

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND)	
TRANSPORTATION COMMISSION,)	DOCKET UG-110723
)	ORDER 07
Complainant,)	
)	
v.)	FINAL ORDER REJECTING
)	TARIFF AND INITIATING
PUGET SOUND ENERGY, INC.,)	INVESTIGATION
)	
Respondent.)	
.....)	

Synopsis. The Commission remains committed to its long-standing pipeline safety program and to enhancing the safety of the natural gas distribution system of Puget Sound Energy, Inc., as well as the systems of other companies the Commission regulates. Although the record in this proceeding reflects party agreement that PSE’s existing pipeline distribution system is safe, the evidence also demonstrates that a program to accelerate the replacement of some higher risk plastic pipe could enhance public safety. However, the record raises more questions than it answers about the desired scope of such a program. In any event, the Company’s tariff filing to create a Pipeline Integrity Program would not result in an appropriate cost recovery mechanism. The Commission, therefore, rejects the tariff but initiates an investigation to promptly determine the extent to which more needs to be done to decrease the risks associated with older pipe. As part of that investigation, the Commission will examine replacement requirements and cost recovery methods, including properly designed incentive mechanisms, taking into consideration the companies’ financial requirements and the impacts to ratepayers.

BACKGROUND

1 On April 26, 2011, June 29, 2011, and July 14, 2011, Puget Sound Energy, Inc., (PSE or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to the Company’s currently effective Tariff WN U-2,

establishing a Pipeline Integrity Program (PIP). PSE's proposed PIP is a cost recovery method providing for the expedited recovery of the Company's investment in new gas transmission and distribution plant. PSE asserts that its proposal would provide an incentive sufficient to accelerate its current pipeline replacement efforts, thus improving its system reliability, integrity, and safety.

- 2 The proposed tariff would establish a cost recovery mechanism that operates between rate cases to expedite the Company's recovery of capital costs incurred to replace wrapped steel services, wrapped steel mains and certain older polyethylene (PE) pipe. The Company seeks both a return of, and a return on, its investment in this plant:

The costs included in the rate adjustment will be based on actual and forecasted incremental: 1) return on incremental plant, net of accumulated depreciation and applicable deferred federal income tax and 2) depreciation expense on the associated incremental plant. Additionally, the rate adjustment will include a true-up of estimates used in any previous filing to actual costs and loads. The rate adjustment will be updated each year with a November 1 effective date.¹

- 3 The Company's proposed tariff includes an annual cap of \$25 million on PIP total capital expenditures and an October 31, 2016, expiration date for the program. Either limitation could be exceeded only with prior Commission approval.²

- 4 On July 15, 2011, the Commission entered Order 01, suspending the tariff filings and setting the matter over for hearing.

- 5 **Appearances.** Sheree Strom Carson, Perkins Coie LLP, Bellevue, Washington, represents PSE. Simon J. ffitch, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of the Attorney General (Public Counsel). Robert D. Cedarbaum, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff (Commission

¹ Story, Exh. No. JHS-3 at 3.

² *Id.* at 8.

Staff or Staff).³ Chad M. Stokes and Tommy A. Brooks, Cable Huston Benedict Haagensen & Lloyd, Portland, Oregon, represent intervenor Northwest Industrial Gas Users (NWIGU).

- 6 The Commission conducted an evidentiary hearing on November 17, 2011. Each party sponsored one or more witnesses who presented testimony at the hearing. On December 16, 2011, all parties filed opening briefs. The parties filed reply briefs on January 6, 2012.

Pipeline Safety Programs

- 7 Pipeline safety was a Commission priority long before recent actions made it a national issue. The Commission's pipeline safety program was organized in 1955 and has grown in size and expertise. In 2003, under authority delegated by the United States Department of Transportation, Pipeline and Hazardous Materials Safety Administration (PHMSA), the pipeline safety program became the lead inspector for all interstate pipeline inspections and incidents within the state of Washington. As part of the program's safety responsibilities, the Commission's pipeline safety staff conducts regular inspections of pipeline facilities, which includes both visual inspection and physical testing. In addition, staff inspects and audits company records to ensure scheduled maintenance is performed and that operator training and certifications are current.
- 8 Should these inspections identify problems, the Commission works with the companies to identify and correct safety standard violations. When necessary, the Commission takes enforcement action against companies for serious or uncorrected violations.⁴ Such an action against PSE resulted in a Commission-approved

³ In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See* RCW 34.05.455.

