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 PUGET SOUND ENERGY, INC.

DECEMBER 16, 2011

PUGET SOUND ENERGY, INC.

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I. INTRODUCTION

1. Puget Sound Energy, Inc. ("PSE" or "the Company") respectfully requests that the Commission issue an order approving its proposed Pipeline Integrity Program ("PIP") tariff in this proceeding. The Company originally proposed the PIP, in collaboration with Pipeline Safety Staff, in an attempt to raise the bar on pipeline safety. The PIP tariff that PSE proposes in this docket provides a mechanism by which the Commission can enhance pipeline integrity management and safety by encouraging accelerated and proactive safety measures beyond minimum state and federal regulatory requirements.

2. PSE hoped that other parties would recognize the significant public benefits of the PIP and work collaboratively with PSE as needed to achieve consensus on the proposal. Instead, the parties have denied the existence of changes in national pipeline safety policy, suggested that the status quo should be maintained, and questioned PSE's motives for proposing the safety enhancements. These arguments are misguided and short-sighted.

3. Adversarial rhetoric aside, the issues in this proceeding boil down to a basic policy decision for the Commission: should the Commission approve a proposed regulatory mechanism to remove disincentives for accelerated pipeline replacement in order to enhance pipeline safety and promote the public interest? Given the record evidence of an increased risk of failure of certain types of legacy pipe beyond PSE's control, the small incremental cost to customers of the program, and the significant public safety benefits that would result from implementing the program, PSE believes that the Commission has ample authority to and should approve the PIP.

II. LEGAL STANDARDS

4. The Commission has broad general powers to "[r]egulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons

engaging within this state in the business of supplying any utility service or commodity to the public for compensation."[1] Balancing the needs of the public to have safe and reliable electric and natural gas services at reasonable rates with the financial ability of a utility to provide such services on an ongoing basis, the Commission is charged with establishing the "just, reasonable, or sufficient rates, charges, regulations, practices or contracts" to be observed and enforced.[2]

III. THE PROPOSED PIPELINE INTEGRITY PROGRAM WILL PROMOTE THE PUBLIC INTEREST AND SHOULD BE APPROVED

A. The Evidence Presented and Legal Authority Support Approval of the PIP Tariff

1. Overview and Origin of the PIP Proposal

5. PSE has had discussions since at least 2008 with members of the Commission's Pipeline Safety Staff regarding ways to facilitate a more proactive approach to replacing pipe with a higher risk of failure, such as older plastic pipe.[3] There has been recognition by Pipeline Safety Staff and PSE that although PSE is meeting the federal and state standards, more can always be done to enhance pipeline safety. Both Pipeline Safety Staff and PSE have looked for ways to remove barriers to pipe replacement and enable a proactive and collaborative approach to pipeline safety.[4] Public advocates have also expressed support for a consensus approach to accelerating vintage pipe replacement.[5]

6. The PIP proposal is designed to achieve this goal. Contrary to Public Counsel's conspiracy theories, PSE's proposal is not a recently-initiated plan designed to increase shareholders' return at ratepayers' expense. The PIP was proposed with the goal of enhancing pipeline safety by accelerating vintage pipe replacement. It does so by promoting transparency

[1] RCW 80.01.040(3).
[2] RCW 80.28.020.
[3] *See* De Boer, TR. 120:20-23; Henderson, Exh. No. DAH-4T at 7:4-11.
[4] Henderson, Exh. No. DAH-4T at 7:4-11.
[5] *See, e.g.,* Bench Exhibit, Exh. No. BE-1 at 3–5 (public comments).

in developing specific risk reduction objectives and by implementing a financial mechanism to mitigate the financial harm that otherwise results from accelerated pipeline replacement under traditional ratemaking principles.

7. The older plastic pipe, wrapped steel mains, and wrapped steel services to be replaced on an accelerated basis as part of the PIP differ from PSE's scheduled replacement of cast iron pipe and bare steel pipe. Both of those programs arose out of settlement agreements in which PSE agreed to a timetable for replacement of pipe in response to allegations that PSE had violated pipeline safety regulations.[6] In contrast, there is no allegation that PSE has violated pipeline safety regulations in regard to replacement of the pipe included in the PIP. As Pubic Counsel pointed out in the hearing, PSE has proactively exceeded the requirements of state and federal regulations.[7] Even so, at the pace at which PSE is currently proactively replacing plastic pipe, it will take several decades to complete the replacement.[8] And, under the current regulatory scheme, there is no guarantee that PSE can continue going beyond the minimum safety requirements on a sustained basis.[9] Duane Henderson and Tom De Boer testified regarding the competing demands for budget dollars.[10] The PIP allows PSE to move forward with sustained proactive replacement of vulnerable pipe by providing a steady and certain source of funding for these important pipeline replacement projects.[11]

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[6] *See WUTC v. Puget Sound Energy, Inc.*, Docket PG-030080, et al., Order 02 (January 31, 2005) (approving bare steel settlement agreement), *amended by* Order 03 (April 26, 2006), *amended by* Order 04 (July 1, 2009); *WUTC v. Wash. Natural Gas Co.*, Docket No. UG-920487, First Supp. Order Accepting Settlement and Operating Agreement (June 19, 1992) (approving cast iron steel settlement agreement).

[7] Henderson, TR. 149:17 – 150:7, 153:8-15, 158:18 – 159:12, 171:8-14, 207:1 –208:20.

[8] *Id.* at 174:16-21.

[9] *See, e.g.*, Henderson, Exh. No. DAH-4T at 3:20 – 4:5.

[10] De Boer, Exh. No. TAD-1T at 3:2-12; De Boer, Tr. 88:21 – 90:2; Henderson, TR. 137:22 – 138:10, 176:12 – 178:11.

[11] *See, e.g.*, De Boer, Exh. No.TAD-1T at 3:8-12; Henderson, Exh. No. DAH-1T at 14:13-20; Henderson, TR. 178:11 – 179:14.

