

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In the Matter of the**

**PUGET SOUND ENERGY**

**For (i) Approval of a Special Contract for 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**

**DOCKET NO. UG-151663**

**NORTHWEST INDUSTRIAL GAS USERS'  
RESPONSE BRIEF**

**May 18, 2016**

## I. INTRODUCTION

1. Pursuant to Order 08 in this matter, dated May 9, 2016, Northwest Industrial Gas Users (“NWIGU”) submits this Response Brief addressing the issues presented by Puget Sound Energy (“PSE”) in its Brief dated April 15, 2016 (“PSE’s Brief”).
2. PSE filed a motion on March 4, 2016 seeking to establish a bifurcated proceeding to allow the Washington Utilities and Transportation Commission (“Commission”) to review an “alternative business model” PSE proposes for development of its liquefied natural gas plant in Tacoma (the “Tacoma LNG Facility”). As described by PSE, its alternative business model “would treat all sales of LNG from the Tacoma LNG Facility for transportation fuel as non-jurisdictional sales and would establish Puget LNG, a newly formed, non-regulated subsidiary of Puget Energy (PSE’s parent corporation) as the business entity that would make such sales from the Tacoma LNG Facility to TOTE and others.”<sup>1</sup>
3. As initially framed by PSE, the first phase of the bifurcated proceeding would address the following:
  - Whether the Commission would provide an exemption to Merger Commitment 56 in Docket U-072375 that would allow Puget Energy to own and operate both PSE and Puget LNG.
  - Whether the Commission would authorize an equal sharing of the projected portfolio benefits associated with the Tacoma LNG Facility between PSE investors and PSE natural gas sales customers for consideration in this proceeding.
4. NWIGU, along with other parties, supported bifurcation of this proceeding, but reserved the right to argue during the first phase that “sharing of benefits associated with the Tacoma LNG Facility

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<sup>1</sup> PSE’s Brief, at ¶13.

between PSE investors and PSE natural gas sales customers, if any, could be in a manner other than the equal sharing proposed by PSE in the Motion to Establish a Bifurcated Proceeding.”<sup>2</sup>

5. While the Commission granted the request to bifurcate this proceeding, it expressed reluctance whether it could authorize an equal sharing, or any other sharing, of the projected portfolio benefits associated with the Tacoma LNG Facility without a more developed record.<sup>3</sup> The Commission nevertheless determined that it may be possible for the Commission to determine the sharing question at least in part or conditionally, subject to the development of a more complete record during the second phase, and, on that basis, concluded it would accept briefs on the sharing question as part of the first phase.<sup>4</sup>
6. PSE’s Brief addresses both its request to waive or modify the Merger Commitments and its demand for equal sharing of the Tacoma LNG Facility’s portfolio benefits between PSE investors and PSE natural gas sales customers. For the reasons stated below, NWIGU does not support waiver or modification of the applicable Merger Commitments, without a better record demonstrating why it must be Puget Energy that owns and operates both PSE and Puget LNG. NWIGU also opposes a sharing of the Tacoma LNG Facility’s portfolio benefits, because PSE already has an economic incentive to develop this resources through the cost recovery and return available through traditional ratemaking. If the Commission is inclined to support an “equitable” sharing of benefits, NWIGU does not believe that an equitable determination can be made without a more fully-developed record and, on that basis, urges the Commission to reject PSE’s demand that the portfolio benefits be shared on an equal (i.e. 50/50) basis.

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<sup>2</sup> Joint Response to Motion to Establish a Bifurcated Proceeding at ¶3.

<sup>3</sup> In the Matter of the Puget Sound Energy For (i) Approval of a Special Contract for 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, Order 07 (Mar.29, 2016) (“Order 07”) at ¶15.

<sup>4</sup> Order 07 at ¶18.

## II. ARGUMENT

### A. The Commission should not approve a waiver of the Merger Commitments.

7. PSE is asking for a waiver of Merger Commitments 56 and 58 so that Puget Energy can own both PSE and Puget LNG. In particular, PSE is asking for a waiver so that Puget Energy will be the sole owner or member of Puget LNG, which will be a special purpose entity that will exist solely to own an approximately 56% undivided interest in the Tacoma LNG Facility as a tenant-in-common with PSE, and to use its existing credit facilities to finance, in part, the construction of the Tacoma LNG facilities. Merger Commitment 56 provided that Puget Energy will not own or operate any businesses other than PSE. Merger Commitment 58 provided that Puget Energy and PSE credit facilities will, by their terms, require that the funds be used only for financing PSE credit expenditures.
8. The 63 Merger Commitments contained in the Merger Order<sup>5</sup> were important to the parties—including NWIGU—and the Commission. The Merger Commitments were included to protect PSE’s customers from a variety of issues and risks, including risks stemming from unregulated business activities. The Commission’s synopsis of its order approving the merger expressly provides that it is all of the Merger Commitments, taken together, that “reasonably assure that Puget Holdings’ proposed acquisition of PSE will not harm the public interest.”<sup>6</sup> While PSE claims that ownership of Puget LNG by Puget Energy will not alter or eliminate the financial integrity commitments in the Merger Order, or increase Puget Energy’s risk profile, PSE has not explained in sufficient detail why the particular corporate structure is needed or required as part of

