

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of )  
 )  
PUGET SOUND ENERGY )  
 )  
For (i) Approval of a Special Contract for ) DOCKET NO. UG-151663  
Liquefied Natural Gas Fuel Service with )  
Totem Ocean Trailer Express, Inc. and (ii) a )  
Declaratory Order Approving the )  
Methodology for Allocating Costs Between )  
Regulated and Non-regulated Liquefied )  
Natural Gas Services )  
\_\_\_\_\_ )

**RESPONSE BRIEF OF THE INDUSTRIAL  
CUSTOMERS OF NORTHWEST UTILITIES**

**May 18, 2016**

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## I. INTRODUCTION

1 Pursuant to the Washington Utilities and Transportation Commission's ("Commission") Order 07, in the above-referenced docket, the Industrial Customers of Northwest Utilities ("ICNU") files this Brief on the issue of whether Puget Sound Energy ("PSE" or the "Company") should be granted an exemption to Merger Commitment 56 in Docket No. U-072375 (the "Merger Proceeding").<sup>1/</sup> ICNU was a signatory to the stipulation the Commission approved in the Merger Proceeding and appreciates the invitation to offer its perspective on the Company's request.

2 In summary, it does not appear to ICNU that the Commission has sufficient information to determine whether PSE's requested waiver of commitments it made during the Merger Proceeding ("Merger Commitments") is just and reasonable and in the public interest. The Company has requested not only to establish an unregulated affiliate of PSE ("Puget LNG"), but one that would share ownership of a large liquefied natural gas ("LNG") facility (the "Tacoma LNG Facility") with PSE, and for which PSE would perform all operations. Yet, neither an ownership nor an operating agreement between PSE and Puget LNG exists that would define the rights and responsibilities of these affiliates, and provide a means to determine whether PSE customers are adequately protected from Puget LNG's operations.

3 PSE's proposal for an "equal sharing of the portfolio benefits" between investors and customers is equally unclear. The Company has not proposed a methodology for calculating these benefits, nor has it provided any evidence on which to base a determination that an "equal" sharing, as opposed to any other amount (or no sharing at all), is just and reasonable.

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<sup>1/</sup> Paragraph 14 of Order 07 states: "we will afford all parties to Docket U-072375, in addition to the parties in this docket, an opportunity to file briefs" on the issue of whether PSE should be granted an exemption to Merger Commitment 56. ICNU was a party to Docket No. U-072375.

4 ICNU believes that these issues implicate other Merger Commitments besides the two – Commitments 56 and 58 – PSE identified. These include protections against the substantive consolidation of PSE with Puget LNG in the event Puget LNG declares bankruptcy, and prohibitions against cross-subsidization. Most importantly from ICNU’s perspective, it is unclear whether the Company’s electric customers, who have no potential to benefit from the Tacoma LNG Facility, can be held harmless from the costs associated with this facility. Moreover, granting a waiver of Merger Commitments in this proceeding will establish a precedent for future waivers that could directly impact electric customers.

5 Before granting a waiver of any of the Merger Commitments PSE and its investors made to the Commission and the Company’s customers, the Commission should fully understand the implications of PSE’s affiliation with Puget LNG. On the record as it currently stands, however, it does not appear that this is possible. Therefore, ICNU recommends that the Commission deny PSE’s request for a waiver of Merger Commitment 56.

## II. BACKGROUND

6 In this phase of the current proceeding, PSE seeks a “limited exemption” from Merger Commitment 56 established in the Merger Proceeding to allow PSE’s parent company, Puget Energy, to own an unregulated subsidiary, Puget LNG, that would market and sell LNG to marine customers.<sup>2/</sup> In its brief, PSE also requests an exemption from Merger Commitment 58 to the extent the Commission determines it still applies.<sup>3/</sup>

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<sup>2/</sup> Docket No. UG-151663, PSE Motion to Establish a Bifurcated Proceeding ¶ 8 (Mar. 4, 2016) (“PSE Motion”).

<sup>3/</sup> PSE Br. ¶ 44.

