

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Application of

PUGET SOUND ENERGY, INC.

for (1) Approval of the Proposed Sale of PSE's
Share of the Centralia Facilities, and
(2) Authorization to Amortize Gain Over a Five-
Year Period.

DOCKET NO. UE-99_____

EXHIBIT NO. ____ (WAG-6)

EXHIBIT NO. ____ (WAG-6)
TO THE DIRECT TESTIMONY
OF WILLIAM A. GAINES

WUTC DOCKET NO. UE-991255
EXHIBIT NO. 107
ADMIT W/D REJECT

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 1999**
OR
 **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OR
THE SECURITIES EXCHANGE ACT OF 1934
(NO FEE REQUIRED)
For the Transition period from _____ to _____**

Commission File Number 1-4393

PUGET SOUND ENERGY, INC.

(Exact name of registrant as specified in its charter)

Washington
(State or other jurisdiction of
incorporation or organization)

91-0374630
(IRS Employer
Identification No.)

411 - 108th Avenue N.E., Bellevue, Washington 98004-5515
(Address of principal executive offices)

(425) 454-6363
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) or the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file for such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No _____

The number of shares of registrant's common stock outstanding at June 30, 1999 was 84,560,539.

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PART I FINANCIAL INFORMATION**Item 1 Financial Statements**

PUGET SOUND ENERGY, INC
CONSOLIDATED STATEMENTS OF INCOME
For the Three Month Periods Ended June 30
(Thousands except per share amounts)
(Unaudited)

	<u>1999</u>	<u>1998</u>
OPERATING REVENUES:		
Electric	\$ 336,895	\$ 286,913
Gas	94,173	76,752
Other	4,371	6,562
Total operating revenues	<u>435,439</u>	<u>370,227</u>
OPERATING EXPENSES:		
Energy costs:		
Purchased electricity	176,116	137,397
Purchased gas	38,822	32,598
Electric generation fuel	11,178	9,500
Residential Exchange	(8,631)	(12,063)
Utility operations and maintenance	60,297	59,229
Other operations and maintenance	5,522	6,704
Depreciation and amortization	42,899	40,446
Taxes other than federal income taxes	41,982	36,877
Federal income taxes	12,357	9,850
Total operating expenses	<u>380,542</u>	<u>320,538</u>
OPERATING INCOME	54,897	49,689
OTHER INCOME	<u>13,102</u>	<u>3,862</u>
INCOME BEFORE INTEREST CHARGES	67,999	53,551
INTEREST CHARGES, net of AFUDC	<u>36,934</u>	<u>34,009</u>
NET INCOME	31,065	19,542
Less: Preferred stock dividends accrual	<u>3,013</u>	<u>3,250</u>
INCOME FOR COMMON STOCK	<u>\$ 28,052</u>	<u>\$ 16,292</u>
COMMON SHARES OUTSTANDING - WEIGHTED AVERAGE	<u>84,561</u>	<u>84,561</u>
BASIC & DILUTED EARNINGS PER COMMON SHARE:	<u>\$ 0.33</u>	<u>\$ 0.19</u>

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

PUGET SOUND ENERGY, INC
CONSOLIDATED STATEMENTS OF INCOME
For the Six Month Periods Ended June 30
(Thousands except per share amounts)
(Unaudited)

	<u>1999</u>	<u>1998</u>
OPERATING REVENUES:		
Electric	\$ 737,709	\$ 655,509
Gas	265,017	224,574
Other	8,046	14,658
Total operating revenues	<u>1,010,772</u>	<u>894,741</u>
OPERATING EXPENSES:		
Energy costs:		
Purchased electricity	361,272	306,655
Purchased gas	117,079	100,526
Electric generation fuel	21,055	20,741
Residential Exchange	(20,315)	(27,570)
Utility operations and maintenance	122,847	119,763
Other operations and maintenance	13,211	12,388
Depreciation and amortization	85,520	81,182
Taxes other than federal income taxes	92,598	82,475
Federal income taxes	60,678	50,211
Total operating expenses	<u>853,945</u>	<u>746,371</u>
OPERATING INCOME	156,827	148,370
OTHER INCOME	<u>16,849</u>	<u>5,625</u>
INCOME BEFORE INTEREST CHARGES	173,676	153,995
INTEREST CHARGES, net of AFUDC	<u>72,855</u>	<u>68,449</u>
NET INCOME	100,821	85,546
Less: Preferred stock dividends accrual	<u>5,889</u>	<u>6,558</u>
INCOME FOR COMMON STOCK	<u>\$ 94,932</u>	<u>\$ 78,988</u>
COMMON SHARES OUTSTANDING - WEIGHTED AVERAGE	<u>84,561</u>	<u>84,561</u>
BASIC & DILUTED EARNINGS PER COMMON SHARE:	<u>\$ 1.12</u>	<u>\$ 0.93</u>

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

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Three Month Periods Ended June 30
(Dollars in Thousands)
(Unaudited)

	<u>1999</u>	<u>1998</u>
Net Income	\$ <u>31,065</u>	\$ <u>19,542</u>
Other comprehensive income, net of tax:		
Unrealized holding gains (losses) arising during period	4,262	(3,639)
Reclassification adjustment for gains included in net income	<u>(12,284)</u>	<u>--</u>
Other comprehensive income	(8,022)	(3,639)
Comprehensive Income	<u>\$ <u>23,043</u></u>	<u>\$ <u>15,903</u></u>