⁴ The Commission does not have enforcement authority over interstate pipelines, but makes recommendations to PHMSA in response to inspection findings.

settlement agreement in which the Company, among other commitments, agreed to replace all of its bare steel pipe by the end of 2014.⁵

9 PSE has its own pipeline safety program. PSE's witnesses testified that a company's pipeline integrity management is a comprehensive approach to ensure the physical integrity and safety of its gas distribution system. PSE states that it has historically embraced risk management methodologies and is fully compliant with applicable legal requirements, including those in the federally mandated Distribution Integrity Management Program (DIMP).⁶

10 As part of its program, PSE systematically evaluates its pipeline distribution system in order to identify and address risks to system integrity. The Company mitigates such risks by conducting leak detection surveys that intensify under certain risk scenarios, making repairs, and, if deemed necessary, by replacing any pipe identified as being at highest risk consistent with the standards set forth in its integrity management program. PSE's risk management program and actions taken under it are overseen by the Commission Pipeline Safety Staff, who reviews and makes recommendations to the Company's risk models and mitigation matrices. In addition, the Company provides Staff with periodic updates on the annual replacement plan and progress on replacement efforts.⁷

11 Each year, PSE identifies pipe segments on which to perform an integrity assessment. The Company enters information into its risk model, which calculates a risk score that PSE uses, in conjunction with other information, to determine which facilities are candidates for replacement. Currently, the Company decides through the annual budget process how many of these replacements it can accomplish each year.⁸

PSE PIP Proposal

12 Under the PIP, the amount of pipe to be replaced annually would not be decided through PSE's internal budget process but would be determined through discussions with Staff and other stakeholders. Rather than focusing narrowly on small segments

⁵ *WUTC v. PSE*, Dockets PG-030080 & PG-030128, Order 02 (Jan. 31, 2005).

⁶ Henderson, Exh. No. DAH-1T at 2-4.

⁷ *Id.* at 4-11.

⁸ *Id.* at 12-13.

of pipe with demonstrated failures, PSE contends that (a) the PIP would allow the Company to operate more efficiently by proactively replacing larger segments; (b) replacement funding for pipeline included in the program would not have to compete in PSE's internal budget process for funding with all the other customer and business needs but would be determined by mutually agreed risk reduction objectives and resource availability; and (c) although PSE's natural gas system is safe, the proposed PIP would benefit customers by enhancing safety through proactive pipe replacement.⁹

- 13 PSE proposes that in August of each year PSE would meet with stakeholders and present the planned pipeline replacement for the upcoming year. Stakeholders would have an opportunity to provide comments to the Commission when PSE submits its filing in November and would have a chance to review the Company's actual expenditures in the following year's true-up filing and in the next general rate case when the plant is rolled into general rates. In addition, the program would be subject to an annual \$25 million dollar cap.¹⁰
- 14 PSE testified that its natural gas delivery system is safe, but the PIP is intended to promote a more proactive approach to pipeline integrity management by encouraging increased levels of investment in pipe replacement that will enhance the safety and reliability of PSE's system. According to the Company, the proposed PIP mitigates a major obstacle to managing safety on a system-wide basis by allowing timely recovery of costs PSE incurs to replace wrapped steel service piping, wrapped steel mains, and older polyethylene pipe.¹¹
- 15 If the Commission does not approve the PIP, PSE states that it will continue to operate under its existing integrity management program and budget process, but without the PIP, it will likely take significantly longer for the Company to replace the pipes identified as strong candidates for replacement but where replacement can be deferred.¹²

⁹ *Id.* at 14-16.

¹⁰ *Id.* at 18:3-11.

¹¹ DeBoer, Exh. No. TAD-1T at 2-3.

¹² *Id.* at 18:14-19.

Responses to the PIP Proposal

- 16 Staff, Public Counsel, and NWIGU all oppose the PIP. They argue that the PIP violates RCW 80.04.250 by requiring ratepayers to prepay the costs of pipeline infrastructure that is not “used and useful” to provide service¹³ and that the PIP represents improper single issue ratemaking as the Commission has defined that concept in prior orders in other dockets.
- 17 Staff recognizes the importance of pipeline safety,¹⁴ but because the Company’s gas delivery system is safe, and PSE does not claim it is financially unable to fund pipeline replacement without the PIP, Staff contends the PIP is not necessary for PSE to meet its public service obligation to “furnish and supply such service, instrumentalities and facilities as shall be safe, adequate and efficient, and in all respects just and reasonable.”¹⁵
- 18 Staff also maintains that, if the goal is to enhance pipeline system safety and reliability, the plan should be designed to encourage spending above and beyond investment that has already been planned and budgeted. The Company’s proposal, however, would recover “incremental” pipeline remediation expenditures, defined as the difference between a projected plant balance and the plant balance at the end of the last test year. While this methodology will provide interim recovery of, and return on, investment in pipe remediation, absent a remediation plan Staff does not believe that the PIP would guarantee accelerated pipe replacement.¹⁶
- 19 Public Counsel and NWIGU share Staff’s concerns.¹⁷ Public Counsel’s witness also testified that pipeline replacement under the PIP cannot realistically be isolated from the PSE budget process as the Company contends. Even if it could, Public Counsel states, doing so would adversely impact ratepayers by reducing PSE’s incentive to replace pipe based on identified need and to make prudent choices about other areas

¹³ RCW 80.04.250 allows the Commission to determine for rate making purposes the value of property “used and useful for service in this state.”

