

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Policy of the) DOCKET UG-120715
Washington Utilities and)
Transportation Commission Related to) COMMISSION POLICY ON
Replacing Pipeline Facilities with an) ACCELERATED REPLACEMENT OF
Elevated Risk of Failure) PIPELINE FACILITIES WITH
) ELEVATED RISK
.....)

I. INTRODUCTION AND SCOPE

1 The Washington Utilities and Transportation Commission (Commission) is charged by statute, in RCW Titles 80 and 81, to regulate investor-owned natural gas utility companies as to rates they charge the public and the safety of their facilities, respectively. The Commission meets its responsibility by issuing orders and establishing rules governing company operations and establishing tariffs that contain the rates and charges those companies must assess for services rendered.

2 This statement states the Commission’s policies relating to the replacement of pipeline facilities that are demonstrated to have an elevated risk of failure and provides conditions for the interim recovery between rate cases of the costs associated with replacing those facilities.

3 Under RCW Title 81, the Commission also regulates the safety of intrastate gas pipelines owned and operated by cities¹ and towns, as well as private intrastate gas pipelines, such as a gas pipeline owned and operated by a manufacturing plant. For two reasons, the Commission limits the application of this policy statement to the investor-owned gas utility companies.

4 First, the cost recovery aspects of this policy statement would apply only to the investor-owned gas utilities the Commission regulates both as to rates and as to pipeline safety. Consequently, the Commission would not have jurisdiction to approve a cost recovery mechanism for a city-owned pipeline or a privately-owned pipeline.

¹ Currently, the Commission regulates the safety of the gas pipelines owned and operated by the cities of Buckley, Ellensburg and Enumclaw.

5 Second, the Commission understands that the city-owned and private gas pipelines do not have the types of pipe that have been proven to have an elevated risk of failure; only the investor-owned gas utility companies have such pipe. Consequently, the need to accelerate pipe replacement for elevated risk pipe appears to apply only to the investor-owned gas utility companies.

6 Therefore, the Commission concludes that at this time, this policy statement should apply only to the investor-owned gas utility companies: Puget Sound Energy, Inc. (PSE), Avista Corp. (Avista), Northwest Natural Gas Company (NWNG) and Cascade Natural Gas Company (CNG). At the same time, the Commission recognizes that the city-owned and private gas pipelines are subject to the same safety rules as the investor-owned gas utility companies. In the ordinary course of business, the Commission reviews the Distribution Integrity Management Plans² for each city and private gas pipeline operator for compliance with those rules.

7 If, in the future, it appears appropriate to include the city-owned or private gas pipelines within the scope of this policy statement (as to its non-rate aspects), the Commission will take the appropriate steps to do so, including notice to the affected gas pipelines.

II. FEDERAL AND STATE RULES

8 The federal government has preempted safety regulation of interstate gas pipeline facilities in this country.³ The Federal government permits states to regulate the safety of intrastate gas pipeline facilities, so long as the state's program is federally-certified. If so, the state can adopt and enforce federal standards with respect to intrastate gas pipelines. In addition, the state can adopt additional or more stringent safety standards than those adopted by the Federal government, so long as those state regulations are compatible with federal regulations.⁴ Set forth in 49 C.F.R. Part 192, the Pipeline and Hazardous Materials Safety Administration's (PHMSA) regulations establish minimum safety standards for gas pipelines.

² We discuss these plans in more detail later in the next section of this policy statement.

³ 49 U.S.C. § 60104(c) (second sentence): "A state authority may not adopt or continue in force safety standards for interstate pipeline facilities or interstate pipeline transportation."

⁴ *Id.* (first sentence): "A state authority that has submitted a current certification under section 60105(a) of this title may adopt additional or more stringent safety standards for intrastate pipeline facilities and intrastate pipeline transportation only if those standards are compatible with the minimum standards prescribed under this chapter."

