

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 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

DECLARATION OF
DAVID C. GOMEZ

1 I, David C. Gomez, under penalty of perjury under the laws of the State of
Washington, declare as follows:

2 I am over 18 years of age, a citizen of the United States, a resident of the State of
Washington, have personal knowledge of the matters set forth in this Declaration, and am
competent to be a witness.

3 I am employed by the Washington Utilities and Transportation Commission
(Commission) as the Assistant Power Supply Manger in the Energy Regulation Division. I
have been employed in this position at for about nine years. As the Assistant Power Supply
Manager, my responsibilities include accounting and financial analysis of regulated energy
utility companies, as well as legislative and policy analysis.

4 This declaration is based upon my understanding of PSE's revised LNG proposal, and
informed by my review and investigation of the subject matter. My opinions offered herein

may be informed by Mr. Ball's economic analysis of PSE's proposal, particularly where I discuss the potential for a fully regulated LNG service.

A. Staff's investigation and familiarity with the subject matter.

5 Mr. Jason Ball and I have been assigned to review the issues presented by this docket. We have reviewed Puget Sound Energy's (PSE or company) filings and associated issues. We have reviewed a number of Data Requests (DR) responses provided to Staff and other parties to this case covering various aspects of the project.

6 Generally, PSE has responded to these data requests. However, the company did refuse to provide certain material it felt was protected under attorney-client privilege. Having now examined unredacted portions of the withheld DR responses, it appears that this material refers to regulatory, permitting and environmental matters, and the evaluation of alternative business models. It is my understanding that these materials were used by PSE management to inform and guide PSE's Board (Board) when making their decision regarding the progress of the Tacoma LNG project.¹

7 This declaration is based upon my understanding of PSE's revised LNG proposal, and informed by my review and investigation of the subject matter. My opinions offered herein may be informed by Mr. Ball's economic analysis of PSE's proposal, particularly where I discuss the potential for a fully regulated LNG service.

¹ On April 27, 2016, a discovery conference was held by the parties. Here, PSE agreed to the release most of the withheld information. PSE continues to withhold materials that relate to options to terminate the project and the legal action filed by the Puyallup Tribe of Indians challenging the permitting of the Tacoma LNG facility.

B. PSE's Revised LNG Proposal.

8 PSE's LNG service will require the expansion of PSE's natural gas distribution network in Tacoma, and the construction of an LNG facility adjacent to TOTE's Dock located off the Hylebos Waterway in Tacoma. PSE's LNG facility would include a natural gas liquefying plant, LNG storage tank, and a vaporizing facility. Of all components of plant operation, only the vaporizing facility would be devoted to the exclusive service of PSE's ratepayers.

9 In its brief, the Company states that "after Order 04, PSE considered proceeding with the Tacoma LNG Facility under at least four alternative business models: 1) All regulated, 2) Hybrid Regulated/Non-Regulated, 3) Smaller Tacoma LNG Facility (140k gal/day located at the Port of Tacoma), and 4) Non-Regulated Affiliate."² In its January 21, 2016, meeting with the Board, the project team discussed the impact of Order 04 and presented a different set of options than those offered to the Commission.³ It appears that PSE's selection of options for LNG development did not include possible modification of the performance obligations set forth in the TOTE agreement.

10 To enable PSE's unregulated LNG business option, PSE proposes creating a subsidiary of the utility (PSE LNG). From this same facility, PSE would provide natural gas peaking service to its natural gas customers.

11 Under PSE's proposed business model, its LNG affiliate would have no employees. Puget LNG's only purpose would be to hold the unregulated interest in the Tacoma LNG facility.⁴ It appears that the regulated utility would have complete operational control of the

² PSE's brief, Page 8, ¶15.

³ Attachment A to PSE's First Revised, First Supplemental Response to Public Counsel Data Request No. 002, Page 22 of 105.

⁴ Declaration of Roger Garratt in Support of Brief of Puget Sound Energy, UG-151663, Page 6:15-24.

Tacoma LNG facility. Staff assumes that a joint operating agreement would be developed between the two entities. However, the specific terms of such an arrangement have not been disclosed. Based on PSE's proposed structure, it also appears that PSE's utility employees will perform all of the plant's day-to-day operations.

