

**CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP**

**ATTORNEYS AT LAW**

**SUITE 2000**

**1001 SW FIFTH AVENUE**

**PORTLAND, OREGON 97204-1136**

---

**TELEPHONE (503) 224-3092**

**FACSIMILE (503) 224-3176**

EDWARD A. FINKLEA  
email address: efinklea@chbh.com

January 18, 2005

**VIA HAND DELIVERY**

Carole J. Washburn  
Secretary  
Washington Utilities and Transportation Commission  
PO Box 47250  
1300 S. Evergreen Park Drive, SW  
Olympia, WA 98504-7250

Re: **WUTC v. Puget Sound Energy**  
**Docket Nos. UG-040640 and UE-040641**

Dear Ms. Washburn:

Enclosed please find an original and 19 copies of the Initial Brief of the Northwest Industrial Gas Users (NWIUGU) in the above-captioned matter. I have enclosed a file copy to be file date stamped and returned in the enclosed self-addressed stamped envelope for our records. An electronic copy is also being sent to the Records Center on January 18, 2005.

Please contact me if you have any questions. Thank you for your assistance.

Very truly yours,



Edward A. Finklea

EAF/lis  
Enclosures  
cc: Service List

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND )  
TRANSPORTATION COMMISSION )  
 )  
Complainant, )  
 )  
vs. )  
 )  
PUGET SOUND ENERGY, INC. )  
 )  
Respondent. )

Docket Nos. UG-040640  
UE-040641

**INITIAL BRIEF  
OF THE  
NORTHWEST INDUSTRIAL GAS USERS**

Edward A. Finklea, OSB No. 84216  
Chad M. Stokes, OSB No. 00400  
Cable Huston Benedict Haagensen & Lloyd LLP  
1001 SW 5<sup>th</sup> Avenue  
Suite 2000  
Portland, OR 97204-1136  
Telephone: (503) 224-3092  
Facsimile: (503) 224-3176  
E-mail: [efinklea@chbh.com](mailto:efinklea@chbh.com)  
[cstokes@chbh.com](mailto:cstokes@chbh.com)

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## **I. AND II. SUMMARY OF ARGUMENT AND INTRODUCTION**

Pursuant to the procedural schedule adopted by Administrative Law Judge Moss, the Northwest Industrial Gas Users (“NWIGU”) hereby submit this Initial Brief in the above-referenced proceeding. Puget Sound Energy, Inc. (“Puget”) filed with the Washington Utilities and Transportation Commission (“WUTC” or “Commission”) for a general rate case seeking to increase natural gas sales and transportation rates by \$47.2 million and electric rates by \$81.6 million. NWIGU is an active intervenor in this proceeding, having sponsored testimony by Donald W. Schoenbeck and Thomas Yarborough. *See* Testimony of Thomas S. Yarborough, Exh. No. 401 (TSY-1T); Testimony of Donald W. Schoenbeck, Exh. Nos. 388-389 (DWS-1T, 3[SIC]).

In this Initial Brief, NWIGU will address only selective issues. NWIGU will address two important issues the Commission must resolve to determine Puget’s cost of capital: 1) cost of equity capital (Designated Issue III.D.) and 2) Puget’s capital structure (Designated Issue III.E.). NWIGU will also address the appropriate level of rate case expenses (Designated as Issue IV. c. iv. Adjustment 2.10 – Rate Case Expense). Finally, NWIGU will address why the Commission should approve the Rate Spread and Rate Design Settlement (Designated as Issue VI).

### **ARGUMENT**

#### **III. CAPITAL STRUCTURE AND COST OF CAPITAL**

##### **D. Common Equity**

###### **1. Puget’s Authorized Return on Equity Should Be Lowered From 11% In Order to Reflect Current Capital Markets.**

What equity return Puget should be authorized to earn is the most controversial and significant issue the Commission must resolve in this proceeding. Puget is seeking to raise its authorized return from 11 to 11.75 percent. Puget’s current authorized return was established in 2002 as part of a global settlement presented to and approved by this Commission. *WUTC v.*

*Puget Sound Energy, Inc.*, Docket Nos. UE-011570 and UG-011571, Ninth Supplemental Order, Appendix A, Settlement Stipulation at 6 (March 28, 2002). Puget has the burden of showing by a preponderance of the evidence that an increase in its authorized return from 11 to 11.75 percent is needed for the Company to attract equity investors at reasonable terms in today's capital markets and to maintain its financial integrity. *WUTC v. Pacific Power & Light Co.*, Cause No. U-84-65, Fourth Supplemental Order, 68 P.U.R. 4th 396, 85 WL 514900, 20 (August 2, 1985).

