PUGET ENERGY INC /WA
Form 10-K
March 02, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2017

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, zip code telephone number	I.R.S. Employer Identification Number
1-16305	PUGET ENERGY, INC. A Washington Corporation 10885 NE 4th Street, Suite 1200 Bellevue, Washington 98004-5591 (425) 454-6363	91-1969407
1-4393	PUGET SOUND ENERGY, INC. A Washington Corporation 10885 NE 4th Street, Suite 1200 Bellevue, Washington 98004-5591 (425) 454-6363	91-0374630

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Puget Energy, Inc. Yes/ / No/X/ Puget Sound Energy, Inc. Yes/ / No/X/

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.
Puget Energy, Inc. Yes/ / No/X/ Puget Sound Energy, Inc. Yes/ / No/X/

Indicate by check mark whether the registrants: (1) have 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 registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days.
Puget Energy, Inc. Yes/X/ No/ / Puget Sound Energy, Inc. Yes/X/ No/ /

Indicate by check mark whether the registrants have submitted electronically and posted on its corporate websites, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to post such files).
Puget Energy, Inc. Yes/X/ No/ / Puget Sound Energy, Inc. Yes/X/ No/ /

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. /X/

Indicate by check mark whether registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Puget Energy, Inc.	Large accelerated filer	/ /	Accelerated filer	/ /	Non-accelerated filer	/X/	Smaller reporting company	/ /	Emerging growth company	/ /
Puget Sound Energy, Inc.	Large accelerated filer	/ /	Accelerated filer	/ /	Non-accelerated filer	/X/	Smaller reporting company	/ /	Emerging growth company	/ /

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. / /

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).
Puget Energy, Inc. Yes/ / No/X/ Puget Sound Energy, Inc. Yes/ / No/X/

As of February 6, 2009, all of the outstanding shares of voting stock of Puget Energy, Inc. are held by Puget Equico LLC, an indirect wholly-owned subsidiary of Puget Holdings LLC.

All of the outstanding shares of voting stock of Puget Sound Energy, Inc. are held by Puget Energy, Inc.

This Report on Form 10-K is a combined report being filed separately by: Puget Energy, Inc. and Puget Sound Energy, Inc. Puget Sound Energy, Inc. makes no representation as to the information contained in this report relating to Puget Energy, Inc. and the subsidiaries of Puget Energy, Inc. other than Puget Sound Energy, Inc. and its subsidiaries.

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DEFINITIONS

AFUDC	Allowance for Funds Used During Construction
AOCI	Accumulated Other Comprehensive Income
ARO	Asset Retirement and Environmental Obligations
aMW	Average Megawatt
ASC	Accounting Standards Codification
ASU	Accounting Standards Update
BPA	Bonneville Power Administration
Colstrip	Colstrip, Montana coal-fired steam electric generation facility
Dth	Dekatherm (one Dth is equal to one MMBtu)
EBITDA	Earnings Before Interest, Tax, Depreciation and Amortization
EPA	Environmental Protection Agency
ERF	Expedited Rate Filing
FASB	Financial Accounting Standards Board
FERC	Federal Energy Regulatory Commission
GAAP	Generally Accepted Accounting Principles
GHG	Greenhouse Gases
GRC	General Rate Case
IRP	Integrated Resource Plan
IRS	Internal Revenue Service
ISDA	International Swaps and Derivatives Association
JPUD	Jefferson County Public Utility District
kW	Kilowatt (one kW equals one thousand watts)
kWh	Kilowatt Hour (one kWh equals one thousand watt hours)
LIBOR	London Interbank Offered Rate
LNG	Liquefied Natural Gas
LTI Plan	Long-Term Incentive Plan
MMBtus	One Million British Thermal Units
MW	Megawatt (one MW equals one thousand kW)
MWh	Megawatt Hour (one MWh equals one thousand kWh)
NAESB	North American Energy Standards Board
NOAA	National Oceanic and Atmospheric Administration
NPNS	Normal Purchase Normal Sale
NWP	Northwest Pipeline, LLC
NYSE	New York Stock Exchange
OCI	Other Comprehensive Income
PCA	Power Cost Adjustment
PCORC	Power Cost Only Rate Case
PGA	Purchased Gas Adjustment
PSE	Puget Sound Energy, Inc.
PTC	Production Tax Credit
PUDs	Washington Public Utility Districts
Puget Energy	Puget Energy, Inc.
Puget Equico	Puget Equico, LLC
Puget Holdings	Puget Holdings, LLC
REC	Renewable Energy Credit

REP	Residential Exchange Program
SEC	United States Securities and Exchange Commission
SERP	Supplemental Executive Retirement Plan
TCJA	Tax Cuts and Jobs Act
Washington Commission	Washington Utilities and Transportation Commission
WSPP	WSPP, Inc.

FORWARD-LOOKING STATEMENTS

Puget Energy, Inc. (Puget Energy) and Puget Sound Energy, Inc. (PSE) include the following cautionary statements in this Form 10-K to make applicable and to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 for any forward-looking statements made by or on behalf of Puget Energy or PSE. Puget Energy and PSE are collectively referred to herein as "the Company". This report includes forward-looking statements, which are statements of expectations, beliefs, plans, objectives and assumptions of future events or performance. Words or phrases such as "anticipates," "believes," "continues," "could," "estimates," "expects," "future," "inter "may," "might," "plans," "potential," "predicts," "projects," "should," "will likely result," "will continue" or similar expressio intended to identify certain of these forward-looking statements and may be included in discussion of, among other things, our anticipated operating or financial performance, business plans and prospects, planned capital expenditures and other future expectations. In particular, these include statements relating to future actions, business plans and prospects, future performance expenses, the outcome of contingencies, such as legal proceedings, government regulation and financial results.

Forward-looking statements reflect current expectations and involve risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed. There can be no assurance that Puget Energy's and PSE's expectations, beliefs or projections will be achieved or accomplished.

In addition to other factors and matters discussed elsewhere in this report, including the risks described in Item 1A, "Risk Factors", some important risks that could cause actual results or outcomes for Puget Energy and PSE to differ materially from past results and those discussed in forward-looking statements include:

- Governmental policies and regulatory actions, including those of the Federal Energy Regulatory Commission (FERC) and the Washington Utilities and Transportation Commission (Washington Commission), that may affect our ability to recover costs and earn a reasonable return, including but not limited to disallowance or delays in the recovery of capital investments and operating costs and discretion over allowed return on investment;
- Changes in, adoption of and compliance with laws and regulations, including decisions and policies concerning the environment, climate change, greenhouse gas or other emissions or by products of electric generation (including coal ash or other substances), natural resources, and fish and wildlife (including the Endangered Species Act) as well as the risk of litigation arising from such matters, whether involving public or private claimants or regulatory investigative or enforcement measures;
- Changes in tax law, related regulations or differing interpretation or enforcement of applicable law by the Internal Revenue Service (IRS) or other taxing jurisdiction and PSE's ability to recover costs in a timely manner arising from such changes;
- Changes in tax law as a result of the Tax Cuts and Jobs Act legislation and uncertain interpretations related thereto;
- Inability to realize deferred tax assets and use Production Tax Credits (PTCs) due to insufficient future taxable income;
- Accidents or natural disasters, such as hurricanes, windstorms, earthquakes, floods, fires and landslides, and other acts of God, terrorism, asset-based or cyber-based attacks, flu pandemic or similar significant events, which can interrupt service and lead to lost revenue, cause temporary supply disruptions and/or price spikes in the cost of fuel and raw materials and impose extraordinary costs;
- Commodity price risks associated with procuring natural gas and power in wholesale markets from creditworthy counterparties;
- Wholesale market disruption, which may result in a deterioration of market liquidity, increase the risk of counterparty default, affect the regulatory and legislative process in unpredictable ways, negatively affect wholesale energy prices and/or impede PSE's ability to manage its energy portfolio risks and procure energy supply, affect the availability and access to capital and credit markets and/or impact delivery of energy to PSE from its suppliers;
- Financial difficulties of other energy companies and related events, which may affect the regulatory and legislative process in unpredictable ways, adversely affect the availability of and access to capital and credit markets and/or impact delivery of energy to PSE from its suppliers;
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- The effect of wholesale market structures (including, but not limited to, regional market designs or transmission organizations) or other related federal initiatives;
- PSE electric or natural gas distribution system failure, blackouts or large curtailments of transmission systems (whether PSE's or others'), or failure of the interstate natural gas pipeline delivering to PSE's system, all of which can affect PSE's ability to deliver power or natural gas to its customers and generating facilities;
- Electric plant generation and transmission system outages, which can have an adverse impact on PSE's expenses with respect to repair costs, added costs to replace energy or higher costs associated with dispatching a more expensive generation resource;
- The ability to restart generation following a regional transmission disruption;
- The ability of a natural gas or electric plant to operate as intended;
- Changes in climate or weather conditions in the Pacific Northwest, which could have effects on customer usage and PSE's revenue and expenses;

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- Regional or national weather, which could impact PSE's ability to procure adequate supplies of natural gas, fuel or purchased power to serve its customers and the cost of procuring such supplies;
- Variable hydrological conditions, which can impact streamflow and PSE's ability to generate electricity from hydroelectric facilities;
- The ability to renew contracts for electric and natural gas supply and the price of renewal;
- Industrial, commercial and residential growth and demographic patterns in the service territories of PSE;
- General economic conditions in the Pacific Northwest, which may impact customer consumption or affect PSE's accounts receivable;
- The loss of significant customers, changes in the business of significant customers or the condemnation of PSE's facilities as a result of municipalization or other government action or negotiated settlement, which may result in changes in demand for PSE's services;
- The failure of information systems or the failure to secure information system data, which may impact the operations and cost of PSE's customer service, generation, distribution and transmission;
- Opposition and social activism that may hinder PSE's ability to perform work or construct infrastructure;
- Capital market conditions, including changes in the availability of capital and interest rate fluctuations;
- Employee workforce factors, including strikes, work stoppages, availability of qualified employees or the loss of a key executive;
- The ability to obtain insurance coverage, the availability of insurance for certain specific losses, and the cost of such insurance;
- The ability to maintain effective internal controls over financial reporting and operational processes;
- Changes in Puget Energy's or PSE's credit ratings, which may have an adverse impact on the availability and cost of capital for Puget Energy or PSE generally; and
- Deteriorating values of the equity, fixed income and other markets which could significantly impact the value of investments of PSE's retirement plan, post-retirement medical benefit plan trusts and the funding of obligations thereunder.

Any forward-looking statement speaks only as of the date on which such statement is made and, except as required by law, the Company undertakes no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made or to reflect the occurrence of unanticipated events. New factors emerge from time to time and it is not possible for management to predict all such factors, nor can it assess the impact of any such factor on the business or the extent to which any factor, or combination of factors, may cause results to differ materially from those contained in any forward-looking statement. For further information, see the reports on Form 10-Q and current reports on Form 8-K.

PART I

ITEM 1. BUSINESS

General

Puget Energy is an energy services holding company incorporated in the state of Washington in 1999. Substantially, all of its operations are conducted through its regulated subsidiary, PSE, a utility company. Puget Energy also has a wholly-owned non-regulated subsidiary, named Puget LNG, LLC (Puget LNG). Puget LNG was formed on November 29, 2016 and has the sole purpose of owning, developing and financing the non-regulated activity of a liquefied natural gas (LNG) facility at the Port of Tacoma, Washington.

Puget Energy is owned through a holding company structure by Puget Holdings, LLC (Puget Holdings). Puget Holdings is owned by a consortium of long-term infrastructure investors including Macquarie Infrastructure Partners, Macquarie Capital Group Limited, the Canada Pension Plan Investment Board (CPPIB), the British Columbia Investment Management Corporation and the Alberta Investment Management Corporation. All of Puget Energy's common stock is indirectly owned by Puget Holdings.

Corporate Strategy

Puget Energy is the direct parent company of PSE, the oldest and largest electric and natural gas utility headquartered in the state of Washington, primarily engaged in the business of electric transmission, distribution and generation and natural gas distribution. Puget Energy's business strategy is to generate stable earnings and cash flow by offering reliable electric and natural gas service in a cost-effective manner through PSE.

Customers and Revenue Overview

PSE is a public utility incorporated in the state of Washington in 1960. PSE furnishes electric and natural gas service in a territory covering approximately 6,000 square miles, principally in the Puget Sound region.

The following tables present the number of PSE customers and revenue by customer class for electric and natural gas as of December 31, 2017 and 2016:

	December 31,			December 31,		
	2017	2016	Percent	2017	2016	Percent
Customer Count by Class	Electric		Change	Natural Gas		Change
Residential	1,003,984	992,959	1.1%	767,045	756,330	1.4%
Commercial	127,836	125,737	1.7	55,996	55,671	0.6
Industrial	3,377	3,417	(1.2)	2,332	2,365	(1.4)
Other	6,856	6,591	4.0	226	227	(0.4)
Total[1]	1,142,053	1,128,704	1.2%	825,599	814,593	1.4%

[1] At December 31, 2017 and 2016, approximately 398,518 and 392,806 customers purchased both electricity and natural gas from PSE, respectively.

	December 31,			December 31,		
Retail Revenue by Class	2017	2016	Percent	2017	2016	Percent
(Dollars in Thousands)	Electric		Change	Natural Gas		Change
Residential	$1,232,075	$1,138,871	8.2%	$686,438	$578,955	18.6%
Commercial	892,360	872,057	2.3	274,907	235,695	16.6
Industrial	112,817	113,469	(0.6)	21,071	19,643	7.3
Other	32,313	30,982	4.3	21,718	20,322	6.9
Total	$2,269,565	$2,155,379	5.3%	$1,004,134	$854,615	17.5%

PSE's revenues and associated expenses are not generated evenly throughout the year, primarily due to seasonal weather patterns, varying wholesale prices for electricity and the amount of hydroelectric energy supplies available to PSE, which make quarter-to-quarter comparisons difficult. Weather conditions in PSE's service territory have an impact on customer energy usage and affect PSE's billed revenue and energy supply expenses. While both PSE's electric and natural gas sales are generally greatest during winter months, variations in energy usage by customers occur from season to season and also month to month within a season, primarily as result of weather conditions. PSE normally experiences its highest retail energy sales, and corresponding higher power costs, during the winter heating season in the first and fourth quarters of the year and its lowest sales and corresponding lower power costs in the third quarter of the year. While fluctuations in weather conditions will continue to affect PSE's billed revenue and energy supply expenses from month to month, PSE's decoupling mechanisms for electric and natural gas operations are expected to normalize the impact of weather on operating revenue and net income. Under the decoupling mechanism, the Washington Commission allows PSE to record a monthly adjustment to its electric and natural gas operating revenues related to electric transmission and distribution, natural gas operations and general administrative costs from residential, commercial and industrial customers. For additional information, see Business, "Regulation and Rates" included in Item 1 of this report and Note 3, "Regulation and Rates" to the consolidated financial statements included in Item 8 of this report.

Capital Expenditures

The following tables present PSE's capital expenditures for the five-year period ended December 31, 2017 and gross utility plant by category and percentages as of December 31, 2017:

Utility Plant Additions/Retirements 5-Year Total	2013-2017		
(Dollars in Thousands)	Electric	Natural Gas	Common
Additions	$2,148,599	$868,919	$499,934
Retirements	(537,049)	(125,042)	(257,473)
Net Utility Plant	$1,611,550	$743,877	$242,461

Utility Plant Balance	December 31, 2017					
(Dollars in Thousands)	Electric		Natural Gas		Common	
Distribution	$3,757,600	36.7 %	$3,532,397	91.0 %	$—	— %
Generation	3,948,102	38.6	5,956	0.2	—	—
Transmission	1,471,337	14.4	—	—	—	—
General Plant & Other	1,055,732	10.3	344,380	8.8	843,145	100.0
Total	$10,232,771	100.0%	$3,882,733	100.0%	$843,145	100.0%

Employees

At December 31, 2017, PSE had approximately 3,140 full-time equivalent employees. Approximately 1,110 PSE employees are represented by the International Brotherhood of Electrical Workers Union (IBEW) or the United Association of Plumbers and Pipefitters (UA). The contracts with the IBEW and the UA were both ratified effective December 2017 and will expire March 31, 2020 and September 30, 2021, respectively.

Puget Energy does not have any employees. PSE's employees provide employment services to Puget Energy and charges for their related salaries and benefits at cost.

Segment Information

Puget Energy and PSE operate one reportable business segment, referred to as the regulated utility segment. For more information on this segment, see Note 17, "Segment Information" to the consolidated financial statements included in Item 8 of this report.

Corporate Location

PSE's and Puget Energy's principal executive offices are located at 10885 NE 4th Street, Suite 1200, Bellevue, Washington 98004 and the telephone number is (425) 454-6363.

Available Information
The information required by Item 101(e) of Regulation S-K is incorporated herein by reference to the material under "Additional Information" in Part III Item 10, "Directors, Executive Officers and Corporate Governance".

Regulation and Rates
PSE is subject to the regulatory authority of: (i) the FERC with respect to the transmission of electricity, the sale of electricity at wholesale, accounting and certain other matters; and (ii) the Washington Commission as to retail rates, accounting, the issuance of securities and certain other matters. PSE also must comply with mandatory electric system reliability standards developed by the North American Electric Reliability Corporation (NERC), the electric reliability organization certified by the FERC, whose standards are enforced by the Western Electricity Coordinating Council (WECC) in PSE's operating territory.
Rate mechanisms include: (i) trackers that typically track specific costs during the previous twelve-month period and (ii) riders that project cost recovery during a forward looking twelve-month period. Both allow recovery of expenditures without the lengthy process of a full GRC.
The following table shows PSE's rate filings for its trackers and riders and whether or not they are included in decoupling rates:

Rate Filings	Electric	Natural Gas
Baseline rates	Yes	Yes
Annual rate plan increase	Yes	Yes
Expedited rate filing rider	Yes	Yes
Merger credit	No	No
Power cost only rates mechanism	No	N/A
Federal incentive tracker	No	N/A
Low income rates tracker	No	No
Pipeline cost recovery mechanism tracker	N/A	No
Prior year decoupling deferral tracker	No	No
Property tax tracker	No	No
Renewable energy credit tracker	No	N/A
Residential exchange credits tracker	No	N/A
Conservation costs rider	No	No
PGA rider	N/A	No

General Rate Case Filing
On January 13, 2017, PSE filed its GRC with the Washington Commission, the settlement agreement was accepted by the Washington Commission on December 5, 2017 and the rates became effective December 19, 2017. For further details regarding the 2017 GRC filing, see Note 3, "Regulation and Rates" to the consolidated financial statements included in Item 8 of this report.

Decoupling Filings
While fluctuations in weather conditions will continue to affect PSE's billed revenue and energy supply expenses from month to month, PSE's decoupling mechanisms assist in mitigating the impact of weather on operating revenue and net income. Since July 2013, the Washington Commission has allowed PSE to record a monthly adjustment to its electric and natural gas operating revenues related to electric transmission and distribution, natural gas operations and general administrative costs from residential, commercial and industrial customers. This monthly adjustment mitigates the effects of abnormal weather, conservation impacts and changes in usage patterns per customer. As a result, these electric and natural gas revenues are recovered on a per customer basis regardless of actual consumption levels. The energy supply costs, which are part of the power cost adjustment (PCA) and purchased gas adjustment (PGA) mechanisms, are not included in the decoupling mechanism. Total electric and natural gas revenue recorded under the decoupling mechanisms will be affected by customer growth and not actual consumption. Following each calendar

year, PSE will recover from, or refund to, customers the difference between allowed decoupling revenue and the corresponding actual revenue during the following May to April time period. For further details regarding decoupling filings, see Note 3, "Regulation and Rates" to the consolidated financial statements included in Item 8 of this report.

Electric Rate Filings

Power Cost Adjustment Mechanism

PSE currently has a PCA mechanism that provides for the deferral of power costs that vary from the “power cost baseline” level of power costs. The “power cost baseline” is set in part, based on normalized assumptions about weather and hydrological conditions. Excess power costs or savings are apportioned between PSE and its customers pursuant to the graduated scale set forth in the PCA mechanism and will trigger a surcharge or refund when the $30.0 million cumulative deferral trigger is reached.

On August 7, 2015, the Washington Commission issued an order approving changes to the PCA mechanism. The settlement agreement took effect January 1, 2017 and will apply the following graduated scale:

Annual Power Cost Variability	Company's Share		Customers' Share	
	Over	Under	Over	Under
Over or Under Collected by up to $17 million	100%	100%	—%	—%
Over or Under Collected by Between $17 million - $40 million	35	50	65	50
Over or Under Collected beyond $40 + million	10	10	90	90

Electric Conservation Rider

The electric conservation rider collects revenue to cover the costs incurred in providing services and programs for conservation. Rates change annually on May 1 to collect the annual budget that started the prior January and to true-up for actual compared to forecast conservation expenditures from the prior year as well as actual load being different than the forecasted load set in rates.

Federal Incentive Tracker Tariff

The Federal Incentive Tracker Tariff passes through to customers the benefits associated with the wind-related treasury grants. The filing results in a credit back to customers for pass-back of treasury grant amortization and pass-through of interest and any related true-ups. The filing is adjusted annually for new Federal benefits, actual versus forecast interest and to true-up for actual load being different than the forecasted load set in rates. Rates change annually on January 1.

Power Cost Only Rate Case

A power cost rate case is a limited-scope proceeding to reset power cost rates. In addition to providing the opportunity to reset all power costs, the PCORC proceeding also provides for timely review of new resource acquisition costs and inclusion of such costs in rates at the time the new resource goes into service. To achieve this objective, the Washington Commission is not required to but historically has used an expedited six-month PCORC decision timeline rather than the statutory 11-month timeline for a GRC.

Residential Exchange Benefit

The residential exchange program passes through the residential exchange program benefits that PSE receives from the Bonneville Power Administration (BPA). Rates change bi-annually on October 1.

Electric Property Tax Tracker Mechanism

The purpose of the property tax tracker mechanism is to pass through the cost of all property taxes incurred by the Company. The mechanism was implemented in 2013 and removed property taxes from general rates and included those costs for recovery in an adjusting tariff rate. After the implementation, the mechanism acts as a tracker rate schedule and collects the total amount of property taxes assessed. The tracker will be adjusted each year in May based on that year's assessed property taxes and true-up from the prior year.

Natural Gas Rate Filings

Natural Gas Cost Recovery Mechanism

The purpose of the CRM is to recover capital costs related to projects included in PSE's pipe replacement program plan on file with the Washington Commission with the intended effect of enhancing the safety of the natural gas distribution system. Rates change annually on November 1.