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<sup>5</sup> In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy for an Order Authorizing Proposed Transaction, Docket U-072375, Order 08 (Approving and Adopting Settlement Stipulation; Authorizing Transaction Subject to Conditions (Dec. 30, 2008 (the “Merger Order”).

<sup>6</sup> Merger Order, Synopsis.

this transaction. In fact, despite the length of its brief, PSE provides little explanation about why the Commission should approve this corporate structure – instead of a different one – that may better insulate the regulated company from the risks associated with unregulated activities. For example, why can Puget LNG not be owned by a different company under the Puget Holdings umbrella instead of by Puget Energy? A simple conclusion that Puget LNG will not increase Puget’s risk profile is not enough to justify PSE’s proposal. Without more information and justification for the waiver of a Merger Commitment, the Commission should deny PSE’s request.

### **B. Portfolio Benefit Sharing**

9. PSE’s Brief asserts that the Tacoma LNG Facility will provide sales customers with portfolio benefits compared to other peak-day resource alternatives.<sup>7</sup> PSE estimates the portfolio benefits to be \$98 million on a net present value basis<sup>8</sup> and argues that these benefits do not exist except for the fact that PSE has found a way to combine the peak shaving portion of the facility with the portion that will serve LNG customers.<sup>9</sup> PSE argues there are additional benefits, such as the fact that the “Tacoma LNG Facility will provide PSE with on-system storage of a significant volume of natural gas, reduce PSE’s reliance on its sole-source pipeline NWP, and provide gas supply diversification,” and that it will provide “significant environmental benefits to Washington state and the Pacific Northwest region such as reduced air emissions from marine vessels and vehicles.”<sup>10</sup> Based on these benefits being made possible by shareholder investment, and the “need” to provide an incentive to shareholders, PSE demands half of the portfolio benefits it has identified in order for the project to go forward. PSE has asked for too much.

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<sup>7</sup> PSE’s Brief at ¶29.

<sup>8</sup> PSE’s Brief at ¶30.

<sup>9</sup> PSE’s Brief at ¶31.

<sup>10</sup> PSE’s Brief at ¶65.

10. The Commission should reject PSE's proposal for an incentive payment for the development of the project above and beyond what is available in the traditional ratemaking process. NWIGU does not dispute that, in some circumstances, sharing benefits between customers and shareholders can be appropriate to recognize the "investment" that each side makes, and perhaps as an incentive to reward the parties for engaging in activities that are a net benefit to the utility and its customers. In those circumstance, an "equitable" sharing mechanism can be determined, but only where there is (i) an in-depth analysis of the costs and benefits of the project; (ii) a review of how and to what extent the investment is leveraging off customer assets; and (iii) a review of the overall risks and value of the project. What NWIGU disputes, however, is that, based on this record, PSE has any basis to ask for, or the Commission has any basis to approve, an "equal" sharing, or any sharing at all. In fact, after a record is fully developed, the Commission could determine that instead of PSE sharing in the portfolio benefits, ratepayers should share in the profits of the unregulated entity because of the leveraging of ratepayer assets required to achieve those profits. At a minimum, a netting of benefits may be appropriate.
11. As the PSE Brief notes, the Commission has a long-standing principle that "benefits should follow burdens and rewards should follow risks." The following factors weigh against approving PSE's request at this time, because the burdens and risks associated with the Tacoma LNG Facility are not defined.
12. First, it is undisputed that the proposed facility will leverage both existing and future ratepayer assets. Existing assets are required because Northwest Pipeline's system will deliver natural gas to PSE's distribution system, which is then used to deliver the gas to the Tacoma LNG Facility.<sup>11</sup>

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<sup>11</sup> Exhibit No. \_\_ (RG-1CT) at p.20, ln.18.