¹⁴ Lykken, Exh. No. DL-1T.

¹⁵ Vasconi, Exh. No. MV-1T at 3 & 9-10.

¹⁶ *Id.* at 3-4 & 7-8.

¹⁷ *E.g.*, Crane, Exh. No. ACC-1T at 7-13.

of its business. Public Counsel fears that instead of replacing pipe that has a high likelihood of failure, PSE may be more inclined to replace pipe more broadly and in lower priority categories more rapidly, resulting in unnecessary replacements and higher rates for ratepayers.¹⁸

20 In addition, Public Counsel contends that the Company's proposal would dilute its responsibility for managing its pipeline replacement activities. PSE management, not a group of stakeholders, should determine which plant investments should be included in the replacement program. Public Counsel also believes that PSE has not adequately addressed procedural issues for such a process, including how the Company will respond to stakeholder comments or otherwise handle disputes. Nor has PSE proposed any measurement or performance standards to evaluate the effectiveness of the PIP.¹⁹

DISCUSSION AND DECISION

21 PSE's filing requires the Commission to resolve two major issues: (1) whether replacement of certain types of pipe warrants a separate mechanism for interim recovery of the costs of that replacement; and (2) if so, whether the Company's PIP proposal is an appropriate cost recovery mechanism. We determine that, while the parties agree that PSE's existing pipeline infrastructure is safe, the evidence suggests that enhanced efforts to replace some of the risky pipeline infrastructure would be in the public interest. That evidence, however, is not sufficient to determine the scope of the need for such efforts. On the other hand, the record adequately demonstrates that the PIP is not an appropriate means of addressing that need, regardless of its scope.

22 Accordingly, because the record does not adequately address the range of risks associated with PSE's older PE pipe, we will promptly undertake an investigation in a new docket. This inquiry will examine the scope of risks associated with this PE pipe, the prevalence of such pipe in systems within our regulatory purview, and the remedies available to address any deficiencies revealed by our investigation.

¹⁸ *Id.* at 16-20.

¹⁹ *Id.* at 20-23.

Public Safety

23 First and foremost, the Commission is committed to ensuring that the natural gas distribution systems under our jurisdiction are operated safely and in accordance with state and federal rules, regulations, and other laws. Reflecting this commitment, our Staff regularly inspects and audits Company records, conducts investigations into Company practices and system events, makes recommendations on necessary corrective actions, and is one of but a few states that has been delegated the authority to inspect interstate pipelines and investigate incidents that occur in their operation. Our commitment to safety does not rest with what we have done and are currently doing. Rather, we must also look forward to address potential problems that could increase in magnitude as the pipeline infrastructure ages. We address PSE's proposal against this backdrop.

24 All parties agree that pipeline safety is an important issue. Furthermore, no party disputes PSE's contention that its existing gas distribution system is safe.²⁰ They point out that the highly publicized pipeline tragedies in California and Pennsylvania were disasters in other parts of the country that involved cast iron pipe, a type of pipe that PSE no longer has in its system.²¹ Indeed, compared with much pipeline infrastructure in the eastern United States, pipelines in Washington are quite modern.

25 Nor does any party question PSE's commitment to safety or the Company's ability to address problems as they emerge. To this point, Staff testified that PSE has improved its safety performance and reduced the public's exposure to risks associated with its gas pipeline system.²²

26 PSE nevertheless maintains that more needs to be done. The Company has planned pipeline replacement projects that it contends are necessary to enhance the safety of its system beyond minimum safety levels, but PSE asserts that without a guaranteed source of funding, these projects may not survive the Company's internal budgeting

²⁰ PSE currently is taking the required actions to meet established safety standards. As noted above, the Commission previously ordered PSE to replace all bare steel pipe because of the public safety risk such pipe poses. The Company is in the process of complying with that order and does not propose to include replacement of bare steel pipe in the PIP.

²¹ Henderson, TR. at 167-69.

²² Lykken, Exh. DL-1T at 4:21-22.

process.²³ PSE proposes that the Commission give these and additional pipeline replacement projects more favorable regulatory treatment to induce Company management to approve them.

- 27 Staff, Public Counsel, and NWIGU, on the other hand, argue that the Company is already exceeding state and federal safety standards through its existing pipeline replacement program. According to these parties, PSE requires no further incentive to continue those efforts. Indeed, they assert, the Company produced no evidence to demonstrate that more favorable regulatory treatment will result in any additional pipeline being replaced.
- 28 Both PSE and Staff raise concerns about PSE's pre-1985 PE pipe, which presents the potential for leakage and possible failure. PSE witness Duane Henderson testified to the Company's knowledge of such PE pipe on its system and expressed concerns regarding PSE's existing pipeline replacement program and its ability to satisfy enhanced safety concerns:

PSE has over 1,000 miles of older DuPont polyethylene ("PE") pipe in its system which is the most brittle and most susceptible to failure. PSE has currently identified over 100 miles of this pipe that have documented risks due to previous leak history and/or adverse environmental conditions and that are strong candidates for replacement. PSE continues to identify additional segments that are candidates for replacement, averaging approximately 14 new miles identified for replacement each year. It has taken PSE, with its current pipe replacement program, two years to replace approximately six miles of this pipe. Simple math shows that with PSE's current program, it would take several decades to replace all of the most hazardous type of pipe in PSE's system.²⁴

²³ *E.g.*, Henderson, TR. at 137-38.

