BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, INC., Respondent.	DOCKET NO. UG-110723

INITIAL BRIEF OF PUBLIC COUNSEL

DECEMBER 16, 2011

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I. INTRODUCTION

1. Pipeline integrity is a basic responsibility of any natural gas utility company, pursuant to its statutory obligation to provide safe and reliable utility service. Customers expect, indeed demand that the natural gas pipeline system is safe. Customers are willing to pay for the cost to maintain safety in their rates, and are legally required to pay sufficient rates for that purpose. Public Counsel fully supports these principles, none of which are at issue in this proceeding.

2. Puget Sound Energy, Inc. (PSE or Company) has well-developed pipeline integrity programs already in place. The evidence is that PSE's system is safe and getting safer. PSE assures that its pipeline integrity programs will continue, as they have for many years, and will continue to evolve in sophistication and effectiveness, through the Distribution Integrity Management Program (DIMP), and other means. These Company programs have been the basis of PSE's safe and improving pipeline system.

3. When examined, it becomes clear that PSE's Pipeline Integrity Proposal (PIP), has little to do with the foregoing principles and should be rejected. It represents nothing more than an effort to accelerate return on investment for PSE's owners. This is illustrated by PSE witness John Story's Exh. No. JHS-4, which shows that of the $1.9 million that would be collected under the first year of the PIP surcharge, only $586,000 would go to replace pipeline plant, while approximately $800,000 would go to investors, with the remainder to taxes on that return.

4. PSE's PIP proposal asks ratepayers to pay millions in new surcharges and to increase owners' returns without receiving any tangible benefit. It simply incorporates existing pipeline programs, projected pipeline replacement and existing and projected budgets, all of which the Company concedes will occur without the PIP and will be recovered in general rates. The PIP proposal does not contain a single specific commitment to accelerate pipeline replacement for

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any type of pipe beyond what is already planned. It contains no means or methodology for the Commission to measure the progress or effect of the PIP in comparison to what would otherwise occur.

5. In addition, the PIP proposal must be rejected on legal grounds. It is a clear violation of the single-issue ratemaking rule, and essentially reprises in modified form a request already rejected on that ground by the Commission. The PIP also does not comply with the statutory "used and useful" requirement.

6. PSE's case is built in large part on misleading premises, talking points, and assertions, all of which dissolve upon comparison with the undisputed facts about PSE's actual pipeline safety programs. Upon this insubstantial foundation, the Commission is asked to impose a multimillion dollar annual surcharge on PSE's customers.

II. LEGAL ISSUES

A. Single-Issue Ratemaking.

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

7. If approved, the PIP would allow PSE to recover budgeted and actual natural 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

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"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]

2. PSE must show that "extraordinary circumstances" justify an exception to the single-issue ratemaking rule.

8. The Commission has historically only approved single-issue ratemaking under exceptional circumstances and for limited purposes. In PSE's 2006 general rate case (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."[4]

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, and shift risks and costs to ratepayers outside of a full review of costs and expenses.[5]

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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.,* Docket Nos. 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).

[4] PSE 2006 GRC, Order 08, ¶ 39.

[5] *Id.,* ¶¶ 41-42.

9. 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 is sparse. PSE argues that PIP approval is simply a policy decision and presents, at best, skeletal factual information to support its request. There is no persuasive evidence showing the existence of any "extraordinary circumstance" of a financial nature requiring extraordinary relief. Nor can PSE seriously claim that maintaining its natural gas system in a safe and reliable manner constitutes an "extraordinary circumstance" that warrants a departure from fundamental ratemaking policy.

3. Authority in other states supports rejection of the PIP.

a. The *Peoples Gas* decision in Illinois.

10. In the *Peoples Gas* case in Illinois, the Attorney General and other parties challenged a decision by the Illinois Commerce Commission approving a special rider for an accelerated natural gas mains replacement program ("Rider ICR").[6] After a careful review of the legal principles of ratemaking, and the precedent on single-issue ratemaking, the Illinois Court of Appeals held:

> In light of *Commonwealth Edison Co.,* we find Rider ICR doe not meet the criteria necessary to warrant single-issue ratemaking. Similar to Rider SMP, the rider at issue here does not include recovery of costs that are necessarily "unexpected, volatile, or fluctuating," as People's Gas alone dictates the program's scope and, therefore, its ultimate cost. Rider ICR is also not intended to recoup expenses for government-mandated environmental remediation; nor are the costs a result of a legislative mandate. Instead the costs covered by the Rider ICR are for capital improvements to Peoples Gas' natural gas delivery system that are likely to have a direct impact on the utility's actual rate of return.
>
> Moreover, similar to Rider SMP, the Staff witnesses' testimony below suggests the costs associated with an accelerated main replacement program under Rider ICR would be recovered through traditional ratemaking procedures. As the People's expert witness noted, People's Gas own historical rate of main replacement investment indicates the costs associated with the improvements were previously able to be recovered through traditional rate cases, without the

[6] *The People ex rel Lisa Madigan, Attorney General of the State of Illinois v. Illinois Commerce Commission; North Shore Gas Company; Peoples Gas Light & Coke Company et al.*, Nos. 1-10-0654 and consolidated dockets, 2011 Ill App (1st) 100654 (Fifth Division) (September 30, 2011)(*Peoples Gas).*

> need to resort to a special rider cost recovery mechanism. Although the Staff's expert witnesses conceded below that acceleration of the main replacement program was in the public's interests, the Staff's evidence also indicated that traditional ratemaking procedures provide an acceptable avenue to pursue such a goal without the use of a rider. In fact, the Commission's order itself specifically notes the Commission could have required Peoples Gas to undertake an accelerated main replacement program under section 8-503 of the Act while utilizing traditional ratemaking procedures[.]
>
> Accordingly, under the standards set out by the Second District in *Commonwealth Edison Co.,* we find that the Commission abused its discretion in approving the Rider ICR because the rider constituted single-issue ratemaking that was not adequately justified by special circumstances. See *Commonwealth Edison Co.,* 405 Ill. App. 3d at 415 ("[t]he evidence showed that ComEd historically has invested in capital distribution improvements and re-couped those costs through traditional ratemaking procedures, and the system modernization program should be treated no differently.") [7]

11. The parallels with the pending case are many. Like the Illinois company, PSE has historically implemented gas infrastructure capital improvements and successfully recouped its costs through traditional ratemaking. As in the Illinois case, the scope and cost of the program is under PSE's control. The mechanism is not related to costs from external causes beyond PSE's control. Like the Rider ICR, PSE's PIP would not simply pass through costs but would affect the PSE's rate of return. Finally, like the Illinois Commerce Commission, the Washington Commission has the authority to order PSE to engage in an accelerated pipeline replacement program while utilizing traditional ratemaking procedures. Public Counsel submits that the PIP proposal suffers from the same infirmities as the Illinois rider and deserves to be likewise rejected as improper single-issue ratemaking.

b. The *Washington Gas Light* decision in Maryland.

12. On November 14, 2011, the Maryland Public Service Commission rejected a proposal

[7] *Peoples Gas*,¶¶ 40-42.

from Washington Gas Light (WGL) for a surcharge (rider) mechanism to fund an Accelerated Pipeline Replacement Program (APRP).[8] The APRP proposal had many similarities to the PSE's PIP proposal, including a return component for the rider. WGL cited the need to "accelerate the improvement of its …distribution system to enhance … safety and service…beyond the norm, while obtaining prompt cost recovery of investment related costs."[9] WGL described the plan as "a proactive approach." [10] WGL also affirmed that it operated in full compliance with all federal and state regulations, but that "approval of the plan would provide the Company with the financial support necessary to replace aging pipe earlier than it could be replaced if the Company were limited to covering related costs using traditional rate base procedures."[11]

13. In contrast to the PIP however, the WGL plan included specific types of pipe targeted for replacement, mileage amounts to be replaced, and an associated total budget and timeline. WGL asserted it would not voluntarily accelerate replacement without accelerated recovery, but conceded at the hearing that denial of the plan would not change the company's approach or commitment to public safety.[12]

14. The Maryland PSC approved the accelerated pipeline replacement plan, but soundly rejected the establishment of a surcharge to recover the costs. The Commission noted that WGL had demonstrated that it would act to mitigate risk and ensure safety without prior approval for

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[8] *In The Matter Of The Application Of The Washington Gas Light Company For Authority To Increase Its Existing Rates And Charges And To Revise Its Terms And Conditions For Gas Service*, Maryland Public Service Commission, Case No. 9267, Order No. 84475 (Nov. 14, 2011) (Washington Gas Light or WGL).