12 Having considered PSE's proposed use of the facility, I believe that day-to-day operations would largely be comprised of unregulated activities, such as refueling TOTE ships and loading tanker trucks. As the company has not provided details otherwise, I also conclude that all costs to improve PSE's natural gas distribution plant to accommodate TOTE's fuel demand would be paid by the utility. The same would be true for the costs to permit and construct the LNG facility at the TOTE dock.

13 PSE does not provide the mechanism by which the utility would recover these costs from PSE LNG. Staff surmises that some form of cost allocation procedure and billing arrangement would be developed between the corporate partners to provide the utility recovery of its service costs. Staff believes that "unwinding" and properly allocating these costs would be administratively burdensome and time consuming. In fact, it may not be possible to unwind accurately the various activities at the TOTE dock in order to facilitate cost allocation. PSE does not address how this function would be performed or the systems that would need to be in place to verify accuracy.⁵ This is a significant problem for both PSE and the Commission.⁶

14 I am also concerned that under PSE's proposed business model, natural gas

⁵ See, Declaration of Roger Garratt in Support of Motion to Establish a Bifurcated Proceeding, Docket No. UG-151663, ¶¶9-14. Declaration of Roger Garratt in Support of Brief of Puget Sound Energy, Page 4:31 through 7:38.

⁶ It is reasonable for Staff to be concerned about the accurate allocation of costs in order to prevent cross-subsidization of the unregulated enterprise by the utility.

ratepayers are being asked to provide PSE LNG an economic safety net should the TOTE agreement be terminated or renegotiated based upon fuel price triggers or the actions of a party.⁷ In any event, Staff believes that PSE's ratepayers should be held harmless from the actions of an unregulated subsidiary of PSE, whether the action is permitted by contract or otherwise. By "homing" the unregulated subsidiary at PSE, ratepayers could be placed at risk of a default by PSE LNG.

15 PSE also does not address what would happen if construction of the LNG plant suffers from cost overruns. In June of 2015, PSE increased its estimates of capital costs for the facility.⁸ The company now estimates its capital costs for the facility at \$370 million which is \$46 million higher than its 2014 estimate. It is Staff's understanding that the pricing in the TOTE agreement reflects an even earlier 2013 cost estimate. Since the TOTE agreement effectively fixes TOTE's payments to PSE within a band, it appears that any cost overruns would have to be stranded with the utility or its shareholders. PSE has not addressed either of these possible outcomes. The proposition that the utility would absorb such cost overruns while the TOTE agreement remains static is unreasonable on its face.

16 PSE's proposal also includes the company's preferred allocation of the Tacoma LNG facility's costs between regulated and unregulated operations. Staff has concerns about PSE's proposed cost allocation proposal, and cannot at this time verify whether it accurately reflects operations of the facility.

17 In my opinion, the day-to-day operations required to serve TOTE at its dock should be allocated entirely to TOTE. This is because the peaking storage capacity required by

⁷ In its response to Staff DR No. 25, PSE confirms that the commodity price triggers which would allow TOTE to exit or renegotiate the contract were reached this spring (2016).

⁸ PSE's confidential response to PC DR No. 002, page 834 of 1227. See also the prefiled testimony of James P. Hogan, Exhibit No JPH-1T at 13:6-7.

ratepayers is only needed intermittently to meet extraordinary weather conditions, generally a few times per year at the most. On the other hand, PSE LNG will be engaged in a constant fuel service rotation involving TOTE's vessels. I conclude that servicing TOTE will drive most activity at the TOTE dock. Therefore, the costs associated with such activity, whether capital or operational, should be allocated to TOTE and not to ratepayers.

18 Up front, PSE seeks to allocate about a third of the facility's operating expenses to ratepayers. I believe PSE's proposed cost allocation does not represent the proper allocation of LNG's actual costs over the life of the facility. I am prepared to address this issue and others in my testimony to be filed later in this proceeding.