²⁴ Henderson, Exh. DAH-4T at 4:11-21.

As Mr. Henderson testified at the hearing, PSE is “filling the bathtub faster than we’re draining it.”²⁵

29 Staff’s pipeline engineering expert also testified with respect to older PE pipe that “[t]he vulnerability of this material to premature cracking represents a serious hazard to public safety.”²⁶ Specific to PSE, however, he noted such older PE pipe constitutes “only a fraction” of its total distribution system, and that PSE’s “good construction practices” have “to a certain extent” minimized the magnitude and frequency of failures associated with this pipe.²⁷

30 Despite the testimony about the fragility of some of PSE’s older PE pipe, the parties agree that such pipe is currently safe and is being managed according to PSE’s integrity management program.²⁸ Based on the record evidence, however, we believe replacement of this pipe deserves further and immediate attention. Therefore, we intend to accelerate the replacement of older PE pipe on PSE’s system. The scope and speed of the replacement program will be dictated by our investigation. Specifically, we need more information on the objectives of PSE’s PE replacement program given its testimony here, which implicates the scope of the problems identified and the expectations of future actions necessary to remediate known and future risks. Our investigation will include these issues and guide decisions regarding the replacement of older PE pipe on PSE’s system and the systems of all natural gas companies under our regulation.

31 Taking further action is consistent with our state policies favoring pipeline safety and is buttressed by the advocacy of the Citizen’s Advisory Committee on Pipeline Safety, which has statutory authority to advise the Commission “on matters relating to

²⁵ Henderson, TR. at 175:6-7. The evidence on the need to accelerate pipeline replacement efforts is focused on the older PE pipe. PSE’s PIP also included so-called wrapped steel mains and services. *E.g.*, Story, Exh. No. JHS-3 at 3. However, the evidence of the need for accelerated replacement of that type of pipe is less robust. *See, e.g.*, Henderson, Exh. No. 4-T at 8.

²⁶ Lykken, Exh. No. DL-1T at 5:20-21; *accord* Lykken, TR. at 250-51.

²⁷ Lykken, Exh. No. DL-1T at 7:1-8

²⁸ Given this agreement, there is no issue before us of whether PSE’s management of the replacement of such pipe is consistent with PSE’s statutory obligation under RCW 80.28.010(2) to provide “safe, adequate and efficient” service. We assume for the purposes of this order that PSE is meeting that obligation with regard to the older PE pipe.

the commission's pipeline safety programs and activities."²⁹ It has encouraged a "consensus approach to spurring investment in replacing vintage pipe."³⁰

Accordingly, we turn to whether PSE's PIP proposal is an appropriate mechanism for addressing this issue.

PSE's PIP Proposal

32 Although we agree that there is a need for some means to accelerate replacement of some risky PE pipe, we find that the PIP would not be an appropriate mechanism for several reasons.

33 First, PSE failed to propose a workable mechanism to determine which pipe replacement projects would be included in the interim recovery program. The Company represents that it would include only pipeline replacement that exceeds minimum safety requirements, but PSE offers no objective basis on which to distinguish between these projects and the pipeline replacements funded through general rates that the Company must undertake to meet minimum safety standards. We cannot approve an auxiliary cost recovery mechanism for infrastructure investment without a reasonable means of identifying the investment it intends to recover. In other words, neither the PIP, nor the evidence produced in support of it, defines with any precision the scope of the pipeline problems it was attempting to resolve.

34 The Company purports to address this issue by proposing a process in which it would develop a list of projects to be funded under the PIP in consultation with stakeholders, after which the list would be provided to the Commission for its approval. This process, however, is nebulous at best, with many details left for future determination, including how to decide the propriety of particular projects, resolution of disputes, and the nature and scope of any Commission approval.³¹ Indeed, there is no assurance that the result would be pipeline replacement above and beyond what PSE normally would undertake pursuant to existing ratemaking standards. Without such assurance,

²⁹ RCW 81.88.140(1).

³⁰ Exh. No. BWE-1 at 5 (Public Comments, Letter from Tim Sweeney, Chair, Citizens Advisory Committee on Pipeline Safety, to UTC Commissioners and Interested Parties (November 22, 2011)).

³¹ *E.g.*, DeBoer, TR. at 78-85 & 99-104.

the PIP poses an unacceptable risk of doing nothing more than inappropriately shifting costs, and risks, from the shareholders to the ratepayers.