8. The Prefiled Direct Testimony of Duane A. Henderson, Exhibit No. DAH-1T, provides an overview of PSE's proposed PIP, including the enhanced safety and other benefits that will result from the program, and the context of PSE's past and current pipeline integrity efforts. Mr. Henderson's prefiled testimony also explains the collaborative process that will be used, which allows interested stakeholders including Commission Pipeline Safety Staff, Public Counsel, NWIGU and others to participate in PSE's process of determining the scope of acceleration of pipeline replacement for vulnerable pipe.[12] While PSE will retain ultimate responsibility for decisions regarding pipeline to be replaced, PSE will seek input from stakeholders as part of the collaborative process before the annual PIP filing is submitted to the Commission.[13]

9. Mr. Henderson's testimony shows PSE's actual capital costs for pipeline replacement, since 2003 and its planned replacements through 2015, absent the PIP.[14] As Mr. Henderson testified, the amounts designated as "planned" for 2013 through 2015 still must go through the budget process—there is no assurance that the full amount designated as "planned" will be budgeted, although PSE will fund whatever is necessary to meet the minimum requirements to keep its system safe.[15] The PIP is designed to allow accelerated replacement of vulnerable pipe beyond amounts that would otherwise have been budgeted. If the PIP is approved, PSE plans to increase its pipeline replacement beyond the current levels of replacement for wrapped steel mains, services and plastic pipe.[16]

10. The Prefiled Direct Testimony of Tom A. De Boer, Exhibit No. TAD-1T, describes reasons PSE proposed the PIP and explains how PSE, its customers, the Commission, and

[12] *See* Henderson, Exh. No. DAH-1T at 14:13-20.
[13] *See* Henderson, Exh. No. DAH-4T at 3:1-16.
[14] Henderson, Exh. No. DAH-1T at 9:19 – 10:1-10.
[15] *See* Henderson, Tr. 205:16 – 206:8, 136:22 – 138:10; Henderson, Exh. No. DAH-1T at 18:14-19.
[16] *See, e.g.*, De Boer, Exh. No. TAD-1T at 4:16 – 5:4; De Boer, Exh. No. TAD-4T at 9:19 – 10:19.

interested stakeholders would benefit from the proactive approach to pipeline integrity management that this tariff provides. The Prefiled Direct Testimony of John H. Story, Exhibit No. JHS-1T, describes the mechanics of the proposed tariff, the impact on customer rates and how these rates will be calculated in future program periods.

11. The PIP gives PSE the ability, in consultation with Commission Staff and others, to accelerate certain pipeline integrity initiatives, through a method of funding the programs that makes sustained, proactive replacement possible. PSE believes the accelerated pipeline replacement provided for in the PIP is appropriate and warranted given the recent pipeline safety issues that have emerged locally and nationally, the impact of traditional ratemaking mechanisms on PSE's ability to accelerate pipeline replacement, and the nature of PSE's pipeline system. Approving the PIP will enable PSE to adopt a more proactive approach to pipeline integrity management and enhance the safety and reliability of PSE's natural gas delivery system.[17]

2. Backdrop: Changing National Policy Framework for Pipeline Safety

12. The policy framework for pipeline safety has evolved dramatically over the past few years. As described in the prefiled testimony of Mr. Henderson, the scope of pipeline safety and compliance programs has been expanding at both the federal and state levels.[18] In December 2009, for example, the Pipeline and Hazardous Materials Safety Administration ("PHMSA") issued a final rule requiring gas pipeline companies, including PSE, to develop and implement a Distribution Integrity Management Program ("DIMP") by August 2, 2011. DIMP requires an operator to: understand the threats to its system; mitigate risks; measure performance; and adjust

[17] *See* De Boer, Exh. No. TAD-4T at 9:19 – 10:19
[18] *See* Henderson, Exh. No. DAH-1T at 2:14 – 3:7; Henderson, Exh. No. DAH-4T at 6:4-20.

mitigation measures as necessary based on performance.[19] As described in the prefiled testimony of Mr. Lykken, the intent of the integrity management regulations is to "promote continuous improvement in pipeline safety by requiring operators to identify and invest in risk control measures beyond core regulatory requirements."[20]

13. While pipeline safety has been a topic of concern for several years, it has taken on new urgency due to recent pipeline explosions that have occurred around the country, disrupting communities and causing loss of life and property. These incidents include the highly publicized explosions in San Bruno and Cupertino, California, and in Philadelphia and Allentown, Pennsylvania. Incidents such as these have prompted a hard look at the nation's aging pipeline infrastructure at both the federal and state levels.[21]

14. As a result of these and other pipeline incidents, federal agencies charged with pipeline safety have intensified efforts to address the nation's aging pipeline infrastructure.[22] On April 4, 2011, U.S. Transportation Secretary Ray LaHood announced a Pipeline Safety Action Plan. In the Plan, Secretary LaHood noted that states are "responsible for the inspection and enforcement of state pipeline safety laws for the natural gas pipeline systems within their respective states" and issued a "Call to Action" to "accelerate rehabilitation, repair, and replacement programs" for the highest risk infrastructure.[23]

15. As part of this federal effort, on June 16, 2011, in testimony focused on pipeline safety before the Subcommittee on Energy and Power, Committee on Energy and Commerce, U.S. House of Representatives, Cynthia L. Quarterman, Administrator of PHMSA, "specifically

[19] Henderson, Exh. No. DAH-1T at 2:14-21.
[20] Lykken, Exh. No. DL-1T at 4:16-18.
[21] De Boer, Exh. No. TAD-4T at 4:15-18.
[22] *Id.* at 4:19-21.
[23] De Boer, Exh. No. TAD-5.

call[ed] upon State Public Utility Commissions to establish cost recovery mechanisms that effectively address infrastructure replacement costs."[24] This testimony reiterated an earlier request by Administrator Quarterman in a letter sent to state utility commissions on March 31, 2011, urging each state to "review your State's current replacement plans for the highest risk pipelines . . . and consider what would be necessary to accelerate these plans."[25]

3. Traditional Ratemaking Principles Provide Disincentives to Accelerated Pipe Replacement

16. Business-as-usual cost recovery in general rate cases discourages utilities from undertaking capital-intensive pipeline safety efforts that go beyond the minimum level required by state and federal pipeline safety requirements.[26] State utility commissions and legislatures across the nation have recognized the appropriateness of adjusting traditional ratemaking methods when existing mechanisms are inconsistent with and undermine modern energy policy goals such as pipeline safety.[27]

17. Traditional cost-of-service ratemaking based on a historical test year delays recovery of capital expenses when utilities invest in capital-intensive programs between rate cases. While a

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[24] De Boer, Exh. No. TAD-6.

