BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

INITIAL POST HEARING BRIEF OF THE NORTHWEST INDUSTRIAL GAS USERS

December 16, 2011

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I. INTRODUCTION

1. Pursuant to Washington Administrative Code (WAC) 480-07-395, the Northwest Industrial Gas Users ("NWIGU") file this Initial Post Hearing Brief in the above referenced consolidated dockets related to Puget Sound Energy, Inc.'s ("Puget's" or "Company's") request for a separate tariff to fund its proposed Pipeline Integrity Program ("Program" or "PIP"). While NWIGU and its members are wholly aligned with Puget and the Commission on a shared goal of public safety, Puget's filing and the record in this matter fail to demonstrate any tangible, quantifiable benefit to ratepayers sufficient to justify approval of the proposed tariff. As discussed in this brief, and as demonstrated by the record in this proceeding, Puget can continue to seek recovery of prudently incurred safety improvements through general rate cases, and the proposed Program cannot be justified through a single-issue ratemaking mechanism as it will benefit only Puget's shareholders without any verifiable increase to the safety of Puget's system. The Commission should reject Puget's PIP proposal because:

- Puget's PIP proposal does not provide any ascertainable net benefits to its customers in risk mitigation;
- The PIP tracker proposal improperly constitutes single-issue ratemaking that isolates one of multiple factors that are increasing and decreasing between rate cases; and,
- The PIP proposal advanced by Puget does not balance shareholders' and ratepayers' interests, and instead advances only the interests of the shareholders by isolating advanced cost recovery of these programs.[1]

2. In this brief, NWIGU addresses: (i) the legal context in which the Commission analyzes requests for single-issue ratemaking mechanisms; (ii) the lack of extraordinary circumstances in the present matter necessary to justify approval of the Program; (iii) the appropriate context in which NWIGU may support approval of the Program in the future;

[1] *See* Exh. No. DWS-1T at 3:8-14.

and, (iv) the flawed allocation process Puget has used to calculate a proposed surcharge on industrial and special contracts customers.

3. With respect to single-issue ratemaking, this Commission has set clear precedent that single-issue ratemaking is appropriate only where a utility's financial circumstances constitute "extraordinary circumstances" such that the utility can clearly demonstrate that it would otherwise be denied a reasonable opportunity to earn its authorized rate of return.[2] Puget has not satisfied its burden of demonstrating such extraordinary circumstances exist.

4. With respect to the context in which NWIGU could support approval of the Program in the future, Puget would have to demonstrate that traditional ratemaking and the regulatory compact are inadequate for cost recovery purposes relative to pipeline safety expenditures. For example, if Puget were subject to a rate moratorium, limiting its ability to recover accelerated pipeline replacement costs through general rates, a separate tracker for those costs might be appropriate. As long as Puget engages in annual rate filings, however, there simply is no basis for not including accelerated pipeline replacement costs in general rates.

5. Even if the Commission finds that a separate tracker is appropriate, Puget has failed to establish the factual basis for how those costs are allocated to industrial customers and special contracts customers. Rather than conduct a cost of service analysis that would determine the appropriate calculation, Puget's PIP proposal relies on a cost of service analysis from a 2009 proceeding that Puget has expressly agreed would not be precedential beyond that proceeding. Until Puget conducts an actual review of the costs and benefits associated with the PIP proposal, its proposal should be rejected.

6. In addition to the points and authorities presented in this brief, NWIGU supports the positions of both Staff and Public Counsel.

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[2] *E.g. WUTC v. PSE*, Docket Nos. UE-060266 and UG-060267 (*consolidated*), Order 08 at ¶¶35-42 (Jan. 5, 2007).