35 Second, the PIP's project approval process comes dangerously close to shifting the burden of managerial decisions on pipeline replacement from the Company to Staff or the Commission itself. Neither the Commission nor its Staff has been involved with the Company's infrastructure construction at the level of detail PSE proposes in the PIP.³²

36 It is the Company's obligation to ensure safe and reliable service,³³ which includes the responsibility to construct its gas distribution network according to explicit safety standards. The Commission establishes and enforces standards within which the Company must operate, but PSE alone shoulders the obligation to apply those standards to specific projects and determine which ones should be constructed and when. More specifically, Staff properly limits its current involvement in project selection to evaluating the Company's risk assessment model and determining whether that model is producing results consistent with its design.³⁴ The PIP would impermissibly expand that role and the involvement of the Commission in Company infrastructure management decisions.³⁵

³² PSE's proposed migration of more managerial discretion to the Commission Staff seems based in part on an inability of lower-level management to convince PSE's highest levels of management to "green light" pipeline safety projects that exceed minimum safety standards. PSE's witnesses maintain that such replacement projects must compete for funding with other budgetary priorities within the Company and thus will not, or may not, ultimately be funded. We assume that PSE's upper management funds infrastructure improvements that are necessary to ensure safe operation of the system. To assume otherwise would have us question PSE's commitment to safety, which would be inconsistent with representations made by the parties here. But beyond that, apparently PSE requests that Staff pick up some of the decision-making slack.

³³ RCW 80.28.010(2).

³⁴ Lykken, TR. at 244-45.

³⁵ Commission enforcement actions have resulted in clear direction to PSE regarding construction decisions. We cross that line reluctantly and only when such action is necessary to protect the public interest. We point to our recent order involving the Company's bare steel pipe, in which we ordered PSE to replace all such pipe on its system within a defined period. Even then, we did not dictate which bare steel projects should precede the others. The details of implementation were left to the Company.

- 37 Third, we are also concerned with the PIP’s proposed modification of the “used and useful” statutory requirement for including PSE property in rates. Generally, infrastructure replacement projects are included in rates only after they have been completed and placed into service. The surcharge the Company proposes to recover return on and of its PIP investment is based on a forecast of that investment, before it has been constructed and placed into service, thus becoming “used and useful.”
- 38 We recognize that PSE proposes to use these forecasts as a means of eliminating constant adjustment of rates to account for each pipeline replacement project as it is completed. Frequent adjustments would be administratively complex and likely would result in constant fluctuation in the surcharge amount. Under current practice, however, we avoid such a result by reviewing these investments in a general rate case, which would address investments already placed into service. We believe that in general, such a process best complies with our statutory obligations. We need not reach a conclusion on whether the PIP violates the “used and useful” mandates of Washington law,³⁶ but we observe that this proposed cost recovery mechanism may tread close to the legal line, a situation we would prefer to avoid.
- 39 Fourth, the PIP process is unduly complicated by its use of multiple cost-recovery layers to provide the program’s annual revenue requirement. The forecast layer is based on an estimate of incremental investment for the rate year. It uses an average-of-monthly-averages (AMA) rate base valuation along with an AMA depreciation expense of the forecasted eligible plant additions for the year.³⁷ Incremental plant, as described by the Company, is “new investment in PIP [eligible] 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.”³⁸ The use of an “incremental plant” concept to measure PIP eligible costs, rather than simply tracking plant additions that conform to the intent of the program, creates unnecessary complexity.
- 40 The Company proposal is further complicated by the need for a true-up layer applied following the forecast layer year. The additional true-up layer recovers or refunds the

³⁶ RCW 80.04.250.

³⁷ Story, Exh. No. JHS-3 at 5(A).

³⁸ Story, Exh. No. JHS-1T at 4:3-6.

under-recovery or over-recovery of PIP costs due to differences between forecasted and actual volumes or plant costs.³⁹ Any true-up layer filing will inevitably require additional Commission and stakeholder review and analysis with the potential for disputes.

- 41 Finally, the PIP is potentially confusing to ratepayers. As envisioned, the costs would be recovered through a separate line item on customer bills. The charge would increase as new investments were made but then would be reset to a lower level when the investments are rolled into base rates after the subsequent rate case. The addition of such a “roller coaster” surcharge to their bills threatens to confuse customers who are already distressed by the frequent adjustments to PSE’s rates as a result of frequent rate cases and the application of various tracker mechanisms.
- 42 The PIP as filed, therefore, is not an appropriate cost recovery mechanism for achieving the public policy goal of enhancing pipeline safety. The Commission therefore rejects the PIP tariff as filed.⁴⁰

³⁹ Filed PSE Tariff WN U-2 Original Sheet No. 1134.

