

PUGET SOUND ENERGY INC  
Form 10-Q/A  
October 18, 2001

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D. C. 20549**

**FORM 10-Q/A**

**Amendment No. 1**

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

For the quarterly period ended June 30, 2001

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OR

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

For the Transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number	Exact name of registrant as specified in its charter, state of incorporation, address of principal executive offices, Telephone	I.R.S. Employer Identification Number
1-16305	PUGET ENERGY, INC. A Washington Corporation 411 - 108th Avenue N.E. Bellevue, Washington 98004-5515 (425) 454-6363	91-1969407
1-4393	PUGET SOUND ENERGY, INC. A Washington Corporation 411 - 108th Avenue N.E. Bellevue, Washington 98004-5515 (425) 454-6363	91-0374630

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

For the Transition period from \_\_\_\_\_ to \_\_\_\_\_

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As of June 30, 2001, (i) the number of shares of Puget Energy, Inc. ( Puget Energy ) common stock outstanding was 86,437,947 (\$.01 par value) and (ii) all of the outstanding shares of Puget Sound Energy, Inc. ( PSE ) common stock were held by Puget Energy.

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### Explanatory Note

The purpose of this Form 10-Q/A is to restate the quarterly consolidated financial statements of Puget Energy and Puget Sound Energy for the quarter and six months ended June 30, 2001. The restatement relates to the accounting treatment of certain purchase gas financial contracts. The contracts, entered into as a part of the Company's plan to secure fixed price gas supplies for winter electric generation purposes, were not matched with purchase of physical gas as of June 30, 2001. As a result, under Statement of Financial Accounting Standard No. 133 the financial gas purchase contracts do not qualify as hedge instruments at June 30, 2001. Therefore, the change in market value of these contracts should have been recorded in operating income for the quarter ended June 30, 2001, but were not reflected in that manner in the Company's initial filing as of June 30, 2001.

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This Quarterly Report on Form 10-Q/A is a combined quarterly report being filed separately by two different registrants: Puget Energy and PSE. Puget Energy became the holding company for PSE on January 1, 2001. Any references in this report to the "Company" are to Puget Energy and PSE collectively. PSE makes no representation as to the information contained in this report relating to Puget Energy and the subsidiaries of Puget Energy other than PSE and its subsidiaries.

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

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

	2001 Restated	2000
	-----	-----
Operating Revenues:		
Electric	\$719,694	\$437,491
Gas	163,013	98,017
Other	52,712	3,293
	-----	-----
Total operating revenues	935,419	538,801
	-----	-----
Operating Expenses:		
Energy costs:		
Purchased electricity	535,277	238,105
Purchased gas	104,184	46,184
Electric generation fuel	63,134	29,904
Residential Exchange	(10,304)	(9,073)
Utility operations and maintenance	65,414	58,395
Other operations and maintenance	41,470	4,045
Depreciation and amortization	52,935	49,316
Conservation amortization	1,603	1,380
FAS-133 unrealized (gain) loss on derivative instruments	(41,527)	-
Taxes other than federal income taxes	45,306	43,914
Federal income taxes	11,856	13,512
	-----	-----
Total operating expenses	869,348	475,682
	-----	-----
Operating Income	66,071	63,119
Other Income	1,568	6,878
	-----	-----
Income Before Interest Charges	67,639	69,997
Interest Charges, Net of AFUDC	48,174	42,628
	-----	-----
Net Income	19,465	27,369
Less: Preferred Stock Dividends Accrual	2,085	2,229
	-----	-----
Income for Common Stock	\$17,380	\$25,140
	=====	=====
Common Shares Outstanding - Weighted Average	86,303	85,295
	=====	=====
Basic Earnings Per Common Share	\$0.20	\$0.29
	=====	=====

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Diluted Earnings Per Common Share \$0.20 \$0.29  
===== =====

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

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

	2001	2000
	Restated	
	-----	-----
Operating Revenues:		
Electric	\$1,484,701	\$875,800
Gas	467,283	303,400
Other	103,299	6,600
	-----	-----
Total operating revenues	2,055,283	1,186,000
	-----	-----
Operating Expenses:		
Energy costs:		
Purchased electricity	925,493	434,300
Purchased gas	320,793	154,300
Electric generation fuel	165,518	50,600
Residential Exchange	(27,045)	(21,200)
Utility operations and maintenance	126,593	113,200
Other operations and maintenance	71,610	7,800
Depreciation and amortization	106,063	95,200
Conservation amortization	3,205	3,900
FAS-133 unrealized (gain) loss on derivative instruments	(15,061)	
Taxes other than federal income taxes	115,386	102,400
Federal income taxes	66,116	66,200
	-----	-----
Total operating expenses	1,858,671	1,007,000
	-----	-----
Operating Income	196,612	179,000
Other Income	3,509	11,200
	-----	-----
Income Before Interest Charges	200,121	190,200
Interest Charges, Net of AFUDC	93,609	84,700
	-----	-----
Income Before Cumulative Effect of Accounting Change	106,512	105,500
Cumulative Effect of Implementation of FAS-133 Derivative Instruments and Hedging Activities (net of tax)	14,749	
	-----	-----
Net Income	91,763	105,500
Less: Preferred Stock Dividends Accrual	4,243	4,500
	-----	-----
Income for Common Stock	\$87,520	\$101,000
	=====	=====
Common Shares Outstanding - Weighted Average	86,169	85,100
	=====	=====
Basic Earnings per Share Before Cumulative Effect of Accounting Change	\$1.19	\$1.19
Cumulative Effect of Accounting Change	(0.17)	
	=====	=====
Basic Earnings Per Common Share	\$1.02	\$1.02
	=====	=====
Diluted Earnings per Share Before Cumulative Effect of Accounting Change	\$1.18	\$1.18
Cumulative Effect of Accounting Change	(0.17)	
	=====	=====
Diluted Earnings Per Common Share	\$1.01	\$1.01

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

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

	2001 Restated	2000
	-----	-----
Net Income	\$19,465	\$27,369
Other comprehensive income, net of tax:		
Unrealized holding losses arising during the period	(612)	(1,580)
Reclassification adjustment for gains included in net income	-	(2,477)
FAS-133 unrealized losses during the period	(278,117)	-
Reversal of FAS-133 unrealized gains settled during the period	(37,267)	-
Other comprehensive income (loss)	(315,996)	(4,057)
Comprehensive Income (Loss)	\$ (296,531)	\$23,312
	=====	=====

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

	2001 Restated	2000
	-----	-----
Net Income	\$91,763	\$105,561
Other comprehensive income, net of tax:		
Unrealized holding gains (losses) arising during the period	(1,407)	2,265
Reclassification adjustment for gains included in net income	-	(3,160)
FAS-133 transition adjustment	286,928	-
FAS-133 unrealized losses during the period	(149,379)	-
Reversal of FAS-133 unrealized gains settled during the period	(143,335)	-
Other comprehensive income (loss)	(7,193)	(895)
Comprehensive Income (Loss)	\$84,570	\$104,666
	=====	=====

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

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

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(Unaudited)

ASSETS

	June 30, ----- 2001 Restated ----	December 31, ----- 2000 -----
Utility Plant: (at original cost, including construction work in progress of \$136,075 and \$164,221 respectively)		
Electric	\$4,114,417	\$4,054,551
Gas	1,497,593	1,459,488
Common	359,609	351,051
Less: Accumulated depreciation and amortization	(2,107,596)	(2,026,681)
	-----	-----
Net utility plant	3,864,023	3,838,409
	-----	-----
Other Property and Investments	367,824	292,297
	-----	-----
Current Assets:		
Cash	69,659	36,383
Accounts receivable, net	305,272	343,108
Unbilled revenue	76,918	211,784
Materials and supplies, at average cost	101,028	99,001
Purchased gas receivable	131,628	96,050
Prepayments and other	12,976	11,607
	-----	-----
Total current assets	697,481	797,933
	-----	-----
Long-Term Assets:		
Regulatory asset for deferred income taxes	196,099	207,350
Regulatory asset for PURPA buyout costs	243,822	243,071
Other	209,302	177,609
	-----	-----
Total long-term assets	649,223	628,030
	-----	-----
Total Assets	\$5,578,551 =====	\$5,556,669 =====

