft relating to retail access for Microsoft loads currently being served under PSE's electric Schedule 40. The special contract includes the following conditions: (i) Microsoft must exceed Washington State's current renewable portfolio standards, (ii) the remainder of power sold to Microsoft must be carbon free, (iii) there will be no reduction in Microsoft's funding of PSE's conservation programs, (iv) Microsoft paid a transition fee that was a straight pass-through to customers and (v) Microsoft will fund enhanced low-income support. Microsoft began taking service under the special contract on April 1, 2019 after meeting the eligibility requirements under the special contract.

Voluntary Long-Term Renewable Energy

Effective September 2016, the Washington Commission approved PSE's tariff revision to create an additional voluntary renewable energy product. This provides customers with electric generation resource options to help them meet their sustainability goals. Incremental costs of the program will be allocated to the voluntary participants of the program as is the case with PSE's existing Green Power programs. PSE initially offered this service, Green Direct, to larger customers (aggregated annual loads greater than 10,000 MWh) and government customers. The initial resource option offered under this rate schedule is a new wind generation facility with the capacity of approximately 136.8 MW that will be constructed in the region by a developer under contract to PSE to meet the demand for this voluntary renewable energy product. The project is fully subscribed and is expected to begin generating power in early 2020. Twenty-one customers will receive the anticipated output of the project.

In July 2018, the Washington Commission approved a second phase of the Green Direct product. The phase 2 offering will be a blend of the phase 1 wind and a solar project. In October 2018, the Washington Commission approved an expansion of the solar project from 120 MW to 150 MW. Phase 1 customers will receive wind through 2020; and then will receive the blended energy in 2021. Open enrollment for phase 2, which is fully subscribed, began on August 31, 2018. Twenty customers will start receiving energy through phase 2 of the program in 2021.

For additional information, see Note 7, "Regulation and Rates" to the consolidated financial statements included in Item 1 of this report.

Other Factors and Trends

Access to Debt Capital

PSE relies on access to bank borrowings and short-term money markets as sources of liquidity and longer-term capital markets to fund its utility construction program, to meet maturing debt obligations and other capital expenditure requirements not satisfied by cash flow from its operations or equity investment from its parent, Puget Energy. Neither Puget Energy nor PSE have any debt outstanding whose maturity would accelerate upon a credit rating downgrade. However, a ratings downgrade could adversely affect the Company's ability to renew existing, or obtain access to new credit facilities and could increase the cost of such facilities. For example, under Puget Energy's and PSE's credit facilities, the borrowing costs increase as their respective credit ratings decline due to increases in credit spreads and commitment fees. If PSE is unable to access debt capital on reasonable terms, its ability to pursue improvements or acquisitions, including generating capacity, which may be relied on for future growth and to otherwise implement its strategy, could be adversely affected. PSE monitors the credit environment and expects to continue to be able to access the capital markets to meet its short-term and long-term borrowing needs.

Regulatory Compliance Costs and Expenditures

PSE's operations are subject to extensive federal, state and local laws and regulations. These regulations cover electric system reliability, natural gas pipeline system safety and energy market transparency, among other areas. Environmental laws and regulations related to air and water quality, including climate change and endangered species protection, waste handling and disposal (including generation by-products such as coal ash), remediation of contamination and siting new facilities also impact the Company's operations. PSE must spend a significant amount of resources to fulfill requirements set by regulatory agencies, many of which have greatly expanded mandates on measures including resource planning, remediation, monitoring, pollution control equipment and emissions-related abatement and fees.

Compliance with these or other future regulations, such as those pertaining to climate change, could require significant capital expenditures by PSE and may adversely affect PSE's financial position, results of operations, cash flows and liquidity.

Other Challenges and Strategies

Competition

PSE's electric and natural gas utility retail customers generally do not have the ability to choose their electric or natural gas supplier; and therefore, PSE's business has historically been recognized as a natural monopoly. However, PSE faces competition from public utility districts and municipalities that want to establish their own municipal-owned utility, as a result of which PSE may lose a number of customers. PSE also faces increasing competition for sales to its retail customers through alternative methods of electric energy generation, including solar and other self-generation methods. In addition, PSE's natural gas customers may elect to use heating oil, propane or other fuels instead of using and purchasing natural gas from PSE.

Results of Operations

Puget Sound Energy

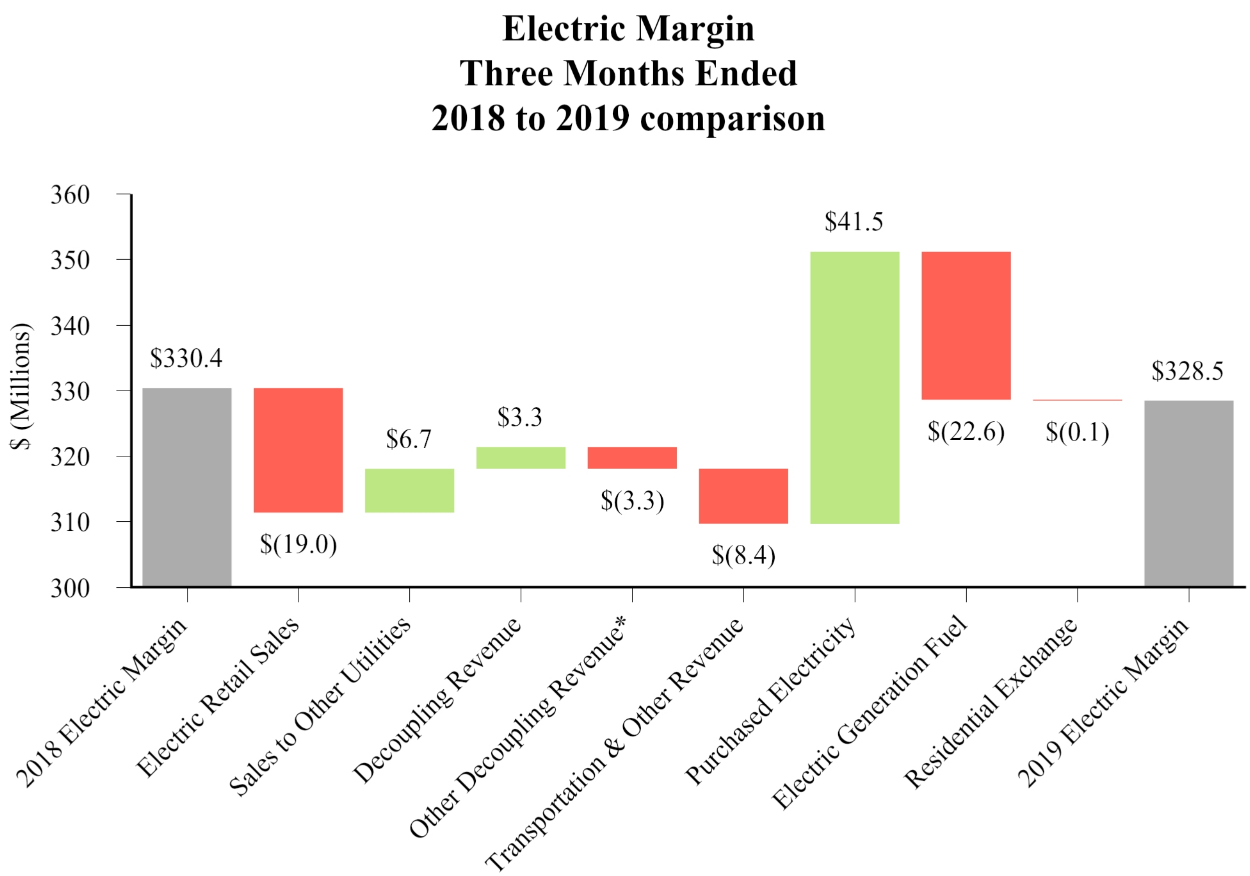
Non-GAAP Financial Measures - Electric and Natural Gas Margins

The following discussion includes financial information prepared in accordance with GAAP, as well as two other financial measures, electric margin and natural gas margin, that are considered "non-GAAP financial measures." Generally, a non-GAAP financial measure is a numerical measure of a company's financial performance, financial position or cash flows that includes adjustments that result in a departure from GAAP presentation. The presentation of electric margin and natural gas margin is intended to supplement an understanding of PSE's operating performance. Electric margin and natural gas margin are used by PSE to determine whether PSE is collecting the appropriate amount of revenue from its customers in order to provide adequate recovery of operating costs, including interest and equity returns. PSE's electric margin and natural gas margin measures may not be comparable to other companies' electric margin and natural gas margin measures. Furthermore, these measures are not intended to replace operating income as determined in accordance with GAAP as an indicator of operating performance.

Electric Margin

Electric margin represents electric sales to retail and transportation customers less the cost of generating and purchasing electric energy sold to customers, including transmission costs, to bring electric energy to PSE's service territory.

The following chart displays the details of PSE's electric margin changes for the three months ended September 30, 2018 and 2019:



* *Includes decoupling cash collections, ROR excess earnings, and decoupling 24-month revenue reserve.*

Three months ended September 30, 2018 compared to 2019

Electric Operating Revenue

Electric operating revenues decreased $20.6 million from the prior year primarily due to a decrease in electric retail sales of $19.0 million, a decrease in other revenues of $8.4 million and decrease in other decoupling revenue of $3.3 million; partially offset by an increase in sales to other utilities of $6.7 million and an increase in decoupling revenue of $3.3 million. These items are discussed in detail below.

- **Electric retail sales** decreased $19.0 million due to a decrease in rates of $11.9 million and a decrease of $7.1 million from reduced retail electricity usage of 1.6% compared to the prior year. The reduction in usage was due to a decrease of commercial, industrial and residential use per customer of 2.4%, 0.9% and 0.7%, respectively, which was driven by a decrease in heating degree days of 11.2% and partially offset by an increase in retail customers of 1.4% compared to 2018. See Management's Discussion and Analysis, "Regulation and Rates" included in Item 2 of this report for rate changes.
- **Sales to other utilities** increased $6.7 million due to a 49.3% increase in volumes sold partially offset by a 22.2% decrease in price. Volumes were higher because market conditions made it economic to run gas fired resources to meet regional demand, and PSE's system load was lower than 2018 load. The decrease in average price was because 2018 prices were abnormally high as a result of higher than normal temperatures.
- **Decoupling revenue** increased $3.3 million, primarily attributable to a $2.7 million increase in PCA fixed cost deferral revenues, driven by decreased usage, as noted above in the retail revenue section. This resulted in allowed PCA revenues

being $1.0 million greater than actual PCA revenues in the current year, whereas actual PCA revenues were $1.7 million greater than allowed PCA revenues in the prior year.

