

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Docket Nos. UG-110723
Puget Sound Energy, Inc.'s
Tariff filing for Pipeline Integrity Program

PUBLIC COUNSEL DATA REQUEST NO. 035

PUBLIC COUNSEL DATA REQUEST NO. 035:

Please provide all credit rating agency reports or analyst reports relating to PSE, PSE Energy, or PSE Holdings issued within the last 18 months.

Response:

Puget Sound Energy, Inc. ("PSE") objects to Public Counsel Data Request No. 035 to the extent it seeks information that is neither relevant to the issues in this proceeding nor reasonably calculated to lead to the discovery of admissible evidence. PSE further objects to Public Counsel Data Request No. 035 as overly broad and unduly burdensome taking into account the needs of the adjudicative proceeding. In particular, this objection applies to requested information related to Puget Holdings. Without waiving such objections, and subject thereto, PSE responds as follows:

Attached as Attachment A to PSE's Response to Public Counsel Data Request No. 035, please find credit rating agency or analyst reports relating to PSE and Puget Energy issued within the last 18 months. There are no credit rating reports issued for Puget Holdings.

**ATTACHMENT A to PSE's Response to
Public Counsel Data Request No. 035**



Standard & Poor's Research

February 24, 2011

Puget Energy Inc.

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Puget Energy Inc.

Major Rating Factors

Strengths:

- Regulated integrated electric and natural gas utility operations that provide relatively stable cash flows;
- Generally supportive regulatory framework with a power cost adjustment (PCA) mechanism and purchased gas adjustment mechanisms, although the PCA mechanism contains deadbands;
- A power-cost-only rate case procedure that functions as a limited-scope rate case for resource additions and other power costs, thus reducing rate lag; and
- The absence of material unregulated businesses.

Corporate Credit Rating

BB+/Stable/--

Weaknesses:

- Aggressive financial strategy, reflecting the additional debt leverage added at the holding company;
- Significant capital expenditure requirements -- driven by infrastructure replacement, renewable portfolio standards, and other new resource requirements -- that increase rate lag;
- Reliance on external debt capital to finance capital plans beyond the company's internal cash funding ability; and
- Moderate price and commodity risk related to a significant reliance on hydroelectric and gas-fired resources, as well as market purchases.

Rationale

The 'BB+' corporate credit rating on Puget Energy Inc. (Puget) primarily reflects the "excellent" business risk profile and "aggressive" financial risk profile of its steady integrated electric and gas utility operations at 'BBB' rated Puget Sound Energy Inc. (PSE), consolidated financial measures that are weaker than PSE's due to additional debt leverage at the holding company, and the disadvantage of insulating provisions pledged at the utility operating company that may limit dividends. Standard & Poor's Ratings Services views all holding company financial obligations as being disadvantaged relative to operating company debts and credit facilities. However, the relationship between these entities and a lack of other operating units constrains the degree of differentiation between the two credit ratings.

We view the package of regulatory commitments that the companies entered into during the merger settlement as providing a degree of insulation to the utility. The package includes the placement of independent directors on the utility's board of directors and dividend restrictions based on a 44% minimum equity level, a 3x EBITDA interest coverage test, and investment-grade ratings on PSE. Despite these minimums related to settlement commitments, a downgrade could occur if the company does not manage the financial profile in a manner that supports investment-grade credit metrics on a consolidated basis.

The business risk profile of Puget is "excellent," primarily reflecting PSE's combined electric and gas utility business focused in the Puget Sound region of Washington State. PSE is subject to regulation by the Washington Utilities and Transportation Commission. The company's management of its regulatory relationships in Washington is a key driver of credit quality, especially in light of PSE's relatively high capital needs and commodity price exposure. PSE's

cost recovery mechanisms support credit quality. PSE passes all increases and decreases in the cost of natural gas supply on to customers through the purchased gas adjustment mechanism. The company also has flexibility in implementing rate changes through its power cost adjustment (PCA) mechanism, but the threshold it must meet to true up undercollected rates is high, and deferred costs are not automatically collected. Each year, uncollected costs are subject to defined sharing bands, allowing the company to defer certain portions for collection from customers. However, the PCA mechanism does not trigger a rate increase until a minimum deferral balance is reached. PSE is also able to update rates for changes in power costs by filing a power-cost-only rate case (PCORC), which gives it the flexibility to file for changes in variable and fixed costs whenever there is a projected deferral balance of \$30 million or more. The PCORC functions as a mini-rate case that takes about five months, and is especially useful for new plant additions or contracts. The use of this mechanism, combined with frequent general rate case filings, has allowed the company to keep deferral balances low and better match actual costs with cash collected.

Puget's consolidated financial risk profile is "aggressive" under Standard & Poor's corporate risk matrix. Consolidated adjusted funds from operations (FFO) to total debt has decreased to 10.3%, excluding reclassified derivative contracts, for the 12 months ended Sept. 30, 2010, but normalized metrics are higher due to the impact of deferred taxes. Adjusted debt to debt and equity -- including debt adjustments for operating leases, purchased power, and hybrid equity -- was 60% as of Sept. 30, 2010. Financial weakness at PSE could restrict its dividends to Puget, pursuant to the company's commitments approved by state regulators, or limit the availability of credit facilities. We expect adjusted FFO to total debt to average no less 12%, and we expect no further elevation in debt leverage, beyond 60%, for Puget to retain the current ratings.

Capital requirements are very high at PSE, with infrastructure replacement, renewable portfolio standards, and other new resource requirements driving capital expenditures of \$1.741 billion planned for 2011-2012. We expect ongoing periodic external financing and funds from Puget to supplement internal cash flows to finance this growth. PSE will need to internally fund significant portions of capital expenditures to maintain a stable capital structure at both the utility and the consolidated entity; higher funding levels may be required. PSE needs to carefully manage capital plans, expenses, and dividends to avoid excessive debt usage, which could jeopardize the financial profile.

Liquidity

Puget consolidated liquidity is "strong" under our corporate liquidity methodology, which categorizes liquidity under five standard descriptors. Projected sources of liquidity (mainly operating cash flow and available bank lines) exceed projected uses (mainly necessary capital expenditures, debt maturities, and common dividends) by more than 2x for the upcoming 12 months. Puget's credit agreement contains financial covenants that may limit its availability. PSE has three committed unsecured revolving credit facilities that provide, in aggregate, \$1.15 billion in short-term borrowing capability. These facilities include a \$400 million credit agreement for working capital needs, a \$400 million credit facility for funding capital expenditures, and a \$350 million facility to support other working capital and energy hedging activities. As of Sept. 30, 2010, PSE had \$89.6 million drawn on the working capital facility, no borrowings under the capital expenditure facility, and \$5.7 million the hedging facility. These facilities mature February 2014.

Effective with the close of the merger, Puget had a \$1.225 billion five-year term loan and a \$1 billion credit facility for funding capital expenditures at PSE. As of Sept. 30, 2010, the term loan was fully drawn at \$1.225 billion and \$258 million was outstanding under the capital expenditures facility. These facilities also mature February 2014, except for \$450 million of the term loan that was refinanced and matures in 2020.

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.

Recovery analysis

Puget's term loans are not notched from our 'BB+' issuer credit rating on the company, based on our speculative-grade recovery criteria and our expectation of meaningful (50%-70%) recovery. Please refer to our recovery report to be published on RatingsDirect on the Global Credit Portal.

Outlook

The stable outlook on the Puget ratings reflects our expectation that the company will be able to refinance term loans and credit facilities well in advance of the 2014 expiration and that Puget will prudently manage financial risks such that consolidated credit metrics remain within our "aggressive" financial category on a consolidated basis, including consolidated adjusted FFO to debt of more than 12% and adjusted debt to debt and equity of no more than 60%. The stable outlook also reflects reasonable and timely rate relief related to resource additions and changes in power costs at PSE, as well as our expectation that PSE will internally fund significant capital expenditures. We could lower the rating if the Puget increases adjusted debt leverage to more than 60% due to excessive debt financing, if PSE is unable to fully recover investment costs due to cost disallowances, or if the ownership consortium collects larger dividends that directly result in weaker consolidated credit metrics, including adjusted leverage of more than 60%. We could raise the rating if Puget is able to sustain significantly higher credit metrics on a consolidated basis, specifically adjusted FFO to debt of more than 15%. However, positive ratings momentum is unlikely at this time.

Table 1.

Puget Energy Inc. -- Peer Comparison*					
	Puget Energy Inc.	Avista Corp.	Portland General Electric Co.	NorthWestern Corp.	IDACORP Inc.
Rating as of Feb. 24, 2011	BB+/Stable/--	BBB-/Positive/A-3	BBB/Stable/A-2	BBB/Stable/A-2	BBB/Stable/A-2
	--Average of past three fiscal years--				
(Mil. \$)					
Revenues	3,302.3	1,535.7	1,764.0	1,163.5	963.2
Net income from cont. oper.	175.5	66.4	109.0	72.8	101.7
Funds from operations (FFO)	657.7	233.3	326.5	212.5	201.3
Capital expenditures	856.9	216.7	511.4	177.1	257.4
Cash and short-term investments	54.2	23.0	38.0	7.3	23.3
Debt	4,044.0	1,302.9	1,875.2	1,079.9	1,708.1
Preferred stock	126.3	46.4	0.0	0.0	0.0
Equity	2,865.8	1,033.5	1,404.3	790.3	1,303.8
Debt and equity	6,909.8	2,336.5	3,279.5	1,870.2	3,011.9
Adjusted ratios					
EBIT interest coverage (x)	2.0	2.3	2.2	2.3	2.3
FFO int. cov. (x)	3.5	3.7	3.5	3.6	3.2
FFO/debt (%)	16.3	17.9	17.4	19.7	11.8

Puget Energy Inc.

Table 1.

Puget Energy Inc. -- Peer Comparison* (cont.)					
Discretionary cash flow/debt (%)	(9.5)	(1.9)	(14.4)	(2.8)	(8.1)
Net cash flow/capex (%)	61.9	89.1	51.5	92.3	57.0
Total debt/debt plus equity (%)	58.5	55.8	57.2	57.7	56.7
Return on common equity (%)	6.2	6.1	6.3	8.2	7.3
Common dividend payout ratio (unadj., %)	68.3	56.7	59.6	67.3	53.8

*Fully adjusted (including postretirement obligations).