C. Alternatives to PSE's Tacoma LNG Facility

19 Through the limited discovery conducted thus far, Staff is uncertain whether the Tacoma LNG Project is the least cost peaking resource available, particularly if TOTE remains as the only contracted and unregulated fuel customer. Staff is continuing to analyze alternative peaking resources for use as comparisons to PSE's proposed Tacoma LNG Project. For example, Staff understands that PSE considered both additional gas pipeline capacity and a stand-alone LNG facility as alternatives to the Tacoma LNG plant. Further analysis would be required to determine whether PSE's LNG proposal represents the utility's least cost alternative. To this end, Staff has performed a general study of LNG alternatives that would enable PSE to serve TOTE under a regulated and unregulated framework. I address a fully regulated service first and then turn to the unregulated model.

20 Staff used PSE's cost of service data to calculate projected tariffed rates for a fully regulated LNG service.⁹ Our analysis showed PSE's projected rates for LNG service to be

⁹ Staff concedes that its rates' study is a scoping of possible rates for LNG service. Cost of service based rates would be dependent upon the facilities' final cost, the allocation of costs between possible rate classes, the cost

slightly higher than TOTE's contracted rate. Based on our review, Staff believes that a fully regulated LNG service offering may be both feasible and competitive. However, offering a competitive service under the precept of a regulated entity carries with it substantial policy questions and may, in effect be somewhat at odds with the proper role of regulation. In fact, treating the fuel service as a regulated offering may distort what is a competitive line of business. Another option PSE explored, but ultimately rejected, was a smaller facility sized to serve TOTE and peaker needs only. Staff believes this option remains viable, as does the development of a peaker-only facility located in Sumner. In my opinion, both options deserve further consideration.

21 PSE's proposed entity structure to home Puget LNG within the utility also has another alternative that would eliminate the need to reopen the merger commitments. As a subsidiary of Puget Holdings LLC, Puget LNG would own the assets of the Tacoma LNG facility and all of plant's operations costs would be captured there. Cost recovery for the peaker portion of the facility would be relatively simple, and be facilitated through an affiliate interest transaction agreement. If properly constructed, such an agreement would provide relative certainty to Puget LNG that it will recover its full costs to serve ratepayers' peak-day needs, and require ratepayers to pay only for the capacity used. Furthermore, Puget LNG would be free to conduct its unregulated business largely outside the commission's regulatory authority.

D. An Overview of the Risks Associated with the Tacoma LNG Project

22 PSE's September 24, 2015, report to its Board identifies the pending outcome of environmental permitting and regulatory approvals along with the company's ability to sell

of capital, and the cost of natural gas.

the remaining 47 percent¹⁰ of the Tacoma LNG facility's capacity into the LNG fuel market as the principal risks facing the project.¹¹ The subjects addressed below are areas which in Staff's opinion represent the most immediate and material risks currently affecting the development of the Tacoma LNG facility.

23 a. Construction costs: PSE states that it has mitigated the majority of its construction cost risks through its plan to award an engineering, procurement and construction (EPC) contract. This option requires the selected contractor to deliver a completed facility at a fixed price by a certain date. However, I question whether such fixed-cost/schedule contracts can be relied upon to both accurately predict a project's final costs and the anticipated date of its completion.

24 PSE acknowledges that LNG facilities like the Tacoma facility "are not "catalog items" akin to some of the modular power plants, such as simple- or combined-cycle combustion turbines or wind projects. It also qualifies its confidence in its budget for the facility by saying that a "complete project cost estimate includes much more than the fixed-price EPC portion of the project, such as development costs; permitting mitigation costs; demolition, ground improvement and other miscellaneous construction costs; project management costs, including outside services; insurance, sales tax, project contingency; overhead; and AFUDC."¹² These non-EPC costs appear to account for almost half of the total \$415 million price tag for the facility.¹³ As noted above, it also appears that the TOTE agreement insulates the shipping company from these risks. Ratepayers do not have such a

¹⁰ PSE's brief at 3 refers to a quarter of the plant's capacity being unsubscribed. This is a reference to allocated capital and not output of LNG. Staff's figures refer to LNG output which is the principal billing determinant.

¹¹ PC DR No. 002, Page 920 of 1227.

¹² PSE's confidential response to Staff DR No. 19.