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the Six Month Periods Ended June 30
(Dollars in Thousands)
(Unaudited)

	<u>1999</u>	<u>1998</u>
Net Income	\$ <u>100,821</u>	\$ <u>85,546</u>
Other comprehensive income, net of tax:		
Unrealized holding gains arising during period	3,482	780
Reclassification adjustment for gains included in net income	<u>(12,284)</u>	<u>--</u>
Other comprehensive income	(8,802)	780
Comprehensive Income	<u>\$ <u>92,019</u></u>	<u>\$ <u>86,326</u></u>

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

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

ASSETS

	<u>June 30,</u> <u>1999</u>	<u>December 31,</u> <u>1998</u>
UTILITY PLANT:		
Electric	\$ 3,763,973	\$ 3,694,593
Gas	1,324,628	1,278,275
Common	188,789	179,140
Less: Accumulated depreciation and amortization	<u>1,788,752</u>	<u>1,721,096</u>
Net utility plant	<u>3,488,638</u>	<u>3,430,912</u>
OTHER PROPERTY AND INVESTMENTS	<u>262,712</u>	<u>260,087</u>
CURRENT ASSETS:		
Cash	43,483	28,216
Accounts receivable	182,706	189,638
Unbilled revenue	62,801	126,740
Materials and supplies, at average cost	51,777	58,534
Purchased gas receivable	16,164	5,492
Prepayments and other	<u>9,168</u>	<u>7,990</u>
Total current assets	<u>366,099</u>	<u>416,610</u>
LONG-TERM ASSETS:		
Regulatory asset for deferred income taxes	231,833	241,406
Deferred PURPA power contract buydown costs	224,268	221,802
Other	<u>150,239</u>	<u>138,870</u>
Total long-term assets	<u>606,340</u>	<u>602,078</u>
TOTAL ASSETS	<u>\$ 4,723,789</u>	<u>\$ 4,709,687</u>

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

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

CAPITALIZATION AND LIABILITIES

	<u>June 30,</u> <u>1999</u>	<u>December 31,</u> <u>1998</u>
CAPITALIZATION:		
Common shareholders' investment:		
Common stock, \$10 stated value, 150,000,000 shares authorized, 84,560,539 and 84,560,561 shares outstanding	\$ 845,605	\$ 845,606
Additional paid-in capital	450,836	450,724
Earnings reinvested in the business	64,441	47,548
Accumulated other comprehensive income	--	8,802
Preferred stock not subject to mandatory redemption	90,000	95,075
Preferred stock subject to mandatory redemption	65,662	73,162
Corporation obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely junior subordinated debentures of the corporation	100,000	100,000
Long-term debt	<u>1,714,770</u>	<u>1,475,106</u>
Total capitalization	<u>3,331,314</u>	<u>3,096,023</u>
CURRENT LIABILITIES:		
Accounts Payable	131,231	163,141
Short-term debt	236,493	450,905
Current maturities of long-term debt	107,000	107,000
Accrued expenses:		
Taxes	79,272	59,764
Salaries and wages	19,536	18,650
Interest	42,704	39,062
Other	<u>22,567</u>	<u>23,150</u>
Total current liabilities	<u>638,803</u>	<u>861,672</u>
DEFERRED INCOME TAXES	<u>626,034</u>	<u>628,554</u>
OTHER DEFERRED CREDITS	<u>127,638</u>	<u>123,438</u>
TOTAL CAPITALIZATION AND LIABILITIES	<u>\$ 4,723,789</u>	<u>\$ 4,709,687</u>

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

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Six Month Periods Ended June 30
(Dollars in Thousands)
(Unaudited)

	<u>1999</u>	<u>1998</u>
<u>OPERATING ACTIVITIES:</u>		
Net Income	\$ 100,821	\$ 85,546
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	85,520	81,182
Deferred income taxes and tax credits - net	7,053	405
Gain from sale of investment in Cabot common stock	(18,899)	--
Other	363	26,265
Change in certain current assets and liabilities (Note 3)	57,321	39,327
Net Cash Provided by Operating Activities	232,179	232,725
<u>INVESTING ACTIVITIES:</u>		
Construction expenditures - excluding equity AFUDC	(163,013)	(141,489)
Additions to energy conservation program	(2,755)	(2,301)
Proceeds from sale of investment in Cabot common stock	37,353	--
Loans to CellNet Data Services	(20,500)	--
Other	5,170	1,601
Net Cash Used by Investing Activities	(143,745)	(142,189)
<u>FINANCING ACTIVITIES:</u>		
Change in short-term debt, net	(214,412)	(156,038)
Dividends paid	(83,777)	(84,422)
Redemption of preferred stock	(12,575)	(5,054)
Issuance of bonds	250,000	200,000
Redemption of bonds and notes	(10,358)	(45,044)
Issue costs of bonds and stock	(2,045)	(1,906)
Net Cash Used by Financing Activities	(73,167)	(92,464)
Net Increase (Decrease) in cash	15,267	(1,928)
Cash at Beginning of year	28,216	10,729
Cash at End of Period	\$ 43,483	\$ 8,801

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Consolidation Policy

The consolidated financial statements include the accounts of Puget Sound Energy, Inc. ("the Company") and its wholly-owned subsidiaries, after elimination of all significant intercompany items and transactions. Certain amounts previously reported have been reclassified to conform with current year presentations with no effect on total equity or net income.