Table 2.

Puget Energy Inc. -- Financial Summary*					
--Fiscal year ended Dec. 31--					
	2009	2008	2007	2006	2005
Rating history	BB+/Stable/--	BBB-/Watch Neg/--	BBB-/Watch Neg/--	BBB-/Stable/--	BBB-/Stable/--
(Mil. \$)					
Revenues	3,328.9	3,357.8	3,220.1	2,905.7	2,573.2
Net income from continuing operations	186.8	154.9	184.7	167.2	146.3
Funds from operations (FFO)	699.6	689.1	584.3	358.1	384.9
Capital expenditures	853.7	915.7	801.5	779.6	598.5
Cash and short-term investments	78.5	38.5	45.6	28.1	16.7
Debt	4,692.7	3,965.5	3,473.9	3,628.2	2,929.7
Preferred stock	125.0	126.9	126.9	20.8	120.8
Equity	3,548.5	2,400.1	2,648.8	2,136.8	2,109.8
Debt and equity	8,241.1	6,365.6	6,122.7	5,765.0	5,039.5
Adjusted ratios					
EBIT interest coverage (x)	2.1	2.0	2.0	2.1	2.0
FFO int. cov. (x)	3.2	4.2	3.3	2.6	2.8
FFO/debt (%)	14.9	17.4	16.8	9.9	13.1
Discretionary cash flow/debt (%)	(9.1)	(11.2)	(8.1)	(17.3)	(14.9)
Net cash flow/capex (%)	66.7	60.1	58.8	32.6	49.6
Debt/debt and equity (%)	56.9	62.3	56.7	62.9	58.1
Return on common equity (%)	5.9	5.8	7.2	7.2	7.3
Common dividend payout ratio (unadj., %)	64.9	83.7	58.7	62.4	60.2

*Fully adjusted (including postretirement obligations).

Table 3.

Puget Energy Inc. -- Quarterly Data*					
	September 2010	June 2010	March 2010	December 2009	September 2009
(Mil. \$)					
Revenues	622.8	673.3	878.2	942.0	592.6
Net income from continuing operations	(37.9)	3.7	(19.2)	53.9	24.5
Funds from operations (FFO)	32.6	153.0	101.5	228.4	160.1
Capital expenditures	255.4	262.2	207.4	213.5	246.1
Cash and short-term investments	86.3	132.9	78.5	78.5	83.5

Puget Energy Inc.

Table 3.

Puget Energy Inc.--Quarterly Data* (cont.)					
Debt	5,020.1	4,941.8	4,731.4	4,692.7	4,652.2
Preferred stock	125.0	125.0	125.0	125.0	125.0
Equity	3,348.5	3,398.5	3,463.3	3,548.5	3,449.8
Debt and equity	8,368.7	8,340.3	8,194.7	8,241.1	8,102.1
Adjusted ratios					
EBIT interest coverage (x)	1.0	1.3	1.5	2.1	2.1
FFO int. cov. (x)	2.4	2.8	2.7	3.2	3.4
FFO/debt (%)	10.3	12.7	12.1	14.9	14.2
Discretionary cash flow/debt (%)	(8.8)	(9.8)	(7.7)	(9.1)	(16.5)
Net cash flow/capex (%)	43.4	55.7	52.8	66.5	45.8
Debt/debt and equity (%)	60.0	59.3	57.7	56.9	57.4
Return on common equity (%)	(0.8)	1.2	2.5	5.9	5.6
Common dividend payout ratio (unadj., %)	23,304.0	167.0	103.9	64.9	83.1

*Fully adjusted (including postretirement obligations).

Table 4.

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

--Fiscal year ended Dec. 31, 2009--

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	4,377.7	3,423.5	956.5	956.5	557.3	273.8	543.9	543.9	121.2	862.9
Standard & Poor's adjustments										
Operating leases	94.3	--	12.6	6.9	6.9	6.9	5.8	5.8	--	--
Intermediate hybrids reported as debt	(125.0)	125.0	--	--	--	(8.7)	8.7	8.7	8.7	--
Postretirement benefit obligations	42.5	--	1.0	1.0	1.0	1.0	5.7	5.7	--	--
Accrued interest not included in reported debt	52.5	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	9.2	(9.2)	(9.2)	--	(9.2)
Power purchase agreements	234.9	--	19.9	19.9	16.6	16.6	3.4	3.4	--	--
Asset retirement obligations	15.7	--	1.5	1.5	1.5	1.5	(3.4)	(3.4)	--	--
Reclassification of nonoperating income (expenses)	--	--	--	--	41.3	--	--	--	--	--

Table 4.

Reconciliation Of Puget Energy Inc. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. \$)* (cont.)											
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	--	144.7	--	--
Total adjustments	315.0	125.0	35.1	29.4	67.3	26.5	11.0	155.7	8.7	(9.2)	

Standard & 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	4,692.7	3,548.5	991.6	985.9	624.6	300.3	554.9	699.6	129.9	853.7

*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 February 24, 2011)*

Puget Energy Inc.	
Corporate Credit Rating	BB+/Stable/--
Senior Secured (3 Issues)	BB+
Corporate Credit Ratings History	
16-Jan-2009	BB+/Stable/--
26-Oct-2007	BBB-/Watch Neg/--
13-May-2005	BBB-/Stable/--
Business Risk Profile	
	Excellent
Financial Risk Profile	
	Aggressive

*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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Standard & Poor's Research

February 24, 2011

Summary: Puget Sound Energy Inc.

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Rationale

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Summary:

Puget Sound Energy Inc.

Credit Rating: BBB/Stable/A-2

Rationale

The 'BBB' corporate credit rating on Puget Sound Energy Inc. (PSE) primarily reflects the "excellent" business risk profile and "aggressive" financial risk profile of its steady integrated electric and gas utility operations. Parent Puget Energy Inc. (Puget) is rated two notches below the utility at 'BB+', reflecting consolidated financial measures that are weaker than PSE's due to additional debt leverage, and the disadvantage of insulating provisions pledged at the utility operating company that may limit dividends. Standard & Poor's Ratings Services views all the financial obligations of Puget as being disadvantaged relative to PSE debts and credit facilities. However, the relationship between these entities and a lack of other operating units constrains the degree of differentiation between the two credit ratings.

We view the package of regulatory commitments that the companies entered into during the merger settlement as providing a degree of insulation to PSE. The package includes the placement of independent directors on the utility's board of directors and dividend restrictions based on a 44% minimum equity level, a 3x EBITDA interest coverage test, and investment-grade ratings on PSE. Despite these minimums related to settlement commitments, a downgrade could occur if Puget does not manage the financial profile in a manner that supports investment-grade credit metrics on a consolidated basis.

The business risk profile of PSE is "excellent," reflecting combined electric and gas utility operations focused in the Puget Sound region of Washington State. PSE is subject to regulation by the Washington Utilities and Transportation Commission. The company's management of its regulatory relationships in Washington is a key driver of credit quality, especially in light of PSE's relatively high capital needs and commodity price exposure. PSE's cost recovery mechanisms support credit quality. PSE passes all increases and decreases in the cost of natural gas supply on to customers through the purchased gas adjustment mechanism. The company also has flexibility in implementing rate changes through its power cost adjustment (PCA) mechanism, but the threshold it must meet to true up undercollected rates is high, and deferred costs are not automatically collected. Each year, uncollected costs are subject to defined sharing bands, allowing the company to defer certain portions for collection from customers. However, the PCA mechanism does not trigger a rate increase until a minimum deferral balance is reached. PSE is also able to update rates for changes in power costs by filing a power-cost-only rate case (PCORC), which gives it the flexibility to file for changes in variable and fixed costs whenever there is a projected deferral balance of \$30 million or more. The PCORC functions as a mini-rate case that takes about five months, and is especially useful for new plant additions or contracts. The use of this mechanism, combined with frequent general rate case filings, has allowed the company to keep deferral balances low and better match actual costs with cash collected.

PSE's consolidated financial risk profile is "aggressive" under Standard & Poor's corporate risk matrix. Consolidated adjusted funds from operations (FFO) to total debt has decreased to 10.3%, excluding reclassified derivative contracts, for the 12 months ended Sept. 30, 2010, but normalized metrics are higher due to the impact of deferred taxes. Adjusted debt to debt and equity -- including debt adjustments for operating leases, purchased

Summary: Puget Sound Energy Inc.

power, and hybrid equity -- was 60% as of Sept. 30, 2010. Financial weakness at PSE could restrict its dividends to Puget, pursuant to the company's commitments approved by state regulators, or limit the availability of credit facilities. We expect adjusted FFO to total debt to average no less 12%, and we expect no further elevation in debt leverage, beyond 60%, for PSE to retain the current ratings. PSE's adjusted FFO to average total debt was 16% for the 12 months ended Sept. 30, 2010, and adjusted debt to capital was 56%.

Capital requirements are high at PSE, with infrastructure replacement, renewable portfolio standards, and other new resource requirements driving capital expenditures of \$1.741 billion planned for 2011-2012. We expect ongoing periodic external financing and funds from the Puget to supplement internal cash flows to finance this growth. PSE will need to internally fund significant portions of capital expenditures to maintain a stable capital structure at both the utility and the consolidated entity; higher funding levels may be required. PSE needs to carefully manage capital plans, expenses, and dividends to avoid excessive debt usage, which could jeopardize the financial profile.

Short-term credit factors

The short-term rating on PSE is 'A-2'. Puget and PSE's consolidated liquidity is "strong" under our corporate liquidity methodology, which categorizes liquidity under five standard descriptors. Projected sources of liquidity (mainly operating cash flow and available bank lines) exceed projected uses (mainly necessary capital expenditures, debt maturities, and common dividends) by more than 2x for the upcoming 12 months. Puget's credit agreement contains financial covenants that may limit its availability. PSE has three committed unsecured revolving credit facilities that provide, in aggregate, \$1.15 billion in short-term borrowing capability. These facilities include a \$400 million credit agreement for working capital needs, a \$400 million credit facility for funding capital expenditures, and a \$350 million facility to support other working capital and energy hedging activities. As of Sept. 30, 2010, PSE had \$89.6 million drawn on the working capital facility, no borrowings under the capital expenditure facility, and \$5.7 million on the hedging facility. These facilities mature February 2014.