13. Future assets are leveraged because of the proposed ratepayer investment required for the regulated portion of the facility. PSE makes the point in several places in its brief (indeed it has done so throughout this proceeding) that there are great economies of scale involved in this project. For example, PSE's Brief asserts that a "smaller stand-alone LNG facility designed to meet only PSE's peaking needs and fuel sales to TOTE would not be cost-effective and PSE would instead rely on the next best alternative to meet its core gas customer needs."<sup>12</sup> What PSE never addresses, however, is the cost of a stand-alone LNG facility designed to meet only the needs of TOTE, or only the needs of the other, non-regulated LNG customers, and the savings PSE investors will experience by combining the unregulated facility with a regulated facility. What the Commission has been told is that it is extremely risky for PSE's shareholder to invest in a facility that is 26% unsubscribed.<sup>13</sup> It follows that it would be even riskier for shareholders if a facility were more than 50% unsubscribed, or even 100% unsubscribed, which would be the case if PSE were to construct a stand-alone facility that served only TOTE and other LNG customers, or just non-TOTE LNG customers, respectively. Put another way, although PSE feels its shareholders are taking a risk investing in a facility that is only 25% unsubscribed, that level of risk is tolerable only because of the ratepayer investments that are being made into the peak shaving half of the facility, which is fully subscribed.

14. Where existing and future ratepayer assets are being leveraged for the benefit of shareholders, sharing of benefits should tilt heavily toward ratepayers. In order to understand how much ratepayers should be compensated in this regard requires a more detailed record showing the exact ratepayer assets that are to be used and how those compare to the overall value of the facility,

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<sup>12</sup> PSE's Brief at ¶31.

<sup>13</sup> PSE's Brief at ¶66.

including the costs that shareholders are foregoing by combining a non-regulated facility with a regulated facility.

15. The Oregon Public Utility Commission (“Oregon Commission”) recently arrived at a similar conclusion.<sup>14</sup> NW Natural operates an interstate storage facility – the Mist storage facility – which utilizes depleted gas reservoirs. The original utility storage and related facilities underwent multiple expansions intended to serve core customers. Capital costs for those expansions were included in NW Natural’s rate base. NW Natural later decided to develop additional storage to serve non-core customers and NW Natural invested shareholder dollars for that purpose. The company also began to “optimize” all of its storage capacity through trading and other activities.
16. Historically, NW Natural shared 20% of its revenue with customers arising from interstate storage activities funded by shareholders. For some of its optimization activities, which primarily use resources paid for by customers, NW Natural shared 67% of the revenue with customers. The Oregon Commission recently reviewed these sharing percentages and addressed the positions of various parties, including NWIGU, regarding their validity. While the sharing percentages had been in place for more than a decade, there was no evidentiary basis in any record to help determine whether the current percentages remained justified. The Oregon Commission agreed that a better evidentiary basis is necessary and required the parties to retain a neutral third party to conduct an evaluation and cost allocation study to “more robustly examine the risks, costs, and benefits of NW Natural’s optimization activities, the assets being utilized for those activities, and allocation between regulated and unregulated services, and the various components of NW Natural’s system that drive the costs and revenues associated with interstate storage services.”<sup>15</sup>

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<sup>14</sup> See *In re Northwest Natural Gas Company, Investigation of Interstate Storage and Optimization Sharing*, OPUC Docket UM 1654, Order (Mar. 5, 2015) (“NW Natural Order”).

<sup>15</sup> NW Natural Order at p.5.



17. This Commission should take a similar approach as the Oregon Commission and require PSE to establish in a much more robust manner the risks, costs, and benefits of its planned LNG activities that are being made possible only by leveraging ratepayer assets.
18. Another factor for consideration by this Commission is whether PSE has demonstrated whether an incentive in the form of portfolio benefit sharing is required at all, much less on a 50/50 basis. In general, PSE's shareholders are compensated in the form of a rate of return on the company's investments. For the peak shaving portion of the facility, that amounts to a return on a \$130 million investment. That kind of return should be incentive enough to pursue the project, even if it means shareholders will also have to invest in less certain activities like the LNG portion of the project.
19. Notwithstanding the significant inherent incentive that is available to regulated companies like PSE, PSE claims that it now must have an additional incentive of 50% of the estimated portfolio benefits in order to pursue this project. What is unclear about this request is why that incentive is now necessary. When PSE first submitted its application in this docket, no such incentive payment was requested. The only major change between the original proposal and the current proposal is that the activities relating to serving TOTE will now be unregulated. The peaking services will remain regulated, and the non-TOTE LNG services will remain unregulated. For some reason PSE felt that the risk was tolerable enough in the original proposal (when the entirety of the non-regulated activities were unsubscribed) that no incentive other than the normal rate of return was warranted. Now that the TOTE portion will be unregulated, however, a risk somehow materializes that PSE believes warrants additional compensation to its shareholders, even though a large portion of the non-regulated activities will now be subscribed.