The consolidated financial statements contained in this Form 10-Q are unaudited. In the opinion of management, all adjustments necessary for a fair presentation of the results for the interim periods have been reflected and were of a normal recurring nature. These condensed financial statements should be read in conjunction with the Company's annual report on Form 10-K.

(2) Earnings per Common Share

Basic earnings per common share have been computed based on weighted average common shares outstanding of 84,561,000 for the three and six months ended June 30, 1999 and 1998.

Diluted earnings per common share have been computed based on weighted average common shares outstanding of 84,813,000 and 84,815,000 for the three and six months ended June 30, 1999, and 84,675,000 and 84,670,000 for the three and six months ended June 30, 1998, respectively. These shares include the dilutive effect of securities related to long-term employee compensation plans approved by shareholders.

(3) Consolidated Statements of Cash Flows

The following provides additional information concerning cash flow activities:

<u>Six Months Ended June 30</u>	<u>1999</u>	<u>1998</u>
Changes in current asset and current liabilities:		
Accounts receivable and unbilled revenue	\$ 70,871	\$ 70,737
Materials and supplies	6,757	2,972
Prepayments and Other	(1,178)	(1,221)
Purchased gas receivable	(10,672)	10,647
Accounts payable	(31,910)	(41,997)
Accrued expenses and Other	23,453	(1,811)
Net change in current assets and current liabilities	\$ 57,321	\$ 39,327
Cash payments:		
Interest (net of capitalized interest)	\$ 71,987	\$ 60,348
Income taxes	\$ 39,750	\$ 50,743

(4) Segment Information

The Company primarily operates in one business segment, Regulated Utility Operations. The Company's regulated utility operation generates, purchases, transports and sells electricity and purchases, transports and sells natural gas. The Company's service territory covers approximately 6,000 square miles in the state of Washington.

Principal non-utility lines of business include real estate investment and development, home security services, small hydro-electric project development and energy-related services. Reconciling items between segments are not material.

Financial data for business segments are as follows:

(Dollars in Thousands) Three Months Ended June 30, 1999	Regulated Utility	Other	Total
Revenues	\$ 431,068	4,371	\$ 435,439
Net Income	22,357	8,708	31,065
Total Assets	4,611,971	111,818	4,723,789

Three Months Ended June 30, 1998	Regulated Utility	Other	Total
Revenues	\$ 363,665	6,562	\$ 370,227
Net Income	20,460	(918)	19,542
Total Assets	4,349,775	106,093	4,455,868

(Dollars in Thousands) Six Months Ended June 30, 1999	Regulated Utility	Other	Total
Revenues	\$ 1,002,726	8,046	\$ 1,010,772
Net Income	94,917	5,904	100,821
Total Assets	4,611,971	111,818	4,723,789

Six Months Ended June 30, 1998	Regulated Utility	Other	Total
Revenues	\$ 880,083	14,658	\$ 894,741
Net Income	84,895	651	85,546
Total Assets	4,349,775	106,093	4,455,868

(5) Other

In September 1998, the Company filed a shelf-registration statement with the Securities and Exchange Commission for the offering, on a delayed or continuous basis, of up to \$500 million principal amount of Senior Notes secured by a pledge of First Mortgage Bonds. On March 9, 1999, the Company issued \$250 million principal amount of Senior Medium-Term Notes, Series B, which consisted of \$150 million principal amount due March 9, 2009, at an interest rate of 6.46% and \$100 million principal amount due March 9, 2029, at an interest rate of 7.0%.

In March 1998, the Company entered into an agreement with CellNet Data Services Inc. ("CellNet") under which the Company will lend CellNet up to \$40 million in the form of multiple draws so that CellNet can finance an Automated Meter Reading (AMR) network system to be deployed in the Company's service territory. The Company's promissory note with CellNet calls for the network system to serve as collateral for the loan. The term of the loan is five years after the first loan under the agreement is made to CellNet. On June 30, 1999, the Company made the first loan under the loan agreement in the amount of \$20.5 million. The loan agreement provides for interest only payments during the five year term, with the principal due at the end of the five year term.

During the first quarter of 1999, the Company adopted Issue 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities" ("EITF 98-10") issued by the Emerging Issues Task Force of the Financial Accounting Standards Board ("FASB"). EITF 98-10 addresses accounting for the purchase and sale of energy trading contracts and is effective for fiscal years beginning after December 15, 1998. The conclusion reached by the EITF was that such contracts should be recorded at fair value when entered into for trading activities with the mark-to-market gains or losses recorded in current earnings. The Company does not consider its current operations to meet the definition of trading activities as described by EITF 98-10. Accordingly, the adoption of EITF 98-10 did not have an impact on the Company's financial position or results of operations.

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("Statement No. 133"). In July 1999, the FASB issued Statement of Financial Accounting Standards No. 137 which delayed the effective date of Statement No. 133 for one year, to fiscal years beginning after June 15, 2000. Statement No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on whether a derivative is designated as part of a hedge transaction and, if it is, the type of hedge transaction. The Company has not yet determined the impact that the adoption of Statement No. 133 will have on its financial statements.

