

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	
)	Docket No. UE-060266
Complainant,)	
)	Docket No. UG-060267
v.)	
)	<i>(consolidated)</i>
PUGET SOUND ENERGY, INC.)	
)	
Respondent.)	
_____)	

REPLY BRIEF OF
THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES

November 14, 2006

TABLE OF CONTENTS

TABLE OF AUTHORITIES	ii
I. INTRODUCTION	1
II. POWER COSTS	2
A. Natural Gas Price Update.....	3
B. Minimum Up/Down Times.....	4
C. Hydro Shaping	5
D. Forward Market Prices.....	7
E. PSE Has Not Shown That Its Proposed PCA Revisions Are Justified.....	7
III. COST OF CAPITAL	7
A. Expiration of the PCA Cost Cap Does Not Justify an Increased ROE.....	7
B. PSE Has Not Shown That It Is Riskier than Other Utilities	8
C. PSE’s Proposed Flotation Cost Adjustment Is Unreasonable.....	9
D. PSE’s Initial Brief Undermines the Validity of Dr. Morin’s 11.25% Recommended ROE	11
E. PSE’s Criticisms of Mr. Gorman’s ROE Analyses Should Be Rejected.....	12
F. ICNU’s Recommended Equity Ratio Is Consistent with Commission Precedent.....	15
IV. CONCLUSION.....	16

TABLE OF AUTHORITIES

Cases and Orders

WUTC v. Avista Corp., WUTC Docket Nos. UE-050482 and UG-050483,
Order No. 05 (Dec. 21, 2005)7

WUTC v. PacifiCorp, WUTC Docket Nos. UE-050684 and UE-050412,
Order No. 04 (Apr. 17, 2006)10

WUTC v. PSE, WUTC Docket Nos. UE-040641 et al., Order No. 06 (Feb.
18, 2005)2, 7

WUTC v. PSE, WUTC Docket No. UE-050870, Order No. 04 (Oct. 20,
2005)4

I. INTRODUCTION

1 In its initial brief in this proceeding, Puget Sound Energy (“PSE” or the “Company”) has failed to show that its proposed power cost level is appropriate for setting rates in this proceeding or that its requested return on equity (“ROE”) and capital structure are reasonable. As a result, PSE has not met its burden of proof on these issues. In contrast, the Industrial Customers of Northwest Utilities (“ICNU”) has provided strong support for its recommendation that the Washington Utilities and Transportation Commission (“WUTC” or the “Commission”) should reduce PSE’s rates by approximately \$20 million.

2 The Commission should adopt the following adjustments to PSE’s filing:

- Require PSE to update natural gas costs prior to the effective date of the rates from this proceeding;
- Replace the minimum up and down times for gas-fired combustion turbine generating units in AURORA with times that reflect actual operating characteristics of the facilities;
- Replace the monthly hydro shaping factors used in PSE’s AURORA model with shaping factors that reflect the expected operation of the Northwest hydro system;
- Replace PSE’s AURORA-derived hourly power prices with forward market electric prices; and
- Adopt a 9.9% ROE for PSE, as well as PSE’s actual test-year common equity ratio of 44.1%.

In addition, the Commission should reject PSE’s proposed changes to its power cost adjustment mechanism (“PCA”) and its proposed depreciation tracker.

II. POWER COSTS

3 PSE's chief criticism of the joint ICNU, Staff, and Public Counsel ("Joint Parties") recommended adjustments to PSE's power costs is that, according to PSE, the Joint Parties advocate for a power cost level that is "too low" and based on an incomplete review of PSE's AURORA data set.^{1/} PSE's criticism is unfounded. The Joint Parties' recommendation is consistent with the Commission's directive in PSE's last rate case, and it matches costs that PSE is reasonably expected to incur during the rate year.^{2/} Moreover, the Joint Parties' review of PSE's AURORA data set was not "piecemeal," and the fact that the Joint Parties did not identify each and every input error does not cure the errors that the Joint Parties did identify.