[25] De Boer, Exh. No. TAD-7.

[26] *See* De Boer, Exh. No. TAD-4T at 2:10-14, 10:8-9.

[27] *See id.* at 5:19 – 6:7 (describing pipeline replacement mechanisms approved in numerous other states); *see also, e.g., Pet. of Bay State Gas Co.*, Mass. D.P.U. 09-30 at 132–34 (Oct. 30, 2009) (finding that proposed "Targeted Infrastructure Reinvestment Factor" mechanism would provide appropriate incentives to expedite replacement of unprotected bare steel pipe; reasoning that "[w]ithout approval of the TIRF mechanism, recovery of this capital will be delayed until a future rate case. The Department expects that providing more certainty for, and more timely recovery of, the revenue requirement associated with capital expenditures for steel replacement between rate cases will provide appropriate incentives for the Company to expedite the replacement of the unprotected steel in its distribution system."); *Petition of New England Gas Co.*, Mass. D.P.U. 10-114 at 62 (Mar. 31, 2011) ("Although we agree with the Attorney General that current rate regulation does not necessarily hinder NEGC from providing safe and reliable distribution service, and that there is no record evidence to demonstrate that NEGC does not maintain safe and reliable service under such a regulatory framework, we reaffirm our previous conclusion that approval of a TIRF mechanism is likely to provide an incentive for more sustained and aggressive replacement of aging infrastructure, because it lessens the impediment of current capital constraints on a gas distribution company."); Bench Request Response, Exh. No. BR-2 (documents describing the System Integrity Program Approved by the Oregon PUC for NW Natural).

certain amount of regulatory lag is intrinsic to traditional cost-of-service ratemaking, PSE faces a massive and long-term capital expenditure program to replace vintage pipeline. Under traditional rate structures, utilities are discouraged from investing in pipeline replacement at a rate exceeding what is otherwise required by minimum state and federal safety requirements and supported by revenue generated from the existing rate structure.[28] As in the case of conservation and efficiency goals, business interests and public safety enhancement goals are not always fully aligned. Particularly in the current economic climate, with tight budgets and numerous competing budget demands, accelerated replacement is less likely to occur without a means to timely recover the cost of such replacement.[29]

18. In sum, traditional ratemaking encourages utilities to replace pipe that is necessary to maintain a safe system—no more and no less.[30] PSE proposed the PIP in recognition of this inherent tension and in response to the expressed desire to find more collaborative ways of removing barriers to accelerated and proactive pipe replacement. PSE believes that the PIP proposal is appropriate, justified by the evidence before the Commission, and well within the Commission's discretion to approve.

4. Approving the PIP Is Within the Commission's Authority

a. The "Rule" Against Single-Issue Ratemaking Does Not Preclude the PIP

19. Public Counsel and Staff have suggested that the PIP is improper because it violates the general rule against single-issue ratemaking. They mistake the Commission's general policy for a binding rule. The Commission's statutory authority gives it ample discretion to depart from

[28] *See* De Boer, Exh. No. TAD-4T at 2:10-14, 10:8-9; *Pet. of Bay State Gas Co.*, Mass. D.P.U. 09-30 at 132–34 (Oct. 30, 2009); *Pet. of New England Gas Co.*, Mass. D.P.U. 10-114 at 62 (Mar. 31, 2011).

[29] Henderson, Exh. No. DAH-4T at 3:20 – 4:2; *see also* Story, Tr. 235–36 (explaining impact of regulatory lag on recovery of pipe replacement costs); De Boer, Exh. No. TAD-4T at 2:10-14, 10:8-9.

[30] De Boer, Exh. No. TAD-4T at 10:8-9.

ordinary ratemaking principles when it determines that doing so is in the public interest and that resulting rates are just, reasonable, and compensatory. The Commission need only be convinced that the record is sufficient to show that the potential advantages from a proposal such as the PIP outweigh the potential disadvantages.[31]

20. The Commission has repeatedly emphasized that its general rule against single-issue ratemaking is *general* only, and a matter of policy not law.[32] "The ultimate determination to be made by the Commission in a rate proceeding is whether the proposed rates and charges are fair, just, reasonable, and sufficient."[33] "A proposal to change a single rate raises two issues: (1) whether the proposed rates in a vacuum are okay; (2) the relationship between the proposed rates and other rates of the company."[34] Power cost adjustments,[35] decoupling mechanisms, conservation riders,[36] REC trackers, and PSE's Tenaska Rider[37] are but a few examples of where Commission has determined that it is appropriate to depart from traditional ratemaking

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[31] *See, e.g.*, RCW 80.01.040 (duty to regulate in the public interest); RCW 80.28.020 (duty to establish just, reasonable, compensatory rates); *see also, e.g., In re Avista*, Docket UG-060518, Order 04 ¶¶ 19–20 (Feb. 1, 2007) (addressing Public Counsel's concern that decoupling proposal would violate matching principle through single-issue ratemaking and observing that, "[c]onsidering these concerns, we must examine carefully the stipulated proposal to determine whether the record is sufficient to prove the potential advantages from decoupling outweigh its potential disadvantages in this case"); *WUTC v. Puget Sound Power and Light Co.*, Docket No. U-81-41, Sixth Supp. Order (Dec. 19, 1988) (stating that test for propriety of recovering past expenses in true up mechanism for future rates "is not whether it constitutes retroactive ratemaking—it does not—but whether there are sound policy and evidentiary reasons for exercising the Commission's judgment to do so").

[32] *See, e.g., Wash. State Attorney Gen.'s Office, et al. v. PacifiCorp*, UE-110070, Order 01 ¶ 42 (April 27, 2011) (acknowledging that "it generally is a matter of policy, not law" but rejecting single issue ratemaking under the circumstances).