[9] WGL, pp. 95-96.

[10] WGL, p. 97 (check page numbers against pdf version).

[11] WGL, p. 98.

[12] WGL, p. 101.

cost recovery and that the company had never been denied budget authority for replacement work.[13] Summarizing its holding, the Commission stated:

> Although we agree fully with the Company that safe and reliable infrastructure is the highest priority and that it should accelerate its program to replace pipe, we decline to authorize a surcharge for the recovery of future pipe replacement expenses. Based on the record in this case, we find that the Company has historically demonstrated the ability to replace its infrastructure when necessary to ensure safety and reliability without compromising its ability to earn an appropriate return. The Company's witnesses confirm that WGL has the operational and financial ability to accelerate its existing pipe replacement program, and we authorize the Company to do so. *But the mere fact that the Company plans increased infrastructure investments does not justify a surcharge, which would represent a fundamental shift from long-standing ratemaking principles.*[14]

4. The PIP is simply a variation on PSE's previously rejected depreciation tracker.

15. As noted above, the Commission reaffirmed the strict limits on single-issue ratemaking in Washington in its ruling on PSE's proposed "depreciation tracker." Like the PIP, the depreciation tracker was justified as necessary to respond to a need for capital investment in replacement and upgrade of natural gas distribution infrastructure. Like the PIP, it was argued that the depreciation tracker was needed to help PSE cope with timely recovery of infrastructure investments between rate cases. Both mechanisms calculate the tracker (surcharge) amount using depreciation. As in the case of the PIP, the depreciation tracker included an annual true-up. The primary difference between the programs is that the PIP is somewhat narrower in that it is limited to gas pipeline replacement. However, the PIP includes a return component which the prior proposal did not. It is interesting to note that, as Mr. Story acknowledged at the

[13] WGL, p. 108.
[14] WGL, p. 2.

hearing, when the depreciation tracker was described as "extreme" by another party in the 2006 case, PSE defended it in part on the grounds that it did not include a return on investment.[15]

16. PSE's PIP proposal is, in many ways, to have a second bite at the apple with a modified version of a proposal properly rejected the first time by the Commission. The PIP suffers from the same fundamental flaws as the prior tracker. Moreover, the Company made a far more serious effort to establish a financial justification for the depreciation tracker than it did for the PIP, presenting attrition evidence that was given detailed consideration by the Commission.[16] No such evidence was presented here. In effect PSE seeks to indirectly reverse the Commission's earlier ruling on the basis of an even weaker case than presented in the 2006 case.

5. Approval of the PIP would establish a poor precedent.

17. Public Counsel is concerned that approval of the PIP mechanism could have far-reaching effects well beyond PSE's pipeline program, in several respects. First, approval would be likely to cause a bandwagon effect, with Washington's three other natural gas utilities requesting similar treatment. The extent of pipeline replacement that would be sought and the size of surcharges imposed is impossible to predict. The impact could be substantial depending on each company's situation. In addition, a proliferation of annual pipeline tracker filings and true-ups for four companies would further strain the Commission's regulatory resources and the resources of stakeholders.

18. A second major concern is the effect on legal and policy precedent. If, in the wake of the Commission's 2006 GRC decision on single-issue ratemaking, a filing as vague and inadequately supported as the PIP is found to pass muster, the "single-issue ratemaking" rule in

[15] Story, TR. 223:8-16
[16] 2006 GRC, Order 08, ¶¶ 39-40.

Washington will effectively become a dead letter. Such a ruling is likely to cause a significant increase in creative requests from companies for a wide variety of trackers and surcharges.

B. The PIP Violates The "Used And Useful" Requirement.

19. A second legal obstacle to adoption of the PIP proposal is that it would ask customers to pay in their rates for utility plant that is not yet installed or in use by the Company. Under Washington law, utility company plant costs may not be included in rates unless the plant is "used and useful" to provide utility service to customers.[17] The Washington Supreme Court has held that "used" in the statute means "employed in accomplishing something."[18]

20. The PIP would violate this statutory requirement. The PIP rate adjustment would be based on "forecasted expense and investment activity through October 31 of the next program period."[19] As Public Counsel witness Andrea Crane explained: "[t]hus, each year, on November 1, ratepayers would be required to begin to pay for plant that is not yet in-service and which will not be in-service until, on average, six months later."[20] Such plant does not satisfy the "used and useful" requirement.

III. PIPELINE SAFETY

A. PSE Has Not Demonstrated Any Safety Or Operational Justification For The PIP.

21. One of the central themes implicit in PSE's advocacy is that the proposal is necessary to improve the safety of its pipeline system. The statement that the PIP tariff is "intended to enhance pipeline safety" conveys the message that enhancements are needed.[21] This is part of a

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[17] RCW 80.04.250; *see* Leonard Goodman, *The Process of Ratemaking*, 799 (1998).

[18] *Peoples' Organization for Washington Energy Resources (POWER) v. Washington Utilities &Transp. Comm'n,* 101 Wn.2d 425, 430, 649 P.2d 425 (1984), citing *Webster's Third New International Dictionary* 2524 (1976).

[19] Exh. No. JHS-3, p. 3.

[20] Exh. No. ACC-1T, p. 14:4-6.

[21] Advice Letter No. 2011-12, April 26, 2011, Tom DeBoer to David Danner, p. 1.

consistent effort throughout the case to create the impression there are serious safety concerns that warrant the adoption of the program. For example, the initial filing states that "[p]ipeline safety has been a topic of concern for several years, but has recently taken on new urgency due to recent explosions in California and Pennsylvania."[22] At the hearing, Mr. DeBoer referred to replacement projects in PIP which involved pipe with "significant safety risks."[23]

22. Given this recurring theme, PSE's case is notable for the lack of evidence supporting the claim. The Company submitted only cursory information regarding its pipeline safety practices, its planned activities, the specific extent or nature of any safety concerns, or how the PIP will make a discernible material difference in safety. Instead, both in its brief written testimony and in its testimony at the hearing, PSE chose to rely on vague descriptions, broad generalizations, and selective summaries of facts.

23. PSE has extensive information in its possession regarding its pipeline system, as the annual reports submitted to Commission reflect. It is striking, therefore, that PSE did not submit any of its annual safety reports for the record, in particular its most recent report, the 2010 Continuing Surveillance Annual Report, filed in May 2011.[24] These reports contain a wealth of useful information about the Company's gas safety programs and performance relevant to the issues in this docket. Neither did PSE provide for the record a copy of the Company's DIMP, a central component of the Company's pipeline safety effort. The DIMP was finalized in August 2011, prior to the Company's direct testimony. The Commission can infer from this, that had

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[22] *Id.;* DeBoer, TR. 90:18 ("tragic explosions").
[23] DeBoer, TR. 81:2-7.
[24] Exh. No. DAH-7. Puget Sound Energy 2010 Continuing Surveillance Annual Report (*2010 Surveillance Report*), Gas System Integrity Department, May 2011. The report was provided to Staff in discovery in June 2011 and to Public Counsel in a later discovery response.

PSE thought this information would be supportive of the Company's proposal, it would have submitted it.

B. PSE Acknowledges That Its Natural Gas Pipeline System Is Safe And That Its Safety Performance Is Improving.

24. Notwithstanding the implicit theme of its case, PSE does not directly claim its system is unsafe. On the contrary, Company witnesses have stated on the record that the Company's pipeline system is safe now and will be safe in the future "without the PIP."[25] Not only is the system safe, the evidence is undisputed that the safety of the system is improving. For example, in response to Staff discovery, PSE stated:

> PSE does not believe that absent the requested accounting treatment that the reliability and safety of our natural gas distribution system will be compromised....*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.* PSE is requesting the PIP tariff to enhance improvements in system reliability and safety. [26]

25. This illustrates the essential contradiction faced by PSE in this case: the effort to create a sense of urgency to address safety while, at the same time denying that any safety problems exist. Chairman Goltz commented on this dichotomy at the hearing, observing that when PSE argues that "plastic pipe is high risk, but yet it's safe at the same time, 99 percent of the people would have trouble reconciling [the statements]." [27]

26. It is also important to put the PIP in context. The most serious pipeline safety risks in Washington have been and will continue to be addressed outside the PIP. By far the most

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[25] Exh. No. TAD-1T (DeBoer Direct), p. 4:12-17; Exh. No. DAH-1T (Henderson Direct), p. 15:14-15 ("Yes, PSE's natural gas system is safe."); Deboer, TR. 84:8-14 ("our system is safe"); Exh. No. DAH-1T, p. 18:12-17. (without the PIP PSE would "continue to maintain system integrity per the existing integrity management program.")