**A. PSE’s Proposal in This Docket**

7 As an alternative to a business arrangement that was rejected by the Commission,<sup>4/</sup> PSE seeks regulatory approval to allow Puget Energy to establish a subsidiary, tentatively named Puget LNG, that would make unregulated sales of LNG to marine customers, primarily Totem Ocean Trailer Express (“TOTE”).<sup>5/</sup> However, PSE notes that “one-quarter of the non-regulated capacity [of the Tacoma LNG Facility] remains unsubscribed.”<sup>6/</sup> By virtue of Puget Energy’s common ownership of PSE and Puget LNG, Puget LNG would be an affiliate of PSE and would also own a portion of the LNG facility as a tenant in common with PSE, from which it would fuel TOTE and, potentially, other marine vessels.<sup>7/</sup> Overall, Puget LNG would own approximately 56% of the Tacoma LNG Facility and PSE would own the remaining 44%.<sup>8/</sup> Puget LNG would wholly own the bunkering facilities, while PSE would wholly own the vaporization facilities.<sup>9/</sup> PSE and its unregulated affiliate would own undivided interests in the other components of the Tacoma LNG Facility, with their ownership interests based upon certain capital allocation factors.<sup>10/</sup>

8 For its part, PSE’s interest in the facility would be to use it as a peaking resource for its distribution gas customers.<sup>11/</sup> PSE’s IRP estimates that, under the base case scenario, the Tacoma LNG Facility could provide its gas customers with approximately \$98 million in benefits on a net present value (“NPV”) basis relative to purchasing additional pipeline capacity to meet this peaking need.<sup>12/</sup> Other scenarios indicate that the portfolio benefits of the LNG

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<sup>4/</sup> Docket No. UG-151663, Order 04 ¶ 28 (Dec. 18, 2015).  
<sup>5/</sup> PSE Br. ¶ 1.  
<sup>6/</sup> *Id.* ¶ 81.  
<sup>7/</sup> *Id.* ¶ 22.  
<sup>8/</sup> *Id.* ¶ 20.  
<sup>9/</sup> *Id.* ¶ 22.  
<sup>10/</sup> *Id.*  
<sup>11/</sup> *Id.* ¶ 29.  
<sup>12/</sup> Docket Nos. UE-141170/UG-141169, PSE 2015 IRP at 2-24.

facility could be as high as \$103.8 million or as low as \$8.4 million on an NPV basis.<sup>13/</sup> Of course, the actual portfolio benefits will not be known until well after the Tacoma LNG Facility is built, and even then it is not clear how they would be calculated, raising the possibility that they could never be known with certainty.<sup>14/</sup> What is known is that the Company has not suggested that its electric customers have the potential to benefit in any way from the Tacoma LNG Facility.

9 PSE's brief also requests that the Commission authorize an equal sharing of the "projected portfolio benefits" from the Tacoma LNG Facility – i.e., the \$98 million discussed above – between its customers and shareholders.<sup>15/</sup> PSE states that this is appropriate because its investors will be taking on a "significant increase in business and financial risk" through Puget LNG's operations.<sup>16/</sup> Without approval of its portfolio sharing proposal, PSE states that it "can no longer proceed with the Tacoma LNG Facility."<sup>17/</sup> Thus, the Company represents that an equal sharing of the portfolio benefits is "an incentive to develop the facility."<sup>18/</sup> Nevertheless, PSE does not provide a basis for its decision to select an "equal" sharing, as opposed to some other proportion, and requests that the determination of how the portfolio benefits are calculated be deferred to a later phase of the proceeding.<sup>19/</sup>

#### **B. PSE's Merger Commitments**

10 At the end of 2007, PSE announced its proposed acquisition by a consortium of international investment and pension funds (the "Merger").<sup>20/</sup> The Commission reviewed the

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<sup>13/</sup> *Id.*

<sup>14/</sup> See PSE Motion ¶ 26 (proposing that the calculation of the projected portfolio benefits be deferred for a separate phase of the current proceeding).

<sup>15/</sup> PSE Br. ¶¶ 65-66.

<sup>16/</sup> *Id.* ¶ 66.

<sup>17/</sup> *Id.*

<sup>18/</sup> *Id.*

<sup>19/</sup> PSE Motion ¶ 26.