- 9 In December 2009, PHMSA issued its rules regarding Distribution Integrity Management Plans (DIMP).⁵ These rules extend previously-established pipeline integrity management principles for hazardous liquid and gas transmission pipelines to gas distribution systems.
- 10 The DIMP rules mandate each gas pipeline operator to prepare a plan that uses a risk-based approach to evaluate the safety conditions that affect that particular pipeline. In each plan, the pipeline operator must document the characteristics of its gas system; identify, categorize and assess system risks; employ risk mitigation measures addressed to each identified risk; and monitor the effectiveness of the program.⁶ The rules require each gas distribution company to have developed and implemented a DIMP by August 2, 2011.⁷
- 11 The risk-management approach inherent in the DIMP rules also recognizes that a gas pipeline operator must consider many factors, not simply the age of pipe, when determining what measures are appropriate to maintain the safety, reliability and integrity of a distribution system. For example, for older gas distribution systems, the appropriate mitigation measures could involve major pipe rehabilitation, repair, and replacement programs. DIMP rules also require pipeline operators to determine the fitness for service of pipeline infrastructure on an ongoing basis.

III. PROCESS FOR DEVELOPMENT OF STATEMENT OF POLICY

- 12 The Commission opened this investigation for the purpose of determining whether companies should be required to enhance the safety of their natural gas distribution systems and, if so, what steps are necessary to accomplish that goal, including incentives for early retirement of pipe with known but managed risks. This action coincided with the Commission's final order rejecting PSE's proposed Pipeline Integrity Program (PIP).⁸ The Commission reasoned that PSE's PIP failed to address specific safety objectives and provide support for the financial incentives it requested.

⁵ 49 C.F.R. §§ 192.1001–1015.

⁶ 49 C.F.R. § 192.1007.

⁷ 49 C.F.R. § 192.1005.

⁸ *Utilities and Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UG-110723, Order 07, Final Order Rejecting Tariff and Initiating Investigation (May 18, 2012).

- 13 In the PIP proceeding, PSE and Commission Staff testified that the Company's system was safe and managed according to state and federal rules and regulations. However, the parties pointed out that certain older polyethylene pipe was prone to leaks and possible failure due to its age, composition and care taken during installation. PSE testified that it had identified over 100 miles of such pipe on its system, and that it was engaged in a replacement program targeting about four miles per year. According to Staff, all companies operating in Washington have some exposure to older polyethylene pipe with varying leak histories.
- 14 In order to develop a more complete record on the amount of older polyethylene or other elevated risk pipe in service, the Commission requested written comments from gas companies and other interested parties on:
- The types of pipe that are in service and need to be replaced to enhance safety;
 - The impediments to replacing that pipe;
 - How the companies assess risk, including the criteria and methodology used;
 - Whether an interim cost recovery mechanism is needed and which category of costs would be included; and
 - Various process matters such as the role of the Commission pipeline safety staff in this process and how a cost recovery mechanism would fit with existing regulatory processes.

The Commission received six sets of comments, including comments from each gas company, the Office of Public Counsel of the Office of the Attorney General (Public Counsel) and the Northwest Industrial Gas Users (NWIGU).

- 15 The Commission held two workshops on these matters. The first, on June 21, 2012, focused on the companies' risk assessment methodologies, pipe replacement programs and perceived barriers to those programs. The second workshop held July 2, 2012, considered different cost recovery mechanisms. In light of the information gathered through the parties' written comments and the workshops, the Commission issued a second notice on August 24, 2012, requesting gas companies to file pipeline replacement plans with the Commission as well as comments on the requirement to file such plans. The notice also requested that interested parties comment on two mechanisms proposed by Commission Staff for the recovery of costs associated with the accelerated replacement of elevated-risk pipe.

16 The Commission received pipeline replacement plans from three gas companies.⁹ The Commission also received comments from each gas company, Public Counsel and NWIGU on the two proposed mechanisms for interim recovery of pipe replacement costs. The Commission also received reply comments on these mechanisms from Public Counsel and NWIGU.

IV. SAFETY OF PIPELINE INFRASTRUCTURE

17 Over the past few years, the pipeline safety community has debated how best to replace aging pipeline facilities exhibiting elevated risk characteristics. The highly publicized natural gas explosions resulting from failure of aging pipeline facilities in California in 2010 and in Pennsylvania in 2011 have added urgency to this debate.