The expert witnesses employed by Puget, WUTC Staff and Public Counsel have widely divergent opinions on what is an appropriate equity return for Puget in today's capital markets. All three experts are highly regarded in the field of cost of capital and all have provided detailed, well-documented analyses to support their conclusions. Dr. Wilson, on behalf of the WUTC Staff, concludes that a 9 percent equity return is appropriate in today's capital markets. *See* Testimony of John L. Wilson, Exh. No. 481 p. 7, (JLW-1T). Public Counsel's expert, Steven Hill, recommends a slightly higher return than Dr. Wilson, concluding that the proper range is 9 to 10 percent, with his point estimate at 9.75 percent. *See* Testimony of Stephen G. Hill, Exh. No. 351 p. 11, (SGH-1T). Puget's witness, Dr. Cicchetti, recommends a substantially higher return of 11.75 percent and claims that his analysis of capital markets and the risks facing Puget supports an even higher return despite current interest rates. *See* Testimony of Charles J. Cicchetti, Exh. No. 201, (CJC-1T).

Both the WUTC Staff and Public Counsel have employed well-recognized experts in the field of cost of capital to address the issues raised by Puget's request for an 11.75 percent return on equity. Dr. Wilson has testified in numerous proceedings over many decades. This Commission has accepted Dr. Wilson's recommendations in a previous proceeding. *See generally* *WUTC v. Olympic Pipeline Co.*, Docket No. TO-011472, Twentieth Supplemental Order, 54 (Sept. 27, 2002). Mr. Hill has testified on behalf of Public Counsel for many years. This Commission has accepted his recommendations in many previous cases. *See generally*

*WUTC v. Washington Natural Gas Co.*, Docket No. UG-920840, Fourth Supplemental Order, 1993 WL 500058, 20 (Sept. 27, 1993).

Because of the reputation of both the WUTC Staff and Public Counsel experts, NWIGU and other intervenors did not sponsor expert witnesses on cost of equity capital. The issue, however, is of critical importance to NWIGU member companies. Thus, NWIGU is bringing forth its perspective on cost of capital through this Initial Brief. NWIGU will show that based on a careful review of prior Commission precedent, that there is no justification for allowing Puget to earn an 11.75 percent return in today's capital markets. Interest rate declines since 2002 require Puget's authorized return to be lowered from its current level of 11 percent.

NWIGU urges the Commission to resolve the cost of equity debate in this proceeding based on the extensive record and in a manner consistent with historic precedent of this Commission and with recent decisions in neighboring states. In today's low interest rate environment, utilities need lower equity returns to attract capital than they have historically. An 11.75 percent return on equity today is as out of sync with capital markets as \$3.00 per MMBtu natural gas would be in today's energy markets. Puget's customers have been forced to absorb the higher prices brought about by the commodity energy markets of this decade. Similarly, Puget's shareholders in 2005 should only have an opportunity to earn a return on equity that reflects today's capital markets, not a return that would be reasonable only if interest rates returned to the levels of the 1980s or 1990s.

**A. It Is Essential To Measure Puget's Requested Return In The Context Of Today's Capital Markets.**

Puget's customers know that by employing the services of a national expert they could not convince this Commission to order Puget to sell natural gas at prices only slightly different than the market prices of the 1980s or 1990s. It would be fundamentally unfair to ignore the actual cost of gas in today's market and simply order Puget to roll back rates to mid-1980s levels. The same should hold true when setting the appropriate return on equity.

Supreme Court precedent and prior decisions of this Commission establish that Puget is entitled to an opportunity to earn a return on equity that is sufficient to maintain its financial integrity and attract capital on reasonable terms. *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679, 690, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944). The return should be comparable to other enterprises of corresponding risk. *Hope Natural Gas Co.*, 320 U.S. at 603. An essential element of the regulatory compact is that rates should be set to allow the utility an opportunity to earn a reasonable return on its shareholders' equity investment. As the court explained more recently in *Duquesne Light Co. v. Barash*, 488 U.S. 299, 307-08, 109 S.Ct. 609, 102 L.Ed.2d 646 (1989), the constitutional standard is that the overall rates of a utility must provide the company with a reasonable opportunity to attract capital and earn a fair return on its investments. In *Duquesne Light Co.*, the Supreme Court clarified that the focus for constitutional analysis is not on any one decision within the process of establishing the utility's rates, but rather on whether the final result gives the company an opportunity to earn a reasonable return. 488 U.S. at 314.

