

**EXHIBIT NO. \_\_\_(EMM-9)  
DOCKET NO. UE-07\_\_\_/UG-07\_\_\_  
2007 PSE GENERAL RATE CASE  
WITNESS: ERIC M. MARKELL**

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY, INC.,**

**Respondent.**

**Docket No. UE-07\_\_\_  
Docket No. UG-07\_\_\_**

**EIGHTH EXHIBIT (NONCONFIDENTIAL) TO THE  
PREFILED DIRECT TESTIMONY OF  
ERIC M. MARKELL  
ON BEHALF OF PUGET SOUND ENERGY, INC.**

**DECEMBER 3, 2007**



**Puget Energy, Inc.:**

*PSD: Rate Case Order Not Great, but Better Than First Blush; Lowering 2007E*

KeyBanc Capital Markets,  
 A Division of McDonald Investments Inc.

Paul T. Ridzon: (216) 263-4789 — [pridzon@keybanccm.com](mailto:pridzon@keybanccm.com)  
 Scott W. Hamann: (216) 563-2137 — [shamann@keybanccm.com](mailto:shamann@keybanccm.com)

**Investors should assume that we are seeking or will seek investment banking or other business relationships with the company described in this report.**

Rating	HOLD (3)
Price	\$24.62
12-Mo. Price Target	NA
Dividend	\$1.00
Yield	4.1%
52-Wk. Range	\$20-\$26
Trading Volume	473,000
Market Cap. (mm)	\$2,843.6
Shares Out. (mm)	115.50
Book Value	\$16.61

Fiscal Year End	December
2007E	\$1.60
2006E	\$1.50
2005A	\$1.42
2007 P/E	15.4x
2006 P/E	16.4x
First Call 2007E	\$1.63
First Call 2006E	\$1.50

Next Quarter	December
Estimate	\$0.47
Vs.	\$0.52
First Call Estimate	\$0.53

**KEY INVESTMENT POINTS**

On January 5, the Washington commission issued its order in PSD's electric and gas rate case.

While we view the traditional ratemaking parameters as reasonable, we believe little progress has been made to structurally alleviate underearning. However, relief mechanisms were outlined by the commission.

The commission declined to accept a depreciation tracker, diluted a gas decoupling plan and maintained the current level of fuel and purchased power costs at risk.

Traditional regulatory math suggests earnings power of \$1.63 per share. However, the regulatory lag stemming from a level of capex greater than depreciation and inflationary pressures should preclude this level of earnings.

**We are therefore reducing our 2007 EPS estimate from \$1.65 to \$1.60 and maintaining our HOLD (3) rating on the shares.** Our estimate assumes a modest benefit from hydro conditions that appear to be tracking above normal.

**VALUATION**

Based upon our revised 2007 estimate, shares of PSD's stock trade at a 3% discount to the group average P/E ratio of 15.9x. We consider shares fairly valued to modestly attractive as above normal growth is balanced by regulatory risk in a state considered somewhat restrictive.

**RISKS**

We believe the primary risk for PSD is the overhang associated with frequent regulatory filings necessary to address the regulatory lag associated with the strong regional growth and accompanying level of capital expenditures required.

**INVESTMENT OPINION**

On January 5, the Washington Utilities and Transportation Commission (WUTC) issued its order in PSD's consolidated electric and natural gas rate cases. We had considered this rate case an important barometer of WUTC's willingness to address the structural inability of the high growth utilities in the state to consistently earn authorized returns. PSD had filed to introduce mechanisms to address these challenges, including a depreciation tracker to allow recovery of investment between rate cases, gas decoupling to allow more level recovery of fixed costs through weather changes and conservation, including some hedging costs in rates, and revisions of the level of risk that could be absorbed around fuel and purchased power costs.

PSD had filed for a ROE of 11.25% on a rate base of \$4.15 billion comprised of a 45% equity layer (previous levels were: 10.3%, \$3.61 billion and 43%, respectively). The parameters in the new order are a ROE of 10.4%, rate base of \$4.16 billion and

**FOR IMPORTANT DISCLOSURES AND CERTIFICATIONS, PLEASE REFER TO PAGES 3 - 4 OF THIS NOTE.**

an equity layer of 44%. We view an incrementally higher ROE and no meaningful rate base disallowances positively. The simplistic regulatory math suggests earnings power of \$1.63 per share.