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

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

CAPITALIZATION AND LIABILITIES

June 30, -----	December 31, -----
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	2001 Restated ----	2000 -----
Capitalization:		
Common shareholder's investment:		
Common stock \$0.01 par value, 250,000,000 shares authorized, 86,437,947 shares outstanding at June 30, 2001 and \$10 stated value, 150,000,000 shares authorized, 85,903,791 shares outstanding at December 31, 2000	\$864	\$859,038
Additional paid-in capital	1,344,216	470,179
Earnings reinvested in the business	100,967	92,673
Accumulated other comprehensive income	(2,443)	4,750
Preferred stock not subject to mandatory redemption	60,000	60,000
Preferred stock subject to mandatory redemption	50,662	58,162
Corporation obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely junior subordinated debentures of the corporation	300,000	100,000
Long-term debt	2,165,649	2,170,797
	-----	-----
Total capitalization	4,019,915	3,815,599
	-----	-----
Current Liabilities:		
Accounts payable	164,782	410,619
Short-term debt	341,105	378,316
Current maturities of long-term debt	82,869	19,000
Accrued expenses:		
Taxes	79,347	103,996
Salaries and wages	16,759	17,445
Interest	44,383	43,955
Current portion of FAS-133 unrealized loss	13,415	-
Other	44,751	26,685
	-----	-----
Total current liabilities	787,411	1,000,016
	-----	-----
Deferred Income Taxes	600,931	608,185
	-----	-----
Other Deferred Credits	170,294	132,869
	-----	-----
Total Capitalization and Liabilities	\$5,578,551	\$5,556,669
	=====	=====

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

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

	2001 Restated ----	2000 -----
Operating Activities:		
-----		
Net Income	\$91,763	\$105,561
Adjustments to reconcile net income		

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to net cash provided by operating activities:		
Depreciation and amortization	106,063	95,201
Deferred income taxes and tax credits - net	3,997	(5,126)
Gain from sale of securities	-	(6,476)
Other	17,627	3,918
Change in certain current assets and current liabilities, net of effects of acquisitions by InfrastruX (Note 4)	(107,030)	44,584
-----		
Net Cash Provided by Operating Activities	112,420	237,662
-----		
Investing Activities:		
-----		
Construction expenditures - excluding equity AFUDC	(135,420)	(151,483)
Additions to energy conservation program	(3,713)	(2,732)
Acquisitions by InfrastruX	(54,247)	-
Proceeds from sale of Centralia Plant	-	24,828
Proceeds from sale of investment in Cabot stock	-	51,463
Loans to Schlumberger RMS (formerly Cellnet Data Services)	(12,158)	(1,325)
Proceeds from sale of securities	-	6,757
Other	(5,903)	(3,499)
-----		
Net Cash Used by Investing Activities	(211,441)	(75,991)
-----		
Financing Activities:		
-----		
Change in short-term debt - net	(38,008)	(146,425)
Dividends paid	(70,675)	(72,828)
Issuance of trust preferred stock	200,000	-
Redemption of preferred stock	(7,500)	(7,500)
Issuance of bonds and long term debt	55,165	225,000
Redemption of bonds and notes	-	(115,980)
Other	(6,685)	(1,005)
-----		
Net Cash Provided (Used) by Financing Activities	132,297	(118,738)
-----		
Net Increase in Cash	33,276	42,933
Cash at Beginning of Year	36,383	65,707
-----		
Cash at End of Period	\$69,659	\$108,640
=====		

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

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

	2001 Restated	2000
	-----	-----
Operating Revenues:		
Electric	\$719,694	\$437,491
Gas	163,013	98,017
Other	7,243	3,293
	-----	-----
Total operating revenues	889,950	538,801
	-----	-----
Operating Expenses:		



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Energy costs:		
Purchased electricity	535,277	238,105
Purchased gas	104,184	46,184
Electric generation fuel	63,134	29,904
Residential Exchange	(10,304)	(9,073)
Utility operations and maintenance	65,414	58,395
Other operations and maintenance	3,496	4,045
Depreciation and amortization	51,517	49,316
Conservation amortization	1,603	1,380
FAS-133 unrealized (gain) loss on derivative instruments	(41,527)	-
Taxes other than federal income taxes	45,306	43,914
Federal income taxes	10,221	13,512
	-----	-----
Total operating expenses	828,321	475,682
	-----	-----
Operating Income	61,629	63,119
Other Income	2,485	6,878
	-----	-----
Income Before Interest Charges	64,114	69,997
Interest Charges, Net of AFUDC	46,839	42,628
	-----	-----
Net Income	17,275	27,369
Less: Preferred Stock Dividends Accrual	2,085	2,229
	-----	-----
Income for Common Stock	\$15,190	\$25,140
	=====	=====

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

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

	2001	2000
	Restated	
	-----	-----
Operating Revenues:		
Electric	\$1,484,701	\$875,847
Gas	467,283	303,487
Other	29,290	6,690
	-----	-----
Total operating revenues	1,981,274	1,186,024
	-----	-----
Operating Expenses:		
Energy costs:		
Purchased electricity	925,493	434,308
Purchased gas	320,793	154,388
Electric generation fuel	165,518	50,653
Residential Exchange	(27,045)	(21,272)
Utility operations and maintenance	126,593	113,245
Other operations and maintenance	6,619	7,819
Depreciation and amortization	103,002	95,201
Conservation amortization	3,205	3,999
FAS-133 unrealized (gain) loss on derivative instruments	(15,061)	-
Taxes other than federal income taxes	115,386	102,429

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Federal income taxes	65,032	66,250
	-----	-----
Total operating expenses	1,749,535	1,007,020
	-----	-----
Operating Income	191,739	179,004
Other Income	5,328	11,268
	-----	-----
Income Before Interest Charges	197,067	190,272
Interest Charges, Net of AFUDC	92,164	84,711
	-----	-----
Income Before Cumulative Effect of Accounting Change	104,903	105,561
Cumulative Effect of Implementation of FAS-133 Derivative Instruments and Hedging Activities (net of tax)	14,749	-
	-----	-----
Net Income	90,154	105,561
Less: Preferred Stock Dividends Accrual	4,243	4,532
	-----	-----
Income for Common Stock	\$85,911	\$101,029
	=====	=====

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

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

	2001 Restated	2000
	-----	-----
Net Income	\$17,275	\$27,369
	-----	-----
Other comprehensive income, net of tax:		
Unrealized holding losses arising during the period	(612)	(1,580)
Reclassification adjustment for gains included in net income	-	(2,477)
FAS-133 unrealized losses during the period	(278,117)	-
Reversal of FAS-133 unrealized gains settled during the period	(37,267)	-
	-----	-----
Other comprehensive income (loss)	(315,996)	(4,057)
	-----	-----
Comprehensive Income (Loss)	\$ (298,721)	\$23,312
	=====	=====

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

	2001 Restated	2000
	-----	-----

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Net Income	\$90,154	\$105,561
	-----	-----
Other comprehensive income, net of tax:		
Unrealized holding gains (losses) arising during the period	(1,407)	2,265
Reclassification adjustment for gains included in net income	-	
		(3,160)
FAS-133 transition adjustment	286,928	-
FAS-133 unrealized losses during the period	(149,379)	-
Reversal of FAS-133 unrealized gains settled during the period	(143,335)	-
	-----	-----
Other comprehensive income (loss)	(7,193)	(895)
	-----	-----
Comprehensive Income (Loss)	\$82,961	\$104,666
	=====	=====