Ratepayers' interests are not properly protected, however, if a utility is authorized to earn a return that is higher than necessary to attract capital in today's equity markets. The Commission must employ its sound judgment and properly balance the shareholders' interests in being fairly compensated for their investments with the Commission's duty to protect ratepayers from excessive rates and charges. See *Washington Natural Gas Co.*, 1993 WL 500058 at 19-20.

In order to apply the legal standards established in *Bluefield*, *Hope* and *Duquesne Light Co.*, and often articulated by this Commission, it is critical to consider both the overall cost of capital in today's markets and to determine the true degree of risk Puget faces as a combined gas and electric utility serving Washington customers in the mid-2000s. Puget's customers and shareholders want the Company to both attract capital in the future on reasonable terms and maintain financial integrity.



Complex financial and analytical techniques have been employed by all three expert witnesses to support their recommendations for an appropriate equity return. WUTC Staff and Public Counsel have each forwarded well-supported cases for an authorized return below 10 percent. The technical work of Dr. Wilson and Mr. Hill is extremely thorough and carefully reasoned. Both witnesses offered strong defenses of their recommendations during cross-examination by Puget and under questioning by the Commissioners. While debate points were made by all sides, there is no fundamental flaw in the technical work of either Dr. Wilson or Mr. Hill.

The resistance to the recommendations of Dr. Wilson and Mr. Hill is somewhat emotional. At first, it sounds somewhat stingy to advocate for a reduction of Puget's authorized return on equity to less than 10 percent. Investor-owned utilities in Washington have been authorized to earn double digit returns for decades. In *WUTC v. Washington Natural Gas Co.*, Cause No. U-77-47, 23 P.U.R. 4th 184, 8 (Nov. 22, 1977), Washington Natural Gas ("WNG") was authorized to earn 13.25 percent on equity. Two years later, WNG was authorized to earn 13.5 percent on equity. *WUTC v. Washington Natural Gas Co.*, Cause No. U-79-15, 32 P.U.R. 4th 530, 15 (Sept. 25, 1979). Based on decades of historic precedent, less than a 10 percent return sounds extremely low.

Puget's expert, Dr. Charles Cicchetti, contends that given the risks Puget faces today, it requires a return of at least 11.75 percent to attract capital in today's markets. See Testimony of Charles J. Cicchetti, Exh. Nos. 201 and 206C, (CJC-1T and CJC-6T). In addition, the company's CEO, Mr. Reynolds, has testified that Puget needs a return of 11.75 percent on equity to improve the company's financial health and to attract the capital it will be investing in the near future to provide natural gas delivery service and bundled and unbundled electric services. See Testimony of Stephen P. Reynolds, Exh. No. 51 (SPR-1T).

In addition to the extensive testimony of WUTC Staff and Public Counsel experts, common sense and historic precedent are strong rebuttals to Puget's request for an authorized

return of 11.75 percent in today's capital markets. Despite his outstanding credentials, the details contained in his analysis, and the expense Puget incurred to forward his effort, Puget's witness Dr. Cicchetti has failed to carry the Company's burden of showing that, in today's capital markets, an authorized return of 11.75 percent is reasonable for Puget or any other entity having corresponding risk. Instead, the record in this case and past precedent of this Commission supports a reduction in Puget's currently authorized return of 11 percent to a lower figure.

**B. Past Precedent of This Commission Supports Lowering Puget's Authorized Return.**

The return on equity sought by Puget is unprecedented given current interest rates. Puget's request for an 11.75 percent return in today's capital markets is completely out of line with this Commission's prior precedent on equity returns. In 2005, Puget is seeking an authorized return on equity in the range granted by this Commission in the mid-1980s. The return it is seeking is 125 basis points higher than WNG<sup>1</sup> was granted as an authorized return in 1993.

Thus far in this decade, customers of Puget and other Washington electric and gas utilities have been forced to pay higher rates as commodity energy prices have risen sharply. Fortunately, while commodity energy prices are at record highs, interest rates are at record lows. As demonstrated by bond yields of A-rated utilities, the cost of capital is less than half the rates that prevailed in the 1980s and much lower than the rates that prevailed in the 1990s. Testimony of Stephen G. Hill ("Hill Testimony"), Exh. No. 356 (SGH-6). By any objective measure, interest rates are at or near record lows. Equity returns must reflect today's capital markets.