¹³ For example, contingencies alone account for almost 40 percent of PSE's total budgeted capital costs for distribution system improvements.

guarantee. Nor can staff predict with any certainty the final agreed upon contract amount.

The projected “cost” would be determined when PSE executes agreements with its winning bidders for construction of the facility.

25 b. Permitting: Permitting risks have always been present for this project. The most recent challenge is the Puyallup Tribe’s appeal of the facility’s environmental impact statement. This appeal and any corresponding delay to the project may have serious implications both to the project’s cost and its schedule.¹⁴ However, Staff understands that the TOTE agreement provides contract off-ramps to PSE for permitting and regulatory approvals.¹⁵

26 c. Unsubscribed sales: It is Staff’s understanding that, besides TOTE, PSE has not subscribed a customer for its LNG fuel. While there may be cause for optimism regarding the long-term prospects for LNG fuel sales, Staff cannot opine on the patience and risk tolerance of PSE investors to take the long view and proceed with the construction of a facility. Staff cannot offer an opinion on whether the forecast below-the-line returns for the LNG plant with TOTE as the only customer are attractive or certain enough to warrant such a large investment by the Company’s shareholders.¹⁶

¹⁴ Attachment A to PSE’s First Revised, First Supplemental Response to PC DR No. 002, Page 16 of 103.

¹⁵ Exhibit No. CR-4HC, Section 2.3 of the LNG Fuel Supply Agreement.

¹⁶ In PSE’s confidential First Revised, First Supplemental Response to PC DR No. 002, summarizing Tacoma LNG project team’s updates to the Board; Pages 4, 34, 40, 41, 83, 84, 89, 95 and 96 outlines the Company’s unregulated LNG fuel sales and marketing strategy as:

- Monitor oil and gas markets and basis spreads; and
- Continue to pursue LNG fuel sales opportunities, including preparing a proposal response to Hawaii Gas RFP for up to 8,000 Dth/day renewable gas (~85-90 percent of the remaining Tacoma LNG plant capacity).

Besides staff’s difficulty in discerning a cogent strategy from the two bullet items provided in a PowerPoint slide, the Company fails to explain how the LNG produced from pipeline gas at the Tacoma plant qualifies as renewable gas.

E. PSE proposal and its impact upon PSE's merger commitments

27 In evaluating the Company's proposal for an exemption to Merger Commitment Nos. 56 and 58, I reviewed PSE's merger docket.¹⁷ As a preliminary matter, I was impressed by the importance of the ring fencing provisions set forth in the final order, and the statements made by representatives of PSE and Macquarie in support of these commitments, including the testimony of Mr. Christopher Leslie, Executive Director of the Macquarie Group of Companies in the merger case.¹⁸

28 In his testimony, Mr. Leslie explained why the merger is consistent with the public interest. He goes on to describe how PSE's regulated electric and natural gas businesses will become a ring-fenced business under Puget Holdings. His testimony also defines the various structural and financial commitments offered by Puget Holdings and PSE to insulate PSE from the financial activities of Puget Holdings and its subsidiaries. Mr. Leslie also assured the Commission that the ring-fencing measures it would put in place for the regulated utility would shield PSE's customers from the financial activities of other entities associated with the new holding company structure. These commitments were also intended to isolate PSE's regulated utility operations from any negative financial impacts flowing from unregulated units. The ring fencing commitments allow PSE to maintain a strong credit rating and attract capital. They prevent cross-subsidization of non-regulated ventures, and they provide the Commission access to timely and accurate information relating to PSE.¹⁹ From this backdrop, I comment on PSE's proposal to waive Merger Commitments 56 and 58.

¹⁷ In the Matter of the *Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc. for an Order Authorizing Proposed Transaction*, Docket U-072375,

¹⁸ In the Matter of the *Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc. for an Order Authorizing Proposed Transaction*, Docket U-072375, Exhibit No. CJL-1T.

¹⁹ *Ibid.*, Pages 34:25 to 35:1.