[26] Exh. No. DAH-7, p. 2 (PSE Response to Informal Staff Data Request No. 22 (b)).

[27] TR. 96:7-12 (Chairman Goltz question for Mr. DeBoer).

significant cause of pipeline accidents in Washington is damage caused by third parties, for example, by excavation during construction.[28] These third party accidents are not a result of pipeline vintage or material type but of human error. PSE has ongoing programs to address the causes of these accidents, and the numbers of accidents are declining.[29]

27. Cast iron, formerly PSE's oldest and riskiest type of pipe, has already been fully replaced.[30] After cast-iron, the most serious risk in PSE's system and its next highest priority for replacement is bare steel pipe.[31] Because bare steel is already being replaced pursuant to Commission order it has, appropriately, been removed from the Company's proposal. When bare steel replacement is completed as scheduled in 2014, the most serious material-related risk in PSE's system will have been addressed.[32]

28. With regard to wrapped steel services, while the program is ongoing, the highest priority pipe targeted for replacement has already been completely replaced as of December 31, 2010.[33] Of the remaining approximately 90,000 services, only 91 (0.1 percent) are identified in the highest risk category ("priority" replacement), with only 303 (0.33 percent) at the next highest level ("scheduled replacement). Company inspections have found that much of the remaining wrapped steel services pipe "is in good condition and will continue to reliably and safely provide natural gas service for many years."[34]

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[28] *2010 Surveillance Report,* Exh. No. DAH-7, p. 13 ("leading threat to the system"), pp. 49-52
[29] *Id.*
[30] *2010 Surveillance Report,* Exh. No. DAH-7, p. 7
[31] *2010 Surveillance Report,* Exh. No. DAH-7, p. 12 (table) showing bare steel with active leaks per mile approximately 9 times greater than wrapped steel, the next highest category.
[32] Exh. No. ACC-1T (Crane), p. 9:3-8
[33] Exh. No. DAH-22 (with minor exception due to permit delay)
[34] Exh. No. DAH-1T, p. 6:5-6.

29. The wrapped steel mains program is quite limited in scope. In 2010, PSE replaced approximately one mile of wrapped steel main and associated services. It is targeting replacement of 3.5 miles for replacement in 2011 and 4 miles for 2012. According to Mr. Henderson, "[t]he majority of the wrapped steel mains are performing very well and we expect they will continue to reliably provide gas service for years to come." [35] The small scale of this program is reflected in the projected expenditures through 2015 of only $3.5 to $5.3 million annually.[36] Beyond this, PSE has not presented any information about the total amount of wrapped steel mains that need to be remediated, having not made that determination.[37]

30. This leaves older polyethylene pipe (older PE) as the last of the three programs currently proposed for the PIP. As discussed in more detail below, while there are safety concerns to be addressed with older PE, PSE has a program in place to evaluate and remediate the problems. PSE has made no determination that extensive replacement is required. PSE has not presented clear evidence that older PE warrants extraordinary remedial action.

31. In summary, when the basic facts are examined, the picture that emerges is of a system where the most serious problems have been addressed, and where the remaining pipeline programs are effectively managing safety and reliability issues.

C. PSE Has A Successful History Of Extensive Pipeline Replacement Programs Under The Existing Regulatory Regime.

32. As mentioned above, pipeline integrity is not a new concept, nor is the concept of replacing pipe, when required, new or novel. Rather this is a fundamental obligation of any

[35] Exh. No. DAH-1T, p. 7:6-7.
[36] Exh. No. DAH-1T, p. 10.
[37] Exh. No. ACC-1T, p. 11:15-16.

natural gas company.[38] PSE has a long and successful history of pipeline replacement programs. The Company has addressed and is currently addressing systemic issues in multiple scenarios, replacing riskier types of pipe to improve customer safety and system reliability, while recovering its costs for the pipe replacement. Mr. Henderson testified that "[s]ince 1992, PSE has been focused on the programmatic replacement of different types of pipe, initially focusing on cast iron pipe, then focusing on bare steel, and in recent years adding a focus on older vintage polyethylene and wrapped steel mains and services."[39] These programs are described in detail in the *2010 Surveillance Report*[40] and have been successfully implemented without the existence of an accelerated recovery program.[41]

33. While PSE's witnesses describe the future flexibility of the PIP in general terms,[42] nothing in the proposal currently before the Commission goes beyond the Company's existing programs. No new systemic issues are identified, and no new plans or programs are recommended. The budget amounts presented for the three existing programs are the existing budgets under the current regulatory framework. There is no incremental change or improvement proposed. There is no specific evidence offered that PSE has a defined plan to do anything more than is already planned and budgeted for the three programs. [43]

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[38] Exh. No. ACC-1T, p. 7:4-11.
[39] Exh. No. DAH-11.
[40] Exh. No. DAH-7, p. 53-55 (bare and wrapped steel), p. 60 (older PE).
[41] Exh. No. ACC-1T, p. 15:1-p. 16:7.
[42] Exh. No. DAH-6
[43] Exh. No. ACC-1T, p. 12:19-p. 13-1-10 (Crane).

D. PSE's Existing Practices And Programs Already Provide For Continuous Improvement In Safety Programs.

34. Pipeline integrity management is not a new activity for PSE, as the Company freely acknowledges. Although recent federal rules have required gas companies to develop Distribution Integrity Management Programs (DIMP), PSE witness Mr. Henderson testified that:

> Prior to the DIMP rule, PSE historically embraced risk management methodologies comparable to DIMP, such as the cast iron and bare steel programs. More recently (but prior to DIMP), PSE developed other risk models including the wrapped steel service assessment program, older polyethylene ("PE") pipe assessment and replacement, and assessment and replacement of wrapped steel mains. *In short, DIMP formalizes many of PSE's existing practices.*[44]

PSE pipeline integrity related activities regarding installation, maintenance, leak survey and repair, third party damage, corrosion control for wrapped steel pipeline, and pipeline replacement have been "performed for many years prior to the issuance of the [DIMP] final rule in December 2009."[45] PSE's own testimony in the case states that all these activities will continue unchanged whether or not the PIP is adopted. The only change identified by PSE is with respect to the budget process.[46]

E. In Support Of The PIP, PSE Witnesses Have Intentionally Mischaracterized The Company's Own Programs And Practices.

35. PSE's case hinges on a number of inaccurate and negative misstatements about the Company's pipeline safety programs.

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[44] Exh. No. DAH-1T, p. 3:1-7.
[45] Exh. No. DAH-11.
[46] Exh. No. DAH-1T, p. 14:1-3 (the current pipeline replacement process "would generally remain the same with the exception of the budget process").

PSE's programs are "reactive" rather than "proactive."

36. Mr. DeBoer asserts that "[t]he proactive pipeline replacement model proposed under the PIP differs from the reactive compliance driven pipeline replacement PSE has undertaken in the past," a theme heard throughout his testimony.[47] This is a misleading description of the Company's current and anticipated programs. PSE's *2010 Surveillance Report* includes a description of PSE's "plans to initiate new *proactive measures*; any plans to continue or enhance *existing proactive measures* and provides a format for tracking and reporting on subsequent progress."[48] The Report goes on to say that "if additional or enhanced measures are needed, these plans will be incorporated in the budget process for funding for the following calendar year."[49] Examples showing that PSE's pro-active approach goes beyond mere "compliance" are described below.

PSE currently only does the minimum required.

37. PSE argues that "[w]ith the PIP, PSE can go beyond addressing what must immediately be replaced to meet minimum safety standards[.]"[50] The Report, however, provides evidence to the contrary. For example, the baseline standard for frequency of leak surveys is generally five-year intervals. PSE conducts surveys at three-year intervals, which Mr. Henderson agreed is "more than the minimum."[51] PSE acknowledges it has the discretion to conduct leak surveys more frequently than required by regulations, and that they "have actually done that with respect

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[47] Advice No. 2011-12, p. 2 (the PIP would "facilitate a proactive versus reactive to integrity improvements[.]" Exh. No. TAD -1T, p. 2:16 (PIP will enable PSE to "promote a more proactive approach"); Exh. No. TAD-13.