However, we believe that the WUTC's lack of willingness to accept structural ratemaking changes will preclude the Company from earning at this level. PSD's regional growth, and need for catch-up spending after the western power crisis put the Company in a tight financial position, implies capex will exceed depreciation for years. PSD proposed that it be allowed to collect in rates this incremental capital (with annual true-ups) through a depreciation tracker. WUTC outright denied this, but did indicate that PSD could file for incremental relief, between full rate cases, so the level of underearning should be lower in the future than the Company has had to accept in the past.

Gas decoupling, which is coming to receive a level of support throughout the country, was also proposed by PSD. This mechanism makes more of a customer bill fixed, lessening the volumetric component of fixed cost recovery, and offering a buffer against conservation and elasticity response. The commission did include an experimental conservation tracker, although we would have preferred taking more weather risk out of rates, but this should average out in the long term.

The WUTC accepted that the cost of a line of credit to support hedging activities benefited and should be borne by the customer. However, we note that the commission indicated that the resulting lower risk experienced by the Company should be considered in the next rate case when determining the cost of capital.

Finally, WUTC denied PSD's request to reduce the magnitude of risk around fuel and purchase power costs. Whereas these costs are frequently a pass-through in ratemaking, in Washington, large levels of variation around plan are retained or foregone by ratepayers and utilities. PSD proposed reducing the current \$20 million deadband with 100% risk (implying earnings could be whipsawed by +/- \$0.11 per share) to \$25 million with 5%/50% sharing. The commission denied this concept and stated any such changes would suggest a lower risk premium in authorized returns. Again, on a note that is more positive than first blush, WUTC indicated that PSD could file for relief through expedited processes (the Power Cost only Rate Case - PCORC).

We are reducing our 2007 EPS estimate to \$1.60 from \$1.65, to account for the stale September 2005 test year cost structure. We are assuming some modest benefit from what appears to have the making of an above normal year for hydro conditions.

### **EPS (Net) Summary**

	2005A	%CHG	2006E	%CHG	2007E	%CHG
1Q	\$0.68	61.9%	\$0.63A	-7.4%	--	--
2Q	\$0.15	0.0%	\$0.26A	73.3%	--	--
3Q	\$0.06	-33.3%	\$0.14A	133.3%	--	--
4Q	\$0.52	-11.9%	\$0.47	-9.6%	--	--
YEAR	\$1.42	18.3%	\$1.50	5.6%	\$1.60	6.7%

*Source: McDonald Investments Inc. estimates*

## KeyBanc Capital Markets Disclosures and Certifications

### Puget Energy, Inc. - PSD

Puget Energy, Inc. is an investment banking client of ours.

We have received compensation for investment banking services from Puget Energy, Inc. during the past 12 months

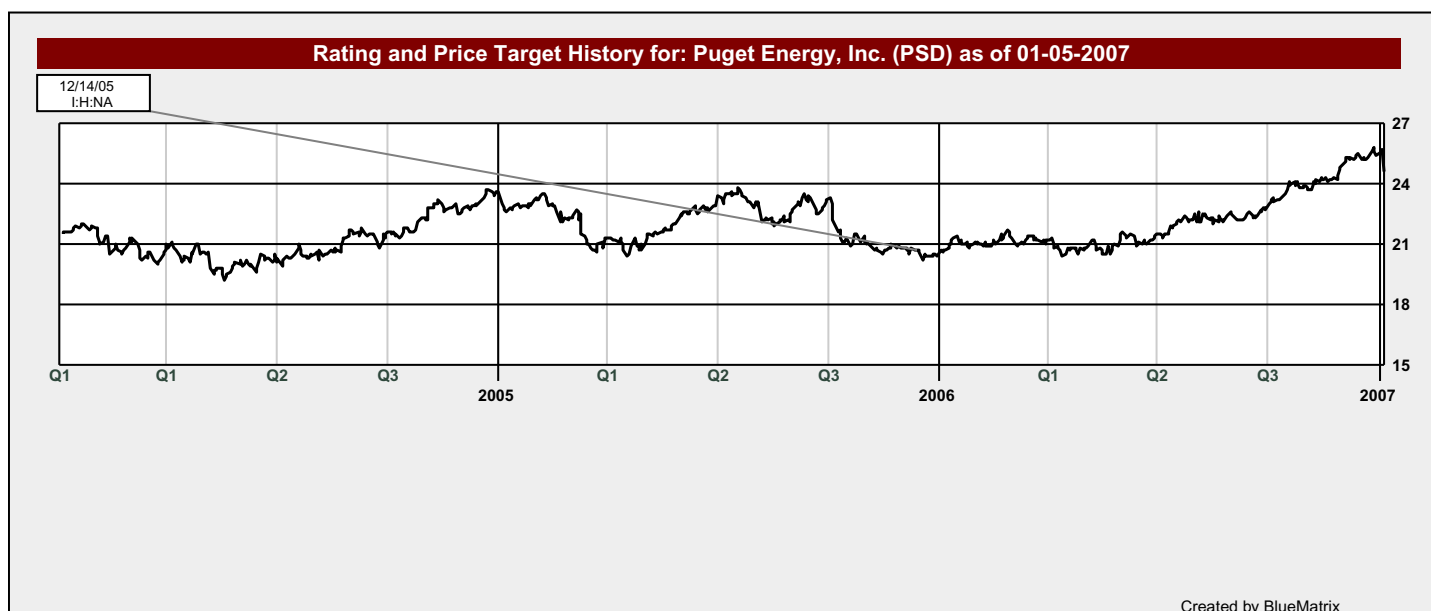
We expect to receive or intend to seek compensation for investment banking services from Puget Energy, Inc. within the next three months.

