

[Service Date August 24, 2012]

August 24, 2012

**NOTICE OF REQUEST FOR PIPELINE REPLACEMENT PLANS**

**(Comments on Plan Requirements due Friday, September 7, 2012;  
Plans due Friday, September 28, 2012)**

**NOTICE OF OPPORTUNITY TO COMMENT ON PROPOSED INTERIM COST  
RECOVERY MECHANISMS**

**(Initial Comments due Friday, September 14, 2012;  
Responses due Friday, September 28, 2012)**

RE: Commission Investigation into the Need to Enhance the Safety of Natural Gas  
Distribution Systems, Docket UG-120715

TO ALL INTERESTED PERSONS:

On May 18, 2012, the Washington Utilities and Transportation Commission (Commission) issued an order in Docket UG-110723 initiating an investigation into whether 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. The Commission received comments from interested parties and conducted workshops on June 21, 2012, and July 1, 2012.

The Commission finds that it needs additional information before taking further action on pipeline integrity issues. Specifically, the Commission requests that (1) the natural gas utilities provide pipeline replacement plans; and (2) interested parties provide additional comment on two mechanisms that Staff has proposed for interim recovery of costs incurred to accelerate replacement of higher risk pipe.

### **Pipeline Replacement Plans**

The initial comments and workshop discussions have enhanced the Commission's understanding of the current state of pipeline replacement efforts, but the information provided to date is insufficient to enable the Commission to fully determine the scope of pipeline integrity issues and company plans for replacement of higher risk pipe. The Commission, therefore, seeks more definitive data on company evaluations of their gas distribution systems and plans to replace potentially problematic pipe.

The Commission prefers to gather this information in this docket, rather than initiate company-specific investigations or other separate proceedings. Accordingly, the Commission requests that Puget Sound Energy, Inc., Avista Utilities, Cascade Natural Gas Company, and Northwest Natural Gas Company each file a plan that details the company's strategy for locating, mapping, and replacing pipe within its system that may pose an elevated risk to pipeline safety. Each plan should include the following sections:

- A. Identification of Pipe of Concern:** Each utility should identify the pipeline segments that it deems desirable to replace because the pipe poses an elevated risk of cracking, leakage, breakage, or other failure. To the extent that the utility cannot, based on information and technology available to it, identify the location of such pipe, it should set forth a plan and timeline within which such location will be identified and explain why the location of all the pipe of concern cannot be identified now. If the utility currently has no such higher-risk pipe in its system, it should so state and explain the basis for that determination.
- B. Scope of Work/Program Rational:** The plan should detail the company's strategy for replacing certain plastic pipe that has been identified as posing an elevated risk of cracking, leakage, breakage, or other failure. The detail should include the expected overall project length, expected replacement schedule, type/vintages of pipe to be replaced, and technical bases (identified threats) for proposed work.
- C. Project Costs Estimates:** The plan should contain a detailed estimate of the costs the company anticipates it would incur under the plan over the next three years should the plan be implemented, along with a total projected cost for replacement all the pipe of concern.
- D. Pipeline Threat Model and Methodology:** The plan should describe a methodology by which the company can itemize, identify and prioritize pipe segments for replacement. The Commission recognizes that additions to and

changes in priority may occur over the course of the project, but it is important that the company develop a methodology to develop such a prioritization. This section would serve as the basis for development of an annual project schedule.

- E. Other Factors:** The plan should detail other factors a company must consider in its development of its plan such as: permitting issues, minimizing service interruptions to customers, scheduling integration with other planned work, weather, and geographic location.
- F. Interim Safety Measures:** The plan should discuss what safety measures are to be taken to minimize risk, if any. Such measures could include increased leak surveys or pressure reductions among others.
- G. Reporting Progress Reports:** The plan should include provisions for providing annual informational reports on the company's pipeline integrity replacement plan. The report would provide progress of replacements reflected by comparisons of target replacement footages to footage completed by year and also as general notice of any addition's or changes in prioritization schedule.

These plans will enable the Commission to determine whether and how to proceed on development of an interim cost recovery mechanism to provide companies with an appropriate incentive to replace higher risk pipe more rapidly. The Commission, therefore, requests that the specified utilities provide their plans by September 28, 2012. If these companies need clarification of the information the Commission is requesting in these plans or have issues with providing that information by the date requested, they should file comments on the plan requirements or an appropriate request with the Commission by September 7, 2012.

### **Interim Cost Recovery Proposals**

Pending receipt and review of utility pipeline replacement plans, the Commission seeks comment on Staff proposals for two methods for interim recovery of pipeline replacement costs. The company pipeline replacement programs addressed by the Staff proposals are limited to replacements that do not produce incremental revenues and that are incurred solely for the purpose of decreasing the risk associated with certain higher-risk gas transmission and distribution pipe.

The Staff's proposals include (1) a capital cost deferral and recovery mechanism, and (2) an interim pipeline replacement cost recovery mechanism. Both methods allow for a deferral and subsequent recovery of certain limited costs associated with a company's

investment in the replacement of higher-risk pipeline. Each proposal is described in detail below.

#### **A. Capital Cost Deferral and Recovery Mechanism (CCDR).**

This proposal would allow a company to recover costs incurred on funds used during an interim period between rate cases for pipeline integrity projects. The Capital Cost Deferral and Recovery Mechanism (CCDR) mechanism would be designed to permit a company to defer its allowed net-of-tax return on eligible replacement projects for later recovery.<sup>1</sup>

**Accounting Treatment:** Beginning on the first day of the calendar year, following the replacement year, a company would begin the deferral of its allowed net-of-tax return associated with eligible pipeline replacement projects. The resulting regulatory asset would be amortized and recovered in rates simultaneously with rates allowed in the first general rate case following the creation of the deferral. The recovery of the deferred amount would be over the remaining life of the associated plant similar to the accounting treatment used for allowance for funds used during construction (AFUDC).