Effective with the close of the merger, Puget has a \$1.225 billion five-year term loan and a \$1 billion credit facility for funding capital expenditures at PSE. As of Sept. 30, 2010, the term loan was fully drawn at \$1.225 billion and \$258 million was outstanding under the capital expenditures facility. These facilities also mature February 2014, except for \$450 million of the term loan that was refinanced and matures in 2020.

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.

Recovery analysis

We rate PSE's first mortgage bonds (FMB) 'A-', two notches higher than the issuer credit rating, with a recovery rating of '1+'. We assign recovery ratings to FMBs issued by U.S. utilities, and this can result in issue ratings being notched above the corporate credit rating (CCR) on a utility, depending on the CCR category and the extent of the collateral coverage. The investment-grade FMB recovery methodology is based on the ample historical record of nearly 100% recovery for secured-bond holders in utility bankruptcies and our view that the factors that supported those recoveries (small size of the creditor class and the durable value of utility rate-based assets during and after a reorganization, given the essential service provided and the high replacement cost) will persist. Under our notching criteria, we consider the limitations of FMB issuance under the utility's indenture relative to the value of the collateral pledged to bondholders, management's stated intentions on future FMB issuance, and the regulatory limitations on bond issuance when assigning issue ratings to utility FMBs. FMB ratings can exceed a utility CCR by as much as one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade

Summary: Puget Sound Energy Inc.

categories. (See "Criteria: Changes To Collateral Coverage Requirements For '1+' Recovery Ratings On U.S. Utility First Mortgage Bonds," published Sept. 6, 2007, on RatingsDirect on the Global Credit Portal.) PSE's collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating of 'A-', two notches above the CCR.

Outlook

The stable outlook on the PSE ratings reflects our expectation that the company will be able to refinance term loans and credit facilities well in advance of the 2014 expiration and that Puget will prudently manage financial risks such that it maintains consolidated credit metrics that are within our "aggressive" financial category on a consolidated basis, including consolidated adjusted FFO to debt of more than 12% and adjusted debt to debt and equity of no more than 60%. The stable outlook also reflects reasonable and timely rate relief related to resource additions and changes in power costs at PSE, as well as our expectation that PSE will internally fund significant capital expenditures. We could lower the PSE rating if Puget increases consolidated adjusted debt leverage to more than 60% due to excessive debt financing, if PSE's adjusted FFO to debt trends below 16%, if it is unable to fully recover investment costs due to cost disallowances, or if the ownership consortium collects larger dividends that directly result in weaker consolidated credit metrics, including adjusted leverage of more than 60%. We could raise the rating if Puget is able to sustain significantly higher credit metrics on a consolidated basis, specifically adjusted FFO to debt above 15%. However, positive ratings momentum is unlikely at this time.

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Standard & Poor's Research

February 24, 2011

Recovery Report: Puget Energy Inc.'s Recovery Rating Profile

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Recovery Report: Puget Energy Inc.'s Recovery Rating Profile

Overview

- Standard & Poor's Ratings Services is updating its analysis of Puget Energy Inc.
- Puget's secured debt is rated 'BB+' (the same as the issuer credit rating).
- This notching is based on a recovery rating of '3' assigned to these debt issues, indicating meaningful (50%-70%) recovery in the event of payment default.

Legal And Structural Considerations

Puget Energy Inc. -- Credit Profile						
Corporate credit rating	BB+/Stable					
Estimated gross EV at default	\$8.2 bil.					
Year of default	2014					
Facility/Issue	Outstanding principal at default (mil. \$)	Issue rating	Recovery rating	Expected recovery (%)	Maturity	
Unsecured debt						
Term Loan Credit Facility	1,225	BB+	3	50-70	2014	
Revolving Capital Expenditure Credit Facility	1,000	BB+	3	50-70	2014	

Capital structure

Puget Energy Inc. (Puget) is the holding company of electric utility Puget Sound Energy Inc. (PSE), an integrated electric utility company based in the State of Washington. The utility company is the sole asset owned by Puget, and the term loan and credit facility are secured by the stock of PSE.

Security and guarantee package

The security collateral package of the term loan and credit facility consists primarily of the equity interests in PSE. These liabilities are secured by the stock of PSE. Standard & Poor's Ratings Services views this package as weaker than an outright pledge of the physical assets.

Documentation/covenants

The covenants include limitations on the distribution test and mandatory redemption of the bonds on certain events. The company is required to maintain predetermined levels of maximum leverage, funds from operations interest coverage, and debt service coverage.

Issuer Credit Rating Rationale

The 'BB+' corporate credit rating on Puget primarily reflects the "excellent" business risk profile and "aggressive" financial risk profile of its steady integrated electric and gas utility operations at 'BBB' rated PSE, consolidated financial measures that are weaker than PSE's due to additional debt leverage at the holding company, and the disadvantage of insulating provisions pledged at the utility operating company that may limit dividends. We view all

Recovery Report: Puget Energy Inc.'s Recovery Rating Profile

holding company financial obligations as disadvantaged relative to operating company debts and credit facilities. However, the relationship between these entities and a lack of other operating units constrains the degree of differentiation between the two credit ratings.

For more information, see our report published Feb. 24, 2011, on RatingsDirect on the Global Credit Portal.

Recovery Analysis

Our default and recovery analysis for utility holding company Puget draws on the methodology established to evaluate recovery for regulated utilities (as discussed more fully in the "Regulated utility recovery methodology" section of this report). Our analysis also incorporates Puget's reliance on cash distributions from utility subsidiary PSE to meet its debt servicing requirements and the structurally junior position of Puget's debt to claims at the utility level. The proposed loans are not secured by any hard assets, but have an indirect priority claim to the equity value of the utility through the pledge of the subsidiary stock.

Standard & Poor's recovery analysis is based on a simulated default for Puget with its current capital structure, and is subject to reevaluation if Puget's capital structure changes. We also note that changes in the debt structure at PSE could lead to a reevaluation of the Puget recovery ratings. At the point of default, we assume that all of Puget's committed credit facilities are fully drawn and have six months' interest outstanding.

Simulated default scenario

Under our simulated default scenario, we assume that financial stress at Puget Sound Energy restricts its ability to distribute cash to its parent company, thus causing Puget Energy to default on its loans. Based on the general credit risk profile of utilities, we believe that the financial stress at PSE is most likely to result from:

- Rapidly rising input prices for fuels such as natural gas and purchased power to meet load obligations; and
- Frozen customer rates and the inability to receive authority to implement price increases on a timely basis.

We note that a default by Puget would not need to result from, or cause, a default at the utility level. However, we believe that a default by Puget is only likely to happen if its equity investment in PSE is insufficient to fully cover the debt at Puget. In this case, Puget's equity owner would be discouraged from injecting additional capital into an investment that was already technically insolvent, and would not be able to sell its investment to pay off its debt.

Valuation

We believe that if Puget were to default, the customer base at PSE would remain intact and that its assets and services would remain valuable. As a result, the recovery potential for Puget's creditors would depend on the value of its equity interest in PSE, its only material asset. To determine the value available to secured creditors of Puget, we make the following assumptions:

- The enterprise value of PSE is equal to the net value of its property, plant, and equipment, \$8.2 billion.
- Amount available is then reduced by 3% to \$7.9 billion to account for administrative bankruptcy claims associated with restructuring.
- Equity value available to Puget is approximately \$1.4 billion after accounting for structurally senior claims by the creditors of PSE, including the maximum allowable amount of first mortgage bonds, the full amount of its credit lines, and its junior subordinated notes.
- Bank facilities at Puget are fully drawn, with approximately six months of interest accrued but unpaid at the

Recovery Report: Puget Energy Inc.'s Recovery Rating Profile

point of default.

Outcome

The remaining value available of about \$1.4 billion leaves Puget's secured lenders with meaningful (50%-70%) recovery in the event of payment default.

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Rating Action: Moody's Upgrades Puget Energy and Puget Sound Energy; Outlook Stable

Global Credit Research - 16 Mar 2011

New York, March 16, 2011 – Moody's Investors Service has today upgraded all long-term ratings of Puget Energy, Inc. (PE), including the long-term ratings of its core regulated electric and gas operating subsidiary, Puget Sound Energy, Inc (PSE) one notch. At the same time we have upgraded PSE short-term commercial paper rating to P-2 from P-3. The outlook is stable.

Ratings upgraded include:

Puget Energy

Issuer Rating – to Ba1 from Ba2

Senior secured bank facility – to Ba1 from Ba2

Senior Secured – to Ba1 from Ba2

Puget Sound Energy

Issuer rating - to Baa2 from Baa3

Senior unsecured bank facility – to Baa2 from Baa3

Senior Unsecured Shelf – to (P) Baa2 from (P) Baa3

Senior Secured – to A3 from Baa1

First Mortgage Bonds – to A3 from Baa1

Subordinated - to Baa3 from Ba1

Short-term commercial paper – to P-2 from P-3

RATINGS RATIONALE

Today's rating action is reflective of a number of considerations including the relative stability in operations observed following the company's purchase by a consortium of investors in February 2009, as well as the progress being made to extend the maturity profile of the debt at the PE level that was used to help finance the acquisition. Prospectively, we believe the utility's capital spending will peak in 2011 resulting in a higher level of retained cash flow in 2012. Additionally, we expect PSE will seek authorization from the Washington Utilities and Transportation Commission for rate increases at both the electric and gas businesses sometime in 2011 (effective 2012), providing an opportunity for stronger positioning at its current rating category.

The Baa2 (senior unsecured) ratings for PSE, reflect the relatively low risk utility operations, collaborative regulatory relationships and recent credit supportive rate case outcomes, efficient handling of electric and gas supply needs, acceptable credit metrics for the rating category, and continued access to its own committed bank credit facilities plus indirect access to the parent's committed capital expenditure facility to supplement internal cash flow.