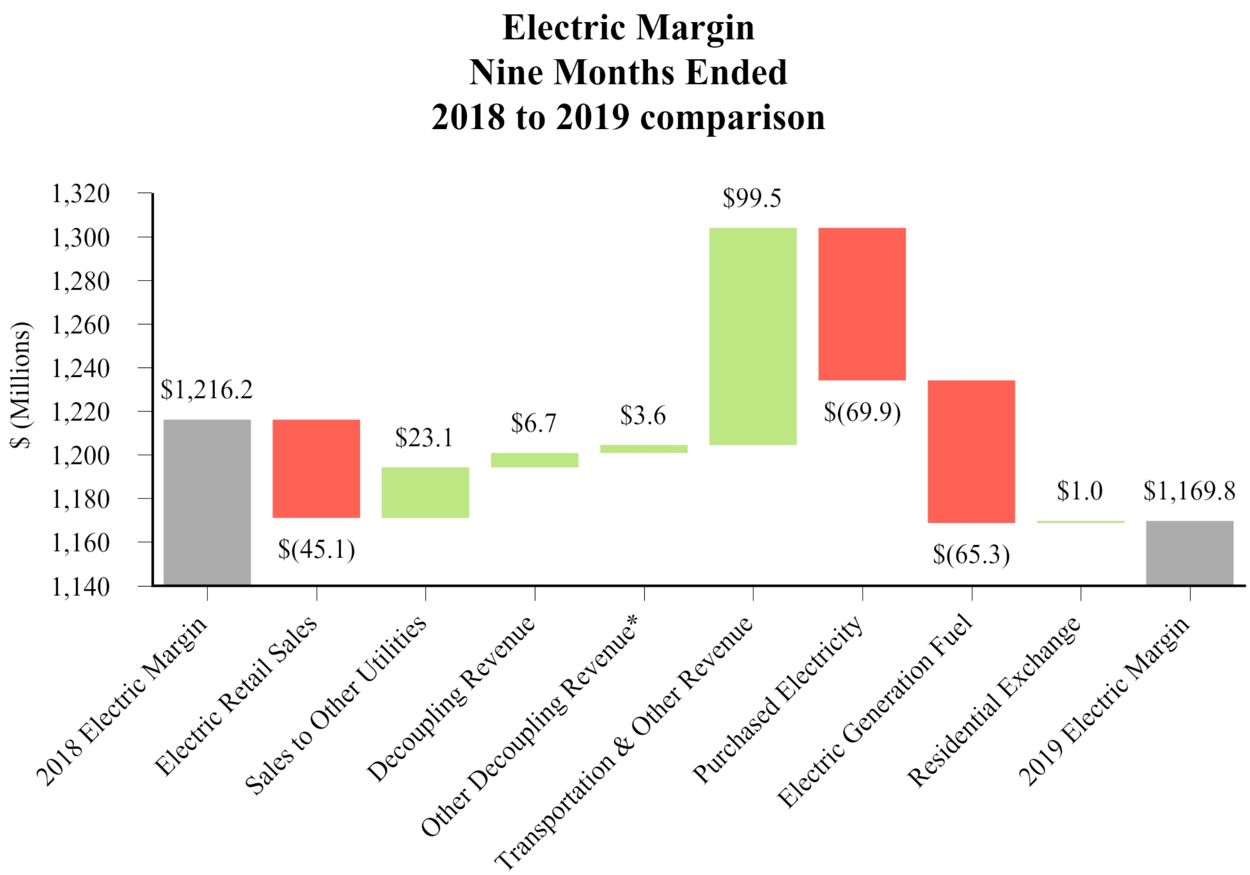
- **Other decoupling revenue** decreased $3.3 million, primarily related to cash refunds of earnings in excess of allowed ROR. In 2018, earnings in excess of allowed ROR of $2.1 million was returned to customers. In the current year, there were no such returns to customers. In addition, current period amortization of prior year over-collection increased by $1.5 million year over year, resulting from higher amortization rates, offset in part by decreased usage.
- **Transportation and other revenue** decreased $8.4 million primarily due to a decrease in production tax credit (PTC) deferral revenue of $8.5 million for the re-purpose of the PTCs, a decrease in non-core gas sales of $2.3 million and a decrease in green energy option revenue of $1.6 million partially offset by an increase in tax reform deferrals returned to customers in 2019 for revenue subject to refunds of $4.9 million.

Electric Power Costs

Electric power costs decreased $18.8 million primarily due to decrease of $41.5 million of purchased electricity costs and was partially offset by an increase of $22.6 million of electric generation fuel expense. These items are discussed in detail below.

- **Purchased electricity** expense decreased $41.5 million primarily due to an 18.1% decrease in wholesale electricity purchases and a 12.0% decrease in wholesale prices. The decrease in purchases was primarily driven by a decrease in load and a decrease in hydro purchases from Mid-Columbia of 16.9%, due to unfavorable hydro conditions, driving an increase in combustion turbine generation, as noted in the section below.
- **Electric generation fuel** expense increased $22.6 million primarily due to a $10.6 million increase in combustion turbine generation costs primarily driven by an increase in generation of 20.0% as a result of favorable heat rates, unfavorable wholesale electricity prices and reduced hydro purchases of 16.9%.

The following chart displays the details of PSE's electric margin changes for the nine months ended September 30, 2018 and 2019:



* *Includes decoupling cash collections, ROR excess earnings, and decoupling 24-month revenue reserve.*

Nine months ended September 30, 2018 compared to 2019

Electric Operating Revenue

Electric operating revenues increased $87.8 million primarily due to transportation and other revenues of $99.5 million, sales to other utilities of $23.1 million, decoupling revenue of $6.7 million, and other decoupling revenue of $3.6 million, partially offset by lower electric retail sales of $45.1 million. These items are discussed in detail below.

- **Electric retail sales** decreased $45.1 million due to a decrease in rates of $52.2 million, offset by an increase of $7.1 million from additional retail residential electricity usage of 1.9% compared to the prior year which was driven by an increase in residential retail customers of 1.4% compared to 2018. See Management's Discussion and Analysis, "Regulation and Rates" included in Item 2 of this report for rate changes.
- **Sales to other utilities** increased $23.1 million due to a 12.1% increase in price and a 23.7% increase in sales volume. During the 1st quarter of 2019, wholesale prices increased 115.7% due to spot power prices at Mid-Columbia that increased to an 18-year high largely driven by record-breaking natural gas prices and there was increase in volumes from an additional 111.8% of combustion turbine generation as a result of favorable heat rates and increased demand for market power.
- **Decoupling revenue** increased $6.7 million, the combination of a $1.4 million decrease in delivery deferral revenues and an $8.1 million increase in PCA fixed cost deferral revenues. The decrease in delivery deferral revenues resulted from a more significant decline in allowed revenues than actual revenues year-over-year, attributable to lower allowed rate per customer. For PCA fixed cost deferrals, actual revenues declined significantly, attributable to lower rates, partially offset by increased usage, as noted above in the retail revenue section, resulting in less over collection in the current year than in the prior year.

- **Other decoupling revenue** increased \$3.6 million, primarily due to a \$7.4 million increase year-over-year related to a decrease in current year amortization of previous years' decoupling deferrals. This resulted from lower amortization rates, partially offset by increased usage. This increase was offset in part by a \$4.1 million decrease related to earnings in excess of allowed ROR. In 2018, earnings in excess of allowed ROR of \$7.5 million was returned to customers, as compared to \$3.5 million returned in the current year.
- **Transportation and other revenue** increased \$99.5 million primarily due to an increase in net wholesale non-core natural gas sales of \$84.4 million and a reduction in tax reform deferrals for revenue subject to refunds of \$32.2 million; partially offset by a change in PTC deferral revenue of \$18.5 million for the re-purpose of the PTCs. The increase in net wholesale non-core gas sales was due to an approximately 143% increase in the average price of the non-core gas sold in 2019 as compared to 2018, offset by a 12% decrease in sales volume and a \$32.0 million increase in the total cost of the non-core gas sold due to an approximately 67% increase in the average cost of the gas sold driven by an increase in the average price of non-core gas purchases. The higher gas prices occurred in early 2019 and were due to the continuing effects of the late 2018 Enbridge pipeline rupture which led to a decrease in pipeline capacity in the region at the same time that there were compressor issues at a gas storage facility which limited natural gas deliverability, and higher than expected load due to cold weather during that time.