4 PSE asserts that because a party must provide full evidentiary support for a proposition it advances, the Commission should not accept adjustments to PSE's power costs absent a complete review of the AURORA inputs.^{3/} PSE does not, however, actually argue that the Joint Parties have not provided full evidentiary support for their proposed adjustments. As a result, the evidentiary support argument is unpersuasive.

5 Interestingly, the Company accepted the Joint Parties' generation capacity adjustment, despite the fact that the Joint Parties testified that "[i]t is extremely unlikely that we have identified and included all missing WECC capacity in the data file."^{4/} It is inconsistent for the Company to accept the Joint Parties' generation capacity adjustment,

^{1/} PSE Initial Brief at ¶¶ 110, 113.

^{2/} See WUTC v. PSE, WUTC Docket Nos. UE-040641 et al., Order No. 06 at ¶ 108 (Feb. 18, 2005).

^{3/} PSE Initial Brief at ¶ 113, n.202.

^{4/} Exh. No. 588C at 11:20-21 (Joint Power Costs).

which did not find every possible adjustment in “the enormous PSE resource data file,”^{5/} and at the same time urge the Commission to reject the Joint Parties’ other adjustments on that basis. Moreover, the Company changed the minimum up and down times in AURORA for its own resources only.^{6/} Therefore, it did the very thing it is arguing should not be done: it changed only a limited number of the inputs without going through the entire data set.

6 The Commission should reject PSE’s position that a review of the AURORA data set must be all or nothing. According to the Company’s rationale, no modification to the Company’s AURORA inputs would be acceptable absent a review of each and every line and column in AURORA. It would be unreasonable to preclude changes to AURORA absent such a burdensome review. Given the schedule in this proceeding, it would have been nearly impossible, and extremely costly, to complete the level of review PSE is demanding. As a result, the Joint Parties focused on the major aspects of PSE’s power cost case.

A. Natural Gas Price Update

7 The Joint Parties have asked the Commission to require PSE to update gas prices for this case before the rates in this proceeding take effect.^{7/} In its initial brief, PSE asserts that it is not opposed to updating its power cost projections, but it requests permission to update not only natural gas prices, but also other unspecified “changes in

^{5/} Id. at 12:1-2.
^{6/} TR 873:13-20 (Mills).
^{7/} ICNU Initial Brief at ¶ 11.

the power portfolio for 2007 that are now known.”^{8/} The Commission should not allow PSE to make selective updates to costs for which PSE has not provided support or documentation. The natural gas price update that the Joint Parties advocate is appropriate because forward gas prices are transparent and known to all other parties. Further, the Commission has permitted natural gas updates in the past.^{9/} In contrast, PSE now proposes to update other costs, but it does not specify what costs it intends to update, and other parties will not be able to verify the accuracy or validity of PSE’s updates. Given the fact that new rates are expected to go into effect on January 1, 2007, there would be no time to review the prudence and reasonableness of the new costs PSE seeks to place in rates through updates. The Commission should require a natural gas price update and reject the Company’s proposal for additional updates.

B. Minimum Up/Down Times

8 The Joint Parties have shown that PSE’s power costs are inflated due to unrealistic assumptions regarding the operating characteristics of Western gas-fired generation. PSE’s use of unrealistic assumptions is demonstrated by the fact that PSE changed the AURORA inputs for its own resources.^{10/}

9 PSE incorrectly asserts that the Joint Parties’ proposed AURORA adjustment for minimum up and down times for gas-fired combustion turbines “is based on a review of only three contracts totaling 1,820 megawatts.”^{11/} In fact, the Joint Parties

^{8/} PSE Initial Brief at ¶ 109.

^{9/} See, e.g., WUTC v. PSE, WUTC Docket No. UE-050870, Order No. 04 at ¶ 16 (Oct. 20, 2005).

^{10/} TR 874:24 – 875:6 (Mills).