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

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

	June 30,	December 31,
	-----	-----
	2001	2000
	Restated	
	----	----
ASSETS		
Utility Plant: (at original cost, including construction work in progress of \$136,075 and \$164,221 respectively)		
Electric	\$4,114,417	\$4,054,551
Gas	1,497,593	1,459,488
Common	359,609	351,051
Less: Accumulated depreciation and amortization	(2,107,596)	(2,026,681)
	-----	-----
Net utility plant	3,864,023	3,838,409
	-----	-----
Other Property and Investments	229,840	292,297
	-----	-----
Current Assets:		
Cash	67,221	36,383
Accounts receivable, net	264,047	343,108
Unbilled revenue	76,918	211,784
Materials and supplies, at average cost	97,196	99,001
Purchased gas receivable	131,628	96,050
Current portion of FAS-133 unrealized gain	-	-
Prepayments and other	10,329	11,607
	-----	-----
Total current assets	647,339	797,933
	-----	-----
Long-Term Assets:		
Regulatory asset for deferred income taxes	196,099	207,350
Regulatory asset for PURPA buyout costs	243,822	243,071
Other	209,302	177,609
	-----	-----

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Total long-term assets	649,223	628,030
	-----	-----
Total Assets	\$5,390,425	\$5,556,669
	=====	=====

*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

June 30,	December 31,		
		-----	-----
		2001	2000
		Restated	
		----	----
Capitalization:			
Common shareholder's investment:			
Common stock, \$10 stated value, 150,000,000 shares authorized, 85,903,791 shares outstanding		\$859,038	\$859,038
Additional paid-in capital		382,591	470,179
Earnings reinvested in the business		112,151	92,673
Accumulated other comprehensive income		(2,443)	4,750
Preferred stock not subject to mandatory redemption		60,000	60,000
Preferred stock subject to mandatory redemption		50,662	58,162
Corporation obligated, mandatorily redeemable preferred securities of subsidiary trust holding solely junior subordinated debentures of the corporation		300,000	100,000
Long-term debt		2,110,806	2,170,797
		-----	-----
Total capitalization		3,872,805	3,815,599
		-----	-----
Current Liabilities:			
Accounts payable		155,495	410,619
Short-term debt		328,853	378,316
Current maturities of long-term debt		79,000	19,000
Accrued expenses:			
Taxes		77,940	103,996
Salaries and wages		16,759	17,445
Interest		44,383	43,955
Current portion of FAS-133		13,414	
Other		28,578	26,685
		-----	-----
Total current liabilities		744,422	1,000,016
		-----	-----
Deferred Income Taxes		605,009	608,185
		-----	-----
Other Deferred Credits		168,189	132,869
		-----	-----

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Total Capitalization and Liabilities	\$5,390,425	\$5,556,669
	=====	=====

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

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

	2001 Restated	2000
	----	----
Operating Activities:		
-----		
Net Income	\$90,154	\$105,561
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	103,002	95,201
Deferred income taxes and tax credits - net	8,074	(5,126)
Gain from sale of securities	-	(6,476)
Other	25,125	
		3,918
Change in certain current assets and current liabilities (Note 4)	(105,642)	44,584
-----		
Net Cash Provided by Operating Activities	120,713	237,662
-----		
Investing Activities:		
-----		
Construction expenditures - excluding equity AFUDC	(135,420)	(151,483)
Additions to energy conservation program	(3,713)	(2,732)
Proceeds from sale of Centralia Plant	-	24,828
Proceeds from sale of investment in Cabot stock	-	51,463
Loans to Schlumberger RMS (formerly Cellnet Data Services)	(12,158)	(1,325)
Proceeds from sale of securities	-	6,757
Other	(5,902)	(3,499)
-----		
Net Cash Used by Investing Activities	(157,193)	(75,991)
-----		
Financing Activities:		
-----		
Change in short-term debt - net	(48,161)	(146,425)
Dividends paid	(70,675)	(72,828)
Issuance of trust preferred stock	200,000	-
Redemption of preferred stock	(7,500)	(7,500)
Issuance of bonds	-	225,000
Redemption of bonds and notes	-	(115,980)
Other	(6,346)	(1,005)
-----		
Net Cash Provided (Used) by Financing Activities	67,318	(118,738)
-----		
Net Increase in Cash	30,838	42,933
Cash at Beginning of Year	36,383	65,707
-----		
Cash at End of Period	\$67,221	\$108,640
=====		

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

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) General**

On January 1, 2001, PSE reorganized into a holding company structure. This reorganization resulted in the creation of a new holding company, Puget Energy. Puget Energy was incorporated in the State of Washington and all of its operations are conducted through its subsidiaries.

Pursuant to the reorganization, Puget Energy became the owner of all of PSE's outstanding common stock. Holders of PSE's existing common stock exchanged their stock on a one-for-one basis for common stock of Puget Energy. Puget Energy is a public utility holding company under the Public Utility Holding Company Act of 1935 but is exempt from registration under such Act.

**(2) Summary of Consolidation Policy**

The consolidated financial statements of Puget Energy include the accounts of Puget Energy and its subsidiaries, including PSE. PSE's consolidated financial statements include the accounts of PSE and its subsidiaries. The consolidated financial statements are presented 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 respective opinions of the managements of Puget Energy and PSE, 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 audited financial statements (and Notes thereto) included in the combined Puget Energy and PSE annual report on Form 10-K for the year ended December 31, 2000.

**(3) Earnings per Common Share**

Puget Energy's basic earnings per common share have been computed based on weighted average common shares outstanding of 86,303,000 and 86,169,000 for the three and six months ended June 30, 2001 and 85,295,000 and 85,178,000 for the three and six months ended June 30, 2000.

Puget Energy's diluted earnings per common share have been computed based on weighted average common shares outstanding of 86,576,000 and 86,443,000 for the three and six months ended June 30, 2001, and of 85,546,000 and 85,413,000 for the three and six months ended June 30, 2000, respectively. These shares include the dilutive effect of securities related to employee and director equity plans.

**(4) Consolidated Statements of Cash Flows**

The following provides additional information concerning cash flow activities:

PUGET ENERGY Six Months Ended June 30 -----	2001 Restated ----	2000 ----
Changes in current assets and current liabilities, net of effects of acquisitions by InfrastruX:		
Accounts receivable and unbilled revenue	\$184,594	\$50,102
Materials and supplies	(639)	3,388
Prepayments and other	(1,168)	364

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Purchased gas receivable	(35,577)	(2,143)
Accounts payable	(251,235)	(24,406)
FAS-133 unrealized loss	13,414	-
Accrued expenses and other	(16,419)	17,279
<hr/>		
Net change in current assets and current liabilities	\$ (107,030)	\$44,584
<hr/>		
Cash payments:		
Interest (net of capitalized interest)	\$93,038	\$91,028
Income taxes	\$59,900	\$48,100
<hr/>		
PUGET SOUND ENERGY		
Six Months Ended June 30	2001	2000
	Restated	
	----	----
<hr/>		
Changes in current assets and current liabilities:		
Accounts receivable and unbilled revenue	\$189,784	\$50,102
Materials and supplies	(3,417)	3,388
Prepayments and other	(416)	364
Purchased gas receivable	(35,577)	(2,143)
Accounts payable	(244,140)	(24,406)
FAS-133 unrealized loss	13,414	-
Accrued expenses and other	(25,290)	17,279
<hr/>		
Net change in current assets and current liabilities	\$ (105,642)	\$44,584
<hr/>		
Cash payments:		
Interest (net of capitalized interest)	\$91,594	\$91,028
Income taxes	\$59,900	\$48,100
<hr/>		

**(5) Segment Information**

The Company operates primarily in one business segment, Regulated Utility Operations. The Company's regulated utility operation generates, purchases 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.