**Cost Tracking (Cost of Service):** Deferrals would be tracked on a project basis and accounted for as a regulatory asset. All other project-related costs flow through in the period incurred. For example, depreciation expense would not be deferred for later recovery but would be recognized in the period service is provided.

**Cost Recovery:** Costs allowed for interim recovery in rates (that is, between rate cases) would include only the net-of-tax capital costs of the funds used in a company's commission-recognized pipeline replacement program. The mechanism would exclude costs related to bare steel replacements along with any period costs such as any incremental changes in operating and maintenance (O&M) expenses. Any decision affecting the prudence of an investment associated with the deferral would result in an adjustment to the balance of the associated regulatory asset and would be decided as an element of the first rate proceeding following the deferral.

**Rate Design:** Proposals for the rate design that allows recovery of the deferred financing would be evaluated in the first full general rate proceeding following the deferral.

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<sup>1</sup> These costs would be based on the capital structure and financing costs approved by the Commission in the company's most recent rate case.

### **B. Interim Pipeline Replacement Cost Recovery Mechanism (IPL-CRM)**

Staff's second proposed cost recovery mechanism would allow a company to recover costs that it incurs due to its pipeline replacement program in the interim periods between rate cases comparable to the method adopted by the Public Utility Commission of Oregon.<sup>2</sup> These costs include incremental O&M costs, income taxes, property taxes, depreciation and related return on investment associated with the pipeline replacement.

**Normalized Investment:** The annualized investment is the cost of pipeline replacement that a company would normally expect to perform during the course of its budget year without the benefit of a recovery mechanism. The mechanism, as proposed, would reduce the total investment in pipeline investment by the amount of normalized investment. For example, if a company normally invests \$3 million in pipeline infrastructure replacement annually, the amount eligible for recovery outside a rate proceeding would be reduced by \$3 million.

**Accounting Treatment:** A company would maintain its accounting records consistent with normal accounting. The mechanism would not provide for deferrals of costs for later recovery but would provide recovery of current costs between general rate proceedings.

Beginning on the first day of a company's purchased gas adjustment mechanism effective date, a company would begin the recovery of the rate year's costs associated with pipeline integrity related capital investment not included in current tariffed rates. Costs eligible for recovery are rate year depreciation and amortization, income taxes, property taxes, and return on investment. Eligible costs would be offset by any associated reduction of incremental O&M costs.

**Cost Tracking (Cost of Service):** Prior to each recovery period a company would develop a cost of service for all pipeline integrity related capital investments that are not recovered in current tariffed rates. Practicalities demand that a portion of the annual costs be based on estimates since the development of a cost of service for the rate period would be constrained by the timing of reasonable effective date for recovery. To the extent that the projected annual costs are different for those embedded in the cost of

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<sup>2</sup> *In the Matter of Northwest Natural's Integrity Program*, Public Util. Comm'n of Oregon Docket No. UM 1406, Order No. 09-067 (March 1, 2009).

service, the company would adjust the subsequent period cost of service to either recover or refund the difference.

**Cost Recovery:** Two months prior to any purchased gas adjustment mechanism effective date a company would file tariffed rates designed to recover the costs reflected in the company's developed cost of service for the rate year.<sup>3</sup> There would be no adjustment for any over (or under) recovery due to differences in actual versus estimate through-put used in developing rates.

**Cap on Amount Deferred:** The annual expenditures on Pipeline Integrity Program Replacement Plan eligible for deferred recovery would be limited to a soft cap of \$XX million. (We seek comment on the amount of such a soft cap.)

**Rate Design:** Recoverable costs would be spread to all customer classes on an equal percent of margin and declining block basis.

## WRITTEN COMMENTS

Comments or requests related to the requested pipeline replacement plans must be filed with the Commission no later than **5:00 p.m., Friday, September 7, 2012**. Pipeline replacement plans must be filed with the Commission no later than **5:00 p.m., Friday, September 28, 2012**. Written comments on the proposed interim pipeline replacement cost recovery mechanisms must be filed with the Commission no later than **5:00 p.m., Friday, September 14, 2012**. Interested persons may file written responses with the Commission no later than **5:00 p.m., Friday, September 28, 2012**. The Commission requests that comments be provided in electronic format to enhance public access, for ease of providing comments, to reduce the need for paper copies, and to facilitate quotations from the comments. You may submit comments via the Commission's Web portal at [www.utc.wa.gov/e-filing](http://www.utc.wa.gov/e-filing) or by electronic mail to the Commission's Records Center at [records@utc.wa.gov](mailto:records@utc.wa.gov). Please include:

- The docket number of this proceeding (UG-120715).
- The commenting party's name.
- The title and date of the comment or comments.

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<sup>3</sup> The rates will be reflected on a new tariff schedule for pipeline integrity replacement program rate adjustment.

An alternative method for submitting comments is by mailing or delivering an electronic copy to the Commission's Records Center on a 3 ½ inch, IBM-formatted, high-density disk, in .pdf Adobe Acrobat format or in Word 97 or later. Include all of the information requested above. The Commission will post on its web site all comments that are provided in electronic format. The website is located at [www.utc.wa.gov/120715](http://www.utc.wa.gov/120715).

If you are unable to file your comments electronically or to submit them on a disk, the Commission will accept a paper document.

If you have questions regarding the pipeline replacement plan or interim cost recovery proposals in this Notice or the Notice itself, you may contact Mark Vasconi, by email at [mvasconi@utc.wa.gov](mailto:mvasconi@utc.wa.gov) or by calling (360) 664-1308.

DAVID W. DANNER  
Executive Director and Secretary