<sup>20/</sup> Docket No. U-072375, Order 08 ¶ 1 (Dec. 30, 2008).

proposed transaction over most of 2008. The proposal was not without its opponents; indeed, not all of the sitting Commissioners at that time agreed that the transaction was in the public interest.<sup>21/</sup> Additionally, most major stakeholders initially opposed the transaction, including Commission Staff, Public Counsel, ICNU, and the Northwest Industrial Gas Users (“NWIGU”).<sup>22/</sup> Ultimately, however, most of these parties withdrew their opposition based on a settlement stipulation in which PSE (and, where applicable, its parent companies) agreed to 63 commitments that obligated it to either take, or refrain from taking, certain actions following approval of the Merger.<sup>23/</sup> The Commission approved the stipulation, including the commitments, in its final order approving the Merger.<sup>24/</sup>

11                   Among the commitments PSE and its parent companies made was Merger Commitment 56, stating that “Puget Energy shall not operate or own any business other than PSE.” Like PSE, ICNU has not discovered the source for this commitment, but agrees that it was likely intended to reduce risk that could be attributed to PSE through its affiliation with other companies.<sup>25/</sup> This would be consistent with many of the other commitments PSE made, which are intended to insulate PSE from risks not attributable to its utility operations. These include ring-fencing commitments that insulate PSE from its parent companies; financial integrity commitments; and management and governance commitments. Among these other commitments are the requirement that PSE obtain a non-consolidation opinion that the ring-fencing commitments it made “are sufficient that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of PSE with those of Puget Energy or its

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<sup>21/</sup> *Id.*, Comm’r Jones *dissenting*.

<sup>22/</sup> Docket No. U-072375, Exh. No. \_\_ (KLE-1THC), Exh. No. \_\_ (BRA-1T), Exh. No. \_\_ (MPG-1T), NWIGU Letter in Support of ICNU Testimony (June 18, 2008).

<sup>23/</sup> Docket No. U-072375, Order 08, Attach. A (Public Counsel did not sign the stipulation).

<sup>24/</sup> *Id.*, Order 08 ¶ 297.

<sup>25/</sup> PSE Br. ¶ 42.



affiliates.”<sup>26/</sup> The Company also committed “that there will be no cross-subsidization by PSE customers of unregulated activities.”<sup>27/</sup>

### III. ARGUMENT

12 ICNU does not consider PSE’s requested waiver of Merger Commitment 56 in order to enable the creation of Puget LNG to be a risk-free venture. It is one thing for a regulated utility to have an unregulated affiliate; it is another for a regulated utility to share ownership and operation of an inherently risky operation with an unregulated affiliate. This is particularly true when PSE’s investors themselves consider the unregulated affiliate’s operations too risky to undertake on their own.<sup>28/</sup>

13 The Company argues that its customers will be insulated from the increased risk associated with Puget LNG by virtue of the various other Merger Commitments that will still be in place.<sup>29/</sup> In reality, that is far from clear. PSE will jointly own the Tacoma LNG Facility with Puget LNG, and will be solely responsible for its operation.<sup>30/</sup> Yet, neither an ownership nor an operating agreement exists between PSE and Puget LNG to define the rights, responsibilities, and liabilities of these entities.<sup>31/</sup> Without these agreements, it is difficult to see how the Commission can determine that, as the Company claims, “PSE will continue to remain insulated from the risks of Puget Energy and its affiliate, including Puget LNG.”<sup>32/</sup> Furthermore, and most importantly from ICNU’s perspective, it is not clear that PSE’s electric customers – who have no potential to benefit from the Tacoma LNG Facility – would be fully insulated from these costs.

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<sup>26/</sup> Merger Commitment 8.  
<sup>27/</sup> Merger Commitment 20.  
<sup>28/</sup> PSE Br. ¶ 66.  
<sup>29/</sup> *Id.* ¶ 37.  
<sup>30/</sup> *Id.* ¶¶ 25-26.  
<sup>31/</sup> *Id.*  
<sup>32/</sup> *Id.* ¶ 37.