⁴⁰ There may be other mechanisms that PSE could consider proposing to facilitate cost recovery during periods of substantial infrastructure investments in its pipeline. In the recently concluded PSE general rate case, we discussed several such mechanisms in Order 08, including two suggested by Commission Staff’s testimony: attrition adjustments and expedited ratemaking process. If the key ratemaking assumption that the test-period relationships will accurately represent relationships in the future fails, cost of service may increase more rapidly than revenues and the rates approved based on test period conditions may not be adequate to achieve the allowed level of return under future conditions. As we recognize in Order 08, high levels of plant additions can result in such earnings attrition, particularly if new plant is more costly than plant being replaced, or more costly than the average cost of plant included in rates. As we state in Order 08:

An attrition adjustment is one among several possible responses the Commission could make to address a demonstrated trend of under earning due to circumstances beyond the Company’s ability to control. This form of adjustment . . . is available today if shown to be a needed response to the challenges posed by PSE’s current intensive capital investment program to replace aging infrastructure.

We also address in Order 08 a proposed process mechanism outlined by Staff, that could help address the particular problems associated with PSE’s current position in a cycle of capital investment that places unusually high demands on it as the Company faces the need to maintain and replace significant amounts of aging infrastructure. A limited rate case proceeding that would allow for a circumscribed update to revenues, expenses, and

43 In his dissent, Commissioner Jones agrees that we should not approve the PSE PIP proposal. However, he indicates that he believes that the record in this case is adequate for the Commission to “craft a mechanism for accelerated cost recovery.” Our differences are more procedural than substantive. We all agree on the importance of pipeline safety, and we concur with Commissioner’s Jones’ praise of the work of the Commission’s pipeline safety staff. And, as we have described above, we agree that our commitment to pipeline safety coupled with the testimony in this case on the risk posed by the older PE pipe supports further action.

44 However, while there may be well be merit in the type of deferred accounting approach Commissioner Jones proposes, we do not believe it is appropriate to “craft” a program without first consulting our own pipeline safety staff, the Company, and the various stakeholders who may be interested. This procedural step should not imply any less of a commitment on our part to the safety of our pipeline infrastructure. Indeed, we believe that our approach will get us safer, sooner. To simply create out of whole cloth an accelerated pipeline replacement mechanism without further vetting of its details among the Company, Staff, and other interested parties could lead to a false start and a program that may not replace the most risky pipe yet could impose substantial cost to the ratepayers. Indeed, although we are confident that any court reviewing our order will give our policy choices broad deference,⁴¹ we are aware that the Administrative Procedure Act (APA) authorizes a court to overturn our decision if it is not based on “substantial evidence” or is “arbitrary or capricious.”⁴² We think it safer to avoid any potential attempt to apply those standards by undertaking some additional vetting of possible mechanisms. This is not letting “perfection be the enemy of the good,” as suggested in the dissent. It is simply ensuring that the perceived “good” is indeed that and that we get this right without any procedural, or legal, pitfalls along the way.

rate base shortly after the conclusion of a full rate case could be resolved on an expedited basis, without a full examination of all the normal complicated issues in a general rate case.

⁴¹ See, e.g., *US West Communications, Inc. v. Washington Utils. & Transp. Comm’n*, 134 Wn.2d 48, 56, 949 P.2d 1321 (1997).

⁴² RCW 34.05.570(3)(e), (h).

Initiation of Commission Investigation

- 45 We are convinced of the need to investigate further the prevalence of older PE and other potentially hazardous pipe, to better understand the longer-term safety concerns raised by the continued use of such pipe, and to take steps that facilitate and encourage more and faster replacement of problematic pipe. However, as this case points out, an adjudicatory proceeding is an awkward process by which to develop what is a legislative proposal.⁴³
- 46 The issue of enhanced pipeline safety highlights the limitations of the adjudicative process as a means of making regulatory policy. PSE proposed its new cost recovery mechanism in the form of a tariff filing, which necessitated suspension and investigation through an adjudication. That process limited Commission review of pipeline safety concerns to consideration of only the Company's proposal through testimony and evidence introduced into the record by the parties. Those concerns, however, are much broader and cannot be explored adequately in this context.
- 47 Accordingly, we deem it better to consider these issues in a new, non-adjudicative docket involving all the local natural gas distribution companies to get a better statewide perspective on the issues.
- 48 We are issuing a notice coincident with this order initiating a new docket under the APA and our rules. Such a proceeding will encompass all regulated natural gas companies, not just PSE, and will allow all interested persons to participate, not just the parties to this proceeding. The Commission, moreover, will be better able to elicit more complete information on the risks associated with older vintage pipe and the appropriate measures for minimizing those risks. The process at this point should be a dialog between the Commission and stakeholders, and an investigation will facilitate such discussion.⁴⁴

⁴³ Our Supreme Court has confirmed that ratemaking is a "legislative in character." *People's Organization for Washington Energy Resources v. Washington Utils. & Transp. Comm'n*, 104 Wn.2d 798, 807, 711 P.2d 319 (1985). However, Washington's Administrative Procedure Act requires that contested rates be set through an adjudicative process. *See* RCW 34.05.010(1) (definition of "adjudicative proceeding" to include "all cases of rate making . . . in which an application for a . . . rate change is denied").