^{11/} PSE Initial Brief at ¶ 118.

testified that they “reviewed the specifications for most of the new large combined cycle combustion turbines . . . that have been added in recent years within the WECC.”^{12/} The three contracts that PSE references are contracts that the Joint Parties used to provide representative examples of the operating characteristics of newer gas generation in their testimony, but they are not the only contracts that the Joint Parties reviewed.^{13/}

10 The Company’s argument that accepting the Joint Parties’ proposal would increase operation and maintenance costs is unfounded.^{14/} As previously explained, PSE has not provided evidentiary support for this argument.^{15/} The Company’s assertion that the Joint Parties’ proposed adjustment might be rendered uneconomic by increased operation and maintenance costs is supported by no more than “a back of the envelope calculation.”^{16/} For the reasons given in ICNU’s initial brief, the Commission should accept the Joint Parties’ adjustment.

C. Hydro Shaping

11 PSE states incorrectly that the “Joint Parties argue that the AURORA model does not model enough hydro into high-value, on-peak hours”^{17/} The Joint Parties’ position on hydro shaping is not, however, that there is a problem with the AURORA model itself. Rather, the Joint Parties argue that the shaping factors that PSE has input to the AURORA model are problematic because they do not shape enough

^{12/} Exh. No. 588C at 12:15-17 (Joint Power Costs).

^{13/} See id.

^{14/} See PSE Initial Brief at ¶ 118.

^{15/} ICNU Initial Brief at ¶ 26.

^{16/} TR 912:18-24 (Mills).

^{17/} PSE Initial Brief at ¶ 114.

hydro into on-peak hours.^{18/} By shaping hydro output into lower value off-peak hours, PSE's shaping factors inflate PSE's power costs.

12 Similarly, contrary to PSE's assertion, the Joint Parties do not ask the Commission to substitute the shaping factors from PSE's April 14, 2006 position and exposure report ("Risk Report") for the shaping factors that PSE used.^{19/} The Joint Parties' position is that their proposed shaping factors are more reasonable than PSE's shaping factors because they are more consistent with both the Risk Report and the Bonneville Power Administration's ("BPA") 2006 Risk Analysis Study Documentation.^{20/} Far from "disregarding how electric systems are managed," the Joint Parties' proposal is more consistent with how the Northwest hydro system is managed, as well as with hydro conditions that may occur during the rate year.^{21/}

13 PSE is wrong that its actual historical on-peak shaping over the past 5 years shows that the Joint Parties' proposal is "artificially high."^{22/} As previously noted, three to four of the last five years were considered poor hydro years.^{23/} In contrast, AURORA assumes normalized hydro conditions. Hence, PSE's experience over the past five years is not a useful basis upon which to assess the strength of PSE's AURORA shaping factors.

^{18/} Exh. No. 588C at 16:19-20 (Joint Power Costs).

^{19/} PSE Initial Brief at ¶ 115.

^{20/} ICNU Initial Brief at ¶¶ 29-31.

^{21/} *Id.* at ¶¶ 32-35.

^{22/} PSE Initial Brief at ¶ 115.

^{23/} TR 894:6-9 (Mills); ICNU Initial Brief at ¶ 34.

D. Forward Market Prices

14 The Joint Parties have asked that the Commission require PSE to use forward market electric prices instead of AURORA-derived hourly prices to determine power costs. Despite the fact that the Joint Parties provided more than fifteen pages of prefiled testimony on the subject,^{24/} PSE asserts that the Joint Parties have “provided no analysis to support the validity of using a three-month Mid-C market price.”^{25/} In addition, the Joint Parties’ suggestion is not, as PSE argues, “an attempt to manipulate model inputs to produce lower power costs.”^{26/} The Joint Parties’ recommendation is consistent with Commission precedent using forward market prices to set power costs.^{27/} It also is consistent with arguments that PSE itself has made in favor of using forward natural gas prices instead of a fundamentals model for determining gas costs.^{28/}

E. PSE Has Not Shown That Its Proposed PCA Revisions Are Justified

15 ICNU adopts the positions set forth regarding the PCA in the Reply Brief of Public Counsel.

III. COST OF CAPITAL

A. Expiration of the PCA Cost Cap Does Not Justify an Increased ROE

16 PSE argues that it requires an ROE that is higher than its currently authorized 10.3% ROE because the current ROE was set before the \$40 million

^{24/} Exh. No. 588C at 25:12 – 41:5 (Joint Power Costs).