II. SUMMARY OF THE PIP PROPOSAL

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

> in order to meet all of its capital requirements, PSE must prioritize these programs and sets separate budgets, timelines and other work requirements which can limit the flexibility in addressing the highest priority safety and compliance issues across the entire system. The proposed PIP mitigates a major obstacle to managing safety on a system-wide basis in that it allows for timely recovery of costs incurred without regard to the artificial program classifications and would allow the Company, in consultation with stakeholders, to increase investments to address reliability, integrity and safety programs.[3]

8. However, as described more fully below, the intra-company budgeting competition is not sufficient to justify a separate tracker to remove pipeline safety costs, because Puget has demonstrated that, despite that competition, it currently maintains a safe system and can recover its costs through general rates.

III. ARGUMENT

A. Legal Context for Single-Issue Ratemaking

9. Puget's request for a new tariff as part of the Program would create a new tracker allowing the Company to recover its costs related to capital expenditures for the replacement of various pipeline segments separate from the recovery of its other costs. Puget does not

[3] Exh. No.TAD-IT at 3:4-12.

disagree that, if enacted, the Program would constitute single-issue ratemaking.[4] To justify the Program, the Company simply argues that single-issue ratemaking is not prohibited and that the Program is the type of issue where single-issue ratemaking is appropriate under WAC 480-07-505(2)(a).[5]

10. NWIGU does not disagree that, under the right circumstances, the Commission has the authority to pursue single-issue ratemaking. However, the Commission's consideration of such ratemaking is not without precedent, and the Commission has made it very clear in prior dockets the standard of review and the factors it will consider before approving such a request. Puget's proposal does not meet that standard.

11. During Puget's general rate case in 2006, it proposed a depreciation tracker to track depreciation expenses for transmission and distribution investments the Company makes between general rate cases (the "Depreciation Tracker").[6] Through the Depreciation Tracker Puget sought: 1) to impose a surcharge; 2) for the recovery of depreciation expenses "over and above the depreciation expense reflected in existing rates"; 3) with an annual true-up; and 4) allowing for "recovery of" investments in new plant between rate cases but not "recovery on" those investments.[7] In support of the Depreciation Tracker, Puget asserted in part that the tracker was necessary "to address regulatory lag."[8]

12. In considering Puget's Depreciation Tracker, the Commission first noted that "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."[9] The Commission then noted that "[i]t requires extraordinary circumstances to support a departure from fundamental principles," and that the Commission would require "a clear and convincing

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[4] *See* Exh. No. TAD-4T at 11:19-12:14.
[5] *Id.*
[6] *WUTC v. PSE*, Docket Nos. UE-060266 and UG-060267 (*consolidated*), Order 08 at ¶35.
[7] *Id.*
[8] *Id.* at ¶36.
[9] *Id.* at ¶37.

showing that the Company will be denied any reasonable opportunity to earn its authorized rate of return without extraordinary relief."[10]

13. Accordingly, the "extraordinary circumstances" that justify single-issue ratemaking are "financial circumstances" resulting from regulatory lag that prevent a utility from making investments necessary to maintain reliable service.[11] As described in more detail below, such extraordinary circumstances do not exist in the present matter and, therefore, the Commission should decline to support Puget's PIP proposal.

B. The PIP Surcharge Fails to Treat Ratepayers Fairly Relative to Puget's Shareholders

14. The PIP surcharge fails to treat ratepayers fairly relative to Puget's shareholders as would be the case if these expenses were treated in a general rate case proceeding. Puget's proposed revenue deficiency for PIP is purportedly based on the incremental investment in the approved programs through the rate year.[12] The incremental investment is defined as the new investment in PIP plant that will be put into service from the end of the most recent test year used to change the general rate tariff schedules for natural gas through the PIP rate year. The revenue deficiency includes the return on this incremental investment, less accumulated depreciation and deferred taxes associated with that investment, plus increased depreciation expense associated with the new investment.[13] When general tariff schedules are changed during a PIP rate year, the PIP calculations would be adjusted, based on the effective date of the new general rate tariff schedules, to reflect the new test year, new net of tax rate of return approved in the general rate tariff filing, and new depreciation rates if any were approved.