As the WUTC observed twenty years ago when resolving a contentious cost of equity dispute:

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<sup>1</sup>As the Commission is aware, the merger between Puget and Washington Natural Gas was approved in 1997. *In re Puget Sound Power & Light Co.*, Docket Nos. UE-951270 and UE-960195, Fourteenth Supplemental Order, 48 (Feb. 5, 1997). Puget's gas customers today were formerly served by Washington Natural Gas.

The commission approves the use of common sense in analysis and the use of common sense as a test or validation of technical theory. *Pacific Power & Light*, 68 P.U.R. 4th 396, 85 WL 514900, 16.

In this proceeding, when common sense is used to validate the theories advanced to support the cost of equity recommendations of the three experts, Dr. Cicchetti's technical theories fail. Carefully reviewing the returns authorized by this Commission starting in the mid-1980s provides a common sense method of testing the validity of the technical theories being advanced by the experts in this proceeding. Dr. Cicchetti's technical arguments for an 11.75 percent return today fail this common sense test when viewed through the precedent of past WUTC decisions.

In 1984, Puget requested a \$98.4 million general rate increase. At the time, the WUTC required Puget to write off a substantial portion of its investment in the then recently cancelled nuclear plant Puget had started to construct at Skagit, Washington. *WUTC v. Puget Sound Power & Light Co.*, Cause No. U-83-54, Fourth Supplemental Order, 62 P.U.R. 4th 557, 5 (Sept. 28, 1984). Issues regarding even greater write-offs associated with abandoned nuclear power plant projects were also being litigated in Washington state courts. *People's Organization for Washington Energy Resources v. Utilities & Transportation Commission*, 104 Wn. 2d 798, 711 P.2d 319 (1985). At that time, Moody's bond yield for A- Rated utilities was over 15 percent. See Hill Testimony, Exh. No. 356 (SGH-6) at p. 1. Puget's embedded cost of long-term debt in the 1984 case was 10.09 percent. *Puget Sound Power & Light Co.*, 62 P.U.R. 4th 557, 6. In the midst of that extremely high interest rate environment, and facing all of the risks associated with large write-offs from abandoned nuclear plant investments, the WUTC authorized Puget to earn a 16.25 percent return on equity. *Id.* at 16. The authorized equity return was approximately 60 percent higher than the actual cost of long-term debt included in Puget's capital structure in that case.

In 1985, Pacific Power and Light Company ("PacifiCorp") sought to increase its rates. *Pacific Power & Light Co.*, 68 P.U.R. 4th 396, 85 WL 514900. In its immediately prior rate case proceeding, PacifiCorp had been authorized by the WUTC to earn a 15.25 percent return on

equity. PacifiCorp sought a rate increase based on a 16.25 percent return on equity. The Commission lowered PacifiCorp's authorized return on equity to 14.8 percent, observing:

The cost of equity rate of 15.25% established by the commission in Cause No. U-83-33 is presumed to have been a correct gauge of investor expectations at the time. Those expectations may be expected to have declined due to the favorable circumstances that have transpired thereafter, providing yet further basis for accepting Dr. Lurito's [WUTC Staff's Expert Witness] estimate of a 14.8% cost of equity in this proceeding. *Id.* at 20.

In that proceeding, PacifiCorp's cost of long-term debt was 9.79 percent. In adopting the 14.8 percent return, the Commission ruled that PacifiCorp "has not established by a preponderance of the evidence that the rate of return it proposes is appropriate." *Id.* at 20. The 14.8 percent authorized return on equity adopted by the WUTC was 52 percent higher than PacifiCorp's cost of long-term debt in that case.

In 1992, WNG filed for a \$41.4 million rate increase for its gas customers. *Washington Natural Gas Co.*, 1993 WL 500058, 1. To support the requested increase, WNG sought a return on equity between 12-12.25 percent. WUTC Staff's witness, Dr. Luritto, recommended a 10.5 percent return on equity. Public Counsel's expert, Mr. Hill, recommended a return on equity in the range of 10.25 to 10.5 percent.