At Ba1 (senior unsecured) for PE following today's rating action, a two notch differential remains between the rating of PSE and its parent. The difference takes into account the structural subordination of PE debt to that of its primary cash flow provider, PSE, but also considers the relative size of the debt (25% of consolidated debt) resulting in weaker credit metrics, and the relatively strong ring-fencing at PSE. The higher leverage at the parent is clearly observed when viewing certain year-end 2010 credit metrics. For example, cash from operations (pre w/c) to debt at PSE was 17% and 10% at PE; however, both metrics are in line with their respective rating categories.

Despite the expected negative free cash flow in 2011, we believe liquidity at both entities is good. This is based on the existing \$1.0 billion committed credit line at PE (approximately \$435 million drawn) and the combined \$1.15 billion of credit lines at PSE (approximately \$507 million drawn). We expect that the company will seek to term-out some of these borrowings in 2011. As noted above, we have also upgraded the short-term rating to P-2. PSE's commercial paper program is backstopped by a committed \$400 million senior unsecured working capital facility that expires January 1, 2014. It has same-day drawing availability and no material adverse event language for ongoing drawdowns.

The rating outlook is stable given that the current credit metrics for both PE and PSE are well placed in the "Ba" and "Baa" categories, respectively. As such, further credit metric strengthening would be necessary for any further positive rating action. However, the stable outlook also incorporates a view that the company will be able to successfully refinance the sizable 2014 acquisition-debt maturity at PE, and skillfully carry out its expected rate cases and capital program over the next 18 months.

The principal methodology used in this rating was Regulated Electric and Gas Utilities published in August 2009.

Headquartered in Bellevue, Washington, Puget Energy, Inc., is an electric utility holding company that operates through its principal operating subsidiary Puget Sound Energy, Inc. PE reported LTM revenue and balance sheet debt of \$3.1 billion and \$4.9 billion, respectively, at December 31, 2010.

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MOODY'S
INVESTORS SERVICE

Credit Opinion: Puget Sound Energy, Inc.

Global Credit Research - 17 Mar 2011

Bellevue, Washington, United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Baa2
First Mortgage Bonds	A3
Senior Secured	A3
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured Shelf	(P)Baa2
Commercial Paper	P-2
Parent: Puget Energy, Inc.	
Outlook	Stable
Issuer Rating	Ba1
Sr Sec Bank Credit Facility	Ba1
Senior Secured	Ba1
Puget Sound Energy, Inc. (Old)	
Outlook	No Outlook
First Mortgage Bonds	Baa1
Bkd Senior Secured	A3
Bkd Jr Subordinate	Baa3
Washington Natural Gas Company	
Outlook	No Outlook
Bkd First Mortgage Bonds	A3

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Key Indicators

Puget Sound Energy, Inc. (The)	31-Dec-2008	31-Dec-2009	31-Dec-2010
Adj CFO (pre w/c) / Debt	17.2%	21.8%	16.4%
Adj CFO (pre w/c) + Interest / Interest	4.1x	4.2x	3.6x
Adj CFO (pre w/c) - Dividends / Debt	13.4%	16.4%	11.5%
Debt / Capitalization	54.5%	44.4%	47.8%
Adj Net Income / Avg Equity	6.8%	5.7%	6.1%
Common Dividends / Adj Net Income	85.7%	115.9%	96.7%

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Drivers

- Sole focus on relatively low risk regulated electric and gas utility operations
- Collaborative regulatory relationships and credit supportive regulatory practices
- Negative free cash flow that creates external financing needs
- Ring-fence-like mechanisms afford protection from risk of excess dividends to the parent

Corporate Profile

Puget Sound Energy, Inc. (PSE), a subsidiary of Puget Energy, Inc. (PE), is an electric and natural gas utility serving about 1.1 million electric

and 750,000 natural gas customers in the State of Washington (primarily in the Puget Sound region). In 2010, the company's electric operations accounted for 67% of revenue and gas 33%.

On February 6, 2009, PE was acquired by Puget Holdings LLC, a consortium of private equity investors led by Macquarie Infrastructure Partners, and PE became a direct wholly-owned subsidiary of Puget Equico LLC, which is an indirect wholly owned subsidiary of Puget Holdings. PSE continues to be regulated by the Washington Utilities and Transportation Commission (WUTC) and the Federal Energy Regulatory Commission.

Recent Events

On March 16, 2011, Moody's upgraded all long-term ratings of PE and PSE by one notch and assigned a stable outlook. At the same time we upgraded PSE's short-term rating to P-2 from P-3. The rating action was reflective of a number of considerations including the relative stability in operations observed following the company's buyout in February 2009, as well as the progress being made to extend the maturity profile, at the PE level, of debt that was used to help finance the acquisition. Prospectively, we believe the utility's capital spending will peak in 2011 resulting in a higher level of retained cash flow in 2012. Additionally, we expect the company will seek authorization from the Washington Commission for rate increases at both the electric and gas businesses sometime in 2011 (effective 2012), providing an opportunity for stronger positioning at its current rating category.

SUMMARY RATING RATIONALE

PSE's Baa2 senior unsecured rating reflects its relatively low risk utility operations, collaborative regulatory relationships and recent credit supportive rate case outcomes, efficient handling of electric and gas supply needs, solid credit metrics, and access to its own committed bank credit facilities plus indirect access to the parent's committed capital expenditure facility to supplement internal cash flow.

PSE's primary near-term challenge includes our expectations for considerable negative free cash flow through 2011 given capital spending plans. Careful management of its significant power and gas supply contracts will continue to be a longer-term rating consideration. PSE's ratings also take into account the 2009 ownership change. At year-end 2010 the parent reported \$1.5 billion of debt above PSE (25% of consolidated debt). PE relies solely on the utility to service those obligations. Although ring-fencing-like mechanisms exist to protect PSE from undue cash demands by the parent, we believe the Baa2 rating captures the increase in financial risk at the holding company.

DETAILED RATING CONSIDERATIONS

CONSERVATIVE REGULATED UTILITY FOCUS

PSE's electric utility operations include its regulated generation, transmission and distribution operations in the State of Washington. By customer count, approximately 88% of electric and 92% of PSE's gas customers are residential. Measured by sales, residential customers accounted for 41% and 51% of electric and gas revenues, respectively. In 2010, PSE's average retail electric cost per residential customer was 10 cents/kWh, a 5.6% increase from the previous year and below the US average; not surprising given the hydro availability.

The company has a conservative utility focus but also some unique attributes. For example, while viewed as a mid-size utility business, PSE is short internally-generated power and has extensive supply agreements to meet its total load requirements. In 2010, approximately 50% of the company's energy production was purchased. These large short-term and long-term purchase agreements need to be managed carefully and as such, liquidity is a heightened area of focus for PSE. Nevertheless, despite a \$398 million gross liability position (61% electric / 39% gas) related to hedging activity at December 31, 2010, the company reported that it was not required to post collateral with counterparties.

Additionally, we note the company elects to classify their hedging activity as fair-value and as such, unrealized non-cash changes in the derivative positions impact the income statement directly. While this increases the "noise" in earnings we look through the accounting convention and focus on cash flow which should be unaffected. Long-term, PSE's electric supply strategy focuses on increasing energy efficiency, while also adding renewable (mostly wind) and natural gas supply sources. These additions are aimed at reducing PSE's dependence on hydro, which we see as beneficial given past supply cost issues due to persistent drought conditions.

COLLABORATIVE REGULATORY RELATIONSHIPS AND CREDIT SUPPORTIVE REGULATORY PRACTICES

As noted above, among the most significant risks that PSE faces are hydro-electric generation variability and the wholesale market prices of natural gas and power. PSE embraces a collaborative regulatory approach in Washington that has been allowing more reasonable rate increases and providing risk-mitigating cost-recovery mechanisms (i.e., the power cost adjustment (PCA) and purchased gas adjustment (PGA) mechanisms). In our view the PCA and PGA are critical underpinnings of the rating given the potential variability in power supply and natural gas costs.

The regulatory framework in Washington also allows for power cost only rate cases (PCORC). APCORC allows PSE to revise electric rates after an expedited 5-month review of the company's power costs and new resources, instead of filing a traditional general rate case, which entails a comprehensive 11-month review of all utility costs. PSE's use of the PCORC process has helped minimize regulatory lag.

In its most recent electric rate case, the company was authorized a \$74 million, or 3.7%, rate increase in April 2010 (74% of requested amount, 48% equity, and 10.1% ROE). On the gas side, the company recently received an approval to settle with the WUTC for authorization to implement a \$19 million, or 1.8%, rate increase.

Although we focus on cash flow, one area of concern has been the under-earning of ROE relative to authorized levels. For example, from 2008-2010 the average achieved ROE was 6.2% (Moody's calculation), well below the recent authorized level. Going forward we expect the company will seek additional rate increases for both gas and electric operations in mid-2011, providing at least the opportunity to achieve its allowed ROE through revenue growth. We note the most recent electric rate case in 2010 used a 2008 test year and authorized a 46% equity component, below the actual 48% reported by the company. We believe these two items, in part, explain some of the under-earning of ROE noted above.

WHAT IS PSE SPENDING CAPITAL ON?

Combining maintenance and growth capex, PSE could spend close to \$2.5 billion over the next three years to support supply and delivery infrastructure needs. This is relative to cash from operations of \$1.8 billion from 2008-2010. Although the future amounts remain subject to review and may change based on economic, regulatory, and other factors, we still expect the trend of higher than historical average capital

expenditures to continue for a few more years. Accordingly, we expect periodic rate cases for PSE to minimize the effects of regulatory lag given the use of historical test years under Washington's regulatory practice. Notable projects include:

- Completion of the first phase of the Lower Snake River Wind Project. Originally a five-phase project (250 megawatts each), the plan is now revised with phase one being increased to 343MW's and the deferral of the following phases to future periods. The company expects that Treasury grants will help reduce the cost of the new generation and this was a consideration in the revised capex strategy. Target completion date is 2012 and total project cost is approximately \$840 million.

- Snoqualmie Falls Redevelopment - Scope of project includes the re-licensing of this existing asset and upgrade MW capacity. The \$240 million project has a 2013 target completion date.

- Baker River Redevelopment - Increasing hydro-electric capacity at an existing asset from 170MW to 200MW. Target completion is 2014 and cost is \$250 million.