⁴⁴ We are confident that our investigation will determine the scope of known and future risks associated with pre-1985 PE pipe and the general timelines necessary to accomplish specific

49 We emphasize that we do not intend to defer taking needed action on this issue any longer than we must to ensure we are fully informed of the nature of the safety risks and the means to address those risks consistent with the public interest. Accordingly, as part of the notice initiating the new docket, we are proposing topics for inquiry and scheduling deadlines for comment and workshops to address those topics.

FINDINGS OF FACT

50 Having discussed above in detail the evidence received in this proceeding concerning all material matters, and having stated findings and conclusions upon issues in dispute among the parties and the reasons therefore, the Commission now makes and enters the following summary findings of fact, incorporating by reference pertinent portions of the preceding detailed findings:

- 51 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, and accounts of public service companies, including natural gas companies.
- 52 (2) Puget Sound Energy is a “public service company” and a “natural gas company,” as those terms are defined in RCW 80.04.010, and as those terms otherwise are used in Title 80 RCW.
- 53 (3) The record evidence indicates a need for additional investigation into the scope of safety concerns arising from older vintage pipe in Puget Sound Energy’s natural gas distribution and the nature of, and extent to which the Commission should authorize, a mechanism for accelerated replacement of such pipe.

objectives that protect public safety. Depending upon the objectives we deem necessary to remediate identified risks, we expect the parties to propose funding mechanisms that provide sufficient capital to accomplish the tasks we identify. We are also confident that, if needed, there are alternative mechanisms that would avoid some of the drawbacks we find in the PIP. These mechanisms could include a deferred accounting mechanisms (perhaps such as the one suggested in the dissent), surcharge or expense mechanisms, or some incentive structure. Of course, our determinations of risk and cost to remediate will guide any decision on how to finance any replacement program. That said, we believe such determinations must benefit from review by the Company, the Staff, and others. Accordingly, we look forward to early comments on such mechanisms, including the one described in the dissent, in response to the notice we are issuing concurrently with this Order.

- 54 (4) The Pipeline Integrity Program that Puget Sound Energy proposes is not an appropriate cost recovery mechanism for encouraging expedited replacement of potentially hazardous older vintage pipe.
- 55 (5) The record evidence supports further inquiry into whether Puget Sound Energy and other companies subject to the Commission's jurisdiction should do more to enhance the safety of their natural gas distribution systems and, if so, into steps the Commission should take to develop appropriate requirements or incentives to accomplish that goal

CONCLUSIONS OF LAW

- 56 Having discussed above all matters material to this decision, and having stated detailed findings, conclusions, and the reasons therefore, the Commission now makes the following summary conclusions of law incorporating by reference pertinent portions of the preceding detailed conclusions:
- 57 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and parties to, this proceeding.
- 58 (2) The revisions to its currently effective tariff WN U-2 that Puget Sound Energy, Inc., filed on April 26, 2011, June 29, 2011, and July 14, 2011, establishing a Pipeline Integrity Program do not result in rates, terms, and conditions that are fair, just, reasonable, and sufficient and should be rejected.
- 59 (3) The Commission should initiate an investigation to promptly determine whether Puget Sound Energy and other companies subject to the Commission's jurisdiction should do more to enhance the safety of their natural gas distribution systems and, if so, to develop appropriate requirements or incentives to accomplish that goal.

ORDER

THE COMMISSION ORDERS that

- 60 (1) The revisions to its currently effective tariff WN U-2 that Puget Sound Energy, Inc., filed on April 26, 2011, June 29, 2011, and July 14, 2011, establishing a Pipeline Integrity Program are rejected.

- 61 (2) Coincident with this Order, the Commission will initiate an investigation to promptly determine whether Puget Sound Energy and other companies subject to the Commission's jurisdiction should do more to enhance the safety of their natural gas distribution systems and, if so, to develop appropriate requirements or incentives to accomplish that goal.
- 62 (3) The Commission retains jurisdiction to enforce the terms of this Order.

Dated at Olympia, Washington, and effective May 18, 2012.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

JEFFREY D. GOLTZ, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner (concurring in part and dissenting in part):

- 63 I concur with the statement in the majority opinion that pipeline safety is an important priority for the Commission. I also agree that our pipeline safety staff has implemented an excellent program over oversight and inspection working in coordination with federal inspectors. I differ with my colleagues, however, in their conclusion that this record is inadequate and that we need more time to investigate the proper cost recovery mechanism for PSE. I believe that we have an adequate record here, and have had ample time since filing to craft a mechanism for accelerated cost recovery now that meets both the needs of our pipeline safety staff and that of PSE. On balance, I believe that the urgent need for ensuring adequate pipeline safety outweighs the desire to seek a perfect mechanism, and that we should act now, on this record, and allow PSE to implement a capital asset tracking mechanism for recovery of accelerated capital investments.