Electric Power Costs

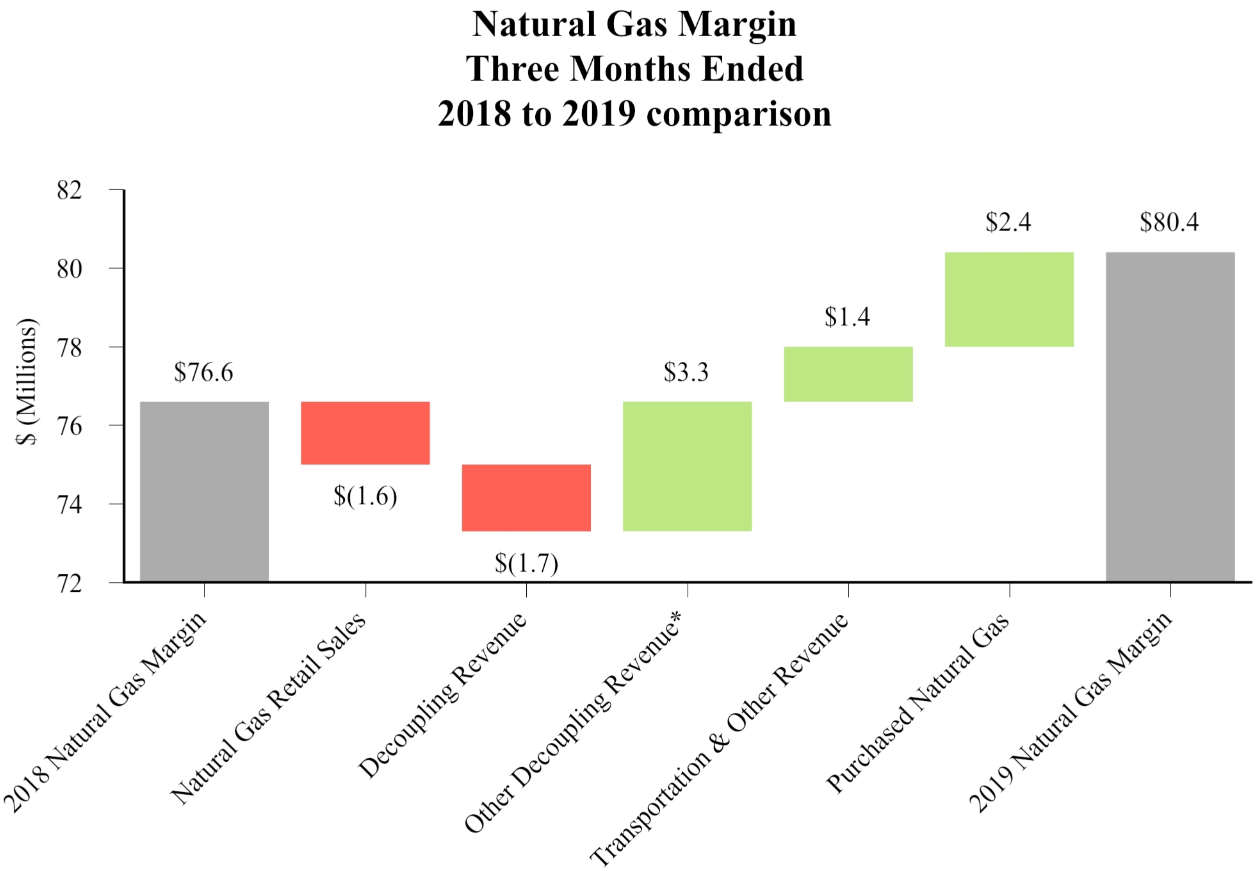
Electric power costs increased \$134.2 million primarily due to an increase of \$69.9 million of purchased electricity costs and an increase of \$65.3 million of electric generation fuel expense. These items are discussed in detail below:

- **Purchased electricity** expense increased \$69.9 million primarily due to a 30.8% increase in wholesale prices partially offset by an 11.4% decrease in wholesale electricity purchases. The decrease in purchases was primarily driven by a decrease in hydro purchases at Mid-Columbia of 27.0%, due to unfavorable hydro conditions, driving an increase in combustion turbine generation, which decreased the need to purchase additional wholesale power. During the 1st quarter of 2019, wholesale prices increased due to spot power prices at Mid-Columbia hit an 18-year high largely driven by record-breaking natural gas prices.
- **Electric generation fuel** expense increased \$65.3 million primarily due to a \$49.6 million increase in combustion turbine generation costs primarily driven by an increase in generation of 46.0% as a result of favorable heat rates, unfavorable wholesale electricity prices, reduced hydro purchases of 27.0% and reduced hydro and wind generation of 21.6% and 12.9%, respectively.

Natural Gas Margin

Natural gas margin is natural gas sales to retail and transportation customers less the cost of natural gas purchased, including transportation costs to bring natural gas to PSE’s service territory. The PGA mechanism passes through increases or decreases in the natural gas supply portion of the natural gas service rates to customers based upon changes in the price of natural gas purchased from producers and wholesale marketers or changes in natural gas pipeline transportation costs. PSE's margin or net income is not affected by changes under the PGA mechanism because over- and under- recoveries of natural gas costs included in baseline PGA rates are deferred and either refunded or collected from customers, respectively, in future periods.

The following chart displays the details of PSE's natural gas margin changes for the three months ended September 30, 2018 and 2019:



* *Includes decoupling cash collections, ROR excess earnings, and decoupling 24-month revenue reserve.*

Three months ended September 30, 2018 compared to 2019

Natural Gas Operating Revenue

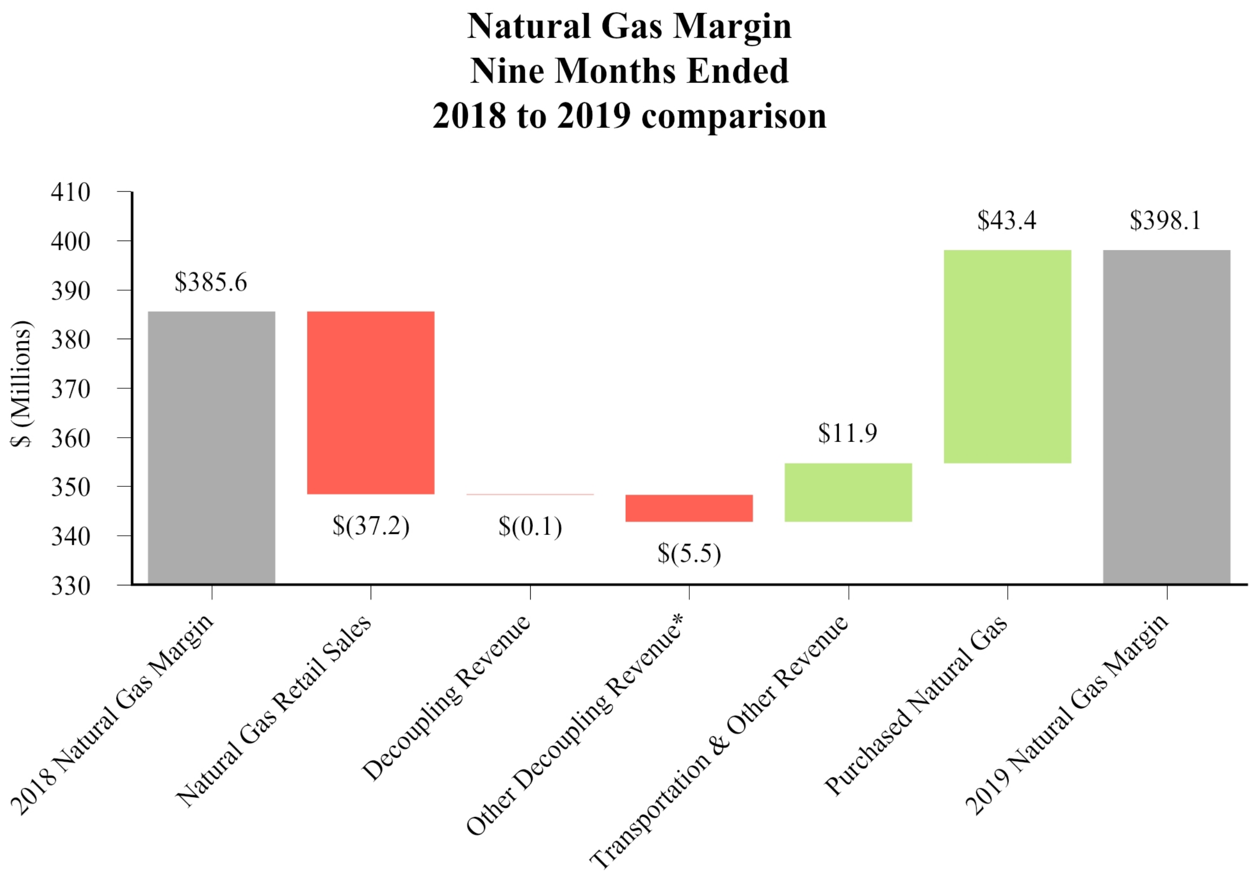
Natural gas operating revenue increased $1.4 million primarily due to an increase of $3.3 million in other decoupling revenue and an increase of transportation and other revenue of $1.4 million; partially offset by a decrease of $1.7 million in decoupling revenue and a decrease of $1.6 million in total retail sales. These items are discussed in detail below.

- **Natural gas retail sales revenue** decreased $1.6 million due to a decrease in rates of $6.8 million partially offset by an increase in natural gas load of 5.0%, or $5.2 million of natural gas sales. Natural gas load increased primarily due to the increase in average therms used per residential, commercial and industrial customers of 3.7%, 6.2% and 63.8%, respectively compared to 2018, as a result of a 1.3% increase in natural gas customers, which increased the natural gas heating load compared to prior year. See Management's Discussion and Analysis, "Regulation and Rates" included in Item 2 of this report for rate changes.
- **Decoupling revenue** decreased $1.7 million. This is primarily attributable to higher natural gas usage, as noted above in the retail revenue section. This resulted in actual natural gas revenues being greater than allowed natural gas revenues in the current year, where as in the prior year allowed natural gas revenues were greater than actual natural gas revenues.
- **Other decoupling revenue** increased $3.3 million, primarily due to a $3.8 million increase year-over-year related to a decrease in current year amortization of previous years' decoupling deferrals resulting from lower amortization rates, partially offset by increased natural gas usage in the current year.
- **Transportation and other revenue** increased $1.4 million primarily due to a decrease of tax reform deferrals returned to customers for revenue subject to refund in 2019 of $1.0 million.

Natural Gas Energy Costs

Purchased natural gas expense decreased $2.4 million due to a decrease in natural gas costs included in PGA rates partially offset by an increase in natural gas usage of 5.0%. See Management's Discussion and Analysis, "Regulation and Rates" included in Item 2 of this report for rate changes.

The following chart displays the details of PSE's natural gas margin changes for the nine months ended September 30, 2018 and 2019:



* *Includes decoupling cash collections, ROR excess earnings, and decoupling 24-month revenue reserve.*

__Nine months ended September 30, 2018 compared to 2019__

Natural Gas Operating Revenue

Natural gas operating revenue decreased $31.0 million primarily due to a decrease of $37.2 million in total retail sales due to a decrease of natural gas rates and a decrease of $5.5 million in other decoupling revenue, partially offset by an increase in transportation and other revenue of $11.9 million. These items are discussed in detail below.