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PSE's Merger Commitment 56 protects ratepayers from unregulated business enterprises owned by its investors. Here PSE committed that it would not operate or own any business other than PSE. Here, PSE is proposing that the Commission waive this requirement, and allow PSE to operate Puget LNG. Given the lack of detail provided in PSE's proposal, it is difficult for Staff to completely understand the future relationship between these two entities. It appears that PSE and Puget LNG will be separate legal entities with different financial statements. However, they also appear to be essentially the same entity, run by the same board of directors and executive management. As addressed above, it also appears that financial obligations undertaken by Puget LNG would be paid for by cash generated by PSE. Commitment 56 expressly protects the utility and ensures that it is not in any way encumbered by unregulated operations. At the most basic level, the commitment ensures that the utility focuses on providing safe, reliable and efficient service to its ratepayers, and is not distracted or impaired by unregulated businesses.

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PSE's proposal also seeks a waiver of Commitment 58. This provision relates to the limitation on the use of capital expenditure credit facilities required by the utility to serve its regulated customers.²⁰ PSE's proposal does not provide details regarding its plans to secure financing for the construction of the Tacoma LNG facility. As a result, many more questions would need to be answered to fully evaluate the Company's request.

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For example, what is the amount and cost of debt the regulated utility holding company will be asked to assume under PSE's proposal? Also, what would be the source of such debt? Would the debt financing be through a third-party lender at the utility's cost of debt? Would the debt instrument allow investors to convert borrowed funds into utility

²⁰ PSE Brief, ¶44.

equity? Without these details, Staff cannot fully evaluate PSE's request to waive the merger commitments, and offer to the Commission its opinion on the reasonableness of PSE's request and its implications.

32 While PSE only requested waivers for Merger Commitments Nos. 56 and 58, Staff believes a number of other merger commitments are also implicated by PSE's proposal. To this point, Staff believes PSE's proposal is affected by the following merger commitments: Commitment No. 9, wherein PSE agreed to hold PSE customers harmless from any business and financial risk exposures associated with Puget Energy, Puget Holdings and its other affiliates;²¹ Commitment No. 26, wherein Puget Holdings and PSE committed to hold PSE's customers harmless from the liabilities of any non-regulated activity of PSE or Puget Holdings. It also states that PSE's rate of return will be determined without the regard to adverse consequences attributable to unregulated activities; Commitment No. 19, wherein Puget Holdings and PSE agreed to provide access to PSE's books and records, including all documents supporting costs allocable to PSE; Commitment No. 27, wherein PSE and Puget Holdings promised to maintain the necessary books and records demonstrating an audit trail for all corporate, affiliate, or subsidiary transactions with PSE, or that result in costs that may be allocable to PSE; and, Commitment No. 20, wherein PSE agreed that there will be no cross-subsidization by PSE customers of unregulated activities.

33 Staff believes these and perhaps other merger commitments require further analysis and consideration. However, until the specific details of PSE's fully developed LNG proposal are known, vetted, and fully understood, Staff cannot provide the Commission a

²¹ Commitment 9 also includes the promise that any nonregulated subsidiary would be established as a subsidiary of either Puget Hoidings, Puget Intermediate Holdings Inc., or Puget Energy rather than as a subsidiary of PSE.

thorough and detailed analysis of how PSE's proposal interacts with the merger commitments made in 2007.

F. The 50/50 sharing of portfolio benefits reduces shareholder risk

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PSE's proposes a regulatory incentive in the form of an equal sharing of the estimated portfolio benefits associated with the Tacoma LNG Facility between PSE's investors and the Company's natural gas sales customers.²² The company states that the incentive is entirely appropriate given its shareholders are "assuming greater business and financial risk."²³ Staff's analysis through the present state of discovery has exposed a number of estimates PSE provided to the Board that forecasts the below-the-line returns under its proposed business model.²⁴ The degree to which the company's investors find these returns, adequately compensate them for their assumption of risk will require further examination by Staff before it can advise the commission on this issue.

DATED at Olympia, Washington, and effective this 18th day of May 2016.



DAVID C. GOMEZ

²² PSE Brief at 66.

²³ PSE Brief, at 66.

²⁴ Attachment A to PSE's First Revised, First Supplemental Response to Public Counsel Data Request No. 002, Pages 23, 35, 50, 74 and 102 of 105.