

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,**

**Complainant,**

**v.**

**PUGET SOUND ENERGY, INC.,**

**Respondent.**

**DOCKET UG-110723**

**REPLY BRIEF  
OF COMMISSION STAFF**

**January 6, 2012**

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## I. INTRODUCTION

1 In its Initial Brief, Staff confirmed its shared goal with Puget Sound Energy, Inc. (“PSE” or the “Company”) to enhance pipeline integrity management and safety.<sup>1</sup>

However, Staff recommended that the Commission reject a new surcharge proposed by the Company to achieve that goal because the surcharge:

- would require ratepayers to prepay the costs of pipeline infrastructure that is not “used and useful” to provide them service, in violation of RCW 80.04.250;
- is single issue ratemaking that guarantees accelerated cost recovery for PSE and its owners with no commensurate assurance for ratepayers of enhanced safety through accelerated pipeline replacement;
- is not necessary for PSE to operate a safe and reliable pipeline system PSE asserts already exists and is committed to maintain even without the surcharge;
- is not necessary for PSE to expand its pipeline integrity efforts above minimum levels, as it has done in the past with cost recovery accomplished successfully through general rate cases;
- is not warranted by recent initiatives of the federal government and other states;
- is not necessary for the Commission’s Pipeline Safety Staff to advocate for enhanced pipeline replacement; and
- is tainted by unresolved process issues.

2 The Company offers essentially two arguments in support of the surcharge. Both arguments have already been rebutted by Staff and, therefore, require little response.<sup>2</sup>

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<sup>1</sup> Staff Initial Br. at ¶ 2.

<sup>2</sup> PSE also states that it proposed the new surcharge in collaboration with Pipeline Safety Staff. PSE Initial Br. at ¶¶ 1 and 5. However, no evidence from Mr. Lykken corroborates the Company’s claim. More important, the issue before the Commission is the ratemaking treatment of pipeline replacement costs. That issue is

## II. THE PROPOSED SURCHARGE DOES NOT GUARANTEE ACCELERATED REPLACEMENT OF PIPELINE

3 PSE's main argument is that the new surcharge will allow accelerated replacement of  
pipeline that will benefit the public through enhanced safety. In fact, by our count, the term  
"accelerate", "accelerated" or "accelerating" appears fifty times in PSE's Initial Brief.

4 However, neither the evidence nor the design of the surcharge itself supports the  
Company's claim no matter how many times PSE may assert it. The lack of specificity  
regarding the scope, timing and cost of a pipeline replacement program shows that the  
surcharge does not guarantee that pipe will be replaced any faster than it would be without  
the surcharge.<sup>3</sup> The fact that the surcharge is designed to recover expenditures that are  
already planned without the surcharge shows that no additional mechanism is necessary to  
encourage PSE to make these investments.<sup>4</sup> PSE's claim that an annual consultative process  
with stakeholders will cure these deficiencies is a red flag to the fatal flaws of the proposal.<sup>5</sup>

5 The Company does emphasize a need to replace older Du Pont plastic pipe and  
Commission Pipeline Safety Staff acknowledges heightened concern with those facilities.<sup>6</sup>  
However, it is not entirely clear how urgent and significant a problem is presented by the Du  
Pont pipe. PSE states that it has identified only 100 miles of that pipe out of 12,000 miles of  
plastic system-wide, but that the number is increasing 14 miles per year.<sup>7</sup> Commission  
Pipeline Safety Staff stated that the level of risk from Du Pont plastic is not well defined  
given insufficient historical documentation.<sup>8</sup> The full details of a Spokane incident cited by

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beyond the responsibility and expertise of Pipeline Safety Staff. Therefore, the surcharge could not have  
resulted from any collaboration between PSE and Pipeline Safety Staff.

<sup>3</sup> Staff Initial Br. at ¶ 22.

<sup>4</sup> Staff Initial Br. at ¶ 25.

<sup>5</sup> Staff Initial Br. at ¶ 23.

<sup>6</sup> PSE Initial Br. at ¶¶ 31-33 and 40, and Exhibit DL-1T at 5:12-6:14.

<sup>7</sup> PSE Initial Br. at ¶ 31.

<sup>8</sup> Exhibit DL-1T at 6:20-23.

PSE involving Avista's Du Pont pipe are not found in this record, nor did the Commission issue an order in the relevant docket confirming PSE's full description.<sup>9</sup>

6           The Company has a legal duty to install and maintain facilities as are necessary to provide safe and reliable natural gas service.<sup>10</sup> Consequently, if it is prudent for PSE to meet this obligation by accelerating the replacement of older Du Pont plastic pipe, or any other type of pipe for that matter, then PSE should take that action. It can then seek to recover associated reasonable costs in a general rate case once the dollars are spent and the facilities are placed in service. This is a far better process than the ill-defined surcharge proposed by PSE. It is also the process that has already worked consistently and successfully for prior Company initiatives to enhance its pipeline integrity programs.