18 On April 18, 2011, in response to the California and Pennsylvania incidents, U.S. Transportation Secretary Ray LaHood convened a Pipeline Safety Forum with a goal of accelerating the rehabilitation, repair, and replacement of critical pipeline infrastructure with known integrity risks. Secretary LaHood's "Call to Action" brought together federal, state and industry stakeholders to share their expertise, experience and ideas for improving the safety and efficiency of the nation's pipeline infrastructure.

19 Subsequently, Cynthia L. Quarterman, the PHMSA Administrator, pointed to recent pipeline accidents and stated that the "timely repair, rehabilitation and replacement of high-risk gas pipeline infrastructure are critical to ensuring public safety."¹⁰ Ms. Quarterman also "recommend[ed] that state public utility commissions consider accelerating work on the following kinds of high-risk intrastate gas infrastructure in the future:

- Cast iron mains, which can be prone to failure as a result of graphitization or brittleness;
- Plastic pipe manufactured in the 1960s to the early 1980s, which is susceptible to premature failure as a result of brittle-like cracking;

⁹ Pipeline Replacement Plans were filed by Avista, CNG and PSE.

¹⁰ Letter to the National Association of Regulatory Utility Commissioners from Cynthia L. Quarterman, Administrator Pipeline and Hazardous Materials Safety Administration (December 19, 2011).

- Mechanical couplings used for joining and pressure sealing pipe, which are prone to failure under certain conditions;
- Bare steel pipe without adequate corrosion control (i.e. cathodic protection or coating);
- Copper piping;
- Older pipe, if it is vulnerable to failure from time-dependent forces, such as corrosion, stress corrosion cracking, settlement or cyclic fatigue factor; and
- Pipelines with inadequate construction records or assessment results to verify their integrity.”¹¹

Information provided by commenters in this proceeding shows that Washington’s gas companies have replaced all cast iron and have programs in place that will remove all remaining wrought iron, copper and bare steel pipe from service over the next five years.¹²

20 No commenting party presented evidence to demonstrate that any deployed pipe that is not already the subject of a Commission replacement order poses an immediate or imminent threat to public health, safety, and welfare. Nor did we expect such a result given the testimony in PSE’s PIP proceeding.¹³ Indeed, in Washington, we are fortunate to have a relatively modern pipeline infrastructure.

21 However, while we are fortunate to have very little of the highest risk, or even dangerous, pipe in service, the companies report that they have other kinds of elevated-risk gas infrastructure in service, including plastic mains and services manufactured before 1986¹⁴ and coated steel mains and services that may not have had adequate corrosion protection throughout their service life.¹⁵ It is these latter types of pipe that is our focus here.

¹¹ *Id.*

¹² CNG plans to remove its remaining nine miles of bare steel by 2018; NWNG plans to remove its remaining four miles by December 2015; and, pursuant to a regulatory order, PSE plans to remove its remaining 47 miles by December 31, 2014.

¹³ *See, e.g., Utilities and Transp. Comm’n v. Puget Sound Energy, Inc.*, Docket UG-110723, Order 07, Final Order Rejecting Tariff and Initiating Investigation, at 26 (May 18, 2012).

¹⁴ Avista has 328 miles of this pipe in service. PSE has identified the location of over 100 miles of such pipe and believes it may have up to 300 more miles in service. NWNG and CNG do not have this pipe in service.

¹⁵ CNG and PSE have this pipe in service.

V. LIMITATIONS ON ABILITY OF UTILITY TO REPLACE PIPELINE WITH ELEVATED RISK

22 Based on the written comments and workshop discussions in this docket, the Commission has identified three barriers to replacing elevated-risk pipe expeditiously: lack of sufficient information about the location of such pipe; construction limitations, including access to an adequate workforce and public rights of way; and cost. Each of these poses unique challenges to the companies and to the Commission.

A. Lack of Location Information

23 Inadequate information about the location of elevated risk pipe is particularly troubling. Each regulated utility has the obligation to ensure that its natural gas distribution system is safe. No commenter questions the safety of the system operated by any of the companies the Commission regulates. At the same time, however, no gas company can demonstrate that its system is safe if that company cannot identify the location and condition of potentially problematic pipe within that system.