[48] Exh. No. DAH-7, p. 9 (emphasis added) [check DAH 7 pages to ensure match with Staff version).

[49] *Id.*

[50] Exh. DAH-4T , p. 2:10-13.

[51] Henderson, TR. 149:6-19.

to wrapped steel."[52] PSE also conducts leak surveys more frequently than required for plastic pipe.[53] This is significant because, as the *2010 Surveillance Report* states, increased surveys lead to increased leak identification.[54] Once leaks are identified, the pipe is evaluated based on the risk models, and some is slated for replacement.[55] This proactive approach by PSE presumably lead to increased pipeline replacement, beyond the minimum required.[56]

38. Additional examples of major proactive replacement programs that go beyond minimum requirements are contained in the *2010 Surveillance Report*, as discussed below.[57]

PSE currently focuses "narrowly on small segments" of pipe.

39. A variation on theme that PSE only does enough to meet the "minimum requirements" is the assertion that PSE is currently focusing replacement actions on an isolated area of the problem pipe only, whereas under the PIP the Company could do more comprehensive or preventive replacements covering larger areas of adjacent pipe.[58] Again, a review of PSE's own *2010 Surveillance Report* shows that PSE is already engaged in this type of activity in three significant areas.

40. For example, in 2009, PSE identified an opportunity to reduce overall system risk by integrating the wrapped steel services replacement program (WSSAP) with the Bare Steel Risk Model. According to Mr. Henderson, this meant PSE could create "some synergies by looking at

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[52] Henderson, TR. 149:20-150:7.
[53] Henderson, TR. 150:8-14; *2010 Surveillance Report*, Exh. No. DAH-7, p. 22.
[54] *2010 Surveillance Report,* Exh. No. DAH-7, p. 23.
[55] *See, e.g.,* Exh. No. DAH-1T (Henderson), p. 5:7-11.
[56] PSE believes its current survey frequencies and risk models are appropriately set, which calls further into question what basis would be used to determine accelerated replacement targets. *2010 Surveillance Report*, Exh. No. DAH-7, p. 28 (surveys); Henderson, TR. 150:15-19 (surveys), TR. 155:15-18 (risk models).
[57] While the bare steel program is no longer included in the PIP proposal, its worth noting that in that program has PSE has replaced substantially more pipe in every year from 2007 through 2010 that it had planned to replace. *2010 Surveillance Report* Exh. No. DAH-7, p. 53, Table 10. Again, this is not consistent with claims that PSE's corporate policy and practice is to just do the minimum required.
[58] Exh. No. DAH-1T, p. 11:12-20; p. 14:7-11.

the two materials together"[59] and making more replacements than they might otherwise make[60] on the basis of the minimum requirements of the risk models. Under this practice, replacements occur "while you've got it opened up." PSE benefits by "not having multiple trips, one to go out and replace a [wrapped steel]service, only to follow up later to replace the main."[61] The benefits of this approach included: "reducing disruption for…customers, fewer paving cuts in the streets, and lower programs costs[.]"[62]

41. This approach was worked out in collaboration with Commission pipeline safety staff. At the hearing, Mr. Henderson was asked to elaborate on what was involved. He stated:

> A. It was an overall discussion of the, just the combination of doing the work in concert with each other and not adhering strictly to the requirements that were outlined in the risk models and the programs that had been presented. So they agreed that it made sense to do things in combination with each other.
>
> Q. To go a little bit beyond what the risk model itself might have mandated?
>
> A. Yes.
>
> Q. So this integration approach here, which sounds really positive, this was not required by state or federal regulations?
>
> A. No. It was how we chose to manage our work in a more efficient manner.[63]

42. Mr. Henderson agreed that this was "above and beyond" the requirements of the Washington Utilities and Transportation Commission (UTC) settlement agreements regarding bare and wrapped steel.[64]

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[59] Henderson, TR. 151:21-22.
[60] Henderson, TR. 153:2-10.
[61] Henderson, TR. 152:6-7. .
[62] *2010 Surveillance Report*, Exh. No. DAH-7, p. 53.
[63] Henderson, TR. 153:2-15.
[64] Henderson, TR. 207:18-20.

43. In a second example, pre-1972 wrapped steel mains that are adjacent to wrapped steel services are also reviewed for replacement when wrapped steel services are reviewed. Mr. Henderson described this as:

> similar to what we described with the bare steel mains…to work the two in concert with each other so that we can take advantage of essentially the crews out there, one move-in, one pavement restoration, do all the work at one time…. The next step that we took here, and this wasn't part of the agreement [with the UTC], or required in the agreement, was then to take that approach more broadly across all of our wrap steel mains.[65]

Mr. Henderson acknowledged that this was not required by state or federal regulations.[66]

44. As a third example, PSE also has an integrated replacement program in place for older PE pipe. In 2010, PSE implemented a new policy to replace pre-1986 PE pipe services as part of larger main replacement programs such as Bare Steel Replacement. PSE determined it was more cost-effective to replace plastic services at the time of main replacement rather than to reconnect and test the service line, even if no immediate need existed. [67]

45. At the hearing, even after describing the above examples, Mr. Henderson nevertheless attempted to repeat the theme that the Company only invests sufficiently to meet "minimum levels of safety."[68] Ultimately, he acknowledged, however, that this is not accurate.

> Q. You're going beyond the bare minimum now, aren't you Mr. Henderson?
>
> A. To some degree, yes.
>
> Q. Is it your testimony that Puget Sound Energy only does the bare minimum required to make its system safe for the public?
>
> A. No. We do go beyond.[69]

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[65] Henderson, TR. 158:13-159:9
[66] Henderson, TR. 159:1-12.
[67] Henderson, TR. 163:2-12.
[68] Henderson, TR. 170:24-25.
[69] Henderson, TR. 171:8-14.

Mr. Henderson stated further that "[w]e take whatever actions are necessary to make sure we have a safe system, from leak prevention to pipe replacement."[70]

46. The examples above represent the very type of activities which PSE has claimed or implied do not occur at the Company and cannot occur absent the PIP.

PSE's does not have a system-wide approach

47. Mr. DeBoer testified that PSE's pipeline program is hampered by "artificial program classifications," [71] and "separate budgets, timelines, and work requirements."[72] In fact, the *2010 Surveillance Report* describes PSE's entire program as "centralized." As noted above, PSE has taken a number of opportunities to find "synergies" between its different pipeline replacement programs.

F. The Status Of Older PE Pipe Has Been Mischaracterized By PSE.

48. Another theme in PSE's advocacy is the need to address substantial risks posed by older PE pipe.[73] As with other claims in the case, a closer review of the facts casts doubt on the claim. While there is no dispute that pre-1986 PE pipe does pose safety risks, PSE has not provided any clear evidence that the PIP is urgently needed to deal with this type of pipe in ways not being addressed by its existing Older PE Pipe Replacement Program. The evidence does not indicate the problem is of an extraordinary scale or scope.