- **Natural gas retail sales revenue** decreased $37.2 million due to a decrease in rates of $63.6 million, offset by an increase in natural gas load of 4.1%, or $26.4 million in natural gas sales. Natural gas load increased primarily due to the increase in average therms used per residential, commercial and industrial customers of 4.7%, 4.2%, and 6.4%, respectively, compared to 2018 as a result of a 3.4% increase in heating degree days in the 1st quarter of 2019 as well as 1.3% increase in natural gas customers. See Management's Discussion and Analysis, "Regulation and Rates" included in Item 2 of this report for rate changes.
- **Other decoupling revenue** decreased $5.5 million, primarily due to 2018 estimated earnings in excess of allowed ROR being trued up to match actual earnings in excess of allowed ROR by $3.4 million whereas no such true up occurred in the current year. In addition, current year amortization of previous years' decoupling deferrals increased year-over-year, resulting in a decrease of $2.4 million, attributable to higher amortization rates and increased natural gas usage in the current year.

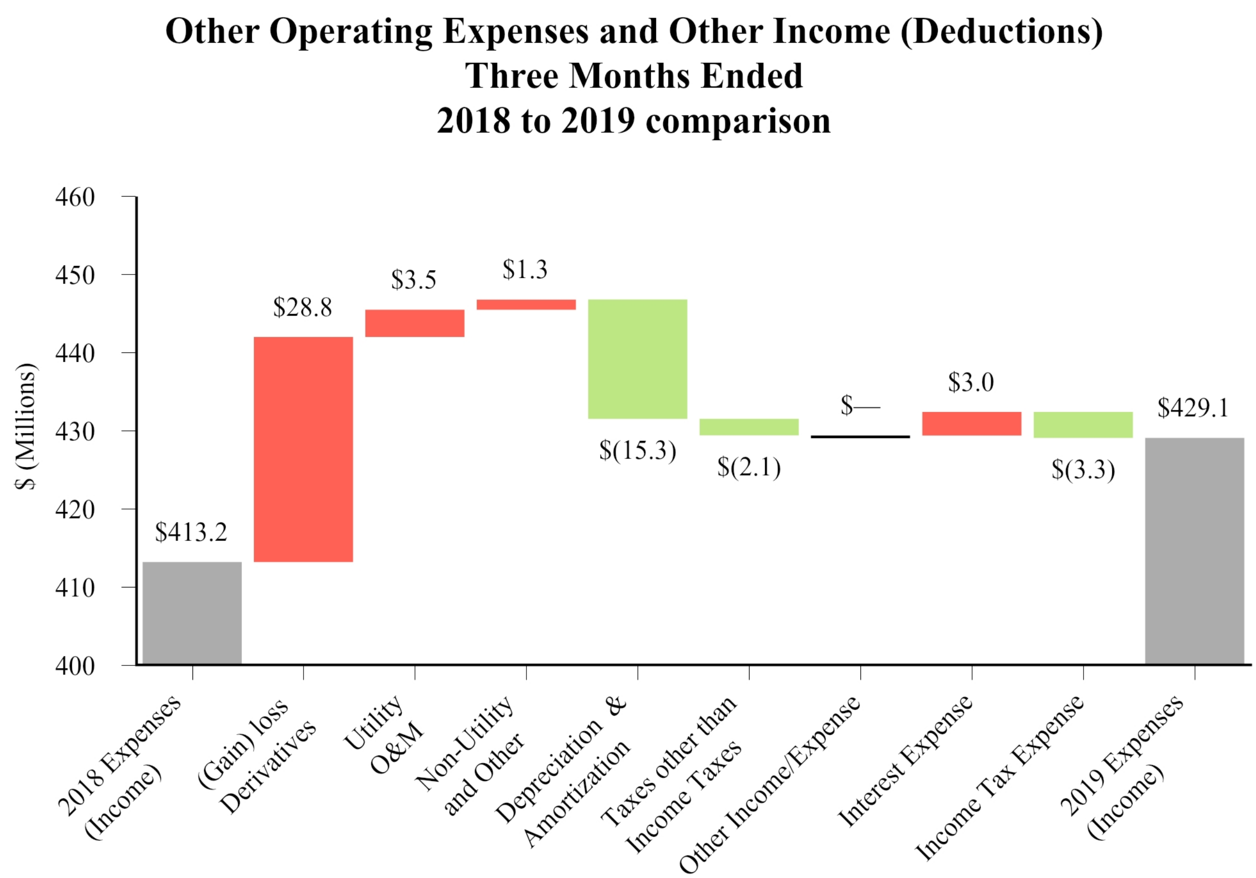
- **Transportation and other revenue** increased $11.9 million primarily due to tax reform deferrals returned to customers for revenue subject to refund of $12.2 million.

Natural Gas Energy Costs

Purchased natural gas expense decreased $43.4 million due to a decrease in natural gas costs included in PGA rates partially offset by an increase in natural gas usage of 4.1%. See Management's Discussion and Analysis, "Regulation and Rates" included in Item 2 of this report for rate changes.

Other Operating Expenses and Other Income (Deductions)

The following chart displays the details of PSE's operating expenses and other income (deductions) for the three months ended September 30, 2018 and 2019:



<u>Three months ended September 30, 2018 compared to 2019</u>

Other Operating Expenses

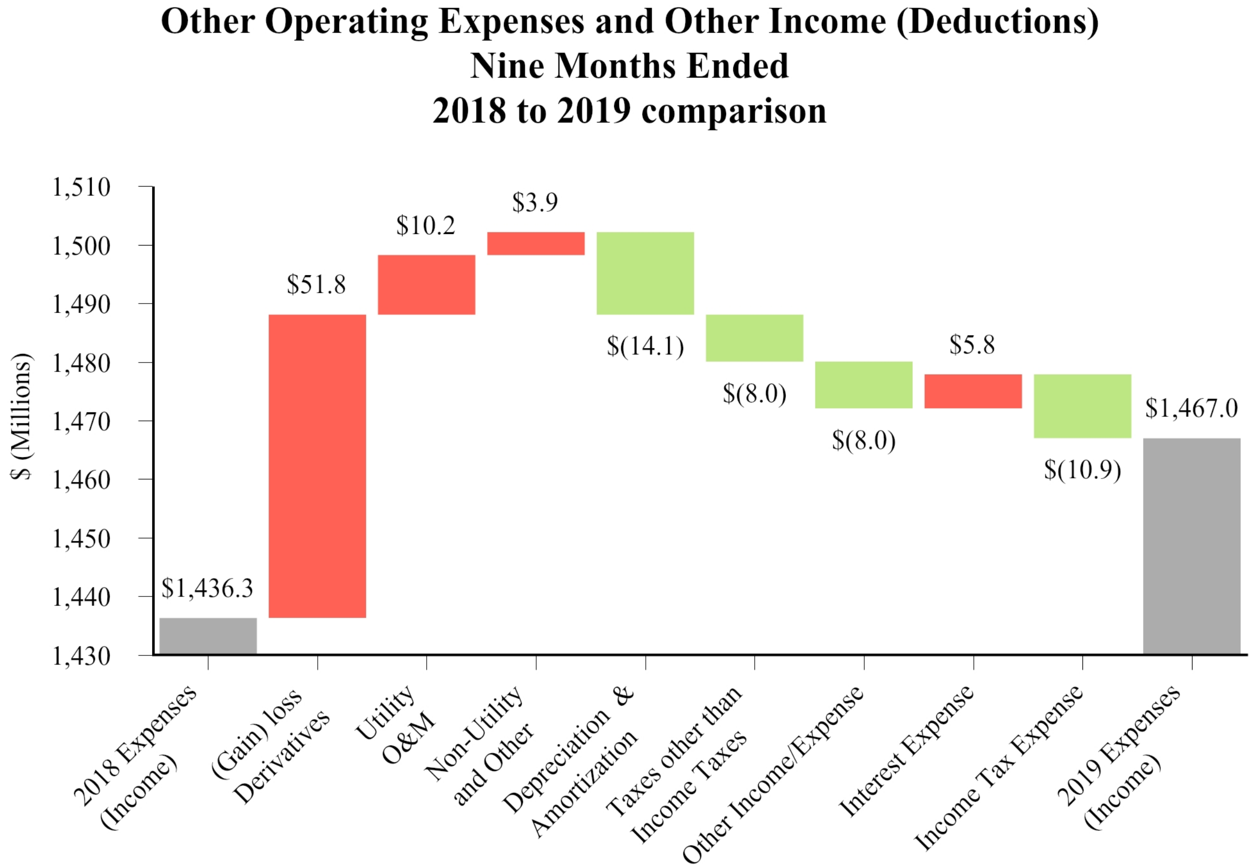
- **Net unrealized (gain) loss on derivative instruments** decreased $28.8 million to a net loss of $14.7 million. The primary drivers for the change related to a decrease in the overall weighted average forward prices resulting in a $25.5 million decrease. Additionally, the change from net settlements of electric and natural gas trades previously recorded as $4.5 million in gains and $1.2 million in losses, respectively, further reduced the net unrealized (gain) loss.
- **Utility operations and maintenance** expense increased $3.5 million primarily due to an increase in (i) hardware and software maintenance costs and IT expense of $3.5 million due to an increase in IT projects; (ii) an increase in damage and liability claims of $2.2 million; and (iii) an increase of $1.5 million of transformer and overhead line expense; partially offset by (iv) a decrease of $4.1 million of bad debt expense due to an improved collection process.
- **Non-Utility and other** expense increased $1.3 million primarily due to an increase in the long-term incentive plan accrual of $3.9 million due to an increase in long-term incentive plan awards in 2019 partially offset by a decrease in biogas gas purchase expense of $3.0 million.

- **Depreciation and amortization** expense decreased $15.3 million primarily driven by: (i) a decrease in amortization of PTC regulatory liability of $8.5 million in 2019 as compared to 2018, (ii) a decrease of $7.6 million in common amortization due the deferral treatment of IT amortization effective May 1, 2019 as submitted to the Washington Commission, (iii) a decrease of $4.9 million for amortization of the Microsoft transition fee set in rates by a Washington Commission order, (iv) a decrease in electric amortization driven by the deferral treatment of $4.6 million for meter assets effective April 1, 2019 as submitted to the Washington Commission, (v) a decrease in conservation amortization of $3.9 million; partially offset by (vi) an increase in common amortization of $8.1 million driven by net additions of $129.9 million of software; (vii) electric depreciation expense increased $4.1 million primarily due to net asset additions to distribution of $213.6 million and (viii) an increase in natural gas depreciation expense of $2.1 million primarily due to net asset additions to distribution of $210.5 million offset by a depreciation rate change to a lower rate.
- **Taxes other than income taxes** decreased $2.1 million primarily due to decreases in municipal taxes of $1.3 million and state excise taxes of $0.8 million as a result of a decrease in retail revenue, as well as a decrease of $0.4 million related to the property tax tracker.