Purchased Gas Adjustment
PSE has a PGA mechanism that allows PSE to recover expected natural gas supply and transportation costs and defer, as a receivable or liability, any natural gas supply and transportation costs that exceed or fall short of this expected natural gas cost amount in PGA mechanism rates, including accrued interest. PSE is authorized by the Washington Commission to accrue carrying costs on PGA receivable and payable balances. A receivable or payable balance in the PGA mechanism reflects an under recovery or over recovery, respectively, of natural gas cost through the PGA mechanism. Rates change annually on November 1.

Natural Gas Property Tax Tracker Mechanism
The purpose of the property tax tracker mechanism is to pass through the cost of all property taxes incurred by the Company. The mechanism was implemented in 2013 and removed property taxes from general rates and included those costs for recovery in an adjusting tariff rate. After the implementation, the mechanism acts as a tracker rate schedule and collects the total amount of property taxes assessed. The tracker is adjusted each year in May based on that year's assessed property taxes and adjustments to the rate from the prior year.

Natural Gas Conservation Rider
The natural gas conservation rider collects revenue to cover the costs incurred in providing services and programs for conservation. Rates change annually on May 1 to collect the annual budget that started the prior January and to true-up for actual versus forecast conservation expenditures from the prior year as well as actual load being different than the forecasted load set in rates.

For additional information on electric and natural gas rates, see Management's Discussion and Analysis, "Regulation and Rates" included in Item 7 of this report.

ELECTRIC UTILITY OPERATING STATISTICS

	Year Ended December 31,		
	2017	2016	2015
Generation and purchased power, MWh			
Company-controlled resources	10,825,778	11,577,608	12,747,014
Contracted resources	8,337,348	7,023,786	5,911,012
Non-firm energy purchased	6,147,778	6,005,797	5,315,266
Total generation and purchased power	25,310,904	24,607,191	23,973,292
Less: losses and Company use	(1,568,599)	(1,547,619)	(1,514,272)
Total energy sales, MWh	23,742,305	23,059,572	22,459,020
Electric energy sales, MWh			
Residential	10,931,999	10,245,326	10,164,703
Commercial	9,089,842	8,895,950	8,999,068
Industrial	1,214,818	1,223,214	1,257,958
Other customers	87,230	90,753	94,847
Total energy sales to customers	21,323,889	20,455,243	20,516,576
Sales to other utilities and marketers	2,418,416	2,604,329	1,942,444
Total energy sales, MWh	23,742,305	23,059,572	22,459,020
Transportation, including unbilled	2,001,244	2,085,574	2,012,827
Electric energy sales and transportation, MWh	25,743,549	25,145,146	24,471,847
Electric operating revenue by classes (Dollars in Thousands)			
Residential	$1,232,075	$1,138,871	$1,061,117
Commercial	892,360	872,057	867,786
Industrial	112,817	113,469	114,223
Other customers	19,729	20,045	20,216
Total operating revenue from customers	2,256,981	2,144,442	2,063,342
Transportation, including unbilled	12,584	10,937	10,143
Sales to other utilities and marketers	53,789	50,124	46,666
Decoupling revenue	9,975	29,968	13,630
Other decoupling revenue[1]	(27,706)	(21,168)	(16,634)
Miscellaneous operating revenue	115,040	24,189	11,321
Total electric operating revenue	$2,420,663	$2,238,492	$2,128,468
Number of customers served (average):			
Residential	998,078	984,739	970,830
Commercial	126,829	125,067	123,072
Industrial	3,399	3,425	3,434
Other	6,722	6,472	6,283
Transportation	16	16	16
Total customers	1,135,044	1,119,719	1,103,635

[1] Includes decoupling cash collections, rate of return excess earnings, and decoupling 24-month revenue reserve.

ELECTRIC UTILITY OPERATING STATISTICS (Continued)

	Year Ended December 31,		
	2017	2016	2015
Average kWh used per customer:			
Residential	10,953	10,404	10,470
Commercial	71,670	71,129	73,120
Industrial	357,404	357,143	366,324
Other	12,977	14,022	15,096
Average revenue per customer:			
Residential	$1,234	$1,157	$1,093
Commercial	7,036	6,973	7,051
Industrial	33,191	33,130	33,262
Other	2,935	3,097	3,218
Average retail revenue per kWh sold:			
Residential	$0.1127	$0.1112	$0.1044
Commercial	0.0982	0.0980	0.0964
Industrial	0.0929	0.0928	0.0908
Other	0.2262	0.2209	0.2131
Average retail revenue per kWh sold	$0.1058	$0.1048	$0.1006
Heating degree days	4,584	3,823	3,800
Percent of normal - NOAA[2] 30-year average	97.2 %	81.0 %	80.5 %
Load factor[3]	51.6 %	56.2 %	56.2 %

[2] National Oceanic and Atmospheric Administration (NOAA).
[3] Average megawatt (aMW) usage by customers divided by their maximum usage.

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Electric Supply

At December 31, 2017, PSE's electric power resources, which include company-owned or controlled resources as well as those under long-term contract, had a total capacity of approximately 4,737 megawatts (MW). PSE's historical peak load of approximately 4,912 MW occurred on December 10, 2009. In order to meet an extreme winter peak load, PSE may supplement its electric power resources with winter-peaking call options and other instruments. When it is more economical for PSE to purchase power than to operate its own generation facilities, PSE will purchase spot market energy when sufficient transmission capacity is available.

The following table shows PSE's electric energy supply resources and energy production for the years ended December 31, 2017 and 2016:

	Peak Power Resources At December 31,						Energy Production At December 31,					
	2017			2016			2017			2016		
	MW	%		MW	%		MWh	%		MWh	%	
Purchased resources:												
Columbia River PUD contracts	711	15.0	%	708	14.6	%	3,355,134	13.3	%	3,371,827	13.7	%
Other hydroelectric	72	1.5		79	1.6		281,619	1.1		365,670	1.5	
Other producers	284	6.0		387	8.0		3,679,623	14.6		2,999,171	12.1	
Wind	56	1.2		56	1.2		119,690	0.5		138,148	0.6	
Short-term wholesale energy purchases	N/A	—		N/A	—		7,049,060	27.8		6,154,767	25.0	
Total purchased	1,123	23.7	%	1,230	25.4	%	14,485,126	57.3	%	13,029,583	52.9	%
Company-controlled resources:												
Hydroelectric	254	5.4	%	254	5.2	%	864,821	3.4	%	933,522	3.8	%
Coal	677	14.3		677	14.0		4,463,705	17.6		4,529,179	18.4	
Natural gas/oil	1,908	40.3		1,908	39.4		3,822,462	15.1		4,152,205	16.9	
Wind	773	16.3		773	16.0		1,674,790	6.6		1,962,702	8.0	
Other[1]	2	—		2	—		—	—		—	—	
Total company-controlled	3,614	76.3	%	3,614	74.6	%	10,825,778	42.7	%	11,577,608	47.1	%
Total resources	4,737	100.0	%	4,844	100.0	%	25,310,904	100.0	%	24,607,191	100.0	%

1 It is estimated that the Glacier Battery Storage has delivered approximately 746.5 and 250.0 MWh as of December 31, 2017 and 2016, respectively.

Company–Owned Electric Generation Resources

At December 31, 2017, PSE owns the following plants with an aggregate net generating capacity of 3,614 MW:

Plant Name	Plant Type	Net Maximum Capacity (MW)[1]	Year Installed
Colstrip Units 3 & 4 (25% interest)	Coal	370	1984 & 1986
Colstrip Units 1 & 2 (50% interest)[2]	Coal	307	1975 & 1976
Mint Farm	Natural gas combined cycle	297	2007; acquired 2008
Goldendale	Natural gas combined cycle	315	2004; acquired 2007; upgraded 2016
Frederickson Unit 1 (49.85% interest)	Natural gas combined cycle	136	2002; added duct firing in 2005
Lower Snake River	Wind	343	2012
Wild Horse	Wind	273	2006 & 2009
Hopkins Ridge	Wind	157	2005 & 2008
Fredonia Units 1 & 2	Dual-fuel combustion turbines	207	1984
Frederickson Units 1 & 2	Dual-fuel combustion turbines	149	1981
Whitehorn Units 2 & 3	Dual-fuel combustion turbines	149	1981
Fredonia Units 3 & 4	Dual-fuel combustion turbines	107	2001
Ferndale	Natural gas co-generation	253	1994; acquired 2012
Encogen	Natural gas co-generation	165	1993; acquired 1999
Sumas	Natural gas co-generation	127	1993; acquired 2008
Upper Baker River	Hydroelectric	91	1959
Lower Baker River	Hydroelectric	109	1925; reconstructed 1960; upgraded 2001 and 2013
Snoqualmie Falls[3]	Hydroelectric	54	1898 to 1911 & 1957; rebuilt 2013
Crystal Mountain	Internal combustion	3	1969
Glacier Battery Storage	Lithium Iron Phosphate	2	2016
Total net capacity		3,614	

1 Net Maximum Capacity is the capacity a unit can sustain over a specified period of time when not restricted by ambient conditions or deratings, less the losses associated with auxiliary loads.

2 In July 2016, PSE reached a settlement with the Sierra Club to retire Colstrip Units 1 and 2 no later than July 1, 2022.

3 The FERC license authorizes the full 54.4 MW; however, the project's water right issued by the State Department of Ecology limits flow to 2,500 cubic feet and therefore output to 47.7MW.

Columbia River Electric Energy Supply Contracts

During 2017, approximately 13.3% of PSE’s energy supply requirement was obtained through long-term contracts with three Washington Public Utility Districts (PUDs) that own and operate hydroelectric projects on the Columbia River (Mid-Columbia). PSE agrees to pay a share of the annual debt service, operating and maintenance costs and other expenses associated with each project in proportion to its share of projected output. PSE’s payments are not contingent upon the projects being operable.

As of December 31, 2017, PSE's portion of the power output of the PUDs’ projects as set forth below:

			Company’s Annual Share (Approximate)	
Project	Contract Expiration Year	License Expiration Year	Percent of Output	MW Capacity
Chelan County PUD:				
Rock Island Project	2031	2029	25.0 %	156
Rocky Reach Project	2031	2052	25.0 %	325
Douglas County PUD:				
Wells Project[1]	2028	2052	29.9 %	251
Grant County PUD:				
Priest Rapids Development	2052	2052	0.6 %	6
Wanapum Development	2052	2052	0.6 %	7
Total				745

1 In March 2017, PSE entered a new PPA with Douglas County PUD for Wells Project output that begins upon expiration of the existing contract on August 31, 2018 and continues through September 30, 2028.

Other Electric Supply, Exchange and Transmission Contracts and Agreements

PSE purchases electric energy under long-term firm purchased power contracts with other utilities and marketers in the Western region. PSE is generally not obligated to make payments under these contracts unless power is delivered. PSE had seasonal energy and capacity exchange agreements with the Bonneville Power Administration (BPA) for 44 aMW of capacity which expired on July 1, 2017 with no provision to renew this agreement. PSE will procure more capacity from Mid-Columbia to recover for this loss of capacity, if needed. PSE also has an agreement with Pacific Gas & Electric Company for 300 MW of capacity which currently has no set expiration.

PSE began participating in the Energy Imbalance Market (EIM) operated by the California Independent System Operator on October 1, 2016. PSE has committed 600 MW of existing BPA transmission solely for the EIM market. Participation has resulted in reduced costs for PSE customers of approximately $10.0 million, enhanced system reliability, integration of variable energy resources, and geographic diversity of electricity demand and generation resources. The calculated benefits represent the cost savings of the EIM dispatch compared with a counter-factual dispatch without the EIM. Benefits can take the form of cost savings or profits or their combination. Benefits include greenhouse gas (GHG) revenue, transfer revenues and flexible ramping revenues.

PSE has entered into multiple various-term transmission contracts with other utilities to integrate electric generation and contracted resources into PSE’s system. These transmission contracts require PSE to pay for transmission service based on the contracted MW level of demand, regardless of actual use. Other transmission agreements provide actual capacity ownership or capacity ownership rights. PSE’s annual charges under these agreements are also based on contracted MW volumes. Capacity on these agreements that is not committed to serve PSE’s load is available for sale to third parties. PSE also purchases short-term transmission services from a variety of providers, including the BPA. In 2017, PSE had 4,646 MW and 595 MW of total transmission demand contracted with the BPA and other utilities, respectively. Additionally, PSE contracted with BPA for an additional 53 MW of transmission demand that went into effect from May to November of 2017. PSE’s remaining transmission capacity needs are met via PSE owned transmission assets.

Natural Gas Supply for Electric Customers

PSE purchases natural gas supplies for its power portfolio to meet demand for its combustion turbine generators. Supplies range from long-term to daily agreements, as the demand for the turbines varies depending on market heat rates. Purchases are made from a diverse group of major and independent natural gas producers and marketers in the United States and Canada. PSE also enters into financial hedges to manage the cost of natural gas. PSE utilizes natural gas storage capacity and transportation that is dedicated to and paid for by the power portfolio to facilitate increased natural gas supply reliability and intra-day dispatch of PSE's natural gas-fired generation resources. During 2017, PSE purchased approximately 69.9% of its natural gas in British Columbia, 21.8% in Alberta and 8.3% in the United States.

Integrated Resource Plans, Resource Acquisition and Development

PSE is required by Washington Commission regulations to file an electric and natural gas integrated resource plan (IRP) every two years. The 2017 IRP was filed on November 14, 2017 and identified the following capacity shortfalls and surpluses:

	2018	2019	2020	2021	2022
Projected MW shortfall/(surplus)	(73)	(34)	(121)	(128)	192

The expected capacity needs reflect the mix of energy efficiency programs deemed cost effective in the 2017 IRP. PSE projects that beginning in 2022 its future energy needs will exceed current resources in its supply portfolio because of the retirement of Colstrip Units 1 and 2, approximately 307 MW of capacity. Therefore, PSE's IRP sets forth a multi-part strategy of implementing energy efficiency programs and pursuing additional renewable resources and additional capacity resources such as battery storage and generation plants that operate during peak loads. If PSE cannot acquire needed energy supply resources at a reasonable cost, it may be required to purchase additional power in the wholesale market. These purchases are subject to the sharing bands of the PCA mechanism, at a cost that could, in the absence of regulatory relief, increase its expenses and reduce earnings and cash flows.

NATURAL GAS UTILITY OPERATING STATISTICS

	Year Ended December 31,		
	2017	2016	2015
Natural gas operating revenue by classes (dollars in thousands):			
Residential	$686,438	$578,955	$597,572
Commercial firm	251,584	213,138	239,849
Industrial firm	20,077	17,753	21,533
Interruptible	24,317	24,447	29,082
Total retail natural gas sales	982,416	834,293	888,036
Transportation services	21,718	20,322	18,666
Decoupling revenue	3,522	52,114	51,981
Other decoupling revenue[1]	(22,862)	(28,761)	(26,038)
Other	12,965	12,542	14,904
Total natural gas operating revenue	$997,759	$890,510	$947,549
Number of customers served (average):			
Residential	761,010	749,586	737,339
Commercial firm	55,372	54,992	54,646
Industrial firm	2,330	2,371	2,378
Interruptible	398	410	429
Transportation	226	227	221
Total customers	819,336	807,586	795,013
Natural gas volumes, therms (thousands):			
Residential	621,915	521,771	492,997
Commercial firm	279,656	233,586	230,507
Industrial firm	25,500	22,783	23,777
Interruptible	49,249	49,533	43,931
Total retail natural gas volumes, therms	976,320	827,673	791,212
Transportation volumes	236,578	230,724	220,392
Total volumes	1,212,898	1,058,397	1,011,604

[1] Includes decoupling cash collections, rate of return excess earnings, and decoupling 24-month revenue reserve.

NATURAL GAS UTILITY OPERATING STATISTICS (Continued)

	Year Ended December 31,		
	2017	2016	2015
Working natural gas volumes in storage at year end, therms (thousands):			
Jackson Prairie	86,051	86,374	78,337
Clay Basin	45,854	63,136	54,199
Average therms used per customer:			
Residential	817	696	669
Commercial firm	5,050	4,248	4,218
Industrial firm	10,944	9,609	9,999
Interruptible	123,742	120,812	102,403
Transportation	1,046,806	1,016,406	997,249
Average revenue per customer:			
Residential	$902	$772	$810
Commercial firm	4,544	3,876	4,389
Industrial firm	8,617	7,488	9,055
Interruptible	61,098	59,626	67,791
Transportation	96,099	89,524	84,460
Average revenue per therm sold:			
Residential	$1.104	$1.110	$1.212
Commercial firm	0.900	0.912	1.041
Industrial firm	0.787	0.779	0.906
Interruptible	0.494	0.494	0.662
Average retail revenue per therm sold	$1.006	$1.008	$1.122
Transportation	0.092	0.088	0.085
Heating degree days	4,584	3,823	3,800
Percent of normal - NOAA 30-year average	97.2 %	81.0 %	80.5 %

Natural Gas Supply for Natural Gas Customers

PSE purchases a portfolio of natural gas supplies ranging from long-term firm to daily from a diverse group of major and independent natural gas producers and marketers in the United States and Canada (British Columbia and Alberta). PSE also enters into physical and financial hedges to manage volatility in the cost of natural gas. All of PSE’s natural gas supply is ultimately transported through the facilities of Northwest Pipeline, LLC (NWP), the sole interstate pipeline delivering directly into PSE’s service territory. Accordingly, delivery of natural gas supply to PSE’s natural gas system is dependent upon the reliable operations of NWP.

For base load, peak management and supply reliability purposes, PSE supplements its firm natural gas supply portfolio by purchasing natural gas in periods of lower demand, injecting it into underground storage facilities and withdrawing it during the peak winter heating season. Underground storage facilities at Jackson Prairie in western Washington and at Clay Basin in Utah are used for this purpose. Clay Basin withdrawals are used to supplement purchases from the U.S. Rocky Mountain supply region, while Jackson Prairie provides incremental peak-day resources utilizing firm storage redelivery transportation capacity. Jackson Prairie is also used for daily balancing of load requirements on PSE’s natural gas system. Peaking needs are also met by using PSE-owned natural gas held in PSE’s LNG peaking facility located within its distribution system in Gig Harbor, Washington; as well as interrupting service to customers on interruptible service rates, if necessary.

PSE expects to meet its firm peak-day requirements for residential, commercial and industrial markets through its firm natural gas purchase contracts, firm transportation capacity, firm storage capacity and other firm peaking resources. PSE believes it will be able to acquire incremental firm natural gas supply and capacity to meet anticipated growth in the requirements of its firm customers for the foreseeable future.

During 2017, PSE purchased approximately 54.8% of its natural gas for its natural gas customers in British Columbia, 19.1% in Alberta and 26.1% in the United States. PSE’s firm natural gas supply portfolio has adequate flexibility in its transportation arrangements to enable it to achieve savings when there are regional price differentials between natural gas supply basins. The geographic mix of suppliers and daily, monthly and annual take requirements permit some degree of flexibility in managing natural gas supplies during periods of lower demand to minimize costs. Natural gas is marketed outside of PSE’s service territory (off-system sales) to optimize resources when on-system customer demand requirements permit and market economics are favorable; the resulting economics of these transactions are reflected in PSE’s natural gas customer tariff rates through the PGA mechanism.

Natural Gas Storage Capacity

PSE holds storage capacity in the Jackson Prairie and Clay Basin underground natural gas storage facilities adjacent to NWP’s pipeline to serve PSE’s natural gas customers. The Jackson Prairie facility is operated and one-third owned by PSE and is used primarily for intermediate peaking purposes due to its ability to deliver a large volume of natural gas in a short time period. Combined with capacity contracted from NWP’s one-third stake in Jackson Prairie, PSE holds firm withdrawal capacity of 453,800 Dekatherm (Dth) per day, and over 9.8 million Dth of storage capacity at the Jackson Prairie facility. Of this total, PSE holds 397,100 Dth per day of the firm withdrawal capacity and over 9.2 million Dth of storage capacity designated to serve natural gas customers. The location of the Jackson Prairie facility in PSE’s market area increases supply reliability and provides significant pipeline demand cost savings by reducing the amount of annual pipeline capacity required to meet peak-day natural gas requirements.

Of the remaining Jackson Prairie storage capacity, 56,700 Dth per day of firm withdrawal capacity and 640,600 Dth of storage capacity is currently designated to PSE's power portfolio, increasing natural gas supply reliability and facilitating intra-day dispatch of PSE's natural gas-fired generation resources. In addition, PSE has temporarily released approximately 6,100 Dth per day of firm withdrawal capacity and 178,500 of Dth of storage capacity to a third party, in exchange for temporary firm pipeline capacity on a constrained portion of NWP's system.

The Clay Basin storage facility is a supply area storage facility that provides operational flexibility and price protection. PSE holds 12.9 million Dth of Clay Basin storage capacity and approximately 107,400 Dth per day of firm withdrawal capacity under two long-term contracts with remaining terms of two and three years and has rights to extend such agreements. PSE has temporarily released a portion of its Clay Basin storage services to third parties, and its net storage capacity and maximum firm withdrawal capacity at Clay Basin is 8.9 million Dth and over 74,000 Dth per day, respectively.

LNG and Propane-Air Resources

LNG and propane-air resources provide firm natural gas supply on short notice for short periods of time. Due to their typically high cost and slow cycle times, these resources are normally utilized as a last resort supply source in extreme peak-demand periods, typically during the coldest hours or days.

During 2014, PSE, working with NWP determined that the pipeline redelivery service to PSE from NWP's Plymouth LNG facility could no longer be considered firm during peak conditions. As a result, PSE terminated the service agreement effective October 31, 2015 and removed the resource from its natural gas firm portfolio. In 2015, PSE and NWP negotiated a new contract for Plymouth LNG service for PSE's generation fleet, which provides for LNG storage services of 241,700 Dth of PSE-owned natural gas at Plymouth, with a maximum daily deliverability of 70,500 Dth. PSE will use the Plymouth contract as an alternate supply source for natural gas required to serve PSE's generation fleet during peak periods on a daily or intra-day basis. In addition, PSE acquired 15,000 Dth/day of firm pipeline capacity from Plymouth for the generation fleet. The balance of the LNG capacity will be delivered using firm NWP pipeline transportation service previously acquired to serve PSE's generation fleet.

PSE owns and operates the Swarr vaporized propane-air station located in Renton, Washington which includes storage capacity for approximately 1.5 million gallons of propane. This vaporized propane-air injection facility delivers the thermal equivalent of 10,000 Dth of natural gas per day for up to 12 days directly into PSE's distribution system; however, it is temporarily not in-service pending planned environmental, safety, efficiency and reliability upgrades. PSE owns and operates an LNG peaking facility in Gig Harbor, Washington, with total capacity of 10,600 Dth, which is capable of delivering the equivalent of 2,500 Dth of natural gas per day.

