

EXHIBIT NO. ___(RAM-1T)
DOCKET NO. UE-060266/UG-060267
2006 PSE GENERAL RATE CASE
WITNESS: DR. ROGER A. MORIN

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY, INC.,

Respondent.

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

PREFILED DIRECT TESTIMONY (NONCONFIDENTIAL) OF
DR. ROGER A. MORIN
ON BEHALF OF PUGET SOUND ENERGY, INC.

REVISED JUNE 7, 2006

1 **4. Market Risk Premium**

2 **Q. What market risk premium estimate did you use in your CAPM analysis?**

3 A. For the market risk premium, I used 7.5%. This estimate was based on the results
4 of both forward-looking and historical studies of long-term risk premiums. First,
5 the Ibbotson Associates study, *Stocks, Bonds, Bills, and Inflation, 2004 Yearbook*,
6 compiling historical returns from 1926 to 2004, shows that a broad market sample
7 of common stocks outperformed long-term U. S. Treasury bonds by 6.6%. The
8 historical market risk premium over the income component of long-term Treasury
9 bonds rather than over the total return is 7.2%. Ibbotson Associates recommend
10 the use of the latter as a more reliable estimate of the historical market risk
11 premium, and I concur with this viewpoint. This is because the income
12 component of total bond return (*i.e.* the coupon rate) is a far better estimate of
13 expected return than the total return (*i.e.* the coupon rate + capital gain), as
14 realized capital gains/losses are largely unanticipated by bond investors.

15 Second, a DCF analysis applied to the aggregate equity market using ~~Value~~
16 ~~Line's~~S & P 500's aggregate stock market index and growth forecasts indicates a
17 prospective market risk premium of 7.7%. I have used the average of the
18 historical and prospective estimates, 7.5%, as a reasonable estimate of the market
19 risk premium.