49. While the majority of PSE's pipe is plastic, only a "fraction,"[74] a "small portion of the overall system mileage,"[75] is the "older PE" of particular concern. PSE has been aware of safety

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[70] Henderson, TR. 169:8-10
[71] Exh. No. TAD-1T, p. 3:10.
[72] *Id.* l. 6.
[73] *See e.g.*, DeBoer, TR. 81:6-7("substantial safety risk").
[74] Exh. No. DL-1T, p. 7:1 (Lykken).
[75] Henderson, TR. 180 (referring to 100 miles).

risks with older PE pipe for at least a dozen years[76] and has implemented improved processes in 2008 to help identify failures.[77] As noted above, starting in 2010 PSE, began a pro-active coordinated program of replacing older PE in connection with larger main replacement. Under the existing regulatory regime, PSE is already planning to more than double its replacement of DuPont PE pipe this year, as compared to 2010.[78]

50. The testimony at the hearing did not reveal any extraordinary or urgent safety problems with older PE. UTC pipeline safety director David Lykken observed that "the documentation needs to be more closely scrutinized to determine exactly the extent of the exposure of this pipe to the public."[79] With regard to the quantities of older PE pipe mentioned by the company, Mr. Lykken stated: "I know that I believe that those quantities could become into question about exactly how much of this pipe has been installed."[80]

51. In his rebuttal testimony, Mr. Henderson mentioned that 100 miles of older PE pipe had been identified as needing attention.[81] When questioned about this at the hearing, however, Mr. Henderson backed away from saying that PSE had 100 miles of dangerous older PE pipe that clearly needed replacement. Instead he stated that "the pipe itself may be performing fine today. We may propose some additional mitigation like we discussed earlier, increased leak surveys, but we have not yet proposed those for replacement."[82] Mr. Henderson testified in fact that the leak frequency practices for older PE were set at appropriate levels and did not need to be

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[76] Henderson, TR 161:23-162:3.
[77] *2010 Surveillance Report,* Exh. No. DAH-7, p. 60.
[78] *Id.*
[79] Lykken, TR. 242:5-8.
[80] Lykken, TR. 243:7-10
[81] Mr. Henderson made this statement in testimony for the first time in his written rebuttal. At the hearing, Mr. Lykken stated: "This is actually the first time I've heard that they've established a number of miles of this type."
[82] Henderson, TR. 182.

increased.[83] In other words, the older PE is being reviewed according to risk models and confirmed leak survey frequencies, and a range of remedial actions are available, which may or may not involve replacement.

52. Mr. Lykken testified that many of the risk issues associated with older PE pipe arise from construction practices which impact the pipe after it is installed. He went on, however, to testify that "[w]e should be glad we don't have the construction–type issues that other states are seeing[.]"[84] It does not appear, therefore, that this is an acute problem in Washington state.

53. Once other programs are complete, Mr. Lykken sees plastic pipe as one of the other opportunities to tackle.[85] Mr. Lykken was asked whether, rather than a PIP type of approach which leaves discretion to the Company to pursue this goal, it would be preferable if the Commission were to simply order PSE to replace the older PE pipe. He answered:

> That's certainly a mechanism that can be considered. What I struggle with is the fact that there aren't a high number of leaks associated with this pipe, nor is there a high rate of incidence with this pipe in this state. So I try to balance that with the need to get other pipe replaced, such as the bare steel and the cast-iron which the company has been working on [.][86]

Mr. Lykken further observed in response to Commission Oshie's questions that a Commission order would give him "more assurance as a regulator that that task will be completed."[87]

54. The record also indicates that as the Bare Steel replacement program is completed, additional funding will become available for older PE pipe replacement, even if current budgets

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[83] Henderson, TR. 150:15-19.
[84] Lykken, TR. 250:15-25.
[85] Lykken, TR. 253:16-19.
[86] Lykken, TR. 253:9-16.
[87] TR. 254:9-10 (Commissioner Oshie question).

remain at the same or similar levels. This would substantially increase the funds available for older PE replacement without the need for funding from a surcharge.[88]

G. The Pipeline Accidents In California And Pennsylvania Are Not Relevant To The PIP Proposal.

55. While PSE referenced the tragic pipeline accidents in California and Pennsylvania several times in testimony, it has avoided any discussion of the underlying causes. Mr. DeBoer's initial advice letter mentions the accidents, as does his direct and rebuttal testimony.[89] At the hearing, however, he said he had could not answer questions about the details of the accidents.[90] Mr. Henderson, who mentioned the accidents in his rebuttal,[91] appeared more familiar with the facts. He acknowledged at the hearing that PSE has presented no evidence that the specific factual situations that caused the California and the Pennsylvania accidents are present in the PSE system, [92] and that PSE has presented no evidence to link those accidents in any way to the specifics of the PIP proposal.

56. PSE's failure to link the accidents to this case is not surprising. As Mr. Henderson acknowledged, the accident in San Bruno, California, involved 50 year-old transmission pipeline. The PIP does not involve transmission pipe, which has different characteristics than the distribution mains and services at issue here.[93] The Allentown, Pennsylvania, accident involved cast-iron pipe installed in 1928. All PSE's cast-iron pipe has been replaced. Little purpose is served by PSE's references to these accidents except to sensationalize the issues in order to create a false sense of concern. No one contests that natural gas is an inherently dangerous

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[88] Crane, TR. 267:20-268:2.
[89] Advice No. 2011-12, p. 1; Exh. No. TAD-1T, p. 2:20; Exh. No. TAD 4T, p. 4:15-18.
[90] DeBoer, TR. 50:13-51:16.
[91] Henderson, TR. 167-169.
[92] Henderson, TR. 167:9-168:10.
[93] Henderson, TR., 168:20-21; *See 2010 Surveillance Report,* Exh. No. DAH-7, p. 63.

substance that poses risks to the public. The issue here, however, is whether there is any operational or engineering justification in PSE's system for the PIP.

57. Mr. DeBoer's rebuttal also includes references to the PHMSA Action Plan announced this year. Again, this federal plan, with its nationwide focus is not tied by PSE to any specifics of its system or the PIP proposal. Based on the examples it refers to, the Action Plan appears most focused on very old vintage cast iron or other unprotected pipe, particularly where there are with very slow, if any, remediation plans.[94] Older PE pipe is not mentioned in the Plan. Mr. Henderson displayed little familiarity with the federal plan under questioning at the hearing.[95]

58. The insertion of these accident references is consistent with PSE's attempts in this case to create the impression that an urgent unaddressed danger exists that requires immediate action, while relying on rhetoric rather than evidence to support the premise.

IV. FINANCIAL ISSUES

A. PSE Has Not Established Extraordinary Circumstances That Warrant An Exception To The Single-issue Ratemaking Rule.

59. As noted in the section on applicable law, PSE must establish the existence of "extraordinary circumstances" in order to avoid the rule disfavoring single-issue ratemaking. For a Company to meet this standard in the financial context, "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.' "[96]

60. PSE has not made that showing. Beyond generalized assertions about regulatory lag and under earning, PSE has made no serious effort to establish that the recovery it currently receives

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[94] Exh. No. TAD-5, p. 3.
[95] Henderson, TR. 166:11-19.
[96] PSE 2006 GRC, Order 08, ¶ 39 (emphasis added).

of and *on* its infrastructure investments in general rates has impaired or will impair its financial integrity. The appropriate forum for such a showing is a general rate case, where a full review of PSE's financial situation can occur. Without such a showing, the proposal fails the Commission's test for allowable single-issue ratemaking proposals, just as the earlier depreciation tracker did. The PIP proposal should be denied on this basis alone.

B. The PIP Is An Accelerated Recovery Program Not An Accelerated Replacement Program.

61. PSE has not provided any specific evidence that any pipeline replacement will occur beyond what is already planned and budgeted.[97] The real focus and underlying purpose of the PIP proposal is to accelerate the owners' return on equity in between rate cases.[98] This was highlighted by an exchange between Commission Oshie and Mr. DeBoer at the hearing. Mr. DeBoer indicated that PSE would not be interested in an approach that would allow up-front recovery of pipeline expenditures, treated as expense, but without a return, stating:

> Well, that doesn't provide the -- I mean, the whole purpose of -- what's driving the acceleration is the ability to actually recover those dollars. *If we don't recover the dollars there isn't a real driver for the company to accelerate the programs.*[99]

There could be no clearer reflection of the Company's goal here. Improvement of public safety alone is not a sufficiently "real driver" to accelerate pipeline replacement.

62. PSE does not dispute that the mechanism will increase its return on equity. In response to Record Requisition No. 1, PSE calculated that return would increase 7 basis points. The

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[97] Exh. No. ACC-1T (Crane), p. 13:11-18.

[98] Recovery is further accelerated because of the inclusion of projected expenditures in the mechanism. Exh. No. ACC-1T, p. 13:1-2.

[99] DeBoer, TR. 111:5-7.

specific amount of the return is a function of the amount of plant allowed for recovery in the PIP in the future.

63. The value of the PIP to the Company was further illustrated by the review of Mr. Story's Exh. No. JHS-4 at the hearing. The exhibit shows that the first year expenditure of $16.4 million for the PIP proposal would be supported by a $1.9 million annual surcharge on ratepayers. Of that $1.9 million, only $586,000 (the depreciation figure), less than one-third, would go towards putting pipeline plant in the ground. A larger portion, over $800,000 of the surcharge, would go to pay an accelerated return. The final $400,000 portion would go to pay taxes associated with the return.[100] As a vehicle purported to support additional investment in infrastructure, this is singularly inefficient.