Tacoma LNG Facility

Currently under construction at the Port of Tacoma, the Tacoma LNG facility is expected to be operational in 2019. On January 24, 2018, the Puget Sound Clean Air Agency's determined a Supplemental Environmental Impact Statement is necessary in order to rule on the air quality permit for the facility. As a result of requiring a Supplemental Environmental Impact Statement, the Company's construction schedule may be impacted depending on the Puget Sound Clean Air Agency's timing and decision on the air quality permit. If delayed, the construction schedule and costs may be adversely impacted. The Tacoma LNG facility will provide peak-shaving services to PSE's natural gas customers, and will provide LNG as fuel to transportation customers, particularly in the marine market. Pursuant to the Washington Commission's order, PSE will be allocated 43.0% of the capital and operating costs, consistent with the regulated portion of the Tacoma LNG facility and Puget LNG will be allocated the remaining 57.0% of the capital and operating costs. The portion of the Tacoma LNG facility allocated to PSE will be subject to regulation by the Washington Commission.

Natural Gas Transportation Capacity

PSE currently holds firm transportation capacity on pipelines owned by NWP, Gas Transmission Northwest (GTN), Nova Gas Transmission (NOVA), Foothills Pipe Lines (Foothills) and Enbridge Westcoast Energy (Westcoast). GTN, NOVA, and Foothills are all TransCanada companies. PSE pays fixed monthly demand charges for the right, but not the obligation, to transport specified quantities of natural gas from receipt points to delivery points on such pipelines each day for the term or terms of the applicable agreements.

PSE holds approximately 542,900 Dth per day of capacity for its natural gas customers on NWP that provides firm year-round delivery to PSE's service territory. In addition, PSE holds approximately 447,100 Dth per day of seasonal firm capacity on NWP to provide for delivery of natural gas stored at Jackson Prairie to natural gas customers. PSE holds approximately 217,900 Dth per day of firm transportation capacity on NWP to supply natural gas to its electric generating facilities. In addition, PSE holds over 34,200 Dth per day of seasonal firm capacity on NWP to provide for delivery of natural gas stored in Jackson Prairie for its electric generating facilities. PSE's firm transportation capacity contracts with NWP have remaining terms ranging from 2 to 27 years. However, PSE has either the unilateral right to extend the contracts under the contracts' current terms or the right of first refusal to extend such contracts under current FERC rules.

PSE's firm transportation capacity for its natural gas customers on Westcoast's pipeline is 135,800 Dth per day under various contracts, with remaining terms of two to six years. PSE has other firm transportation capacity on Westcoast's pipeline, which supplies the electric generating facilities, totaling 88,400 Dth per day, with remaining terms of three to six years and an option for PSE to renew its rights under the Westcoast contract. PSE has firm transportation capacity for its natural gas customers on NOVA and Foothills pipelines, each totaling approximately 79,000 Dth per day, with remaining terms of three to six years and an option for PSE to renew its rights on the capacity on NOVA and Foothills pipelines. PSE has other firm transportation capacity on NOVA and Foothills pipelines, which supplies the electric generating facilities, each totaling approximately 41,000 Dth per day, with remaining terms of three to six years. PSE's firm transportation capacity for its natural gas customers on the GTN pipeline, totaling over 77,000 Dth per day, with remaining terms of six years and PSE has a first right-of-refusal to extend such contracts under current FERC rules. PSE has other firm transportation capacity on GTN pipeline, which supplies the electric generating facilities, totaling 40,600 Dth per day, with remaining terms of three to six years.

Capacity Release

The FERC regulates the release of firm pipeline and storage capacity for facilities which fall under its jurisdiction. Capacity releases allow shippers to temporarily or permanently relinquish unutilized capacity to recover all or a portion of the cost of such capacity. The FERC allows capacity to be released through several methods including open bidding and pre-arrangement. PSE has acquired some firm pipeline and storage service through capacity release provisions to serve its growing service territory and electric generation portfolio. PSE also mitigates a portion of the demand charges related to unutilized storage and pipeline capacity through capacity release. Capacity release benefits derived from the natural gas customer portfolio are passed on to PSE's natural gas customers through the PGA mechanism.

Energy Efficiency

PSE is required under Washington state law to pursue all available conservation that is cost-effective, reliable and feasible. PSE offers programs designed to help new and existing residential, commercial and industrial customers use energy efficiently. PSE uses a variety of mechanisms including cost-effective financial incentives, information and technical services to enable customers to make energy efficient choices with respect to building design, equipment and building systems, appliance purchases and operating practices. PSE recovers the actual costs of its electric and natural gas energy efficiency programs through rider mechanisms. However, the rider mechanisms do not provide assistance with gross margin erosion associated with reduced energy sales. To address this issue, PSE received approval in 2017 from the Washington Commission for continuation of electric and natural gas decoupling mechanisms, which mitigates gross margin erosion resulting from the Company's energy efficiency efforts.

Environment

PSE's operations, including generation, transmission, distribution, service and storage facilities, are subject to environmental laws and regulations by federal, state and local authorities. See below for the primary areas of environmental law that have the potential to most significantly impact PSE's operations and costs.

Air and Climate Change Protection

PSE owns numerous thermal generation facilities, including natural gas plants and an ownership percentage of Colstrip. All of these facilities are governed by the Clean Air Act (CAA), and all have CAA Title V operating permits, which must be renewed every five years. This renewal process could result in additional costs to the plants. PSE continues to monitor the permit renewal process to determine the corresponding potential impact to the plants. These facilities also emit greenhouse gases (GHG), and thus are also subject to any current or future GHG or climate change legislation or regulation. The Colstrip plant represents PSE's most significant source of GHG emissions.

Species Protection

PSE owns hydroelectric plants, wind farms and numerous miles of above ground electric distribution and transmission lines which can be impacted by laws related to species protection. A number of species of fish have been listed as threatened or endangered under the Endangered Species Act (ESA), which influences hydroelectric operations, and may affect PSE operations, potentially representing cost exposure and operational constraints. Similarly, there are a number of avian and terrestrial species that have been listed as threatened or endangered under the ESA or are protected by the Migratory Bird Treaty Act or the Bald and Golden Eagle Protection Act. Designations of protected species under these laws have the potential to influence operation of our wind farms and above ground transmission and distribution systems.

Remediation

PSE and its predecessors are responsible for environmental remediation at various sites. These include properties currently and formerly owned by PSE (or its predecessors), as well as third-party owned properties where hazardous substances were allegedly generated, transported or released. The primary cleanup laws to which PSE is subject include the Comprehensive Environmental Response, Compensation and Liability Act (federal) and, in Washington, the Model Toxics Control Act (state). PSE is also subject to applicable remediation laws in the state of Montana for its ownership interest in Colstrip. These laws may hold liable any current or past owner or operator of a contaminated site, as well as any generator, transporter, arranger, or disposer of regulated substances.

Hazardous and Solid Waste and PCB Handling and Disposal

Related to certain operations, including power generation and transmission and distribution maintenance, PSE must handle and dispose of certain hazardous and solid wastes. These actions are regulated by the Solid Waste Disposal

Act, as amended by the Resource Conservation and Recovery Act (federal), the Toxic Substances Control Act (federal) and hazardous or dangerous waste regulations (state) that impose complex requirements on handling and disposing of regulated substances.

Water Protection

PSE facilities that discharge wastewater or storm water or store bulk petroleum products are governed by the Clean Water Act (federal and state) which includes the Oil Pollution Act amendments. This includes most generation facilities (and all of those

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with water discharges and some with bulk fuel storage), and many other facilities and construction projects depending on drainage, facility or construction activities, and chemical, petroleum and material storage.

Mercury Emissions

Mercury control equipment has been installed at Colstrip and has operated at a level that meets the current Montana requirement. Compliance, based on a rolling twelve-month average, was first confirmed in January 2011, and PSE continues to meet the requirement.

The EPA published the final Mercury and Air Toxics Standard (MATS) in February 2012. Generating units were given three years, until April 2015, to comply with MATS and could receive up to a 1-year extension from state permitting authorities if necessary for the installation of controls. Colstrip met the MATS limits for mercury and acid gases as of April 2017.

Siting New Facilities

In siting new generation, transmission, distribution or other related facilities in Washington, PSE is subject to the State Environmental Policy Act, and may be subject to the federal National Environmental Policy Act, if there is a federal nexus, in addition to other possible local siting and zoning ordinances. These requirements may potentially require mitigation of environmental impacts as well as other measures that can add significant cost to new facilities.

Recent and Future Environmental Law and Regulation

Recent and future environmental laws and regulations may be imposed at a federal, state or local level and may have a significant impact on the cost of PSE operations. PSE monitors legislative and regulatory developments for environmental issues with the potential to alter the operation and cost of our generation plants, transmission and distribution system, and other assets. Described below are the recent, pending and potential future environmental law and regulations with the most significant potential impacts to PSE’s operations and costs.

Climate Change and Greenhouse Gas Emissions

PSE recognizes the growing concern that increased atmospheric concentrations of GHG contribute to climate change. PSE believes that climate change is an important issue that requires careful analysis and considered responses. As climate policy continues to evolve at the state and federal levels, PSE remains involved in state, regional and federal policymaking activities. PSE will continue to monitor the development of any climate change or climate change related air emission reduction initiative at the state and western regional level. PSE has considered the known impact of any future legislation or new government regulation on the cost of generation in its IRP process.

PSE's Greenhouse Gas Emission Reporting

PSE is required to submit, on an annual basis, a report of its GHG emissions to the state of Washington including a report of emissions from all individual power plants emitting over 10,000 tons per year of GHGs and from certain natural gas distribution operations. Emissions exceeding 25,000 tons per year of GHGs from these sources must also be reported to the environmental protection agency (EPA). Capital investments to monitor GHGs from the power plants and in the distribution system are not required at this time. Since 2002, PSE has voluntarily undertaken an annual inventory of its GHG emissions associated with PSE’s total electric retail load served from a supply portfolio of owned and purchased resources.

The most recent data indicate that PSE’s total GHG emissions (direct and indirect) from its electric supply portfolio in 2016 were 10.8 million metric tons of carbon dioxide equivalents. Approximately 43.0% of PSE’s total GHG emissions (approximately 4.6 million metric tons) are associated with PSE’s ownership and contractual interests in Colstrip. PSE’s overall emissions strategy demonstrates a concerted effort to manage customers’ needs with an appropriate balance of new renewable generation, existing generation owned and/or operated by PSE and significant energy efficiency efforts.

Federal Greenhouse Gas Rules

On August 3, 2015, the EPA announced a final rule regarding New Source Performance Standard (NSPS) for the control of carbon dioxide (CO_2) from new power plants that burn fossil fuels under section 111(b) of the Clean Air Act. The rule was published on October 23, 2015, and separates standards for new power plants fueled by natural gas and coal. New natural gas power plants can emit no more than 1,000 lbs. of CO_2/megawatt hour (MWh) which is achievable with the latest combined cycle technology. New coal power plants can emit no more than 1,400 lbs. of CO_2/MWh, which is less stringent than the draft rule. The standard for coal plants would not specifically require Carbon Dioxide Capture and Sequestration (CCS) but CCS was reaffirmed by the EPA as the “best system of emission reductions” (BSER). These 111(b) standards are implemented by the states, but states have limited flexibility to alter the standards set by the EPA.

The EPA announced the final rule for 111(d), the Clean Power Plan rule, on August 3, 2015 and published it on October 23, 2015. On October 10, 2017, the EPA proposed to repeal this rule and will accept comments until April 26, 2018. As such, PSE is monitoring the situation and awaiting the final determination by the EPA.

Washington Clean Air Rule

The Clean Air Rule (CAR) was adopted on September 15, 2016 in Washington State and attempts to reduce greenhouse gas emissions from "covered entities" located within Washington State. Included under the new rule are large manufacturers, petroleum producers and natural gas utilities, including PSE. CAR sets a cap on emissions associated with covered entities, which decreases over time approximately 5.0% every three years. Entities must reduce their carbon emissions, or purchase emission reduction units (ERUs), as defined under the rule, from others. CAR covers natural gas distributors and subjects them to an emissions reduction pathway based on the indirect emissions of their customers. CAR regulates the emissions of natural gas utilities 1.2 million customers across the state, adding to the cost of natural gas for homes and businesses, which may increase costs to PSE customers.
On September 27, 2016, PSE, along with Avista Corporation, Cascade Natural Gas Corporation and NW Natural, filed an action in the U.S. District Court for the Eastern District of Washington challenging CAR. On September 30, 2016, the four companies filed a similar challenge to CAR in Thurston County Superior Court. On December 15, 2017, the Thurston County Superior Court invalidated the CAR. A final court order is pending and in the meantime, the Washington State Department of Ecology, submitted a brief requesting severability, which would make the rule valid for industries with direct emissions. This would apply to the Company's electric utility thermal generation units but not to its natural gas utility. Appeals could be filed to the Thurston County Court of Appeals after the court's final order, including its ruling on severability.

Regional Haze Rule

On January 10, 2017, the EPA provided revisions to the Regional Haze Rule which were published in the Federal Register. Among other things, these revisions delayed new Regional Haze review from 2018 to 2021; however, the end date will remain 2028. Aspects of these revisions are currently being challenged by various entities nationwide and briefing has not yet been scheduled. In the meantime, the state of Montana has indicated plans to work on and submit a State Implementation Plan for the second planning period.

Coal Combustion Residuals

On April 17, 2015, the EPA published a final rule, effective October 19, 2015, that regulates Coal Combustion Residuals (CCR's) under the Resource Conservation and Recovery Act, Subtitle D. The EPA issued another rule, effective October 4, 2016, extending certain compliance deadlines under the CCR rule. The CCR rule is self-implementing at a federal level or can be taken over by a state. The rule addresses the risks from coal ash disposal, such as leaking of contaminants into ground water, blowing of contaminants into the air as dust, and the catastrophic failure of coal ash containment structures by establishing technical design, operation and maintenance, closure and post closure care requirements for CCR landfills and surface impoundments, and corrective action requirements for any related leakage. The rule also sets forth recordkeeping and reporting requirements, including posting specific information related to CCR surface impoundments and landfills to publicly-accessible websites.
The CCR rule requires significant changes to the Company's Colstrip operations and those changes were reviewed by the Company and the plant operator in the second quarter of 2015. PSE had previously recognized a legal obligation under the EPA rules to dispose of coal ash material at Colstrip in 2003. Due to the CCR rule, additional disposal costs were added to the Asset Retirement and Environmental Obligations (ARO).

PCB Handling and Disposal

In April 2010, the EPA issued an Advanced Notice of Proposed Rulemaking soliciting information on a broad range of questions concerning inventory, management, use, and disposal of polychlorinated biphenyl (PCB) containing equipment. The EPA is using this Advanced Notice of Proposed Rulemaking to seek data to better evaluate whether to initiate a rulemaking process geared toward a mandatory phase-out of all PCBs.

The rule was scheduled to be published in July 2015 but due to the number of comments received by the EPA, the rule has undergone multiple extensions and revisions. It was anticipated that the rule would be published in November 2017. However on January 30, 2017 the Trump Administration published the Executive Order on Reducing Regulation and Controlling Regulatory Costs directive which placed the rulemaking on indefinite hold. At this point, PSE cannot determine what impacts this rulemaking will have on its operations, if any, but will continue to work closely with the Utility Solid Waste Activities Group and the American Gas Association (AGA) to monitor developments.

Executive Officers of the Registrants
The executive officers of Puget Energy as of March 1, 2018 are listed below along with their business experience during the past five years. Officers of Puget Energy are elected for one-year terms.

Name	Age	Offices
K. J. Harris	53	President and Chief Executive Officer since March 2011
D. A. Doyle	59	Senior Vice President and Chief Financial Officer since November 2011
S. R. Secrist	56	Senior Vice President, General Counsel and Chief Ethics and Compliance Officer since January 2014; Vice President, General Counsel and Chief Ethics and Compliance Officer January 2011-January 2014
S. J. King	34	Controller and Principal Accounting Officer since November 2, 2017. Senior Manager (audited utility, technology and telecommunication companies) at PwC July 2016 - November 2017; Manager at PwC July 2013 - July 2016; Senior Associate at PwC July 2010 - July 2013

The executive officers of PSE as of March 1, 2018 are listed below along with their business experience during the past five years. Officers of PSE are elected for one-year terms.

Name	Age	Offices
K. J. Harris	53	President and Chief Executive Officer since March 2011
D. A. Doyle	59	Senior Vice President and Chief Financial Officer since November 2011
B. K. Gilbertson	54	Senior Vice President, Operations since March 2015; Vice President, Operations March 2013 – February 2015; Vice President, Operations Services February 2011 – February 2013
M. D. Mellies	57	Senior Vice President and Chief Administrative Officer since February 2011
D. E. Mills	60	Senior Vice President, Policy and Energy Supply since February 2018; Senior Vice President, Energy Operations January 2017 - February 2018; Vice President, Energy Operations January 2016 - January 2017; Vice President, Energy Supply Operations January 2012 - January 2015
S. R. Secrist	56	Senior Vice President, General Counsel and Chief Ethics and Compliance Officer since January 2014; Vice President, General Counsel and Chief Ethics and Compliance Officer January 2011-January 2014
S. J. King	34	Controller and Principal Accounting Officer since November 2, 2017. Senior Manager (audited utility, technology and telecommunication companies) at PwC July 2016 - November 2017; Manager at PwC July 2013 - July 2016; Senior Associate at PwC July 2010 - July 2013

ITEM 1A. RISK FACTORS

The following risk factors, in addition to other factors and matters discussed elsewhere in this report, should be carefully considered. The risks and uncertainties described below are not the only risks and uncertainties that Puget Energy and PSE may face. Additional risks and uncertainties not presently known or currently deemed immaterial also may impair PSE’s business operations. If any of the following risks actually occur, Puget Energy’s and PSE’s business, results of operations and financial conditions would suffer.

RISKS RELATING TO PSE’s REGULATORY AND RATE-MAKING PROCEDURES

PSE's regulated utility business is subject to various federal and state regulations. PSE's regulatory risks include, but are not limited to, the items discussed below.

The actions of regulators can significantly affect PSE’s earnings, liquidity and business activities. The rates that PSE is allowed to charge for its services is the single most important item influencing its financial position, results of operations and liquidity. PSE is highly regulated and the rates that it charges its wholesale and retail customers are determined by both the Washington Commission and the FERC.

PSE is also subject to the regulatory authority of the Washington Commission with respect to accounting, operations, the issuance of securities and certain other matters, and the regulatory authority of the FERC with respect to the transmission of electric energy, the sale of electric energy at the wholesale level, accounting and certain other matters. In addition, proceedings with the Washington Commission typically involve multiple stakeholder parties, including consumer advocacy groups and various

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consumers of energy, who have differing concerns but who have the common objective of limiting rate increases or decreasing rates. Policies and regulatory actions by these regulators could have a material impact on PSE's financial position, results of operations and liquidity.

PSE's recovery of costs is subject to regulatory review and its operating income may be adversely affected if its costs are disallowed. The Washington Commission determines the rates PSE may charge to its electric retail customers based, in part, on historic costs during a particular test year, adjusted for certain normalizing adjustments. Power costs on the other hand, are normalized for market, weather and hydrological conditions projected to occur during the applicable rate year, the ensuing twelve-month period after rates become effective. The Washington Commission determines the rates PSE may charge to its natural gas customers based on historic costs during a particular test year. Natural gas costs are adjusted through the PGA mechanism, as discussed previously. If in a specific year PSE's costs are higher than the amounts used by the Washington Commission to determine the rates, revenue may not be sufficient to permit PSE to earn its allowed return or to cover its costs. In addition, the Washington Commission has the authority to determine what level of expense and investment is reasonable and prudent in providing electric and natural gas service. If the Washington Commission decides that part of PSE's costs do not meet the standard, those costs may be disallowed partially or entirely and not recovered in rates. For the aforementioned reasons, the rates authorized by the Washington Commission may not be sufficient to earn the allowed return or recover the costs incurred by PSE in a given period.

PSE is currently subject to a Washington Commission order that requires PSE to share its excess earnings above the authorized rate of return with customers. The Washington Commission previously approved an electric and natural gas decoupling mechanism for the recovery of its delivery-system costs, along with an ERF, a rate plan and an earnings sharing mechanism that requires PSE and its customers to share in any earnings in excess of the authorized rate of return of 7.77% during the term of the rate plan. The earnings test is done for each service (electric/natural gas) separately, so PSE would be obligated to share the earnings for one service exceeding the threshold, even if the other service did not meet the earnings test. The settlement agreement accepted by the Washington Commission on December 5, 2017 and effective December 19, 2017 provided for an updated rate of return of 7.60%.

The PCA mechanism, by which variations in PSE's power costs are apportioned between PSE and its customers pursuant to a graduated scale, could result in significant increases in PSE's expenses if power costs are significantly higher than the baseline rate. PSE has a PCA mechanism that provides for recovery of power costs from customers or refunding of power cost savings to customers, as those costs vary from the "power cost baseline" level of power costs which are set, in part, based on normalized assumptions about weather and hydrological conditions. Excess power costs or power cost savings will be apportioned between PSE and its customers pursuant to the graduated scale set forth in the PCA mechanism and will trigger a surcharge or refund when the cumulative deferral trigger is reached. As a result, if power costs are significantly higher than the baseline rate, PSE's expenses could significantly increase.

RISKS RELATING TO PSE's OPERATION

PSE's cash flow and earnings could be adversely affected by potential high prices and volatile markets for purchased power, recurrence of low availability of hydroelectric resources, outages of its generating facilities or a failure to deliver on the part of its suppliers. The utility business involves many operating risks. If PSE's operating expenses, including the cost of purchased power and natural gas, significantly exceed the levels recovered from retail customers, its cash flow and earnings would be negatively affected. Factors which could cause PSE's purchased power and natural gas costs to be higher than anticipated include, but are not limited to, high prices in western wholesale markets during periods when PSE has insufficient energy resources to meet its energy supply needs and/or purchases in wholesale markets of high volumes of energy at prices above the amount recovered in retail rates due to:

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- Below normal levels of generation by PSE-owned hydroelectric resources due to low streamflow conditions or precipitation;
- Extended outages of any of PSE-owned generating facilities or the transmission lines that deliver energy to load centers, or the effects of large-scale natural disasters on a substantial portion of distribution infrastructure; and
- Failure of a counterparty to deliver capacity or energy purchased by PSE.