The anticipated financing for the capex program is likely to be met from a combination of internal cash flow and utility issued debt, while targeting a capital structure that includes common equity equal to the level that regulators use in setting rates. PSE has committed to keep a minimum common equity of 44% as calculated by the state regulators, unless the WUTC establishes some lower level as the basis for setting rates.

The Investor consortium has now owned PSE for two years and has generally operated the company with no change of strategy from what was contemplated at the time of the acquisition. However, we note the ownership group has contributed no "new" equity since the initial acquisition. We expect that going forward managing the dividend will be a tool to adjust equity rather than new contributions. However, given the large size of the current capital investment program new equity would be viewed as credit supportive. Conversely, large dividend payments at the PSE or PE level would be viewed negatively.

KEY FINANCIAL METRICS IN LINE WITH EXPECTATIONS

PSE's results in 2010 generated CFO (pre-w/c) plus interest to interest and CFO (pre-w/c) to debt of 3.6x and 16.4%, respectively. These results compare well to the mid-range of the "Baa" category for utilities of 2.7-4.5x and 13-22%, for the same metrics. They are also slightly below the 3-year average on both measures as this was partly attributable to weather-related weakness in the early part of 2010 (2010 electric usage was down 4.4% and gas 9%) but also as 2009 results were positively impacted by movements in deferred taxes that positively impacted cash flow.

At the parent level PE's results were also in line with expectations and the rating category. For example, CFO (pre w/c) to debt was 10%, approximate to the mid-point of the 5-13% range for the "Ba" category. We note as well that in addition to Moody's standard adjustments (pension, lease, and capitalized interest) we make an additional adjustment in the case of PE to remove the effect of re-classified derivative contracts at the time of acquisition.

PSE should have ample flexibility to comply with key financial covenants in its bank revolvers and regulatory mandates that govern its dividend distributions to the parent. The regulatory protections have become an increasingly important aspect of the analysis of PSE as substantial debt was introduced above the operating company for the first time when the ownership change occurred.

Key among the ring-fence-like mechanisms established when the WUTC approved the change in ownership are: a required "golden share" vote to address concern about potential substantive consolidation of PSE in any parent bankruptcy and any voluntary filing by PSE; minimum required levels of PSE common equity to be maintained and limits on PSE and parent distributions under certain circumstances.

Liquidity

To supplement internal cash flow, PSE relies on three five-year committed credit facilities aggregating \$1.150 billion (i.e. \$400 million to support working capital and act as backup to the commercial paper program, \$350 million to support its energy hedging program, and \$400 million to provide another source of funding for utility capex), all of which expire in February 2014. Puget Energy's \$1.0 billion committed capex facility is available through February 2014 to support the planned utility investments as well. As of December 31, 2010 there was \$742 million of unused capacity under the parent's capex facility. All PSE facilities have (4) day borrowing notice requirement with same day borrowing ability in an amount up to \$50 million and no material adverse event language for ongoing drawdowns. Although PSE's liquidity should remain sufficient to meet its short-term working capital needs, liquidity will likely be stretched as external borrowings are made to fund anticipated negative free cash flow due to the large capex program.

The quality of the alternate liquidity provided by PSE's bank facilities benefits from not having any ongoing material adverse change clause or any onerous financial covenant requirements (i.e. fairly low cash flow coverage tests as defined, which replace the former maximum allowed debt covenant in the prior facilities). We expect that PSE should maintain adequate headroom against the covenants given expected financial performance.

Rating Outlook

PSE's rating outlook is stable, and reflects our view that the utility can sustain its current financial performance.

What Could Change the Rating - Up

Positive pressure could develop if PSE achieves stronger financial results, while coping with the challenges of executing a large capital program and helping service the parent's standalone debt. In particular, producing CFO (pre-w/c) plus interest to interest and CFO (pre-w/c) to debt above 4x and 20%, respectively, on a sustainable basis could overcome the existing constraints in the rating and provide impetus for positive rating action. This improvement would also need to be accompanied by improvement at PE such that CFO (pre w/c) / debt reached the low teens.

What Could Change the Rating - Down

Adding more debt above PSE that creates undue pressure for higher dividends could lead to a downgrade, especially if there are any unexpected changes that weaken the ring-fencing like measures established by the WUTC. Moreover, shortfalls in PSE's performance that

reduce CFO (pre-w/c) plus interest to interest and CFO (pre-w/c) to debt below 3.5x and the mid teens, respectively, for an extended period of time, could lead to a downgrade.

Rating Factors

Puget Sound Energy, Inc.

Regulated Electric and Gas Utilities [1][2]	Dec-31-2010		Moody's 12-18 month Forward View As of March 16, 2011*	
	Measure	Score	Measure	Score
Factor 1: Regulatory Framework (25%)				
a) Regulatory framework		Baa		Baa
Factor 2: Ability to Recover Cost and Earn Returns (25%)				
a) Ability to recover Cost and Earn Returns		Baa		Baa
Factor 3: Diversification (10%)				
a) Market Position		Baa		Baa
b) Generation and Fuel Diversity		Ba		Ba
Factor 4: Financial Strength, Liquidity, & Metrics (40%)				
a) Liquidity		Baa		Baa
b) CFO (pre w/c) + Interest / Interest	3.6%	Baa	2.7 - 4.5X	Baa
c) CFO (pre w/c) / Debt	0.2x	Baa	13 - 22%	Baa
d) CFO (pre w/c) - Dividends / Debt	11.5%	Baa	9 - 17%	Baa
e) Debt / Capitalization	47.8%	Baa	45 - 55%	Baa
Rating:				
Indicated Rating from Grid		Baa2		Baa2
Actual Rating Assigned		Baa3		Baa3

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010; Source: Moody's Financial Metrics



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Standard & Poor's Research

August 26, 2011

Summary: Puget Energy Inc.

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Rationale

Outlook

Summary: Puget Energy Inc.

Credit Rating: BB+/Stable/--

Rationale

The 'BB+' corporate credit rating on Puget Energy Inc. (Puget) primarily reflects the excellent business risk profile and aggressive financial risk profile of its steady integrated electric and gas utility operations at 'BBB' rated Puget Sound Energy Inc. (PSE), consolidated financial measures that are weaker than PSE's due to additional debt leverage at the holding company, and the disadvantage of insulating provisions pledged at the utility operating company that may limit dividends. Standard & Poor's Ratings Services views all holding company financial obligations as being disadvantaged relative to operating company debts and credit facilities. However, the relationship between these entities and a lack of other operating units constrains the degree of differentiation between the two credit ratings.

We view the package of regulatory commitments entered into during the merger settlement as providing a degree of insulation to the utility. The package includes the placement of independent directors on the utility's board of directors and dividend restrictions based on a 44% minimum equity level, a 3x EBITDA interest coverage test, and investment-grade ratings on PSE. Despite these minimums related to settlement commitments, a downgrade could occur if the company does not manage the financial profile in a manner that supports investment-grade credit metrics on a consolidated basis.

The business risk profile of Puget is excellent, primarily reflecting PSE's combined electric and gas utility business focused in the Puget Sound region of Washington State. PSE is subject to regulation by the Washington Utilities and Transportation Commission. The company's management of its regulatory relationships in Washington is a key driver of credit quality, especially in light of PSE's relatively high capital needs and commodity price exposure. PSE's cost recovery mechanisms support credit quality. PSE passes all increases and decreases in the cost of natural gas supply on to customers through the purchased gas adjustment mechanism. The company also has flexibility in implementing rate changes through its power cost adjustment (PCA) mechanism, but the threshold it must meet to true up undercollected rates is high, and deferred costs are not automatically collected. Each year, uncollected costs are subject to defined sharing bands, allowing the company to defer certain portions for collection from customers. However, the PCA mechanism does not trigger a rate increase until a minimum deferral balance is reached. PSE is also able to update rates for changes in power 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 it projects a deferral balance of \$30 million or more. The PCORC functions as a mini-rate case that takes about five months, and is especially useful for new plant additions or contracts. The use of this mechanism, combined with frequent general rate case filings, has allowed the company to keep deferral balances low and better match actual costs with cash collected.

Puget's consolidated financial risk profile is aggressive under Standard & Poor's corporate risk matrix. Consolidated adjusted funds from operations (FFO) to total debt was 12.3%, excluding reclassified derivative contracts, for the 12 months ended June 30, 2011, bolstered by cooler weather and higher rates at the utility. Adjusted debt to debt and equity -- including debt adjustments for operating leases, purchased power, and hybrid equity -- was 60% as of June 30, 2011. A weakening of the financial profile at PSE could restrict its dividends to Puget, pursuant to the

Summary: Puget Energy Inc.

company's commitments approved by state regulators, or limit the availability of credit facilities due to financial covenants. We expect adjusted FFO to total debt to average no less 12%, and we expect no further elevation in debt leverage, beyond 60%, for Puget to retain the current ratings.

Capital requirements are very high at PSE, with infrastructure replacement, renewable portfolio standards, and other new resource requirements driving planned capital expenditures of \$1.053 billion in 2011 and \$737 million in 2012. We anticipate ongoing periodic external financing at Puget and PSE to supplement the gap between internal cash and capital expenditures, to maintain a stable capital structure. PSE needs to carefully manage capital plans, expenses, and dividends to avoid excessive debt usage to maintain the financial profile through the current period of heavy capital spending.

Liquidity

Puget consolidated liquidity is strong under our corporate liquidity methodology, which categorizes liquidity under five standard descriptors. Projected sources of liquidity (mainly operating cash flow and available bank lines) exceed projected uses (mainly necessary capital expenditures, debt maturities, and common dividends) by more than 2x for the upcoming 12 months.

PSE has three committed unsecured revolving credit facilities that provide, in aggregate, \$1.15 billion in short-term borrowing capability. These facilities include a \$400 million credit agreement for working capital needs, a \$400 million credit facility for funding capital expenditures, and a \$350 million facility to support other working capital and energy hedging activities. As of June 30, 2011, PSE had only a \$12.5 million letter of credit on the working capital facility, and nothing drawn or outstanding under the capital expenditure facility or the hedging facility. These facilities mature February 2014.

