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**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

DOCKET NO. UG-110723

Complainant,

v.

PUGET SOUND ENERGY, INC.,
Respondent.

**RESPONSE TESTIMONY
OF
DONALD W. SCHOENBECK
ON BEHALF OF
THE NORTHWEST INDUSTRIAL GAS USERS**

OCTOBER 25, 2011

1 **RESPONSE TESTIMONY OF DONALD W. SCHOENBECK**
2 **ON BEHALF OF THE NORTHWEST INDUSTRIAL GAS USERS**

3 **INTRODUCTION AND SUMMARY**

4 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS**

5 A. My name is Donald W. Schoenbeck. I am a member of Regulatory &
6 Cogeneration Services, Inc. ("RCS"), a utility rate and economic consulting firm. My
7 business address is: 900 Washington Street, Suite 780, Vancouver, WA 98660.

8 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
9 **PROFESSIONAL EXPERIENCE.**

10 A. I have a Bachelor of Science Degree in Electrical Engineering from the University
11 of Kansas, a Master of Science Degree in Engineering Management from the University
12 of Missouri, and I have completed all the course work toward a Master of Science Degree
13 in Nuclear Engineering. From June of 1972 until June of 1980, I was employed by Union
14 Electric Company in the Transmission and Distribution, Rates, and Corporate Planning
15 functions. In the Transmission and Distribution function, I had various areas of
16 responsibility, including load management, budget proposals and special studies. While
17 in the Rates function, I worked on rate design studies, filings, and exhibits for several
18 regulatory jurisdictions. In Corporate Planning, I was responsible for the development
19 and maintenance of computer models used to simulate the Company's financial and
20 economic operations.

21 In June of 1980, I joined the national consulting firm of Drazen-Brubaker &
22 Associates, Inc. Since that time, I have participated in the analysis of various utilities for
23 power cost forecasts, avoided cost pricing, contract negotiations for gas and electric
24 services, siting and licensing proceedings, and rate case purposes including revenue
25 requirement determination, class cost-of-service, and rate design.

1 In April 1988, I formed RCS. RCS provides consulting services in the field of
2 public utility regulation to many clients, including large industrial and institutional
3 customers. We also assist in the negotiation of contracts for utility services for large
4 users. In general, we are engaged in regulatory consulting, rate work, feasibility,
5 economic and cost-of-service studies, design of rates for utility service, and contract
6 negotiations. I have appeared before the Washington Utilities and Transportation
7 Commission (“WUTC” or “Commission”) on many occasions, including proceedings
8 regarding the establishment of charges for customers of Puget Sound Energy, Inc.
9 (“Puget” or the “Company”).

10 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

11 **A.** I am testifying on behalf of the Northwest Industrial Gas Users (“NWIGU”).
12 NWIGU is a nonprofit association comprised of thirty-seven end-users of natural gas
13 with major facilities in the states of Washington, Oregon and Idaho. NWIGU members
14 include diverse industrial interests, including food processing, pulp and paper, wood
15 products, electric generation, aluminum, steel, chemicals, electronics and aerospace. The
16 association provides an information service to its members and participates in various
17 regulatory matters that affect member interests. NWIGU member companies purchase
18 natural gas sales and transportation services from local distribution companies (“LDCs”),
19 including Puget.

20 **Q. PLEASE BRIEFLY SUMMARIZE THE TOPIC YOU WILL ADDRESS AND**
21 **YOUR RECOMMENDATION.**

22 **A.** I am responding to the proposal forwarded by Mr. De Boer, Mr. Story and Mr.
23 Henderson to establish a Pipeline Integrity Program (“PIP”) that would allow Puget to
24 impose a tracker surcharge mechanism for a portion of its gas infrastructure investment,
25 specifically replacement of three types of existing pipe, and to recover those costs from
26 its ratepayers on an annual basis outside of its pending and future rate cases. *See Ex.*

1 Nos.: TAD-IT, Direct Testimony Tom De Boer; JHS-IT, Direct Testimony of John Story;
2 and DAH-IT, Direct Testimony of Duane Henderson. Puget is proposing a tracking
3 mechanism to surcharge natural gas customers in order to accelerate its recovery of these
4 expenses. While NWIGU supports appropriate, prudent expenditures for public safety
5 made by regional utilities like Puget, this PIP surcharge should be rejected by the
6 Commission for its inappropriate accounting and ratemaking structure. Specifically this
7 PIP filing should be rejected because:

- 8 • Puget's PIP proposal does not provide any ascertainable net benefits to its customers
9 in risk mitigation;
- 10 • The PIP tracker proposal constitutes single-issue ratemaking that isolates one of
11 multiple factors that are increasing and decreasing between rate cases; and,
- 12 • The proposal advanced by Puget does not balance shareholders' and ratepayers'
13 interests, and instead advances only the interests of the shareholders by isolating
14 advanced cost recovery of these programs.