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

The following discussion of the Company's business includes some forward-looking statements that involve risks and uncertainties. Words such as "estimates," "expects," "anticipates," "plans," and similar expressions identify forward-looking statements involving risks and uncertainty. Those risks and uncertainties include, but are not limited to, the ongoing restructuring of the electric and gas industries and the outcome of regulatory proceedings related to that restructuring. The ultimate impacts of both increased competition and the changing regulatory environment on future results are uncertain, but are expected to fundamentally change how the Company conducts its business. The outcome of these changes and other matters discussed below may cause future results to differ materially from historic results, or from results or outcomes currently expected or sought by the Company.

Results of Operations

Net income for the three months ended June 30, 1999, was \$31.1 million on operating revenues of \$435.4 million, compared with net income of \$19.5 million on operating revenues of \$370.2 million for the same period in 1998. Income for common stock was \$28.1 million for the second quarter of 1999 and \$16.3 million for the second quarter of 1998. Basic and Diluted earnings per common share were \$0.33 for the second quarter of 1999 compared to \$0.19 for the second quarter of 1998.

For the first six months of 1999, net income was \$100.8 million on operating revenues of \$1,011 million, compared with net income of \$85.5 million on operating revenues of \$894.7 million for the corresponding period in 1998. Income for common stock was \$94.9 million for the first half of 1999 and \$79.0 million for the same period in 1998. Basic and diluted earnings per common share were \$1.12 for the six months ended June 30, 1999, and \$0.93 for the same period in 1998.

Results from non-utility operations for the three months ended June 30, 1999, were positively impacted by approximately \$0.10 per share, the result of a gain from the sale of the Company's investment in common stock of Cabot Oil & Gas Corporation, offset in part by the cost of a wholly-owned subsidiary's exiting certain product lines. The increase in net income and earnings per share for the three and six months ended June 30, 1999, compared to the same periods in 1998 are also the result of continued customer growth, cooler weather than the same period last year and the positive contribution of favorable hydroelectric conditions to electric margins.

Total kilowatt-hour sales were 7.6 billion, including 2.7 billion in sales to other utilities, for the second quarter of 1999, compared to 6.3 billion, including 1.5 billion in sales to other utilities, for the second quarter of 1998. For the six month periods ended June 30, 1999 and 1998, total kilowatt-hour sales were 16.3 billion, including 5.4 billion in sales to other utilities, and 13.9 billion, including 3.3 billion in sales to other utilities, respectively.

Total gas volumes were 228.2 million therms, including 57.4 million therms in transportation volumes for the three months ended June 30, 1999, compared to 199.0 million therms, including 63.1 million therms of transportation, for the same period in 1998. For the six months ended June 30, 1999, total gas volumes were 620.4 million therms, including 126.5 million therms of transportation, compared to 551.0 million therms, including 138.9 million therms of transportation, for the same period in 1998.

The Company's operating revenues and associated expenses are not generated evenly during the year. Variations in energy usage by customers occur from season to season and from month to month within a season, primarily as a result of changing weather conditions. The Company normally experiences its highest energy sales in the first and fourth quarters of the year. Electric sales to other utilities also vary by quarter and year depending principally upon water conditions for the generation of hydroelectric power, customer usage and the energy requirements of other utilities.

Results of Operations
Comparative Three and Six Month Periods Ended
June 30, 1999 vs. June 30, 1998
Increase (Decrease)

	<u>Three Month Period</u>	<u>Six Month Period</u>
	(In Millions)	
Operating revenue changes		
General rate increase - electric	\$3.9	\$7.8
BPA Residential Purchase & Sale Agreement	(1.5)	(3.6)
Sales to other utilities and marketers	38.8	53.9
Electric load and other changes	8.8	24.1
Gas revenue change	17.4	40.4
Other revenue changes	(2.2)	(6.6)
Total operating revenue change	<u>65.2</u>	<u>116.0</u>
Operating expense changes		
Energy costs:		
Purchased electricity	38.7	54.6
Purchased gas	6.2	16.6
Electric generation fuel	1.7	0.3
Residential exchange credit	3.4	7.2
Utility operations and maintenance	1.1	3.1
Other operations and maintenance	(1.2)	0.8
Depreciation and amortization	2.5	4.3
Taxes other than federal income taxes	5.1	10.1
Federal income taxes	2.5	10.5
Total operating expense change	<u>60.0</u>	<u>107.5</u>
Other income	9.2	11.2
Interest charges	2.9	4.4
Net income change	<u>\$ 11.5</u>	<u>\$ 15.3</u>

The following is additional information pertaining to the changes outlined in the above table.

Operating Revenues - Electric

Electric revenues for the quarter ended June 30, 1999, were \$336.9 million, up \$50.0 million or 17.4% over the same period in 1998. Revenues in the second quarter of 1999 increased \$3.9 million compared to the second quarter of 1998 due to a general electric rate increase that averaged 1.2% effective January 1, 1999.

Electric revenues for the six months ended June 30, 1999, were \$737.7 million, up \$82.2 million or 12.5% over the same period in 1998. Revenues in the first half of 1999 increased \$7.8 million compared to the first half of 1998 due to a general electric rate increase that averaged 1.2% effective January 1, 1999.