**A. PSE’s proposal may alter or diminish the impact of Merger Commitment 8.**

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ICNU does not agree with the Company’s conclusion that only two Merger Commitments are potentially implicated by the creation of Puget LNG.<sup>33/</sup> Commitment 8 required PSE and Puget Holdings to obtain a non-consolidation opinion finding that “the ring fencing provisions are sufficient that a bankruptcy court would not order the substantive consolidation of the assets and liabilities of PSE with those of Puget Energy *or its affiliates or subsidiaries*.”<sup>34/</sup> The proposed transaction will result in a new affiliate for PSE, one that shares ownership of the Tacoma LNG Facility with PSE and for which PSE performs all operations. This is an affiliate that was not considered in the original non-consolidation opinion. While the Company claims that “Puget Energy’s ownership of Puget LNG would not alter the conclusions reached in” the non-consolidation opinion it obtained following the Merger, it does not provide any support for this statement.<sup>35/</sup>

15

Substantive consolidation “combine[s] the assets and liabilities of separate and distinct – but related – legal entities into a single pool and treat[s] them as though they belong to a single entity.”<sup>36/</sup> Ninth Circuit precedent allows for the substantive consolidation of non-debtor estates with the debtor’s estate.<sup>37/</sup> While substantive consolidation is to be used sparingly, it is an equitable doctrine the fundamental purpose of which is to ensure fairness to all creditors.<sup>38/</sup> In *In re Bonham*, the Ninth Circuit established the standards for substantive consolidation within its jurisdiction, which it adopted from the Second Circuit.<sup>39/</sup> Specifically, the Ninth Circuit uses a two part test: (1) “whether creditors dealt with the entities as a single economic unit and did not

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<sup>33/</sup> *Id.*

<sup>34/</sup> Merger Commitment 8 (emphasis added).

<sup>35/</sup> PSE Br. ¶ 56.

<sup>36/</sup> *In re Bonham*, 229 F.3d 750, 764 (9th Cir. 2000).

<sup>37/</sup> *In re Clark*, -- B.R. --, 2016 WL 1249348 at \*4 (B.A.P. 9th Cir., Mar. 30, 2016).

<sup>38/</sup> *Id.* at \*5.

<sup>39/</sup> 229 F.3d at 766 (citing *In re Augie/Restivo Baking Co.*, 860 F.2d 515, 518 (2d Cir. 1988)).

rely on their separate identity in extending credit;” or (2) “whether the affairs of the debtor are so entangled that consolidation will benefit all creditors.”<sup>40/</sup> Because this is a disjunctive test, “[t]he presence of either factor is a sufficient basis to order substantive consolidation.”<sup>41/</sup> “[T]he bankruptcy court must in essence determine that the assets of all of the consolidated parties are substantially the same.”<sup>42/</sup>

16           This fact-specific test establishes a high bar for substantive consolidation, such that it is an uncommon remedy. Still, the possibility of PSE’s substantive consolidation with Puget LNG plainly exists as they are “separate and distinct – but related – legal entities.”<sup>43/</sup> Moreover, while PSE has a cost-allocation methodology, it is a generic methodology that may not be appropriate to apply in its current form to allocations between PSE and Puget LNG.<sup>44/</sup> Certainly, the fact that PSE will operate the Tacoma LNG Facility for Puget LNG entwines the Company’s regulated operations with those of its unregulated affiliate. This, combined with the absence of ownership and operating agreements, makes it difficult to determine whether substantive consolidation of PSE with Puget LNG is a possibility. If it is, then PSE’s customers face the risk of substantial harm from a Puget LNG bankruptcy.

17           Moreover, even if PSE were not substantively consolidated with Puget LNG in a bankruptcy, the Company would be a tenant in common with a bankrupt entity, holding undivided ownership shares of the Tacoma LNG Facility, and presumably the Company would remain responsible for operating the entire facility. It is difficult to understand how such a circumstance could have no impact on PSE and its customers. If, after a Puget LNG bankruptcy,

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<sup>40/</sup>     *Id.*

<sup>41/</sup>     *Id.*

<sup>42/</sup>     *Id.* at 771.

<sup>43/</sup>     *Id.* at 764.

<sup>44/</sup>     Docket No. U-072375, Order 08 at 151 (Attach. B). The Company’s cost allocation manual, for instance, notes that “[w]here practical, nonregulated subsidiaries will maintain separate facilities for staff and operations.”

PSE becomes solely responsible for the costs of owning and operating the Tacoma LNG Facility, this is not likely to be a cost-effective resource for the Company's gas customers.