15 **Q. WOULD YOU PLEASE BRIEFLY CHARACTERIZE THE PIP?**

16 **A.** The PIP is limited in scope initially to the following programs: (1) Wrapped Steel
17 Service Assessment; (2) Wrapped Steel Main Assessment; and (3) Older Polyethylene
18 Pipe Replacement. The proposed tariff revision would increase natural gas service
19 revenues under the new cost recovery method by approximately \$2 million for the initial
20 program period proposed through October 31, 2012. Notably the PIP is not merely a
21 pass-through of capital costs to ratepayers as it includes a return on as well as return of
22 investment to Puget's shareholders, and without any consideration of the mechanism's
23 impact upon Puget's return on equity. According to Mr. De Boer, the PIP proposal
24 assists Puget with its inter-company budgeting for safety expenditures:

25 "… in order to meet all of its capital requirements, PSE must prioritize
26 these programs and sets separate budgets, timelines and other work

1 requirements which can limit the flexibility in addressing the highest
2 priority safety and compliance issues across the entire system. The
3 proposed PIP mitigates a major obstacle to managing safety on a system-
4 wide basis in that it allows for timely recovery of costs incurred without
5 regard to the artificial program classifications and would allow the
6 Company, in consultation with stakeholders, to increase investments to
7 address reliability, integrity and safety programs.”

8 (Ex. No. TAD-IT, p. 3, lines 4-12).

9 **Q. DO THE THREE PIP PROGRAMS ADDRESS ANY NEW, PREVIOUSLY
10 UNANTICIPATED SAFETY REQUIREMENTS FOR PUGET’S CUSTOMERS
11 IN THE FUTURE TEST YEAR?**

12 **A.** No. To the contrary, the PIP covers future expenses anticipated from ongoing
13 safety program efforts going back several years. According to Mr. Henderson’s
14 testimony, the wrapped steel assessment program has been underway by Puget since
15 2006 and the wrapped steel main assessments and older polyethylene pipe replacement
16 programs began in 2010. Ex. No. DAH-IT, pp. 7 -9. However, Puget makes clear that
17 the Company intends to use the program “to be flexible to address safety concerns as they
18 arise in the future.” (Ex. No. TAD-IT, p. 3, lines 17-18). This PIP filing does not define
19 these speculative expenditures that are intended by Puget to be a part of the proposed
20 tariff.

21 **Q. IN YOUR OPINION IS THIS PIP MECHANISM CONSISTENT WITH
22 PRINCIPLES OF SOUND RATEMAKING?**

23 **A.** No, it is not. The Company has made no showing that would justify this
24 surcharge as a net benefit to ratepayers. To quote, Mr. De Boer, PSE “believes this
25 accelerated funding is appropriate given the recent pipeline safety issues that have
26 emerged locally and nationally and the age and performance of PSE’s system.” (Ex. No.
TAD-IT, p. 5, lines 2-4).

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1 **Q. DO YOU AGREE WITH ACCELERATED FUNDING WITH THE PIP AS**
2 **BEING JUSTIFIED?**

3 A. No. The unfortunate pipeline safety incidents that have occurred and the
4 emerging discussion of potential improved safety regulatory requirements that may arise
5 do not justify accelerating funding for Puget shareholders under the PIP.

6 **Q. IS THIS ACCELERATED FUNDING MECHANISM CONSISTENT WITH**
7 **WUTC PRECEDENT?**

8 A. No, it is not. Contrary to WUTC precedent, the PIP incorporates a future test year
9 to capture projected, incremental costs of these three programs and potentially others, all
10 using a form of cost recovery in single issue ratemaking that should not be permitted
11 except under extraordinary circumstances. Puget has made no showing that any
12 extraordinary circumstances exist in this case. Under WUTC precedent, the Company
13 has not demonstrated financial circumstances that might justify extraordinary relief.
14 See e.g., *WUTC v. PSE*, Docket Nos. UE-060266, UG-060267 (PSE 2006 GRC), Order
15 08, ¶¶ 37-39 (rejecting Puget's proposed depreciation tracker and noting how single issue
16 ratemaking violates the matching principle as it precludes consideration of all revenues,
17 costs, and adjustments).