64. Another related aspect of the PIP, including the "true-up" component of the mechanism, is that it shifts risk to ratepayers. While he argued in testimony that the Commission should not reduce PSE's authorized ROE if it approves the PIP, Mr. DeBoer agreed on cross-examination that the PIP "improves our recovery." He was asked:

> Q. You aren't suggesting that accelerated cost-recovery coupled with the true-up has no impact on Puget Sound Energy's financial risk, are you?
>
> A. No. [TR. 72:21-24]

If the UTC were to approve the PIP, it would need to examine the impact of reduced risk on ROE in a general rate proceeding.[101]

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[100] Story, TR. 219:21-222:3; Crane, TR. 261:16-24.

[101] Exh. No. ACC-1T, p. 25:18 – p, 28:2 (Crane)(discussing impact on shareholders risk)

C. PSE Is Financially Healthy And Has Adequate Access To Capital To Meet Its Needs.

1. PSE is rated as financially healthy by Moody's and Standard &Poor's.

65. The evidence in the record does not support a conclusion that PSE's financial integrity is in jeopardy. In March, Moody's upgraded all long term ratings for both Puget Energy and PSE and assigned the company a stable outlook, at the same time upgrading PSE's short term rating. This rating action was taken with the knowledge that PSE plans large and higher than historical average capital expenditures of approximately $2.5 billion over the next three years to meet both supply and infrastructure needs.[102] In discussing PSE's substantial capex program, Moody's comments: "we note the ownership group has contributed no 'new' equity since the initial acquisition."[103]

66. In August 2011, Standard and Poor's (S&P), reported PSE's rating at BBB/Stable/A-2, reflecting, *inter alia,* an "excellent business risk profile."[104] The S&P rating takes into account that "capital requirements are very high at PSE, with infrastructure replacement, renewable portfolio standards, and other new resource requirements driving planned capital expenditures of $1.053 billion in 2011 and $737 million in 2012."[105] S&P goes on to describe PSE's liquidity as "very strong," stating that "projected sources of liquidity (mainly operating cash flow and available bank lines) exceed projected uses (mainly necessary capital expenditures, debt maturities , and common dividends) by more than 2x for the coming 12 months."[106] S&P particularly notes the very limited use that PSE had made of its $1.15 billion in short-term credit

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[102] Exh. No. TAD-9, p. 4 (See discussion "What is PSE Spending Capital On?").
[103] *Id.*
[104] *Id.*, p. 8.
[105] *Id.*, p. 9.
[106] *Id.*

facilities, and that "nothing [was] drawn or outstanding under the capital expenditure facility" of $400 million.[107]

67. Both rating agencies devote attention to the existing regulatory environment in Washington, describing it in positive terms. PSE's frequent rate case filings are viewed as mitigating concerns about regulatory lag,[108] and along with the PCA, PGA, and PCORC, a means to allow the Company to keep deferral balances low and better match actual costs with cash collected.[109] Despite the absence of an infrastructure tracker mechanism the regulatory environment was deemed positive and the Company received these favorable ratings.

2. PSE's claims about limited capital are not consistent with representations made at the time of the acquisition by the Investor Consortium.

68. PSE's assertion that it has limited capital to make public safety related infrastructure investments, and that infrastructure must therefore compete against other needs, sounds a disturbingly false note in light of the record in the recent acquisition of the Company by the Investor Consortium. A central argument offered by in favor of the transaction was that it would offer PSE access to abundant, and patient capital:

> Simply stated, Puget Energy and PSE concluded that partnering with a consortium of *committed and experienced infrastructure investors, like the Investor Consortium, that have access to significant investment capital and that are focused on the long-term investment* in the U.S. utility business was the best means to balance all the interests of customers, shareholders, and employees. Partnering with the Investor Consortium provides a more reliable method of obtaining needed capital now and in the future on reasonable terms without being subject to the vagaries of quarterly and annual earnings forecasts and short-term market restrictions. *The Investor Consortium's expected infusion of such capital in PSE (through a multi-staged plan of recapitalization) will continue to help*

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[107] *Id.* See discussion below regarding these and other capital commitments made by the investor consortium at the time of the PSE acquisition.

[108] *Id.*

[109] *Id.*, p. 8.

strengthen and grow PSE in the years ahead, while providing the same safe, reliable service expected by PSE's customers.[110]

There was no dispute in the acquisition case "that PSE must raise a substantial amount of capital over the next few years to invest in infrastructure."[111] The record in the instant docket reflects that all of the pipeline replacement issues cited by the Company have been known to PSE since prior to the sale.

69. The Commission found that "[i]n stark contrast to the uncertainties that Puget and PSE currently face in the public equity market, the evidence shows that the Consortium understands the extent and importance of PSE's capital needs and has the capacity to fulfill them."[112] The discussion of capital needs focused particularly on the 2008-2013 time period.[113] The Commission order carefully details the specific credit facilities that were to be available to PSE following the acquisition, including credit facilities for $1 billion and $400 million. Commitment 58 to the Sale settlement assured that the credit facilities would be "used exclusively to fund PSE's capital needs."[114] As noted in the discussion above, these credit facilities have not been substantially drawn down and the Investor Consortium has provided no new equity capital since the time of the sale.

70. The Investor Consortium committed, in specific provision of the Multiparty Settlement Agreement with Commission Staff and intervenors, to give special attention to PSE's investment needs. Condition 2 to the agreement provided:

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[110] *In the Matter of the Joint Application of Puget Holdings LLC and Puget Sound Energy, Inc., For An Order Authorizing Proposed Transaction*, Docket No. U-072375, Order 08, Approving and Adopting Settlement Stipulation; Authorizing Transaction Subject To Conditions (*PSE Sale Order*), ¶ 142 (quoting Eric Markell) (emphasis added).

[111] *PSE Sale Order* ¶ 122.

[112] *PSE Sale Order*, ¶ 137.

[113] *PSE Sale Order*, ¶ 155.

[114] *PSE Sale Order*, ¶¶ 138-139.

> Puget Holdings acknowledges PSE's need for significant amounts of capital to invest in its energy supply *and delivery infrastructure* and commits that meeting these capital requirements will by considered a high priority by the Boards of Puget Holdings and PSE.[115]

Condition 3 committed to provide $1.4 billion in credit facilities, as described above, to support PSE's capital expenditure programs.[116]

71. Access to abundant patient capital was the leading rationale cited by the Commission in approving the sale of PSE to the Investor Consortium as being in the public interest.:

> In the final analysis, PSE is trading uncertainty for certainty in terms of its ability to access on reasonable terms very significant amounts of capital it requires over the next five years. *These assured sources of capital through 2013 will fund new and improved infrastructure that is necessary to ensure PSE's provision of safe, reliable electricity and natural gas service in the Puget Sound region now and in the future decades.* Beyond 2013, the nature and quality of these investors, their deep pockets, and their commitment to fund PSE's ongoing capital needs all are factors that suggest improved access to capital relative to the *status quo*.[117]

PSE now appears to be hoping that collective amnesia will afflict the Commission and other parties with respect to these prior representations and commitments. In light of the foregoing record, PSE cannot credibly make the argument that capital constraints make it impossible for it to pursue accelerated pipeline replacement. The effort to obtain approval for an accelerated recovery mechanism from the Commission appears to be directly inconsistent with the commitments made at the time of the sale.

D. PSE's Arguments About Competition For Capital Are Not Credible.

72. PSE makes unsubstantiated claims that "competition for capital" restricts its ability to pursue pipeline replacement. PSE argues that the capital it needs to maintain and improve

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[115] *PSE Sale Order*, App A, p. 1 (Transaction Commitments) Multiparty Settlement Stipulation (emphasis supplied).

[116] *Id.*

[117] *PSE Sale Order*, ¶ 155.

pipeline safety must somehow compete with other capital needs and, without the "affirmative action" for pipeline expenditures offered by the PIP, public safety will lose out in the budget process. However, the record is devoid of any evidence of such a problem, other than the unfounded assertions in the written testimony of Messrs. DeBoer and Henderson.

73. On questioning from the bench at the hearing, Mr. Henderson could not identify a single instance where a budget request for pipeline expenditures had been rejected because of competition for capital or lack of a tracker mechanism. At the same time, as discussed below in the "safety" portion of the brief, there is specific evidence that PSE has gone beyond minimum pipeline safety requirements in a range of settings.[118] These activities are not consistent with the described budget constraints.