The other business segment is non-utility lines of business which include development and marketing of customer information and billing system software, specialized contracting services to utilities and telecommunications companies (See Note 7) and real estate investment and development. Reconciling items between segments are not material.

Financial data for business segments are as follows (restated for 2001)::

(Dollars in Thousands)	Regulated		
Three Months Ended June 30, 2001	Utility	Other	Total
Revenues	\$882,707	\$52,712	\$935,419
Net Income	14,956	4,509	19,465
Total Assets	5,240,263	338,288	5,578,551
<hr/>			
Three Months Ended June 30, 2000	Regulated Utility	Other	Total
Revenues	\$535,508	\$3,293	\$538,801
Net Income	25,952	1,417	27,369

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Total Assets	4,982,452	150,462	5,132,914
-----			
(Dollars in Thousands)	Regulated		
Six Months Ended June 30, 2001	Utility	Other	Total
-----			
Revenues	\$1,951,984	\$103,299	\$2,055,283
Net Income	75,375	16,388	91,763
Total Assets	5,240,263	338,288	5,578,551
-----			
	Regulated		
Six Months Ended June 30, 2000	Utility	Other	Total
-----			
Revenues	\$1,179,334	\$6,690	\$1,186,024
Net Income	103,871	1,690	105,561
Total Assets	4,982,452	150,462	5,132,914
-----			

**(6) Accounting for Derivative Instruments and Hedging Activities (restated)**

On January 1, 2001, Puget Energy adopted Financial Accounting Standards Board Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities" (Statement No. 133), as amended by Statement No. 138. Statement No. 133 requires that all derivative instruments be recorded on the balance sheet at their fair value. Puget Energy enters into both physical and financial contracts to manage its energy resource portfolio. Certain of these contracts met the derivative classification requirements of the statement and are reported at fair value on the balance sheet. Beginning with the implementation of Statement No. 133, 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 a qualifying cash flow hedge under the statement. For the three month period ended June 30, 2001, Puget Energy recorded approximately \$41.5 million pre-tax (\$27.0 million after-tax) increase to current earnings, and a \$41.6 million reduction to the previously recorded liability asset for the mark-to-market of electric derivative transactions for the quarter.

For the six months ended June 30, 2001, Puget Energy recognized the cumulative effect of this change in accounting principle by recording an after-tax decrease to current earnings of approximately \$14.7 million. In addition, Puget Energy recorded approximately \$15.1 million pre-tax (\$9.8 million after-tax) increase to current earnings for the six month period related to the mark-to-market of electric derivative transactions. When the underlying contracts giving rise to the income statement losses are fulfilled over the next 12 months, the deferred liability (included in current liabilities on the balance sheets) established under Statement No. 133 will be reversed.

For the three month period ended June 30, 2001, Puget Energy recorded a reduction in the deferred asset for electric energy contracts designated as qualifying cash flow hedges of approximately \$309.6 million after-tax for previously recorded gains and recorded a net deferred liability of \$5.8 million after-tax for the excess cash flow hedge loss. A decrease of approximately \$315.4 million after-tax was recorded in other comprehensive income for the period. Puget Energy anticipates approximately \$13.8 million net loss will reverse over the following twelve months as the underlying contracts are settled and will, as a result, report a corresponding decrease to the deferred liability and to other comprehensive income for this reversal. The decrease in the deferred liability and in other comprehensive income will have no net effect on current earnings and the economic effects of the transactions will be recorded upon settlement. These estimates are based upon the forward market prices for energy at June 30, 2001. These forward prices have dramatically declined from those at March 31, 2001 due to several factors ranging from energy conservation on the West Coast, cooler temperatures in California, additional generation resources becoming available and approval by the Federal Energy Regulatory Commission (FERC) of wholesale price controls in all of the western states. Derivative transactions related to the retail gas business are deferred under Puget Energy's Purchased Gas Adjustment mechanism and recorded in earnings as the transactions are executed under the PGA Incentive



Mechanism.

For the six months ended June 30, 2001, Puget Energy recorded a net deferred liability of approximately \$5.8 million after-tax and a decrease in other comprehensive income. As contracts are settled, the deferred liability will decrease and a corresponding amount will be reversed from other comprehensive income.

In June 2001, the Financial Accounting Standards Board's Derivative Implementation Group for Statement No. 133 issued guidance under Issue No. C15 that would allow certain purchase power and sales agreements, including capacity contracts, to be exempt under the normal purchase and normal sales exemption beginning in the third quarter of 2001. If a contract meets the criteria for normal purchase and normal sales exemption, then the contract is not marked-to-market in current earnings or other comprehensive income. PSE is currently evaluating its contracts that are currently marked-to-market to determine if any would meet the criteria for the exemption.

#### (7) Acquisitions

During the third quarter of 2000, InfrastruX Group Inc. ("InfrastruX"), a wholly-owned subsidiary of Puget Energy, acquired Utilx Corporation, a provider of infrastructure construction services to utilities and telecommunications companies, and Lineal Industries, a privately held pipeline infrastructure construction company. Lineal provides pipeline construction, maintenance and rehabilitation services primarily for the natural gas and petroleum industries. The total purchase price of the two acquisitions was approximately \$87.7 million.

During the first six months of 2001, InfrastruX acquired four additional companies. InterCon Construction, Inc., a privately held infrastructure construction company that provides construction services for natural gas, electric, telecommunication and cable industries, was acquired at the end of the first quarter for \$35.5 million. Trafford Corporation, a privately held Pittsburgh based natural gas pipeline construction company, Keystone Pipeline Services, Inc., a provider of natural gas pipeline maintenance and construction services, and Seen Corporation, a regional construction services company providing natural gas distribution pipeline construction, maintenance and repair and construction services to the telecommunications industry, were acquired during the second quarter of 2001 for approximately \$24.8 million.

The acquisitions have been accounted for using the purchase method of accounting and, accordingly, the operating results of these companies have been included in Puget Energy's consolidated financial statements since their acquisition dates. Goodwill representing the excess of cost over the net tangible and identifiable intangible assets of the business was approximately \$80.0 million. During 2001, goodwill is being amortized on a straight-line basis using a 30-year life. With the implementation of Statement of Financial Accounting Standards No. 142 - Goodwill and Other Intangible Assets in January 2002, Puget Energy will discontinue amortizing goodwill and, instead, perform impairment tests to determine if goodwill should be written-down. The pro forma combined revenues, net income, and earnings per common share of Puget Energy presented below give effect to the acquisitions as if they had occurred on January 1, 2000. These results are not necessarily indicative of the results of operations that would have occurred had the acquisitions of these companies been consummated for the period for which they are being given effect.

Unaudited restated for 2001 (Thousands, except per share amounts)		
For the three months ended:	June 30, 2001	June 30, 2000
Operating Revenues	\$ 938,733	\$ 591,823
Net Income	17,408	27,760
Basic Earnings per Common Share	\$ 0.20	\$ 0.33
Diluted Earnings per Common Share	\$ 0.20	\$ 0.32

Unaudited restated for 2001 (Thousands, except per share amounts)		
For the six months ended:	June 30, 2001	June 30, 2000

Operating Revenues	\$ 2,071,431	\$ 1,287,312
Net Income	87,592	104,142
Basic Earnings per Common Share	\$ 1.02	\$ 1.22
Diluted Earnings per Common Share	\$ 1.02	\$ 1.22

**(8) Other**

In October 2000, PSE 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, Subordinated Debentures or Trust Preferred Securities. On November 9, 2000, PSE issued \$260 million principal amount of 7.69% Senior Medium-Term Notes, Series C. The Notes are due February 1, 2011. On May 24, 2001, PSE issued \$200 million principal amount of 8.40% Trust Preferred Securities. The Trust Preferred Securities have a maturity date of June 30, 2041.