18 **Q. DOES THE FACT THAT THE COMMISSION IS LOOKING AT PSE'S**
19 **REVENUES AND EXPENSES IN TOTAL ON A REGULAR BASIS THROUGH**
20 **THE COMPANY'S FREQUENT GENERAL RATE CASE FILINGS MITIGATE**
21 **CONCERNS REGARDING SINGLE ISSUE RATE MAKING?**

22 A. No, it does not. In fact Puget's frequent rate case filings evidence that the
23 recovery and prudence of safety expenditures can be addressed on a regular basis through
24 a full review of costs and expenses with appropriate inclusion of prudently incurred
25 safety expenditures in base rates.

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1 **Q. HAS PUGET PROVIDED ANY EVIDENCE THAT IT IS UNABLE TO**
2 **RECOVER ITS INFRASTRUCTURE INVESTMENTS FOR PIPELINE SAFETY**
3 **PROGRAMS THROUGH STANDARD RATEMAKING PROCEDURES?**

4 **A.** No. Current ratemaking in Washington allows for both recovery of and recovery
5 on prudent infrastructure investments. Both the safety concerns and safety requirements
6 associated with the natural gas distribution business have been well known to the
7 Company. Puget does not claim that its current system is unsafe, and Puget has indicated
8 that without the PIP, its current program will continue to improve pipeline reliability.

9 **Q. WHY DO YOU RECOMMEND REJECTION OF THE PIP SURCHARGE?**

10 **A.** The record evidence does not support the approval of a novel mechanism that
11 would change rates, shift risks and costs to ratepayers outside of a full review of costs
12 and expenses.

13 **Q. IS THIS PIP PROPOSAL SIMILAR TO THAT APPROVED IN OREGON FOR**
14 **NW NATURAL THAT WAS SUPPORTED BY THE NORTHWEST**
15 **INDUSTRIAL GAS USERS?**

16 **A.** No, it is not in two fundamental ways. First, the NW Natural program stipulation
17 in Oregon was initiated due to a known and substantial change in federal safety
18 regulation that had a significant impact on NW Natural because its Oregon system is a
19 high pressure transmission line system that became subject to the Pipeline Safety
20 Improvement Act of 2002. The law requires operators of transmission pipeline to assess
21 the condition of the higher-pressure gas transmission pipelines for high consequence
22 areas on a cycle of no greater than every seven years (“TIMP”). The program is
23 administered by the US Department of Transportation, Pipeline and Hazardous Materials
24 Safety Administration (“PHMSA”). Second the NW Natural program stipulation
25 incorporated an eight-year rate case moratorium for Oregon ratepayers.

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1 Q. ARE THERE ADDITIONAL POLICY CONCERNS THAT YOU HAVE WITH
2 THE PIP PROPOSAL?

3 A. Yes, in three key areas: additional rate recovery structure concerns; the utility's
4 obligation to provide safe and adequate service; and, the potential for dilution in efficient
5 cost management of safety expenditures with a PIP program.

6 Q. WHAT CONCERNS DO YOU HAVE WITH THE RATE RECOVERY
7 STRUCTURE IN ADDITION TO THOSE ALREADY DISCUSSED IN YOUR
8 TESTIMONY?

9 A. As I have previously noted a PIP surcharge fails to treat ratepayers fairly relative
10 to Puget's shareholders as would be the case if these expenses were treated in a general
11 rate case proceeding. Puget's proposed revenue deficiency for PIP is based on the
12 incremental investment in the approved programs through the rate year. The incremental
13 investment is defined as the new investment in PIP plant that will be put into service from
14 the end of the most recent test year used to change the general rate tariff schedules for
15 natural gas through the PIP rate year. The revenue deficiency includes the return on this
16 incremental investment, less accumulated depreciation and deferred taxes associated with
17 that investment, plus increased depreciation expense associated with the new investment.
18 See Ex. No. JHS-IT, pp.4-6. When general tariff schedules are changed during a PIP rate
19 year, the PIP calculations would be adjusted, based on the effective date of the new
20 general rate tariff schedules, to reflect the new test year, new net of tax rate of return
21 approved in the general rate tariff filing, and new depreciation rates if any were approved.
22 Puget's true-up in the PIP to actual PIP expenses does not track any other expenses which
23 may decline in the PIP test year. Moreover, the PIP does not address situations of
24 increased capacity that may occur when a PIP program results in larger capacity
25 installations. In addition to its failure to track expense reductions and exclude increased
26 capacity, the PIP proposal fails to reflect cost of service among Puget's customers
applying only its own study from its most recently completed gas rate case, the 2010 Gas

1 Tariff Increase Filing ("GTIF"), Docket No. UG-101644, but without any consideration
2 of other allocation methodologies advocated by other parties in that case or that may
3 occur in future cases and be adopted by the WUTC. In addition, Puget also erroneously
4 includes special contract customers in the scope of surcharges at the same level as
5 Schedules 87/87T when they should be excluded from application.