PSE’s electric generating facilities are subject to operational risks that could result in unscheduled plant outages, unanticipated operation and maintenance expenses and increased power purchase costs. PSE owns and operates coal, natural gas-fired, hydroelectric, and wind-powered generating facilities. Operation of electric generating facilities involves risks that can adversely affect energy output and efficiency levels or increase expenditures, including:

- Facility shutdowns due to a breakdown or failure of equipment or processes;
- Volatility in prices for fuel and fuel transportation;
- Disruptions in the delivery of fuel and lack of adequate inventories;
- Regulatory compliance obligations and related costs, including any required environmental remediation, and any new laws and regulations that necessitate significant investments in our generating facilities;
- Labor disputes;
- Operator error or safety related stoppages;
- Terrorist or other attacks (both cyber-based and/or asset-based); and
- Catastrophic events such as fires, explosions or acts of nature.

If PSE is unable to protect its physical assets from terrorist attacks or its information technology infrastructure and network against data corruption, cyber-based attacks or network security breaches, its operations could be disrupted. Despite PSE's implementation of security measures, its physical assets and technology systems may be vulnerable to disability, failures or unauthorized access due to hacking, viruses, acts of war or terrorism and other causes. If the technology systems were to fail or be breached and PSE were unable to recover in a timely manner, PSE may be unable to fulfill critical business functions and sensitive, confidential and other data could be compromised, which could have a material adverse effect on its results of operations, financial condition and cash flows. In addition, these physical asset or cyber-based attacks could disrupt its ability to produce or distribute some portion of our energy products and could affect the reliability or operability of the electric and natural gas systems. As a result, PSE endeavors to maintain vigilant security programs and procedures to protect against the continuous threat of physical asset and cyber-based attacks, and as a result, PSE may be required to expend significant dollars and other resources to protect against existing and ensuing threats.

PSE is subject to the commodity price, delivery and credit risks associated with the energy markets. In connection with matching PSE's energy needs and available resources, PSE engages in wholesale sales and purchases of electric capacity and energy and, accordingly, is subject to commodity price risk, delivery risk, credit risk and other risks associated with these activities. Credit risk includes the risk that counterparties owing PSE money or energy will breach their obligations for delivery of energy supply or contractually required payments related to PSE's energy supply portfolio. Should the counterparties to these arrangements fail to perform, PSE may be forced to enter into alternative arrangements. In that event, PSE’s financial results could be adversely affected. Although PSE takes into account the expected probability of default by counterparties, the actual exposure to a default by a particular counterparty could be greater than predicted.

Costs of compliance with environmental, climate change and endangered species laws are significant and the costs of compliance with new and emerging laws and regulations and the incurrence of associated liabilities could adversely affect PSE’s results of operations. PSE’s operations are subject to extensive federal, state and local laws and regulations relating to environmental issues, including air emissions and climate change, endangered species protection, remediation of contamination, avian protection, waste handling and disposal, decommissioning, water protection and siting new facilities. To fulfill these legal requirements, PSE must spend significant sums of money to comply with these measures including resource planning, remediation, monitoring, analysis, mitigation measures, pollution control equipment and emissions related abatement and fees. New environmental laws and regulations affecting PSE’s operations may be adopted, and new interpretations of existing laws and regulations could be adopted or become applicable to PSE or its facilities. Compliance with these or other future regulations could require significant expenditures by PSE and adversely affect PSE’s financial position, results of operations, cash flows and liquidity. In addition, PSE may not be able to recover all of its costs for such expenditures through electric and natural gas rates, in a timely manner, at current levels in the future.

Under current law, PSE is also generally responsible for any on-site liabilities associated with the environmental condition of the facilities that it currently owns or operates or has previously owned or operated. The incurrence of a material environmental liability or new regulations governing such liability could result in substantial future costs and have a material adverse effect on PSE’s results of operations and financial condition.

Specific to climate change, Washington State has adopted both renewable portfolio standards and GHG legislation, including an emission performance standard provision and the EPA set CO_2 emission standards with specific state goals.

PSE's operating results fluctuate on a seasonal and quarterly basis and can be impacted by various impacts of climate change. PSE's business is seasonal and weather patterns can have a material impact on its revenue, expenses and operating results. Demand for electricity is greater in the winter months associated with heating. Accordingly, PSE's operations have historically generated less revenue and income when weather conditions are milder in winter. In the event that the Company experiences unusually mild winters, its results of operations and financial condition could be adversely affected. PSE's hydroelectric resources are also dependent on snow conditions in the Pacific Northwest.

PSE may be adversely affected by extreme events in which PSE is not able to promptly respond, repair and restart the electric and natural gas infrastructure system. PSE must maintain an emergency planning and training program to allow PSE to quickly respond to extreme events. Without emergency planning, PSE is subject to availability of outside contractors during an extreme event which may impact the quality of service provided to PSE’s customers and also require significant expenditures by PSE. In addition, a slow or ineffective response to extreme events may have an adverse effect on earnings as customers may be without electricity and natural gas for an extended period of time.

PSE depends on an aging work force and third party vendors to perform certain important services and may be negatively affected by its inability to attract and retain professional and technical employees or the unavailability of vendors. PSE is subject to workforce factors, including but not limited to an aging workforce, loss or retirement of key personnel and availability of qualified personnel. PSE’s ability to implement a workforce succession plan is dependent upon PSE’s ability to employ and retain skilled professional and technical workers. Without a skilled workforce, PSE’s ability to provide quality service to PSE’s customers and to meet regulatory requirements could affect PSE’s earnings. Also, the costs associated with attracting and retaining qualified employees could reduce earnings and cash flows. PSE continues to be concerned about the availability and aging of skilled workers for special complex utility functions. PSE also hires third party vendors to perform a variety of normal business functions, such as power plant maintenance, data warehousing and management, electric transmission, electric and natural gas distribution construction and maintenance, certain billing and metering processes, call center overflow and credit and collections. The unavailability of skilled workers or unavailability of such vendors could adversely affect the quality and cost of PSE’s natural gas and electric service and accordingly PSE’s results of operations.

Potential municipalization may adversely affect PSE's financial condition. PSE may be adversely affected if we experience a loss in the number of our customers due to municipalization or other related government action. When a town or city in PSE's service territory establishes its own municipal-owned utility, it acquires PSE's assets and takes over the delivery of energy services that PSE provides. Although PSE is compensated in connection with the town or city's acquisition of its assets, any such loss of customers and related revenue could negatively affect PSE's future financial condition.

Technological developments may have an adverse impact on PSE's financial condition. Advances in power generation, energy efficiency and other alternative energy technologies, such as solar generation, could lead to more wide-spread use of these technologies, thereby reducing customer demand for the energy supplied by PSE which could negatively impact PSE's revenue and financial condition.

RISKS RELATING TO PUGET ENERGY'S AND PSE'S FINANCING

The Company's business is dependent on its ability to successfully access capital. The Company relies on access to internally generated funds, bank borrowings through multi-year committed credit facilities and short-term money markets as sources of liquidity and longer-term debt markets to fund PSE's utility construction program and other capital expenditure requirements of PSE. If Puget Energy or PSE are unable to access capital on reasonable terms, their ability to pursue improvements or acquisitions, including generating capacity, which may be necessary for future growth, could be adversely affected. Capital and credit market disruptions, a downgrade of Puget Energy's or PSE's credit rating or the imposition of restrictions on borrowings under their credit facilities in the event of a deterioration of financial ratios, may increase Puget Energy's and PSE’s cost of borrowing or adversely affect the ability to access one or more financial markets.

The amount of the Company's debt could adversely affect its liquidity and results of operations. Puget Energy and PSE have short-term and long-term debt, and may incur additional debt (including secured debt) in the future. Puget Energy has access to a multi-year $800.0 million revolving credit facility, secured by substantially all of its assets, which has a maturity date of October 25, 2022. There was $102.6 million outstanding under the facility as of December 31, 2017. Puget Energy's credit facility includes an expansion feature that could, upon the banks' approval, increase the size of the facility to $1.3 billion. PSE also has a separate credit facility, which provides PSE with access to $800.0 million in short-term borrowing capability, and includes an expansion feature that could, upon the banks' approval, increase the size of the facility to $1.4 billion. The PSE credit facility matures on October 25, 2022. As of December 31, 2017, no amounts were drawn and outstanding under the PSE credit facility. In addition, Puget Energy has issued $1.8 billion in senior secured notes, whereas PSE, as of December 31, 2017, had approximately $3.8 billion outstanding under first mortgage bonds, pollution control bonds, senior notes and junior subordinated notes. The Company's debt level could have important effects on the business, including but not limited to:

- Making it difficult to satisfy obligations under the debt agreements and increasing the risk of default on the debt obligations;
- Making it difficult to fund non-debt service related operations of the business; and
- Limiting the Company's financial flexibility, including its ability to borrow additional funds on favorable terms or at all.

A downgrade in Puget Energy’s or PSE’s credit rating could negatively affect the ability to access capital, the ability to hedge in wholesale markets and the ability to pay dividends. Although neither Puget Energy nor PSE has any rating downgrade provisions in its credit facilities that would accelerate the maturity dates of outstanding debt, a downgrade in the Companies’ credit ratings could adversely affect the ability to renew existing or obtain access to new credit facilities and could increase the cost of such facilities. For example, under Puget Energy’s and PSE’s facilities, the borrowing spreads over the London Interbank Offered Rate (LIBOR) and commitment fees increase if their respective corporate credit ratings decline. A downgrade in commercial paper ratings could increase the cost of commercial paper and limit or preclude PSE’s ability to issue commercial paper under its current programs.
Any downgrade below investment grade of PSE’s corporate credit rating could cause counterparties in the wholesale electric, wholesale natural gas and financial derivative markets to request PSE to post a letter of credit or other collateral, make cash prepayments, obtain a guarantee agreement or provide other mutually agreeable security, all of which would expose PSE to additional costs.
PSE may not declare or make any dividend distribution unless on the date of distribution PSE’s corporate credit/issuer rating is investment grade, or if its credit ratings are below investment grade, PSE’s ratio of earnings before interest, tax, depreciation and amortization (EBITDA) to interest expense for the most recently ended four fiscal quarter periods prior to such date is equal to or greater than 3.0 to 1.0.

The Company may be negatively affected by unfavorable changes in the tax laws or their interpretation. The Company’s tax obligations include income, real estate, public utility, municipal, sales and use, business and occupation and employment-related taxes and ongoing audits related to these taxes. Changes in tax law, related regulations or differing interpretation or enforcement of applicable law by the IRS or other taxing jurisdiction could have a material adverse impact on the Company’s financial statements. The tax law, related regulations and case law are inherently complex. The Company must make judgments and interpretations about the application of the law when determining the provision for taxes. These judgments may include reserves for potential adverse outcomes regarding tax positions that may be subject to challenge by the taxing authorities. Disputes over interpretations of tax laws may be settled with the taxing authority in examination, upon appeal or through litigation.

In particular, the Tax Cuts and Jobs Act which was enacted on December 22, 2017 introduced significant permanent and temporary changes to the federal tax code. These changes include a tax rate change from 35.0% to 21.0%, the exclusion of utility businesses from claiming bonus depreciation, the limitation of interest deductibility by non-utility businesses, in addition to numerous other changes. The final interpretation and regulatory treatment of the tax reform changes is uncertain.

Poor performance of pension and postretirement benefit plan investments and other factors impacting plan costs could unfavorably impact PSE’s cash flow and liquidity. PSE provides a defined benefit pension plan and postretirement benefits to certain PSE employees and former employees. Costs of providing these benefits are based, in part, on the value of the plan’s assets and the current interest rate environment and therefore, adverse market performance or low interest rates could result in lower rates of return for the investments that fund PSE’s pension and postretirement benefits plans and could increase PSE’s funding requirements related to the pension plans. Changes in demographics, including increased numbers of retirements or changes in life expectancy assumptions, may also increase PSE's funding requirements related to the pension plans. Any contributions to PSE’s plans in 2018 and beyond as well as the timing of the recovery of such contributions in GRCs could impact PSE’s cash flow and liquidity.

Potential legal proceedings and claims could increase the Company’s costs, reduce the Company’s revenue and cash flow, or otherwise alter the way the Company conducts business. The Company is, from time to time, subject to various legal proceedings and claims, either asserted or unasserted. Any such claims, whether with or without merit, could be time-consuming and expensive to defend and could divert management’s attention and resources. While management believes the Company has reasonable and prudent insurance coverage and accrues loss contingencies for all known matters that are probable and can be reasonably estimated, the Company cannot assure that the outcome of all current or future litigation will not have a material adverse effect on the Company and/or its results of operations.

RISKS RELATING TO PUGET ENERGY'S CORPORATE STRUCTURE

Puget Energy's ability to pay dividends may be limited. As a holding company with no significant operations of its own, the primary source of funds for the repayment of debt and other expenses, as well as payment of dividends to its shareholder, is cash dividends PSE pays to Puget Energy. PSE is a separate and distinct legal entity and has no obligation to pay any amounts to Puget Energy, whether by dividends, loans or other payments. The ability of PSE to pay dividends or make distributions to Puget Energy, and accordingly, Puget Energy’s ability to pay dividends or repay debt or other expenses, will depend on PSE’s earnings, capital requirements and general financial condition. If Puget Energy does not receive adequate distributions from PSE, it may not be able to meet its obligations or pay dividends. The payment of dividends by PSE to Puget Energy is restricted by provisions of certain covenants applicable to long-term debt contained in PSE’s electric and natural gas mortgage indentures. In addition, beginning February 6, 2009, pursuant to the terms of the Washington Commission merger order, PSE may not declare or pay dividends if PSE’s common equity ratio calculated on a regulatory basis is 44.0% or below, except to the extent a lower equity ratio is ordered by the Washington Commission. Also, pursuant to the merger order, PSE's ability to declare or make any distribution is limited by its' corporate credit/issuer rating and EBITDA to interest ratio, as previously discussed above. The common equity ratio, calculated on a regulatory basis, was 48.0% at December 31, 2017 and the EBITDA to interest expense was 5.5 to 1.0 for the twelve-months ended December 31, 2017.
PSE’s ability to pay dividends is also limited by the terms of its credit facilities, pursuant to which PSE is not permitted to pay dividends during any Event of Default (as defined in the facilities), or if the payment of dividends would result in an Event of Default, such as failure to comply with certain financial covenants.

Challenges relating to the construction or future operation of the Tacoma LNG facility could adversely affect the Company’s operations. PSE and Puget Energy’s subsidiary, Puget LNG, currently are constructing the Tacoma LNG facility at the Port of Tacoma, a jointly owned facility intended to provide peak-shaving services to PSE’s natural gas customers, and to provide LNG as fuel primarily to the maritime market. Puget LNG has entered into one fuel supply agreement with a maritime customer, and is marketing the facility’s expected output to other potential customers. Scheduled to be completed in 2019, delays in the facility’s construction and operation or in its ability to timely deliver fuel to customers could expose Puget LNG to damages under one or more fuel supply contracts, which could unfavorably impact Puget Energy’s return on investment.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The principal electric generating plants and underground natural gas storage facilities owned by PSE are described under Item 1, Business – Electric Supply and Natural Gas Supply. PSE owns its transmission and distribution facilities and various other properties. Substantially all properties of PSE are subject to the liens of PSE’s mortgage indentures. The Company’s corporate headquarters is housed in a leased building located in Bellevue, Washington.

ITEM 3. LEGAL PROCEEDINGS

For information on litigation or legislative rulemaking proceedings, see Item 1, "Business, Recent and Future Environmental Law and Regulation" and Note 14, "Litigation" to the consolidated financial statements included in Item 8 of this report.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

All of the outstanding shares of Puget Energy's common stock, the only class of common equity of Puget Energy, are held by its direct parent Puget Equico LLC (Puget Equico), which is an indirect wholly-owned subsidiary of Puget Holdings, and are not publicly traded. The outstanding shares of PSE's common stock, the only class of common equity of PSE, are held by Puget Energy and are not publicly traded.
The payment of dividends on PSE common stock to Puget Energy is restricted by provisions of certain covenants applicable to long-term debt contained in PSE's mortgage indentures in addition to terms of the Washington Commission merger order. Puget Energy's ability to pay dividends is also limited by the merger order issued by the Washington Commission as well as by the terms of its credit facilities. For further discussion, see Item 1A, "Risk Factors"- Risks Relating to Puget Energy's Corporate Structure and Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in this report.
From time to time, when deemed advisable and permitted, PSE and Puget Energy pay dividends on its common stock. During 2017, 2016 and 2015, PSE paid dividends to its parent, Puget Energy, and Puget Energy paid dividends to its parent, Puget Equico, in the amounts shown in Puget Energy's and PSE's Consolidated Statements of Common Shareholder's Equity, included in this Form 10-K.

ITEM 6. SELECTED FINANCIAL DATA

The following tables show selected financial data. This information should be read in conjunction with the audited consolidated financial statements and the related notes found in Item 8, "Financial Statements and Supplementary Data" along with the information included in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operation" of this Form 10-K.

Puget Energy

Summary of Operations	Year Ended December 31,				
(Dollars in Thousands)	2017	2016	2015	2014	2013
Operating revenue	$3,460,276	$3,164,301	$3,092,700	$3,113,171	$3,187,297
Operating income	760,497	785,384	671,925	577,851	755,160
Net income	175,194	312,899	241,179	171,835	285,728
Total assets at year-end	$13,690,789	$13,266,380	$12,814,254	$12,637,946	$12,781,672
Long-term debt	5,207,929	5,104,073	5,077,518	4,957,951	4,943,577
Junior subordinated notes	250,000	250,000	250,000	250,000	250,000
Capital lease obligations	1,129	645	378	9,473	17,051

Puget Sound Energy

Summary of Operations	Year Ended December 31,				
(Dollars in Thousands)	2017	2016	2015	2014	2013
Operating revenue	$3,460,276	$3,164,618	$3,093,258	$3,116,123	$3,187,335
Operating income	748,609	774,993	656,138	568,693	735,574
Net income	320,054	380,581	304,189	236,614	356,129
Total assets at year-end	$11,731,706	$11,297,080	$10,799,513	$10,552,727	$10,636,634
Long-term debt	3,499,911	3,497,298	3,494,362	3,484,571	3,482,062
Junior subordinated notes	250,000	250,000	250,000	250,000	250,000
Capital lease obligations	1,129	645	378	9,473	17,051

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis should be read in conjunction with the financial statements and related notes thereto included elsewhere in this report on Form 10-K. The discussion contains forward-looking statements that involve risks and uncertainties, such as Puget Energy, Inc. (Puget Energy) and Puget Sound Energy, Inc. (PSE) objectives, expectations and intentions. Words or phrases such as "anticipates," "believes," "continues," "could," "estimates," "expects," "future," "intends," "may," "might," "plans," "potential," "predicts," "projects," "should," "will likely result," "will similar expressions are intended to identify certain of these forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this report. Puget Energy's and PSE's actual results could differ materially from results that may be anticipated by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in the section entitled "Forward-Looking Statements" and "Risk Factors" included elsewhere in this report. Except as required by law, neither Puget Energy nor PSE undertakes an obligation to revise any forward-looking statements in order to reflect events or circumstances that may subsequently arise. Readers are urged to carefully review and consider the various disclosures made in this report and in Puget Energy's and PSE's other reports filed with the United States Securities and Exchange Commission (SEC) that attempt to advise interested parties of the risks and factors that may affect Puget Energy's and PSE's business, prospects and results of operations.

Overview

Puget Energy is an energy services holding company and substantially all of its operations are conducted through its subsidiary PSE, a regulated electric and natural gas utility company. PSE is the largest electric and natural gas utility in the state of Washington, primarily engaged in the business of electric transmission, distribution and generation and natural gas distribution. Puget Energy's business strategy is to generate stable cash flows by offering reliable electric and natural gas service in a cost-effective manner through PSE. Puget Energy also has a wholly-owned non-regulated subsidiary, Puget LNG, LLC (Puget LNG). Puget LNG was formed on November 29, 2016, and has the sole purpose of owning, developing and financing the non-regulated activity of the Tacoma LNG facility, currently under construction. All of Puget Energy's common stock is indirectly owned by Puget Holdings, LLC (Puget Holdings). Puget Holdings is owned by a consortium of long-term infrastructure investors including Macquarie Infrastructure Partners, Macquarie Capital Group Limited, the Canada Pension Plan Investment Board, the British Columbia Investment Management Corporation, and the Alberta Investment Management Corporation. Puget Energy and PSE are collectively referred to herein as "the Company."
PSE generates revenue and cash flow primarily from the sale of electric and natural gas services to residential and commercial customers within a service territory covering approximately 6,000 square miles, principally in the Puget Sound region of the state of Washington. PSE continually balances its load requirements, generation resources, purchase power agreements, and market purchases to meet customer demand. The Company's external financing requirements principally reflect the cash needs of its construction program, its schedule of maturing debt and certain operational needs. PSE requires access to bank and capital markets to meet its financing needs.
Factors affecting PSE's performance are set forth in this "Overview" section, as well as in other sections of the Management's Discussion and Analysis.

Non-GAAP Financial Measures
The following discussion includes financial information prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP), as well as return on equity (ROE) excluding unrealized gains and losses on derivative instruments (net income plus unrealized losses and/or minus unrealized gains on derivative instruments divided by average common equity) that is considered a "non-GAAP financial measure." Generally, a non-GAAP financial

measure is a numerical measure of a company’s financial performance, financial position or cash flows that includes adjustments that result in a departure from GAAP presentation. The Company believes that return on average of monthly averages (AMA) equity, also a non-GAAP measure, is a more suitable metric for comparing ROE across years and is a more accurate metric for assessing and evaluating ROE performance against the Company's authorized regulated ROE. The AMA equity is not intended to represent the regulated equity. PSE's ROE may not be comparable to other companies' ROE measures. Furthermore, this measure is not intended to replace ROE (GAAP net income divided by GAAP average common equity) as an indicator of operating performance.

The following table presents PSE's ROE, its return on AMA equity and its authorized regulated ROE for 2017 and 2016:

(Dollars in Thousands)	2017 Earnings	2017 Average Common Equity	2017 Return on Equity	2016 Earnings	2016 Average Common Equity	2016 Return on Equity
Return on equity	$320,054	$3,545,686	9.0%	$380,581	$3,426,620	11.1%
Less/Plus: Unrealized gains and losses on derivative instruments, after-tax	20,014	—	*	(54,467)	—	*
Less/Plus: Equity adjustments[1]	—	169,298	*	—	177,196	*
Plus: Impact of average of monthly average (AMA)	—	78,793	*	—	57,212	*
Return on AMA equity	$340,068	$3,793,777	9.0%	$326,114	$3,661,028	8.9%
Authorized regulated return on equity[2]			9.8%			9.8%

1 Equity adjustments are related to removing the impacts of accumulated other comprehensive income (AOCI), subsidiary retained earnings, retained earnings of derivative instruments, and decoupling 24-month revenue reserve.