15. Puget's true-up in the PIP to actual PIP expenses does not track any other expenses which may decline in the PIP test year. Moreover, the PIP does not address situations of increased capacity that may occur when a PIP program results in larger capacity

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[10] *Id.* at ¶39.

[11] *Id.* at ¶41.

[12] Despite Puget's claim that the PIP proposal is based on "incremental" investment, Puget witness Duane Henderson, in response to questioning from Chair Goltz, acknowledges that the proposal attempts to recover all pipeline safety replacement costs, not just incremental costs. Henderson, TR. 191:9-192:5.

[13] *See* Exh. No. JHS-IT at 4:18-6:14.

installations. In addition to its failure to track expense reductions and exclude increased capacity, the PIP proposal fails to reflect cost of service among Puget's customers applying only its own study from a prior rate case, Docket No. UG-090705, but without any consideration of other allocation methodologies advocated by other parties in that case or that may occur in future cases and be adopted by the WUTC. In addition, Puget also erroneously includes special contract customers in the scope of surcharges at the same level as Schedules 87/87T when they should be excluded from application.

C. Puget Does Not Face Extraordinary Circumstances With Respect to Pipeline Safety

16. Puget has failed to clearly and convincingly show that the Company will be denied any reasonable opportunity to earn its authorized rate of return without the PIP or that regulatory lag will prevent it from making investments necessary to maintain reliable service. To the contrary, the evidence in the record clearly demonstrates that the Company is able to go beyond the minimum safety standards while remaining financially whole.

17. First, Puget witness Mr. DeBoer admits in his rebuttal testimony that "PSE has never claimed it has not recovered the costs to replace these facilities eventually in a rate proceeding."[14] Mr. DeBoer then expands on that point and clarifies that the Company's pipeline safety programs "have been ongoing and will continue if the PIP is not approved."[15]

18. Mr. DeBoer's testimony does attempt to describe the traditional ratemaking process as one that encourages the Company to do only that which is necessary to meet minimum requirements.[16] However, that testimony directly conflicts with the testimony of another of the Company's witnesses, who acknowledges that the Company pipeline safety programs currently do go beyond minimum safety requirements.[17]

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[14] Exh. No. TAD-4T at 8:20-21.

[15] *Id.* at 9:21-22.

[16] *See id.* at 10:8-9 ("Traditional ratemaking encourages the Company to replace pipe that is necessary to maintain a safe system – no more and no less.").

[17] *See, e.g.,* Henderson, TR. 171:11-14 ("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."); *see also* Henderson, TR. 149:17, 153:8-15, 159:10-12 (each describing where Puget has gone beyond minimum safety standards).

19. Second, Puget has not demonstrated – or even attempted to demonstrate – the actual costs and benefits of the PIP proposal, which prevents the Commission from evaluating the Company's financial circumstances. Without such an evaluation, it is impossible for the Commission to determine if those financial circumstances are extraordinary enough to justify a single-issue ratemaking mechanism.

20. All of Puget's claimed benefits of the Program are qualitative in nature. Puget has not undertaken *any* cost-benefit studies relating to the acceleration of its pipe replacement programs.[18] Moreover, Puget expressly admits that it has not attempted to analyze or determine *any* non-qualitative customer benefits.[19] With respect to those "qualitative" costs or benefits, Puget struggles to even describe what those costs or benefits would be. For example, Puget's witness Mr. DeBoer testified that the cost to customers of the PIP is small "[i]n relationship to the safety benefit they receive."[20] Yet, Mr. DeBoer makes no attempt to describe what the actual increment of safety will be, only that the already-safe system will be "safer."[21]

21. Finally, Puget does not attempt to segregate the pipeline safety costs it already recovers in its rates from the costs it expects to incur solely as a result of accelerating pipeline replacement as part of the PIP.[22] Thus, even if there is a quantifiable financial impact that results from accelerating pipeline replacement programs that the Commission ought to consider – which, again, Puget has not demonstrated – it is impossible for the Commission to determine if that impact rises to the level of an extraordinary circumstance because Puget has lumped those impacts together with the impacts of what it is already required to do to maintain a safe system, which it has built into its existing rates.