The WUTC rejected the rate of return sought by WNG and adopted the recommendation of WUTC Staff and Public Counsel, authorizing WNG to earn a 10.5 percent return on equity. *Id.* at 21. It is instructive to note that WNG's long-term debt cost at the time was 8.72 percent. *Id.* The authorized return on equity of 10.5 percent was just 22 percent higher than the cost of WNG's long-term debt in that case.

In this proceeding, it is uncontested that Puget's cost of long-term debt is only 6.86 percent. Hill Testimony, Exh. No. 368 (SGH-18). Yet Puget is seeking an authorized return on equity of 11.75 percent. Puget is seeking an authorized return on equity that would be 72 percent higher than the Company's actual cost of long-term debt. Even when Puget was an electric-only utility facing \$100s of millions in write-offs for abandoned nuclear plants, the authorized return

on equity of 16.25 percent was only 60 percent higher than the Company's cost of long-term debt.

In this proceeding, Puget has been highly critical of the recommendations of WUTC Staff witness Dr. Wilson and Public Counsel witness Mr. Hill. One generalized theme has been to question the credibility of an expert recommending less than a 10 percent return on equity. A simple but common sense answer is that a 9.5 percent return on equity is 40 percent higher than the Company's actual cost of long-term debt. Adopting a return anywhere at the high end of the range recommended by the WUTC Staff and Public Counsel witnesses would be a far higher equity return relative to the Company's actual long-term debt cost than the WUTC authorized WNG to earn in 1993. An 8.2 percent return on equity for Puget in this case is arguably the equivalent return to what the WUTC authorized WNG to earn in 1993. Viewed in such a fashion, Dr. Wilson's recommendation of a 9 percent return would compensate Puget for greater risk than was built into the 10.5 percent return WNG was authorized to earn in 1993.

NWIGU is not suggesting this Commission can determine the proper return on equity by simply applying a percentage multiplier to the cost of long-term debt. The extensive analytical work performed by the three expert witnesses in the case must be weighed. The experts retained by WUTC Staff and Public Counsel have performed their analyses consistent with the accepted methods for establishing returns. A careful review of Commission precedent from the 1980s and 1990s shows that the recommendations of WUTC Staff and Public Counsel are well within the range of historic returns, and are in fact higher than the return WNG was authorized to earn in 1993. It is the 11.75 percent return sought by Puget that is outside the range of reasonableness based on a careful analysis of past precedent.

**C. Recent Precedent of This Commission and Commissions of Neighboring States Also Supports Reducing Puget's Authorized Return to Below 11 Percent.**

This Commission's recent order involving a combined gas and electric utility, Avista's year 2000 rate case, is also instructive in resolving the cost of equity dispute in this proceeding.

*WUTC v. Avista Corp.*, Docket Nos. UE 991606 and UG-991607, Third Supplemental Order, 204 P.U.R. 4th 1, 2000 WL 1532899 (Sept. 29, 2000). In that case, Avista sought rate increases for gas and electric customers. Avista proposed a power cost adjustment mechanism that would have protected shareholders from the risks associated with hydro variability and market power purchases by passing power cost variations through to ratepayers. *Id.* at 13. Even with the proposed power cost adjustment mechanism, Avista sought an authorized return on equity of 12.25 percent. *Id.* at 74. Staff witness Dr. Lurito recommended a cost of equity of 10.4 percent. *Id.* at 75. Mr. Hill testified that a reasonable range was 10.5 percent to 11.25, and pinpointed his recommendation at 10.875 percent. *Id.*

This Commission denied Avista's request for a power cost adjustment mechanism but set Avista's authorized return at 11.16 percent. *Id.* at 77. The authorized return was slightly above Mr. Hill's pinpoint recommendation, but within his range. Avista's cost of long-term debt in that case was 7.45 percent. *Id.* at 80. Thus, the authorized return on equity was slightly less than 50 percent higher than Avista's actual cost of long-term debt.

In 2005, Puget has a power cost adjustment mechanism that protects it from some of the risk Avista was trying to place upon ratepayers in its rejected year 2000 power cost adjustment proposal. As a combined gas and electric utility in 2005, Puget certainly faces less risk than Avista faced in 2000. The decline in interest rates since 2000 makes this Commission's Avista decision strong precedent for lowering Puget's return today to less than 11 percent. Avista's long-term debt cost in the year 2000 was 59 basis points higher than Puget's long-term debt cost in this case.

Litigated outcomes from neighboring states also provide some guidance in helping this Commission reach a judgment on return in this proceeding. NWIGU does not suggest that decisions of other jurisdictions are a reason alone for selecting an authorized return. The decisions of neighboring Commissions, however, can help confirm the validity of authorized return figures advanced by the three experts that testified in this proceeding.

