BEFORE THE WASHINGTON

UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of Petition of PUGET SOUND ENERGY, INC. and NW ENERGY COALITION For an Order Authorizing PSE to Implement Electric and Natural Gas Decoupling Mechanisms and to Record Accounting Entries Associated with the Mechanisms	) Docket UE-121697) Docket UG-121705) (Consolidated)

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test year period in that case was end of calendar year 2010, was it not?

A. I believe that's right, yes.

Q. So those -- that analysis was based on the end of 2010. And then we have the 2011/2012 period, then we're projecting three years into the future.

So how do you advise that we -- that the commission should look at the financial market conditions in terms of the time period?

A. Well, I think the -- the relevant period is the period rates will be in effect. So the cost of capital today I think is the most important element in assessments of whether or not there's a consensus by independent economists that that capital market cost will change over the next three years. And that's what I tried to capture in my return on equity study.

By looking at current cost of capital with the DCF analysis and the risk premium studies, but also looking at forward trends and projected capital cost by using forecast interest rates in the CAPM and one component of my risk premium study. So that I think is the most relevant --

Q. Okay.

A. -- time period for this, but I also think it's important to look at the observable market evidence of changes in capital cost today relative to the time the last order was issued.

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And the -- the irrefutable observable market evidence is that capital market costs are lower now than they were at the time the commission's order was approved.

Q. You're anticipating a future question, so just let me get back to the commission-authorized ROE's and the trends there.

Do you have any data that you can refer to us on first quarter 2013 trends in commission-authorized ROE's that -- that support your thesis that ROE's are continuing to trend down both for natural gas utilities and electric utilities?

A. Well, the Regulatory Research Associates is probably the -- that most source studies relied on most often at regulatory proceedings.

Q. Yes, and we receive that here at the commission.

A. So I would point to that for regulatory-approved returns on equity. But generally what I was referring to was more market-driven capital market cost, because with -- because with the authorized returns on equity for many regulatory decisions around the country now, those have been considering, in my judgment, factors more than just the current market cost of equity.

They also reflect, I think, commissioners' concern about where -- where capital market costs will be during the rate effective period. So I think they -- they encapsulate those commissions' judgments as well as assessments of the

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return-on-equities, such as a return that -- in Virginia, as an example, that is based on state law which encourages investment in generation and asset development inside the state that burns Virginia coal and some other -- some other requirements.

If you don't remove those from the mix, you're not getting a true estimate of what regulatory commissions are finding as a cost of capital for integrating utility companies.

Q. Okay. If you could turn to page MPG-1-T, your responsive testimony page -- what page are we on? Page 12. We're talking about the risk premium.

A. I'm there.

Q. Okay. So just -- I just want to make sure I understand this. And again, if there's any more recent data on this.

But this basically you're trying to get at the -- the -- the yield spread between treasuries; correct, and --

A. No, these are the actual utility bond yields --

Q. Okay.

A. -- for a 13-week period at two points in time.

Q. All right.

A. One is in May 2012 at the time that the commission ordered, and the other one is a more recent 13-week period. And I use this to illustrate that observable market evidence on current cost of capital tells us that utilities cost of capital is 25 to 40 basis points lower for debt capital right now. And

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that's a pretty good indication that cost of capital for electric securities are also down a fair amount.

Q. Uh-huh. And is there -- the same point here. Is there any more recent data? Have these trends continued in the first quarter of 2013?

A. We are developing a study right now, and I will know the answer to that when I look at the results of that study. But the last few studies I've seen, the single A-rated utility bond yield has been pretty consistently in the low fours for most of this year.

Q. Okay. And Puget would be not in the top line. It's not an A-rated utility bond yield, but a BAA. This is the Moody's classification, BAA-rated utility bond yield?

A. Correct.

Q. So that would correspond to a 41 basis point reduction?

A. Yes.

Q. Okay. In your study, did you -- or well, I'll first address this to PSE. Based on Mr. Doyle's rebuttal testimony and what you know about the company, has -- PSE is a little bit unique, is it not, because it only goes to the capital markets for debt, not for equity.

Is that common throughout the country, to have privately owned utilities that don't need to raise equity in public markets?

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correct?
A. Yes.
Q. Okay. In terms of your specific recommendation on cost of capital, you're recommending that we adopt a 9.30 cost return on equity; correct?
A. Yeah, I believe that's the best estimate of the current market cost of equity.
Q. Let's go back to your recommendation in the latest rate case that we had with Puget. Your recommendation there was 9.70 percent; right?
A. I would have to check that, but that sounds correct.
Q. And we ended up with an order at 9.8 percent; correct?
A. Yes.
Q. Okay. So that's a 40 basis point reduction. So what is your primary -- it's in your return on equity study, but I'd like you to summarize it.
What is the primary reason for that 40 basis point recommendation that you're -- that you're providing to us?
A. The primary basis for it is the market's valuation of utility securities. The dividend yields of utilities have come down significantly over the last five years, and they have over the last year.
The -- and when the price goes up, the yield comes down. The cost of capital for utility comes down as the price goes up. Essentially means the utility can sell fewer shares

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to attract the capital it needs to invest in utility plan equipment.

Utility bonds yields have also come down during that time period. And that also is an indication that the market is willing to invest in utilities at a lower rate of return. All that again reflects the general assessment by market participants that utilities are low-risk, safe-haven-type investments.

And that's what the market's looking for, particularly during times in the marketplace that we've seen over the last five years or so. So the reason for it is simply a balanced application of the cost of capital models in the same way in this case that I did the last case.

But in this case I didn't rely as heavily on the results of my CAPM study, because I found that result to be too low. And the reason I think it's too low is I think there's a temporary imbalance between the estimate of the market risk rerate and then the market risk premium. So I didn't give that significant, if any, weight in forming my recommended return.

But the analyses here were very same as the analyses I used before, and my recommended return on equity in this case, like the last case, is my best estimate of what the current cost of capital is for a utility.

Q. I think your CAPM result came out at about 8.4 percent, did it not?