24 In other words, companies need to assess the scope of the potential problem to be able to develop the necessary plan to replace elevated risk pipe in their systems, and they simply cannot do so effectively if they have not identified each type of pipe in its system and the location of each type of pipe.

25 This issue is most acute for PSE. PSE states in its initial comments that it is now “in the process of implementing a Geographic Information System that will better provide inventory and pipe location data for all of [PSE’s] pipe.”¹⁶ PSE’s existing records reflect only that “approximately 500 miles of larger diameter, high density polyethylene DuPont pipe was purchased and *may* have been installed.”¹⁷ However, PSE does not know the amount of this elevated risk pipe actually installed and its locations. The company cannot know the risk posed by this pipe without knowing what was installed and where it is located. Until such information is known, we have no assurance that system risk is adequately managed.

¹⁶ Comments of PSE at 3 (June 8, 2012).

¹⁷ PSE Pipeline Replacement Plan at page 3, filed September 14, 2012.

B. Construction Challenges

- 26 Even with more complete knowledge of the location of problematic pipe and the economic incentive to replace it, utilities also face practical limitations on their ability to accelerate pipe replacement efforts. Avista, for example, related its experience that “[l]ocal contractors supporting distribution pipeline companies, like Avista, are losing qualified workers to [oil and gas field] projects” in other states.¹⁸ For some utilities, winter weather conditions limit their ability to replace pipe. As Avista further observed, “contractors will lose qualified employees in the winter months unless the commitment is made to provide year-round employment.”¹⁹
- 27 PSE agrees that “[u]ncertainty in the amount of pipeline replacement work that will be done from year to year can be an impediment to accelerating the replacement of pipelines with integrity issues due to shortage of qualified personnel and available equipment.”²⁰
- 28 Local government restrictions, including franchising and permitting requirements, also slow the process of pipeline replacement. Avista details several such restrictions that have hampered its recent pipe replacement projects.²¹ Other utilities have had similar experiences or express comparable concerns in varying degrees.²²
- 29 Obviously, the Commission cannot influence local government processes or requirements, but providing a mechanism for sustained, long-term pipeline replacement could allow companies to more effectively manage their construction efforts to mitigate these obstacles. Also, the consequences of a local government’s siting and permitting requirements may lead the Commission to consider alternatives to imposing those costs on the whole of the utilities’ customers.

¹⁸ Comments of Avista at 5 (June 8, 2012).

¹⁹ *Id.* at 6.

²⁰ Comments of PSE at 9 (June 8, 2012).

²¹ Comments of Avista at 6-7 (June 8, 2012).

²² *See* Comments of NWNG at 7 (June 8, 2012); PSE Comments at 9 (June 8, 2012); Comments of CNG at 2-3 (June 8, 2012).

C. Cost

30 Another stated impediment to more rapid replacement of elevated risk pipe is the costs companies incur to replace that pipe. In a previous proceeding PSE stated that pipe replacement costs could be as high as \$1 million per mile.²³ Further, unlike many utility investments that facilitate customer growth, the replacement pipe under consideration here does not produce new revenue, thereby making the economics of pipeline replacement more challenging for the utilities.

VI. METHODS OF COST RECOVERY FOR REPLACEMENT OF PIPELINE INFRASTRUCTURE

31 The Commission's regulatory framework is designed to allow the companies to recover infrastructure investment, including pipeline replacement costs, and a reasonable return on invested capital. Investment for new customers, in theory, generates new revenue to cover expenses and a return on the new plant investment. Other plant investment needs that exceed the rate of depreciation are recovered primarily through general rate case proceedings.

32 However, the companies' concern is that "regulatory lag", which is the time period between the investment expenditure and the recovery of and on those expenditures in rates. While the Commission recognizes the presence of regulatory lag, it also considers it, to some extent, an incentive for efficient and effective management.

33 A goal of this policy statement is to develop a way for a gas company to reduce substantially that lag for recovering its investment pursuant to a pipe replacement program that is consistent with this policy statement.