2 The authorized regulated return on equity rate changed to 9.5% effective December 19, 2017, per the approved GRC.

* Not meaningful and/or applicable.

The Company's 2017 return on AMA equity was 9.0%, which is lower than the authorized regulated ROE primarily due to the following:

- Regulated equity (rate base time's equity percent) was $478.0 million lower than AMA equity for the year ended December 31, 2017. The variance was primarily driven by the impact on rate base of the deferred tax liability for utility, plant and equipment. The impact on ROE for this variance was negative 1.2%.
- Rates are based on an assumption of normal weather. The amount of variance due to weather was $13.2 million, which resulted in an impact on ROE of positive 0.3%.
- Depreciation expense was $24.8 million higher than the amount allowed in rates for the year ended December 31, 2017 for an impact on ROE of negative 0.7%.
- Partially offsetting the above was net revenue from below the line activities and interest savings which totaled $28.2 million for an impact on ROE of positive 0.7%.

The Company's 2016 return on AMA equity was 8.9%, which is lower than the authorized regulated ROE primarily due to the following:

- Regulated equity (rate base time's equity percent) was $360.0 million lower than AMA equity for the year ended December 31, 2016. The variance was primarily driven by the impact on rate base of the deferred tax liability for utility, plant and equipment. The impact on ROE for this variance was negative 1.0%.
- Depreciation expense was $10.5 million higher than the amount allowed in rates for the year ended December 31, 2016.
- Partially offsetting the above was net revenue from below the line activities which totaled $4.3 million.

Factors and Trends Affecting PSE's Performance

PSE's ongoing regulatory requirements and operational needs necessitated the investment of substantial capital in 2017 and will continue to do so in future years. Because PSE intends to seek recovery of such investments through the regulatory process, its financial results depend heavily upon favorable outcomes from that process. The principal business, economic and other factors that affect PSE's operations and financial performance include:

- The rates PSE is allowed to charge for its services;
- PSE's ability to recover power costs that are included in rates, which are based on volume;
- Weather conditions, including the impact of temperature on customer load; the impact of extreme weather events on budgeted maintenance costs; meteorological conditions such as snow-pack, stream-flow and wind-speed which affect power generation, supply and price;
- Regulatory decisions allowing PSE to recover purchased power and fuel costs, on a timely basis;
- PSE's ability to supply electricity and natural gas, either through company-owned generation, purchase power contracts or by procuring natural gas or electricity in wholesale markets;
- Equal sharing between PSE and its customers of earnings which exceed PSE's authorized rate of return;
- Availability and access to capital and the cost of capital;
- Regulatory compliance costs, including those related to new and developing federal regulations of electric system reliability, state regulations of natural gas pipelines and federal, state and local environmental laws and regulations;
- Wholesale commodity prices of electricity and natural gas;
- Increasing capital expenditures with additional depreciation and amortization;
- Tax reform, the effect of lower tax rates, and regulatory treatment of excess deferred tax balances on rate base and customer rates;
- General economic conditions in PSE's service territory and its effects on customer growth and use-per-customer; and
- Federal, state, and local taxes.

Regulation of PSE Rates and Recovery of PSE Costs

The rates that PSE is allowed to charge for its services influence its financial condition, results of operations and liquidity. PSE is highly regulated and the rates that it charges its retail customers are approved by the Washington Commission. The Washington Commission has traditionally required these rates be determined based, to a large extent, on historic test year costs plus weather normalized assumptions about hydroelectric conditions and power costs in the relevant rate year. Incremental customer growth and sales typically have not provided sufficient revenue to cover general cost increases over time due to the combined effects of regulatory lag and attrition. In addition, the Washington Commission determines whether the Company's expenses and capital investments are reasonable and prudent for the provision of cost effective, reliable and safe electric and natural gas service. If the Washington Commission determines that an operating expense or capital investment does not meet the reasonable and prudent standards, the costs (including return on any resulting rate base) related to such operating expense or capital investment may be disallowed, partially or entirely, and not recovered in rates.

During 2013, PSE completed an expedited rate filing (ERF), which was a limited scope rate proceeding, and established a decoupling mechanism for natural gas operations and electric transmission, distribution and administrative costs. The ERF proceeding established baseline rates on which the decoupling mechanism will operate during the rate plan period. The ERF also established a property tax tracker mechanism in which any difference between amounts in rates and property tax payments will be deferred and recovered in an annual filing based on the actual cash payments for the year.

The decoupling mechanism allows PSE to recover delivery costs on a per customer basis rather than on a consumption basis. Included in the decoupling petition was a rate plan that allows PSE an opportunity to earn its authorized rate of return without the need for another GRC process during the rate plan period. The rate plan included predetermined annual increases to PSE's allowed electric and natural gas revenue. This plan required PSE to file a GRC no later than April 1, 2016, which was later extended to January 17, 2017. The GRC was filed with the Washington Commission on January 13, 2017.

Washington state law also requires PSE to pursue electric conservation that is cost-effective, reliable and feasible. PSE's mandate to pursue electric conservation initiatives may have a negative impact on the electric business financial performance due to lost margins from lower sales volumes as variable power costs are not part of the decoupling mechanism. Although not specified by Washington state law, the Washington Commission also sets natural gas conservation achievement standards for PSE. The effects of achieving these standards will, however, have only a slight negative impact on natural gas business financial performance due to the natural gas business being almost fully decoupled.

2013 Expedited Rate Filing and Decoupling Decision

In 2013, the Washington Commission issued final orders resolving the amended decoupling petition, the ERF filing and the Petition for Reconsideration (related to the TransAlta Centralia power purchase agreement). Order No. 7 in the ERF/decoupling proceeding approved PSE's ERF filing with a small change to its cost of capital to 7.77% which updated long-term debt costs and a capital structure that included 48.0% common equity with a return on equity (ROE) of 9.8%. This order also approved the property tax tracker discussed below and approved the amended decoupling and rate plan filing with the further condition that PSE will share 50.0% of any earnings in excess of the 7.77% authorized rate of return with customers. In addition, the K-Factor (rate plan) increase allowed decoupling revenue per customer for the recovery of delivery system costs to subsequently increase by 3.0% per year for electric customers and 2.2% per year for natural gas customers on January 1 of each year, until the effective date of new rates in PSE's General Rate Case (GRC). The new rates became effective December 19, 2017, as discussed below. In the decoupling mechanism, increases were subject to a cap of 3.0% of the total revenue for customers.

General Rate Case Filing

On January 13, 2017, PSE filed its GRC with the Washington Commission the settlement agreement was accepted by the Washington Commission on December 5, 2017 and the rates became effective December 19, 2017. For further details regarding the 2017 GRC filing, see Note 3, "Regulation and Rates" to the consolidated financial statements included in Item 8 of this report.

Decoupling Filings

On December 5, 2017, the Washington Commission approved PSE’s request within the 2017 GRC to extend the decoupling mechanism with some changes to the methodology that took effect on December 19, 2017. Electric and natural gas delivery revenues will continue to be recovered on a per customer basis and electric fixed production energy costs will now be decoupled and recovered on a fixed monthly amount basis. The allowed decoupling revenue will no longer increase annually on January 1 for electric and natural gas customers and these amounts can only be changed in a GRC, Power Cost Only Rate Case (PCORC) or ERF filing. Other changes include regrouping of electric and natural gas non-residential customers and the exclusion of certain electric schedules from the decoupling mechanism going forward. The rate cap which limits the amount of revenues PSE can collect in its annual filings increased from 3.0% to 5.0% for natural gas customers but will remain at 3.0% for electric customers. The decoupling mechanism will end on the effective date of PSE's first GRC filed in or after 2021, or in a separate proceeding if appropriate unless the continuation of the mechanism is approved in either of those proceedings. PSE’s decoupling mechanism over and under collections will still be collectible or refundable after this effective date even if the decoupling mechanism is not extended.

The Washington Commission approved the following PSE requests to change rates under its electric and natural gas decoupling mechanisms:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)[1]
Electric:		
May 1, 2017	2.0%	$41.9
May 1, 2016	1.0	20.8
May 1, 2015	2.6	53.8
Natural Gas:		
May 1, 2017	2.4%	$22.4
May 1, 2016	2.8	25.4
May 1, 2015	2.1	22.0

[1] The increase in revenue is net of reductions from excess earnings of $11.9 million for electric and $2.2 million for natural gas effective May1, 2017, and $11.9 million for electric and $5.5 million for natural gas effective May 1,

2016.

As noted earlier, at the time of the filings below, the Company was also limited to a 3.0% annual decoupling related cap on increases in total revenue. This limitation has been triggered as follows:

Effective Date Accrued Through	Deferrals not Included in Annual Rate Increases (Dollars in Millions)
Natural Gas:	
2016	$47.4
2015	28.7

Existing deferrals may be included in customer rates beginning in May 2018, subject to subsequent application of the earnings test and the cap on decoupling related rate increases for natural gas customers, which was changed from 3.0% to 5.0% as a result of the Washington Commission order in PSE's GRC.

Electric Rates

Power Cost Adjustment Mechanism

PSE currently has a PCA mechanism that provides for the deferral of power costs that vary from the “power cost baseline” level of power costs. The “power cost baseline” levels are set, in part, based on normalized assumptions about weather and hydrological conditions. Excess power costs or savings are apportioned between PSE and its customers pursuant to the graduated scale set forth in the PCA mechanism and will trigger a surcharge or refund when the cumulative deferral trigger is reached.

The graduated scale that was applicable through December 31, 2016 was as follows:

Annual Power Cost Variability	Company’s Share	Customers' Share
+/- $20 million	100 %	— %
+/- $20 million - $40 million	50	50
+/- $40 million - $120 million	10	90
+/- $120 + million	5	95

On August 7, 2015, the Washington Commission issued an order approving the changes to the PCA mechanism. The settlement agreement took effect January 1, 2017 and will apply the following graduated scale:

	Company's Share		Customers’ Share	
Annual Power Cost Variability	Over	Under	Over	Under
Over or Under Collected by up to $17 million	100%	100%	—%	— %
Over or Under Collected by between $17 million - $40 million	35	50	65	50
Over or Under Collected beyond $40 + million	10	10	90	90

The PCA settlement also resulted in the following changes to the PCA mechanism:

- Reduction to the cumulative deferral trigger for surcharge or refund from $30.0 million to $20.0 million;
- Removal of fixed production costs from the PCA mechanism and placing them in the decoupling mechanism. Inclusion of these costs in the decoupling mechanism was subsequently approved in the GRC. These fixed production costs include: (i) return and depreciation/amortization on fixed production assets and regulatory assets and liabilities; (ii) return, depreciation, transmission expense and revenues on specific transmission assets; and (iii) hydroelectric, other production and other power related expenses and O&M costs;
- Suspension of the requirement that a GRC must be filed within three months after rates are approved in a PCORC;
- Agreement, for a five-year period, that PSE will not file a GRC or PCORC within six months of the date rates go into effect for a PCORC filing; and
- Establishment of a five-year moratorium on changes to the PCA.

On September 30, 2016, PSE filed an accounting petition with the Washington Commission, which requested deferral of the variances, either positive or negative, between the fixed costs previously recovered in the PCA and the revenue received to cover the allowed fixed costs. The deferral period requested was January 1, 2017 through December 31, 2017, when rates went into effect from PSE's 2017 GRC. On November 10, 2016, the Washington Commission issued Order No. 01 approving PSE's accounting petition. With the final determination in PSE's GRC, this deferral ceased with the rate effective date of December 19, 2017.

For the year ended December 31, 2017, in its PCA mechanism, PSE under recovered its power costs by $11.5 million of which no amount was apportioned to customers. This compares to an under recovery of power costs of $1.0 million for the year ended December 31, 2016 of which no amounts were apportioned to customers. Although load increased in 2017 compared to 2016, that increase was offset by a decrease in the total baseline rate and an increase in costs. Additionally, the year over year variance was due to the 2017 mechanism changes where fixed production costs, other costs and adjustments are no longer included. The mechanism is now comparing variable PCA costs using the variable costs portion of the baseline rate. The fixed costs became part of the decoupling mechanism, effective December 19, 2017 as a result of the GRC but until then the revenue variance associated with the fixed production costs are being deferred using the fixed cost portion of the baseline rate. The revenue variance associated with the fixed production costs was deferred using the fixed cost portion of the baseline rate until December 19, 2017, when the fixed costs became part of the decoupling mechanism with the resolution of PSE's GRC.

Electric Conservation Rider

The following table sets forth conservation rider rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2017	0.7%	$16.5
May 1, 2016	(0.5)	(11.7)
May 1, 2015	0.2	4.2

Federal Incentive Tracker Tariff

The following table sets forth Federal Incentive Tracker Tariff rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates from prior year	Total credit to be passed back to eligible customers (Dollars in Millions)
January 1, 2018	0.2%	$(48.2)
January 1, 2017	0.3	(51.7)
January 1, 2016	(0.2)	(57.3)
January 1, 2015	(0.2)	(55.2)

Power Cost Only Rate Case and Update Compliance Filing

The following table sets forth PCORC and update compliance filing rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
December 1, 2016	(1.7)%	$(37.3)

Residential Exchange Benefit

The residential exchange program passes through the residential exchange program benefits that PSE will be receiving from the Bonneville Power Administration (BPA) between October 1, 2017 and September 30, 2019. Rates change bi-annually on October 1.

The following table sets forth residential exchange benefit adjustments approved by the Washington Commission and the corresponding expected annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Total credit to be passed back to eligible customers (Dollars in Millions)
October 1, 2017	(0.6)%	$(80.8)
October 1, 2015	2.4	(76.4)

Electric Property Tax Tracker Mechanism

The following table sets forth property tax tracker mechanism rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2017	(0.4)%	$(0.9)
May 1, 2016	0.3	5.7
May 1, 2015	0.3	6.5

Natural Gas Rates

Natural Gas Cost Recovery Mechanism

The following table sets forth CRM rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
November 1, 2017	0.5%	$4.9
November 1, 2016	0.6	5.6
November 1, 2015	0.5	5.3

Purchased Gas Adjustment

The following table sets forth PGA rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
November 1, 2017	(3.3)%	$(30.8)
November 1, 2016	(0.4)	(4.1)
November 1, 2015	(17.4)	(185.9)

Natural Gas Property Tax Tracker Mechanism

The following table sets forth property tax tracker mechanism rate adjustments approved by the Washington Commission and the corresponding impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2017	(0.1)%	$(1.1)
May 1, 2016	0.4	3.5
June 1, 2015	(0.2)	(2.3)

Natural Gas Conservation Rider

The following table sets forth conservation rider rate adjustments approved by the Washington Commission and the corresponding annual impact on PSE's revenue based on the effective dates:

Effective Date	Average Percentage Increase (Decrease) in Rates	Increase (Decrease) in Revenue (Dollars in Millions)
May 1, 2017	(0.1)%	$(1.0)
May 1, 2016	0.3	2.9
May 1, 2015	0.2	2.3

Other Proceedings

Large Customer Retail Wheeling

On October 7, 2016, PSE filed a tariff to provide open access service to a narrow set of qualifying customers. Subsequent to that tariff filing, parties to the case reached an all-party settlement that converted the tariff to a special contract only allowing retail access for the loads of the Microsoft Corporation currently being served under PSE's electric Schedule 40. The special contract includes the following conditions: (i) Microsoft exceed Washington State's current renewable portfolio standards, (ii) the remainder of power sold to it be carbon free, (iii) there be no reduction in its funding of PSE's conservation programs, (iv) an exit fee be paid that will be a straight pass-through to customers and (v) Microsoft fund enhanced low-income support. A definitive agreement among the parties, the special contract and supportive testimony were filed with the Washington Commission on April 11, 2017 with hearings that occurred on May 3, 2017. The Washington Commission issued an order on July 13, 2017 approving PSE's special contract with Microsoft. Microsoft cannot begin taking service under the special contract until it has the required metering installed, has contracts for the supply and transmission of its power supply and pays the exit fee. PSE currently anticipates these conditions will be met in early 2019.

Voluntary Long-Term Renewable Energy
On September 28, 2016, the Washington Commission approved PSE's tariff revision to create an additional voluntary renewable energy product, effective September 30, 2016. This provides customers with energy choices to help them meet their sustainability goals. Incremental costs of the program will be allocated to the voluntary participants of the program as is the case with PSE’s existing Green Power programs. PSE initially offered this service, Green Direct, to larger customers (aggregated annual loads greater than 10,000,000 kWh) and government customers. Approximately 136.8 MW of new wind generation facilities will be constructed in the region by a developer under contract to PSE to meet the demand for this voluntary renewable energy product project. PSE anticipates that customers will start receiving energy through this program in 2019.

For additional information, see Business, "Regulation and Rates" included in Item 1 of this report.

Access to Debt Capital
PSE relies on access to bank borrowings and short-term money markets as sources of liquidity and longer-term capital markets to fund its utility construction program, to meet maturing debt obligations and other capital expenditure requirements not satisfied by cash flow from its operations or equity investment from its parent, Puget Energy. Neither Puget Energy nor PSE have any debt outstanding whose maturity would accelerate upon a credit rating downgrade. However, a ratings downgrade could adversely affect the Company's ability to renew existing, or obtain access to new credit facilities and could increase the cost of such facilities. For example, under Puget Energy's and PSE's credit facilities, the borrowing costs increase as their respective credit ratings decline due to increases in credit spreads and commitment fees. If PSE is unable to access debt capital on reasonable terms, its ability to pursue improvements or acquisitions, including generating capacity, which may be relied on for future growth and to otherwise implement its strategy, could be adversely affected. PSE monitors the credit environment and expects to continue to be able to access the capital markets to meet its short-term and long-term borrowing needs. In October 2017, PSE and Puget Energy each entered into new 5-year credit facilities that replaced the previous facilities and are scheduled to mature in October 2022. For additional information on credit facilities, see Note 7, “Liquidity Facilities and Other Financing Arrangements" included in Item 8 of this report.

Regulatory Compliance Costs and Expenditures
PSE's operations are subject to extensive federal, state and local laws and regulations. These regulations cover electric system reliability, natural gas pipeline system safety and energy market transparency, among other areas. Environmental laws and regulations related to air and water quality, including climate change and endangered species protection, waste handling and disposal (including generation by-products such as coal ash), remediation of contamination and siting new facilities also impact the Company's operations. PSE must spend a significant amount of resources to fulfill requirements set by regulatory agencies, many of which have greatly expanded mandates on measures including resource planning, remediation, monitoring, pollution control equipment and emissions-related abatement and fees.
Compliance with these or other future regulations, such as those pertaining to climate change, could require significant capital expenditures by PSE and may adversely affect PSE's financial position, results of operations, cash flows and liquidity.

Other Challenges and Strategies
Competition
PSE’s electric and natural gas utility retail customers generally do not have the ability to choose their electric or natural gas supplier; and therefore, PSE’s business has historically been recognized as a natural monopoly. However, PSE faces competition from public utility districts and municipalities that want to establish their own municipal-owned utility, as a result of which PSE may lose a number of customers. Further, PSE faces increasing competition for sales to its retail customers. Alternative methods of electric energy generation, including solar and other self-generation methods, compete with PSE for sales to existing electric retail customers. In addition, PSE’s natural gas customers

may elect to use heating oil, propane or other fuels instead of using and purchasing natural gas from PSE.

Results of Operations
Puget Sound Energy
The following discussion should be read in conjunction with the audited consolidated financial statements and the related notes included elsewhere in this document. The following discussion provides the significant items that impacted PSE's results of operations for the years ended December 31, 2017, 2016 and 2015.

Non-GAAP Financial Measures – Electric and Natural Gas Margins
The following discussion includes financial information prepared in accordance with GAAP, as well as two other financial measures, electric margin and natural gas margin, that are considered "non-GAAP financial measures." Generally, a non-GAAP financial measure is a numerical measure of a company's financial performance, financial position or cash flows that includes adjustments that result in a departure from GAAP presentation. The presentation of electric margin and natural gas margin is intended to supplement an understanding of PSE's operating performance. Electric margin and natural gas margin are used by PSE to determine whether PSE is collecting the appropriate amount of revenue from its customers to maintain electric and natural gas margins to ultimately provide adequate recovery of operating costs, including interest and equity returns. PSE's electric margin and natural gas margin measures may not be comparable to other companies' electric margin and natural gas margin measures. Furthermore, these measures are not intended to replace operating income as determined in accordance with GAAP as an indicator of operating performance.

Electric Margin
Electric margin represents electric sales to retail and transportation customers less the cost of generating and purchasing electric energy sold to customers, including transmission costs to bring electric energy to PSE's service territory.

The following chart displays the changes in PSE's electric margin from 2016 to 2017:

* Includes decoupling cash collections, rate of return excess earnings, and decoupling 24-month revenue reserve.

2016 compared to 2017

Electric Operating Revenue

Electric operating revenues increased $182.2 million primarily due to higher retail sales of $112.5 million, increased transportation and other revenue of $92.5 million, partially offset by decreased decoupling revenue of $20.0 million and other decoupling revenue of $6.5 million. These items are discussed in detail below:

- Electric retail sales increased $112.5 million due an increase of $100.0 million from additional retail electricity usage of 4.2% compared to the prior year and an increase in rates of $12.5 million due to the decoupling rate mechanism. The additional usage was due to an increase of residential and commercial use per customer of 6.7% and 2.2%, respectively, an increase in heating degree days of 19.9% compared to 2016, and an increase in retail customers of 1.4%.

- Decoupling revenue decreased $20.0 million due to a decrease in decoupling deferrals of $23.5 million driven by actual revenue being closer to PSE's allowed revenue per the decoupling mechanism compared to 2016. The increase in actual revenue was due to an increase in load as discussed above in electric retail sales. This was partially offset by an increase in decoupling revenue of $3.5 million due to fixed production cost deferrals, which were removed from the PCA mechanism and placed into the decoupling mechanism effective January 1, 2017.
- Other decoupling revenue decreased $6.5 million due to an increase in decoupling collections of $9.5 million due to an increase in rates in 2017. In 2016, there was $1.3 million of decoupling deferred revenue that could not be collected within 24 months compared to no reserve in the current year. The decoupling collection and refund of rate of return (ROR) excess earnings are driven by the tariff rates and retail sales.
- Transportation and other revenue increased $92.5 million primarily due to a change in production tax credit (PTC) deferral revenue of $73.2 million due to a $19.9 million reduction to revenue in 2016 as PTCs were generated compared to no PTC generated in 2017, as well as, a $51.2 million remeasurement of the PTC deferral in 2017 due to tax law change. Additionally, there was an increase in net wholesale natural gas sales of $17.5 million due to increased purchased electricity, as discussed below.