Other Income, Interest Expense and Income Tax Expense

- **Interest expense** increased $3.0 million primarily related to PSE's issuance of $450.0 million of senior notes at an interest rate of 3.25%. For additional information, see Note 10, "Other" to the consolidated financial statements included in Item 1 of this report.
- **Income tax expense** decreased $3.3 million primarily driven by a decrease in pre-tax income.

The following chart displays the details of PSE's operating expenses and other income (deductions) for the nine months ended September 30, 2018 and 2019:



Nine months ended September 30, 2018 compared to 2019

Other Operating Expenses

- **Net unrealized (gain) loss on derivative instruments** decreased $51.8 million to a net loss of 29.9 million. The primary drivers for the change related to net settlements of $50.9 million and $22.9 million of electric and natural gas trades previously recorded as gains. However, these settlements were offset by an increase in gains due to an increase in the overall weighted average forward prices, resulting in a $22.0 million increase.
- **Utility operations and maintenance** expense increased $10.2 million primarily due to an increase in (i) hardware and software maintenance costs and IT expense of $9.6 million due to an increase in IT projects, (ii) non-deferred storm costs of $4.9 million primarily related to first quarter storms; and (iii) an increase in AMI meter reading costs of $1.7 million; (iv) an increase in damage and liability claims of $1.7 million; and (v) an increase in wild horse maintenance costs of $1.6 million due to normal cycled maintenance every 3-5 years; partially offset by (vi) a decrease of $5.0 million of bad debt expense due to an improved collection process and (vii) a decrease in underground cable expense of $3.3 million.
- **Non-utility and other** expense increased $3.9 million primarily due to an increase in the long-term incentive plan accrual of $6.5 million due to an increase in long-term incentive plan awards in 2019 partially offset by a decrease in biogas gas purchase expense of $2.9 million.
- **Depreciation and amortization** expense decreased $14.1 million primarily driven by: (i) a decrease in amortization of PTC regulatory liability of $18.5 million in 2019 as compared to 2018, (ii) a decrease of $12.9 million in common amortization due the deferral treatment of IT amortization effective May 1, 2019 as submitted to the Washington Commission, (iii) a decrease of $4.9 million for amortization of the Microsoft transition fee set in rates by a Washington Commission order, (iv) a decrease in electric amortization driven by the deferral treatment of $8.4 million for meter assets effective April 1, 2019 as submitted to the Washington Commission, (v) a decrease in conservation amortization of $11.4 million due to lower rates in 2019 as compared to 2018; partially offset by (vi) an increase in common amortization of

$29.1 million driven by net additions of $129.9 million of software; (vii) electric depreciation expense increased $7.9 million primarily due to net asset additions to distribution of $213.6 million and (viii) an increase in natural gas depreciation expense of $5.8 million primarily due to net asset additions to distribution of $210.5 million.

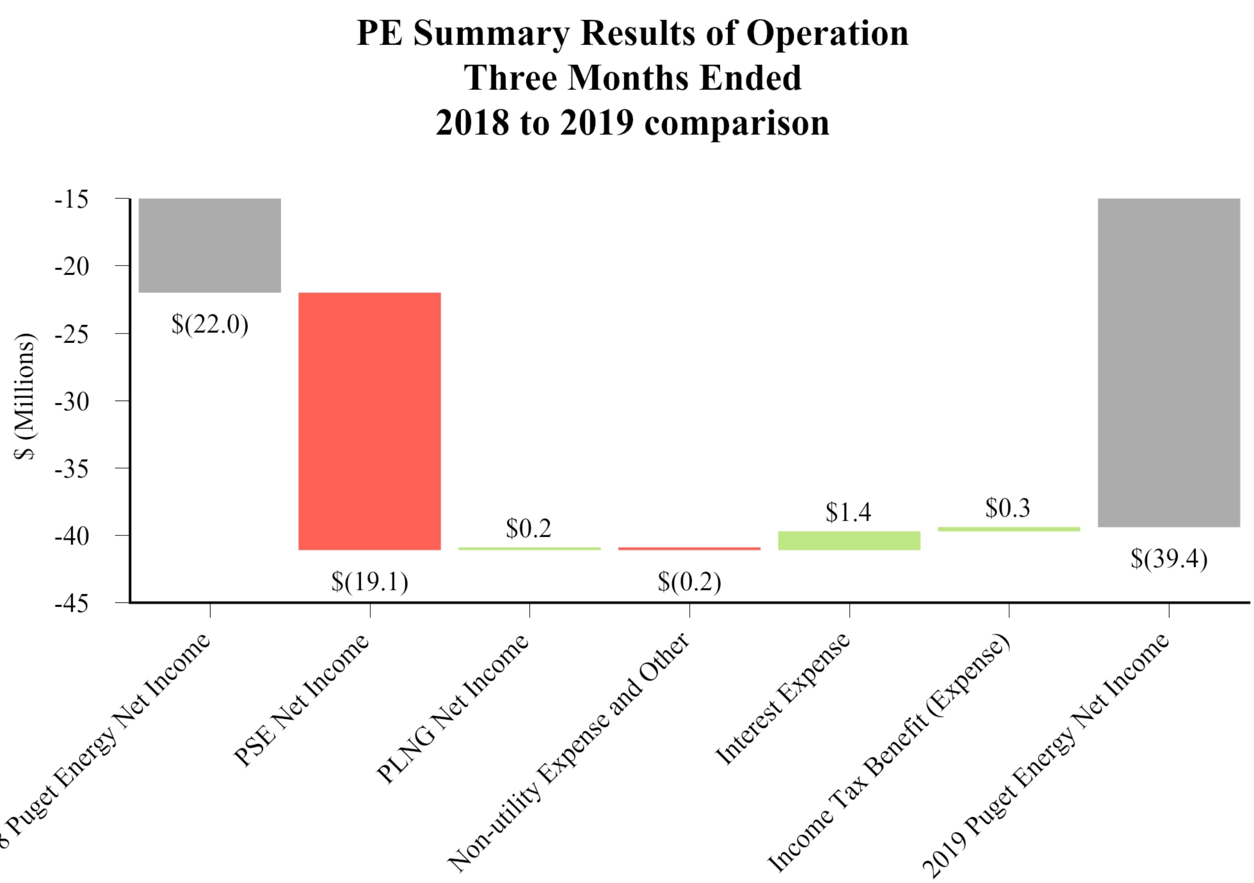
- **Taxes other than income taxes** decreased $8.0 million primarily due to decreases in municipal taxes of $4.6 million and state excise taxes of $3.1 million as a result of a decrease in retail revenue, as well as a decrease of $2.2 million related to the property tax tracker.

Other Income, Interest Expense and Income Tax Expense

- **Other Income/expense** increased $8.0 million primarily due to a $4.5 million increase in PGA interest income driven by a larger under-recovery compared to an over-recovery in 2018 and a $4.7 million increase in allowance for funds used during construction (AFUDC) driven by a change in the rate and an increase in eligible construction work in progress.
- **Interest expense** increased $5.8 million primarily related to PSE's issuance of $450.0 million of senior notes at an interest rate of 3.25%. For additional information, see Note 10, "Other" to the consolidated financial statements included in Item 1 of this report.
- **Income tax expense** decreased $10.9 million primarily driven primarily driven by a decrease in pre-tax income.

Puget Energy

Primarily, all operations of Puget Energy are conducted through its subsidiary PSE. Puget Energy's net income (loss) for the three months ended September 30, 2018 and 2019 are as follows:

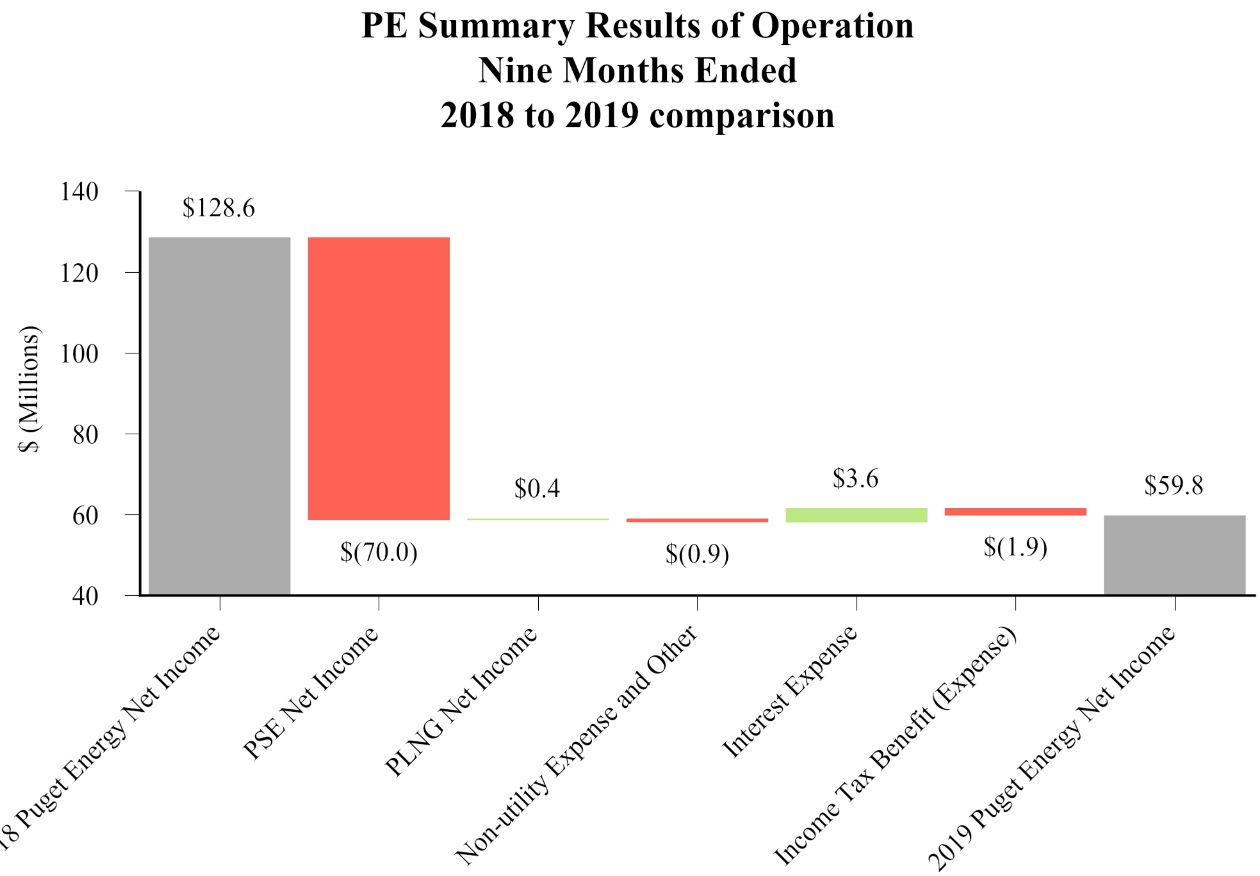


<u>Three months ended September 30, 2018 compared to 2019</u>

Summary Results of Operation

Puget Energy's net income decreased for the three months ended September 30, 2019 by $17.4 million primarily due to a decrease in PSE's net income compared to the same period in the prior year.