**B. PSE's proposal violates Merger Commitment 20.**

18 In Merger Commitment 20, PSE committed "that there will be no cross-subsidization by PSE customers of unregulated activities." This is consistent with the purpose of the Affiliated Interest law codified at RCW Chapter 80.16, which the Commission has recognized "is to protect ratepayers from cross-subsidization by regulated companies of unregulated affiliates."<sup>45/</sup> ICNU considers the Company's proposal for "an equal sharing of the projected portfolio benefits" it ascribes to the Tacoma LNG Facility to constitute cross-subsidization of Puget LNG by PSE's customers that is prohibited by Merger Commitment 20.

19 This is because a sharing of "portfolio benefits" between PSE customers and shareholders is tantamount to including the costs of unregulated operations in the rates charged to customers for the Company's regulated gas sales operations. The Commission has previously made clear that it "bases the regulated company's rates *only* on the revenue requirements of the regulated company .... Commission-approved rates do not include a subsidy for other operations."<sup>46/</sup> Yet, while PSE does not specifically state how its investors will use the portfolio benefits they would receive from customers, it has made clear that Puget LNG will not exist but for the sharing of these benefits.<sup>47/</sup> PSE's gas customers' rates, in other words, will enable the existence of Puget LNG – a subsidy of unregulated operations if there ever was one.

The Commission has further explained that:

In establishing rates for regulated utilities, we have followed well-established principles regarding the segregation of regulated and

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<sup>45/</sup> *WUTC v. Avista Corp.*, Docket No. UG-021584, 6th Supp. Order ¶ 24 (Feb. 13, 2004).

<sup>46/</sup> *Re Application GA-896 of Superior Refuse Removal Corp.*, Order M.V.G. No. 1639, 1993 WL 13811933 at \*5 (June 28, 1993) (emphasis added).

<sup>47/</sup> PSE Br. ¶ 66.

non-regulated operations, as they are fundamentally different in nature and purpose. Regulated operations serve the public with rates and conditions of service established by the Commission according to regulatory principles embodied in statutes and rules that protect the public from monopoly rents and unreasonable terms and conditions. On the other hand, non-regulated operations are competitive enterprises offering services and products unnecessary to, and many times wholly unrelated to, the utility service offered to the public.

Consistent with our regulatory principles, if a utility's costs are prudently incurred and if property is used and useful in providing utility service, it is entitled to recover those costs and to place such property in its rate base, where it may recover and have an opportunity to earn a reasonable return on its original investment. Conversely, a utility is not allowed to recover in customer rates costs or expenses related to activities that do not provide service to its ratepayers. For this reason, we strive to isolate ratepayers from the impacts of a utility's non-regulated activities, concluding that ratepayers should not be required to subsidize or be exposed to the risks of the non-regulated operations of a utility.<sup>48/</sup>

Yet, despite the Commission's clearly articulated requirements that ratepayers not be required to subsidize or be exposed to the risks of non-regulated operations, PSE openly admits that "an equal sharing of the portfolio benefits associated with the Tacoma LNG Facility between PSE investors and PSE natural gas sales customers *would create sufficient risk distribution* to allow Puget Energy to be willing to make the investment and facilitate the development of the Tacoma LNG Facility."<sup>49/</sup>

20 In essence, then, PSE is asking its customers to insulate its investors from the downside risks of Puget LNG, while retaining for its investors all of the upside. If the Commission authorizes the Company's equal sharing proposal, PSE's gas customers will pay rates that include costs associated with Puget LNG and are designed to mitigate the risk PSE's

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<sup>48/</sup> *WUTC v. Avista Corp.*, Docket No. UE-080416/UG-080417, Order 08 ¶¶ 28-29 (Dec. 29, 2008).  
<sup>49/</sup> PSE Motion ¶ 24 (emphasis added). Notably, and despite the Company's invocation of the maxim that "reward follows risk and benefit follows burden," PSE Br. ¶ 75, while the Company's investors are requesting that customers mitigate their risk associated with Puget LNG, they are not proposing to provide customers with a corresponding claim to any upside profit from Puget LNG.

investors would take on through ownership of Puget LNG. That is the same thing as asking customers to subsidize unregulated operations, in contravention of Merger Commitment 20.

