

Exhibit \_\_\_ (KLE-14)  
Docket U-072375  
Witness: Kenneth L. Elgin

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the Joint Application of**

**DOCKET U-072375**

**PUGET HOLDINGS LLC AND PUGET  
SOUND ENERGY, INC.,**

**For an Order Authorizing Proposed  
Transaction**

**EXHIBIT TO TESTIMONY OF**

**Kenneth L. Elgin**

**STAFF OF  
WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION**

*Standard & Poor's Ratings Direct  
Puget Energy Inc.  
Summary and Major Rating Factors  
March 26, 2008*

**June 18, 2008**

March 26, 2008

**Summary:**  
**Puget Energy Inc.**

**Primary Credit Analyst:**

Antonio Bettinelli, San Francisco (1) 415-371-5067; antonio\_bettinelli@standardandpoors.com

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Rationale

## Summary:

# Puget Energy Inc.

**Credit Rating:** BBB-/Watch Neg/--

## Rationale

The 'BBB-' corporate credit rating on Puget Energy Inc. (Puget) and PSE remains on CreditWatch with negative implications, pending the requisite approvals for final outcome of regulatory approval proceedings. The ratings reflect the excellent business profile of PSE, a regulated, vertically integrated electric and gas utility, and the consolidated financial risk profile of Puget.

Bellevue, Wash.-based Puget had roughly \$3.1 billion of total debt outstanding as of Dec. 31, 2007.

The CreditWatch listing reflects the possibility that debt ratings for Puget and PSE could be lowered contingent on the final outcome of regulatory merger approval proceedings. Importantly, the company's credit profile has been improving, which provides financial flexibility to accommodate the proposed capital structure at the current rating level. Still, Puget's expected consolidated credit measures post-transaction will be stretched and the final regulatory order could weaken anticipated cash flow coverage metrics.

Standard & Poor's Ratings Services placed the ratings of holding company Puget Energy Inc. and its electric and gas utility subsidiary Puget Sound Energy Inc. on CreditWatch with negative implications on Oct. 26, 2007. The action followed the announcement that Puget Energy has agreed to sell itself to a consortium of private investors led by Macquarie Infrastructure Partners, an affiliate of Macquarie Group Ltd. (A-/Stable/A-2) for \$7.4 billion. The proposed transaction is to be financed with a significant amount of debt at the holding company and is expected to increase debt leverage on a consolidated basis.

Puget's business risk profile is "excellent," reflecting the combined electric and gas utility business of PSE, which is subject to regulation by the Washington Utilities and Transportation Commission (WUTC). The regulatory environment in Washington and how the company manages its relationship with the WUTC are key drivers of credit quality, especially in light of PSE's high capital needs and commodity price exposure. The company's most recent general rate case granted PSE a 10.4% return on equity on a hypothetical 44% equity layer, as well as permission to recover costs for recent plant additions and for short-term financing needs related to power supply hedging. The commission did not approve the company's requests for a gas "decoupling" mechanism, a depreciation tracker, and a modification to its power cost adjustment (PCA) mechanism. An electric case is currently pending for a \$174 million, or 9.5%, rate increase and a gas case for \$56.8 million, or 5.3%, annually. Both are expected to be finalized by November.

Puget's cost recovery mechanisms also support credit quality. The company has a great degree of flexibility in implementing rate changes through its PCA, but the threshold it must meet to update rates is high and deferred costs are not automatically collected. Each year, uncollected costs are subject to defined sharing bands, allowing the company to defer certain portions for collection from customer. However, the PCA mechanism does not trigger a rate increase until a minimum deferral balance is reached. Puget is also able to update rates for changes in projected costs by filing a power cost only rate case (PCORC), which gives it the flexibility to file for changes in variable and

fixed costs whenever there is a projected deferral balance of \$30 million or more. The PCORC functions as a "mini" rate case that takes about five months and is especially useful for new plant additions or contracts.

Puget's financial risk profile is "aggressive" under Standard & Poor's corporate risk matrix. Financial measures have been adequate for the rating, although cash flow coverage metrics have been mixed and are expected to weaken if the pending acquisition by Macquarie is completed. Adjusted funds from operations (FFO) to interest coverage was approximately 3.2x, while FFO to average total debt was at about 16.1% for the 12 months ended Dec. 31, 2007. Adjusted debt leverage -- including debt adjustments for operating leases, purchased power, and hybrid equity -- was approximately 56.6% as of Dec. 31, 2007, and was bolstered by a private equity placement of about \$300 million with Macquarie Infrastructure. Although this transaction has strengthened the balance sheet, Puget's consolidated credit measures post-transaction will be weaker, assuming successful completion of the merger.