20. The sole basis for PSE's request to share the portfolio benefits it describes is its conclusory statement that, without equal sharing, the Tacoma LNG Facility will not be built.<sup>16</sup> PSE provides no analysis to support that statement. Did the company actually determine that a 51/49 split in favor of ratepayers would not pencil out? What about a 75/25 split or a 90/10 split? The Commission will never know, because it appears that no such analysis was actually performed. If one was performed, it was not provided to the Commission. Again, nor was an analysis performed to identify benefits shareholders will already receive by being able to take advantage of the opportunity and combining a non-regulated facility with a regulated facility.
21. To be clear, NWIGU does agree that there are other policies the Commission should pursue that weigh in favor of finding a way to ensure the Tacoma LNG Facility, or something like it, is constructed. For example, the environmental benefits associated with replacing diesel and other transportation fuels with natural gas are real, including those benefits associated with reduced carbon dioxide emissions. NWIGU supports the use of natural gas for that purpose. NWIGU also supports finding least-cost alternatives to ensure that ratepayers are not paying more than they have to for essential utility services. But PSE has taken the least cost concept and twisted it so that ratepayers do not get the full benefit of the savings, because half the savings go to shareholders under PSE's proposal. This turns the regulatory compact, and least cost planning, on its head. If a peak shaving facility can be more efficiently constructed by combining it with a non-regulated activity, the Commission should give that serious consideration. But PSE's all or nothing approach is not supported by the record. NWIGU request that the Commission deny PSE's request to share in the portfolio benefits from the combined use of the Tacoma LNG Facility.

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<sup>16</sup> PSE's Brief at ¶81.

### III. CONCLUSION

22. NWIGU does not support waiver or modification of the applicable Merger Commitments without a more developed record demonstrating why Puget Energy needs to own and operate both PSE and Puget LNG. NWIGU also opposes a sharing of the Tacoma LNG Facility's portfolio benefits, because PSE already has an economic incentive to develop this resources through the cost recovery and return available through traditional ratemaking. If the Commission is inclined to support a sharing of benefits, NWIGU does not believe that an equitable determination can be made without a more fully-developed record and, on that basis, urges the Commission to reject PSE's demand that the portfolio benefits be shared on an equal (i.e. 50/50) basis.

Dated: May 18, 2016.

Respectfully submitted,



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Chad M. Stokes, WSB 37499, OSB 00400  
Tommy A. Brooks, WSB 40237, OSB 076071  
Cable Huston LLP  
1001 SW 5<sup>th</sup> Avenue, Suite 2000  
Portland, OR 97204-1136  
Telephone: (503) 224-3092  
Facsimile: (503) 224-3176  
E-mail: cstokes@cablehuston.com  
tbrooks@cablehuston.com

Of Attorneys for  
Northwest Industrial Gas Users

**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that I have this day served the foregoing document upon all parties of record (listed below) in this proceeding by electronic mail and by mailing a copy properly addressed with first class postage prepaid.

Patrick Oshie  
Assistant Attorney General  
WUTC  
PO Box 40128  
Olympia, WA 98504-0128  
poshie@utc.wa.gov


Finklea, Ed  
Executive Director  
NORTHWEST INDUSTRIAL GAS  
USERS  
545 Grandview Drive  
Ashland, OR 97520  
efinklea@nwigu.org

Jason Kuzma  
Perkins Coie, LLP  
10885 N.E. Fourth St.  
Bellevue, WA 98004-5579  
JKuzma@perkinscoie.com

Simon ffitch  
Office of the Attorney General  
800 Fifth Avenue, Suite 2000  
Seattle, WA 98104-3188  
simonf@atg.wa.gov

Ken Johnson  
Director - Rates & Regulatory Affairs  
Puget Sound Energy  
PO BOX 97034, PSE-08N  
Bellevue, WA 98009-9734  
ken.s.johnson@pse.com

Dated in Portland, Oregon this 18<sup>th</sup> day of May 2016.



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Chad M. Stokes, WSBA 37499, OSB 00400  
Tommy A. Brooks, WSBA 40237, OSB 076071  
Cable Huston LLP  
1001 SW Fifth Avenue, Suite 2000  
Portland, OR 97204-1136  
Telephone: (503) 224-3092  
Facsimile: (503) 224-3176  
E-mail: cstokes@cablehuston.com  
tbrooks@cablehuston.com

Of Attorneys for the  
Northwest Industrial Gas Users