**III. COST RECOVERY THROUGH GENERAL RATE CASES DOES NOT DISCOURAGE PSE FROM UNDERTAKING PIPELINE INTEGRITY MEASURES THAT EXCEED MINIMUM STANDARDS**

7           The Company's second argument is that cost recovery through general rate cases "discourages utilities from undertaking capital intensive pipeline safety efforts that exceed the minimum level required by state and federal pipeline safety requirements."<sup>11</sup> PSE's argument is noteworthy only because it refers generally to "utilities" and never to its own experience. That is not surprising given the numerous actions taken already by PSE to expand its pipeline integrity programs beyond minimum requirements, with cost recovery always accomplished successfully through general rate cases.<sup>12</sup> Indeed, PSE admitted that it

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<sup>9</sup> PSE Initial Br. at ¶ 32, citing Mr. Lykken's testimony at Tr. 249:10-252:22 and Docket PG-052049. Mr. Lykken did state that the incident was caused by third party damage to the plastic pipe, so it is unclear whether the incident could have been avoided if another type of pipe had been involved.

<sup>10</sup> RCW 80.28.010(2).

<sup>11</sup> PSE Initial Br. at ¶¶ 16-18.

<sup>12</sup> Staff Initial Br. at ¶¶ 33-36.

has always recovered in general rate cases the cost of accelerated pipeline replacement<sup>13</sup> and that the same result will hold prospectively for prudent expenditures incurred *at and beyond* budgeted levels.<sup>14</sup> Even in its Initial Brief, PSE concedes that it 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.”<sup>15</sup> Internal budgeting processes and competition among other capital programs have not prevented those efforts.

8 PSE argues that it has taken these proactive actions despite “pernicious” under-earning caused by regulatory lag and that the new surcharge will enable pipeline safety enhancements to proceed despite “potential” continued under-earning.<sup>16</sup> However, as PSE admits, whether, why and to what extent it suffers from under-earning are issues properly being addressed in a pending general rate case.<sup>17</sup> Therefore, allegations of under-earning should not be heard in this docket to justify abandoning general rate case procedures that have always allowed PSE to recover the cost of its pipeline integrity programs.

9 Moreover, PSE claims that its actual return on equity will improve only very minimally (7 basis points) if the new surcharge is approved by the Commission.<sup>18</sup> Therefore, it cannot be argued reasonably that rejection of the new surcharge will exacerbate any under-earning, even if PSE’s criticism of general rate case cost recovery had merit. This conclusion is further supported by PSE’s relatively small budget for pipeline replacement

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<sup>13</sup> Exhibit TAD-4T at 8:20-21 and Exhibit TAD-10. This includes significant costs to replace PSE’s cast iron (\$80 million) and bare steel (\$83.5 million) pipeline systems.

<sup>14</sup> Tr. 60:10-13 (DeBoer), Tr. 62:16-18 (DeBoer), Tr. 63:14-22 (DeBoer) and Tr. 65:19-66:10 (DeBoer); Exhibit DAH-5; and Tr. 212:15-213:13 (Story).

<sup>15</sup> PSE Initial Br. at ¶ 40. Such efforts include the proactive replacement of pipe, increased leak survey frequency, and the identification of synergies in the manner in which PSE replaces mains and services beyond the requirements of its risk model. PSE Initial Br. at ¶ 50.

<sup>16</sup> PSE Initial Br. at ¶¶ 25 and 50.

<sup>17</sup> PSE Initial Br. at ¶ 25.

<sup>18</sup> PSE Initial Br. at ¶ 50.

compared to its overall capital expenditure program.<sup>19</sup> It is simply not realistic to conclude that PSE could not accelerate pipeline replacement without the new surcharge.

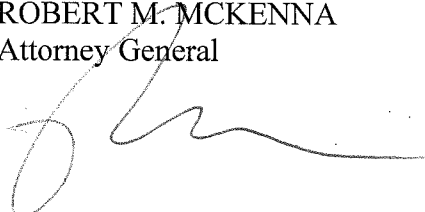
10 In any event, even taking PSE's evidence at face value does not lead one to conclude that the Company suffers from "pernicious" under-earning. PSE's most recent data shows an adjusted overall rate of return of 7.67 percent, not far below its authorized rate of return of 8.10 percent.<sup>20</sup> At the very least, PSE's own evidence calls into question its allegations of under-earning that form the very basis for its theory that the surcharge is necessary because general rate case ratemaking cannot accommodate enhanced pipeline capital expenditures.<sup>21</sup>

11 For these reasons and the reasons addressed by Staff in its Initial Brief, the Commission should reject the new surcharge proposed by the Company in this docket.

DATED this 6<sup>th</sup> day of January 2012.

Respectfully submitted,

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<sup>19</sup> Exhibit TAD-9 at 4.

<sup>20</sup> Exhibit JHS-10T at 6: Table.

<sup>21</sup> Moreover, the Company's current overall authorized rate of return of 8.10 percent is under investigation in the pending general rate case and could be lowered. This further calls into question PSE's claim of under-earning and highlights the general rate case as the appropriate forum to address the Company's claim.