74. PSE's underlying premise, that the pipeline replacements under discussion are significant in the context of overall PSE's planned capital budget, is highly questionable and not consistent with the reality of utility capital financing. PSE's planned capital budget for 2011is approximately $1 billion. As Public Counsel witness Andrea Crane pointed out in testimony, utility capital expenditures are funded by equity, short and long-term debt, and retained earnings.[119] Mr. Story confirmed this description of the source of financing for pipeline investment under the PIP and observed "You're not going to have dollars that are coded...that these are long term debt dollars, these are equity dollars. "[120]

75. There is no separate pot of money for these pipeline expenditures, nor does the Company

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[118] As noted above, PSE is planning to more than double its replacement of plastic pipe this year. PSE also exceeded its planned replacement of bare steel pipe in 2007 and every year thereafter by significant margins.

[119] Crane, TR. 261:25-262:5.

[120] Story, TR. 221:19-22.

go to the owners and request, for example, a discrete contribution of $10 million to support specific pipeline infrastructure investment. Furthermore, given the size of PSE's capital budget, $1 billion for 2011, the potential pipeline expenditures under discussion here are minute. Even at the proposed cap of $25 million this represents 2.5% of the capital budget. The suggestion that these are material amounts in the context of the overall capital budget is not realistic. The creation of a tracker does not "earmark" dollars for pipeline expenditure, nor would it have any real impact on the overall capital budget process.

76. Mr. Story acknowledged on cross-examination regarding Exh. No. JHS-4 that if the company spent $16.4 million on plant in the first year of the PIP, and only collected $586,000 for return of that investment via depreciation, the remaining $15.8 million would come from PSE's standard forms of capital financing just like any other capital project.[121] The funds would include equity, long and short-term debt, depreciation, and from internally generated funds.[122] As a practical matter, the PIP would not make any noticeable difference with respect to the supposed "competition for capital" it is allegedly intended to remedy.[123]

E. PSE Has Not Demonstrated Any Barrier To Recovery Of Pipeline Replacement Costs In General Rates

1. PSE has never been denied recovery of pipeline replacement costs in rates.

77. PSE has successfully implemented multiple major pipeline replacement programs for cast-iron, bare steel, and wrapped steel and older PE pipe. These programs have required large capital expenditures. [124]

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[121] Story, TR. 221:24-222:3
[122] Crane, TR. 262:2-22
[123] Exh. No. ACC -1T (Crane), p. 17:13-22.
[124] Exh. No. DAH-13 and 14.

78. In all cases, PSE has recovered, or is currently recovering the cost of the pipeline replacement in rates. Mr. DeBoer conceded in testimony that PSE has never claimed that it has not recovered the cost of pipeline replacement eventually through rates.[125] Nor can PSE suggest there is any substantial uncertainty about recovery for this type of investment. PSE has identified no Commission order disallowing recovery for natural gas pipe of the type covered by the PIP proposal.[126]

2. The UTC has authority to allow recovery for accelerated pipeline replacement in general rates.

79. If PSE wishes to accelerate its pipeline replacement program in Washington it is entirely free to do so. If it chose to, it could develop the program in a collaborative process with a focus on enhancing replacement in specific geographic areas or for types of pipe in the same fashion as the PIP would do. Similarly the Commission has the authority to order the company to implement such an accelerate or enhanced pipeline replacement approach, without accelerated recovery.[127] In either scenario, assuming the costs are prudently incurred, the PSE can expect to recover its costs through general rates. The Company conceded these points at the hearing.[128]

V. FLAWS IN THE PIP PROPOSAL

A. PSE Cannot Explain How The PIP Would Work In Practice Or How It Would Provide New Benefits.

1. The PIP creates a "pre-approval" mechanism with no clear determination of prudence.

80. When asked by Judge Kopta to provide detail about the PIP process, Mr. DeBoer agreed with the judge that PSE "would present to the Commission after the collaborative process

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[125] Exh. No. TAD-4T, p. 8:20-21.
[126] Exh. No. TAD-10.
[127] RCW 80.28.130.
[128] DeBoer, TR. 62:8-63:23.

specific projects that the company proposes to undertake as part of [the PIP] program."[129] He went on to say that "[t]here would be a list of projects and budgets attached to those projects as well as a total amount, and their rate to collect that amount."[130]

81. The PIP framework clearly anticipates putting the Commission in the position of pre-approving specific projects and expenditures. Mr. DeBoer testified:

> Q. [Mr. Cedarbaum] But you're saying the parties would have the opportunity to agree to the specific projects that would accomplish that [safety] goal.?
>
> A. The parties would agree, and it would be brought before the Commission before the tariff is implemented and it would be approved at the commission before hand, and then it would be trued-up after the fact[.][131]

82. Pre-approval is disfavored in regulation because it blurs the roles and responsibilities of the regulator and the utility management.[132] Pre-approval of a specific utility expense ordinarily implies that a prudence determination has been made. When asked to explain when the prudence determination would be made in the PIP, however, Mr. DeBoer could not provide a clear answer. He testified: "I can't answer that question"[133] and "I don't know…factually or legally when that happens."[134]

83. In a telling comment at the hearing, Mr. DeBoer candidly observed that once a pipeline project had been approved in the collaborative, presented to the Commission and approved with a budget, and put in rates: "I can't imagine after that point—I suppose there's theoretically a risk of imprudence after the fact, but I can't imagine the situation that that could occur." [135] As he

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[129] Deboer, TR. 78:12-16.
[130] DeBoer, TR. 78:16-19.
[131] DeBoer, TR 58:5-11.
[132] Pre-approval frequently is sought on abbreviated timelines that reduce opportunity for analysis.
[133] DeBoer, TR. 55:11-12.
[134] DeBoer, TR. 55:22-23.
[135] DeBoer, TR. 56:8-11.

stated: "people have looked at what the pipe—the projects will be, and have agreed that these make sense, so to me that's prudence."[136] It is clear that even if there is a formal reservation of prudence review for a later stage, such as the true-up filing, or a subsequent rate case, the process would be meaningless as a practical matter.

84. Later in the hearing, Mr. DeBoer seemed to back away from this description and suggest that the Commission could simply be asked to approve a pipeline budget and place it in rates without any specific details about what the funds would be spent on. That is not, however, the proposal that is before the Commission. In any event, Commission pre-approval of expenditure of funds on such a generic basis has even more legal infirmities than the current proposal.

2. PSE has proposed no benchmarks to measure PIP performance.

85. PSE's initial filing and testimony did not contain any type of metric or baseline that could be used by the Commission, its Staff, other stakeholders, or the public, to determine if the accelerated recovery of funds under the PIP was improving PSE's pipeline safety in any way, relative to what would otherwise occur under existing practice. PSE was asked in discovery: "[f]rom an operational perspective, what, if any, specific performance criteria and benchmarks would the Company use to determine if the proposed PIP is successful relative to its current practices with regard to pipeline replacement?" PSE answered that "the effectiveness of overall pipe replacement will be evaluated based on trending leak performance. This evaluation will be based on actual pipe replaced, as Puget Sound Energy, Inc., will not know what pipe would have been replaced absent the Pipeline Integrity Program tariff."[137]

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[136] DeBoer, TR. 56:16-19.

[137] Exhibit No. DAH-21. Its not entirely clear what this answer means, since leak surveys are conducted on all pipe in the system, not simply on "actual pipe replaced." Whatever the methodology, as PSE's answer itself suggests, there is no way to know whether that pipe would have been replaced in any event.

86. As an overall matter, as discussed in the safety section of the brief, system performance and leak trends are already showing improvement over time. PSE does not explain how existing "trending leak performance" offers any tools for the Commission to determine whether the PIP is having any effect, for better or worse. It is no answer to simply look at the same measures that PSE is already using. Mr. Henderson essentially concurred that there "isn't any way to tell if the PIP were to be enacted whether things are turning out differently" observing that "[t]hat is one of the challenges of DIMP program."[138]

87. At the hearing, Mr. Henderson was asked about the lack of benchmarks. He testified that the reference to leak trends in the discovery response meant all the leak trend measures listed in the *2010 Surveillance Report*. This encompasses at least 12 leak data measures.[139] However, specific benchmarks been only been adopted for two of these measures.[140] Mr. Henderson testified that, as a general matter, "we have not yet identified a reduction objective or threshold, if you will, that we are striving for."[141] PSE is still in the process of developing reporting systems that would enable it to have baselines for specific materials or locations.[142]

88. Mr. Henderson also suggested that an "inventory metric" might be used, to show a reduction in the amount of higher risk pipes in the system. He acknowledged however, that PSE already measures this under existing practice and that PSE is already lowering the amount of high risk pipe in it system.[143] He did not explain how the "inventory metric" would be used to evaluate the success of the PIP compared to existing practices.