64 Pipeline safety is one of the paramount responsibilities of the Commission. The Legislature stated the importance of pipeline safety in RCW 81.88.065 and urged us to coordinate our work with the federal government and even to go beyond minimum federal standards, if appropriate. As outlined in the majority opinion, under the direction of PHMSA of the Department of Transportation, our pipeline safety division has been delegated the authority of inspection and oversight of pipelines within our state's borders and has an excellent program in place. However, pipeline safety is not a static concept and cannot be strictly classified on a continuum of "safe" or "safer" or "safest" from an engineering standpoint. New technologies are developed, and PSE and our pipeline safety staff constantly learn from leak surveys, new risk assessment methods, and after-incident analyses of pipe when its integrity is compromised. These factors argue for a more proactive approach with our pipeline safety staff in both risk assessment and the setting of priorities for accelerated pipeline replacement.

65 The record in this case has amply demonstrates the need for an accelerated pipeline replacement program. The Company has proposed appropriate pipeline to be replaced, including older polyethylene (PE) Dupont pipe (pre-1986) and wrapped steel service piping and wrapped steel mains (pre-1972). Much of the testimony during the hearing focused on the older PE pipe, including its brittleness after installation when subject to certain conditions in the ground, but I believe the Company correctly proposes to apply an interim cost recovery mechanism to the replacement of all three types of pipe. Based on the record, including certain testimony from our pipeline safety staff, I believe we should require PSE to start now to accelerate the replacement of these categories of pipeline due to their age and risk of failure. We should not wait further. The Company has identified over 100 miles of just the older PE pipe as "candidates for replacement" according to its current risk assessment methodology yet is annually replacing only 4 miles (over 21,000 feet) at the current schedule. Moreover, the Company admits that more candidate replacement pipeline is being added every year based on new engineering evidence and updates to its risk assessment methods.

66 I agree with the majority opinion that the Company's PIP proposal, as filed, falls short of the mark. As with my colleagues, I want to craft a mechanism that provides adequate protection for consumers as well as providing strict oversight and a certain

sunset for the program. I differ with their reasoning in two respects, however. First, I believe that the capital budget of PSE, as for any utility, is constrained and that management always needs to make trade-offs and priorities. These are hard decisions, and capital is not an infinite commodity: this is both a fact of utility management and financial markets. Hence, it is indeed in the public interest to align the Company's financial interest in accelerated cost recovery and avoiding the effects of regulatory lag, with the Commission's overarching public interest in ensuring pipeline safety. Second, I don't believe that PSE's proposed mechanism violates the used and useful doctrine, especially in light of a host of other mechanisms and capital assets, including early acquisition of a renewable resource or a gas-fired CCCT in advance of need that we have approved in recent rate cases with PSE and other regulated utilities.

67 Instead of a surcharge subject to an annual true-up, I would have approved now a deferred accounting mechanism for PSE based on structure and components outlined in RCW 80.80.060(6), clarified by WAC 480-100-435 and consistent with the deferred accounting treatment that we have authorized for other capital investments and certain expenses. It is a common mechanism that the Commission has used in many other cases, including many with PSE, when we conclude generally that the capital investments or expenses are important to satisfy a certain public interest, but that they should be deferred and considered for inclusion in base rates in a future rate case. Such a deferral mechanism would include operating and maintenance costs, depreciation, taxes, and the cost of invested capital. The deferred costs should be recovered over the life of the pipeline replacement. I would authorize this as a pilot program for three years, subject to thorough review at the end of this period to determine whether the program should continue, with or without modifications, or be eliminated. I would have required the Company to file a detailed plan within 30 days of this Order consistent with the establishment of a deferred accounting mechanism, including a schedule for pipeline replacement over the next 12 months and its plans to update the risk assessment methodology. Furthermore, the Company would commit to a coordinated but rigorous process in which it would consult with our pipeline safety staff on all aspects of this accelerated program.

68 I don't see the need to establish an industry-wide "standard" or "accelerated cost recovery mechanism" that would apply equally to all companies. As we did in decoupling or lost margin recovery mechanism proposals, we concluded that it would

be best to address these issues on a case-by-case basis since the specific issues on the ground differ significantly by company. Such reasoning applies here as well, and I would have preferred a utility-by-utility approach, starting with an appropriate mechanism for PSE.

69 Having said the above, I understand the need of my colleagues for further investigation and deliberation on these issues, and the initiation of a formal Commission investigation across all gas LDCs in our state. I think this non-adjudicatory approach offers certain advantages in terms of a more open process, more flexibility, and the ability to learn best practices of other companies. I will participate fully in these processes. But I sincerely hope that this investigation does not get bogged down in detailed discussions on either the engineering aspects of pipeline safety and replacement program, or on certain legal issues, and that we could include site visits to selected sites for pipeline replacement to give us a sense of what is occurring on the ground. I would have preferred to make a decision now, and then move on to the next phase of oversight. Let us not make perfection the enemy of the good, and instead make the best decision now based on the existing facts. Again, I believe that this record militates for immediate action for a mechanism for PSE. But I accept my colleagues' decision for further study and process, and will work collaboratively toward an optimal final decision.

PHILIP B. JONES, Commissioner

NOTICE TO PARTIES: This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.