^{25/} PSE Initial Brief at ¶ 113.

^{26/} Id.

^{27/} WUTC Docket Nos. UE-040641 et al., Order No. 06 at ¶¶ 112-16; WUTC v. Avista Corp., WUTC Docket Nos. UE-050482 and UG-050483, Order No. 05 at ¶¶ 105-07 (Dec. 21, 2005).

^{28/} See WUTC Docket Nos. UE-040641 et al., Order No. 06 at ¶ 104.

cumulative cap in the PCA expired.^{29/} As an initial matter, the PCA cap was never “firmly in place,” as PSE asserts.^{30/} It was a temporary cap that was designed to expire after four years. The cap’s expiration has been on the horizon since the PCA was established, and it does not now subject PSE to a sudden, disastrous shift in risk.

17 Furthermore, PSE makes an unsubstantiated argument that absent adoption of PSE’s proposed changes to the PCA, the cap’s expiration will cause PSE’s financial condition to deteriorate.^{31/} PSE’s witness, Dr. Morin, provided no objective evidence to support his statements about the effect of the cap’s expiration.^{32/} As explained thoroughly by Public Counsel and ICNU in their initial briefs, the objective evidence in the record shows that expiration of the cost cap does not expose PSE to extreme risk.^{33/}

B. PSE Has Not Shown That It Is Riskier than Other Utilities

18 PSE argues that it requires an increased ROE to account for its alleged greater risk than other comparable utilities, but PSE has failed to demonstrate that it actually has greater risk. PSE incorrectly states that its cost of capital witness, Dr. Morin, concluded “that PSE (with its proposed mechanisms to reduce risk) contains greater risks than that of his comparable group of utilities (with their mechanisms to reduce risk).”^{34/} PSE does not cite any portion of Dr. Morin’s testimony to support this statement, because Dr. Morin did not do the comparison or reach the conclusion that PSE claims he did. Dr.

^{29/} PSE Initial Brief at ¶ 57.

^{30/} See *id.* at ¶ 22.

^{31/} See *id.* at ¶ 84.

^{32/} See Exh. No. 301 at 63:9-19 (Morin Direct).

^{33/} Public Counsel Initial Brief at ¶¶106-111; ICNU Initial Brief at ¶ 51.

^{34/} PSE Initial Brief at ¶ 22.

Morin proposed a 25 basis point risk adder, but it was not based on a direct comparison of PSE's risks and the risks of Dr. Morin's comparable group.^{35/}

19

In his rebuttal to Mr. Gorman's testimony, Dr. Morin did include a table that purported to show that PSE has greater construction risk than the utilities in Dr. Morin's comparable group.^{36/} That table, however, was based on past, not future, expenditures, so it does not show that PSE has greater construction risk going forward.^{37/} Dr. Morin did not provide direct comparisons for any of the other types of risk that he identified in his testimony. Moreover, although Dr. Morin asserted that PSE has greater purchased power risk than the utilities in his comparable group, he admitted that he did not actually compare PSE's purchased power risk to that of his comparable group.^{38/} As a result, PSE's request that the Commission add a 25 basis point "risk" adjustment to PSE's ROE estimate is unsupported and should be rejected.

