EXHIBIT NO. ___(RAM-23) DOCKET NO. UE-060266/UG-060267 2006 PSE GENERAL RATE CASE WITNESS: ROGER A. MORIN

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,

Complainant,

v.

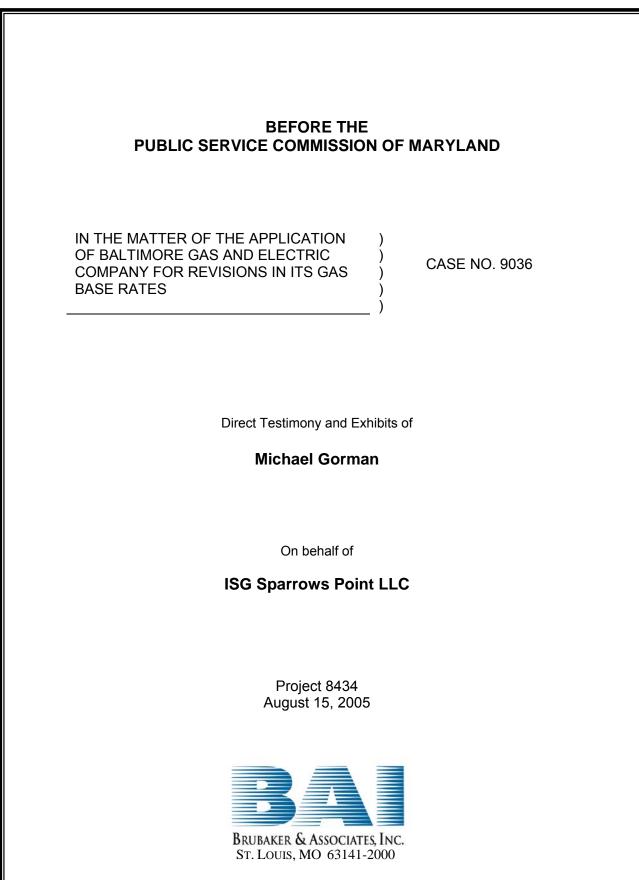
Docket No. UE-060266 Docket No. UG-060267

PUGET SOUND ENERGY, INC.,

Respondent.

EIGHTH EXHIBIT (NONCONFIDENTIAL) TO THE PREFILED REBUTTAL TESTIMONY OF ROGER A. MORIN ON BEHALF OF PUGET SOUND ENERGY, INC.

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1 Q. WHAT DID YOU USE AS AN ESTIMATE OF THE MARKET RISK-FREE RATE?

A. I used Blue Chip Financial Forecast's projected 20-year Treasury bond yield of 5.2%
(Blue Chip Financial Forecast, August 1, 2005 at 2).

4 Q. WHY DID YOU USE LONG-TERM TREASURY BOND YIELDS AS AN ESTIMATE

5 OF THE RISK-FREE RATE?

6 Α. Treasury securities are backed by the full faith and credit of the United States 7 government. Therefore, long-term Treasury bonds are considered to have negligible 8 credit risk. Also, long-term Treasury bonds have an investment horizon similar to that 9 of common stock. As a result, investor-anticipated long-run inflation expectations are 10 reflected in both common stock required returns and long-term bond yields. 11 Therefore, the nominal risk-free rate (or expected inflation rate and real risk-free rate) 12 included in a long-term bond yield is a reasonable estimate of the nominal risk-free 13 rate included in common stock returns.

Treasury bond yields, however, do include risk premiums related to unanticipated future inflation and interest rates. Therefore, a Treasury bond yield is not a risk-free rate. Risk premiums related to unanticipated inflation and interest rates are systematic or market risks. Consequently, for companies with betas less than one, using the Treasury bond yield as a proxy for the risk-free rate in the CAPM analysis can produce an overstated estimate of the CAPM return.

20 Q. WHAT BETA DID YOU USE IN YOUR ANALYSIS?

A. I relied on the group average beta estimate for the proxy group. Group average beta
is more reliable than a single company beta. A group average beta has stronger
statistical parameters that better describe the systematic risk of the group, than does

1	an individual company beta.	For this reason,	a group	average	beta w	ill produce	a
2	more reliable return estimate.						

I relied on The Value Line Investment Survey published beta for each of the
companies in my comparable group. The average beta for my proxy utility group is
0.78 as shown on my Exhibit MPG-11 ().

6 Q. HOW DID YOU DERIVE YOUR MARKET PREMIUM ESTIMATE?

A. I derived two market premium estimates, a forward-looking estimate and one based
on a long-term historical average.

9 The forward-looking estimate was derived by estimating the expected return 10 on the market (S&P 500) and subtracting the risk-free rate from this estimate. I 11 estimated the expected return on the S&P 500 by adding an expected inflation rate to 12 the long-term historical arithmetic average real return on the market. The real return 13 on the market represents the achieved return above the rate of inflation.

The Ibbotson and Associates' <u>Stocks, Bonds, Bills and Inflation 2005 Year</u> <u>Book</u> estimates the historical arithmetic average real market return over the period 16 1926-2004 as 9.2%. A current five-year consensus analyst inflation projection, as 17 measured by the Consumer Price Index, is 2.5% (Blue Chip Financial Forecasts, 18 March 10, 2005 at 15). Using these estimates, the expected market return is 11.9%. 19 The market premium then is the difference between the 11.9% expected market 20 return, and my 5.2% risk-free rate estimate, or 6.7%.

The historical estimate of the market risk premium was also estimated by Ibbotson and Associates in the <u>Stock, Bonds, Bills and Inflation, 2005 Year Book</u>. Over the period 1926 through 2004, Ibbotson's study estimated that the arithmetic average of the achieved total return on the S&P 500 was 12.4%, and the total return