Revenues in 1999 and 1998 were reduced because of the credit that the Company received through the Residential Purchase and Sale Agreement with the Bonneville Power Administration ("BPA"). The agreement enables the Company's residential and small farm customers to receive the benefits of lower-cost federal power. On January 29, 1997, the Company and BPA signed a Residential Exchange Termination Agreement. The Termination Agreement ends the Company's participation in the Residential Purchase and Sale agreement with BPA. As part of the Termination Agreement, the Company will receive payments by the BPA of approximately \$235 million over an approximately five-year period ending June 2001. Under the rate plan approved by the Washington Commission in its merger order, the Company will continue to reflect, in customers' bills, the current level of Residential Exchange benefits. Over the remainder of the Residential Exchange Termination Agreement from July 1999 through June 2001, it is projected that the Company will credit customers approximately \$132.1 million more than it will receive from BPA during the following periods:

<u>Period</u>	<u>Dollars in Millions</u>
July- December 1999	\$26.9
January - December 2000	68.3
January - June 2001	<u>36.9</u>
	<u>\$132.1</u>

Electric sales to other utilities and marketers increased \$38.8 million and \$53.9 million in the quarter and six months ended June 30, 1999, respectively, over the same periods in 1998 as wholesale sales to marketers have increased. Related power cost expenses for the periods also increased as the Company generated and purchased more power for these sales.

Also contributing to the increase in electric revenues in the three and six months ended June 30, 1999, when compared to the previous year were colder temperatures during the 1999 periods and a 2% increase in the number of electric customers. Temperatures during the six months ended June 30, 1999, averaged slightly colder than normal.

Operating Revenues - Gas

Gas operating revenues for the quarter ended June 30, 1999, increased \$17.4 million or 22.7% from the prior year quarter. Total gas volumes increased 14.6% from 199.0 million therms to 228.2 million therms. Gas margin (regulated utility sales less the cost of gas sold) also increased by \$11.1 million, or 26.9% in the second quarter of 1999 compared to the same period in 1998. The primary reasons for the increase in gas

sales volume, gas sales revenue and margin in the quarter ended June 30, 1999, was the 4.5% increase in gas customers and cooler temperatures than the prior year. A larger percentage of firm gas sales with higher prices and less transportation sales volumes in 1999 when compared to last year also contributed to increased revenues.

For the six months ended June 30, 1999, gas operating revenues increased \$40.4 million or 18.0% from \$224.6 million in the six months ended June 30, 1998, to \$265.0 million while total gas volumes increased 12.6%. The increase in the period was primarily due to a 4.4% increase in gas customers and the impact of cooler weather on the Company's gas heating load during the first two quarters of 1999 compared to 1998. A larger percentage of firm gas sales with higher prices and less transportation sales volumes in 1999 when compared to last year also contributed to increased revenues. Gas margin in the six months ended June 30, 1999, also increased \$23.8 million or 20.1%.

Other revenues decreased \$2.2 million and \$6.6 million in the three months and six months ended June 30, 1999, respectively, as compared to the same periods in 1998 due to decreased revenues at the Company's subsidiaries.

Operating Expenses

Purchased electricity expenses increased \$38.7 million and \$54.6 million for the three and six month periods ended June 30, 1999, respectively, compared to the same periods in 1998. The increases were due primarily to increased secondary power purchases to support wholesale sales and the increased load due to cooler temperatures than in the prior year and a greater number of electric customers in 1999.

Purchased gas expenses increased \$6.2 million and \$16.6 million for the three and six month periods ended June 30, 1999, respectively, due to both increased volumes of purchases as a result of higher heating load and the increase in gas service customers.

Fuel expense increased \$1.7 million in the second quarter of 1999 compared to the same period in 1998 due to the Company generating more electricity at Company-owned combustion turbines.

Residential exchange credits associated with the Residential Purchase and Sale Agreement with BPA decreased \$3.4 million and \$7.2 million in the three and six month periods ended June 30, 1999, compared to the prior year periods, primarily as a result of the 1997 Residential Exchange Termination Agreement discussed in "Operating Revenues - Electric."

Utility operations and maintenance expenses increased slightly for the three and six month periods ended June 30, 1999, compared to the same periods in 1998 due primarily to an increase in storm-repair costs of approximately \$6.2 million in the six-month period ended June 30, 1999, compared to the same period in 1998. The increase in storm restoration costs was partially offset by decreases in vegetation management expenses of \$.9 million and \$3.4 million in the three and six month periods ended June 30, 1999, compared to the same periods in 1998. The Company performed the majority of vegetation management work in 1998 during the first six months of the year due to the availability of contractors, favorable weather conditions and in anticipation of beginning a new "Tree Watch" program under which trees are removed outside of the Company's right of ways after obtaining customer permission. Utility operations and maintenance expenditures in 1999 also include costs of \$5.3 million for Year 2000 remediation efforts.

Depreciation and amortization expense increased \$2.5 million and \$4.3 million for the three and six month periods June 30, 1999, respectively, from the same periods in 1998 due primarily to the effects of new plant placed into service during the past year.

Taxes other than federal income taxes increased \$5.1 million and \$10.1 million for the three and six month periods ended June 30, 1999, compared to the same periods in 1998 due primarily to increases in municipal and state excise taxes which are revenue based and increased state property taxes.