**C. The other Merger Commitments may be insufficient to protect PSE customers.**

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Together, Merger Commitments 9 and 26 ensure that “PSE’s customers will be held harmless from the liabilities of any non-regulated activity of PSE or Puget Holdings.” The Company states that “the regulatory commitments in Commitment 9 ensure that Puget Holdings and PSE will hold the customers of PSE harmless from any business and financial risk exposures associated with Puget LNG.”<sup>50/</sup> This is not, however, clear. For instance, PSE has not discussed the Company’s exposure to potential environmental liability from the Tacoma LNG Facility. As an owner and operator of the facility, PSE likely will be jointly and severally liable for remediation required under various federal and state laws.<sup>51/</sup> If Puget LNG is unable to cover its share of liability for these costs – indeed, likely a majority share given its majority ownership of the facility – responsibility for those costs could fall to PSE. Under joint and several liability, such liabilities will belong to PSE just as much as they belong to an unregulated affiliate.<sup>52/</sup> Thus, the Merger Commitments that hold PSE customers harmless from non-regulated liabilities do not necessarily protect customers from risks for which PSE will be jointly and severally liable with Puget LNG by virtue of their joint ownership and PSE’s sole operation of the Tacoma LNG Facility. Similarly, if, as discussed above, PSE is substantively consolidated with Puget LNG in a bankruptcy proceeding, it is not clear that customers would be held harmless.

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<sup>50/</sup> PSE Br. ¶ 54.

<sup>51/</sup> See, e.g., Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§ 9601 *et seq.*; Resource Conservation and Recovery Act, 42 U.S.C. §§ 6901 *et seq.*; Washington State Model Toxics Control Act, RCW Chapter 70.105D.

<sup>52/</sup> Restatement (3d) of Torts § 10 (“When, under applicable law, some persons are jointly and severally liable to an injured person, the injured person may sue for and recover the full amount of recoverable damages from any jointly and severally liable person”).

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Furthermore, there are other, more amorphous, risks that would likely be impossible to protect against and, most importantly from ICNU's perspective, could impact both gas and electric customers. A downgrade in PSE's credit rating that is at least partially due to circumstances associated with its joint ownership and operation of the Tacoma LNG Facility, for instance, likely would increase the Company's operating costs overall, which would impact both gas and electric customers. Whatever the Commission determines with respect to the balancing of risks and benefits of the Company's gas customers with respect to the Tacoma LNG Facility, it is not appropriate for this facility to expose the Company's electric customers to increased risk as they have no potential to receive any corresponding benefits.

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Finally, ICNU is concerned about the precedent a waiver of Merger Conditions would set. The Company states that it is only requesting a "limited" waiver of Merger Condition 56,<sup>53/</sup> but it is not clear what is "limited" about the waiver beyond the fact that this is the first time it has requested one. The purpose of the Merger Conditions was to provide parties and the Commission with assurances that the Merger would not adversely affect PSE's provision of utility service.<sup>54/</sup> The Company, therefore, should bear a high burden to demonstrate that a waiver of any of the Merger Commitments will not diminish the protections those commitments were intended to provide. On the record of this case, ICNU does not believe the Company has met this burden.

#### IV. CONCLUSION

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For the foregoing reasons, ICNU recommends that the Commission deny the Company's requested waiver of Merger Commitment 56 at this time. The Company has not provided sufficient information for the Commission to determine whether an exemption from

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<sup>53/</sup> PSE Motion ¶ 8.

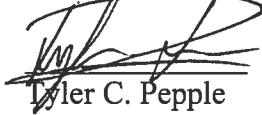
<sup>54/</sup> Docket No. U-072375, Order 08 ¶¶ 7-9.

this commitment is just and reasonable and in the public interest. The unique relationship between PSE and Puget LNG that includes shared ownership and operation of the Tacoma LNG Facility appears to present risks to PSE's customers that the Company has not adequately identified how it will protect against. This includes the lack of ownership or operating agreements, and the possibility of substantive consolidation of PSE with Puget LNG in a Puget LNG bankruptcy. Moreover, the Company's proposal for an equal sharing of the portfolio benefits of the Tacoma LNG Facility between shareholders and customers appears to constitute a prohibited cross-subsidization of an unregulated affiliate by PSE's customers.

Dated in Portland, Oregon, this 18th day of May, 2016.

Respectfully submitted,

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