Puget Energy's net income (loss) for the nine months ended September 30, 2018 and 2019 are as follows:



<u>Nine months ended September 30, 2018 compared to 2019</u>

Summary Results of Operation

Puget Energy's net income decreased for the nine months ended September 30, 2019 by $68.8 million primarily due to a decrease in PSE's net income compared to the same period in the prior year partially offset by an increase in interest expense of $3.6 million, as Puget Energy entered into a new $210.0 million term loan agreement and an additional $24.0 million of supplemental loans under the expansion feature of the existing term loan agreement during 2019. For additional information, see Note 10, "Other" to the consolidated financial statements included in Item 1 of this report.

Capital Requirements

Contractual Obligations and Commercial Commitments

During the nine months ended September 30, 2019, there were no material changes to the contractual obligations and consolidated commercial commitments disclosed in Note 16, "Commitments and Contingencies" to the consolidated financial statements included in Item 8 of the Company's Form 10-K for the period ended December 31, 2018.

The following are the Company's aggregate availability under commercial commitments as of September 30, 2019:

Puget Energy and Puget Sound Energy	Amount of Available Commitments Expiration Per Period				
(Dollars in Thousands)	Total	2019	2020-2021	2022-2023	Thereafter
Commercial commitments:					
PSE revolving credit facility	$ 800,000	$ —	$ —	$ 800,000	$ —
Inter-company short-term debt	30,000	—	—	—	30,000
Total PSE commercial commitments	$ 830,000	$ —	$ —	$ 800,000	$ 30,000
Puget Energy revolving credit facility	783,100	—	—	783,100	—
Less: Inter-company short-term debt elimination	(30,000)	—	—	—	(30,000)
Total Puget Energy commercial commitments	$ 1,583,100	$ —	$ —	$ 1,583,100	$ —

For further discussion, see Management's Discussion and Analysis, "Financing Program" in Item 2.

Off-Balance Sheet Arrangements

As of September 30, 2019, the Company had no off-balance sheet arrangements that have or are reasonably likely to have a material effect on the Company's financial condition.

Utility Construction Program

PSE’s construction programs for generating facilities, the electric transmission system, the natural gas and electric distribution systems and the Tacoma LNG facility are designed to meet regulatory requirements, support customer growth and to improve energy system reliability. Construction expenditures, excluding equity AFUDC, totaled $680.1 million for the nine months ended September 30, 2019. Presently planned utility construction expenditures, excluding equity AFUDC, are as follows:

Capital Expenditure Projections			
(Dollars in Thousands)	2019	2020	2021
Total energy delivery, technology and facilities expenditures	$ 885,623	$ 916,545	$ 895,610

The program is subject to change based upon general business, economic and regulatory conditions. Utility construction expenditures and any new generation resource expenditures may be funded from a combination of sources which may include cash from operations, short-term debt, long-term debt and/or equity. PSE’s planned capital expenditures may result in a level of spending that will exceed its cash flow from operations. As a result, execution of PSE’s strategy is dependent in part on continued access to capital markets.

Capital Resources

Cash from Operations

Puget Sound Energy (Dollars in Millions)	Nine Months Ended September 30, 2019	2018	Change
Net income	$ 123,720	$ 193,709	$ (69,989)
Non-cash items[1]	531,225	493,821	37,404
Changes in cash flow resulting from working capital[2]	(163,835)	158,184	(322,019)
Regulatory assets and liabilities	(46,993)	(22,545)	(24,448)
Other non-current assets and liabilities[3]	(13,028)	(8,356)	(4,672)
Net cash provided by operating activities	$ 431,089	$ 814,813	$ (383,724)

1 *Non-cash items include depreciation, amortization, deferred income taxes, net unrealized (gain) loss on derivative instruments, AFUDC-equity, PTCs and other miscellaneous non-cash items.*

2 *Changes in working capital include receivables, unbilled revenue, materials/supplies, fuel/gas inventory, income taxes, prepayment, PGA, accounts payable and accrued expenses.*

3 *Other non-current assets and liabilities include funding of pension liability.*

Nine months ended September 30, 2019 compared to 2018

Cash generated from operations for the nine months ended September 30, 2019 decreased by $383.7 million including a net income decrease of $70.0 million. The following are significant factors that impacted PSE's cash flows from operations:

- Cash flow adjustments resulting from non-cash items increased $37.4 million primarily due to a $51.8 million change from a net unrealized gain on derivative instruments of $22.0 million to a net unrealized loss on derivative instruments of $29.9 million, as well as a decrease in production tax credit monetization of $20.7 million, offset by decreases in depreciation and amortization of $2.7 million, conservation amortization of $11.4 million, and deferred income taxes of $14.4 million. For further details, see Management's Discussion and Analysis, "Other Operating Expenses" in Item 2.
- Cash flows resulting from changes in working capital decreased $322.0 million partly due to changes in purchased gas adjustments of $165.7 million caused by actual natural gas costs being above natural gas baseline rates in the PGA mechanism. For further details, see Management's Discussion and Analysis, "Natural Gas Margin" in Item 2. In addition, Accounts payable increase in cash outflow of $122.9 million was primarily due to payment of significant power and natural gas costs accrued at December 31, 2018 that were paid in 2019. Finally, cash outflows associated with taxes payable increased by $47.8 million, as property taxes were paid in September of 2019 as compared to October of 2018.
- Cash flows resulting from regulatory assets and liabilities decreased $24.4 million primarily due to an increase in the power cost adjustment mechanism due to actual power costs being above power baseline costs. For further details, see Management's Discussion and Analysis, "Electric Margin" in Item 2.

Puget Energy (Dollars in Millions)	Nine Months Ended September 30, 2019	2018	Change
Net income	$ (63,961)	$ (65,138)	$ 1,177
Non-cash items[1]	5,990	616	5,374
Changes in cash flow resulting from working capital[2]	(10,938)	2,058	(12,996)
Regulatory assets and liabilities	—	—	—
Other noncurrent assets and liabilities[3]	(8,047)	(10,016)	1,969
Net cash provided by operating activities	$ (76,956)	$ (72,480)	$ (4,476)

1 *Non-cash items include depreciation, amortization, deferred income taxes, net unrealized (gain) loss on derivative instruments, AFUDC-equity, PTCs and other miscellaneous non-cash items.*

2 *Changes in working capital include receivables, unbilled revenue, materials/supplies, fuel/gas inventory, income taxes, prepayments, PGA, accounts payable and accrued expenses.*

3 *Other non-current assets and liabilities include funding of pension liability.*

Nine months ended September 30, 2019 compared to 2018

Cash generated from operations for the nine months ended September 30, 2019, in addition to the changes discussed at PSE above, decreased by $4.5 million compared to the same period in 2018. The change was primarily impacted by the factors explained below:

- Cash flow resulting from non-cash items increased $5.4 million primarily due to changes in deferred income taxes.
- Cash flow resulting from working capital decreased $13.0 million primarily due to changes in eliminations of PSE's intercompany account receivable balances with PLNG.

Financing Program

The Company's external financing requirements principally reflect the cash needs of its construction program, its schedule of maturing debt and certain operational needs. The Company anticipates refinancing the redemption of bonds or other long-term borrowings with its credit facilities and/or the issuance of new long-term debt. Access to funds depends upon factors such as Puget Energy's and PSE's credit ratings, prevailing interest rates and investor receptivity to investing in the utility industry, Puget Energy and PSE. The Company believes it has sufficient liquidity through its credit facilities and access to capital markets to fund its needs over the next twelve months.

Proceeds from PSE's short-term borrowings and sales of commercial paper are used to provide working capital and the interim funding of utility construction programs. Puget Energy and PSE continue to have reasonable access to the capital and credit markets.

Puget Sound Energy

Credit Facility

As of September 30, 2019, PSE had an $800.0 million credit facility to meet short-term liquidity needs. The credit facility includes a swingline feature allowing same day availability on borrowings up to $75.0 million. The credit facility has an expansion feature which, upon the banks' approval, would increase the total size of the facility to $1.4 billion. On September 25, 2019, with no changes to the size, terms or conditions, the maturity of the unsecured revolving credit facility was extended for one year. The facility now matures in October 2023.

The credit agreement is syndicated among numerous lenders and contains usual and customary affirmative and negative covenants that, among other things, place limitations on PSE's ability to transact with affiliates, make asset dispositions and investments or permit liens to exist. The credit agreement also contains a financial covenant of total debt to total capitalization of 65.0% or less. PSE certifies its compliance with such covenants to participating banks each quarter. As of September 30, 2019, PSE was in compliance with all applicable covenant ratios.

The credit agreement provides PSE with the ability to borrow at different interest rate options. The credit agreement allows PSE to borrow at the bank's prime rate or to make floating rate advances at the London Interbank Offered Rate (LIBOR) plus a spread that is based upon PSE's credit rating. PSE must pay a commitment fee on the unused portion of the credit facility. The spreads and the commitment fee depend on PSE's credit ratings. As of the date of this report, the spread to the LIBOR is 1.25% and the commitment fee is 0.175%.