C. PSE's Proposed Flotation Cost Adjustment Is Unreasonable

20

PSE asserts that because its parent company, Puget Energy, issued common stock during the test year and expects to incur issuance expenses during the rate year to finance PSE's construction program, the Commission should allow PSE's flotation cost adjustment.^{39/} The Commission should reject PSE's request because PSE has not shown that a specific amount of Puget Energy's flotation costs is properly

^{35/} Exh. No. 471C at 28:7-10 (Gorman Direct); see Exh. No. 301 at 58-59 (Morin Direct).

^{36/} Exh. No. 315 at 92:6-10 (Morin Rebuttal).

^{37/} See TR 373:5-18 (Morin).

^{38/} Exh. No. 315 at 94:3-4 (Morin Rebuttal); TR 366:16 – 367:5 (Morin).

^{39/} PSE Initial Brief at ¶ 58.

allocable to PSE.^{40/} The empirical evidence that PSE provides is insufficient, given that Dr. Morin admits that it is “absolutely” possible for the Company to track the amount of flotation costs that is allocable to PSE.^{41/} The Company has offered no explanation as to why it has not proposed a flotation cost adjustment based on the costs that are actually allocable to PSE, when it would be possible for it to do so.

21 PSE attempts to bolster its argument by citing the Commission’s recent PacifiCorp decision, but that decision does not support PSE’s argument.^{42/} There, the Commission said: “While, in some circumstances, we have permitted adjustments to a Company’s cost of equity to reflect issuance expenses or flotation costs, we cannot do so in this case because PacifiCorp did not incur such expenses in the test year, nor does the Company expect to incur such expenses in the future.”^{43/} The Commission’s reasoning in that case should apply with equal force to PSE, which has not shown that its proposed flotation cost adjustment is based on costs that Puget Energy has incurred on PSE’s behalf during the test year or on costs that Puget Energy will incur on PSE’s behalf during the rate year. Instead, it is based on “a general study of market flotation costs that may or may not have any relationship to PSE’s actual cost of issuing stock to the public.”^{44/}

22 Mr. Gorman testified that a flotation cost adjustment like that proposed by PSE could be supportable if the utility demonstrated three things: 1) that the utility’s

^{40/} Exh. No. 471C at 48:6 – 49:2 (Gorman Direct).

^{41/} TR 351:23 – 352:1 (Morin).

^{42/} PSE Initial Brief at ¶ 58 n.97.

^{43/} WUTC v. PacifiCorp, WUTC Docket Nos. UE-050684 and UE-050412, Order No. 04 at ¶ 122 (Apr. 17, 2006).

^{44/} Exh. No. 471C at 48:14-15 (Gorman Direct).

parent company issued common stock to the public; 2) that the costs incurred for issuing the stock were reasonable; and 3) that a particular amount of the costs incurred by the parent company should be allocated to the utility.^{45/} PSE's proposal does not meet any of these criteria. The flotation cost adjustment that PSE proposes is not known and measurable, and the Commission should reject it.

D. PSE's Initial Brief Undermines the Validity of Dr. Morin's 11.25% Recommended ROE

23 PSE contends that a reduction from "the upper end of the range" of its proposed ROE may be warranted if the Commission adopts PSE's proposed PCA revisions and tracking mechanisms.^{46/} First, PSE's ROE witness did not propose a "range" of ROEs for PSE. Dr. Morin proposed an 11.25% ROE.^{47/} Second, Dr. Morin's proposed ROE was based on the assumption that the Commission *did* accept the PCA revisions and the proposed trackers.^{48/} Now, PSE is saying that a reduction to its proposed ROE would be warranted under the same circumstances—in other words, PSE is now asking the Commission to assume that Dr. Morin's proposed ROE assumed that the Commission *did not* accept the PCA revisions and proposed trackers.^{49/} This is fundamentally inconsistent with Dr. Morin's testimony, and it implies that PSE itself believes that Dr. Morin's 11.25% recommended ROE is too high.

24 Another fallacy in PSE's argument is that although PSE now asserts that its proposed ROE assumes that the Commission does not approve the PCA revisions and

^{45/} TR 391:9-15 (Gorman).