22. As noted above, the Depreciation Tracker proposal included only the Company's incremental depreciation costs, beyond the costs that it recovered in its existing rates. The

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[18] Exh. No. DAH-29; Henderson, TR. 132:2-6.
[19] Henderson, TR. 134:2-4.
[20] DeBoer, TR. 75:6-7.
[21] Exh. No. TAD-4T at 4:6-7.
[22] Henderson, TR. 191:15-20.

Commission rejected that proposal in part because the Company did not demonstrate a mismatch between revenues, expenses and rate base. If incremental costs like those proposed in the Depreciation Tracker did not demonstrate such a mismatch, it is difficult to fathom how the costs included in the PIP proposal could. If the Company wants to make that case, the Commission should require it to do so through a full review of revenue and expenses and not through reliance on undefined "qualitative" benefits only.

23. Despite the foregoing, Puget insists that "there is ample evidence that extraordinary circumstances exist" in this matter.[23] As examples of that "ample evidence," Puget points to a "nationally-recognized need" to accelerate pipe replacement and federal policies calling for "mechanisms to encourage proactive replacement of pipeline."[24] However, this evidence in no way implicates the Company's *financial circumstances* or in any way leads to a conclusion that the Company is at risk of being denied a reasonable opportunity to earn its authorized rate of return. Simply put, there is no basis for allowing Puget to rely on the significance of a federal policy as a surrogate for the extraordinary financial circumstances this Commission requires before approving a single-issue ratemaking mechanism. Puget already maintains a safe system, going beyond minimum safety requirements, and it has presented no compelling reason that it cannot pursue an even safer system through traditional ratemaking procedures.

D. Puget Has Failed to Show That Other States' Recovery Mechanisms Are an Adequate Comparison to the PIP.

24. Puget attempts to rely on other states' efforts as evidence that the PIP is not a novel approach to ratemaking. The glaring omission is that Puget fails to identify how any specific state's mechanism is similar to the PIP or how the other utilities are similar to Puget. Puget simply asserts that 19 states have some mechanism for cost recovery relating to pipeline replacement. This argument is not compelling.

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[23] Exh. No. TAD-4T at 12:8.
[24] *Id.* at 12:9-14.

25. Just because a particular state may have some special recovery mechanism for pipeline replacement for a specific utility does not mean that the PIP is appropriate for Puget. The Oregon Public Utilities Commission approved a tracker for NW Natural's System Integrity Program in 2009, for example, but that mechanism was formulated in an entirely different context that justified the mechanism. Specifically, NW Natural's program was created as part of a stipulated settlement.[25] NWIGU was a party to that stipulated settlement and supported the creation of a new tracker blending together NW Natural's Transmission Integrity Management, Bare Steel Replacement and Distribution Integrity Management programs, but only did so in light of the fact that NW Natural had been subject to a rate moratorium with no new rate cases since 2003 when its Oregon rates were aligned with its relative cost of service. In drastic contrast to that eight-year time period, Puget files general rate cases on a near-annual basis in Washington, with one case currently pending (Docket UG-111049) and another case planned for 2012.[26] And Puget does not dispute that pipeline replacement costs can be addressed in upcoming general rate cases.[27] There is simply no justification for the PIP when Puget files rate proceedings annually and can recover prudently incurred costs as part of that process.

26. There are other factors in Oregon that also differentiate NW Natural's situation from Puget's situation. For example, Oregon gas utilities are subject to an earnings test whereby gas utilities share earnings beyond a specified threshold with their customers.[28] This prevents a utility from over-earning.