In June 2001, InfrastruX signed a credit agreement with several banks for up to \$150 million. Under the credit agreement, Puget Energy is the guarantor of the line of credit. At June 30, 2001, InfrastruX had \$53.4 million of borrowings outstanding under the agreement.

**(9) Restatement**

The consolidated financial statements of Puget Energy and Puget Sound Energy were restated for the quarter and six months ended June 30, 2001. The restatement relates to the accounting treatment of certain purchase gas financial contracts. The contracts, entered into as a part of the Company's plan to secure fixed price gas supplies for winter electric generation purposes, were not matched with purchase of physical gas as of June 30, 2001. As a result, under Statement of Financial Accounting Standard No. 133 the financial gas purchase contracts do not qualify as hedge instruments at June 30, 2001. Therefore, the change in market value of these contracts should have been recorded in operating income for the quarter ended June 30, 2001, but were not reflected in that manner in the Company's initial filing as of June 30, 2001. The effects of this restatement of \$5.5 million after-tax, decreases net income on previously reported consolidated financials statement for Puget Energy and Puget Sound Energy are as follows:

**Puget Energy**

(in thousands, except per share amounts)

	Three Months Ended June 30, 2001	
	As previously reported	Restated
Consolidated Statement of Income:		
Net income for common stock	\$22,887	\$17,380
Basic earnings per share before cumulative effect of accounting change	\$0.27	\$0.20
Cumulative effect of accounting change	-	-
Basic earnings per share	\$0.27	\$0.20
Diluted earnings per share before cumulative effect of accounting change	\$0.26	\$0.20
Cumulative effect of accounting change	-	-

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Diluted earnings per share \$0.26 \$0.20

	June 30, 2001
	----- As previously reported -----
Balance Sheet:	
Total assets	\$5,583,914
Total liabilities	1,558,491
Total capitalization	4,025,423
Total capitalization and liabilities	\$5,583,914

**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 uncertainties. 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**

The consolidated financial statements of Puget Energy and Puget Sound Energy were restated for the quarter and six months ended June 30, 2001. The restatement relates to the accounting treatment of certain purchase gas financial contracts. The contracts, entered into as a part of the Company's plan to secure fixed price gas supplies for winter electric generation purposes, were not matched with purchase of physical gas as of June 30, 2001. As a result, under Statement of Financial Accounting Standard No. 133 the financial gas purchase contracts do not qualify as hedge instruments at June 30, 2001. Therefore, the change in market value of these contracts should have been recorded in operating income for the quarter ended June 30, 2001, but were not reflected in that manner in the Company's initial filing as of June 30, 2001.

Puget Energy's net income for the three months ended June 30, 2001 was \$19.5 million on operating revenues of \$935.4 million, compared with net income of \$27.4 million on operating revenues of \$538.8 million for the same period in 2000. Income for common stock was \$17.4 million for the second quarter of 2001 compared to \$25.1 million for the second quarter of 2000. Basic earnings per share were \$0.20 for the second quarter of 2001 compared to \$0.29 for the second quarter of 2000. Diluted earnings per share were \$0.20 for the second quarter of 2001 compared to \$0.29 for the second quarter of 2000.

For the first six months of 2001, net income was \$91.8 million on operating revenues of \$2.1 billion, compared with net income of \$105.6 million on operating revenues of \$1.2 billion for the corresponding period in 2000. Income for common stock was \$86.6 million for the first half of 2001 and \$101.0 million for the same period in 2000. Basic

and diluted earnings per common share were \$1.02 and \$1.01 for the six months ended June 30, 2001, and \$1.19 and \$1.18, respectively, for the same period in 2000.

Total kilowatt-hour electric sales were 6.7 billion, including 2.0 billion in sales to other utilities and marketers, for the second quarter of 2001, compared to 7.7 billion, including 2.8 billion in sales to other utilities and marketers, for the second quarter of 2000. For the six month periods ended June 30, 2001 and 2000, total kilowatt-hour sales were 14.2 billion, including 3.9 billion in sales to other utilities and marketers, and 16.2 billion, including 5.2 billion in sales to other utilities and marketers, respectively.

Total gas volumes were 204.8 million therms, including 44.2 million therms in transportation volumes for the three months ended June 30, 2001, compared to 204.1 million therms, including 49.5 million therms of transportation, for the same period in 2000. For the six months ended June 30, 2001, total gas volumes were 574.2 million therms, including 93.2 million therms of transportation, compared to 606.6 million therms, including 108.1 million therms of transportation, for the same period in 2000.

PSE's operating revenues and associated expenses are not generated evenly during the year. Variations in energy usage by consumers do occur from season to season and from month to month within a season, primarily as a result of weather conditions. PSE normally experiences its highest retail energy sales in the first and fourth quarters of the year. Volatile wholesale electric prices and the amount of hydroelectric energy supplies available to PSE also make quarter-to-quarter comparisons difficult.

PSE meets its forecasted electric supply needs throughout the year through PSE-owned electric generation and by obtaining power through long-term contracts, annual contracts and short-term markets. PSE meets its forecasted natural gas supply needs throughout the year through PSE-owned gas storage and by purchasing gas supplies through long-term contracts, annual contracts and short-term markets. PSE also performs risk management activities to optimize the value of energy supply and transmission assets and to ensure that physical energy supply is available to meet the customer demand loads. PSE also purchases energy when demand exceeds available supplies in its portfolio; likewise PSE makes sales to other utilities and marketers when surplus energy is available. These transactions are part of PSE's normal operations to meet retail load. Electric sales to other utilities and marketers vary by quarter and year depending principally upon water conditions for the generation of hydroelectric power, retail customer usage, the energy requirements of other utilities and energy market conditions in the Pacific Northwest. The July 1, 2001, seasonal water supply forecast published by the National Weather Service indicated that the total forecasted runoff into the Grand Coulee reservoir for the period April through September 2001 would be 57% of average. PSE, therefore, expects the total annual generation from the Mid-Columbia projects and PSE-owned hydro-electric projects will be substantially below normal in 2001, which increases electric generation fuel and operating expenses and purchased electricity expenses.

Beginning in the second half of 2000, the West Coast wholesale energy market began experiencing energy prices that greatly exceeded historical norms, reflecting unfavorable hydro conditions and increased consumer demand in California, among other factors. As a result, certain of PSE's industrial index-rate electric customers have been reducing their usage due to these high prices. Other customers' usage in general has declined slightly due to energy conservation measures by PSE's customers. To the extent electric retail load is reduced, PSE, when in a surplus power situation, has more power to sell into the wholesale market or when in a deficit power situation, has to purchase less power in the wholesale market to meet its electric retail load. During June 2001, wholesale electric energy prices have dramatically declined due to several factors.

On June 19, 2001, FERC implemented price controls on wholesale electricity in the western states. Several factors, including the price controls, have contributed to the dramatic decline in wholesale electric prices by the end of the second quarter of 2001 and, therefore, have diminished the value of PSE's excess electric energy during that period and into the foreseeable future. PSE and other western utilities have filed an appeal asking FERC to review its June 19, 2001 order and make modifications to the price controls to stabilize wholesale prices in California and prevent the

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energy problems from spreading to other states.

Temperatures based on heating-degree-days measured at Seattle-Tacoma airport during the three months ended June 30, 2001 and June 30, 2000 were cooler than normal and near normal, respectively.