As of September 30, 2019, no amounts were drawn and outstanding under PSE's credit facility and $69.0 million was outstanding under the commercial paper program. Outside of the credit agreement, PSE had a $2.8 million letter of credit in support of a long-term transmission contract and a $1.0 million letter of credit in support of natural gas purchases in Canada.

Demand Promissory Note

In 2006, PSE entered into a revolving credit facility with Puget Energy, in the form of a credit agreement and a demand promissory note (Note) pursuant to which PSE may borrow up to $30.0 million from Puget Energy subject to approval by Puget Energy. Under the terms of the Note, PSE pays interest on the outstanding borrowings based on the lower of the weighted-average interest rates of PSE's outstanding commercial paper interest rate or PSE's senior unsecured revolving credit facility. Absent such borrowings, interest is charged at one-month LIBOR plus 0.25%. As of September 30, 2019, PSE had no outstanding balance under the Note.

Debt Restrictive Covenants

The type and amount of future long-term financings for PSE may be limited by provisions in PSE's electric and natural gas mortgage indentures.

PSE's ability to issue additional secured debt may also be limited by certain restrictions contained in its electric and natural gas mortgage indentures. Under the most restrictive tests at September 30, 2019, PSE could issue:

- Approximately $1.8 billion of additional first mortgage bonds under PSE's electric mortgage indenture based on approximately $3.0 billion of electric bondable property available for issuance, subject to an interest coverage ratio limitation of 2.0 times net earnings available for interest (as defined in the electric utility mortgage), which PSE exceeded at September 30, 2019; and

- Approximately $591.0 million of additional first mortgage bonds under PSE's natural gas mortgage indenture based on approximately $985.0 million of natural gas bondable property available for issuance, subject to a combined natural gas and electric interest coverage test of 1.75 times net earnings available for interest and a natural gas interest coverage test of 2.0 times net earnings available for interest (as defined in the natural gas utility mortgage), both of which PSE exceeded at September 30, 2019.

At September 30, 2019, PSE had approximately $7.6 billion in electric and natural gas rate base to support the interest coverage ratio limitation test for net earnings available for interest.

Shelf Registrations

On August 2, 2019, PSE filed a new shelf registration statement for under which it may issue, up to $1.0 billion aggregate principal amount of senior notes secured by first mortgage bonds. As of the date of this report, $550.0 million was available under the registration. The shelf registration will expire in August 2022.

Dividend Payment Restrictions

The payment of dividends by PSE to Puget Energy is restricted by provisions of certain covenants applicable to long-term debt contained in PSE's electric and natural gas mortgage indentures. At September 30, 2019, approximately $816.5 million of unrestricted retained earnings was available for the payment of dividends under the most restrictive mortgage indenture covenant.

Pursuant to the terms of the Washington Commission merger order, PSE may not declare or pay dividends if PSE's common equity ratio, calculated on a regulatory basis, is 44.0% or below except to the extent a lower equity ratio is ordered by the Washington Commission. Also, pursuant to the merger order, PSE may not declare or make any distribution unless on the date of distribution PSE's corporate credit/issuer rating is investment grade, or, if its credit ratings are below investment grade, PSE's ratio of earnings before interest, tax, depreciation and amortization (EBITDA) to interest expense for the most recently ended four fiscal quarter periods prior to such date is equal to or greater than 3.0 to 1.0. The common equity ratio, calculated on a regulatory basis, was 48.4% at September 30, 2019 and the EBITDA to interest expense was 5.3 to 1.0 for the twelve months ended September 30, 2019.

PSE's ability to pay dividends is also limited by the terms of its credit facilities, pursuant to which PSE is not permitted to pay dividends during any Event of Default (as defined in the facilities), or if the payment of dividends would result in an Event of Default, such as failure to comply with certain financial covenants.

Long-Term Debt

On August 30, 2019, PSE issued $450.0 million of senior notes at an interest rate of 3.25%. The notes pay interest semi-annually and are due to mature on September 15, 2049. Proceeds from the sale of the notes were used to repay outstanding short term debt under the Company's commercial paper program.

Puget Energy

Credit Facility

As of September 30, 2019, Puget Energy maintained an $800.0 million credit facility. The Puget Energy revolving senior secured credit facility also has an accordion feature which, upon the banks' approval, would increase the size of the facility to $1.3 billion. On September 25, 2019, with no changes to the size, terms or conditions, the maturity of the facility was extended for one year. The facility now matures in October 2023.

The revolving senior secured credit facility provides Puget Energy the ability to borrow at different interest rate options and includes variable fee levels. Interest rates may be based on the bank's prime rate or LIBOR, plus a spread based on Puget Energy's credit ratings. Puget Energy must pay a commitment fee on the unused portion of the facility. As of September 30, 2019, there was $16.9 million drawn and outstanding under the facility. As of the date of this report, the spread over LIBOR was 1.75% and the commitment fee was 0.275%.

The revolving senior secured credit facility contains usual and customary affirmative and negative covenants. The agreement also contains a maximum leverage ratio financial covenant as defined in the agreement governing the senior secured credit facility. As of September 30, 2019, Puget Energy was in compliance with all applicable covenants.

Long-Term Debt

In April 2019, Puget Energy entered into an additional $24.0 million of supplemental loans under the expansion feature of the term loan agreement with the existing lenders. All other terms and conditions of the agreement remain unchanged. The proceeds from the term loan and supplemental loans will be used to repay borrowings under the revolving credit facility, which carries a higher interest rate.

On September 26, 2019, Puget Energy entered into a separate $210.0 million, three-year term loan agreement with a small group of banks. The agreement allows Puget Energy to borrow at either the banks' prime rate or LIBOR plus a spread, which will vary as those base rates fluctuate over the loan period. The Term Loan Agreement also includes an expansion feature, pursuant to which Puget Energy may request to increase the aggregate amount of the Term Loan Agreement, obtain incremental term loans or any combination of increases and incremental term loans in an amount up to $100.0 million. The proceeds from the term loan were contributed as equity to PSE and used to repay outstanding short term debt under the Company's commercial paper program.

Dividend Payment Restrictions

Puget Energy's ability to pay dividends is also limited by the merger order issued by the Washington Commission. Pursuant to the merger order, Puget Energy may not declare or make a distribution unless on such date Puget Energy's ratio of consolidated EBITDA to consolidated interest expense for the four most recently ended fiscal quarters prior to such date is equal to or greater than 2.0 to 1.0. Puget Energy's EBITDA to interest expense was 3.6 to 1.0 for the twelve months ended September 30, 2019.

At September 30, 2019, the Company was in compliance with all applicable covenants, including those pertaining to the payment of dividends.

Other

New Accounting Pronouncements

For the discussion of new accounting pronouncements, see Note 2, "New Accounting Pronouncements" to the consolidated financial statements in Item I of this report.

Washington Clean Energy Transition Act

In May 2019, Washington State passed the 100 Percent Clean Electric Bill that supports Washington's clean energy economy and transitioning to a clean, affordable, and reliable energy future. The Clean Energy Transition Act requires all electric utilities to eliminate coal-fired generation from their allocation of electricity by December 31, 2025; to be carbon-neutral by January 1, 2030, through a combination of non-emitting electric generation, renewable generation, and/or alternative compliance options; and makes it the state policy that, by 2045, 100% of electric generation and retail electricity sales will come from renewable or non-emitting resources. Clean Energy Implementation plans are required every four years from each investor-owned utility (IOU) and must propose interim targets for meeting the 2045 standard between 2030 and 2045, and lay out an actionable plan that they intend to pursue to meet the standard. The Washington Commission may approve, reject, or recommend alterations to an IOU's plan.

In order to meet these requirements, the Act clarifies the Washington Commission's authority to consider and implement performance and incentive-based regulation, multi-year rate plans, and other flexible regulatory mechanisms where appropriate. The Act mandates that the Commission accelerate depreciation schedules for coal-fired resources, including transmission lines, to December 31, 2025, or to allow investor-owned utilities to recover costs in rates for earlier closure of those facilities. Investor-owned utilities will be allowed to earn a rate of return on certain Power Purchase Agreements (PPA's) and 36 months deferred accounting treatment for clean energy projects (including PPAs) identified in the utility's clean energy implementation plan.

IOUs are considered to be in compliance when the cost of meeting the standard or an interim target within the four-year period between plans equals a 2% increase in the weather adjusted sales revenue to customers from the previous year. If relying on the cost cap exemption, IOUs must demonstrate that they have maximized investments in renewable resources and non-emitting generation prior to using alternative compliance measures.

Colstrip

PSE has a 50% ownership interest in Colstrip Units 1 and 2 and a 25% interest in Colstrip Units 3 and 4. In March 2013, the Sierra Club and the Montana Environmental Information Center filed a Clean Air Act citizen suit against all Colstrip owners in the U.S. District Court, District of Montana. In July 2016, PSE reached a settlement with the Sierra Club to dismiss all of the Clean Air Act allegations against the Colstrip Generating Station, which was approved by the court in September 2016. As part of the settlement that was signed by all Colstrip owners, Colstrip 1 and 2 owners, PSE and Talen Energy, agreed to retire the two oldest units (Units 1 and 2) at Colstrip in eastern Montana no later than July 1, 2022. Depreciation rates were updated in the GRC effective December 19, 2017, where PSE's depreciation increased for Colstrip Units 1 and 2 to recover plant costs to the expected shutdown date. The GRC also repurposed PTCs and hydro-related treasury grants to fund and recover decommissioning and remediation costs for Colstrip Units 1 and 2. Additionally, PSE has accelerated the depreciation of Colstrip Units 3 and 4, per the terms of the GRC settlement, to December 31, 2027.

On June 11, 2019, Talen made a public announcement that Colstrip 1 and 2 will be shut down at the end of the year due to operational losses associated with the Units. The regulatory asset associated with early retirement of Colstrip Units 1 and 2 increased from $130.7 million as of December 31, 2018, to $178.2 million as of September 30, 2019. The Washington Clean Energy Transition Act requires the Washington Commission to provide recovery of the investment, decommissioning, and remediation costs associated with the facilities. The full scope of decommissioning activities and costs may vary from the estimates that are available at this time.