Federal income taxes increased \$2.5 million and \$10.5 million for the three month and six month periods ended June 30, 1999, primarily due to higher pre-tax operating income for the periods.

Other Income

Other income, net of federal income tax, increased \$9.2 million and \$11.2 million for the three month and six month periods ending June 30, 1999, respectively, compared to the same periods in 1998. The increases in both periods were due primarily to the net after-tax gain of \$12.3 million as a result of the sale of the Company's investment in the common stock of Cabot Oil and Gas Corporation in May 1999, offset in part by the cost of ConnexT, a wholly-owned subsidiary, exiting certain product lines.

Interest Charges

Interest charges, which consist of interest and amortization on long-term debt and other interest, increased \$2.9 million and \$4.4 million for the three and six month periods ended June 30, 1999, respectively, compared to the same periods in 1998 as a result of the issuance of \$200 million 6.74% Senior Medium-Term Notes, Series A, in June 1998 and \$250 million Senior Medium-Term Notes, Series B, in March 1999. These increases were partially offset by the repayment of \$61 million in Secured Medium-Term Notes since February 1999 and the redemption of \$30 million 9.14% Secured Medium-Term Notes, Series A, in June 1998. Other interest expense decreased \$1.9 million for the three and six months ended June 30, 1999, compared to the same periods in 1998 as a result of lower weighted average interest rates and lower average daily short-term borrowings.

Construction, Capital Resources and Liquidity

Construction expenditures, which include energy conservation expenditures and exclude AFUDC, for the second quarter of 1999 were \$70.8 million compared to \$73.2 million for the second quarter of 1998. Year-to-date construction expenditures totaled \$161.1 million compared to \$140.4 million for the same period in 1998. Construction expenditures for 1999 and 2000 are expected to be \$303 million and \$259 million, respectively. Cash provided by operations (net of dividends and AFUDC) as a percentage of construction expenditures (excluding AFUDC) was 51% and 32% for the second quarters of 1999 and 1998, respectively. Cash provided by operations (net of dividends and AFUDC) as a percentage of construction expenditures (excluding AFUDC) was 89% and 103% for the six month periods ended June 30, 1999 and 1998, respectively. Construction expenditure estimates are subject to periodic review and adjustment.

On June 30, 1999, the Company had available \$375.0 million in lines of credit with various banks, which provide credit support for outstanding commercial paper borrowing of \$62.5 million, reducing the available borrowing capacity under these lines of credit to \$312.5 million. In addition, the Company has agreements with several banks to borrow on an uncommitted, as available, basis at money-market rates quoted by the banks. There are no costs, other than interest, for these arrangements.

Year 2000 Conversion

Background

The Year 2000 issue results from the use of two digits rather than four digits in computer hardware and software to define the applicable year. If not corrected on computer systems that must process dates both before and after January 1, 2000, two-digit year fields may create processing errors or system failures. The Company believes that all mission-critical operational systems, as defined by the North American Electric Reliability Council ("NERC"), are Year 2000 ready. Project work, including remediation and testing is substantially complete for the Company's other priority business systems. Follow-up for a limited number of non-critical systems and certain vendors will continue into the third quarter.

Project Approach and Progress

The number of people working full time and part time on the Company's Year 2000 project fluctuates between 125 and 150. The Company has established a central project team to coordinate all Year 2000 activities and identified exposure in three categories: information technology; embedded chip technology; and external non-compliance by customers and suppliers. The project team is taking a phased approach in conducting the Year 2000 project for its internal systems. The phases include inventory, assessment, remediation, testing, implementation and contingency planning. In addition, the Company has engaged outside consultants and technicians to aid in formulating and implementing its plan. All business units have completed the inventory, assessment, remediation, testing and implementation phases with the exception of the Company's Customer Information System ("CIS") discussed below.

The Company has been upgrading mainframe and client server financial and business applications since 1997 and replacing many of its business systems as part of its business plans following its merger in 1997. In September 1998, the Company implemented a Systems, Applications, Products in Data Processing ("SAP") business system which includes essentially all of the Company's business applications with the exception of its CIS. This SAP system is Year 2000 compliant.

A new CIS, which is designed to be Year 2000 compliant, is currently being developed by the Company. Development is expected to continue in 1999. The Company has also begun implementation activities with respect to the new system which will continue during 1999. The Company has also elected to remediate critical elements of its existing CIS for Year 2000 compliance purposes. The Company has formed a specialized team which has completed the inventory, assessment and remediation activities for the existing system. Testing and implementation activities for the existing system are expected to be completed in the third quarter of 1999.

A specialized embedded systems team has been formed by the Company to inventory, assess and remediate microprocessor technology in its generation, transmission and distribution systems for both gas and electric operations. The inventory, assessment, remediation, testing and implementation phases for all mission critical embedded systems are complete. Contingency planning specific to the Year 2000 issue began in November 1998, and contingency plans were submitted on June 30, 1999, to the Washington Commission and NERC. These plans will be refined and updated as remediation and test results are analyzed.