Effective with the close of the merger, Puget had a \$1.225 billion five-year term loan. In June, Puget issued \$500 million of senior secured notes due 2021, using the proceeds to repay a portion of the term loan. Prior to this, Puget issued \$450 million due 2020 to refinance term loan balances. Only \$298 million remains outstanding. Puget also uses a \$1 billion credit facility for funding capital expenditures at PSE. As of June 30, 2011, \$258 million was outstanding under the capital expenditure facility. The outstanding term loan balance and the capital expenditure facility mature February 2014. Puget's credit agreement contains financial covenants that can limit its availability.

Recovery analysis

Puget's term loans are not notched from our 'BB+' issuer credit rating on the company, based on our speculative-grade recovery criteria and our expectation of meaningful (50% to 70%) recovery. (For the complete recovery analysis, please refer to our recovery report published Feb. 24, 2011, on RatingsDirect on the Global Credit Portal.)

Outlook

The stable outlook on the Puget ratings reflects our expectation that the company will be able to refinance term loans and credit facilities well in advance of the 2014 expiration and that Puget will prudently manage financial risks such that consolidated credit metrics remain within our aggressive financial category on a consolidated basis, including consolidated adjusted FFO to debt of more than 12% and adjusted debt to debt and equity of no more than 60%. The stable outlook also reflects reasonable and timely rate relief related to resource additions and changes in power costs at PSE, as well as our expectation that PSE will internally fund significant capital

Summary: Puget Energy Inc.

expenditures. We could lower the rating if Puget increases adjusted debt leverage to more than 60% due to excessive debt financing, if PSE is unable to fully recover investment costs due to cost disallowances, or if the ownership consortium collects larger dividends that directly result in weaker consolidated credit metrics, including adjusted leverage of more than 60%. We could raise the rating if Puget is able to sustain significantly higher credit metrics on a consolidated basis, specifically adjusted FFO to debt of more than 15%. However, positive ratings momentum is unlikely at this time.

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Standard & Poor's Research

August 26, 2011

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Table Of Contents

Rationale

Outlook

Summary:

Puget Sound Energy Inc.

Credit Rating: BBB/Stable/A-2

Rationale

The 'BBB' corporate credit rating on Puget Sound Energy Inc. (PSE) primarily reflects the excellent business risk profile and aggressive financial risk profile of its steady integrated electric and gas utility operations. Parent Puget Energy Inc. (Puget) is rated two notches below the utility at 'BB+', reflecting consolidated financial measures that are weaker than PSE's due to additional debt leverage, and the disadvantage of insulating provisions pledged at the utility operating company that may limit dividends. Standard & Poor's Ratings Services views all the financial obligations of Puget as being disadvantaged relative to PSE debts and credit facilities. However, the relationship between these entities and a lack of other operating units constrains the degree of differentiation between the two credit ratings.

We view the package of regulatory commitments entered into during the merger settlement as providing a degree of insulation to PSE. The package includes the placement of independent directors on the utility's board of directors and dividend restrictions based on a 44% minimum equity level, a 3x EBITDA interest coverage test, and investment-grade ratings on PSE. Despite these minimums related to settlement commitments, a downgrade could occur if Puget does not manage the financial profile in a manner that supports investment-grade credit metrics on a consolidated basis.

The business risk profile of PSE is excellent, reflecting combined electric and gas utility operations focused in the Puget Sound region of Washington State. PSE is subject to regulation by the Washington Utilities and Transportation Commission. The company's management of its regulatory relationships in Washington is a key driver of credit quality, especially in light of PSE's relatively high capital needs and commodity price exposure. PSE's cost recovery mechanisms support credit quality. PSE passes all increases and decreases in the cost of natural gas supply on to customers through the purchased gas adjustment mechanism. The company also has flexibility in implementing rate changes through its power cost adjustment (PCA) mechanism, but the threshold it must meet to true up undercollected rates is high, and deferred costs are not automatically collected. Each year, uncollected costs are subject to defined sharing bands, allowing the company to defer certain portions for collection from customers. However, the PCA mechanism does not trigger a rate increase until a minimum deferral balance is reached. PSE is also able to update rates for changes in power 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 it projects a deferral balance of \$30 million or more. The PCORC functions as a mini-rate case that takes about five months, and is especially useful for new plant additions or contracts. The use of this mechanism, combined with frequent general rate case filings, has allowed the company to keep deferral balances low and better match actual costs with cash collected.

PSE's consolidated financial risk profile is aggressive under Standard & Poor's corporate risk matrix. Consolidated adjusted funds from operations (FFO) to total debt was 12.3%, excluding reclassified derivative contracts, for the 12 months ended June 30, 2011, bolstered by cooler weather and higher rates at the utility. Adjusted debt to debt and equity -- including debt adjustments for operating leases, purchased power, and hybrid equity -- was 60% as of

Summary: Puget Sound Energy Inc.

June 30, 2011. A weakening of the financial profile at PSE could restrict its dividends to Puget, pursuant to the company's commitments approved by state regulators, or limit the availability of credit facilities due to financial covenants. We expect adjusted FFO to total debt to average no less 12%, and we expect no further elevation in debt leverage, beyond 60%, for PSE to retain the current ratings. PSE's adjusted FFO to average total debt was 19.5% for the 12 months ended June 30, 2011, and adjusted debt to capital was 53%.

Capital requirements are very high at PSE, with infrastructure replacement, renewable portfolio standards, and other new resource requirements driving planned capital expenditures of \$1.053 billion in 2011 and \$737 million in 2012. We anticipate ongoing periodic external financing at Puget and PSE to supplement the gap between internal cash and capital expenditures, to maintain a stable capital structure. PSE needs to carefully manage capital plans, expenses, and dividends to avoid excessive debt usage to maintain the financial profile through the current period of heavy capital spending.

Liquidity

The short-term rating on PSE is 'A-2'. Puget and PSE's consolidated liquidity is strong under our corporate liquidity methodology, which categorizes liquidity under five standard descriptors. Projected sources of liquidity (mainly operating cash flow and available bank lines) exceed projected uses (mainly necessary capital expenditures, debt maturities, and common dividends) by more than 2x for the upcoming 12 months.

PSE has three committed unsecured revolving credit facilities that provide, in aggregate, \$1.15 billion in short-term borrowing capability. These facilities include a \$400 million credit agreement for working capital needs, a \$400 million credit facility for funding capital expenditures, and a \$350 million facility to support other working capital and energy hedging activities. As of June 30, 2011, PSE had only a \$12.5 million letter of credit on the working capital facility, and nothing drawn or outstanding under the capital expenditure facility or the hedging facility. These facilities mature February 2014.

Effective with the close of the merger, Puget had a \$1.225 billion five-year term loan. In June, Puget issued \$500 million of senior secured notes due 2021, using the proceeds to repay a portion of the term loan. Prior to this, Puget issued \$450 million due 2020 to refinance term loan balances. Only \$298 million remains outstanding. Puget also uses a \$1 billion credit facility for funding capital expenditures at PSE. As of June 30, 2011, \$258 million was outstanding under the capital expenditure facility. The outstanding term loan balance and the capital expenditure facility mature February 2014. Puget's credit agreement contains financial covenants that can limit its availability.

Recovery analysis

We rate PSE's first mortgage bonds (FMB) 'A-', two notches higher than the issuer credit rating, with a recovery rating of '1+'. We assign recovery ratings to FMBs issued by U.S. utilities, and this can result in issue ratings being notched above the corporate credit rating (CCR) on a utility, depending on the CCR category and the extent of the collateral coverage. The investment-grade FMB recovery methodology is based on the ample historical record of nearly 100% recovery for secured-bond holders in utility bankruptcies and our view that the factors that supported those recoveries (small size of the creditor class and the durable value of utility rate-based assets during and after a reorganization, given the essential service provided and the high replacement cost) will persist. Under our notching criteria, we consider the limitations of FMB issuance under the utility's indenture relative to the value of the collateral pledged to bondholders, management's stated intentions on future FMB issuance, and the regulatory limitations on bond issuance when assigning issue ratings to utility FMBs. FMB ratings can exceed a utility CCR by as much as one notch in the 'A' category, two notches in the 'BBB' category, and three notches in speculative-grade

Summary: Puget Sound Energy Inc.

categories. (See "Criteria: Changes To Collateral Coverage Requirements For '1+' Recovery Ratings On U.S. Utility First Mortgage Bonds," published Sept. 6, 2007, on RatingsDirect on the Global Credit Portal.) PSE's collateral coverage of more than 1.5x supports a recovery rating of '1+' and an issue rating of 'A-', two notches above the CCR.

Outlook

The stable outlook on the PSE ratings reflects our expectation that the company will be able to refinance term loans and credit facilities well in advance of the 2014 expiration and that Puget will prudently manage financial risks such that it maintains consolidated credit metrics that are within our aggressive financial category on a consolidated basis, including consolidated adjusted FFO to debt of more than 12% and adjusted debt to debt and equity of no more than 60%. The stable outlook also reflects reasonable and timely rate relief related to resource additions and changes in power costs at PSE, as well as our expectation that PSE will internally fund significant capital expenditures. We could lower the PSE rating if Puget increases consolidated adjusted debt leverage to more than 60% due to excessive debt financing, if PSE's adjusted FFO to debt trends below 16%, if it is unable to fully recover investment costs due to cost disallowances, or if the ownership consortium collects larger dividends that directly result in weaker consolidated credit metrics, including adjusted leverage of more than 60%. We could raise the rating if Puget is able to sustain significantly higher credit metrics on a consolidated basis, specifically adjusted FFO to debt above 15%. However, positive ratings momentum is unlikely at this time.

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MOODY'S
INVESTORS SERVICE

Rating Action: Moody's assigns Ba2 to Puget Energy's planned senior secured note issue; outlook stable

Global Credit Research - 29 Nov 2010

Approximately \$4.7 billion of securities affected

New York, November 29, 2010 – Moody's Investors Service assigned a Ba2 rating to a planned issue of senior secured notes by Puget Energy, Inc. and affirmed all of the company's other existing ratings, including its Ba2 Term Loans, as well as its stable rating outlook. Concurrently, Moody's affirmed all the existing ratings and the stable rating outlook of Puget Energy's utility subsidiary, Puget Sound Energy, Inc. (PSE), including ratings as follows: Baa1 senior secured first mortgage bonds, medium-term notes and tax-exempt debt; Baa3 Issuer Rating; Baa3 bank credit facilities; Ba1 junior subordinated notes; (P) Baa1/(P)Baa3 shelf rating for prospective issuance of senior secured and senior unsecured debt, respectively; and P-3 short-term rating for commercial paper.