Regional Haze Rule

In January 2017, the U.S. Environmental Protection Agency (EPA) published revisions to the Regional Haze Rule. Among other things, these revisions delayed new Regional Haze review from 2018 to 2021, however the end date will remain 2028. In January 2018, EPA announced that it was reconsidering certain aspects of these revisions and PSE is unable to predict the outcome.

Clean Air Act 111(d)/EPA Affordable Clean Energy Rule

In October 2015, the EPA issued the Clean Power Plan (CPP) rule under Section 111(d) of the Clean Air Act designed to regulate GHG emissions from existing power plants, which included state-specific goals and guidelines for states to develop plans for meeting these goals. However, after signing a notice of withdrawal of the CPP in March 2017, the EPA finalized a rule to repeal the CPP rule in June 2019

In August 2018, the EPA proposed the Affordable Clean Energy (ACE) rule to replace the 2015 CPP. The ACE rule was finalized in June 2019, and establishes emission guidelines for states to develop plans to address greenhouse gas emissions from existing coal-fired power plants. PSE is evaluating the final ACE rule to determine its impact on operations.

Washington Clean Air Rule

The CAR was adopted in September 2016, in Washington State and attempts to reduce greenhouse gas emissions from “covered entities” located within Washington State. Included under the new rule are large manufacturers, petroleum producers and natural gas utilities, including PSE. The CAR sets a cap on emissions associated with covered entities, which decreases over time approximately 5.0% every three years. Entities must reduce their carbon emissions, or purchase emission reduction units (ERUs), as defined under the rule, from others.

In September 2016, PSE, along with Avista Corporation, Cascade Natural Gas Corporation and NW Natural, filed a lawsuit in the U.S. District Court for the Eastern District of Washington challenging the CAR. In September 2016, the four companies filed a similar challenge to the CAR in Thurston County Superior Court. In March 2018, the Thurston County Superior Court invalidated the CAR. The Department of Ecology appealed the Superior Court decision in May 2018. As a result of the appeal, direct review to the Washington State Supreme Court was granted and oral argument was held on March 16, 2019, but no determination by the court has yet been made. The federal court litigation has been held in abeyance pending resolution of the state case.

Related Party Transactions

In August 2015, PSE filed a proposal with the Washington Commission to develop an LNG facility at the Port of Tacoma. The Tacoma LNG facility will provide peak-shaving services to PSE’s natural gas customers, and will provide LNG as fuel to transportation customers, particularly in the marine market. Following a mediation process and the filing of a settlement stipulation by PSE and all parties, the Washington Commission issued an order on October 31, 2016, that allowed PSE’s parent company, Puget Energy, to create a wholly-owned subsidiary, named Puget LNG, which was formed on November 29, 2016, for the sole purpose of owning, developing and financing the non-regulated activity of the Tacoma LNG facility. Puget LNG has entered into one fuel supply agreement with a maritime customer and is marketing the facility’s expected output to other potential customers.

The Tacoma LNG facility is currently under construction. Pursuant to the Commission’s order, Puget LNG will be allocated approximately 57.0% of the capital and operating costs of the Tacoma LNG facility and PSE will be allocated the remaining 43.0% of the capital and operating costs. PSE and Puget LNG are considered related parties with similar ownership by Puget Energy. Therefore, capital and operating costs that occur under PSE and are allocated to Puget LNG are related party transactions by nature. Per this allocation of costs, $191.8 million of construction work in progress and $1.0 million of operating costs related to Puget LNG's portion of the Tacoma LNG facility are reported in the Puget Energy "Other property and investments" and "Non-utility expense and other" financial statement line items, respectively, as of September 30, 2019. The portion of the Tacoma LNG facility allocated to PSE will be subject to regulation by the Washington Commission.

Item 3. **<u>Quantitative and Qualitative Disclosure about Market Risk</u>**

The Company is exposed to various forms of market risk, consisting primarily of fluctuations in commodity prices, counterparty credit risk, as well as interest rate risk. PSE maintains risk policies and procedures to help manage the various risks. There have been no material changes to market risks affecting the Company from those set forth in Part II, Item 7A - "Quantitative and Qualitative Disclosures about Market Risk" of the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

Commodity Price Risk

The nature of serving regulated electric and natural gas customers with its portfolio of owned and contracted electric generation resources exposes PSE and its customers to some volumetric and commodity price risks. PSE's Energy Management Committee establishes energy risk management policies and procedures to manage commodity and volatility risks and the related effects on credit, tax, accounting, financing and liquidity.

PSE's objective is to minimize commodity price exposure and risks associated with volumetric variability in the natural gas and electric portfolios. It is not engaged in the business of assuming risk for the purpose of speculative trading. PSE hedges open natural gas and electric positions to reduce both the portfolio risk and the volatility risk in prices.

Counterparty Credit Risk

PSE is exposed to credit risk primarily through buying and selling electricity and natural gas to serve customers. Credit risk is the potential loss resulting from a counterparty's non-performance under an agreement. PSE manages credit risk with policies and procedures for counterparty analysis and measurement, monitoring and mitigation of exposure. Additionally, PSE has entered into commodity master arrangements (i.e., WSPP, Inc. (WSPP), International Swaps and Derivatives Association (ISDA) or North American Energy Standards Board (NAESB)) with its counterparties to mitigate credit exposure.

Interest Rate Risk

The Company believes its interest rate risk primarily relates to the use of short-term debt instruments, variable-rate leases and anticipated long-term debt financing needed to fund capital requirements. The Company manages its interest rate risk through the issuance of mostly fixed-rate debt with varied maturities. The Company utilizes internal cash from operations, borrowings under its commercial paper program, and its credit facilities to meet short-term funding needs. Short-term obligations are commonly refinanced with fixed-rate bonds or notes when needed and when interest rates are considered favorable. The Company may also enter into swaps or other financial hedge instruments to manage the interest rate risk associated with the debt.

Item 4. **<u>Controls and Procedures</u>**

Puget Energy

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of Puget Energy's management, including the President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, Puget Energy has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2019, the end of the period covered by this report. Based upon that evaluation, the President and Chief Executive Officer and Senior Vice President and Chief Financial Officer of Puget Energy concluded that these disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

During 2018, PE implemented internal controls covering the evaluation and assessment of leasing contracts related to the adoption of the new leasing standard as of January 1, 2019.

There have been no changes in Puget Energy's internal control over financial reporting during the quarter ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, Puget Energy's internal control over financial reporting.

Puget Sound Energy

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of PSE's management, including the President and Chief Executive Officer and Senior Vice President and Chief Financial Officer, PSE has evaluated the effectiveness of its disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of September 30, 2019, the end of the period covered by this report. Based upon that evaluation, the President and Chief Executive Officer and Senior Vice President and Chief Financial Officer of PSE concluded that these disclosure controls and procedures are effective.

Changes in Internal Control over Financial Reporting

During 2018, PSE implemented internal controls covering the evaluation and assessment of leasing contracts related to the adoption of the new leasing standard as of January 1, 2019.

There have been no changes in PSE's internal control over financial reporting during the quarter ended September 30, 2019 that have materially affected, or are reasonably likely to materially affect, PSE's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. **Legal Proceedings**

Contingencies arising out of the Company's normal course of business existed as of September 30, 2019. Litigation is subject to numerous uncertainties and the Company is unable to predict the ultimate outcome of these matters. For details on legal proceedings, see Note 8, "Commitments and Contingencies" in the Combined Notes to Consolidated Financial Statements in Item I.

Item 1A. **Risk Factors**

There have been no material changes from the risk factors set forth in Part I, Item 1A, "Risk Factors" of the Company's Annual Report on Form 10-K for the period ended December 31, 2018.

Item 6. **Exhibits**

Included in the Exhibit Index are a list of exhibits filed as part of this Quarterly Report on Form 10-Q.

EXHIBIT INDEX

3(i).1	Amended Articles of Incorporation of Puget Energy (incorporated herein by reference to Exhibit 3.1 to Puget Energy's Current Report on Form 8-K, dated February 6, 2009, Commission File No. 1-16305).
3(i).2	Amended and Restated Articles of Incorporation of Puget Sound Energy, Inc. (incorporated herein by reference to Exhibit 3.2 to Puget Sound Energy's Current Report on Form 8-K, dated February 6, 2009, Commission File No. 1-4393).
3(ii).1	Amended and Restated Bylaws of Puget Energy dated February 6, 2009 (incorporated herein by reference to Exhibit 3.3 to Puget Energy's Current Report on Form 8-K, Commission File No. 1-16305).
3(ii).2	Amended and Restated Bylaws of Puget Sound Energy, Inc. dated February 6, 2009 (incorporated herein by reference to Exhibit 3.4 to Puget Sound Energy's Current Report on Form 8-K, Commission File No. 1-4393).
10.1*	Term Loan Agreement, dated as of September 26, 2019. by and among Puget Energy, as borrower, Mizuho Bank as Administrative Agent and Mizuho Bank, U.S. Bank and Co-Bank as lenders.
10.2*	Employment Offer Letter, dated as of June 20, 2019, by and between Puget Sound Energy, Inc. and Mary E. Kipp.
31.1*	Chief Executive Officer certification of Puget Energy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Principal Financial Officer certification of Puget Energy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.3*	Chief Executive Officer certification of Puget Sound Energy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.4*	Principal Financial Officer certification of Puget Sound Energy pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Chief Executive Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2*	Principal Financial Officer certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Financial statements from the Quarterly Report on Form 10-Q of Puget Energy, Inc. and Puget Sound Energy, Inc. for the quarter ended September 30, 2019 filed on November 6, 2019 formatted in XBRL: (i) the Consolidated Statement of Income (Unaudited), (ii) the Consolidated Statements of Comprehensive Income (Unaudited), (iii) the Consolidated Balance Sheets (Unaudited), (iv) the Consolidated Statements of Cash Flows (Unaudited), and (v) the Notes to Consolidated Financial Statements (submitted electronically herewith).

* *Filed herewith.*

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, each registrant has duly caused this report to be signed on their behalf by the undersigned thereunto duly authorized.

PUGET ENERGY, INC.
PUGET SOUND ENERGY, INC.

/s/ Stephen King

Stephen King
Controller & Principal Accounting Officer

Date: November 6, 2019