34 All of the regulated natural gas companies agree that "allowing operators to recover pipeline replacement costs, and/or other prudently incurred pipeline integrity management costs (capital or O&M) through an interim rate treatment mechanism would facilitate operator actions to accelerate the replacement of pipeline facilities or otherwise enhance pipeline safety."²⁴ For example, these companies point to a project

²³ *WUTC v. PSE*, Docket UG-110723, TR 185:20-21 (PSE Henderson).

²⁴ Comments of NWNG at 9 (June 8, 2012); *accord* PSE Comments at 10; Comments of Avista Utilities at 11 (June 8, 2012); Comments of CNG at 3 (June 8, 2012).

NWNG undertook in Oregon as proof that such a cost recovery mechanism can result in more certain and rapid replacement of problematic pipe with much less lag.

35 Without specific cause to order pipe replacement, we look to economic incentives as leverage to increase the replacement rate for elevated risk pipe. We have acknowledged that some form of interim cost recovery might be warranted under appropriate circumstances. We reiterate our interest in such a result here. However, we caution that any economic incentive must be tailored to achieve results. Companies seeking such incentives must meaningfully expedite and improve company performance in their pipe replacement programs.

VII. STATEMENT OF COMMISSION POLICY

A. Introduction

36 Today, each gas company subject to Commission economic regulation under Chapter 80.28 RCW replaces pipe as part of its normal operations, and recovers related costs from customers through rates. There are no statutes or rules that mandate when a gas company should replace a particular section of pipe, or a particular type of pipe. Consequently, and in general, gas companies have exercised a range of discretion regarding how to address risk of failure on their systems. As a result, some gas companies are proactive²⁵ in replacing pipe that presents an elevated risk of failure, while other gas companies are less so.

37 It is in the public interest for all gas companies to take a proactive approach to replacing pipe that presents an elevated risk of failure. The Commission expects each gas company to have a pipe replacement program plan that contains the elements discussed in this section.

38 Some gas companies will need to make little or no change in operations to be consistent with this policy statement. Other gas companies may need to change management focus and perhaps company culture. The Commission strongly encourages these changes, though the Commission is also realistic. For example, despite the well-documented concerns over certain types of gas pipe facilities, for some gas companies, cost considerations have been identified as a barrier to creating a more vigorous and responsive pipe replacement program.

²⁵ “Pro-active” in this context means a gas company has a definite plan in place to replace all gas pipes that presents a demonstrated, elevated risk of failure.

39 To address this concern, the Commission will approve a special pipe replacement program cost recovery mechanism (CRM) based generally on the recovery cost mechanism used in Oregon with NWNNG, so long as the gas company's program meets the elements in this section. A gas company seeking a CRM below may file a tariff reflecting such a mechanism as described below.

40 While each gas company should have a pipe replacement program that is consistent with this policy statement,²⁶ a CRM is optional. Gas companies that can effectively manage their pipe replacement program without a special cost recovery mechanism may continue to do so.

41 Whether it seeks a CRM or not, each gas company should file with the Commission for approval a pipe replacement program plan with the supporting information identified in this section.

B. Company Pipeline Replacement Plan

42 The pipe replacement program plan should consist of three parts: (1) a "master" plan for replacing all pipes with an elevated risk of failure; (2) a two-year plan that specifically identifies the pipe replacement program goals for the upcoming two year period; and (3) if applicable, a plan for identifying the location of pipe that presents elevated risk of failure.

43 The first pipe replacement program plan should be filed by June 1, 2013, covering planned pipeline replacement through 2015. Subsequent plan filings should be filed by June 1 every two years thereafter (*i.e.*, June 1, 2015, 2017, 2019, etc.). If the company makes no changes to its master plan, it need file only the two-year plan in each filing after June 1, 2013. If the company makes a material change either to its master plan, its two-year plan or its pipe location plan, it should file plan changes with the commission within 30 days.