Capital requirements are very high at PSE, with capital expenditures of \$2.7 billion planned for 2008 through 2009 related to system upgrade needs, customer growth, and further resource additions. Ongoing periodic debt and equity funds are expected to finance this growth.

#### Short-term credit factors

PSE's short-term rating is 'A-3'. Overall liquidity at PSE was adequate, with \$384 million in available capacity as of Dec. 31, 2007, under its \$500 million committed unsecured bank credit agreement at PSE that expires April 15, 2012, and a fully available \$350 million facility to support hedging activities. Secondary liquidity resources at PSE include a \$200 million receivables securitization facility with \$48 million available as of Dec. 31, 2007. Liquidity requirements will remain high at PSE due to a high level of planned capital spending and potential collateral requirements related to the company's electric and gas supply arrangements. Debt maturities are manageable, with about \$179 million due in 2008 and \$158 million due in 2009. We expect Puget to internally fund about 50% of capital expenditures in order to maintain a stable capital structure.

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March 26, 2008

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**Primary Credit Analyst:**

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Major Rating Factors

Rationale

# Puget Energy Inc.

## Major Rating Factors

### Strengths:

- Regulated electric and gas operations that provide relatively stable cash flows;
- A generally supportive state regulatory regime with good power and fuel cost adjustment mechanisms;
- A growing base of electric and gas customers in the Puget Sound region; and
- The absence of material, unregulated businesses.

### Corporate Credit Rating

BBB-/Watch Neg/--

### Weaknesses:

- Aggressive financial strategy;
- Heavy capital requirements driven by system maintenance and resource requirements;
- Moderate price and commodity risk related to Puget Sound Energy's (PSE) reliance on hydroelectric; and gas-fired resources as well as a moderate amount of market purchases.

## Rationale

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recover costs for recent plant additions and for short-term financing needs related to power supply hedging. The commission did not approve the company's requests for a gas "decoupling" mechanism, a depreciation tracker, and a modification to its power cost adjustment (PCA) mechanism. An electric case is currently pending for a \$174 million, or 9.5%, rate increase and a gas case for \$56.8 million, or 5.3%, annually. Both are expected to be finalized by November.

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**Short-term credit factors**

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Table 1

Puget Energy Inc. -- Peer Comparison*				
Industry Sector: Combo				
	Puget Energy Inc.	Avista Corp.	Portland General Electric Co.	IDACORP Inc.
Rating as of March 25, 2008	BBB-/Watch Neg/--	BBB-/Stable/A-3	BBB+/Stable/A-2	BBB/Stable/A-2



Table 1

<b>Puget Energy Inc. -- Peer Comparison*(cont.)</b>				
<b>--Average of past three fiscal years--</b>				
<b>(Mil. \$)</b>				
Revenues	2,899.7	1,427.9	1,569.7	882.8
Net income from cont. oper.	166.1	52.3	93.3	89.4
Funds from operations (FFO)	433.0	186.2	281.2	149.1
Capital expenditures	787.0	194.5	359.6	232.8
Cash and investments	30.1	20.6	69.0	23.4
Debt	3,337.5	1,368.8	1,390.0	1,416.1
Preferred stock	89.5	0.0	0.0	0.0
Equity	2,298.5	854.7	1,217.5	1,099.7
Debt and equity	5,636.0	2,223.5	2,607.5	2,515.8
<b>Adjusted ratios</b>				
EBIT interest coverage (x)	2.0	1.8	2.3	2.3
FFO int. cov. (x)	2.9	2.7	3.6	2.9
FFO/debt (%)	13.0	13.6	20.2	10.5
Discretionary cash flow/debt (%)	(15.5)	(1.7)	(12.5)	(9.7)
Net cash flow / Capex (%)	42.1	81.0	56.3	41.9
Debt/total capital (%)	59.2	61.6	53.3	56.3
Return on common equity (%)	7.2	5.7	5.9	7.2
Common dividend payout ratio (un-adj.) (%)	60.4	54.7	84.3	57.8

\*Fully adjusted (including postretirement obligations).