Electric Power Costs

Electric power costs increased $43.2 million primarily due to an increase of $58.4 million of purchased electricity costs, partially offset by a decrease of $9.1 million of electric generation fuel expense and an increase of $6.1 million of residential exchange credits. These items are discussed in detail below:

- Purchased electricity expense increased $58.4 million primarily due to an 11.2% increase in wholesale electricity purchases, partially offset by a 0.2% decrease in prices. The increase in purchases was primarily driven by an increase in load and lower wholesale electricity prices on the open market compared to generating power. Additionally, a decrease of hydro and wind production of 7.4% and 14.7%, increased the need to purchase additional wholesale power.
- Electric generation fuel expense decreased $9.1 million primarily due to a $2.7 million reduction in combustion turbine generation costs as a result of a 7.9% reduction in combustion turbine generation due to favorable wholesale electricity prices and a $6.3 million decrease in coal generation costs primarily at Colstrip units 3 and 4 for variable fuel costs due to less coal delivered and burned in 2017.
- Residential exchange credits increased $6.1 million resulting from higher Residential Exchange Program (REP) credits associated with the BPA REP settlement due to the REP credit tariff increase in 2017 and increased usage. The REP credit is a pass-through tariff item with a corresponding credit in electric operating revenue, with no impact on net income. The Northwest Power Act, through the REP, provides access to the benefits of low-cost federal power for residential and small farm customers of regional utilities, including PSE. The program is administered by BPA. Pursuant to agreements (including settlement agreements) between BPA and PSE, BPA has provided payments of REP benefits to PSE, which PSE has passed through to its residential and small farm customers in the form of electricity bill credits.

The following chart displays the changes in PSE's electric margin from 2015 to 2016:

* Includes decoupling cash collections, rate of return excess earnings, and decoupling 24-month revenue reserve.

2015 compared to 2016
Electric Operating Revenue
Electric operating revenues increased $110.0 million primarily due to higher retail sales of $81.1 million, increased decoupling revenue of $16.3 million and transportation and other revenue of $13.6 million. These items are discussed in detail below:

- Electric retail sales increased $81.1 million due to increases in rates of $86.4 million primarily from the reduction of the residential exchange credits and an increase in the decoupling rate mechanism. The increase from rates was partially offset by $5.6 million due to a 0.3% reduction in retail electricity usage. The reduction in usage was due to a decrease of residential, commercial and industrial average use per customer of 0.6%, 2.7% and 2.5%, respectively, as a result of energy efficiency. The reduction in use per customer were offset by an increase in retail customers of 1.5% and an increase in heating degree days of 0.6% compared to 2015.

- Decoupling revenue increased $16.3 million due to actual revenues were lower than PSE's allowed revenue per the decoupling mechanism compared to 2015. This increase was primarily from residential and commercial decoupled rate schedules, which increased $15.6 million in 2016. The increase was driven from an increase in customers which increases the allowed revenue and a decrease in use per customer, which lowers the actual revenue resulting in higher decoupled revenue.
- Other decoupling revenue decreased $4.5 million due to an increase of $16.8 million of decoupling collections as compared to 2015 from an increase in rates in 2016; partially offset by a decrease in the ROR excess earnings sharing of $13.5 million from a reduction in the ROR excess earnings accrual of $6.5 million compared to 2015 and an increase of $7.0 million in refunds to customers for the 2015 ROR excess earnings set into customer rates in 2016. The decoupling collection and refund of ROR excess earnings are driven by the tariff rates and retail sales.
- Transportation and other revenue increased $13.6 million primarily due to a reduction of amortization of PTC deferral credits of $10.1 million since PTC generation at Hopkins Ridge ended in 2015 and increase in net wholesale natural gas sales of $6.8 million.

Electric Power Costs

Electric power costs increased $40.1 million primarily due to a decrease of $42.6 million of residential exchange credit, an increase of $32.1 million of purchased electricity costs, partially offset by a decrease of $34.6 million of electric generation fuel expense. These items are discussed in detail below:

- Purchased electricity expense increased $32.1 million primarily due to a 16.1% increase in wholesale electricity purchases, partially offset by a 8.3% decrease in wholesale electricity prices. The increase in purchases was primarily driven by an increase in load and lower wholesale electricity prices on the open market compared to generating power. Additionally, an increase of hydro and wind production of 32.2% and 14.4% decreased the need to purchase additional wholesale power due to favorable conditions.
- Electric generation fuel expense decreased $34.6 million primarily due to a $43.0 million reduction in combustion turbine costs as a result of a 28.8% reduction in combustion turbine generation due to favorable wholesale electricity prices and increased wind and hydro generation. This was partially offset by an $8.4 million increase in coal generation costs primarily due to an increase in the weighted-average cost of coal.
- Residential exchange credits decreased $42.6 million resulting from lower Residential Exchange Program (REP) credits associated with the BPA REP settlement. The REP credit tariff was lowered effective October 1, 2015. The REP credit is a pass-through tariff item with a corresponding credit in electric operating revenue, with no impact on net income. The Northwest Power Act, through the REP, provides access to the benefits of low-cost federal power for residential and small farm customers of regional utilities, including PSE. The program is administered by BPA. Pursuant to agreements (including settlement agreements) between BPA and PSE, BPA has provided payments of REP benefits to PSE, which PSE has passed through to its residential and small farm customers in the form of electricity bill credits.

Natural Gas Margin
Natural gas margin is natural gas sales to retail and transportation customers less the cost of natural gas purchased, including transportation costs to bring natural gas to PSE’s service territory. The PGA mechanism passes through to customers increases or decreases in the natural 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 natural gas pipeline transportation costs. PSE's margin or net income is not affected by changes under the PGA mechanism because over and under recoveries of natural gas costs included in baseline PGA rates are deferred and either refunded or collected from customers, respectively, in future periods.
The following chart displays the changes in PSE’s natural gas margin from 2016 to 2017:

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* Includes decoupling cash collections, rate of return excess earnings, and decoupling 24-month revenue reserve.

2016 compared to 2017
Natural Gas Operating Revenue
Natural gas operating revenue increased $107.3 million primarily due to higher retail sales of $148.1 million and increased other decoupling revenue of $5.9 million; partially offset by a decrease in decoupling revenue of $48.6 million. These items are discussed in the following details:

- Natural gas retail sales increased $148.1 million due to an increase of $155.1 million in natural gas sales, which is a result of an increase in natural gas load of 18.0% from 2016, partially offset by a decrease in revenue per therm of $6.9 million. The decrease in revenue per therm was primarily due to a rate decrease on customer bills for PGA, which decreased rates 0.4% effective November 1, 2016 and increase in decoupling rates of 2.4% effective May 1, 2017, see Management's Discussion and Analysis, "Regulation and Rates" included in Item 7 of this report for natural gas rate changes. Natural gas load increased primarily due to the increase in average therms used per residential and commercial customers of 17.4% and 18.9%, respectively, compared to 2016 as a result of a 19.9% increase in heating degree days and an increase of 1.5% in natural gas customers, which increased the natural gas heating load compared to prior year.

- Decoupling revenue decreased $48.6 million primarily due to an increase in use per customer, driven by an increase in heating degree days as discussed above in natural gas retail sales. This caused actual revenue to increase closer to PSE's allowed revenue, which lowered decoupled revenue in 2017.
- Other decoupling revenue increased $5.9 million due to the following: (i) an increase in decoupling collections of $14.7 million from an increase in the amortization rate in 2017 and an increase in therms used; (ii) in 2017, there was $19.6 million of deferred decoupling revenue that was recognized as it met the alternative revenue program revenue recognition criteria that it is expected to be collected from customers within 24 months, compared to the 24-month reserve of $9.6 million in 2016; and (iii) an increase in net overearnings accruals and cash refunds of $8.6 million.

Natural Gas Energy Costs

Purchased natural gas expense increased $46.1 million due to an increase in natural gas costs included in PGA rates effective November 1, 2016 as compared to those effective November 1, 2015, and an increase in natural gas usage of 18.0%.

The following chart displays the changes in PSE’s natural gas margin from 2015 to 2016:

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* Includes decoupling cash collections, rate of return excess earnings, and decoupling 24-month revenue reserve.

2015 compared to 2016

Natural gas operating revenue decreased $57.0 million primarily due to lower natural gas retail sales revenue of $53.7 million and a decrease in other decoupling revenue of $2.7 million, see discussion below.

- Natural gas retail sales revenue decreased $53.7 million due to a decrease in revenue per therm of $90.6 million, partially offset by an increase of $41.0 million in natural gas sales, due to an increase in natural gas load of 4.6% from 2015. The decrease in revenue per therm was primarily due to a rate decrease on customer bills for PGA, which decreased rates 17.4% effective November 1, 2015 partially offset by an increase in decoupling rates of 2.8% effective May 1, 2016, see Management's Discussion and Analysis, "Regulation and Rates" included in Item 7 of this report for natural gas rate changes. Natural gas load increased primarily due to the increase in average therms used per residential and commercial customers of 4.0% and 0.7%, respectively, compared to 2015. In addition, natural gas customers increased by 1.6% and heating degree days increased by 0.6%, which increased the natural gas heating load compared to prior year.
- Other decoupling revenue decreased $2.7 million due to an increase in decoupling deferral collection of $17.9 million, as a result of an additional $17.3 million being set in rates on May 1, 2016, which was partially offset by a decrease in ROR excess earnings sharing accrual of $12.5 million and an increase in ROR excess earnings refund in 2016 of $2.5 million. The decoupling collection and refund of ROR excess earnings are driven by the tariff rates and customer usage.

Natural Gas Energy Costs

Purchased natural gas expense decreased $89.4 million primarily due to lower natural gas costs included in PGA rates effective November 1, 2015, which was partially offset by an increase in natural gas usage of 4.6%.

Other Operating Expenses and Other Income (Deductions)

The following chart displays the details of PSE's other operating expenses and other income (deductions) from period 2016 to 2017:

2016 compared to 2017

Other Operating Expenses

- Net unrealized (gain) loss on derivative instruments expense increased $114.6 million to a net loss of $30.8 million for the year ended December 31, 2017. The primary drivers for the increase consist of a reduction of $20.6 million in gains from contract settlements previously recorded as losses that settled to purchased electricity or electric generation fuel and a $94.0 million loss due to a decrease in natural gas and electricity forward prices of 26.9% and 27.5%, respectively. The $20.6 million reduction from contract settlements was comprised of a $16.5 million from natural gas and a $4.1 million from wholesale electric contracts. The decrease in the weighted average natural gas and wholesale electric forward prices resulted in a $78.4 million loss and a $15.6 million loss, respectively.
- Utility operations and maintenance expense increased $15.8 million primarily driven by increases in the following: $6.7 million for electric and natural gas operations primarily due to increased electric operations third-party service provider costs of $3.2 million and gas distribution system integrity costs of $2.0 million $5.5 million increase in outside services expense for customer service optimization initiatives that began in 2016, and a $4.6 million increase in overall labor expense. These increases were partially offset by $1.6 million reduction of uncollectible account costs compared to 2016.
- Non-utility and other expense increased $14.5 million primarily due to an increase in the long-term incentive plan of $12.3 million in 2017 which resulted from a total return in 2017 of 29.1% which resulted in the total return component to be funded at 200.0%. For more information see Part III, "Executive Compensation" included in Item 11 of this report for the Company's long term incentive plan.
- Depreciation and amortization expense increased $55.8 million primarily due to the following: (i) electric depreciation expense of $12.1 million, primarily due to asset net additions to distribution, transmission, and general plant of $186.4 million, $92.0 million and $83.1 million respectively; (ii) natural gas depreciation expense of $6.1 million increased due primarily to net additions to distribution assets of $192.3 million; (iii) $15.5 million of amortization expense due to

computer software net additions of $123.7 million; (iv) amortization of PTC regulatory liability of $2.1 million in 2017; (v) a decrease of Lower Snake River U.S. Treasury interest amortization of $3.2 million; (vi) an increase of ARO accretion expense of $2.8 million due to a change in the Colstrip ARO in 2016; and (vii) conservation amortization increased $13.4 million, $10.3 for electric and $3.2 for natural gas, primarily due to an increase of usage attributed to an increase in heating degree days and customers for both electric and natural gas in 2017 as compared to 2016.

- Taxes other than income taxes increased $32.0 million primarily due to increases in municipal taxes of $11.5 million and state excise taxes of $10.2 million as a result of an increase in revenue and an increase of $9.3 million in property taxes related to increased property values and expected levy rates.

Other Income, Interest Expense and Income Tax Expense

- Income tax expense increased $36.6 million primarily driven by the impact of tax reform on the deferred tax balances and partially offset by a 4.3% decrease in pre-tax income. For additional information, see Note 13, "Income Taxes" to the consolidated financial statements included in Item 8 of this report.

The following chart displays the details of PSE's other operating expenses and other income (deductions) from period 2015 to 2016:

2015 compared to 2016

Other Operating Expenses

- Net unrealized (gain) loss on derivative instruments expense decreased $71.1 million to a net gain of $83.8 million for the year ended December 31, 2016. The primary drivers for the 2016 net gain consist of a $61.7 million gain from contract settlements previously recorded as losses in the 2015 unrealized gain on derivative instruments that settle to purchased electricity and electric generation fuel. The $61.7 million gain from contract settlements was comprised of a $39.7 million gain from natural gas and a $22.0 million gain from wholesale electric contract settlements. Natural gas and wholesale electricity gain increased $22.1 million primarily due to increases in forward market prices of 5.7% and 10.8%, respectively. This compares to a net gain of $12.7 million in 2015, comprised of $83.6 million in settlement gains offset by a $70.9 million loss due to a decrease in natural gas and wholesale electricity prices.

- Utility operations and maintenance expense increased $37.8 million primarily driven by (i) an increase of $26.9 million of maintenance expense primarily related to natural gas leak repairs and sewer cross bore inspections, maintenance on gearboxes and generators at the Hopkins Ridge and Wild Horse wind generation facilities, electric distribution maintenance for overhead lines and vegetation management; (ii) an increase of outside services expense of $7.4 million primarily related to customer service initiatives; (iii) an increase of salary expense of $2.9 million primarily related to incentive increases; partially offset by (iv) a decrease of $4.6 million in meter reading expense due to the purchase of previously leased meter reading equipment during 2015.
- Depreciation and amortization expense increased $15.7 million primarily due to $16.5 million of depreciation expense primarily due to net additions of $173.9 million of natural gas distribution assets, $148.5 million of electric distribution assets and $90.6 million of electric transmission assets.
- Taxes other than income taxes increased $8.1 million primarily due to an increase in electric property taxes of $6.0 million based on assessed value and levy rates, electric state excise and municipal taxes of $5.8 million driven by an increase in electric revenue, partially offset by a decrease of $4.8 million in natural gas state excise and municipal taxes from a decrease in natural gas revenue.

Other Income, Interest Expense and Income Tax Expense

- Interest expense decreased $6.3 million primarily due to a reduction of $3.8 million in interest on long-term debt related to debt that was refinanced in May 2015 at an interest rate of 4.30% compared to interest rates of 5.197% and 6.75%; and an increase of $1.7 million related to allowance for funds used during construction (AFUDC) debt due to an increase in average construction work in progress (CWIP).
- Income tax expense increased $49.4 million primarily driven by $44.0 million from higher pre-tax income and an increase of $6.5 million due to Hopkins Ridge no longer generating PTCs. PTCs are generated for the first ten years at a wind facility. As of December 2015, Hopkins Ridge is no longer eligible to generate PTCs. For additional information, see Note 13, "Income Taxes" to the consolidated financial statements included in Item 8 of this report.

Puget Energy

Substantially all the operations of Puget Energy are conducted through its regulated subsidiary, PSE. Puget Energy's results of operation for the years ended December 31, 2017, 2016 and 2015 were as follows:

2016 compared to 2017

Summary Results of Operations

Puget Energy's net income decreased by $137.7 million, which is primarily attributable to an income tax expense increase of $79.3 million, as well as PSE's net income decrease of $60.5 million. The following are significant factors that impacted Puget Energy's net income which are not included in PSE's discussion:

- Income Tax Expense increased by $79.3 million primarily due to tax reform passed on December 22, 2017 that lowered the corporate tax rate from 35.0% to 21.0%. As a result, income tax expense was effected by the revaluation of Puget Energy's deferred tax assets at the 21.0% rate.

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2015 compared to 2016

Summary Results of Operations

Puget Energy’s net income increased by $71.7 million, which is primarily attributable to PSE's net income increase of $76.4 million. The following are significant factors that impacted Puget Energy’s net income which are not included in PSE’s discussion:

- Non-utility expense and other increased $5.1 million primarily due to legal outside services of $2.8 million and qualified pension expense of $1.2 million.

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Capital Resources and Liquidity

Capital Requirements

Contractual Obligations and Commercial Commitments

The following are PSE’s and Puget Energy’s aggregate contractual obligations as of December 31, 2017:

	Payments Due Per Period				
(Dollars in Thousands)	Total	2018	2019 - 2020	2021 - 2022	Thereafter
Contractual obligations:					
Energy purchase obligations[1]	$5,508,991	$824,417	$1,352,132	$1,184,192	$2,148,250
Long-term debt including interest[2]	7,967,957	402,854	393,521	393,521	6,778,061
Short-term debt including interest	329,463	329,463	—	—	—
Service contract obligations	724,899	76,919	145,371	149,222	353,387
Non-cancelable operating leases[3]	171,813	21,371	36,584	15,884	97,974
PSE capital leases[3]	1,162	527	538	97	—
Pension and other benefits funding and payments	78,187	23,803	10,685	6,305	37,394
Total PSE contractual cash obligations	14,782,472	1,679,354	1,938,831	1,749,221	9,415,066
Long-term debt including interest[2]	2,321,374	201,763	647,043	1,038,008	434,560
Total Puget Energy contractual cash obligations	$17,103,846	$1,881,117	$2,585,874	$2,787,229	$9,849,626

1 Energy purchase contracts were entered into as part of PSE’s obligation to serve retail electric and natural gas customers’ energy requirements. As a result, costs are generally recovered either through base retail rates or adjustments to retail rates as part of the power and natural gas cost adjustment mechanisms.

2 For individual long-term debt maturities, see Note 6, "Long-Term Debt," to the consolidated financial statements included in Item 8 of this report. For Puget Energy, the amount above excludes the fair value adjustments related to the merger.

3 For additional information, see Note 8, "Leases" to the consolidated financial statements included in Item 8 of this report.

The following are PSE’s and Puget Energy’s aggregate availability under commercial commitments as of December 31, 2017:

	Amount of Available Commitments Expiration Per Period				
(Dollars in Thousands)	Total	2018	2019 - 2020	2021 - 2022	Thereafter
Commercial commitments:					
PSE revolving credit facility[1]	$800,000	$ —	$ —	$800,000	$ —
Inter-company short-term debt[2]	30,000	—	—	—	30,000
Total PSE commercial commitments	830,000	—	—	800,000	30,000
Puget Energy revolving credit facility[3]	697,400	—	—	697,400	—
Less: Inter-company short-term debt elimination[2]	(30,000)	—	—	—	(30,000)
Total Puget Energy commercial commitments	$1,497,400	$ —	$ —	$1,497,400	$ —

1 As of December 31, 2017, PSE had a credit facility which provides $800.0 million of short-term liquidity needs and includes a backstop to the Company's commercial paper program. The credit facility matures in October 2022. The credit facility also includes a swingline feature allowing same day availability on borrowings up to $75.0 million and an expansion feature that, upon the banks' approval, would increase the total size of the facility to $1.4 billion. As of December 31, 2017, no loans or letters of credit were outstanding under the credit facility and $329.5 million

was outstanding under the commercial paper program. The credit agreement is syndicated among numerous lenders. Outside of the credit agreement, PSE has a $3.1 million letter of credit in support of a long-term transmission contract and a $1.0 million letter of credit in support of natural gas purchases in Canada.

2 As of December 31, 2017, PSE had a revolving credit facility with Puget Energy in the form of a promissory note to borrow up to $30.0 million.

3 As of December 31, 2017, Puget Energy had a revolving senior secured credit facility totaling $800.0 million, which matures in October 2022. The revolving senior secured credit facility is syndicated among numerous lenders. The revolving senior secured credit facility also has an expansion feature that, upon the banks' approval, would increase the size of the facility to $1.3 billion. As of December 31, 2017, there was $102.6 million drawn and outstanding under the Puget Energy credit facility.

Off-Balance Sheet Arrangements

As of December 31, 2017, the Company had no off-balance sheet arrangements that have or are reasonably likely to have a material effect on the Company's financial condition, other than the items disclosed in Note 8, "Leases" and in Note 15, "Commitment and Contingencies" to the consolidated financial statements included in Item 2 of this report.

Utility Construction Program

PSE's construction programs for generating facilities, the electric transmission system, the natural gas and electric distribution systems and the Tacoma LNG facility are designed to meet regulatory requirements and customer growth and to support reliable energy delivery. Construction expenditures, excluding equity AFUDC, totaled $963.7 million in 2017. Presently planned utility construction expenditures, excluding equity AFUDC, are as follows:

Capital Expenditure Projections

(Dollars in Thousands)	2018	2019	2020
Total energy delivery, technology and facilities expenditures	$1,003,000	$839,000	$740,000

The program is subject to change based upon general business, economic and regulatory conditions. Utility construction expenditures and any new generation resource expenditures are typically funded from a combination of cash from operations, short-term debt, long-term debt and/or equity. PSE's utility construction program expenditures periodically can and do exceed cash flow generated from operations. As a result, execution of PSE's utility construction program is dependent, in part, on continued access to capital markets.

Capital Resources

Cash from Operations

Puget Sound Energy	Year Ended December 31,		
(Dollars in Millions)	2017	2016	Change
Net income	$320,054	$380,581	$(60,527)
Non-cash items[1]	782,890	631,440	151,450
Changes in cash flow resulting from working capital[2]	105,281	(46,554)	151,835
Regulatory assets and liabilities	(88,875)	(152,786)	63,911
Other non-current assets and liabilities[3]	(32,547)	6,235	(38,782)
Net cash provided by operating activities	$1,086,803	$818,916	$267,887

1 Non-cash items include depreciation, amortization, deferred income taxes, net unrealized (gain) loss on derivative instruments, AFUDC-equity, production tax credits and miscellaneous non-cash items.

2 Changes in working capital include receivables, unbilled revenue, materials/supplies, fuel/gas inventory, income taxes, prepayments, purchased gas adjustments, accounts payable and accrued expenses.