During the past 12 months, Puget Energy, Inc. has been a client of the firm or its affiliates for non-securities related services.

### Reg A/C Certification

The research analyst(s) responsible for the preparation of this research report certifies that:(1) all the views expressed in this research report accurately reflect the research analyst's personal views about any and all of the subject securities or issuers; and (2) no part of the research analyst's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the research analyst(s) in this research report.

### Three-Year Rating and Price Target History



### Rating Disclosures

Distribution of Ratings/IB Services Firmwide and by Sector									
KeyBanc Capital Markets					ENERGY				
Rating	Count	Percent	IB Serv./Past 12 Mos.		Rating	Count	Percent	IB Serv./Past 12 Mos.	
			Count	Percent				Count	Percent
BUY [AB/BUY]	125	41.39	125	100.00	BUY [AB/BUY]	10	16.67	10	100.00
HOLD [HOLD]	167	55.30	166	99.40	HOLD [HOLD]	50	83.33	50	100.00
SELL [UND/SELL]	10	3.31	9	90.00	SELL [UND/SELL]	0	0.00	0	0.00

### **Rating System**

AGGRESSIVE BUY (1) - The security is expected to outperform the market over the short term; investors should consider adding the security to their portfolios, subject to their overall diversification requirements.

BUY (2) - The security is expected to outperform the market over the long term; investors should consider adding the security to their holdings opportunistically, subject to their overall diversification requirements.

HOLD (3) - The security is expected to perform in line with general market indices; no buy or sell action is recommended at this time.

UNDERWEIGHT (4) - The security is expected to underperform the market; investors should reduce their holdings opportunistically.

SELL (5) - Absolute downside risk is evident for the security; investors should liquidate their holdings.

The information contained in this report is based on sources considered to be reliable but is not represented to be complete and its accuracy is not guaranteed. The opinions expressed reflect the judgment of the author as of the date of publication and are subject to change without notice. This report does not constitute an offer to sell or a solicitation of an offer to buy any securities. Our company policy prohibits research analysts and members of their families from owning securities of any company followed by that analyst, unless otherwise disclosed. Our officers, directors, shareholders and other employees, and members of their families may have positions in these securities and may, as principal or agent, buy and sell such securities before, after or concurrently with the publication of this report. In some instances, such investments may be inconsistent with the opinions expressed herein. One or more of our employees, other than the research analyst responsible for the preparation of this report, may be a member of the Board of Directors of any company referred to in this report. The research analyst responsible for the preparation of this report is compensated, based in part, on investment banking revenue which may include revenue derived from the Firm's performance of investment banking services for companies referred to in this report, although such compensation is not based upon specific investment banking services transactions for these or any other companies. In accordance with industry practices, our analysts are prohibited from soliciting investment banking business for our Firm.

© Copyright 2007, McDonald Investments Inc. All rights reserved.

#### **Securities, mutual funds and other investment products are:**

- **Not Insured by the FDIC.**
- **Not deposits or other obligations of, or guaranteed by McDonald Investments Inc., KeyBank or any of their affiliates.**
- **Subject to investment risks, including possible loss of the principal amount invested.**