²⁶ The Commission recognizes that policy statements are not rules, and thus are not enforceable as a rule. However, for gas companies that do not wish to follow this policy statement, the Commission will initiate a proceeding to evaluate a gas company's pipe replacement program. The Commission does not predict the outcome of such a docket. However, depending on the evidence presented, the record in such a proceeding may justify Commission imposition of penalties if violations of Commission rules are proven, or a Commission order requiring the gas company to improve its practices, per, e.g., RCW 80.28.010(2), .040, and .130. There may be other related or unrelated remedies available.

44 A pipe replacement program plan acceptable to the Commission (and also eligible for a CRM) should contain the following elements:

1. The pipe replacement program plan should target pipe that poses an elevated risk of failure

45 In support of its pipe replacement program plan, each gas company should demonstrate that the type of pipe to be replaced under its program presents an elevated risk of cracking, leakage, breakage or other failure. The gas company should explain why the particular type(s) of pipe presents an elevated risk, such as the physical qualities of the pipe as manufactured (e.g., low ductile plastic pipe), the condition of the pipe as installed (e.g., poor soil conditions) or as maintained (e.g., no cathodic protection), the age of the pipe, etc.

46 The gas company should also provide detailed analysis and explanation demonstrating why the pipe it seeks to replace is appropriate for replacement, compared to other pipe. To the extent practical, the gas company should quantify and explain the degree to which risk of failure is elevated for such pipe, compared to other pipe.

47 Unless it is demonstrated otherwise, the Commission will consider a company's DIMPs and Transmission Integrity Management Plans (TIMPs) to be a fundamental source of information for evaluating elevated risk of pipe failure. However, each DIMP and TIMP should be robust and sufficiently populated with reliable data to justify conclusions regarding the risk presented by various types of pipe.

2. The pipe replacement program plan should contain a plan for identifying the location of pipe that presents elevated risk of failure

48 In the course of this docket, the Commission has learned that the degree of knowledge regarding the location of each type of pipe in its system varies widely, company to company. However, most (if not all) gas companies are expending effort to acquire or refine knowledge regarding pipe location.

- 49 A prudent pipe replacement program should contain a plan for identifying the location of elevated risk pipe; to the extent the gas company does not presently know the location. The plan should include a timetable under which the gas company will know the location of its elevated risk pipe. The Commission strongly supports a gas company's efforts to enhance the knowledge of its gas pipeline systems, including the location of the types of pipe that present an elevated risk of failure.
- 50 The Commission will not require a gas company to know the location of all of its elevated risk pipe as a prerequisite for having a pipe replacement program consistent with the policy statement. A pipe replacement program may focus initially on pipe for which the gas company knows the location.
- 51 At the same time, the Commission considers a gas company's knowledge of the location of each type of pipe it uses in its system to be a basic part of gas company operations. Stated differently, a gas company's failure to know where elevated risk pipe is located may itself present a safety risk the gas company should address and minimize. Consequently, a gas company may not include in the CRM the cost of locating pipe eligible for replacement under its pipeline replacement program.²⁷ Such knowledge should be an essential part of utility operations, not part of an incentive program.
- 52 After the first year, a company's continued participation in the program will be contingent on its substantial progress identifying the location of its elevated risk pipe. If a Company fails to so identify the location of such pipe prior to its initial filing for cost recovery, then it must demonstrate why it cannot identify the location of its elevated risk pipe and a plan for compliance with this requirement. Without such a demonstration of progress (or legitimate reasons for lack of progress), the company's participation will be limited to recovery of its first year costs, including return. A company in this circumstance may make a compliance filing at any time during the program year and allowed to participate for the remainder of the year in question.

²⁷ Nothing in this statement prevents a gas company from seeking recovery of such costs through and consistent with the traditional ratemaking process.

3. The pipe replacement program plan should be a measured and reasonable response in relation to the elevated risk and such a program must not unduly burden ratepayers

53 The Commission expects all gas company pipe replacement program plans to reflect a measured, fact-based response to the elevated risk which the gas company has demonstrated. The Commission understands that the significance of the effort will depend on, among other things, the nature and quantity of the pipe involved the difficulty in replacing it, and the cost of replacing it. Considerations such as weather, permitting, ground conditions, crew availability, etc., can affect the term and cost of a pipe replacement program. Accordingly, the Commission anticipates that some master plans may have terms exceeding 20 years.