3 Other non-current assets and liabilities include funding of pension liability.

Year Ended December 31, 2017 compared to 2016

Cash generated from operations for the year ended December 31, 2017 increased by $267.9 million including a net income decrease of $60.5 million. The following are significant factors that impacted PSE's cash flows from operations:

- Non-cash items increased $151.5 million primarily due to changes in derivative instruments of $114.6 million, depreciation and amortization of $42.4 million, deferred taxes of $36.1 million and conservation amortization of $13.4 million offset by a decrease of $53.3 million in production tax credits. For further discussion, see Other Operating Expenses in Item 7, Management's Discussion and Analysis and Note 13, "Income Taxes" in Item 8.
- Changes in cash flow resulting from working capital increased $151.8 million primarily due to changes in accounts receivable and unbilled revenue of $50.7 million, an increase to the purchased gas adjustment of $34.2 million as discussed previously in the electric and natural gas margin discussion, an increase of $27.5 million in materials and supplies, and an increase of $47.0 million in prepayments.

- Regulatory assets and liabilities cash flow increased $63.9 million primarily due to changes in decoupling and derivatives offset by changes in purchased gas adjustments.

- Other non-current assets and liabilities cash flow decreased $38.8 million primarily due to an increase in the long-term incentive plan accrual, an increase in major maintenance and inspections, reduced pension funding and other changes in long-term assets and liabilities.

Puget Energy	Year Ended December 31,		
(Dollars in Millions)	2017	2016	Change
Net income	$175,194	$312,899	$(137,705)
Non-cash items[1]	837,569	602,535	235,034
Changes in cash flow resulting from working capital[2]	93,654	(24,936)	118,590
Regulatory assets and liabilities	(88,875)	(153,643)	64,768
Other non-current assets and liabilities[3]	(45,411)	(7,565)	(37,846)
Net cash provided by operating activities	$972,131	$729,290	$242,841

1 Non-cash items include depreciation, amortization, deferred income taxes, net unrealized (gain) loss on derivative instruments, AFUDC-equity, production tax credits and other miscellaneous non-cash items.

2 Changes in working capital include receivables, unbilled revenue, materials/supplies, fuel/gas inventory, income taxes, prepayments, purchased gas adjustments, accounts payable and accrued expenses.

3 Other non-current assets and liabilities include funding of pension liability.

Year Ended December 31, 2017 compared to 2016

Cash generated from operations for the year ended December 31, 2017 increased by $242.8 million compared to the same period in 2016. The net difference was primarily impacted by the increase from cash flow provided by the operating activities of PSE, as previously discussed. The remaining variance is explained below:

- Non-cash items increased $83.6 million primarily due to changes in deferred taxes of $78.8 million. For further discussion, see Note 13, "Income Taxes" in Item 8.
- Changes in cash flow resulting from working capital decreased $33.2 million primarily due to amounts owed to PSE related to Puget LNG.

Financing Program

The Company's external financing requirements principally reflect the cash needs of its construction program, its schedule of maturing debt and certain operational needs. The Company anticipates refinancing the redemption of bonds or other long-term borrowings with its credit facilities and/or the issuance of new long-term debt. Access to funds depends upon factors such as Puget Energy's and PSE's credit ratings, prevailing interest rates and investor receptivity to investing in the utility industry, Puget Energy and PSE. The Company believes it has sufficient liquidity through its credit facilities and access to capital markets to fund its needs over the next twelve months.

Proceeds from PSE's short-term borrowings and sales of commercial paper are used to provide working capital and the interim funding of utility construction programs. Puget Energy and PSE continue to have reasonable access to the capital and credit markets.

For information on Puget Energy and PSE dividends, long-term debt and credit facilities, see Note 4, "Dividend Payment Restrictions, Note 6, "Long-term Debt" and Note 7, "Liquidity Facilities and Other Financing Arrangements" to the consolidated financial statements included in Item 8 of this report.

Debt Restrictive Covenants

The type and amount of future long-term financings for PSE may be limited by provisions in PSE's electric and natural gas mortgage indentures.

PSE's ability to issue additional secured debt may also be limited by certain restrictions contained in its electric and natural gas mortgage indentures. Under the most restrictive tests, at December 31, 2017, PSE could issue:

- Approximately $2.6 billion of additional first mortgage bonds under PSE's electric mortgage indenture based on approximately $4.3 billion of electric bondable property available for issuance, subject to an interest coverage ratio limitation of 2.0 times net earnings available for interest (as defined in the electric utility mortgage), which PSE exceeded at December 31, 2017; and
- Approximately $535.0 million of additional first mortgage bonds under PSE's natural gas mortgage indenture based on approximately $891.7 million of natural gas bondable property available for issuance, subject to a combined natural gas and electric interest coverage test of 1.75 times net earnings available for interest and a natural gas interest coverage test of 2.0 times net earnings available for interest (as defined in the natural gas utility mortgage), both of which PSE exceeded at December 31, 2017

At December 31, 2017, PSE had approximately $7.2 billion in electric and natural gas rate base to support the interest coverage ratio limitation test for net earnings available for interest.

Other

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires that management apply accounting policies and make estimates and assumptions that affect results of operations and the reported amounts of assets and liabilities in the financial statements. Management believes the following accounting policies are particularly important to the financial statements and require the use of estimates, assumptions and judgment to describe matters that are inherently uncertain.

Revenue Recognition

Operating utility revenue is recognized when the basis of service is rendered, which includes estimated unbilled revenue. PSE's estimate of unbilled revenue is based on a calculation using meter readings from its automated meter reading (AMR) system. The estimate calculates unbilled usage at the end of each month as the difference between the customer meter readings on the last day of the month and the last customer meter readings billed during the month less unbilled revenues recorded in the prior month. The "current" month unbilled usage is then priced at published rates for each schedule to estimate the unbilled revenues by customer.

Beginning July 1, 2013, certain revenues from PSE's electric and natural gas operations are subject to a revenue decoupling mechanism under which PSE's actual energy delivery revenues related to electric transmission and distribution, natural gas operations and general administrative costs are compared with authorized revenues allowed under the mechanism. The mechanism mitigates volatility in revenue due to weather and gross margin erosion related to energy efficiency. Any differences are deferred to a regulatory asset for under recovery or a regulatory liability for over recovery. Revenues associated with power costs under the PCA mechanism and PGA rates are excluded from the decoupling mechanism.

As defined by Accounting Standards Codification (ASC) 980, “Regulated Operations” (ASC 980), the decoupling mechanism is an alternative revenue program that allows billings to be adjusted for the effects of weather abnormalities, conservation efforts or other various external factors. PSE adjusts these billings in the future in response to these effects to collect additional revenues provided under the decoupling mechanism. Once billing of additional revenues under the decoupling mechanism is permitted, the additional revenue can be recognized when the following criteria specified by ASC 980 are met: (i) the program is established by an order from the Washington Commission that allows for automatic adjustment of future rates, (ii) the amount of additional revenues for the period is objectively determinable and is probable of recovery and (iii) the additional revenues will be collected within 24 months following the end of the annual period in which they are recognized. PSE meets the criteria to recognize revenue under the decoupling mechanism. The Company will not record any decoupling revenue that is expected to take longer than 24 months to collect following the end of the annual period in which the revenues would have otherwise been recognized. Once determined to be collectible within 24 months, any previously non-recorded amounts will be recorded.

Regulatory Accounting

As a regulated entity of the Washington Commission and FERC, PSE prepares its financial statements in accordance with the provisions of ASC 980. The application of ASC 980 results in differences in the timing and recognition of certain revenue and expenses in comparison with businesses in other industries. The rates that are charged by PSE to its customers are based on cost base regulation reviewed and approved by the Washington Commission and FERC. Under the authority of these commissions, PSE has recorded certain regulatory assets and liabilities at December 31, 2017 in the amount of $953.1 million and $1,758.6 million, respectively, and regulatory assets and liabilities at December 31, 2016 of $1.1 billion and $653.3 million, respectively. Such amounts are amortized through a corresponding liability or asset account, respectively, with no impact to earnings. PSE expects to fully recover its regulatory assets and liabilities through its rates. If future recovery of costs ceases to be probable, PSE would be required to write off these regulatory assets and liabilities. In addition, if PSE determines that it no longer meets the criteria for continued application of ASC 980, PSE could be required to write off its regulatory assets and liabilities related to those operations not meeting ASC 980 requirements.

Also encompassed by regulatory accounting and subject to ASC 980 are the PCA and PGA mechanisms. The PCA and PGA mechanisms mitigate the impact of commodity price volatility upon the Company and are approved by the Washington Commission. The PCA mechanism provides for a sharing of costs that vary from baseline rates over a graduated scale. For further discussion regarding the PCA mechanism, see Item 7, "Business – Regulation and Rates". The increases and decreases in the cost of natural gas supply are reflected in customer bills through the PGA mechanism. PSE expects to fully recover/refund these regulatory balances through its rates. However, both mechanisms are subject to regulatory review and approval by the Washington Commission on a periodic basis.

Goodwill

In 2009, Puget Holdings completed its merger with Puget Energy. Puget Energy remeasured the carrying amount of all its assets and liabilities to fair value, which resulted in recognition of approximately $1.7 billion in goodwill. ASC 350, “Intangibles - Goodwill and Other,” (ASC 350) requires that goodwill be tested for impairment at the reporting unit level on an annual basis and between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. These events or circumstances could include a significant change in the Company’s business or regulatory outlook, legal factors, a sale or disposition of a significant portion of a reporting unit or significant changes in the financial markets which could influence the Company’s access to capital and interest rates. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assignment of assets and liabilities to reporting units, assignment of goodwill to reporting units and the determination of the fair value of the reporting units. Management has determined Puget Energy has only one reporting unit.

The goodwill recorded by Puget Energy represents the potential long-term return to the Company’s investors. Goodwill is tested for impairment annually using a qualitative and quantitative test. Management must first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount, including goodwill. If, after assessing the totality of events or circumstances during a qualitative assessment, management determines the fair value of a reporting unit is less than its carrying amount, then the entity shall perform a quantitative test to determine impairment. This would entail a full valuation of Puget Energy’s assets and liabilities and comparing the valuation to its carrying amounts, with the aggregate difference indicating the amount of impairment. Goodwill of a reporting unit is required to be tested for impairment on an interim basis if an event occurs or circumstances change that would cause the fair value of a reporting unit to fall below its carrying amount.

Puget Energy conducted its most recent annual impairment test as of October 1, 2017. The fair value of Puget Energy's reporting unit was estimated using the weighted-averages from an income valuation method, or discounted cash flow method, and a market valuation approach. These valuations required significant judgments, including: (i) estimation of future cash flows, which is dependent on internal forecasts and other market factors, (ii) estimation of the long-term rate of growth for Puget Energy's business including other market factors, (iii) estimation of the useful life over which cash flows will occur, (iv) the selection of utility holding companies determined to be comparable to Puget Energy, and (v) the determination of an appropriate weighted-average cost of capital or discount rate.

Management estimated the fair value of Puget Energy's equity to be approximately $5.5 billion at the October 1, 2017 measurement date for the annual test of goodwill impairment. The carrying value of Puget Energy's equity was approximately $3.8 billion with the excess of the fair value over the carrying value representing 44.7% or $1.7 billion. The income approach and the market approach valuations resulted in Puget Energy equity values of $5.2 and $5.8 billion, respectively. The result of the income approach was very sensitive to long-term cash flow growth rates applicable to periods beyond management's five-year business plan and financial forecast period and the weighted-average cost of capital assumptions of 3.0% and 5.9%, respectively.
The following table summarizes the results of the income valuation method, using the long-term growth rate and weighted average cost of capital:
Equity Value Sensitivity Table
(Dollars in Billions)

Weighted-Average Cost of Capital Rate	Long-Term Growth Rate					
	2.8 %	2.9 %	3.0 %	3.1 %	3.2 %	3.3 %
6.2%	$3.7	$4.0	$4.3	$4.6	$4.9	$5.3
5.9	4.5	4.9	5.2	5.6	6.0	6.5
5.7	5.6	6.0	6.4	6.9	7.4	7.9

Derivatives
ASC 815, "Derivatives and Hedging" (ASC 815), requires that all contracts considered to be derivative instruments be recorded on the balance sheet at their fair value unless the contracts qualify for an exception. The Company enters into derivative contracts to manage its energy resource portfolio and interest rate exposure including forward physical and financial contracts and swaps. Some of PSE's physical electric supply contracts qualify for the normal purchase normal sale (NPNS) exception to derivative accounting rules. Generally, NPNS applies to contracts with creditworthy counterparties, for which physical delivery is probable and in quantities that will be used in the normal course of business. Power purchases designated as NPNS must meet additional criteria to determine if the transaction is within PSE's forecasted load requirements and if the counterparty owns or controls energy resources within the western region to allow for physical delivery of the energy. PSE may enter into financial fixed contracts to economically hedge the variability of certain index-based contracts. Those contracts that do not meet the NPNS exception are marked-to-market to current earnings in the statements of income. Natural gas derivative contracts qualify for deferral under ASC 980 due to the PGA mechanism.
Puget Energy and PSE elected to de-designate all energy related derivative contracts previously recorded as cash flow hedges for the purpose of simplifying their financial reporting. The contracts that were de-designated related to physical electric supply contracts and natural gas swap contracts used to fix the price of natural gas for electric generation. For these contracts and contracts initiated after such date, all mark-to-market adjustments are recognized through earnings. The amount previously recorded in accumulated other comprehensive income (AOCI) is transferred to earnings in the same period or periods during which the hedged transaction affects earnings or sooner if management determines that the forecasted transaction is probable of not occurring.
PSE values derivative instruments based on daily quoted prices from an independent external pricing service. The Company regularly confirms the validity of pricing service quoted prices (e.g. Level 2 in the fair value hierarchy) used to value commodity contracts to the actual prices of commodity contracts entered into during the most recent quarter. When external quoted market prices are not available for derivative contracts, PSE uses a valuation model that uses volatility assumptions relating to future energy prices based on specific energy markets and utilizes externally available forward market price curves. All derivative instruments are sensitive to market price fluctuations that can occur on a daily basis. The Company is focused on commodity price exposure and risks associated with volumetric variability in the natural gas and electric portfolios. PSE is not engaged in the business of assuming risk for the purpose of speculative trading. The Company economically hedges open natural gas and electric positions to reduce both the portfolio risk and the volatility risk in prices. The exposure position is determined by using a probabilistic risk system that models 250 simulations of how the Company's natural gas and power portfolios will perform under various weather, hydrological and unit performance conditions.

The Company may enter into swap instruments or other financial derivative instruments to manage the interest rate risk associated with its long-term debt financing and debt instruments. As of December 31, 2017, the Company did not have any outstanding interest rate swap instruments.

For additional information, see Item 7A, "Quantitative and Qualitative Disclosures about Market Risk" Note 9, "Accounting for Derivative Instruments and Hedging Activities" and Note 10, "Fair Value Measurements" to the consolidated financial statements included in Item 8 of this report.

Fair Value

ASC 820, “Fair Value Measurements and Disclosures” (ASC 820), defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). However, as permitted under ASC 820, the Company utilizes a mid-market pricing convention (the mid-point price between bid and ask prices) as a practical expedient for valuing the majority of its assets and liabilities measured and reported at fair value. The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated or generally unobservable. The Company primarily applies the market approach for recurring fair value measurements as it believes that this approach is used by market participants for these types of assets and liabilities. Accordingly, the Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. For further discussion on market risk, see Item 7A, "Quantitative and Qualitative Disclosures about Market Risk".

Pension and Other Postretirement Benefits

PSE has a qualified defined benefit pension plan covering substantially all employees of PSE. PSE recognized qualified pension expense of $12.1 million, $14.5 million and $22.9 million for the years ended December 31, 2017, 2016 and 2015, respectively. Of these amounts, approximately 51.6%, 55.5% and 58.5% were included in utility operations and maintenance expense in 2017, 2016 and 2015, respectively, and the remaining amounts were capitalized. For the years ended December 31, 2017 and 2016, Puget Energy recognized incremental qualified pension income of $13.4 million and $15.5 million, respectively. In 2018, it is expected that PSE and Puget Energy will recognize pension expense of $11.5 million and incremental qualified pension income of $13.0 million, respectively.

PSE has a Supplemental Executive Retirement Plan (SERP). PSE recognized pension and other postretirement benefit expenses of $4.8 million, $4.8 million and $5.6 million for the years ended December 31, 2017, 2016 and 2015, respectively. For the years ended December 31, 2017 and 2016, Puget Energy recognized incremental income of $0.5 million and $0.4 million, respectively. In 2018, it is expected that PSE and Puget Energy will recognize pension expense of $5.1 million and incremental pension income of $0.5 million, respectively.

PSE also has other limited postretirement benefit plans. PSE recognized income of $0.5 million, $0.5 million and $0.2 million for the years ended December 31, 2017, 2016 and 2015, respectively. For the years ended December 31, 2017 and 2016, Puget Energy recognized incremental expense of $0.2 million each year. In 2018, it is expected that PSE and Puget Energy will recognize income of $0.5 million and incremental expense of $0.2 million, respectively.

The Company’s pension and other postretirement benefits income or expense depend on several factors and assumptions, including plan design, timing and amount of cash contributions to the plan, earnings on plan assets, discount rate, expected long-term rate of return, mortality and health care cost trends. Changes in any of these factors or assumptions will affect the amount of income or expense that the Company records in its financial statements in future years and its projected benefit obligation. The Company has selected an expected return on plan assets based on a historical analysis of rates of return and the Company’s investment mix, market conditions, inflation and other factors. The Company’s accounting policy for calculating the market-related value of assets is based on a five-year smoothing of asset gains or losses measured from the expected return on market-related assets. This is a calculated value that recognizes changes in fair value in a systematic and rational manner over five years. The same manner of calculating market-related value is used for all classes of assets, and is applied consistently from year to year. During 2017, the Company made cash contributions of $18.0 million to the qualified defined benefit plan. Management is closely monitoring the funding status of its qualified pension plan. At December 31, 2017 and 2016, the Company’s qualified pension plan was $3.9 million overfunded and $32.3 million underfunded as measured under GAAP, or 100.6% and 95.0% funded, respectively. As of January 1, 2018, the plan's estimated funded ratio, as calculated under guidelines from The Pension Protection Act of 2006 and considering temporary interest rate relief measures approved by Congress, was more than 100%. The aggregate expected contributions and payments by the Company to fund the pension plan, SERP and other postretirement plans for the year ending December 31, 2018 are expected to be at least $18.0 million, $5.5 million and $0.3 million, respectively.

The discount rate used in accounting for pension and other benefit obligations decreased from 4.50% in 2016 to 4.00% in 2017. The discount rate used in accounting for pension and other benefit expense decreased from 4.65% in 2016 to 4.50% in 2017. The rate of return on plan assets for qualified pension benefits decreased from 7.75% in 2016 to 7.45% in 2017. The rate of return on plan assets for other benefits in 2017 and 2016 was 6.75%, respectively.
The following tables reflect the estimated sensitivity associated with a change in certain significant actuarial assumptions (each assumption change is presented mutually exclusive of other assumption changes):

Puget Energy and Puget Sound Energy	Change in Assumption	Impact on Projected Benefit Obligation Increase /(Decrease)		
(Dollars in Thousands)		Pension Benefits	SERP	Other Benefits
Increase in discount rate	50 basis points	$(38,831)	$(1,940)	$ (548)
Decrease in discount rate	50 basis points	43,000	2,069	601

Puget Energy	Change in Assumption	Impact on 2017 Pension Expense Increase /(Decrease)		
(Dollars in Thousands)		Pension Benefits	SERP	Other Benefits
Increase in discount rate	50 basis points	$155	$(173)	$ (50)
Decrease in discount rate	50 basis points	2,333	181	52
Increase in return on plan assets	50 basis points	(3,207)	*	(34)
Decrease in return on plan assets	50 basis points	3,207	*	34

Puget Sound Energy	Change in Assumption	Impact on 2017 Pension Expense Increase /(Decrease)		
(Dollars in Thousands)		Pension Benefits	SERP	Other Benefits
Increase in discount rate	50 basis points	$(2,906)	$(173)	$ (51)
Decrease in discount rate	50 basis points	3,026	181	52
Increase in return on plan assets	50 basis points	(3,212)	*	(34)
Decrease in return on plan assets	50 basis points	3,212	*	34

* Calculation not applicable.

Recently Adopted Accounting Pronouncements

For the discussion of recently adopted accounting pronouncements, see Note 2, "New Accounting Pronouncements" to the consolidated financial statements included in Item 8 of this report.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Energy Portfolio Management

PSE maintains energy risk policies and procedures to manage commodity and volatility risks and the related effects on credit, tax, accounting, financing and liquidity. PSE's Energy Management Committee establishes PSE's risk management policies and procedures and monitors compliance. The Energy Management Committee is comprised of certain PSE officers and is overseen by the PSE Board of Directors.

PSE's objective is to minimize commodity price exposure and risks associated with volumetric variability in the natural gas and electric portfolios. It is not engaged in the business of assuming risk for the purpose of speculative trading. PSE hedges open natural gas and electric positions to reduce both the portfolio risk and the volatility risk in prices.

PSE's energy risk portfolio management function monitors and manages these risks using analytical models and tools including a probabilistic risk system that models 250 simulations of how PSE's natural gas and power portfolios will perform under various weather, hydroelectric and unit performance conditions. Based on the analytics from all of its models and tools, PSE enters into forward physical electric and natural gas purchase and sale agreements, fixed-for-floating swap contracts, and commodity call/put options to manage its electric and natural gas portfolio risks. The forward physical electric and natural gas contracts are both fixed and variable (at index). To fix the price of wholesale electricity and natural gas, PSE may enter into fixed-for-floating swap (financial) contracts. PSE also utilizes natural gas call and put options as an additional hedging instrument to increase the hedging portfolio's flexibility to react to commodity price fluctuations.

The following table presents the fair value of the Company's energy derivatives instruments, recorded on the balance sheets:

Puget Energy and Puget Sound Energy	December 31, 2017		December 31, 2016	
(Dollars in Thousands)	Assets	Liabilities	Assets	Liabilities
Electric portfolio:				
Current	$12,553	$ 37,991	$30,596	$ 30,997
Long-term	838	11,059	5,864	10,332
Total electric derivatives	13,391	49,050	36,460	41,329
Natural Gas portfolio:				
Current	9,694	26,868	23,745	13,172
Long-term	1,320	10,176	2,874	5,929
Total natural gas derivatives	11,014	37,044	26,619	19,101
Total energy derivatives	$24,405	$ 86,094	$63,079	$ 60,430

At December 31, 2017, the Company had total assets of $24.4 million and total liabilities of $86.1 million related to derivative contracts used to hedge the supply and cost of electricity and natural gas to serve PSE customers. As the gains and losses in the electric portfolio are realized, they will be recorded as either purchased power costs or electric generation fuel costs under the PCA mechanism. Any fair value adjustments relating to the natural gas business have been deferred in accordance with ASC 980, due to the PGA mechanism, which passes the cost of natural gas supply to customers. As the gains and losses on the hedges are realized in future periods, they will be recorded as natural gas costs under the PGA mechanism.