[33] *MCI Telecom. Corp., v. GTE Nw., Inc.*, Docket UT-970653, Second Supp. Order Dismissing Comp. (Oct. 22, 1997) (internal citation omitted).

[34] *Id.* at n.3.

[35] *See, e.g. WUTC v. Puget Sound Energy, Inc.* Docket UE-011570, *et al.*, Twelfth Supp. Order (June 20, 2002) (approving PCORC and Power Cost Adjustment mechanisms); *WUTC v. Puget Sound Energy, Inc.* Docket UG-021059, et al., Order Approving Purchased Gas Adjustment on Less than Statutory Notice (Aug. 28, 2002)

[36] *See In re Petition of Puget Sound Energy, Inc.*, Docket UE-970686, Final Order (May 16, 1997) (approving PSE's Electricity Conservation Service Rider).

[37] *See WUTC v. Puget Sound Energy, Inc.*, Docket UE-090704, et al., Order 11 ¶¶ 175–80 (April 2, 2010) (requiring PSE's Tenaska rider). Staff specifically supported the Tenaska rider—a deviation from traditional ratemaking that benefited customers—in PSE's 2009 GRC.

principles. Departures from traditional ratemaking mechanisms are commonly adopted by state utility commissions in order to implement particular public policy goals.[38]

(i) Extraordinary Circumstances Are Not Required to Approve the PIP

21. Public Counsel's testimony asserts that the Commission's legal precedent requires "extraordinary circumstances" to justify a deviation from traditional ratemaking principles.[39] In support of this assertion, Public Counsel cites to PSE's 2006 general rate case, in which the Commission rejected a proposed "depreciation tracker surcharge" that PSE had presented to the Commission as an attrition adjustment mechanism to address regulatory lag and earnings attrition.[40] Public Counsel's interpretation of the Commission's precedent is incorrect.

22. In the 2006 general rate case, the Company argued that an attrition adjustment mechanism was necessary to address revenue attrition and presented a detailed attrition study to demonstrate that future earnings attrition justified the single-issue rate adjustment.[41] In rejecting the proposal, the Commission reasoned:

> 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." We have considered the evidence PSE presented concerning attrition in some detail. Our analysis of the evidence leaves us unpersuaded that PSE will suffer earnings attrition as a result of not recovering depreciation on infrastructure investments it makes between rate cases.[42]

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[38] *See generally*, Leonard Saul Goodman, THE PROCESS OF RATEMAKING at 156 ("State utility commissions depart from traditional cost-of-service ratemaking to implement policies relating to conservation, demand side management (DSM), and least cost planning. . . . Under the governing statutes, costs outside the regulated company's experienced or forecast costs, so called "externalities," may also be relevant goals of these programs. . . . The statutory standards alone govern the agency's available choices of rate policy.").

[39] Crane, Exh. No. ACC-1T at 29–30.

[40] *See WUTC v. Puget Sound Energy, Inc.*, Docket UE-060266, *et al.*, Order 08 ¶ 36 (January 5, 2007).

[41] *Id.* ¶¶ 38–41.

[42] *Id.* at 39 (footnote omitted).

23. In a supporting footnote, the Commission agreed with Staff that, consistent with a 1993 order in which the Commission rejected an attrition adjustment proposed by Washington Natural Gas,[43] the Commission would not approve an attrition adjustment for the primary purpose of mitigating earnings attrition without a demonstration of extraordinary circumstances:

> The Commission has granted extraordinary relief to utilities upon demonstration through attrition studies that circumstances are likely to prevent them from earning their allowed rate of return. Staff is correct to argue that such relief should be granted only under extraordinary circumstances and with clear evidence that the utility would be harmed without such relief.[44]

24. Public Counsel reads the Commission's 2006 GRC order too broadly in asserting that the Commission's precedent makes extraordinary circumstances a prerequisite for all deviations from traditional ratemaking standards. The Commission's statement in the 2006 GRC order must be read in the context of the attrition adjustment then-proposed, the primary purpose of which was to address continued financial harm caused by regulatory lag.[45]

25. Here, in contrast, the primary purpose of the PIP is not to address the problem of PSE's chronic under-earnings—a problem that is properly being addressed in the pending GRC. Rather, the PIP is designed to enable pipeline safety enhancements to proceed even in the face of potential continued under-earnings. As discussed above, the PIP will allow pipeline safety enhancements that are developed and agreed-upon through the collaborative process with Pipeline Safety Staff and other stakeholders to proceed through PSE's budgeting process without having to directly compete for additional dollars in an already staggering capital budget. As summarized by Mr. Story in his testimony:

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[43] *WUTC v. Wash. Natural Gas Co.*, Docket No. UG-920840, 4th Supp. Order 29–30 (Sept. 27, 1993).
[44] *WUTC v. Puget Sound Energy, Inc.*, Dockets UE-060266, *et al.*, Order 08 ¶ 39 n.27 (Jan. 5, 2007).
[45] *See id.* ¶ 36.

> The purpose of the PIP is to put an emphasis on this program to enhance safety and reliability of the system. One of the benefits of having the PIP program makes it an earning asset earlier, which helps us in both financing this construction and other construction.[46]

By mitigating the inherent tension created by traditional ratemaking mechanisms—a tension that is only exacerbated in times of under-earning—the PIP serves to more fully align business interests with the public's interest in enhanced pipeline safety.

26. It is certainly true, as Mr. Story acknowledged in his testimony, that the PIP mitigates some of the effects of attrition by allowing for earlier recovery of certain pipeline replacement revenues.[47] In this sense, however, almost all rate adjustment mechanisms that positively affect utility revenues could be characterized as having an attrition adjustment component. The requirement of extraordinary circumstances is not triggered by the mere fact that a proposed deviation from traditional ratemaking principles could positively impact utility revenues. The Commission's approval of PSE's Power Cost Only Rate Case ("PCORC") mechanism is one of many examples where the Commission has not required "extraordinary circumstances" to approve a rate adjustment mechanism.[48]

27. By facilitating public safety enhancements at a more rapid pace than can be achieved under traditional ratemaking, the PIP is far more than an attrition adjustment mechanism. In circumstances such as these, the Commission has broad discretion to develop, apply, and adapt

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[46] Story, Tr. 235:7-15.