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[138] Henderson, TR: 148:13-19.
[139] *2010 Surveillance Report*, DAH-7, p. 22.
[140] *Id.*, p. 20.
[141] Henderson, TR. 132:21-23.
[142] Henderson, TR. 147:15-18
[143] Henderson, TR. 148:6-12.

89. In summary, PSE has only addressed the "metrics" issue when asked in discovery and in cross-examination. To date, however, PSE has not itself proposed any method that would allow Commission to measure the success of the PIP. The absence of any measurement tool is a further indication that the true intent of the mechanism to accelerated recovery and enhance return.

3. The open-ended nature of the PIP potentially exposes customers to significant increases in the surcharge.

90. An additional problem with the PIP is its open-ended nature. The Commission and customers are being asked to adopt the framework of a program that could change dramatically from its current form.

91. PSE has declined to provide any detail about what types of programs or investments might be included in the future, portraying this flexibility as a selling point. For ratepayers, however, this means exposure to substantial increases in the size of the surcharge beyond its initial levels. For example, PSE testified that it has identified 100 miles of older PE pipe that deserve added scrutiny.[144] At an estimated replacement cost of $1 million per mile, this becomes a $100 million program, even without including other wrapped steel programs, or additional older PE. As Chairman Goltz noted, if thousands of miles of pipe are replaced, the total cost could be in the billions. The $25 million cap proposal may not provide long term protection for customers, since it can be modified at Company request.[145] The accelerated return component creates a strong incentive for PSE to significantly increase the scale of the PIP in order to increase return, without regard to whether the expansion has a real safety justification.

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[144] Exh. No. DAH-4T, p. 4:13-14. As noted above, PSE has not proved on this record a need to replace 100 miles of pipe. If the PIP is approved, however, this is one possible scenario that PSE could pursue if it chose to go beyond its risk model.

4. The PIP has no demonstrated customer benefits.

92. PSE has made no showing that that the PIP will provide any benefits to its customers. It has conducted no cost-benefit analysis.[146] It does not claim that any cost savings will result from the program. It points to undefined qualitative benefits, amounting essentially to undefined increases in safety.[147] As discussed elsewhere in this brief, it has completely failed to make a showing that the PIP will produce any different result than its existing programs.

93. On the other hand, there is quantifiable detrimental customer impact. Through the PIP surcharge every November 1, customers will pay an accelerated return to PSE investors. These charges will include plant that has not yet been placed in service.

B. Collaboration Already Occurs Between PSE And UTC Pipeline Safety Staff.

94. Another supposed benefit of the PIP proposal much emphasized by PSE is the creation of a process in which stakeholders and Company collaborate in selecting pipeline projects to be funded by the PIP. The Company is not specific about who the stakeholders would be and it appears from questioning at the hearing that, in reality, the "stakeholder group" is most likely to consist of PSE and Commission pipeline safety staff.[148] Other parties lack the technical expertise, financial resources, or time to meaningfully participate in such a process.

95. What PSE does not mention in its filing is that collaboration between PSE and Commission pipeline safety staff is already extensive. Mr. Henderson acknowledged at the hearing that PSE meets with pipeline safety staff "on a very regular basis, and it takes a number

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[145] Moreover, as Ms. Crane points out, the cap may come to be viewed simply as a de facto pre-approved expenditure level. Exh. No. ACC-1T, p. 22:1-11.

[146] Exh. No. ACC-1T (Crane), pp. 24-25.

[147] Exh. No. DAH-30.

[148] DeBoer, TR. 98:5-12.

of forms."[149] In rebuttal testimony he described "years of discussion" with Commission Staff.[150] Mr. Lykken confirmed that significant collaboration currently occurs.[151]

96. In summary, the collaborative process proposed in the PIP does not offer any new benefit. To the extent that there is value in additional collaboration, it can take place now or at any future time, at the instance of PSE or the Commission pipeline safety staff, whether or not pipeline tracker exists. The "stakeholder collaborative" proposal is yet another aspect of the PIP proposal built on a false premise, i.e., that cooperative action does not now occur, and cannot occur without adoption of the tracker.

C. The PIP Would Dilute PSE's Responsibility To Operate A Safe System.

97. One of the most problematic aspects of the PIP collaborative proposal is the potential for substantial dilution of PSE's responsibility to operate a safe and reliable natural gas distribution system. Under Washington law, PSE is required to provide safe and reliable natural gas service to its customers.[152] PSE assures the Commission that it would fully retain this obligation if the PIP is adopted. While certainly the statutory obligation would remain in place, the practical mechanics of the PIP would clearly enmesh stakeholders and the Commission itself in direct managerial and operational decisions regarding the safety of PSE's natural gas system.[153] As Mr. DeBoer described the process at the hearing:

> [t]hese are projects that will be agreed in advance by the [stakeholder] group, will be approved by the Commission when we implement the rate before any pipe goes in the ground.

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[149] Henderson, TR. 129:2-3.
[150] Exh. No. DAH 4T.
[151] TR. 246:1-21 (Lykken, questioning by Chairman Goltz and Commissioner Oshie).
[152] RCW 80.28.010(8), 80.28.210.
[153] Exh. No. ACC-1T, p. 21:1-20.

So the parties and the Commission will have had an opportunity to look at the facilities that will be going in."[154]

98. An example of what this might look like can be found in Exh. No. DAH-9. In this exhibit, PSE provides a list of the specific locations where wrapped steel services were identified for priority replacement in 2010. Under the PIP, the Commission and stakeholders would be asked to ratify such a list in advance and approve inclusion of the projected costs in rates.

99. If an explosion or other serious accident were to occur in another section of pipe in PSE's system not approved for replacement in the PIP process, the Commission and stakeholders would inevitably bear some responsibility for that decision. No verbal assurance from PSE about continued responsibility can avoid the reality that the PIP would introduce a new dynamic into utility management decision making. The UTC would no longer be a watchdog, charged with ensuring that the utility meets its obligations, but a co-manager of the company system.

100. Inevitably, this weakens the appropriate incentives for prudent utility management decisions. If an accident occurs and questions are raised, PSE will undoubtedly point to the record of Commission and stakeholder review and approval of its specific decisions. Public Counsel does not believe this is an appropriate role for a regulatory body, or for stakeholders, under Washington's regulatory framework.

VI. RECOMMENDATION AND CONCLUSION

101. PSE's pipeline replacement surcharge request should be denied. Public Counsel witness Andrea Crane aptly summarized the weaknesses in the Company proposal in her testimony:[155]

- The PIP is a proposal for accelerated recovery of pipeline replacement costs, and

[154] DeBoer, TR. 56:5-6.
[155] Exh. No. ACC-1T, p. 3.

not a proposal to accelerate replacements to meet identified needs.

- The proposed PIP would improperly reduce shareholder risk, transfer risk from shareholders to ratepayers, and increase shareholders' return on equity.
- The PIP constitutes single-issue ratemaking and has not been justified on either financial or operational grounds. In addition, it violates the used and useful standard.
- The Company has not demonstrated that there are any safety concerns with its current system that would require adoption of the PIP.
- The Company has not demonstrated that any change from the traditional method of recovering pipeline replacement costs through general rates is either necessary or desirable.
- The PIP proposal would dilute PSE's responsibility for managing its pipeline replacement activities.
- The Company has not shown that the PIP provides any net benefits to ratepayers.

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102. If the Commission has concerns about specific safety conditions that are not addressed by PSE's existing programs, it could direct its pipeline safety staff to initiate an investigation to determine whether a program similar to the bare steel, or wrapped steel services program should be implement to make improvements to PSE's system. If such a program is found to be necessary, it can be implemented pursuant to Commission order, and recovery sought in general rates.

103. DATED this 16th Day of December, 2011.

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