A hypothetical 10.0% increase or decrease in market prices of natural gas and electricity would change the fair value of the Company's derivative contracts by $10.6 million.

The change in fair value of the Company's outstanding energy derivative instruments from December 31, 2016 through December 31, 2017 is summarized in the table below:

Puget Energy and Puget Sound Energy Energy Derivative Contracts Asset (Liability) (Dollars in Thousands)	
Fair value of contracts outstanding at December 31, 2016	$2,649
Contracts realized or otherwise settled during 2017	54,169
Change in fair value of derivatives	(118,507)
Fair value of contracts outstanding at December 31, 2017	$(61,689)

The fair value of the Company's outstanding derivative instruments at December 31, 2017, based on pricing source and the period during which the instrument will mature, is summarized below:

Puget Energy and Puget Sound Energy Source of Fair Value	Fair Value of Contracts by Settlement Year				
(Dollars in Thousands)	2018	2019-2020	2021-2022	Thereafter	Total
Prices provided by external sources[1]	$(46,927)	$(17,434)	$ (349)	$ —	$(64,710)
Prices based on internal models and valuation methods	4,315	18	(1,312)	—	3,021
Total fair value	$(42,612)	$(17,416)	$ (1,661)	$ —	$(61,689)

[1] Prices provided by external pricing service, which utilizes broker quotes and pricing models.

For further details regarding both the fair value of derivative instruments and the impacts such instruments have on current period earnings, see Note 9, "Accounting for Derivative Instruments and Hedging Activities" and Note 10, "Fair Value Measurements" to the consolidated financial statements included in Item 8 of this report.

Contingent Features and Counterparty Credit Risk

PSE is exposed to credit risk primarily through buying and selling electricity and natural gas to serve customers. Credit risk is the potential loss resulting from a counterparty's non-performance under an agreement. PSE manages credit risk with policies and procedures for, among other things, counterparty analysis and measurement, monitoring and mitigation of exposure.

PSE has entered into commodity master arrangements with its counterparties to mitigate credit exposure to those counterparties. PSE generally enters into the following master arrangements: WSPP, Inc. (WSPP) agreements which standardize physical power contracts in the electric industry; International Swaps and Derivatives Association (ISDA) agreements which standardize financial natural gas and electric contracts; and North American Energy Standards Board (NAESB) agreements which standardize physical natural gas contracts. PSE believes that entering into such agreements reduces the credit risk exposure because such agreements provide for the netting and offsetting of monthly payments as well as right of set-off in the event of counterparty default. It is possible that volatility in energy commodity prices could cause PSE to have material credit risk exposures with one or more counterparties. If such counterparties fail to perform their obligations under one or more agreements, PSE could suffer a material financial loss. In order to mitigate concentrated credit risk with a subset of counterparties, PSE executed a futures and cleared swaps agreement in November 2016, and began transacting power futures contracts on the Intercontinental Exchange (ICE) in early 2017.

Where deemed appropriate, and when allowed under the terms of the agreements, PSE may request collateral or other security from its counterparties to mitigate the potential credit default losses. Criteria employed in this decision include, among other things, the perceived creditworthiness of the counterparty and the expected credit exposure. As of December 31, 2017, PSE held approximately $458.5 million in standby letters of credit or limited parental guarantees and had 6 counterparties with unlimited parental guarantees, in support of various electric and natural gas transactions. The Company monitors counterparties for significant swings in credit default swap rates, credit rating changes by external rating agencies, ownership changes or financial distress. As of December 31, 2017, approximately 83.6% of the Company's energy portfolio exposure, including NPNS transactions, were entered into with investment grade counterparties which, in the majority of cases, do not require collateral calls on the contracts. Counterparty credit risk may impact PSE's decisions on derivative accounting treatment.

Should a counterparty file for bankruptcy, which would be considered a default under master arrangements, PSE may terminate related contracts. Derivative accounting entries previously recorded would be reversed in the financial statements. PSE would compute any terminations receivable or payable, based on the terms of existing master agreements. The Company computes credit reserves at a master agreement level by counterparty. The Company considers external credit ratings and market factors, such as credit default swaps and bond spreads, in determination of reserves. The Company recognizes that external ratings may not always reflect how a market participant perceives a counterparty's risk of default. The Company uses both default factors published by Standard & Poor's and factors derived through analysis of market risk, which reflect the application of an industry standard recovery rate. The Company selects a default factor by counterparty at an aggregate master agreement level based on a weighted-average default tenor for that counterparty's deals. The default tenor is determined by weighting the fair value and contract tenors for all deals by counterparty and arriving at an average value. The default factor used is dependent upon whether the counterparty is in a net asset or a net liability position after applying the master agreement levels.
The Company applies the counterparty's default factor to compute credit reserves for counterparties that are in a net asset position. The Company calculates a non-performance risk on its derivative liabilities by using its estimated incremental borrowing rate over the risk-free rate. The fair value of derivatives includes the impact of credit and non-performance reserves. As of December 31, 2017, the Company was in a net liability position with the majority of its counterparties, therefore the default factors of counterparties did not have a significant impact on reserves for the year. As of December 31, 2017, PSE has posted a $1.0 million letter of credit as a condition of transacting on a physical energy exchange and clearinghouse in Canada. PSE did not trigger any collateral requirements with any of its counterparties.

Interest Rate Risk

The Company believes its interest rate risk primarily relates to the use of short-term debt instruments, variable-rate leases and anticipated 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 utilizes internal cash from operations, borrowings under its commercial paper program, and its credit facilities to meet short-term funding needs. Short-term obligations are commonly refinanced with fixed-rate bonds or notes when needed and when interest rates are considered favorable.
The following table presents the carrying value and fair value of Puget Energy and Puget Sound Energy's debt instruments:

Financial Debt Instruments	December 31, 2017		December 31, 2016	
(Dollars in Thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Puget Energy	$5,787,392	$7,191,513	$5,599,836	$6,805,791
Puget Sound Energy	$4,079,374	$5,118,528	$3,993,061	$4,816,807

For further details regarding Puget Energy and Puget Sound Energy debt instruments, see Note 6, "Long-Term Debt" and Note 10, "Fair Value Measurements" to the consolidated financial statements included in Item 8 of this report.
From time to time, PSE may enter into treasury locks or forward starting swap contracts to hedge interest rate exposure related to an anticipated debt issuance. The ending balance in OCI related to the forward starting swaps and previously settled treasury lock contracts at December 31, 2017 was a net loss of $5.0 million after tax and accumulated amortization. This compares to an after-tax loss of $5.4 million in OCI as of December 31, 2016. All financial hedge contracts of this type are reviewed by an officer, presented to the Board of Directors, or a committee of the Board, as applicable and are approved prior to execution. PSE had no treasury locks or forward starting swap contracts outstanding at December 31, 2017.
The Company may also enter into swap instruments or other financial hedge instruments to manage the interest rate risk associated with these debts. In January 2017, Puget Energy's outstanding interest rate swaps matured, and as of December 31, 2017, the Company had no outstanding interest rate swap instruments.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

All other schedules have been omitted because of the absence of the conditions under which they are required, or because the information required is included in the consolidated financial statements or the notes thereto.

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REPORT OF MANAGEMENT AND STATEMENT OF RESPONSIBILITY

PUGET ENERGY, INC.
AND
PUGET SOUND ENERGY, INC.

Puget Energy, Inc. and Puget Sound Energy, Inc. (the Company) management assumes accountability for maintaining compliance with our established financial accounting policies and for reporting our results with objectivity and integrity. The Company believes it is essential for investors and other users of the consolidated financial statements to have confidence that the financial information we provide is timely, complete, relevant and accurate. Management is also responsible to present fairly Puget Energy's and Puget Sound Energy's consolidated financial statements, prepared in accordance with GAAP.

Management, with oversight of the Board of Directors, established and maintains a strong ethical climate under the guidance of our Corporate Ethics and Compliance Program so that our affairs are conducted to high standards of proper personal and corporate conduct. Management also established an internal control system that provides reasonable assurance as to the integrity and accuracy of the consolidated financial statements. These policies and practices reflect corporate governance initiatives designed to ensure the integrity and independence of our financial reporting processes including:

- Our Board has adopted clear corporate governance guidelines.
- With the exception of the President and Chief Executive Officer, the Board members are independent of management.
- All members of our key Board committees – the Audit Committee, the Compensation and Leadership Development Committee and the Governance and Public Affairs Committee – are independent of management.
- The non-management members of our Board meet regularly without the presence of Puget Energy and Puget Sound Energy management.
- The Charters of our Board committees clearly establish their respective roles and responsibilities.
- The Company has adopted a Corporate Ethics and Compliance Code with a hotline (through an independent third party) available to all employees, and our Audit Committee has procedures in place for the anonymous submission of employee complaints on accounting, internal accounting controls or auditing matters. The Compliance Program is led by the Chief Ethics and Compliance Officer of the Company.
- Our internal audit control function maintains critical oversight over the key areas of our business and financial processes and controls, and reports directly to our Board Audit Committee.

Management is confident that the internal control structure is operating effectively and will allow the Company to meet the requirements under Section 404 of the Sarbanes-Oxley Act of 2002.

PricewaterhouseCoopers LLP, our independent registered public accounting firm, reports directly to the Audit Committee of the Board of Directors. PricewaterhouseCoopers LLP's accompanying report on our consolidated financial statements is based on its audit conducted in accordance with auditing standards prescribed by the Public Company Accounting Oversight Board, including a review of our internal control structure for purposes of designing their audit procedures. Our independent registered accounting firm has reported on the effectiveness of our internal control over financial reporting as required under Section 404 of the Sarbanes-Oxley Act of 2002.

We are committed to improving shareholder value and accept our fiduciary oversight responsibilities. We are dedicated to ensuring that our high standards of financial accounting and reporting as well as our underlying system of internal controls are maintained. Our culture demands integrity and we have confidence in our processes, our internal controls and our people, who are objective in their responsibilities and who operate under a high level of ethical standards.

/s/ Kimberly J. Harris	/s/ Daniel A. Doyle	/s/ Stephen J. King
Kimberly J. Harris	Daniel A. Doyle	Stephen J. King
President and Chief Executive Officer	Senior Vice President and Chief Financial Officer	Controller and Principal Accounting Officer

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholder of
Puget Energy, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the consolidated financial statements, including the related notes and financial statement schedules, of Puget Energy, Inc. (the Company) and its subsidiaries as listed in the accompanying index (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
Seattle, Washington
March 1, 2018

We have served as the Company or its predecessor’s auditor since 1933.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholder of
Puget Sound Energy, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the consolidated financial statements, including the related notes and financial statement schedule, of Puget Sound Energy, Inc. (the Company) and its subsidiary as listed in the accompanying index (collectively referred to as the "consolidated financial statements"). We also have audited the Company's internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2017, based on criteria established in Internal Control - Integrated Framework (2013) issued by the COSO.

Basis for Opinions

The Company's management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on the Company's consolidated financial statements and on the Company's internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
Seattle, Washington
March 1, 2018

We have served as the Company or its predecessor's auditor since 1933.

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Thousands)

	Year Ended December 31,		
	2017	2016	2015
Operating revenue:			
Electric	$2,420,663	$2,238,492	$2,128,468
Natural gas	997,759	890,510	947,549
Other	41,854	35,299	16,683
Total operating revenue	3,460,276	3,164,301	3,092,700
Operating expenses:			
Energy costs:			
Purchased electricity	590,030	531,596	499,522
Electric generation fuel	206,275	215,331	249,907
Residential exchange	(75,933)	(69,824)	(112,473)
Purchased natural gas	360,009	313,954	403,310
Unrealized (gain) loss on derivative instruments, net	30,790	(83,795)	(13,233)
Utility operations and maintenance	584,263	568,492	530,720
Non-utility expense and other	40,487	27,151	10,818
Depreciation and amortization	481,969	439,579	420,807
Conservation amortization	121,216	107,784	110,866
Taxes other than income taxes	360,673	328,649	320,531
Total operating expenses	2,699,779	2,378,917	2,420,775
Operating income (loss)	760,497	785,384	671,925
Other income (deductions):			
Other income	27,892	25,539	20,711
Other expense	(14,104)	(10,923)	(6,764)
Non-hedged interest rate swap expense	28	(1,062)	(3,796)
Interest charges:			
AFUDC	10,826	9,304	7,575
Interest expense	(354,802)	(355,139)	(356,696)
Income (loss) before income taxes	430,337	453,103	332,955
Income tax (benefit) expense	255,143	140,204	91,776
Net income (loss)	$175,194	$312,899	$241,179

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

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Thousands)

	Year Ended December 31,		
	2017	2016	2015
Net income (loss)	$175,194	$312,899	$241,179
Other comprehensive income (loss):			
Net unrealized gain (loss) from pension and postretirement plans, net of tax of $5,078, $(3,471) and $5,087, respectively	9,430	(6,446)	9,444
Reclassification of net unrealized (gain) loss on energy derivative instruments, net of tax of $0, $0 and $179, respectively	—	—	333
Other comprehensive income (loss)	9,430	(6,446)	9,777
Comprehensive income (loss)	$184,624	$306,453	$250,956

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

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

ASSETS

	December 31, 2017	2016
Utility plant (at original cost, including construction work in progress of $495,937 and $420,278, respectively):		
Electric plant	$8,135,847	$7,673,772
Natural gas plant	3,307,545	3,051,586
Common plant	811,815	594,994
Less: Accumulated depreciation and amortization	(2,428,524)	(2,161,796)
Net utility plant	9,826,683	9,158,556
Other property and investments:		
Goodwill	1,656,513	1,656,513
Other property and investments	182,355	106,418
Total other property and investments	1,838,868	1,762,931
Current assets:		
Cash and cash equivalents	26,616	28,878
Restricted cash	10,145	12,418
Accounts receivable, net of allowance for doubtful accounts of $8,901 and $9,798, respectively	341,110	329,375
Unbilled revenue	222,186	234,053
Purchased gas adjustment receivable	—	2,785
Materials and supplies, at average cost	107,003	106,378
Fuel and natural gas inventory, at average cost	49,908	58,181
Unrealized gain on derivative instruments	22,247	54,341
Prepaid expense and other	21,996	43,046
Power contract acquisition adjustment gain	12,207	33,413
Total current assets	813,418	902,868
Other long-term and regulatory assets:		
Regulatory asset for deferred income taxes	—	72,038
Power cost adjustment mechanism	4,576	4,531
Regulatory assets related to power contracts	19,454	22,613
Other regulatory assets	948,532	1,034,348
Unrealized gain on derivative instruments	2,158	8,738
Power contract acquisition adjustment gain	162,711	241,648
Other	74,389	58,109
Total other long-term and regulatory assets	1,211,820	1,442,025
Total assets	$13,690,789	$13,266,380

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

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

CAPITALIZATION AND LIABILITIES

	December 31, 2017	2016
Capitalization:		
Common shareholder's equity:		
Common stock $0.01 par value, 1,000 shares authorized, 200 shares outstanding	$—	$—
Additional paid-in capital	3,308,957	3,308,957
Retained earnings	465,355	413,468
Accumulated other comprehensive income (loss), net of tax	(24,282)	(33,712)
Total common shareholder's equity	3,750,030	3,688,713
Long-term debt:		
First mortgage bonds and senior notes	3,164,412	3,362,000
Pollution control bonds	161,860	161,860
Junior subordinated notes	250,000	250,000
Long-term debt	1,902,600	1,812,480
Debt discount, issuance costs and other	(220,943)	(234,679)
Total long-term debt	5,257,929	5,351,661
Total capitalization	9,007,959	9,040,374
Current liabilities:		
Accounts payable	359,586	317,043
Short-term debt	329,463	245,763
Current maturities of long-term debt	200,000	2,412
Purchased gas adjustment payable	16,051	—
Accrued expenses:		
Taxes	117,948	111,428
Salaries and wages	53,220	49,749
Interest	73,564	73,610
Unrealized loss on derivative instruments	64,859	44,310
Power contract acquisition adjustment loss	2,762	3,159
Other	80,206	71,996
Total current liabilities	1,297,659	919,470
Other Long-term and regulatory liabilities:		
Deferred income taxes	746,868	1,570,931
Unrealized loss on derivative instruments	21,235	16,261
Regulatory liabilities	731,587	654,622
Regulatory liability for deferred income taxes	1,011,626	—
Regulatory liabilities related to power contracts	174,918	275,061
Power contract acquisition adjustment loss	16,693	19,454
Other deferred credits	682,244	770,207
Total other long-term and regulatory liabilities	3,385,171	3,306,536
Commitments and contingencies (Note 15)		
Total capitalization and liabilities	$13,690,789	$13,266,380

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

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMMON SHAREHOLDER'S EQUITY
(Dollars in Thousands)

	Common Stock		Additional		Accumulated Other	
	Shares	Amount	Paid-in Capital	Retained Earnings	Comprehensive Income (Loss)	Total Equity
Balance at December 31, 2014	200	$ —	$3,308,957	$271,414	$ (37,043)	$3,543,328
Net income (loss)	—	—	—	241,179	—	241,179
Common stock dividend paid	—	—	—	(263,059)	—	(263,059)
Other comprehensive income (loss)	—	—	—	—	9,777	9,777
Balance at December 31, 2015	200	$ —	$3,308,957	$249,534	$ (27,266)	$3,531,225
Net income (loss)	—	—	—	312,899	—	312,899
Common stock dividend paid	—	—	—	(148,965)	—	(148,965)
Other comprehensive income (loss)	—	—	—	—	(6,446)	(6,446)
Balance at December 31, 2016	200	$ —	$3,308,957	$413,468	$ (33,712)	$3,688,713
Net income (loss)	—	—	—	175,194	—	175,194
Common stock dividend paid	—	—	—	(123,307)	—	(123,307)
Other comprehensive income (loss)	—	—	—	—	9,430	9,430
Balance at December 31, 2017	200	$ —	$3,308,957	$465,355	$ (24,282)	$3,750,030

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

PUGET ENERGY, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in Thousands)

	Year Ended December 31,		
	2017	2016	2015
Operating activities:			
Net income (loss)	$175,194	$312,899	$241,179
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	481,969	439,579	420,807
Conservation amortization	121,216	107,784	110,866
Deferred income taxes and tax credits, net	254,524	139,640	91,978
Net unrealized (gain) loss on derivative instruments	30,650	(88,704)	(17,255)
Derivative contracts classified as financing activities due to merger	—	—	8,045
AFUDC - equity	(15,027)	(12,576)	(9,325)
Production tax credits	(53,331)	—	—
Other non-cash	17,568	16,812	16,155
Funding of pension liability	(18,000)	(24,000)	(18,000)
Regulatory assets and liabilities	(88,875)	(153,643)	(156,491)
Other long-term assets and liabilities	(27,411)	16,435	21,729
Change in certain current assets and liabilities:			
Accounts receivable and unbilled revenue	132	(21,763)	(66,703)
Materials and supplies	(625)	(28,134)	4,945
Fuel and natural gas inventory	8,266	473	9,332
Prepayments and other	21,050	(25,927)	4,086
Purchased gas adjustment	18,836	(15,374)	33,662
Accounts payable	26,396	32,465	(48,037)
Taxes payable	6,520	(3,426)	7,072
Other	13,079	36,750	(5,323)
Net cash provided by (used in) operating activities	972,131	729,290	648,722
Investing activities:			
Construction expenditures - excluding equity AFUDC	(1,040,135)	(706,444)	(587,225)
Restricted cash	2,273	(4,469)	24,914
Other	(195)	(1,921)	754
Net cash provided by (used in) investing activities	(1,038,057)	(712,834)	(561,557)
Financing activities:			
Change in short-term debt, net	83,700	86,759	74,004
Dividends paid	(123,307)	(148,965)	(263,059)
Proceeds from long-term debt and bonds issued	90,120	12,481	825,000
Redemption of bonds and notes	—	—	(711,000)
Derivative contracts classified as financing activities due to merger	—	—	(8,045)
Other	13,151	19,653	902
Net cash provided by (used in) financing activities	63,664	(30,072)	(82,198)
Net increase (decrease) in cash and cash equivalents	(2,262)	(13,616)	4,967
Cash and cash equivalents at beginning of period	28,878	42,494	37,527
Cash and cash equivalents at end of period	$26,616	$28,878	$42,494
Supplemental cash flow information:			
Cash payments for interest (net of capitalized interest)	$326,798	$329,603	$339,866
Cash payments (refunds) for income taxes	1,649	—	2

Non-cash financing and investing activities:			
Accounts payable for capital expenditures eliminated from cash flows	$92,959	$76,813	$51,588
Reclassification of Colstrip from utility plant to a regulatory asset	(49,177)	176,804	—
Reclassification of hydro treasury grants to a regulatory liability	95,935	—	—

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

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF INCOME
(Dollars in Thousands)

	Year Ended December 31,		
	2017	2016	2015
Operating revenue:			
Electric	$2,420,663	$2,238,492	$2,128,468
Natural gas	997,759	890,510	947,549
Other	41,854	35,616	17,241
Total operating revenue	3,460,276	3,164,618	3,093,258
Operating expenses:			
Energy costs:			
Purchased electricity	590,030	531,596	499,522
Electric generation fuel	206,275	215,331	249,907
Residential exchange	(75,933)	(69,824)	(112,473)
Purchased natural gas	360,009	313,954	403,310
Unrealized (gain) loss on derivative instruments, net	30,790	(83,795)	(12,688)
Utility operations and maintenance	584,263	568,492	530,720
Non-utility expense and other	52,389	37,859	26,618
Depreciation and amortization	481,955	439,579	420,807
Conservation amortization	121,216	107,784	110,866
Taxes other than income taxes	360,673	328,649	320,531
Total operating expenses	2,711,667	2,389,625	2,437,120
Operating income (loss)	748,609	774,993	656,138
Other income (deductions):			
Other income	26,853	25,537	20,711
Other expense	(14,104)	(10,923)	(6,764)
Interest charges:			
AFUDC	10,826	9,304	7,575
Interest expense	(240,144)	(242,983)	(247,571)
Income (loss) before income taxes	532,040	555,928	430,089
Income tax (benefit) expense	211,986	175,347	125,900
Net income (loss)	$320,054	$380,581	$304,189

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

PUGET SOUND ENERGY, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Dollars in Thousands)

	Year Ended December 31,		
	2017	2016	2015
Net income (loss)	$320,054	$380,581	$304,189
Other comprehensive income (loss):			
Net unrealized gain (loss) from pension and postretirement plans, net of tax of $9,848, $2,004 and $10,987, respectively	18,288	3,722	20,404