RATINGS RATIONALE

The rating assignment and affirmations take into account that the planned senior secured notes are, subject to certain exceptions, secured by substantially all of Puget Energy's assets and equity interests owned by its unrated parent company, Puget Equico. The collateral consists mainly of all of the issued and outstanding stock in Puget Energy's wholly owned operating subsidiary, PSE. The same security also applies to Puget Energy's existing bank debt, which is also rated Ba2. Moody's anticipates that Puget Energy will use the net proceeds from the issuance of the senior secured notes to repay a portion of its outstanding bank debt. The Ba2 rating also considers that Puget Energy is following through on plans to lengthen and diversify its debt maturity profile and that all of Puget Energy's debt is structurally subordinated to all the existing and future indebtedness, obligations, and other liabilities of PSE.

"The Ba2 rating reflects a wider than typical notching from the PSE Baa3 senior unsecured rating due to the significant financial risks that exist since almost \$1.5 billion of standalone debt resides above PSE following the February 2009 ownership change and we anticipate that this amount will increase" said Kevin Rose, Moody's lead analyst for Puget Energy. "The wider notching also incorporates the ring-fence mechanisms in place to protect investors at the PSE level, which could potentially limit the upstream of distributions to service the standalone parent debt" Rose added.

The ratings for Puget Energy and PSE incorporate the relatively low risk utility operations of PSE, whose business profile is characterized by generally collaborative regulatory relationships and reasonably credit supportive rate case outcomes, efficient handling of growing electric and gas supply needs, solid credit metrics under Moody's Rating Methodology for Regulated Electric and Gas Utilities published in August 2009, and ample access to committed bank credit facilities to supplement internal cash flow. Prospectively, we currently see Puget Energy as reasonably well positioned at Ba2, assuming continuation of credit supportive regulatory decisions in the pending and periodic future rate case proceedings that we expect for PSE given a very large multi-year capital program over the next few years, albeit reduced from earlier levels planned due to the effects of the economy and changes to the company's proposed resource plans. The ratings capture the increase in financial risk we see as Puget Energy is expected to continue to support PSE's funding needs primarily with draws under the holding company's committed \$1.0 billion capital expenditure facility, thereby considerably weakening key credit metrics from stronger levels noted at September 30, 2010, which are largely due to accounting conventions related to the ownership change in February 2009. Despite the sizable standalone parent debt that increases dependence on PSE to service those obligations, we currently believe that PSE will have sufficient flexibility to comply with key financial covenants in its bank revolvers and regulatory mandates that govern its dividend distributions to the parent. Moreover, there are financial covenants that preclude Puget Energy's payment of distributions to private equity investors under certain circumstances, which afford some additional protection for debt holders at the parent level.

The stable rating outlooks for Puget Energy and PSE reflect our view that PSE can sustain its recent financial performance under its private equity ownership structure, which is paramount given the significant amount of structurally subordinated standalone debt at the parent. Our expectations assume that sufficiently conservative financing strategies are maintained and that PSE continues to receive supportive decisions from the Washington Utilities and Transportation Commission (WUTC) in the pending and periodic rate cases expected in the future. Under this scenario, PSE should have ample flexibility to pay dividends to Puget Energy in support of meeting the parent's debt obligations.

An upgrade in the near term is unlikely given the significant standalone debt that currently exists at Puget Energy which is expected to increase over the next several years. Puget Energy and PSE could be upgrade candidates in the medium term if stronger than anticipated consolidated financial results are achieved, while PSE copes with the challenges of executing a large capital program and helping service the parent's standalone debt. In particular, if Puget Energy can produce consolidated CFO Pre-W/C plus interest to interest and consolidated CFO Pre-W/C to debt closer to 3x and the low-to-mid-teens, respectively, on a sustainable basis excluding the effects of accounting conventions related to the ownership change, then a positive rating action could occur. As for PSE, producing CFO Pre-W/C plus interest to interest and CFO Pre-W/C to debt closer to the mid-4x and 23%, respectively, on a sustainable basis could overcome the existing constraints in the rating and provide impetus for positive rating action.

Adding more standalone debt at Puget Energy than currently expected that creates undue pressure for higher utility dividends could lead to a downgrade at both companies, especially if there is any unexpected decline in the WUTC's supportiveness. Moreover, shortfalls in consolidated financial performance that reduce Puget Energy's CFO Pre-W/C plus interest to interest and consolidated CFO Pre-W/C to debt well below 2.8x and 10%, respectively, for an extended period of time, could lead to a downgrade. A downgrade of PSE's ratings could result from shortfalls in its performance that reduce CFO Pre-W/C plus interest to interest and CFO Pre-W/C to debt well below 3.0x and the low teens, respectively, for an extended period of time.

The principal methodology used in this rating was Regulated Electric and Gas Utilities published in August 2009.

Puget Energy, Inc. is a holding company whose sole subsidiary is Puget Sound Energy, Inc., a combination electric and natural gas utility. Both companies are headquartered in Bellevue, Washington.

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MOODY'S
INVESTORS SERVICE

Credit Opinion: Puget Energy, Inc.

Global Credit Research - 17 Mar 2011

United States

Ratings

Category	Moody's Rating
Outlook	Stable
Issuer Rating	Ba1
Sr Sec Bank Credit Facility	Ba1
Senior Secured	Ba1
Puget Sound Energy, Inc.	
Outlook	Stable
Issuer Rating	Baa2
First Mortgage Bonds	A3
Senior Secured	A3
Sr Unsec Bank Credit Facility	Baa2
Senior Unsecured Shelf	(P)Baa2
Commercial Paper	P-2
Puget Sound Energy, Inc. (Old)	
Outlook	No Outlook
First Mortgage Bonds	Baa1
Bkd Senior Secured	A3
Bkd Jr Subordinate	Baa3
Washington Natural Gas Company	
Outlook	No Outlook
Bkd First Mortgage Bonds	A3

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Key Indicators

Puget Energy, Inc. (The)	31-Dec-2008	31-Dec-2009	31-Dec-2010
Adj CFO (pre w/c) / Debt	16.2%	14.4%	10.0%
Adj CFO (pre w/c) + Interest / Interest	3.9x	3.3x	2.5x
Adj CFO (pre w/c) - Dividends / Debt	12.9%	11.8%	8.0%
Debt / Capitalization	56.1%	50.4%	53.4%
Adj Net Income / Common Equity	6.8%	1.2%	2.5%
Common Dividends / Adj Net Income	79.8%	356.0%	123.6%

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

Opinion

Rating Drivers

Parent holding company with ownership of one core subsidiary - sole focus on regulated electric and gas utility operations

Collaborative regulatory relationships and credit supportive regulatory practices

Negative free cash flow creates external financing needs

Ring-fence-like mechanisms protect subsidiary to the potential detriment of the parent's credit quality; parent also subject to certain dividend restrictions

Corporate Profile

Puget Energy, Inc. (PE), is a holding company whose sole business is conducted through its subsidiary, Puget Sound Energy, Inc. (PSE), an electric and natural gas utility serving about 1.1 million electric and 750,000 natural gas customers in the State of Washington (primarily in the Puget Sound region). In 2010, the company's electric operations accounted for 67% of revenue and gas 33%.

On February 6, 2009, PE was acquired by Puget Holdings LLC, a consortium of private equity investors led by Macquarie Infrastructure Partners, and PE became a direct wholly-owned subsidiary of Puget Equico LLC, which is an indirect wholly owned subsidiary of Puget Holdings. PSE continues to be regulated by the Washington Utilities and Transportation Commission (WUTC) and the Federal Energy Regulatory Commission.

Recent Events

On March 16, 2011, Moody's upgraded all long-term ratings of PE and PSE by one notch and assigned a stable outlook. At the same time we upgraded PSE's short-term rating to P-2 from P-3. The rating action was reflective of a number of considerations including the relative stability in operations observed following the company's buyout in February 2009, as well as the progress being made to extend the maturity profile, at the PE level, of debt that was used to help finance the acquisition. Prospectively, we believe the utility's capital spending will peak in 2011 resulting in a higher level of retained cash flow in 2012. Additionally, we expect the company will seek authorization from the Washington Commission for rate increases at both the electric and gas businesses sometime in 2011 (effective 2012), providing an opportunity for stronger positioning at its current rating category.

SUMMARY RATING RATIONALE

Underpinning Puget Energy's rating is the ownership of its operating subsidiary Puget Sound Energy. PSE's Baa2 senior unsecured rating reflects its relatively low risk utility operations, collaborative regulatory relationships and recent credit supportive rate case outcomes, efficient handling of electric and gas supply needs, solid credit metrics, and access to its own committed bank credit facilities plus indirect access to the parent's committed capital expenditure facility to supplement internal cash flow. PSE's primary near-term challenge includes our expectations for considerable negative free cash flow through 2011 given capital spending plans. Careful management of its significant power and gas supply contracts will continue to be a longer-term rating consideration.

At two notches down from PSE's Baa2, PE's Ba1 senior unsecured issuer rating reflects a wider than typical one-notch down of a corporate parent due to structural subordination. This is due to our view of the increased financial risk as almost \$1.5 billion of standalone debt now exists following the February 2009 ownership change (approximately 25% of consolidated debt at December 31, 2010 was borrowed at the PE holding company level). The wider notching also considers the weaker consolidated cash flow metrics and the ring-fence-like mechanisms in place to protect investors at the PSE level, which could potentially limit the upstream of distributions to service the standalone parent debt.

DETAILED RATING CONSIDERATIONS

CONSERVATIVE REGULATED UTILITY FOCUS

PSE's electric utility operations include its regulated generation, transmission and distribution operations in the State of Washington. By customer count, approximately 88% of electric and 92% of PSE's gas customers are residential. Measured by sales, residential customers accounted for 41% and 51% of electric and gas revenues, respectively. In 2010, PSE's average retail electric cost per residential customer was 10 cents/kWh, a 5.6% increase from the previous year and below the US average; not surprising given the hydro availability.