Table 2

<b>Puget Energy Inc. -- Financial Summary*</b>					
<b>Industry Sector: Combo</b>					
<b>--Fiscal year ended Dec. 31--</b>					
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>
Rating history	BBB-/Watch Neg/--	BBB-/Stable/--	BBB-/Stable/--	BBB-/Positive/--	BBB-/Positive/--
<b>(Mil. \$)</b>					
Revenues	3,220.1	2,905.7	2,573.2	2,198.9	2,491.5
Net income from continuing operations	184.7	167.2	146.3	125.4	121.3
Funds from operations (FFO)	555.9	358.1	384.9	566.3	390.1
Capital expenditures	801.5	960.9	598.5	450.5	300.6
Cash and investments	45.6	28.1	16.7	19.7	27.5
Debt	3,454.6	3,628.2	2,929.7	3,052.6	2,985.8
Preferred stock	126.9	20.8	120.8	142.0	141.9
Equity	2,648.8	2,136.8	2,109.8	1,715.8	1,770.8
Debt and equity	6,103.5	5,765.0	5,039.5	4,768.5	4,756.6
<b>Adjusted ratios</b>					
EBIT interest coverage (x)	2.0	2.1	2.0	1.5	1.7
FFO int. cov. (x)	3.2	2.6	2.8	3.6	2.6

Table 2

Puget Energy Inc. -- Financial Summary* (cont.)					
FFO/debt (%)	16.1	9.9	13.1	18.6	13.1
Discretionary cash flow/debt (%)	(9.0)	(22.3)	(14.9)	0.1	(1.1)
Net cash flow / Capex (%)	55.3	26.4	49.6	106.4	101.0
Debt/debt and equity (%)	56.6	62.9	58.1	64.0	62.8
Return on common equity (%)	7.2	7.2	7.3	7.2	7.1
Common dividend payout ratio (un-adj.) (%)	58.7	62.4	60.2	69.3	70.1

\*Fully adjusted (including postretirement obligations).

Table 3

## Reconciliation Of Puget Energy Inc. Reported Amounts With Standard &amp; Poor's Adjusted Amounts (Mil. \$)\*

--Fiscal year ended Dec. 31, 2007--

## Puget Energy Inc. reported amounts

	Debt	Shareholders' equity	Operating income (before D&A)	Operating income (before D&A)	Operating income (after D&A)	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	3,118.8	2,523.8	768.4	768.4	449.2	205.2	564.2	564.2	108.4	780.7

## Standard &amp; Poor's adjustments

Operating leases	97.9	--	14.4	6.0	6.0	6.0	8.4	8.4	--	33.4
Intermediate hybrids reported as debt	(125.0)	125.0	--	--	--	(4.4)	4.4	4.4	4.4	--
Postretirement benefit obligations	--	--	(4.9)	(4.9)	(4.9)	--	1.4	1.4	--	--
Capitalized interest	--	--	--	--	--	12.6	(12.6)	(12.6)	--	(12.6)
Power purchase agreements	362.9	--	63.8	63.8	25.6	25.6	38.2	38.2	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	21.4	--	--	--	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	(48.1)	--	--
Total adjustments	335.8	125.0	73.2	64.8	48.1	39.9	39.7	(8.3)	4.4	20.8

## Standard &amp; Poor's adjusted amounts

	Debt	Equity	Operating income (before D&A)	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	3,454.6	2,648.8	841.5	833.2	497.3	245.1	603.9	555.9	112.8	801.5

Table 3

**Reconciliation Of Puget Energy Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)\*(cont.)**

\*Puget Energy Inc. reported amounts shown are taken from the company's financial statements but might include adjustments made by data providers or reclassifications made by Standard & Poor's analysts. Please note that two reported amounts (operating income before D&A and cash flow from operations) are used to derive more than one Standard & Poor's-adjusted amount (operating income before D&A and EBITDA, and cash flow from operations and funds from operations, respectively). Consequently, the first section in some tables may feature duplicate descriptions and amounts.

**Ratings Detail (As Of March 26, 2008)\*****Puget Energy Inc.**

Corporate Credit Rating	BBB-/Watch Neg/--
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**Corporate Credit Ratings History**

26-Oct-2007	BBB-/Watch Neg/--
13-May-2005	BBB-/Stable/--
19-Nov-2003	BBB-/Positive/--

**Related Entities****Puget Sound Energy Inc.**

Issuer Credit Rating	BBB-/Watch Neg/A-3
Commercial Paper	
<i>Local Currency</i>	A-3/Watch Neg
Junior Subordinated	
<i>Local Currency</i>	BB/Watch Neg
Preferred Stock	
<i>Local Currency</i>	BB/Watch Neg
Senior Secured	
<i>Local Currency</i>	BBB+/Watch Neg

**Puget Sound Power & Light Co.**

Issuer Credit Rating	BBB-/Watch Neg/NR
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**Washington Natural Gas Co.**

Issuer Credit Rating	BBB-/Watch Neg/--
Senior Secured	
<i>Local Currency</i>	BBB+/Watch Neg

\*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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