27. Unlike NW Natural in Oregon, Puget cannot demonstrate any real lag between its investments and its ability to recover those costs in new rates beyond the lag that is inherent in traditional ratemaking. For that reason, the Commission should reject any comparison to NW Natural's System Improvement Program. The Commission should also reject Puget's

[25] Exh. No. BR-2 at p.2.
[26] DeBoer, TR. 67:18-21.
[27] Story, TR. 212:15-21.
[28] OAR 860-022-0070.

assertion that the mere presence of a recovery mechanism in other states for pipeline safety is sufficient to justify the PIP proposal in Washington when Puget has failed to carry its burden to show that: (1) the other pipeline safety programs are similar to the PIP; (2) the other regulatory programs are similar to that in Washington; and (3) the other utilities subject to such programs are similarly situated to Puget.

E. Industrial Customers and Special Contracts

28. Even if Puget has carried its burden of demonstrating extraordinary financial circumstances sufficient to justify creation of a new tracker for the PIP – which it has not – Puget has not adequately demonstrated that the surcharge it proposes for industrial customers and special contracts customers is supported by a proper allocation basis. Specifically, the record is void of an adequate factual basis supporting the costs Puget incurs that support the rates it developed for those customers.

29. Puget asserts that the cost of service approach it used to allocate PIP costs is the same cost of service analysis it developed in its 2009 general rate case, Docket No. UG-090705.[29] Because a majority of the parties in that rate case supported that cost of service analysis, Puget reasons that the analysis is "acceptable."[30] However, that cost of service analysis has no bearing beyond its application in the 2009 rate case. The 2009 rate case was resolved through settlement and the cost of service analysis was never determined by the Commission to be an accurate reflection of Puget's actual costs. Moreover, Puget acknowledges, as it must, that the parties in that proceeding, including Puget, expressly agreed that the cost of service analysis would be used only for that proceeding and that it would not have any bearing on future proceedings.[31]

30. Even if the 2009 cost of service analysis was applicable, Puget has not properly applied the results of that analysis. For example, Puget's witness John Story testified that, in developing the PIP surcharge, the Company did not segregate out the pipeline segments that

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[29] Exh. No. JHS-10T at 7:9.
[30] *Id.* at 7:14.
[31] Story, TR. 217:23-218:1.

would be replaced under the PIP program and run those costs through the cost of service analysis. Instead, the Company simply allocated its expected costs "in the same way the 2009 allocations were done for pipe" across customer classes, which included all costs and not just those associated with pipeline replacement.[32]

31. The rate-making process, whether through traditional means or as part of a special mechanism, should be based on the Company's actual costs of service to its various customer classes. Such costs should be fact-based and, for the Commission to approve them, must be supported by substantial evidence in the record.[33] Because Puget relies on a prior analysis that it expressly agreed would have no precedential value in future proceedings, the Commission should reject Puget's reliance on that analysis in this proceeding.

IV. CONCLUSION

32. NWIGU takes Puget at its word that it maintains a safe, reliable system that goes beyond the minimum safety requirements. Safety is a shared goal, and the Company is right to explore ways to make an even safer system. However, the PIP program, as designed, is not necessary or beneficial to customers to achieve that outcome. The PIP only ensures that Puget's shareholders will accelerate their recovery of pipeline safety improvements and that they will receive an additional benefit through recovery on those improvements. But such recovery would also occur as part of this Commission's traditional ratemaking process. Accordingly, the PIP program is not appropriate or necessary and should be rejected.

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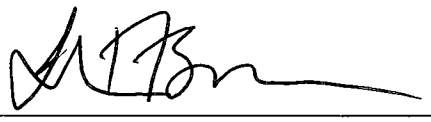
[32] Story, TR. 217:4-18.

[33] *State ex rel. Pac. Tel. & Tel. Co. v. Dep't of Pub. Serv.*, 19 Wash. 2d 200, 215 (1943) ("In all jurisdictions, the rate making authority is required to gather facts upon which to base an order affecting rates, and from those facts make findings which support the order entered.").

33. For these reasons, and the reasons set forth in the briefs from Commission Staff and Public Counsel, the Commission should reject Puget's implementation of the proposed PIP.

Dated in Portland, Oregon, this 16th day of December, 2011.

Respectfully submitted,



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