54 In this regard, each gas company must analyze the relative costs and burdens of the plan under various time scenarios, and explain the basis for choosing a particular term. In addition, each gas company pipeline replacement program plan generally must prioritize the replacement of elevated risk pipe within the program, based on the relative level of risk presented. For example, and in general, a gas company should replace pipe located near a school, hospital or in a heavily populated area before it replaces pipe located in a sparsely populated area.

55 It is a reality that the prudent investment in a pipe replacement program plan will be borne by those the plan intends to protect: the gas company's customers. At the same time, the Commission will consider the rate impact of a pipe replacement program plan, and expects each gas company to analyze rate impacts in each plan it files pursuant to this policy statement.

4. The pipe replacement program plan must be in the public interest

56 The elements identified in this section are not all-inclusive of the elements the Commission may require in the public interest. The Commission will consider other public interest factors as they arise.

5. Commission approval of the pipe replacement program plan

57 Each pipe replacement program plan is subject to Commission approval. The Commission will determine an appropriate approval process for each plan after it is filed.

C. Special Pipe Replacement Program Cost Recovery Mechanism (CRM)

58 The discussion of the development of a CRM has been robust with all parties providing quality input. After two workshops²⁸ and various written comments there is general consensus that an interim recovery mechanism would provide an incentive to accelerate replacement of pipe that presents an elevated risk of failure. We agree that a CRM similar to a cost recovery mechanism used with NWNG in Oregon would provide a benefit but only within in the parameters set out below and in this policy statement.

59 As presented in the August 24 Notice, the CRM would exclude all costs related to replacement of bare steel along with any period costs such as any incremental changes in operating and maintenance (O&M) expenses. A number of the parties argued that the scope of the mechanism should be widened to also allow recovery of investment in bare steel, wrapped steel pipe and other elevated-risk pipe in addition to the so called “DuPont pipe”.

60 We agree that it is in the public interest to expand the program to the other pipe types within the constraints of the planning and pipe location identification requirements of this policy statement.²⁹

²⁸ Including one workshop which was focused solely on interim cost recovery mechanisms.

²⁹ However, PSE included its sewer cross bore program in the pipeline replacement plan it filed on September 14, 2012. We do not believe that the sewer cross bore program has been sufficiently developed for the company to sufficiently document the risk presented by such occurrences at this time. It still may be eligible for recovery through the normal rate setting process and for inclusion in a future CRM filing when results from its pilot program have been analyzed and presented, and reviewed by the Commission.

61 The CRM would allow for the return of and return on specific identified investment with elevated risk between rate cases, as approved in a company's pipeline replacement program plan. This mechanism would minimize the time the investment is made to the time of recovery to just a few months through annual recovery.

62 The CRM would have an effective life of four years with a general rate case filing required at the end of the life to fold plant investment into base rates and adjust the CRM.

63 A pipe replacement cost recovery mechanism acceptable to the commission must conform to the following elements:

1. Filing for a CRM

64 A company seeking a CRM would elect this option when it files its pipe replacement program plan June 1, 2013. Any company electing a CRM will prepare and submit the information described in this section of the policy statement with its program plan.³⁰ A company that does not request a CRM by June 1, 2013, may do so June 1 of any subsequent year.

2. Investment

65 Annual investment in pipeline replacement that would be eligible for recovery under the CRM is limited to elevated-risk pipe. The pipe must be readily identifiable in the company's pipeline replacement program plan by both location and timetable. Costs recoverable under the CRM must not include: (1) the costs of locating pipe eligible for replacement; (2) pipeline costs associated with normal growth, system expansion, and repair and replacement of pipe damaged by third parties; and (3) the cost of pipe that a company is required to replace by a Commission order or approved settlement.

³⁰ If a company files for a CRM at the same time it files its Pipeline Replacement Plan on June 1, 2013, the Commission anticipates a concurrent review process with the final approval of the CRM contingent upon the approval of the Pipeline Replacement Plan as outlined in Section B.