Results of Operations		
Comparative Three and Six Months Ended		
June 30, 2001 vs. June 30, 2000		
Restated		
Increase (Decrease)		
	Three Month Period	Six Month Period
	-----	-----
(Dollars in Millions)		
Operating revenue changes:		
General rate increases	\$ 4.6	\$ 7.3
BPA Residential Purchase & Sale Agreement	1.2	3.9
Electric sales to other utilities and marketers	242.0	517.0
Electric revenue sold at index rates	24.1	94.8
Electric load and other	10.4	(14.7)
Gas revenue	65.0	163.8
InfrastruX revenue	45.5	74.0
Other revenue	3.8	23.2
	-----	-----
Total operating revenue change	396.6	869.3
Operating expense changes:		
Energy costs:		
Purchased electricity	297.2	491.2
Purchased gas	58.0	166.4
Electric generation fuel	33.2	114.9
Residential exchange credit	(1.2)	(5.8)
Utility operations and maintenance	7.0	13.3
InfrastruX operations and maintenance	37.9	64.9
Other operations and maintenance	(0.5)	(1.1)
Depreciation and amortization	3.6	10.9
Conservation amortization	0.2	(0.8)
FAS-133 unrealized (gain) loss	(41.5)	(15.1)
Taxes other than federal income taxes	1.4	12.9
Federal income taxes	(1.6)	(0.1)
	-----	-----
Total operating expense change	393.7	851.6
	-----	-----
Other income (net of tax) change	(5.3)	(7.9)
Interest charges	5.5	8.9
FAS-133 transition adjustment loss (net of tax)	-	14.7
	-----	-----
Net income change	\$ (7.9)	\$ (13.8)
	=====	=====

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

**Operating Revenues - Electric**

Electric revenues for the three months ended June 30, 2001 were \$719.7 million, an increase of \$282.2 million compared to the same period in 2000. Electric sales to other utilities and marketers in the western wholesale market, including the Pacific Northwest, increased \$242.0 million in the three months ended June 30, 2001 compared to the same period in 2000 due to increased prices in the wholesale electricity market while wholesale sales volumes

declined by 796.3 million kWh or 28.2% as compared to 2000. Retail sales volumes declined 4.0% from 4.9 billion kWh in 2000 to 4.7 billion kWh in 2001. Retail sales revenue increased as a result of higher rates paid by industrial customers on market index rate tariffs and contracts.

Electric revenues for the six months ended June 30, 2001, were \$1.5 billion, an increase of \$608.9 million or 69.5% over the same period in 2000. Electric sales to other utilities and marketers in the western market, including the Pacific Northwest, increased \$517.0 million in the six months ended June 30, 2001 compared to the same period in 2000 due to increased prices in the wholesale electricity market while wholesale sales volumes declined by 1.3 billion kWh or 25.7% as compared to 2000. Retail sales volumes declined 6.2% from 11.0 billion kWh in 2000 to 10.3 billion kWh in 2001. Retail sales revenue increased as a result of higher rates paid by industrial customers on market index rate tariffs and contracts. A 1.7% increase in the number of electric customers served also contributed to the increase in revenue.

Electric revenues in the second quarter of 2001 increased significantly compared to that of the second quarter of 2000 due to increased prices related to electric energy sales to other utilities and marketers and sales to customers whose rates are tied to a market index. Several factors, including the near historically low hydroelectric conditions in the Pacific Northwest and the increased consumer demand in California had raised wholesale market prices on the West Coast to unprecedented levels beginning in May 2000. During June 2001, wholesale electric energy prices have dramatically declined due to several factors. PSE continues to operate without an electric rate adjustment mechanism.

In the second quarter of 2001, electric revenues were reduced by approximately \$3.4 million related to a customer conservation incentive credit which was approved by the Washington Commission on April 25, 2001. The conservation incentive credit reduces customers' bills by \$0.05 per kWh for each kWh reduction in excess of 10% from the same billing period in the prior year through December 2001.

On April 25, 2001, the Washington Commission approved "time-of-day" rates for approximately 300,000 residential electric customers for the period May 1, 2001 through September 30, 2001. In the order, if the cumulative revenues collected under "time-of-day" tariff during the period May 1, 2001 through September 30, 2001 exceed the revenues that would have been collected under the original tariffs, PSE must defer any overcollection and refund it to participating customers. Through June 30, 2001, revenues billed under the "time-of-day" tariff have been less than original tariffs by an immaterial amount, thus no deferred liability was established at June 30, 2001. In addition, Personal Energy Management consumption information is available to all classes of customers. Customers are able to monitor their energy usage and shift usage to low-demand off-peak periods. This program is expected to benefit overall conservation efforts by reducing the demand for peak power generation.

Revenues from electric customers in the first six months of 2001 and 2000 were reduced by a Residential and Farm Energy Exchange credit tariff in place since October 1, 1995. Under the rate plan approved by the Washington Commission in its merger order, PSE reflected in customers' bills the level of Residential Exchange benefits in place at the time of the merger with Washington Energy Company in 1997. On January 29, 1997, PSE and Bonneville Power Administration (BPA) signed an agreement under which PSE received payments from BPA of approximately \$235 million over an approximately five-year period that ended June 2001. These payments are recorded as a reduction of purchased electricity expenses.

On June 13, 2001, the Washington Commission approved an amended Residential Purchase and Sale Agreement between PSE and BPA, under which PSE's residential and small farm customers would receive benefits of federal power. Completion of this agreement enables PSE to continue to provide, and in fact increase, effective January 1, 2002, the Residential and Farm Energy Exchange credit. Under the amended settlement agreement, PSE will receive cash payments during the period July 1, 2001 through September 30, 2006 and benefits in the form of power and/or cash equivalent to approximately 648 annual average MW from October 1, 2006 through September 30, 2011. The level and form of any federal benefits to be received by PSE's residential and small farm customers may vary, depending on the outcome of regulatory and legal proceedings and reviews. For calendar 2001, the benefits of the

Residential and Farm Energy Exchange credited to customers is anticipated to be approximately \$106.0 million as compared to an offsetting reduction in Purchased Electricity Expense of \$81.9 million. Beginning in 2002, the cash payments received from BPA by PSE will be passed-through to eligible residential and small farm customers, with an offsetting reduction in Purchased Electricity Expense recorded. PSE expects payments from BPA spread monthly in the amount of \$127.3 million for the period January 2002 through September 2002 and \$702.2 million for the period October 2002 through September 2006.

To implement this agreement for rate purposes, the Washington Commission approved tariff revisions to transfer the Residential and Farm Energy Exchange credit in effect since October 1, 1995 in the amount of 1.085 cents per kWh, to general rates effective July 1, 2001. Also approved was a supplemental Residential and Farm Energy Exchange credit for eligible residential and small farm customers. This Residential and Farm Exchange Benefit Supplement Rider will be a credit of 0.265 cents per kWh for the period January 1, 2002 through September 30, 2002, 0.600 cents per kWh for the period October 1, 2002 through May 31, 2006 and 1.050 cents per kWh for the period June 1, 2006 through September 30, 2006. The approval of the tariffs by the Washington Commission, effective July 1, 2001, is without predetermining or prejudicing any argument as to whether or how the terms of the Washington Commission's order dated February 5, 1997, regarding the merger of Washington Natural Gas Company and Puget Sound Power and Light Company into Puget Sound Energy, "have been fulfilled, or as of what effective date any relief, if warranted, should be granted". The level and form of any Residential and Farm Energy Exchange credit is subject to revision.