On September 7, 2001 the Oregon Public Utility Commission (OPUC) granted PacifiCorp a \$64.421 million increase in the rates it charges for electric service in Oregon. *In re PacifiCorp*, Docket No. UE-117, Order No. 01-787, 212 P.U.R. 4th 379, 2001 WL 1285997, 1 (Sept. 7, 2001). The OPUC carefully weighed the expert testimony of its Staff expert, of an expert retained by intervenors, and PacifiCorp's expert, Dr. Hadaway. *Id.* at 22-34. After carefully weighing the DCF and CAPM analysis of all three experts, the OPUC selected 10.75 percent as an authorized return for PacifiCorp providing electric-only utility service in 2001. *Id.* at 34. PacifiCorp's cost of long-term debt in that case was 6.88 percent. *Id.* Thus, the authorized equity return was 56 percent higher than PacifiCorp's long-term cost of debt.

A final decision that warrants consideration is a 2004 decision of the Idaho Public Utility Commission granting Idaho Power Company a \$25.3 million increase in its electric rates. *In re Idaho Power Co.*, Case No. IPC E-03-13, Order No. 29505, 233 P.U.R. 4th 107, 2004 WL 1299892 (May 25, 2004). The Idaho Commission authorized Idaho Power to earn 10.25 percent on equity. *Id.* at 1. The Idaho Commission was presented with testimony from experts providing a range from 8.4 percent to 11.9, but chose a return in the low 10 percent range. *Id.* at 60.

NWIGU finds no precedent for granting Puget an increase in its currently authorized return on equity. The return level recommended by WUTC Staff expert Dr. Wilson sounds low at first blush, but when taken in historic context is found to be reasonable in today's capital markets and within the range supported by historic precedent. Mr. Hill's recommended range of 9 percent to 10 percent is well within the range of equity returns that this Commission has adopted in previous cases, when viewed in comparison to actual debt costs and today's low interest rate environment. If Puget were granted a return approximately 50 percent higher than long-term debt costs of 6.86 percent, the authorized return would be slightly higher than the top end of the range recommended by Mr. Hill. NWIGU would find an outcome within that range to

be reasonable. Puget's requested return, however, is unreasonable on its face and the current authorized return should be lowered.

**2. Risks Facing Puget Do Not Justify A Risk Premium High Enough To Justify Even the Current 11 Percent Return.**

The Puget of 2005 may face more risks than a select few of the combined gas and electric utilities in 2005, but it certainly faces fewer risks than the Puget of the mid 1980s. To be fair to ratepayers and shareholders, the Commission should not authorize Puget to earn a return far above the range advocated by Dr. Wilson and Mr. Hill. To grant Puget the return it seeks, this Commission would have to grant Puget an unprecedented, and unjustified, risk premium above today's risk-free cost of money.

Puget faces far fewer risks today than it did in the mid-1980s, when the utility took large write offs over abandoned generation. Furthermore, as a combined gas and electric utility, Puget has lowered its risks compared to when it was a stand-alone electric utility. On the gas side, approximately 64 percent of the costs prudently incurred to provide service, including taxes, are purchased gas costs. These costs are ultimately passed through to customers without any risk of recovery because all purchased gas costs, including commodity and interstate transportation, are passed through to customers through a Purchased Gas Adjustment mechanism. *See* Testimony of B. Luscier, Exh. 263, (BAL-G3), p. 1, Adjusted Results of Operation Column. Thus, the acquisition of WNG by Puget has certainly lowered the combined utility's risk compared with a stand-alone electric utility.

Furthermore, Puget has recently been granted a power cost adjustment and the PCORC, both of which lower risk when compared to an electric utility without such mechanisms. Tr. Vol IV, p. 512. Thus, while Puget will be making significant investments in the near future to provide gas and electric services, it is not a utility that faces unprecedented risks. Yet the 11.75 percent Puget seeks would grant Puget an unprecedented return in today's capital markets. There is no rational basis for granting such a high risk premium to Puget.



The final argument advanced by Puget in favor of a high return is that Puget currently has a lower bond rating than is desirable, and a high equity return would help increase the Company's bond rating. Yet nothing in the record supports the conclusion that it is the currently authorized return on equity that is harming Puget's bond rating. The financial problems Puget faces are much more closely tied to problems with subsidiaries and problems with actually earning its authorized return. TR. Vol IV, p. 562, lines 1-10 (Wilson).