[47] *Id.* at 231:10-11 (acknowledging that the PIP could be characterized as an attrition adjustment "[i]f you define attrition adjustment as including future looking numbers").

[48] *See, e.g. WUTC v. Puget Sound Energy, Inc.* Docket UE-011570, *et al.*, Twelfth Supp. Order (June 20, 2002) (approving PCORC and Power Cost Adjustment mechanisms); *WUTC v. Puget Sound Energy, Inc.* Docket UG-021059, et al., Order Approving Purchased Gas Adjustment on Less than Statutory Notice (Aug. 28, 2002); *In re Petition of PSE,* UE-970686, Final Order (May 16, 1997) (approving PSE's Electricity Conservation Service Rider).

its general policies in furtherance of its statutory duty to balance customers' and utilities' interests.

(ii) Extraordinary Circumstances Exist that Justify Approving the PIP

28. Even if extraordinary circumstances were required to approve the PIP, which they are not, there is ample evidence in the record that extraordinary circumstances do, in fact, exist. As discussed above, there is a nationally-recognized need to accelerate the replacement of aging pipeline throughout the country's natural gas delivery system. The United States Department of Transportation, the PHMSA, and others have all called for accelerated replacement of vintage pipe and have urged state utility commissions to establish mechanisms that encourage proactive, rather than reactive, replacement of pipeline infrastructure. Pipeline infrastructure cost recovery mechanisms are common and expanding.[49]

29. The circumstances that have prompted other states to take action to promote pipeline safety are equally present in Washington. As both Mr. Henderson and Mr. Lykken testified, there is more work to be done in terms of pipe replacement despite significant efforts over the past decade and despite compliance with minimum state and federal pipeline safety regulations.[50] The documented history of higher safety concerns with older plastic pipe, wrapped steel mains, and wrapped steel services justifies a mechanism that will remove barriers to allow for more rapid replacement of these higher-risk gas facilities.[51]

30. For example, the presence of significant amounts of older, higher-risk polyethylene pipeline in the distribution system presents risks that are difficult to quantify and even more difficult to mitigate without a proactive, enhanced pipeline safety program that exceeds

[49] De Boer, Exh. No. TAD-4T at 5:19 – 6:7.

[50] *See* Henderson, Exh. No. DAH-1T at 3:8 – 9:14, 15:14 – 17:6; Henderson, Tr. 157:25 – 158:6, 164:14 – 165:4, 181:7-14; Lykken, Tr. 247:16-21, 249:18-25, 250:22 – 251:4, 251:17-22, 253:10-19.

[51] De Boer, Exh. No. TAD-4T at 2:10-13.

applicable safety requirements. There have been a number of serious pipeline incidents associated with older plastic pipe materials that have been identified as being susceptible to premature brittle-like cracking. Pipeline operators in states such as Arizona, Illinois, Minnesota, Texas, Iowa, and Missouri have replaced thousands of miles of this pipe.[52]

31. Although there are not a high number of leaks or incidents associated with this pipe,[53] and the pipe can perform satisfactorily in certain environments,[54] incidents across the country demonstrate that there are issues with the pipe that can make it susceptible to problems that are outside of the operator's control.[55] Moreover, as Mr. Henderson testified, the risk associated with older plastic pipe cannot be measured in terms of leak trends, as is the case with steel pipe:

> [T]he manner in which steel leaks present themself [sic] is more along the lines of a small leak that grows over time, whereas plastic pipe doesn't give us necessarily that forewarning so it pushes us more into a take action and replace pipe versus the steel wrap pipe which you have a little more time to plan things out.[56]

When leaks do occur on plastic pipe, they tend to require immediate attention:

> More than 75 percent of the leaks found on plastic pipe require immediate or next day repair . . . . [P]lastic pipe, when it does fail, tends to fail suddenly, and with a higher hazard to the public.[57]

Thus, the positive leak trending that PSE has experienced as a result of its pipeline programs,[58] as documented in its 2010 Continuing Surveillance Annual Report,[59] should be viewed in the

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[52] Lykken, Exh. No. DL-1T at 5:21–6:1.
[53] Lykken, Tr. 253:11-12.
[54] *See id.* at 250:22 – 251:4.
[55] *See id.* at 250:22 – 251:4, 251:17-22.
[56] Henderson, Tr. 157:25 – 158:6; *see also id.* 164:14 –165:4 (noting that the majority of higher grade leaks indicative of plastic pipe failure are not found by leak surveys but reported by the public).
[57] Henderson, Tr. 181:7-14. Significantly, Mr. Lykken likened the risks associated with plastic pipe to the Ford Pinto: "[W]e recognize across the country where there's other people having issues with this pipe that it is susceptible to problems." Lykken, Tr. 251:9-22.
[58] *See* Henderson, Tr. 143:13 – 144:3.
[59] *See* Henderson, Exh. No. DAH-7 at Attach. A.

proper context,[60] particularly when considering the benefit of accelerating replacement of older plastic pipe. As Mr. Henderson testified, reducing the inventory of this higher risk plastic pipe, in general, may be a more important metric than declining leaks.[61] One-twelfth of PSE's natural gas system—or approximately 1000 miles of pipe—is pre-1986 plastic pipe.[62] Currently PSE has identified 100 miles of this pipe as candidates for replacement, and this has been growing by 14 miles per year.[63]

32. Plastic pipe is a growing area of focus for pipeline safety. By way of example, third party damage was the cause of Avista's 2005 pipeline explosion in Spokane, Washington, which injured two people. The natural gas leak that led to the explosion and fire originated at a crack in "Aldyl A" plastic pipe manufactured by Du Pont. The crack apparently resulted from downward deflection of the pipe, which was caused by improper backfilling methods by a third-party during sewer work, resulting in later failure of the pipe. The Commission's safety investigation revealed no violations of federal or state pipeline safety requirements on the part of Avista.[64]