The company has a conservative utility focus but also some unique attributes. For example, while viewed as a mid-size utility business, PSE is short internally-generated power and has extensive supply agreements to meet its total load requirements. In 2010, approximately 50% of the company's energy production was purchased. These large short-term and long-term purchase agreements need to be managed carefully and as such, liquidity is a heightened area of focus for PSE. Nevertheless, despite a \$398 million gross liability position related to hedging activity (61% electric / 39% gas) at December 31, 2010, the company reported that it was not required to post collateral with counterparties.

Additionally, we note the company elects to classify their hedging activity as fair-value and as such, unrealized non-cash changes in the derivative positions impact the income statement directly. While this increases the "noise" in earnings we look through the accounting convention and focus on cash flow which should be unaffected. Long-term, PSE's electric supply strategy focuses on increasing energy efficiency, while also adding renewable (mostly wind) and natural gas supply sources. These additions reduce PSE's dependence on hydro, which we see as beneficial given past supply cost issues due to persistent drought conditions.

COLLABORATIVE REGULATORY RELATIONSHIPS AND CREDIT SUPPORTIVE REGULATORY PRACTICES

As noted above, among the most significant risks that PSE faces are hydro-electric generation variability and the wholesale market prices of natural gas and power. PSE embraces a collaborative regulatory approach in Washington that has been allowing more reasonable rate increases and providing risk-mitigating cost-recovery mechanisms (i.e., the power cost adjustment (PCA) and purchased gas adjustment (PGA) mechanisms). In our view the PCA and PGA are critical underpinnings of the rating given the potential variability in power supply and natural gas.

The regulatory framework in Washington also allows for power cost only rate cases (PCORC). APCORC allows PSE to revise electric rates after an expedited 5-month review of the company's power costs and new resources, instead of filing a traditional general rate case, which entails a comprehensive 11-month review of all utility costs. PSE's use of the PCORC process has helped minimize regulatory lag.

In its most recent electric rate case, the company was authorized a \$74 million, or 3.7%, rate increase in April 2010 (74% of requested amount, 48% equity, and 10.1% ROE). On the gas side, the company recently received approval to settle with the WUTC for authorization to implement a \$19 million, or 1.8%, rate increase.

Although we focus on cash flow, one area of concern has been the under-earning of ROE relative to authorized levels. For example, from 2008-2010 the average achieved ROE was 6.2% (Moody's calculation), well below the recent authorized level. Going forward we expect the company will seek additional rate increases for both gas and electric operations in mid-2011, providing at least the opportunity to achieve its allowed ROE through revenue growth. We note the most recent electric rate case in 2010 used a 2008 test year and authorized a 46% equity component, below the actual 48% reported by the company. We believe these two items, in part, explain some of the under-earning of ROE noted above.

The regulatory protections have become an increasingly important aspect of the analysis of PE and PSE given the standalone parent debt that

has already been introduced. Key among the strong ring-fence-like mechanisms established when the WUTC approved the change in ownership are: a required "golden share" vote to address concern about potential substantive consolidation of PSE in any parent bankruptcy and any voluntary filing by PSE; minimum required levels of PSE common equity to be maintained and limits on PSE and parent distributions under certain circumstances.

WHAT IS PSE SPENDING CAPITAL ON?

Combining maintenance and growth capex, PSE could spend close to \$2.5 billion over the next three years to support supply and delivery infrastructure needs. This is relative to cash from operations from 2008-2010 of \$1.8 billion. Although the future amounts remain subject to review and may change based on economic, regulatory, and other factors, we still expect the trend of higher than historical average capital expenditures to continue for the next 12-24 months. Accordingly, we expect periodic rate cases for PSE to minimize the effects of regulatory lag given the use of historical test years under Washington's regulatory practice. Notable projects include:

- Completion of the first phase of the Lower Snake River Wind Project. Originally a five-phase project (250 megawatts each), the plan is now revised with phase one being increased to 343MW's and the deferral of followings phases to future periods. The company expects that Treasury grants will help reduce the cost of the new generation and this was a consideration in the revised capex strategy. Target completion date is 2012 and total project cost is approximately \$840 million.
- Snoqualmie Falls Redevelopment - Scope of project includes the re-licensing of this existing asset and upgraded MW capacity. The \$240 million project has a 2013 target completion date.
- Baker River Redevelopment - Increasing hydro-electric capacity at an existing asset from 170MW to 200MW. Target completion is 2014 and cost is \$250 million.

The anticipated financing for the capex program is likely to be met from a combination of internal cash flow and utility issued debt, while targeting a capital structure that includes common equity equal to the level that regulators use in setting rates. Given the construction, bonus depreciation may also provide some near-term cash flow benefit. PSE has committed to keep a minimum common equity of 44% as calculated by the state regulators, unless the WUTC establishes some lower level as the basis for setting rates.

The Investor consortium has now owned PSE for two years and has generally operated the company with no change of strategy from what was contemplated at the time of the acquisition. However, we note the ownership group has contributed no "new" equity since the initial acquisition. We expect that going forward managing the dividend will be a tool to adjust equity rather than new contributions. However, given the large size of the current capital program new equity would be viewed as credit supportive. Conversely, large dividend payments at the PSE or PE level would be viewed negatively.

KEY FINANCIAL METRICS IN LINE WITH EXPECTATIONS

PSE's results in 2010 generated CFO (pre-W/C) plus interest to interest and CFO (pre-W/C) to debt of 3.6x and 16.4%, respectively. These results compare well to the mid-range of the "Baa" category for utilities of 2.7-4.5x and 13-22%, for the same metrics. They are also slightly below the 3-year average on both measures. This was partly attributable to weather-related weakness in the early part of 2010 (2010 electric usage was down 4.4% and gas 9%) but also as 2009 results were impacted by movements in deferred taxes that positively impacted cash flow.

At the parent level, PE's results were also in line with expectations and the rating category. For example, CFO (pre w/c) to debt was 10%, approximate to the mid-point of the 5-13% range for the "Ba" category. We note as well that in addition to Moody's standard adjustments (pension, lease, and capitalized interest) we make an additional adjustment in the case of PE to remove the effect of "re-classified" derivative contracts at the time of acquisition.

PSE should have ample flexibility to comply with key financial covenants in its bank revolvers and regulatory mandates that govern its expected dividend distributions to the parent. The regulatory protections have become an increasingly important aspect of the analysis of PSE as substantial debt was introduced above the operating company for the first time when the ownership change occurred.

Liquidity

To supplement internal cash flow, PSE relies on three five-year committed credit facilities aggregating \$1.150 billion (i.e. \$400 million to support working capital and act as commercial paper back-up, \$350 million to support its energy hedging program, and \$400 million to provide another source of funding for utility capex). The facilities, which expire in February 2014, have a (4) day borrowing notice requirement with same day borrowing ability in an amount up to \$50 million.

Puget Energy's \$1.0 billion committed capex facility is available through February 2014 to support the planned utility investments as well. As of December 31, 2010, there was \$742 million of unused capacity under the parent's capex facility. Although PSE's liquidity should remain sufficient to meet its short-term working capital needs, liquidity will likely be stretched as external borrowings are made to fund anticipated negative free cash flow due to the large capex program.

The quality of the alternate liquidity provided by PSE's bank facilities benefits from not having any ongoing material adverse change (MAC) clause or any onerous financial covenant requirements (i.e. fairly low cash flow coverage tests as defined, which replace the former maximum allowed debt covenant in the prior facilities). We expect that PSE should maintain adequate headroom against the covenants given expected financial performance and there are no rating triggers in the bank facilities. The Puget Energy bank facility has various financial covenants that we don't currently expect to pose undue concerns; however, the quality of the alternate liquidity provided by this facility is of weaker quality than the PSE facilities given the ongoing nature of the MAC clause requirement for each borrowing. Like the PSE facilities, there are no rating triggers.

Rating Outlook

Puget Energy's rating outlook is stable, reflecting our view that prospective improvement in operating results at PSE could improve the credit profile of PE, absent a dividend policy that is not consistent with maintaining a near-investment grade capital structure.

What Could Change the Rating - Up

Given the recent rating action, and capital program at the utility, an upgrade in the near-term is unlikely. However, the ability to report consolidated CFO (pre w/c) plus interest to interest and consolidated CFO (pre w/c) to debt above 3.0x, and the mid-teens range, respectively, on a sustainable basis could provide impetus for positive rating action.

What Could Change the Rating - Down

Any aggressive debt-funded dividends could lead to a downgrade, especially if there is any unexpected decline in the WUTC's supportiveness. Moreover, shortfalls in consolidated financial performance that reduce consolidated CFO (pre-w/c) plus interest to interest and consolidated CFO (pre w/c) to debt well below 3.0x and 10%, respectively, for an extended period of time, could lead to a downgrade.

Rating Factors

Puget Energy, Inc.

Regulated Electric and Gas Utilities [1][2]	Dec-31-2010		Moody's 12-18 month Forward View As of March 16, 2011*	
	Measure	Score	Measure	Score
Factor 1: Regulatory Framework (25%)				
a) Regulatory framework		Baa		Baa
Factor 2: Ability to Recover Cost and Earn Returns (25%)				
a) Ability to recover Cost and Earn Returns		Baa		Baa
Factor 3: Diversification (10%)				
a) Market Position		Baa		Baa
b) Generation and Fuel Diversity		Baa		Baa
Factor 4: Financial Strength, Liquidity, & Metrics (40%)				
a) Liquidity		Ba		Ba
b) CFO (pre w/c) + Interest / Interest	2.5x	Ba	1.5 - 2.7x	Ba
c) CFO (pre w/c) / Debt	10.0%	Ba	5 - 13%	Ba
d) CFO (pre w/c) - Dividends / Debt	8.0%	Ba	0 - 9%	Ba
e) Debt / Capitalization	53.4%	Baa	45 - 55%	Baa
Rating:				
Indicated Rating from Grid		Baa3		Baa3
Actual Rating Assigned		Ba2		Ba2

* THIS REPRESENTS MOODY'S FORWARD VIEW; NOT THE VIEW OF THE ISSUER; AND UNLESS NOTED IN THE TEXT DOES NOT INCORPORATE SIGNIFICANT ACQUISITIONS OR DIVESTITURES

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 12/31/2010; Source: Moody's Financial Metrics



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