NWIGU has supported efforts to allow Puget to recover more of its fixed costs through higher customer charges and demand charges. This Commission has made changes in Puget's rate design in recent years that should improve Puget's ability to earn its authorized return. The rate spread and rate design settlement should also further improve Puget's fixed-cost recovery. See Partial Settlement Agreement, Exh. No. 1, Attachment A, at 11-20.

This Commission should not artificially inflate Puget's authorized return to help Puget's bond rating or to help Puget actually earn its authorized return. The authorized return should be lower than the current authorized level of 11 percent. A generous but fair return would be in the range supported by WUTC Staff and Public Counsel witnesses, with a few basis points added to the high end of that range to account for recent upward movement in interest rates above the record lows reached in 2004. Anything higher would be excessive.

#### **E. Total Capital – Capital Structure**

In the settlement of Puget's last rate case, customer groups, including NWIGU, supported raising the equity component of Puget's capital structure to 40 percent. Rates were established based on a hypothetical capital structure subject to Puget meeting certain benchmarks. The settlement accomplished its desired objective of helping raise the equity component of Puget's capital structure.

Puget's actual equity component is 40 percent of its capital structure. Puget's rates no longer need to be established assuming the existence of hypothetical equity. Public Counsel's

expert, Mr. Hill, has testified that 40 percent equity should be used in Puget's capital structure. Hill Testimony, Exh. No. 356 (SGH-1T), p. 29, lines 1-3. NWIGU supports his recommendation as reasonable.

#### **IV. REVENUE REQUIREMENT**

##### **c. Contested Adjustments – Gas**

##### **iv. Adjustment 2.10 – Rate Case Expense**

With respect to the adjustment of rate case costs, NWIGU supports the positions taken by Commission Staff and ICNU expert Schoenbeck briefly summarized below. Commission Staff recommended an amortization of the 2001 rate case costs deferred by Puget and amortization of the 2004 rate case costs deferred by Puget through August 2004. Testimony of James M. Russell ("Russell Testimony"), Exh. No. 421 (JMR-1T), p. 20, lines 17-20. It was also recommended by Commission Staff that the Commission allow a normalized level of PCORC and remaining 2004 rate case costs. Russell Testimony, Exh. No. 421 (JMR-1T), pp. 20-21, 22-23. *Id.*, line 19 through p. 21, line 1.

The ICNU representative specifically addressed Puget's proposal to recover rate case expenses related to outside legal and consulting fees. ICNU estimates that Puget will spend millions of dollars on outside services in connection with the past proceedings and the current docket. Testimony of Donald W. Schoenbeck ("Schoenbeck Testimony"), Exh. No. 371HC (DWS-1HCT), p. 28. Witness Schoenbeck recommended that Puget be allowed to recover 50 percent of its outside legal and consulting expenses for activities decided prudent by the Commission. *Id.* at 29, lines 11-13. NWIGU concurs with Witness Schoenbeck's recommendation.

ICNU also recommends a reduction of outside services. Schoenbeck Testimony, Exh. No. 371HC (DWS-1HCT), p. 30, lines 19-20. This recommendation is based on the normalization rationale presented by Commission Staff in response to Puget's petition for

deferred accounting treatment of these costs. *Id.* In that response, Commission Staff indicated a concern that the level of legal expenses was high in comparison to those incurred in similar proceedings. Schoenbeck Testimony, Exh. No. 385 (DWS-15), p. 2. NWIGU also supports ICNU's proposal that a portion of the outside services expense be shared 50/50 between ratepayers and Puget shareholders. Schoenbeck Testimony, Exh. No. 371 HC (DWS-1HCT), p. 30, lines 21-23.

The Commission must act to reign in runaway spending of ratepayer money by utilities to advance their positions when seeking rate increases. WUTC Staff, Public Counsel and intervenors find it difficult to pursue just and reasonable rates for customers if utilities have seemingly endless resources to expend advocating for higher rates.