33. As evident from the Avista incident, this legacy plastic pipe can fail despite utilities' compliance with best practices and all applicable safety requirements.[65] There is nothing in the pipeline safety rules that requires complete replacement of this pipe.[66] PSE can make replacements gradually, at a pace that meets pipeline safety standards. But faced with potentially

[60] *See, e.g.*, Henderson, Tr. 145:18 – 146:5 ("[W]e have over 6,000 miles of plastic pipe in the system. If you look at average numbers, it might tend to lead you to a conclusion that the system is performing adequately and no additional work is required, but as we drill down on whether it's vintages or even specific areas we find different numbers.").
[61] *See id.* at 148:2-6.
[62] *See id.* at 160:22 – 161:8.
[63] *Id.* at 173:22 – 174:2.
[64] *See* Lykken, Tr. at 249:10 – 252:22; PG- 052049.
[65] *See id.* at 249–52.
[66] *See* Lykken, Tr. 247:16-21.

decades-long replacement of plastic pipe and wrapped steel mains and services, the point of PSE's PIP proposal is to accelerate pipe replacement, not merely maintain the status quo.[67] The PIP is designed in part to respond to the nationwide concerns that there is a significant amount of older plastic pipe in the ground that is prone to unpredictable failure and that should be identified and replaced before problems arise.[68]

(iii) The Policy Concerns Underlying the Single-Issue Ratemaking Doctrine Are Not Present Here

34. Any concerns regarding single-issue ratemaking and the matching principle are mitigated by the fact that the Commission has recently examined all of PSE's revenues and expenses in a general rate case, is currently examining PSE's revenues and expenses in an ongoing general rate case, and is anticipated to continue regularly examining all of PSE's revenues and expenses in general rate cases for the foreseeable future.[69] Under these circumstances, concerns about single-issue ratemaking do not provide a legitimate reason to oppose the PIP. Approving a regulatory mechanism such as the PIP is well within the Commission's authority to ensure that PSE's service is safe, adequate and efficient and in all respects just and reasonable.

b. The PIP Provides Significant Customer Benefits

35. The proactive pipeline replacement model proposed under the PIP provides significant customer benefits by providing the opportunity to accelerate the replacement of older vintage pipe resulting in a more rapid and efficient pipeline replacement program, improving the safety of the natural gas distribution system, and benefiting customers and the communities in which

[67] *See* De Boer, Exh. No. TAD-4T at 10:16-19.
[68] *See, e.g.*, De Boer, Exh. No. TAD-4T at 10:1-15.
[69] *See e.g., WUTC v. Puget Sound Energy, Inc.*, Docket UE-060266, *et al.*, Order 08 ¶ 51 (January 5, 2007) (allowing for out-of-period adjustments to rate base and noting important considerations are whether there has been a very recent general rate case or a rate case is planned soon after the additions are allowed); Crane, Tr. 259:7-13 (acknowledging PSE's regular general rate cases).

they live. Customers recognize the benefit of accelerated pipeline replacement and increased pipeline safety.[70] Other parties sell short their clients' interests when they measure customer benefits solely in terms of rates paid. The PIP—with its minimal rate increase in exchange for accelerated replacement of vulnerable pipe—offers significant benefits that are important to customers.

36. The proposed program will help PSE improve pipeline reliability, integrity and safety programs by providing for more efficient, accelerated pipe replacement along with timely recovery of the additional investments necessary to implement this expanded and accelerated replacement program. Under the current regulatory framework, pipe replacements are generally limited to those areas presenting the highest risks. With the PIP, PSE can go beyond addressing what must immediately be replaced to meet minimum pipeline safety standards, and can look at what additional pipe should be replaced based on mutually-agreed risk reduction alternatives and resource availability.[71]

37. For example during the PIP review process, stakeholders will discuss whether it makes sense to replace pipe for an entire neighborhood rather than just pipe of the immediate block that has demonstrated a need near-term replacement. Where one area has experienced failure, adjacent segments with similar characteristics could be proactively replaced before they reach the higher risk rating. In addition to enhancing pipeline integrity, this is more economical, providing greater flexibility to coordinate permitting and planning with affected jurisdictions, to minimize neighborhood disruption, and maximize the efficient use of resources—all of which help to control costs. Customers would benefit from not having their neighborhoods repeatedly

[70] *See* Bench Exhibit, Exh. No. BE-1 at 3–5 (public comments).
[71] *See* Henderson, Exh. No. DAH-1T at 14:13-20.

disrupted by piecemeal pipe replacement activities.[72] The end result of this process will be accelerated replacement of pipe and enhanced pipeline safety.

38. Other parties argue that customers will not benefit from the PIP because PSE's system is already safe, and because PSE is obligated by pipeline safety requirements to maintain the safety of its system. They assert that the pipe that is the subject of the PIP (wrapped steel services, wrapped steel mains, and older plastic pipe) will ultimately be replaced regardless of whether or not the PIP is approved.[73] It is correct that, if the PIP is not approved, PSE will continue to invest in pipeline replacement programs at a level supported by PSE's internal budgeting process and will maintain system integrity in compliance with all pipeline safety requirements.[74] Without the PIP, however, it will likely take significantly longer for PSE to replace the pipes identified as strong candidates for future replacement where replacement can be deferred consistent with regulatory requirements.[75]

39. PSE also agrees with other parties that its natural gas distribution system is safe.[76] The Company's overall system performance continues to improve as a result of the existing integrity programs. However, system performance would still benefit from expanding and accelerating pipeline replacement. Like any utility system, PSE's system can always be made saf*er*. Safety is not a single point but a continuum, with the lowest acceptable point set by state and federal

[72] *Id.* at 15:2-10.
[73] *See, e.g.*, Crane, Exh. No. ACC-1T at 9:12-14.
[74] Henderson, Exh. No. DAH-1T at 18:14-17; Henderson, Tr. 170:24-25.
[75] Henderson, Exh. No. DAH-1T at 18:17-19; Henderson, Exh. No. DAH-4T at 3:20 – 4:1; Henderson, Tr. 170:24 – 171:6; De Boer, Exh. No. TAD-4T at 10:16-19.
[76] *See, e.g.*, Henderson, Exh. No. DAH-1T at 15:14-18; Henderson, Tr. 134:9 – 135:2, 169:5–10; De Boer, Exh. No. TAD-4T at 3:8-9.