6 **Q. IN ADDITION TO RATE STRUCTURE CONCERNS, WHY DO YOU ALSO**
7 **HIGHLIGHT THE MANDATE TO PROVIDE SAFE, RELIABLE, AND**
8 **ADEQUATE SERVICE?**

9 **A.** The PIP undermines part of the basic compact of monopoly utility regulation in
10 Washington State. That compact requires that utilities provide customers with utility
11 service at reasonable rates; allows utility shareholders the opportunity to earn a fair rate
12 of return on their investments; and, finally the utility, in turn, has the duty or obligation to
13 provide safe and adequate service. This has been the basis for utility regulation in the
14 state of Washington for many decades. RCW 80.28.010. This is the most fundamental
15 of all mandates to public utilities. The provision of safe, reliable, adequate service should
16 be the minimum accepted standard for utility service. The issue of whether Puget should
17 receive extraordinary cost recovery treatment for the PIP projects is a separate issue from
18 the requirement for provision of safe, reliable service.

19 **Q. HAS THE COMPANY REPRESENTED THAT THEY EITHER WILL NOT OR**
20 **WILL BE UNABLE TO PROVIDE SAFE, ADEQUATE, RELIABLE SERVICE**
21 **SHOULD THE COMMISSION DECIDE TO DENY THEIR PROPOSAL TO**
22 **IMPLEMENT THE PIP?**

23 **A.** No, but NWIGU is concerned that the Company is painting an unjustified black
24 cloud over Commission denial of the PIP. On behalf of NWIGU member companies, I
25 am in no way suggesting that PIP denial should suggest that the Company discontinue or
26 slow its implementation of the TIMP, Distribution Integrity Management Plan ("DIMP"),
or other pipeline safety and integrity measures. The Company should continue to

1 implement the federally mandated TIMP and DIMP programs, and other pipeline
2 integrity measures the Company decides appropriate to provide safe, reliable and
3 adequate service. While there may indeed be serious pipeline safety and integrity issues
4 that these programs and initiatives are intended to address, the Company has not
5 established the need for extraordinary cost recovery and has shown no factual nexus
6 between the type of cost recovery requested and safe utility operations.

7 **Q. IS NWIGU SUGGESTING THAT THE PIP PROGRAMS DESCRIBED BY THE**
8 **COMPANY ARE UNNECESSARY?**

9 A. No, not at all. The Company should implement those programs and projects
10 that are consistent with its obligation to provide safe and reliable service. The
11 Commission should demand this regardless of any decision related to extraordinary
12 recovery of program or project costs.

13 **Q. IS THERE AN ADDITIONAL POLICY CONCERN THAT YOU BELIEVE IS**
14 **RELEVANT TO THE COMMISSION'S DETERMINATION ON THE PIP?**

15 A. Yes. When cost recovery is guaranteed through adjustment clauses like the PIP
16 tracker proposed here, the incentive for Puget to control costs, to prioritize projects and to
17 be more efficient is diminished. The incentive to control costs is important in rate based
18 regulation. This incentive should not be lost or diminished by advance cost recovery for
19 an expense that is normal and ongoing to operating a utility system. I recommend that
20 the Commission reject the proposed PIP tracker and continue its practice of allowing
21 pipeline safety initiative costs to be recovered in base rates.

22 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

23 A. Yes.

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on October 25, 2011, I caused to be served the foregoing RESPONSE TESTIMONY OF DONALD W. SCHOENBECK ON BEHALF OF THE NORTHWEST INDUSTRIAL GAS USERS upon all parties of record on the following current Service List of these proceedings via Federal Express to their respective addresses, and via e-mail to those parties who provided e-mail addresses, as indicated below:

Table with 2 columns and 3 rows containing contact information for Robert D. Cedarbaum, Donna Barnett, Simon ffitch, Tom DeBoer, and Sheree Carson.

Dated at Portland, Oregon, this 25th day of October, 2011.

Handwritten signature of Chad M. Stokes above a horizontal line, followed by typed name and address: Chad M. Stokes, Cable Huston Benedict Haagensen & Lloyd LLP, 1001 SW Fifth Avenue, Suite 2000, Portland, OR 97204-1136, Telephone: (503) 224-3092, Facsimile: (503) 224-3176, E-mail: cstokes@cablehuston.com

Of Attorneys for the Northwest Industrial Gas Users