^{46/} PSE Initial Brief at 8.

^{47/} Exh. No. 301 at 78:10-12 (Morin Direct).

^{48/} *Id.* at 62:4-6; Exh. No. 315 at 94:10-12 (Morin Rebuttal).

^{49/} PSE Initial Brief at ¶ 21.

tracking mechanisms, it also takes the position that if the Commission does not approve them, it should increase PSE's ROE.^{50/} This makes no sense. If PSE's recommended ROE assumed that the PCA revisions and tracking mechanisms were not accepted (which it does not), there would be no reason to increase it if they were not accepted.

25 PSE's argument on the appropriate ROE is hopelessly muddled. On the one hand, the Company has hired an expert to testify that an 11.25% ROE is appropriate if the Commission accepts the PCA revisions and tracking mechanisms; on the other hand, the Company now argues that "a ROE level in the high 10% range" would be appropriate under those circumstances.^{51/} This inconsistency casts doubt on the validity of Dr. Morin's recommendation, and ICNU urges the Commission to take this into account when determining the amount of weight to assign to Dr. Morin's testimony.

E. PSE's Criticisms of Mr. Gorman's ROE Analyses Should Be Rejected

26 PSE's overall criticism of ICNU's recommended 9.9% ROE for PSE is that it is lower than the average authorized ROE for Mr. Gorman's comparable group of 10.88%.^{52/} The average authorized ROE of Mr. Gorman's comparable group, however, is not a valid measure of what PSE's ROE should be. If it were, ROE experts could do away with all of their detailed technical analyses and rely on simple averages instead. Mr. Gorman's ROE recommendation is based on the results of three analytical models,

^{50/} Id.
^{51/} Id. at ¶ 57.
^{52/} PSE Initial Brief at ¶ 56.

and it is further supported by Mr. Gorman's conclusion that a 9.9% ROE will allow PSE to maintain its financial integrity, while fairly compensating for investment risk.^{53/}

27

Turning to Mr. Gorman's specific analyses, PSE criticizes the beta that Mr. Gorman used in his CAPM analysis because Mr. Gorman did not use the average beta of his comparable group.^{54/} PSE incorrectly asserts that Mr. Gorman relied "on the beta for a single utility" for his CAPM analysis.^{55/} In fact, Mr. Gorman testified that he used "informed judgment" to reject beta estimates for some of the companies in his comparable group. This was not because their risk profiles are different from PSE, as PSE asserts,^{56/} but, as explained more thoroughly in ICNU's initial brief, because Mr. Gorman did not believe that their beta estimates accurately reflected those companies' levels of regulated risk.^{57/} Mr. Gorman did rely "primarily" on Puget Energy's beta estimate for his CAPM analysis, but he explained that he did so because in his judgment Puget Energy's beta of 0.80 "conservatively reflects the market's assessment of the risk of PSE."^{58/} Mr. Gorman's conclusion ultimately is supported by the fact that the Company's and Staff's ROE witnesses both used betas that are very close to the beta that Mr. Gorman used.^{59/}

^{53/} Exh. No. 471C at 2:4-6 (Gorman Direct).

^{54/} PSE Initial Brief at ¶ 69.

^{55/} Id.

^{56/} Id. at ¶ 69 n.121.

^{57/} Exh. No. 471C at 20:6-13 (Gorman Direct); ICNU Initial Brief at ¶¶ 65-66.

^{58/} Exh. No. 471 C at 20:15-16 (Gorman Direct).

^{59/} Exh. No. 301 at 28:15-16 (Morin Direct); Exh. No. 544.

28

PSE also argues that the historical market risk premium of 6.5% that Mr. Gorman used in his CAPM analysis is too low.^{60/} ICNU thoroughly explained the reasons that Dr. Morin's market risk premium is too high in its initial brief.^{61/} Mr. Gorman properly relied on the Ibbotson and Associates' 2006 study to derive his historical estimate of the market risk premium, based on the actual market investment return premium over treasury bonds.^{62/} In contrast, Dr. Morin's risk premium is a contrived estimate that is based on incomplete and selective use of historical data.^{63/}

29

Next, PSE criticizes Mr. Gorman's use of a medium-term inflation rate forecast in his CAPM's prospective market risk premium.^{64/} As Dr. Morin admitted at the hearing, however, the accuracy of long-term forecasts is more uncertain than that of short-term forecasts.^{65/} Rates should be set based on more accurate data. If interest rates do increase over the long term, then the Company's ROE can be adjusted in a future rate case. The higher equity cost estimate, made with the highly uncertain long-term inflation forecast, exceeds PSE's equity cost using current and near-term projected inflation. This higher-cost equity may never exist because the inflation projection is so uncertain.

30

Finally, PSE argues that Mr. Gorman's historical risk premium analysis is flawed because it fails "to account for the inverse relationship between authorized risk

^{60/} PSE Initial Brief at ¶¶ 72-73.
^{61/} ICNU Initial Brief at ¶¶ 74-75.
^{62/} Exh. No. 471C at 22:3-8 (Gorman Direct).
^{63/} *Id.* at 31:17-21.
^{64/} PSE Initial Brief at ¶76.
^{65/} TR 359:24 – 360:9 (Morin).

premiums and interest rates.”^{66/} This alleged inverse relationship, however does not exist. As Mr. Gorman explained,

Dr. Morin’s analysis simply does not comport with observable market data or commission-authorized returns. Equity risk premiums do not move directly with simple changes to nominal interest rates. Rather, equity risk premiums should increase as perceptions of equity risk change in relationship to bond risks.^{67/}

In addition, although Dr. Morin provided a chart in his rebuttal testimony purporting to support the supposed inverse relationship, his chart does not support his theory because the data does not include a period when interest rates are increasing.^{68/} His chart merely shows that ROEs decrease more slowly than interest rates.

F. ICNU’s Recommended Equity Ratio Is Consistent with Commission Precedent

31 According to PSE, ICNU’s proposed capital structure does not comport with the Commission’s guidance that the Company’s equity ratio should be set “at the level that the evidence shows is most likely to prevail, on average, over the course of the rate year.”^{69/} In fact, ICNU’s recommendation is consistent with this guidance, while PSE’s is not. ICNU recommends that the Commission adopt PSE’s actual test-year capital structure.^{70/} PSE, on the other hand, proposes an equity ratio that is based on capital structure changes that the evidence does not show to be more likely than not to

^{66/} PSE Initial Brief at ¶ 81.
^{67/} Exh. No. 471C at 44:5-8 (Gorman Direct); see also id. at 44:9 – 45:16.
^{68/} Exh. No. 315 at 83:12-15 (Morin Rebuttal).
^{69/} PSE Initial Brief at ¶ 49.
^{70/} Exh. No 471C at 1:19-20 (Gorman Direct).

occur.^{71/} It is more likely that ICNU's recommended equity ratio of 44.1%, based on PSE's current equity ratio, will prevail during the rate year.

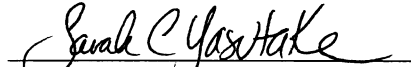
IV. CONCLUSION

32 PSE has not carried its burden of proof to support any increase in rates at this time. ICNU urges the Commission to adopt power cost levels that reflect the actual costs that PSE is expected to incur during the rate year, and to adopt a reasonable ROE and capital structure. These adjustments show that a \$20 million rate reduction is justified.

Dated this 14th day of November, 2006.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.



S. Bradley Van Cleve

Sarah C. Yasutake

333 S.W. Taylor, Suite 400

Portland, Oregon 97204

(503) 241-7242 telephone

(503) 241-8160 facsimile

mail@dvclaw.com

Of Attorneys for Industrial Customers
of Northwest Utilities

^{71/} Id. at 5:7 – 6:3.