pipeline safety standards.[77] There is no such thing as absolute safety—all safety issues are based on a relative basis and addressed through risk models.[78]

40. PSE has already gone beyond minimum pipeline safety requirements to ensure the safety and reliability of its pipeline system in a cost-effective and efficient manner.[79] But there is still much work to be done—particularly with respect to plastic pipe—and there are limits to how fast PSE can undertake this work under the current regulatory framework. While PSE's system remains and will always remain within an appropriate band of safety, the Commission can enhance pipeline safety and integrity by approving a mechanism to encourage accelerated replacement of higher risk pipe.[80]

41. Customers will also benefit from the collaborative forum in which PSE can share the findings of its risk evaluation process and receive stakeholder input on the sections of pipe it proposes to replace.[81] This process will provide stakeholders—including customer advocates—an increased opportunity to provide input into pipe replacement decisions. With the PIP, PSE will identify specifically how much more pipe can be replaced in a given year, how much faster it can be replaced, and stakeholders will have a voice in the collaborative effort to identify exactly how much should be spent. In a collaborative setting, the Commission and stakeholders will actually see more cost detail than with PSE's current system.[82] Stakeholders will also have a chance to review the actual expenditures in the following year's true-up filing.[83] Ratepayers are also protected by the $25 million per year cap on the program absent Commission approval for a

[77] *See, e.g.*, Henderson, Tr. 134:9 – 135:2; De Boer, Exh. No. TAD-4T at 3:14 – 4:7.
[78] *See* De Boer, Tr. 87:21 – 88:4; Henderson, Tr. 175:10-15.
[79] *See, e.g.*, Henderson, Tr. 149:17 – 150:7, 153:8-15, 158:18 – 159:12, 171:8-14, 207:1 –208:20.
[80] *See* De Boer, Exh. No. TAD-1T at 4:16 – 5:4; Henderson, Exh. No. DAH-1T at 15:14-18; Henderson, Tr. 169:8–10, 170:24 – 171:6.
[81] De Boer, Exh. No. TAD-1T at 5:6-14.
[82] Henderson, Exh. No. DAH-4T at 5:8-18.
[83] Henderson, Exh. No. DAH-1T at 18:7-8.

higher amount.[84] Finally, having a steady workforce consistently working on pipeline replacement also provides benefits to PSE and its customer base.[85]

42. Given the significant customer benefits that would result from the PIP compared to the cost of achieving these benefits, approving the PIP is appropriate. The revenue increase under the current proposal represents an average of only 0.2 percent increase over customer base rates.[86] For a typical residential customer, this increase is expected to average approximately 16 cents a month.[87] PSE believes that the enhanced pipeline safety resulting from the PIP far outweighs these costs and that customers are willing to pay a few cents more per month to accelerate pipeline replacement for enhanced pipeline safety. The rate that customers pay is not the only way to measure customer benefits.[88]

43. Based on the evidence presented in this proceeding, it is reasonable and appropriate for the Commission to step out of its traditional ratemaking and pipeline safety method of operation and to approve the PIP. Approval of the PIP tariff will provide an opportunity to accelerate pipeline replacement at a pace that reflects stakeholders' mutual risk reduction objectives, benefiting customers by enhancing safety.

B. Intervenors' Other Objections Are Unpersuasive

1. The PIP Does Not Dilute PSE's Pipeline Safety Responsibilities

44. PSE will work with Commission Pipeline Safety Staff to develop subsequent year programs and will discuss the proposal with interested parties prior to each annual filing.[89] While intervenors characterize this lack of specificity as a deficiency, the program was designed

[84] *See id.* at 18:9-11.
[85] *See id.* at 19:16-18.
[86] Story, Exh. No. JHS-1T at 3:13-14.
[87] *Id.* at 8:3-4.
[88] De Boer, Exh. No. TAD-4T at 11:8-12.
[89] Henderson, Exh. No. DAH-1T at 16:5-7, 18:3-7.

to be flexible in developing the scope of the program for the following year. The fact that the collaborative process may lead to a program change does not alter the fact that PSE always has and will continue to be solely responsible for the operation and safety of its system.[90] Collaborative working groups such as the forum proposed under the PIP have historically been effective tools in obtaining stakeholder input into issues such as conservation and pipelines safety.[91]

45. PSE's Conservation Resource Advisory Group ("CRAG") process, for example, has successfully operated for many years.[92] The fact that PSE works with the CRAG to develop its programs has never resulted in PSE being considered less responsible for its electric conservation programs. There is no reason to think the parties will rubber stamp pipeline safety replacement projects under the PIP any more than they rubber stamp pipeline replacement projects and expenditures in current rate cases. Similarly, NW Natural Gas Company has had a comparable stakeholder process to review pipeline safety projects since at least 2001.[93] Formulating the PIP program to be flexible to address safety concerns as they may arise in the future and to incorporate stakeholder concerns in no way dilutes PSE's responsibility for managing its pipeline replacement activities.[94]

2. The PIP Does Not Violate the Used and Useful Doctrine

46. As explained in Mr. Story's testimony,[95] the PIP was designed so that new plant would be added on a monthly basis, based on when the Company plans to replace the old pipe and put

[90] *See* Henderson, Exh. No. DAH-4T at 3:4-16.
[91] *Id.* at 3:9-10; De Boer, Tr. 80:22 – 81:1.
[92] *See* De Boer, Tr. 82:8-24.
[93] *See* Bench Request Response, Exh. No. BR-2 (documents describing the System Integrity Program Approved by the Oregon PUC for NW Natural).
[94] Henderson, Exh. No. DAH-4T at 3:1-16.
[95] Story, Exh. No. JHS-10T at 2:3-9.

the new plant in service. These additions are then averaged using the average of monthly averages to match the rate base additions to the revenues collected during the rate year. The actual amount collected in revenues will be compared to the actual amounts that should have been collected and any differences will be trued up. This approach is consistent with the Commission's practice of approving future costs and rate base additions that are calculated using the average of the monthly average of rate base during the rate year such as new electric production facilities.[96]

