Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Michael Gorman, and my business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.

Q. WHAT IS YOUR OCCUPATION?

A. I am a consultant in the field of public utility regulation and a managing principal with the firm of Brubaker & Associates, Inc., energy, economic, and regulatory consultants.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. These are set forth on Exhibit No.___(MPG-2).

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the Industrial Customers of Northwest Utilities ("ICNU").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. I will recommend a fair return on common equity and an overall rate of return for Puget Sound Energy, Inc. ("PSE" or the "Company").

Q. PLEASE SUMMARIZE YOUR RATE OF RETURN RECOMMENDATIONS.

A. I recommend the Washington Utilities and Transportation Commission (the "Commission") award PSE a return on common equity of 10.12% and an overall rate of return of 8.~~30~~15%, as shown on Exhibit No.___(MPG-3).

My recommended return on equity for PSE is based on a Discounted Cash Flow ("DCF"), a Risk Premium ("RP"), and a Capital Asset Pricing Model ("CAPM") analyses.

I demonstrate that my recommended return on equity and proposed capital structure for PSE will provide PSE with an opportunity to realize cash flow financial coverages and balance sheet strength that conservatively supports PSE's current bond yield to be 4.9%, and a 10-year Treasury bond yield to be 4.3%.[11] Using the projected 30-year bond yield of 4.9%, and a Treasury bond risk premium of 4.40% to 5.89%, produces an estimated common equity return in the range of 9.30% to 10.79%, with a midpoint estimate of 10.05%.

I next added my equity risk premium over utility bond yields to a current 13-week average yield on "Baa" rated utility bonds for the period ending ~~April 4~~May 2, 2008 of 6.69%. This current "Baa" utility bond yield is developed on Exhibit No.___(MPG-17). Adding the utility equity risk premium of 3.03% to 4.39% to a "Baa" rated bond yield of 6.69%, produces a cost of equity in the range of 9.72% to 11.08%, with a midpoint of 10.40%.

My risk premium analyses produce a return estimate in the range of 10.05% to 10.40%, with a midpoint estimate of 10.23%.

CAPITAL ASSET PRICING MODEL

Q. PLEASE DESCRIBE THE CAPM.

A. The CAPM method of analysis is based upon the theory that the market required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific security. This relationship between risk and return can be expressed mathematically as follows:

Ri = Rf + Bi x (Rm - Rf) where:

Ri = Required return for stock i
Rf = Risk-free rate
Rm = Expected return for the market portfolio
Bi = Beta - Measure of the risk for stock

The stock-specific risk term in the above equation is beta. Beta represents the investment risk that cannot be diversified away when the security is held in a diversified

[11] *Blue Chip Financial Forecasts*, May 1, 2008 at 2.

assessment of PSE's total credit risk exposure. S&P publishes a matrix of financial ratios that defines the level of financial risk as a function of the level of business risk.

S&P publishes ranges for three primary financial ratios that it uses as guidance in its credit review for utility companies. The three primary financial ratio benchmarks it relies on in its credit rating process include: (1) funds from operations ("FFO") to debt interest expense, (2) FFO to total debt, and (3) total debt to total capital.

Q. HOW DID YOU APPLY S&P'S FINANCIAL RATIOS TO TEST THE REASONABLENESS OF YOUR RATE OF RETURN RECOMMENDATIONS?

A. I calculated each of S&P's financial ratios based on PSE's cost of service for retail operations. While S&P would normally look at total Puget Energy consolidated financial ratios in its credit review process, my investigation in this proceeding is to judge the reasonableness of my proposed cost of capital for rate setting in PSE's utility operations. Hence, I am attempting to determine whether the rate of return and cash flow generation opportunity reflected in my proposed utility rates for PSE will support target investment grade bond ratings and financial integrity.

Q. PLEASE DESCRIBE THE RESULTS OF THIS CREDIT METRIC ANALYSIS FOR PSE.

A. The S&P financial metric calculations for PSE are developed on Exhibit No.___(MPG-21).

As shown on Exhibit No.___(MPG-21), page 1, columns 1 and 3, based on an equity return of 10.12%, PSE will be provided an opportunity to produce an FFO to debt interest expense of 4.1~~0~~x. This FFO to interest coverage ratio is within S&P's old benchmark ratio guideline of 4.2x to 3.5x[16] for an "A" rated utility company with a business profile score of '4,' and is slightly above (stronger than) S&P's new guideline range of 2.0~~5~~x to 3.5x.[17] This ratio supports an improvement of PSE's "BBB" bond rating to "A."

PSE's retail operations FFO to total debt coverage at a 10.12% equity return would be 23%, which is within S&P's old credit metric guideline range of 20% to 28% for an "A" bond rating and within the new metric guideline range of 10% to 30%. The FFO/total debt ratio will support an "A" rated investment grade bond rating, an improvement to PSE's current bond rating.

Finally, PSE's total debt ratio to total capital is 58%. This is at about the midpoint of S&P's "BBB" rated utility old guideline range of 52% to 62%, and within the new guideline range of 45% to 60%. This total debt ratio will support a "BBB" investment grade bond rating.

At PSE's proposed capital structure and my return on equity, PSE's financial credit metrics are supportive of a strong "BBB" utility bond rating.

RESPONSE TO PSE WITNESS DR. ROGER MORIN

Q. WHAT RATE OF RETURN ON COMMON EQUITY IS PSE REQUESTING IN THIS PROCEEDING?

A. PSE is requesting a return on common equity of 10.8%. This return on common equity is at the low end of the range of 10.8% to 11.2% supported by PSE witness Dr. Roger Morin.

16/ Standard & Poor's: New Business Profile Scores Assigned to U.S. Utilities and Power Companies; Financial Guidelines Revised, June 2, 2004.

17/ Standard & Poor's: U.S. Utilities Rating Analysis Now Portrayed in the S&P Corporate Ratings Matrix; November 30, 2007.