3. Accounting Treatment

66 A company would maintain its accounting records consistent with normal accounting. The proposed mechanism would not provide for deferrals of costs, or the accrual of interest on that cost, for later recovery. The CRM is intended to provide recovery of both a return on and a return of investment between general rate proceedings through annual rate increases.

4. Cost Recovery

67 A CRM would recover the return on the prior year's plant investment and recover depreciation expense associated with a company's elevated-risk pipe replacement investment program plan approved pursuant to Section B above. An operations and maintenance offset for the reduction in accelerated leak surveys or related expense will be considered.

68 For 2013, a company would be allowed to recover through the CRM approved replacement program costs incurred for the twelve month period November 1, 2012, to October 31, 2013. Recovery would be effective November 1, 2013, consistent with the company's annual purchased gas adjustment (PGA) filing and tariff. By looking retrospectively at a company's elevated risk replacement program, we ensure that improvements actually in service are included in rates, and that program investments are consistent with a company's replacement plans.

69 On June 1 of each year a company that participates in a CRM must file actual and projected investment for that program year. The June 1 filing would include investment incurred from November 1 of the previous year to April 30 of the current year and projected costs from May 1 through October 31 consistent with the approved replacement plan. The company will update the projected costs with actual investment incurred during May through July and revised costs estimates for August through October with its annual Purchased Gas Adjustment tariff filing. Once actual project cost data are available, a company will submit actual cost data through September and an updated estimate for October under the PGA docket for that year.³¹

³¹ The Commission recognizes that these data may be available at different times for different companies.

This process should give reasonable recognition of the proposed tariff's effective date and the *used and useful* constraint.³²

70 After the initial year, the CRM will require a separate revenue requirement calculation by program year considering changes to net rate base, depreciation, and operations and maintenance offsets. After the Commission has approved a CRM for a company, any general rate case filing must include all plan investment in base rates and reset the tariff to exclude any CRM recovery.

5. Cost of Service

71 Each company will develop a cost of service considering investment and related elements provided for in the CRM. The capital structure and cost of equity should be those used in its most recent general rate case.

6. Tariff and Billing

72 A company must file tariffed rates designed to recover the revenues reflected in the company's developed cost of service calculation for the rate year at least two months prior to the effective date of the company's PGA. The company will include and identify separate recovery.

73 The Commission will determine how the increase in customers' rates will appear on bills when the company makes its tariff filing.

7. Cap on Amount Considered for Recovery

74 In its filing, each company will propose and support a cap for annual expenditures recoverable through the CRM for an elevated-risk pipe replacement program under this policy. Companies may consider a percent of rate base, percent of revenues, total expenditures or other basis for its cap. As part of that proposal the company will address expected rate impact on customers and other factors supporting the cap.

³² Whether the Commission will allow into rates the costs associated with a resource acquisition requires utilities to demonstrate that the acquisition is "used and useful" in the service of providing electricity to customers. RCW 80.04.250; see Leonard S. Goodman, *The Process of Ratemaking* 799 (1998). To the extent any estimated costs for the final month are different for those embedded in the CRM, the company will adjust the subsequent period CRM to either recover or refund the difference.

8. CRM Life and General Rate Case Filing Requirement

75 The CRM will have a life of up to four years before including the investment covered by the program in base rates. If a company does not file a rate case during the four year period, it should file a rate case with a rate year effective date closely following the completion of the final year of the CRM. The CRM investment would be included in base rates with this general rate case. If a company files a general rate case within the four year life of the CRM, investment would be included in base rates. The CRM process would commence again within the framework of that general rate case.

9. Other Factors

76 The elements identified in this section are not all-inclusive of the elements the Commission may require in the public interest. The Commission will consider other public interest factors as they arise.

VIII. CONCLUSION

77 The Commission will review this policy after it acts on the second round of CRM filings in 2015, and periodically thereafter, to determine whether it has accomplished the hoped-for results of more proactive replacement of elevated risk pipe.

DATED at Olympia, Washington, and effective December 31, 2012.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

JEFFREY D. GOLTZ, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner