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June 27, 2011

SENT VIA E-MAIL & ABC LMI
David Danner
Executive Director and Secretary
Washington Utilities and Transportation Commission
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PO Box 47250
Olympia, WA 98504-7250

Re: Advice No. 2011-12
PSE Natural Gas Tariff Filing – Pipeline Integrity Program
Docket No. UG-110723
Comments of Public Counsel

Dear Mr. Danner:

Public Counsel files these comments to address Puget Sound Energy's (PSE) Pipeline Integrity Program ("PIP" or "tracker"), which is scheduled to be considered at the Commission's June 30, 2011, Open Meeting.

Public Counsel Recommendation

Public Counsel recommends that the tariff be suspended and set for adjudication and a hearing. If suspended, Public Counsel further recommends that it be consolidated for hearing with PSE's 2011 General Rate Case, filed on June 13, 2011. *WUTC v. PSE*, Docket Nos. UE-111048, UG-111049 (PSE 2011 GRC).

Summary

The proposed Pipeline Integrity Program constitutes single-issue ratemaking, a form of cost recovery not permitted except under "extraordinary circumstances." PSE has made no showing that any extraordinary circumstances exist in this case. PSE has provided no evidence that it is unable to recover its infrastructure investments through standard ratemaking procedures. Current ratemaking in Washington allows for both recovery of and recovery on such infrastructure investments. Both the safety concerns and safety requirements associated with the natural gas distribution business have been well known to the Company. PSE does not claim that its current system is unsafe, and has indicated that without the PIP, the current program will continue to improve pipeline reliability.

Approval of PSE's new pipeline tracker mechanism is problematic on several additional grounds. The inclusion of a rate of return component makes the mechanism different from most "pass through" trackers, and adds complexity. The open-ended nature of the PIP true-up exposes customers to unpredictable levels of cost. The pipeline tracker shifts risk to customers while reducing risk for the company, with no adjustment to the overall cost of capital. The abbreviated and undefined oversight procedure seriously weakens the opportunity for effective review of the prudence of infrastructure expenditures by Staff, Public Counsel, intervenors, and the Commission, creates time and resource burdens, and involves stakeholders in a potential "pre-approval" role.

Discussion

A. The proposed PIP mechanism constitutes impermissible single-issue ratemaking.

If approved, the PIP would allow PSE to recover budgeted and actual gas pipeline-related costs in isolation from all other costs and revenues and would clearly constitute "single-issue ratemaking." As a general proposition single issue ratemaking is strongly disfavored. It is a deviation from the fundamental principles of ratemaking in that it violates the "matching principle." On numerous occasions, this Commission has made clear that it "generally will not engage in single-issue or 'piecemeal' ratemaking."[1] As the Commission has stated:

> In particular, we disfavor and typically avoid single-issue ratemaking and we are careful to preserve so far as is reasonable the "matching principle" that relies on our consideration of all revenues, costs, and adjustments in the context of a test year with a definite ending date.[2]

In recent rate cases for both PSE and Avista, the Commission has strongly reaffirmed the continued vitality of the "matching principle" in Washington ratemaking.[3]

PSE's Chief Executive Officer Kimberly Harris endorses these fundamental principles in her testimony in the Company's recently filed general rate case. There, Ms Harris observes, "as the Commission has noted, the need for rate relief is not evaluated on the basis of any one single

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[1] *See, e.g., MCI Telecom Corp. v. GTE Northwest, Inc,*. Docket No. UT-970653, Second Supplemental Order (Oct. 1997) (citations omitted).
[2] *WUTC v. PSE,* Docket Nos. UE-060266, UG-060267 (PSE 2006 GRC), Order 08, ¶ 37.
[3] *WUTC v. PSE,* Docket Nos. UE-090704, UG-090705, Order 11, ¶¶ 25-27; *WUTC v. Avista Corp.,* UE-090134, UG-090135, Order 10, ¶¶ 46-49 (Re pro forma adjustments and the matching principle. The decisions also reject the practice of basing rates on budgeted and projected costs in most circumstances).

issue but on a comprehensive review of a wide variety of factors that bear on a company's financial performance and its ability to provide reliable service to its customers."[4]

B. PSE has made no showing of "extraordinary circumstances."

The Commission has historically only approved single-issue ratemaking under "exceptional" circumstances, for limited purposes. In PSE's 2006 GRC, the Company proposed a depreciation tracker for both electric and gas services. In its order rejecting the tracker, the Commission stated,

> It requires extraordinary circumstances to support a departure from fundamental ratemaking principles. In prior cases, the Commission has required "a clear and convincing showing that the Company will be denied any reasonable opportunity to earn its authorized rate of return without extraordinary relief."[5]

In the end, the Commission decided that the Company had not demonstrated financial circumstances that might justify extraordinary relief, and that the record did not support the approval of a novel mechanism that would change rates, shift risks and costs to ratepayers outside of a full review of costs and expenses.[6]

The Commission had an extensive record in the PSE 2006 GRC on which to decide the merits of PSE's depreciation tracker proposal. By contrast, PSE's filing in this docket consists of a two-page cover letter, an attachment vaguely outlining the Company's intended accounting and procedural proposal, and the tariff itself. There is no testimony or other evidentiary support for the existence of any "extraordinary circumstance" to warrant an exception to the rule against single-issue ratemaking. PSE has the burden of proof to make such a showing but has not carried its burden.

PSE can make no serious claim that maintaining its natural gas system in a safe and reliable manner constitutes an "extraordinary circumstance" that warrants a departure from Commission ratemaking policy. Neither PSE's need to replace aging pipeline infrastructure in order to provide safe and reliable service, nor the reliability, integrity, and safety programs cited as the rationale for the mechanism are newly discovered phenomena. In fact, many of the infrastructure needs and safety requirements included in this filing have been detailed in numerous proceedings before the Commission in recent years.

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[4] PSE 2011 GRC, Exhibit No. KJH-1T, p. 2:16-3:9.
[5] PSE 2006 GRC, Order 08, ¶ 39.
[6] *Id.*, ¶¶ 41-42.

For example, in PSE's 2006 GRC just mentioned, PSE Witness Sue McLain discussed PSE's gas infrastructure needs, maintenance and replacement spending, PSE's programmatic approach to replacement of aging facilities, and gas system compliance regulations the Company would have to meet—including elements related to"integrity management."[7] Similarly, in the proceeding to review the proposed sale of PSE to infrastructure investors, the capital needs of PSE were extensively discussed, including necessary investments related to "planned reliability improvements and projects needed to comply with various laws and regulation, projects to maintain and strengthen gas and electric systems...and projects in which PSE is responding to external requirements such as relocating facilities."[8]

In its cover letter, PSE refers to accidents in California and Pennsylvania, but does not explain how those events are comparable or relevant to the Company's situation. Nor does PSE provide any of its own safety data with its filing. However, in response to an informal data request by Staff, PSE states:

> PSE does not believe that absent the requested accounting treatment that the reliability and safety of our natural gas distribution system will be comprised....PSE's System Performance has been improving due to existing integrity programs. PSE will continue these programs and continue to improve the safety and reliability of our distribution system even without the approval of the PIP tariff. [9]

These improvements have occurred despite Ms. McClain's projection in the 2006 general rate case that the Company's ability to make the investments required to maintain a safe, reliable and robust gas and electric system would be hindered if the depreciation tracker were rejected.[10]

C. PSE does not explain the connection between the proper management pipeline safety and the asserted need to change its cost recovery mechanism.

As noted above, PSE has not provided any evidence in this filing that it cannot recover its infrastructure investments or earn a return on those investments under current ratemaking practice. The Company's reliance on vague and well-worn generalities such as the need for "timely recovery" do not take the place of hard evidence. The assertions regarding timely

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[7] PSE 2006 GRC Exhibit No. SML-1CT, pp. 18-24.
[8] PSE Sale, Exhibit No. EMM-1T, p. 9.
[9] PSE Response to Informal Staff Data Request No. 22. Attachment 22 (a) to the response is the "2010 Continuing Surveillance Annual Report, which states on p. 11: "Overall, PSE's distribution system performance has improved over the years."
[10] PSE 2006 GRC, Exhibit No. SML-5T, p. 7.

recovery carry little weight when PSE has just filed its eleventh rate case since 2000 and has indicated it plans to continue this pace of annual filings. Furthermore, the claims of urgency for capital recovery are out of tune with the assurances at the time of the Macquarie acquisition that PSE's new owners would provide new patient capital, and would, as "[i]nfrastructure investors understand that to achieve a desired long term return, they must take a long term view and invest in the business."[11] The new owners assured the Commission that they would "invest heavily, even where the benefits only accrue at some point in the future, as opposed to next quarter's earnings per share or dividend."[12]

PSE has demonstrated no factual nexus between the type of cost recovery requested and safe utility operations. The claim is that this tariff will "eliminate a major obstacle…in that it allows for timely recovery of costs incurred without regard to artificial program classifications."[13] Additionally, the Company refers to alleged problems with "separate budgets, timelines, and work requirements" related to State and Federal mandates, however PSE does not explain how these program structures relate to cost recovery, or why internal organizational problems are not within the scope of management discretion to address.

Safe gas pipelines and integrity management are a function of training, equipment, planning, materials, management and employee focus, and other such practical operational factors,[14] and do not depend on whether a company has a particular form of cost recovery.

D. Additional concerns regarding PSE's proposal.

The proposed tariff raises additional concerns beyond those listed above.

- Open-ended exposure for customers. The proposed mechanism is open-ended, in that the annual true-up could result in much more than the budgeted amount being passed on to customers. The tariff contains no limit on spending. It is unclear how prudence issues would be addressed for any amount beyond what was budgeted. Furthermore, PSE has left the door open to add additional cost elements to the mechanism in the future, stating

[11] *In the Matter of the Joint Application of Puget Holdings Llc And Puget Sound Energy Inc. For An Order Authorizing Proposed Transaction*, Docket No. UE-072375 (PSE Sale), Exhibit No. (CJL-8HCT), p. 11:10-12.
[12] PSE Sale, Exhibit No. CJL-8HCT, p. 11:20-12:1.
[13] Advice Letter, April 26, 2011, p. 1.
[14] *See e.g.*, U.S. Dept. of Transportation, Pipeline and Hazardous Materials Safety Administration (PHMSA), Briefing "Integrity Management" which states: " An integrity management program is a set of safety management, analytical, operations and maintenance processes that are implemented in an integrated and rigorous manner to assure operators provide protection for HCAs [High Consequence Areas, such as urban areas]." The document does not identify cost recovery trackers as an element of integrity management. http://primis.phmsa.dot.gov/comm/IM.htm?nocache=8321 (accessed June 15, 2011).

it is "flexible with respect to the scope of the programs that could be included in the future."[15] Thus, there is no clear picture of how this mechanism might grow over time.[16]

- Precedent. Public Counsel is concerned that approval of the PIP under these circumstances would seriously undermine Washington's existing strong policy disfavoring single-issue ratemaking, significantly lowering the bar for other "tracker" proposals for any company wanting to recover individual costs.

- Rate of return. The PIP includes a rate of return element, something that Public Counsel is unaware the Commission has approved before for any mechanism similar to this. This is uncharted territory. Moreover, if the rate of return authorized in the most recent rate case is used, it may not be accurate, particularly if significant time has passed since the case or if the rate case was resolved through a "black box" settlement.

- Undue burden/no clear process. The proposal will place substantial new burdens on the time and resources of the Commission, Staff, Public Counsel, and other stakeholders, with a shortened time frame for review. This is additionally problematic considering that the proposed "consultation process" with stakeholders is undefined. There is no explanation of how disagreements between parties would be resolved or how prudence review would be affected. The collaborative process contemplated may draw stakeholders into a *de facto* pre-approval role for infrastructure investment. Furthermore, if other natural gas companies request similar mechanisms related to pipeline integrity the Commission, Staff and other parties would be expected to participate in a proliferation of separate expedited reviews of gas infrastructure deployment plans.

Conclusion and Recommendation

For the reasons stated, Public Counsel recommends that the tariff be suspended for investigation and set for hearing. The docket should be consolidated with the general rate case recently filed by PSE in order to thoroughly address overlapping issues. This will also allow the parties to efficiently conduct a more thorough review. PSE has created potential procedural problems by choosing to file this matter separately, while knowing it would be filing a 2011 gas and electric rate case in the same time frame. PSE also chose to make its separate request only months after its most recent gas rate case concluded. Other parties should not be procedurally disadvantaged

[15] Advice Letter, p. 2.
[16] While PSE's filing letter states that the amount that will be collected through the mechanism initially is $732,000, this amount does not portray the true scale of the costs that anticipates it will collect through the mechanism annually. The Company has estimated that the first 12 months budget would be considerably higher ($5.7 million) at the time of the proposed update through the PGA in November 2011.

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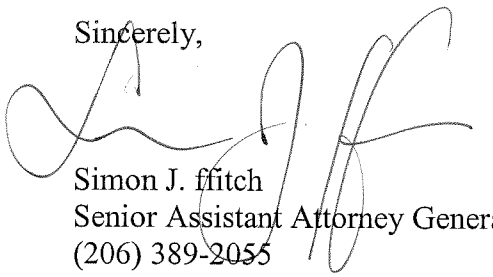
because PSE has chosen to request a mechanism with such substantial policy and financial ramifications outside of a general rate case.

Public Counsel will have a representative at the June 30 Open Meeting to address this matter.

Sincerely,



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