## **VI. RATE SPREAD AND RATE DESIGN SETTLEMENT**

NWIGU urges the Commission to approve the Rate Spread and Rate Design Settlement. The natural gas rate spread agreed to by all parties allocates any resulting rate increase from this proceeding in a manner that is consistent with the results of the natural gas cost of service study. Partial Settlement Agreement, Exh. No. 1 at ¶13. Sales Schedule 87 and Transportation Schedule 57 were combined for purposes of the cost study since the delivery service Puget provides under the two schedules is the same. Moving all schedules closer to parity with the results of the cost of service study is fair to all customers and consistent with prior Commission precedent. The Commission should spread any rate increase resulting from this proceeding consistent with the rate spread and design settlement. Since the rate design settlement allows Puget to collect some additional fixed costs through customer service charges, the settlement should also assist Puget in actually earning its authorized return on equity.

## **IX. CONCLUSION**

NWIGU urges the Commission to lower Puget's authorized return on equity from the current level of 11 percent. An equity return slightly above the high end of the 9-10 percent

range found reasonable by Public Counsel's expert Mr. Hill would be a fair return in today's capital markets and would fully compensate investors for the risks Puget faces in 2005. Moreover, Puget's capital structure should include no more than 40 percent equity. Rate case expenses should be normalized as recommended by Staff and ICNU. Finally, the rate increase the Commission authorized should be spread in accordance with the rate spread and design settlement agreed to by all Parties to this proceeding.

Dated in Portland, Oregon, this 18<sup>th</sup> day of January, 2005.

Respectfully submitted,



Edward A. Finklea OSB 84216

Chad M. Stokes OSB 00400

Cable Huston Benedict Haagensen & Lloyd LLP

1001 SW 5<sup>th</sup> Avenue

Suite 2000

Portland, OR 97204-1136

Telephone: (503) 224-3092

Facsimile: (503) 224-3176

E-mail: [efinklea@chbh.com](mailto:efinklea@chbh.com)

[cstokes@chbh.com](mailto:cstokes@chbh.com)

## CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing document upon the parties of record in these proceedings listed below by mailing a copy properly addressed with first class postage prepaid. Electronic copies will be e-mailed to all parties of record on January 18, 2005.

KIRSTIN DODGE  
JASON KUZMA  
PERKINS COIE LLP  
10885 NE 4TH STREET STE 700  
BELLEVUE, WA 98004

KIMBERLY HARRIS  
PUGET SOUND ENERGY, INC.  
10885 NE FOURTH ST.  
BELLEVUE, WA 98004

MICHAEL KURTZ  
BOEHM, KURTZ, & LOWRY  
36 E. SEVENTH ST. STE 2110  
CINCINNATI OH 45202

S. BRADLEY VAN CLEVE  
DAVISON VAN CLEVE  
1000 S.W. BROADWAY STE 2460  
PORTLAND OR 97205

NORMAN J. FURUTA  
DEPARTMENT OF THE NAVY  
SUITE 600  
2001 JUNIPERO SERRA BLVD.  
DALY CITY, CA 94014

JOHN CAMERON  
DAVIS WRIGHT TREMAINE  
1300 S W FIFTH AVE STE 2300  
PORTLAND OR 97201

JOHN O'ROURKE  
CITIZENS' UTILITY ALLIANCE  
212 W. 2ND AVE., #100

SPOKANE, WA 99201

DANIELLE DIXON  
NW ENERGY COALITION  
SUITE 100  
219 FIRST AVE. SOUTH  
SEATTLE, WA 98104

RONALD ROSEMAN  
ATTORNEY AT LAW  
2011 - 14TH AVENUE E.  
SEATTLE, WA 98112

SIMON J. FFITCH  
PUBLIC COUNSEL SECTION  
AG'S OFFICE  
SUITE 2000  
900 FOURTH AVENUE  
SEATTLE, WA 98164

ROBERT D. CEDARBAUM  
KRISTA LINLEY  
1400 S. EVERGREEN PARK DR. SW  
PO BOX 40128  
OLYMPIA, WA 98504

ELAINE SPENCER  
GRAHAM & DUNN  
PIER 70 STE 300  
2801 ALASKAN WAY  
SEATTLE WA 98121-1128

Dated in Portland this 18<sup>th</sup> day of January, 2005.

*Edward A Finklea*

Edward A. Finklea, OSB No. 84216

Chad M. Stokes, OSB No. 00400

Cable Huston Benedict Haagensen & Lloyd LLP

Portland, OR 97204

Telephone: (503) 224-3092

Facsimile: (503) 224-3176

E-mail: [efinklea@chbh.com](mailto:efinklea@chbh.com)

[cstokes@chbh.com](mailto:cstokes@chbh.com)

Of Attorneys for the Northwest Industrial  
Gas Users