47. Moreover, the Commission recently reiterated that it applies a flexible approach to the determination of when plant is used and useful. The Commission considers whether the plant provides benefits to customers, either directly or indirectly.[97] Under the PIP, customers are paying for plant as it goes into service and the plant provides benefits to customers by enhancing the safety and integrity of the pipeline.[98]

3. No Operations and Maintenance Offset or ROE Adjustment Is Necessary or Appropriate

48. As explained in the prefiled direct testimony of Mr. Henderson,[99] the effect of the PIP on operations and maintenance ("O&M") spending will be minimal. While there is likely to be a slight decrease in leak repairs as new pipe replaces old pipe, the O&M costs related to replacing the older pipe offset any decrease in ongoing operations and maintenance costs. In addition, PSE will still be required to perform routine inspections and surveys, such as leak inspections, of the new pipe. Accordingly, no offset for O&M savings is necessary or appropriate—particularly given that the PIP program does not seek accelerated recovery of any O&M expenses related to

[96] *Id.* at 2:10-20.
[97] *Report and Policy Statement Concerning Acquisition of Renewable Res. by Investor Owned Utils.*, Docket UE-100849 ¶¶ 30–31 (Dec. 30, 2010).
[98] Story, Exh. No. JHS-10T at 3:4-6.
[99] Henderson, Exh. No. DAH-1T at 19:3-10.

replacing the older pipe.[100] Moreover, any savings in O&M would be accounted for in the next general rate case.[101]

49. Similarly, while the PIP may mitigate some of the financial harm that otherwise results from accelerating pipe replacement under the current regulatory framework, the PIP does not increase PSE's authorized return on equity.[102] Nor should the Commission adjust PSE's authorized return on equity downward with approval of the PIP. PSE's return on equity is based on analyses of PSE's rate of return in relation to other comparable companies. There are a wide variety of rate adjustment mechanisms in place for electric and natural gas utilities across the country, and many of these mechanisms are already reflected in the rates of return for comparable companies. Given that these comparable companies may have in place a similar tariff, a future test year, or other rate adjustment mechanisms, the Commission should not arbitrarily reduce PSE's return on equity because of the PIP tariff.[103]

50. While it is true that PSE's actual return on equity is estimated to improve very minimally—approximately seven basis points—as a result of the PIP,[104] this stands in contrast to the significant under-earning of its return on equity that PSE has experienced over the past several years. PSE's actual adjusted rate of return, as determined by the Commission in recent general rate case proceedings and taken from the Company's compliance filing in those dockets, is well below the rate of return authorized by the Commission, as shown in the prefiled rebuttal testimony of Mr. Story.[105] This difference in the rate of return earned versus allowed amounts to

[100] *See* Story, Exh. No. JHS-10T at 5:7-12.
[101] Henderson, Exh. No. DAH-1T at 19:8-10.
[102] De Boer, Exh. No. TAD-4T at 11:16-18.
[103] De Boer, Exh. No. TAD-1T at 6:12-19.
[104] *See* Records Requisition Response, Exh. No. RR-1; Story, TR. 225:14-16.
[105] *See* Story, Exh. No. JHS-10T at 5:13-6:5.

millions of dollars.[106] Despite this under-earning, PSE has done the right thing in terms of pipeline safety and integrity. PSE has gone beyond the state and federal requirements in its pipeline safety and integrity programs.[107] PSE has proactively replaced pipe,[108] increased its survey frequency,[109] and identified synergies in the manner in which it replaces mains and services beyond the requirements of its risk model.[110] This proactive approach to pipeline integrity management likely has contributed to PSE's under-earning. The PIP will provide some correction by allowing PSE to increase the pace of this proactive replacement of vulnerable pipe, while at the same time limiting the Company's pernicious under-earning.

4. The Cost of Service Approach Used to Allocate the Costs of the PIP Is Appropriate

51. Distribution main and service line costs included in the PIP were allocated to rate schedules based on the allocated costs of mains and service pipe in the natural gas cost of service study filed by PSE in its most recently completed gas rate case, the 2010 Gas Tariff Increase Filing, Docket No. UG-101644 and the 2009 general rate case, Docket No. UG-090705, as discussed in Mr. Story's testimony.[111] WUTC Staff, Public Counsel and Nucor Steel Seattle, Inc. are all on record as generally supporting the proposed rate spread resulting from the Company's gas cost of service methodology. The only party to object to PSE's proposed gas cost of service methodology in its 2009 general rate case was NWIGU. The rate for special contract customers was set to equal the rate for Schedules 87 and 87T, to ensure that special contract customers do

[106] *Id.*
[107] *See, e.g.*, Henderson, TR. 149:17 – 150:7, 153:8-15, 158:18 – 159:12, 171:8-14, 207:1 – 208:20.
[108] *See id.* at 148:7-12.
[109] *See id.* at 149:4-19.
[110] *See id.* at 151:1 – 153:15.
[111] *See* Story, Exh. No. JHS-10T at 7:9-17.

not pay a higher rate than they would pay if they took service on general tariff schedules.[112] PSE's cost of service methodology is appropriate for allocating PIP costs.[113]

IV. CONCLUSION

52. PSE operates a safe natural gas system and has demonstrated a track history of going beyond the minimum federal and state pipeline safety requirements. The PIP will allow PSE to move the dial even farther on pipeline safety and reliability by accelerating replacement of pipe that is vulnerable to failure—and replacing it more rapidly than what is likely to occur under the traditional ratemaking model. The Commission is authorized to approve this tariff, and doing so is consistent with the calls to action of the U.S. Department of Transportation Secretary and the PHMSA Administrator. The minimal rate increase that customers will experience is far outweighed by the benefits of enhanced safety and reliability. For the reasons set forth above and in the evidence that is before the Commission, PSE respectfully requests that the Commission issue an order approving the PIP tariff.

DATED this 16th day of December, 2011.

Respectfully submitted,

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[112] *Id.* at 6:8 –7:4.