The Company sent letters to its suppliers, financial institutions and other business partners to coordinate Year 2000 conversion and determine the extent to which the Company is exposed to third party compliance failures. All significant vendors and suppliers have been contacted to date. All third party

assessment was completed in June 1999. If the Company identified concerns, it followed up with third parties by telephone. In addition, the Company held meetings with critical vendors described below in order to assess and monitor compliance measures. All critical vendors and suppliers have responded to the Company's written requests and follow up telephone calls. They have indicated either that they are Year 2000 compliant or that they expect to be compliant later in 1999. Where appropriate company line managers have developed alternate sources or other contingency plans for critical vendors and suppliers.

The Company depends upon third parties for a significant portion of its energy supply and transportation. The majority of the high voltage transmission facilities used by the Company are owned and operated by Bonneville Power Administration and the Company's natural gas supplies are transported to its service area by natural gas pipelines in the western United States and Canada. The Company purchases 100% of its natural gas supplies and approximately 75% of its electric power supplies. Major energy suppliers and transporters are considered critical vendors because their failure to supply or deliver energy to the Company could adversely affect the reliability of the Company's electric or gas service to its customers.

In addition, the Company is working with various industry groups including NERC and the regional reliability council, the Western Systems Coordinating Council ("WSCC") during the millennium transition. The United States Department of Energy has asked NERC to assume a leadership role in preparing the U.S. electric industry for the transition to the Year 2000.

Costs

While the replacement of business systems under business plans developed as a result of the Merger are not included in the Company's Year 2000 project, those replacements substantially reduce the number of internal business applications that require remediation. In addition to the costs of replacing new business systems, the Company estimates that total Year 2000 project costs will approximate \$14 million, exclusive of internal labor costs, of which \$9.7 million has been expended through June 30, 1999.

Risk Assessment

The electric power supply systems of North America are connected into three major interconnections called grids. The western grid covers the western third of the U.S., western Canada and parts of Mexico. The BPA is the largest supplier of transmission services in the Pacific Northwest. The Company's reasonably likely worst case scenario is that operational component failures of any entity connected to the grid could cause other failures in that grid. Such failures would adversely affect the Company's ability to provide reliable service to its customers and correspondingly reduce revenues. The Company will need to continue to assess this risk as the millennium approaches to evaluate the likelihood of power failures and develop approaches for mitigating the risk of failures.

Much of the natural gas and electric distribution systems are comprised of wires, poles and pipes containing no embedded chips. However, these systems do employ some computer components that could be affected by the Year 2000 transition. Since many of the components used by the Company exist in multiple sub-station locations, there is a risk that a component could be missed, a component manufacturer could provide erroneous information, or the component (while deemed and tested compliant) could fail in a specific configuration found at the Company. The Company has formed a special team to handle these types of components (embedded systems), and has retained an independent engineering firm with specific utility experience to assist in the effort. Results of assessment to date reveal that there are fewer components that are not Year 2000 ready than initially thought. This is consistent with industry findings published in the NERC report to the Department of Energy dated January 11, 1999.

The failure to correct a material Year 2000 problem could result in an interruption in, or a failure of, Company business activities or operations. Such failures could materially and adversely affect the Company's results of operations, liquidity and financial condition. Due to the general uncertainty inherent in the Year 2000 problem, resulting in part from the uncertainty of the Year 2000 readiness of third-party suppliers and customers, the Company is unable to determine at this time whether the consequences of Year 2000 failures will have a material impact on the Company's results of operations, liquidity or financial condition. The Year 2000 project is expected to significantly reduce the Company's level of uncertainty about the Year 2000 problem and the Year 2000 readiness of its material vendors. The Company believes that, with the implementation of new business systems and completion of the project as scheduled, the possibility of significant interruptions of normal operations should be reduced.

Contingency Plans

The Company is identifying various scenarios that could occur in the event that Year 2000 issues are not resolved in a timely manner. These efforts will build upon the work in scenario development and contingency planning that is being done by the WSCC contingency planning task force. A specialized team has been formed that has developed contingency plans and updated existing emergency preparedness plans to identify and address risk scenarios for the Company. Contingency plans were sent to the Washington Commission and NERC on June 30, 1999. These plans will be refined and updated as remediation and test results are analyzed.

Forward Looking Statements

Readers are cautioned that forward-looking statements contained in the Year 2000 update are based on management's best estimates and may be influenced by factors that could cause actual outcomes and results to be materially different than projected. Specific factors that might cause differences between the estimates and actual results include, but are not limited to, the availability and cost of personnel trained in these areas, the ability to locate and correct all relevant computer code, timely responses to and corrections by third-parties and suppliers, the ability to implement new systems in a timely manner, the ability to implement interfaces between the new systems and the systems not being replaced, and similar uncertainties. Due to the general uncertainty inherent in the Year 2000 problem, resulting in part from the uncertainty of the Year 2000 readiness of third-parties and the interconnection of global businesses, the Company cannot ensure its ability to timely and cost-effectively resolve problems associated with Year 2000 issues that may affect its operations and business, or expose it to third-party liability.

Other

On April 30, 1999, the Company filed a registration statement and prospectus for the formation of a holding company structure. The holding company proposal was approved by shareholders at the Company's annual meeting on June 23, 1999. The proposed holding company structure is also subject to regulatory approval by the Washington Utilities and Transportation Commission and the Federal Energy Regulatory Commission.