To meet customer demand, PSE's power supply portfolio includes net purchases of power under long-term supply contracts. However, depending principally upon streamflow available for hydro-electric generation and weather effects on customer demand, from time to time, PSE may have surplus power available for sale to wholesale customers. PSE manages its core energy portfolio through short and intermediate-term purchases, sales, arbitrage and other risk management techniques. PSE also operates its combustion turbine plants located in Western Washington when it is cost-effective to do so. During the first six months of 2001, PSE has operated its combustion turbine plants extensively to meet retail load requirements. PSE's Risk Management Committee oversees energy price risk matters.

PSE operates within the western wholesale market and has made sales into the California energy market. During the first quarter of 2001, PSE received partial payments for sales made in the fourth quarter of 2000. At December 31, 2000, PSE's receivables from the California Independent System Operators (CAISO) and other counter-parties, net of reserves, were \$41.8 million. At June 30, 2001, such receivables were reduced to approximately \$26.6 million.

On July 25, 2001, the Federal Energy Regulatory Commission (FERC) ordered a 60-day evidentiary hearing to determine what refunds California energy buyers are due for spot market purchases made through the California Independent Operator and California Power Exchange covering the period October 2, 2000 through June 20, 2001. On July 25, 2001, FERC also established a separate preliminary evidential proceeding, to be completed in 30 days, for the purpose of exploring whether there have been excessive charges for spot market sales to Pacific Northwest buyers since December 25, 2000. PSE is unable to predict the outcomes of these two FERC proceedings.

#### **Operating Revenues - Gas**

Gas operating revenues for the three months ended June 30, 2001 increased by \$65.0 million from the same period in 2000. Total gas sales volumes increased 0.4% from 204.1 million therms in 2000 to 204.8 million therms in 2001. The primary reason for the increase in gas sales revenue was higher natural gas prices that are passed through to customers in the Purchased Gas Adjustment (PGA). Increases under the PGA were effective August 1, 2000 and January 12, 2001. As a result of the PGA increases, gas rates to all sales customers increased by an average of 30.2% on August 1, 2000 and 26.4% on January 12, 2001.

For the six months ended June 30, 2001, gas operating revenues increased \$163.8 million or 54.0% from \$303.5 million in the six months ended June 30, 2000, to \$467.3 million in the six months ended June 30, 2001, while total

gas volumes decreased 5.3%. The increase in revenues in the period was primarily due to higher natural gas prices as previously mentioned.

#### **Operating Revenues - Other**

Other operating revenues for the three and six months ended June 30, 2001 increased by \$49.4 million and \$96.6 million from the same periods in 2000. This increase in other operating revenues was due primarily to InfrastruX, which has acquired several companies beginning in the third quarter of 2000. InfrastruX contributed to an increase of \$45.5 million and \$74.0 million for the three and six month periods ended June 30, 2001, respectively, and PSE's subsidiary, Puget Western, Inc. contributed to an increase of \$26.2 million from property sales in the first half of 2001.

#### **Operating Expenses**

Purchased electricity expenses increased \$297.2 million and \$491.2 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000. The increase was due primarily to increased prices for non-firm power from other utilities and marketers in the West Coast power market during a period of near historic low hydroelectric conditions. In addition, PSE experienced unplanned outages at certain generating facilities during the second quarter of 2001.

Purchased gas expenses increased \$58.0 million and \$166.4 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000. The increase was due primarily to the impact of increased gas costs, which are passed through to customers through the PGA mechanism.

Fuel expense increased \$33.2 million and \$114.9 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000 as a result of increased generation and higher fuel costs at PSE-owned combustion turbine facilities. These facilities operated at much higher levels in the second quarter of 2001 as compared to the same period in 2000 due to lower hydroelectric energy produced.

Utility operations and maintenance increased \$7.0 million and \$13.3 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000 primarily due to costs related to the Personal Energy Management™ energy-efficiency program and increases in non-production costs such as maintenance of underground lines due to outages and operations costs of new meters. PSE's Personal Energy Management program helps to minimize energy purchases at peak times when electric energy is most costly.

InfrastruX's operations and maintenance expenses for the three and six months ended June 30, 2001 were \$37.9 million and \$64.9 million higher than comparable periods in 2000 due to the activities of its subsidiaries that were acquired beginning in the third quarter of 2000.

Depreciation and amortization expense increased \$3.6 million and \$10.9 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000 due primarily to the effects of new plant placed into service during the past year, including PSE's ConsumerLinX(TM) customer information and billing system in 2000.

Financial Accounting Standards Board Statement No. 133 (FAS-133) was adopted on January 1, 2001. During the three months ended June 30, 2001 an increase to current earnings of approximately \$41.5 million pre-tax (\$27.0 million after-tax) was recognized for unrealized gains associated with electric derivative transactions during the quarter. During the six months ended June 30, 2001 an increase to current earnings of approximately \$15.1 million pre-tax (\$9.8 million after-tax) was recognized for unrealized gains associated with electric derivative transactions and a \$14.7 million after-tax transition adjustment loss was recorded during the first half of 2001 resulting from recognizing the cumulative effect of this change in accounting principle. (For further discussion see Note 6).



Taxes other than federal income taxes increased \$1.4 million and \$12.9 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000 primarily due to increases in municipal and state excise taxes which are revenue based.

#### **Other Income**

Other income, net of federal income tax, decreased \$5.3 million and \$7.9 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000, due primarily to the sale of certain non-core investments and the increase in goodwill amortization related to acquisitions by InfrastruX.

#### **Interest Charges**

Interest charges, which consist of interest and amortization on long-term debt and other interest, increased \$5.5 million and \$8.9 million for the three and six month periods ended June 30, 2001 compared to the same periods in 2000. Interest on long-term debt increased \$6.5 million and \$13.7 million in the three and six month periods ended June 30, 2001 compared to the same period in 2000 as a result of the issuance of \$225 million 7.96% Senior Medium-Term Notes, Series B, in February 2000, the issuance of \$25 million 7.61% Senior Medium-Term Notes, Series B, in September 2000, and the issuance of \$260 million 7.69% Senior Medium-Term Notes, Series C, in November 2000. Other Interest Expense decreased \$3.5 million and \$7.7 million in the three and six month periods ended June 30, 2001 compared to the same period in 2000 due primarily to interest offset related to the PGA.

#### **Capital Expenditures, Capital Resources and Liquidity**

Current construction expenditures for generation, transmission and distribution are designed to meet continuing customer growth and to improve efficiencies of PSE's energy delivery systems. Construction expenditures, excluding equity AFUDC, were \$135.4 million for the six months ended June 30, 2001 compared to \$151.5 million for the same period in 2000. Capital expenditures for the year are expected to be \$247 million.

Puget Energy issued common stock for the Company's Stock Purchase and Dividend Reinvestment Plan of \$6.4 million (270,818 shares) and \$12.8 million (534,280 shares) in the three and six months ended June 30, 2001 compared to \$3.3 million (139,096 shares) and \$10.0 million (441,969 shares) for the same periods in 2000.

On June 30, 2001, PSE had available \$375.0 million in lines of credit with various banks, which provide credit support for outstanding bank loans and commercial paper of \$233.7 million, effectively reducing the available borrowing capacity under these lines of credit to \$141.3 million. In addition, PSE 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. There was \$95 million outstanding under these arrangements at June 30, 2001.

On June 30, 2001, InfrastruX and its subsidiaries had available \$171.5 million in lines of credit with various banks, which provide credit support for outstanding bank loans of \$66.1 million, effectively reducing the available borrowing capacity under these lines of credit to \$105.4 million.

#### **Other**

In October 2000, PSE 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, Subordinated Debentures or Trust preferred Securities. On November 9, 2000, PSE issued \$260 million principal amount of 7.69% Senior Medium-Term Notes, Series C. The Notes are due February 1, 2011. On May 24, 2001, PSE issued \$200 million principal amount of 8.40% Trust Preferred Securities. The Trust Preferred Securities have a maturity date of June 30, 2041.

In May 2001, PSE filed a request with the Washington Utilities and Transportation Commission ("Washington Commission") for a short-term extension of the Purchased Gas Adjustment ("PGA") Incentive Mechanism. The original PGA Incentive Mechanism had a sunset date of June 30, 2001. On June 27, 2001, the Washington Commission approved PSE's request to extend the sunset date of the PGA Incentive Mechanism to October 31, 2001. PSE is currently modifying the existing PGA Incentive for the Washington Commission's consideration as a long-term incentive mechanism.

On June 18, 2001, the Federal Energy Regulatory Commission issued an order extending its price mitigation plan for the California wholesale sales to the entire 11 state western region. Under the plan, the market price of wholesale sales will be based upon the bid price of the highest cost gas-fired unit located in California that is needed to serve the California Independent Systems Operator's load when the generating operating reserves in California are below 7 percent. The bid price will reflect a published gas cost plus an additional amount for operating and maintenance expenses. The mitigation plan will terminate September 30, 2002.

On July 25, 2001, the Federal Energy Regulatory Commission (FERC) ordered a 60-day evidentiary hearing to determine what refunds California energy buyers are due for spot market purchases made through the California Independent Operator and California Power Exchange covering the period October 2, 2000 through June 20, 2001. On July 25, 2001, FERC also established a separate preliminary evidential proceeding, to be completed in 30 days, for the purpose of exploring whether there have been excessive charges for spot market sales to Pacific Northwest buyers since December 25, 2000. PSE is unable to predict the outcomes of these two FERC proceedings.

In June 2001, the Financial Accounting Standards Board's Derivative Implementation Group for Statement No. 133 issued guidance under Issue No. C15 that would allow certain purchase power and sales agreements, including capacity contracts, to be exempt under the normal purchase and normal sales exemption beginning in the third quarter of 2001. If a contract meets the criteria for normal purchase and normal sales exemption, then the contract is not marked-to-market in current earnings or other comprehensive income. PSE is currently evaluating its contracts that are currently marked-to-market to determine if any would meet the criteria for the exemption.

On July 24, 2001, PSE filed a request with the Washington Commission to lower gas rates by an average of 8.3% due to lower natural gas costs purchased for customers under terms of the Purchased Gas Adjustment (PGA) mechanism. The PGA mechanism passes through to customers increases or decreases in the gas supply portion of the natural gas service rates based upon changes in the price of natural gas purchased from producers and wholesale marketers or changes in gas pipeline transportation costs PSE's gas margin and net income is not affected by changes under the PGA.

In July 2001, the Financial Accounting Standards Board issued Statement No. 142 - Goodwill and Other Intangible Assets. Statement No. 142 establishes accounting and reporting standards for goodwill and other intangible assets for fiscal years beginning after December 15, 2000 recognized in the Company's financial statements at this date. Certain provisions of Statement No. 142 will be applied to goodwill and other intangible assets acquired after June 30, 2001. Upon adoption of Statement No. 142, the Company will discontinue amortizing goodwill and, instead, perform impairment tests to determine if goodwill should be written down.

### **Item 3. Quantitative and Qualitative Disclosure About Market Risk**

Puget Energy is exposed to market risks, including changes in commodity prices and interest rates.

#### **Commodity Price Risk**

PSE's energy related businesses are exposed to risks related to changes in commodity prices. As part of its business, PSE markets power to wholesale customers by entering into contracts to purchase or supply electric energy or natural gas at specified delivery points and at specified future delivery dates. PSE's energy risk management

function manages PSE's core electric and gas supply portfolio.

PSE manages its energy supply portfolio to achieve three primary objectives:

- (i) Ensure that physical energy supplies are available to serve retail customer requirements;
- (ii) Manage portfolio risks to limit undesired impacts on PSE financial results; and
- (iii) Optimize the value of PSE's energy supply assets.

The portfolio is subject to major sources of variability (e.g., hydro generation, temperature-sensitive retail sales, and market prices for gas and power). At certain times, these sources of variability can mitigate portfolio imbalances; at other times they can exacerbate portfolio imbalances.

Hedging strategies for PSE's energy supply portfolio interact with portfolio optimization activities. Some hedges can be implemented in ways that retain PSE's ability to use its energy supply portfolio to produce additional value; other hedges can only be achieved by forgoing optimization opportunities.

The prices of energy commodities are subject to fluctuations due to unpredictable factors including weather, generation outages and other factors that 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. PSE may use forward delivery agreements, swaps and option contracts for the purpose of hedging commodity price risk. Unrealized changes in the market value of these derivatives are generally deferred and recognized upon settlement along with the underlying hedged transaction. Effective January 1, 2001, pursuant to Financial Accounting Standards Board Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities", which requires all derivative instruments to be recorded on the balance sheet at fair value, changes in the fair value of PSE's derivatives will be recorded each period in current earnings or other comprehensive income, depending on whether the derivative is designated as a qualifying hedge under the statement. PSE does not consider its current operation to meet the definition of trading activities as described by the Emerging Issues Task Force of the Financial Accounting Standards Board Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities".

At June 30, 2001, PSE had an after-tax liability of approximately \$5.8 million of energy contracts designated as qualifying as cash flow hedges and a corresponding amount in other comprehensive income. PSE also had energy contracts that were marked-to-market through current earnings for the three and six month periods of \$27.0 million and \$4.9 million after-tax which includes \$14.7 million for the cumulative effect of the accounting change in the first quarter. A hypothetical 10% increase in the market prices of natural gas and electricity prices would increase the fair value of qualifying cash flow hedges by approximately \$33.7 million after-tax and would have an immaterial impact on current earnings for those contracts marked-to-market in earnings.

In addition, PSE 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 manage these risks monitors compliance with PSE's policies and procedures. In addition, the Audit Committee of PSE's Board of Directors has oversight of the Risk Management Committee.

#### **Interest rate risk**

The Company believes interest rate risk of the Company primarily relates 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.

## **PART II OTHER INFORMATION**

### **Item 6. Exhibits and Reports on Form 8-K**

(a) See Exhibit Index for exhibits.

(b) Reports on Form 8-K

### **Filed by Puget Energy:**

Form 8-K dated April 17, 2001, Item 5 - Other Events, related to release of first quarter earnings.

### **Filed by Puget Energy & Puget Sound Energy:**

Form 8-K dated April 6, 2001, Item 5 - Other Events, the Company issued the following press release, Puget Sound Energy Announces Constructive Settlement With Industrial Customers .

### **Filed by Puget Sound Energy:**

Form 8-K dated May 18, 2001, Item 5 - Other Events, related to PSE and PSE Capital Trust II entering into an underwriting agreement with Merrill Lynch, Pierce, Fenner & Smith Incorporated for the sale of 8,000,000 8.40% Trust Preferred Securities.

## **SIGNATURES**

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

**PUGET ENERGY, INC.**

**PUGET SOUND ENERGY, INC.**

**James W. Eldredge**

**James W. Eldredge**

**Corporate Secretary and Chief Accounting Officer**

Date: October 18, 2001

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

### **Exhibit Index**

The following exhibits are filed herewith:

10-1\*

Credit Agreement dated June 29, 2001, among InfrastruX Group, Inc. and v

Interest rate risk

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NA as Administrative Agent.

12-1\*\* Statement setting forth computation of ratios of earnings to fixed charges (for the six months ended June 30, 2001) for Puget Energy.

12-2\*\* Statement setting forth computation of ratios of earnings to combined fixed charges (for the six months ended June 30, 2001) for PSE.

\* Previously filed. \*\* Filed herewith.