The power supply operating alliance between the Company and Duke Energy Trading and Marketing ("DETM"), whereby the Company participated in the Western market activities of DETM, was terminated as of May 31, 1999. Going forward the Company will perform the functions of minimizing the cost of, and optimizing the value inherent in, its core power supply portfolio. The Company will overlay its traditional supply management activities with an energy price risk hedging capability. Termination of the agreement may result in a reduction in the Company's volume of nonfirm and short term firm wholesale sales.

On July 1, 1999, the Company called for redemption all outstanding shares of its 8.5% Preferred Stock, Series III. The shares will be redeemed on September 1, 1999, at the redemption price of \$25 per share plus accrued dividends.

On July 29, 1999, the Company was served a lawsuit by Tacoma Power, a Washington municipal corporation. The anti-trust claim seeks modification of a service area agreement for electrical power and unspecified damages. The Company is currently evaluating the claim.

The Company has an Optional Large Power Sales Rate and certain "special contracts" for its largest customers. Customers who elect the Optional Large Power Sales Rate are no longer considered "core" customers, and the Company no longer has an obligation to plan for future resources to serve their needs. The non-core customers receive access to electric energy that is priced at current market cost and pay a charge for energy delivery (including a charge for conservation programs) and a transition charge (representing the difference between the Company's present cost and the current market cost of electric energy and capacity). The transition charge will be phased out before the end of the year 2000. Non-core customers also take on the risk that market costs could become volatile and that electricity could be unavailable on the open market. In November 1998, a number of industrial customers filed a complaint with the Washington Commission that the Company was incorrectly billing for energy under the Optional Large Power Sales Rate. On August 3, 1999, the Company received an order from the Washington Commission requiring the Company to refund approximately \$2.8 million to five customers. This amount includes disputed amounts back to June 1, 1998, plus interest. The Company is considering its options with respect to the order, including appeal and has not recorded a reserve for this amount.

Item 3 Quantitative and Qualitative Disclosures About Market Risk

The Company is exposed to market risks, including changes in commodity prices and interest rates.

Commodity Price Risk

The prices of energy commodities and transportation services are subject to fluctuations due to unpredictable factors including weather, transportation congestion and other factors which impact supply and demand. This commodity price risk is a consequence of purchasing energy at fixed and variable prices and providing deliveries at different tariff and variable prices. Costs associated with ownership and operation of production facilities are another component of this risk. The Company may use forward delivery agreements and option contracts for the purpose of hedging commodity price risk. Unrealized changes in the market value of these derivatives are deferred and recognized upon settlement along with the underlying hedged transaction. In addition, the Company believes its current rate design, including its Optional Large Power Sales Rate, various special contracts and the PGA mechanism mitigate a portion of this risk.

Market risk is managed subject to parameters established by the Board of Directors. A Risk Management Committee separate from the units that create these risks monitors compliance with the Company's policies and procedures. In addition, the Audit Committee of the Company's Board of Directors has oversight of the Risk Management Committee.

Interest rate risk

The Company believes interest rate risks of the Company primarily relate to the use of short-term debt instruments and new long-term debt financing needed to fund capital requirements. The Company manages

its interest rate risk through the issuance of mostly fixed-rate debt of various maturities. The Company does utilize bank borrowings, commercial paper and line of credit facilities to meet short-term cash requirements. These short-term obligations are commonly refinanced with fixed rate bonds or notes when needed and when interest rates are considered favorable. The Company may enter into swap instruments to manage the interest rate risk associated with these debts, and one interest rate swap was outstanding as of June 30, 1999.

PART II OTHER INFORMATION

Item 1 Legal Proceedings

Contingencies arising out of the normal course of the Company's business exist at June 30, 1999. The ultimate resolution of these issues is not expected to have a material adverse impact on the financial condition, results of operations or liquidity of the Company.

Item 4 Submission of Matters to a Vote of Security Holders

At the annual meeting of shareholders held on June 23, 1999, the following proposals were adopted by the margins indicated:

(a) Approve a proposal to adopt a holding company structure, to be implemented through a plan of exchange whereby each share of Puget Sound Energy, Inc. Common stock will be automatically exchanged for one share of Puget Energy, Inc. Common stock.

For	56,442,280
Against	6,734,870
Abstain	1,580,486

(b) To elect four directors to hold office until the annual meeting of shareholders in 2002, or until their successors are elected and qualified.

	Number of Shares	
	For	Withheld
Charles W. Bingham	75,699,485	1,321,248
Robert L. Dryden	75,653,121	1,367,611
John D. Durbin	75,706,964	1,313,769
Sally G. Narodick	75,538,299	1,482,434

Broker non-votes were not readily available.

Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits

The following exhibits are filed herewith:

12-a Statement setting forth computation of ratios of earnings to fixed charges (1994 through 1998 and 12 months ended June 30, 1999)

12-b Statement setting forth computation of ratios of earnings to combined fixed charges and preferred stock dividends (1994 through 1998 and 12 months ended June 30, 1999)

27 Financial Data Schedule

(b) Reports of Form 8-K

The Company did not file any reports on Form 8-K during the quarter ended June 30, 1999.

SIGNATURES

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

PUGET SOUND ENERGY, INC.

/s/ James W. Eldredge

James W. Eldredge

Corporate Secretary and Controller

Date: August 13, 1999

Chief accounting officer and officer duly authorized to sign this report on behalf of the registrant