BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. PUGET SOUND ENERGY, Respondent.	DOCKETS UE-230393 & UG-210918 (*Consolidated*)
In the Matter of the Petition of PUGET SOUND ENERGY For an Order Authorizing Deferred Accounting Treatment for Puget Sound Energy's Share of Costs Associated with the Tacoma LNG Facility	

POST-HEARING BRIEF OF COMMISSION STAFF

December 8, 2023

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I. INTRODUCTION

1 In 2016, PSE's board of directors approved a plan to build a dual-use liquefied natural gas (LNG) facility on the Tacoma tide flats. PSE planned to use the facility as a peak shaving resource, providing capacity for PSE's sales customers; an unregulated PSE affiliate, Puget LNG, planned to use the LNG produced by the facility to serve the marine fueling market. PSE and Puget LNG subsequently built the facility, and, seven years and several PSE general rate cases later, PSE now files tariff revisions to recover through a tracker mechanism various costs related to the LNG facility. The company also seeks approval of its proposed cost allocation for the four-mile distribution pipe connecting the LNG facility to its distribution system.

2 Staff makes three recommendations with regard to PSE's filing: (1) adjust the tracker's revenue requirement, (2) reject PSE's proposed allocation of the four-mile pipe and accept Staff's, and (3) order PSE to renegotiate the facility's operating agreement and notify the Commission when it notifies the Puget Sound Clean Air Agency (PSCAA) of air quality permit violations.

3 First, the Commission should make three adjustments to PSE's as-filed revenue requirement request based on bedrock ratemaking principles. Specifically, the Commission should: (1) disallow PSE from recovering the deferred return on its investment in the LNG facility recorded between February 1, 2022, and January 11, 2023, because PSE has not justified the use of this exceptional ratemaking tool; (2) remove a portion of the deferred depreciation expense and return on investment in the facility[1] recorded for the year 2022 because distribution system constraints limited the use and usefulness of the facility during that year; and (3) disallow the incremental costs associated with redesign of the LNG facility's pre-

[1] The disallowance of the return on for 2022 is moot if the Commission accepts Staff's recommendation and disallows all recovery of deferred return.

liquefaction equipment because that redesign was unneeded to serve PSE's natural gas sales customers, and thus the expenses were not prudently incurred on behalf of those customers.

4 Second, the Commission should reject PSE's proposed allocation of the four-mile distribution pipe and adopt Staff's. PSE rooted its allocation of the pipe's costs between Puget LNG and PSE's natural gas sales customers on an improper functionalization of the pipe, skewing the allocation and unfairly benefiting Puget LNG. Staff, on the other hand, applied recognized cost-causation principles to arrive at a fair and proper allocation of the pipe, and it is that allocation that the Commission should embed in rates. After accepting Staff's allocation, the Commission should require PSE to rerun its Rule 6 calculation to determine if the new allocation warrants requiring Puget LNG to make a contribution in aid of construction.

5 Third, Staff recommends that the Commission order PSE to take certain operational steps. Specifically, the Commission should require the company to: (1) renegotiate the contract with the facility's third-party operator to incent compliance with the facility's air quality permit, and (2) copy the Commission whenever it reports permit violations to the PSCAA. While the PSCAA holds primary jurisdiction over the LNG facility's air emissions, the Commission should use whatever tools it can bring to bear to minimize the environmental burdens that can result from the facility's operations.

II. BACKGROUND

A. The Tacoma Tide Flats, the Tacoma LNG facility, and PSE's Distribution System

6 The Tacoma LNG facility sits on the Tacoma tide flats near the mouths of the Blair and Hylebos waterways.[2] It is located on the ancestral homelands of the Puyallup Tribe of Indians

[2] Roberts, Exh. RJR-1T at 2:12-13.

and is "directly adjacent" to the Tribe's reservation lands,[3] meaning that it sits next door to a highly impacted community.[4] More broadly, the areas surrounding the facility bear heavy socio-environmental burdens, scoring highly across a range of categories on the Washington Environmental Health Disparities Map[5] created by the University of Washington's Department of Environmental and Occupational Health Sciences.[6]

7 As relevant here, the facility consists of the equipment necessary to liquefy, store and vaporize LNG.[7] On-site equipment allows the facility to vaporize up to 66,000 dekatherms of stored LNG per day.[8] Because PSE cannot transport natural gas to the facility while vaporizing, it can make an additional 19,000 dekatherms per day available to customers during peak shaving events by diverting otherwise inbound gas.[9] This combination of vaporization and diversion gives PSE up to 85,000 dekatherms of capacity for core customers when it needs to draw on the LNG facility.[10]

8 The site on which PSE and Puget LNG built the LNG facility was isolated from PSE's distribution system. PSE built a four-mile distribution main to address that isolation.[11] Ultimately, PSE determined that it needed a 16-inch diameter main.[12] That decision was driven by PSE's vaporization needs: a 12-inch pipe would have sufficed to transport natural gas to the

[3] Sahu, Exh. RXS-1T at 18:3-5.
[4] RCW 19.405.020; *see* 18 U.S.C. § 1151(23).
[5] *Cf.* RCW 19.405.140.
[6] Sahu, Exh. RXS-1T at 25:3-20; Sahu, Exh. RXS-23.
[7] Erdahl, Exh. BAE-1CT at 5:11-19.
[8] Erdahl, Exh. BAE-1CT at 6:1-6.
[9] Roberts, Exh. RJR-11T at 6:20 – 7:1; *see* Erdahl, Exh. BAE-1CT at 6:4-6.
[10] Erdahl, Exh. BAE-1CT at 6:1-6.
[11] Erdahl, Exh. BAE-1CT at 20:7-8; Donahue, Exh. WFD-1T at 2:15-3:5.
[12] Erdahl, Exh. BAE-1CT at 20:9-12; Donahue, Exh. WFD-1T at 6:5-13.

facility, but a larger pipe was necessary to accommodate the volume when sending gas out from the facility.[13]

9 Bringing the LNG facility fully online required other changes to PSE's distribution system. Specifically, PSE needed to make improvements to the system in order to make full use of the 85,000 dekatherms of capacity offered by the facility.[14] The company once planned to make those upgrades to its Bonney Lake lateral in order to connect a wider customer base to the LNG facility,[15] but ultimately decided against doing so. Instead, PSE upgraded its North Tacoma Gate Station at some point in early 2023, which connected sufficient customers to the facility to make full use of its capacity.[16]

B. The LNG Facility's History at the Commission

10 The LNG facility first appeared as a subject of a Commission docket in UG-151663. There, PSE initially petitioned the Commission for approval of a special contract with a marine shipping company and an allocation of the LNG's facility's costs between PSE's regulated and unregulated operations.[17] In doing so, PSE explained that it saw the facility providing three separate services: (1) marine-LNG fueling services on a regulated basis for one customer under the special contract, (2) marine-LNG and other transportation fueling services for all other customers on an unregulated basis, and (3) peak shaving capacity for regulated customers.[18]

11 Interested parties raised jurisdictional concerns about PSE's proposal to treat marine-fueling services as both a regulated and unregulated service, and the Commission resolved that

[13] Erdahl, Exh. BAE-1CT at 20:9-12; Donahue, Exh. WFD-1T at 6:5-13.
[14] Erdahl, Exh. BAE-1CT at 14:13-19.
[15] Erdahl, Exh. BAE-1CT at 14:15-16.
[16] Erdahl, Exh. BAE-1CT at 15:13-16.
[17] *See generally In re Petition of Puget Sound Energy*, Docket UG-151663, Petition for (i) Approval of a Special Contract for Liquefied Natural Gas Fuel Service with Totem Ocean Trailer Express, Inc. and (ii) a Declaratory Order Approving the Methodology for Allocating Costs Between Regulated and Non-regulated Liquefied Natural Gas Services (Aug. 11, 2015).
[18] *See generally id.*

issue early on in the docket. After briefing, it disclaimed jurisdiction over the special contract, reasoning that

> if PSE is offering LNG as marine fuel as a public service it has an obligation to serve on a non-discriminatory basis, on demand, all marine shippers that request such service. PSE's filing does not establish facts to show that it is holding out to provide LNG service to all customers who are reasonably entitled to service. To the contrary, the facts that PSE has provided show that TOTE will be served under the terms of a unique contract specifically tailored to meet its needs. It appears that no other customers are engaged to take LNG marine fuel service from PSE at this time. Moreover, PSE makes no representations regarding the terms and conditions under which it would serve other customers, whether in tariff or under special contracts. PSE says only that the unsubscribed capacity of the Tacoma LNG facility would be offered to non-TOTE third parties at non-regulated prices. We can only conclude that PSE "offers to serve only particular individuals of its own selection," namely TOTE, rather than offering to serve the public as a class.
>
> Other factors may be considered when determining whether a particular service is a public service, but where it is clear that the service is not being offered generally to the public and, to the contrary, is offered selectively to a single customer, or to select companies the service provider is free to accept or reject, we cannot find that the service is dedicated or devoted to a public use. We determine, therefore, that PSE's service to TOTE as presently proposed is not within the Commission's jurisdiction to regulate.[19]

12 The Commission then allowed the parties to explore alternative business models.[20] One potential model flagged for PSE's consideration involved treating all marine-LNG fuel sales as regulated by the Commission.[21] PSE and the parties, however, ultimately settled on sharing the LNG facility with Puget LNG, a newly formed corporate affiliate.[22] Under that model, PSE would use the facility to provide peak shaving capacity to its core customers, and Puget LNG would use the facility to sell LNG to the marine and other transportation industries.[23] The

[19] *In re Petition of Puget Sound Energy*, Docket UG-151663, Order 04, 15 ¶¶ 27-28 (Dec. 18, 2015).
[20] *Id.* at 16 ¶ 30.
[21] *In re Petition of Puget Sound Energy*, Docket UG-151663, Commission Staff Response Brief, 7 ¶ 13 (May 18, 2016).
[22] *See generally In re Petition of Puget Sound Energy*, Docket UG-151663, Order 10 (Oct. 31, 2016).
[23] *See generally id.*

Commission approved that settlement, and in doing so, it approved allocations of the LNG facility's costs between PSE and Puget LNG intended to assign ownership of facility's component parts, and thus responsibility for their costs, based on usage.[24]

13 With that approval in hand, PSE's board of directors voted to move forward on the project in September, 2016.[25] As construction of the facility neared completion, PSE filed another petition. That one sought approval for "deferred accounting treatment for operation and maintenance expense, depreciation, and PSE's return at its authorized rate of return on its investment in rate base . . . resulting from the operation of PSE's share of the Tacoma LNG facility beginning as of the date of commercial operation of th[e] facility."[26] The petition specifically asked the Commission to defer any ratemaking decision as to these deferred costs.[27] The Commission consolidated that petition with the general rate case that PSE filed in 2022.[28]

14 The parties resolved that rate case (and the consolidated petition seeking an accounting order) through three contested multiparty settlements. The settlement containing the terms governing the ratemaking treatment for the LNG facility, as relevant: (1) stipulated to the approval of PSE's accounting petition; (2) authorized PSE to file tariff pages to recover LNG facility costs through a tracker mechanism; and (3) stipulated to the prudence of PSE's actions from the inception of the project through September 22, 2016.[29]

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[24] *See generally id.* at 27, Table 2, 46-49 ¶¶ 106-14, 61 ¶ 161.
[25] Roberts, Exh. RJR-1T at 5:3-15.
[26] *In re Petition of Puget Sound Energy*, Docket UG-210918, Petition of Puget Sound Energy, 2 ¶ 5 (Nov. 24, 2021).
[27] *Id.* at 3-4 ¶ 8.
[28] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Docket UE-220066, UG-220067 & UG-210918, Order 14, 2 ¶ 4-6 (May 12, 2022).
[29] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-220066, UG-220067 & UG-210918, Order 24/10, Appx. C (Dec. 22, 2022) ("Order 24/10").

15 The Commission approved those settlements, with conditions, over objections from, among others, the Public Counsel Unit of the Attorney General's Office and the Puyallup Tribe of Indians.[30] The Commission conditioned this approval on further consideration of the appropriate allocation for the costs of the four-mile distribution pipe when PSE filed the tracker tariff pages.[31]

C. Permitting the LNG Facility

16 PSE and Puget LNG needed numerous permits to build and operate the facility. These included a Notice of Construction (NOC) air permit from the PSCAA.[32] The NOC, which PSE encountered hiccups in obtaining,[33] imposed certain limits on PSE's use of the LNG facility.[34] These conditions included: (1) limiting PSE's use of the facility's vaporizer to "no more than 240 hours per any 12 consecutive month period,"[35] and (2) limiting PSE, Puget LNG, or any contractor operating the facility, to "produc[ing] and/or process[ing] [no] more than 250,000 gallons of liquefied natural gas per calendar day."[36]

17 PSE has had difficulty complying with the NOC's conditions. It has admitted to producing more than 250,000 gallons of LNG in a calendar day.[37] It has also admitted to receiving roughly two dozen notices of violation from the PSCAA.[38] A number of these violations concerned flare diversion, visible emissions, or problems with the flare

[30] *Id.* at 7-8 ¶ 33.
[31] *Id.* at 120 ¶ 410.
[32] *See* Roberts, Exh. RJR-1T at 27:11-16.
[33] *E.g.*, Roberts, Exh. RJR-1T at 18:3-18.
[34] Erdahl, Exh. BAE-7 at 1-9.
[35] Erdahl, Exh. BAE-7 at 1. The permit also contained numerous other conditions not relevant here.
[36] Erdahl, Exh. BAE-7 at 6.
[37] Erdahl, Exh. BAE-9 at 2(c). PSE contends that it did not violate the condition, and has asked the PSCAA to state that the condition's prohibition on producing more than 250,000 gallons per day does not actually forbid the production of more than 250,000 gallons per day. Roberts, Exh. RJR-11T at 36:1-7.
[38] *E.g.*, Roberts, Exh. RJR-22X.

temperature.[39] These violations resulted in PSE either not destroying toxic air pollutants with the flare (in the case of diversion), or not fully destroying the toxic air pollutants emitted by the facility (in the case of problems with the flare temperature).[40] These violations raise equity concerns because they result in the emission of air pollutants that can cause localized health harms.[41]

D. Redesign

18 At some point after PSE began construction of the LNG facility, it began to see higher percentages of other volatile compounds such as ethane and propane in the gas feedstock arriving at the facility.[42] PSE subsequently redesigned the pre-liquefaction equipment to account for that changing feedstock composition.[43]

III. ARGUMENT

19 As the Commission has noted, the LNG facility is among the more controversial projects PSE has embarked upon.[44] Staff makes three sets of recommendations in an attempt to reach a reasonable resolution of the issues raised by PSE's request to recover the facility's costs through rates. First, the Commission should disallow certain LNG costs based on well-established ratemaking principles. Second, the Commission should reject PSE's proposed allocation of the four-mile distribution main connecting the facility to PSE's system and instead accept Staff's, again based on well-established ratemaking principles. Third, the Commission should require PSE to make certain operational changes to minimize the environmental burdens created by the facility's operation.

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[39] Roberts, Exh. RJR-22X.
[40] Sahu, Exh. RXS-35T at 11:16-13:6.
[41] Sahu, Exh. RXS-1T at 20:4-14, 21:3-31:10.
[42] Erdahl, Exh. BAE-1CT at 17:11-13.
[43] Erdahl, Exh. BAE-1CT at 17:11-13.
[44] Order 24/10 at 114 ¶ 391.

A. The Commission Should Adjust the Tracker's Revenue Requirement to Reflect the Disallowance of Certain Costs

20 The Commission should disallow three separate costs included within the LNG tracker's revenue requirement. The first is the deferred return on PSE's investment in the LNG facility booked between February 1, 2022, and January 11, 2023, which the Commission should disallow because PSE has failed to show that the LNG facility involves the type of exceptional project for which the Commission will allow recovery of deferred return on investment. The second cost consists of a portion of the deferred depreciation expense and return on investment booked for the year 2022, which the Commission should disallow because those amounts are associated with plant that was not used and useful during the year due to constraints in PSE's distribution system. The third is the incremental cost of redesigning the pre-liquefaction equipment, which the Commission should disallow because PSE admits the redesign was not required to serve its regulated customers.

1. The Commission should not authorize PSE's recovery of the deferred return on its investment in the LNG facility recorded between February 1, 2022, and January 11, 2023.

21 The Commission rarely allows utilities to recover deferred return on an investment.[45] It has previously called the recovery of such costs "exceptional," and allowed them only when associated with an "unusual" project.[46] The Commission takes this stance as a matter of policy: recovery of deferred return on property incents the use of frequent accounting petitions to effectively add to rate base outside of a general rate case.[47]

[45] Erdahl, Exh. BAE-1T at 9:21-10:4.
[46] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Dockets UE-140762, UE-140617, UE-131384, UE-140094, Order 08, 104 ¶ 245, 107 ¶ 251 (Mar. 25, 2015).
[47] *Id.* at 104-07 ¶¶ 246-51.

22 The Commission's view of the recovery of deferred return on should cause it to disallow recovery of the deferred return on here. The LNG facility is not an unusual project, at least as far as PSE or its ratepayers are concerned. It is a peak-shaving resource built by PSE to provide capacity that PSE must have in order to satisfy its public service obligations. In that sense, it is no different than any other capacity-providing plant, and not exceptional or unique by any means.

23 PSE, however, urges the Commission to allow it to recover the deferred return on investment based on: (1) consistency with PSE's electric vehicle (EV) investments, or (2) the investment in the LNG facility's effects on PSE's financial condition. Staff addresses each rationale in turn.

a. The Commission's treatment of PSE's investment in EV infrastructure does not justify the use of exceptional ratemaking tools in this case.

24 PSE first urges the Commission to allow it to recover deferred return on based on what it sees as similarities between RCW 80.28.280, which declares the development of marine-LNG fueling stations to be in the public interest, and RCW 80.28.360, which directed the Commission to incent the development of electric vehicle (EV) infrastructure. The Commission should reject that argument, for reasons both legal and factual.

25 Beginning with the legal issues, RCW 80.28.280(1) reads:

> The legislature finds that compressed natural gas and liquefied natural gas offer[] . . . significant potential to reduce vehicle and vessel emissions and to significantly decrease dependence on petroleum-based fuels. The legislature also finds that well-developed and convenient refueling systems are imperative if compressed natural gas and liquefied natural gas are to be widely used by the public. The legislature declares that the development of compressed natural gas and liquefied natural gas motor vehicle refueling stations and vessel refueling facilities are in the public interest. Except as provided in subsection (2) of this section, nothing in this section and RCW 80.28.290is intended to alter the regulatory practices of the commission or allow the subsidization of one ratepayer class by another.

Nothing in RCW 80.28.280 provides any explicit legislative direction to utilities to build marine-LNG fueling stations, and nothing in it directs the Commission to incent the building of those facilities. [48,49] RCW 80.28.280 instead explicitly disclaims any legislative intent to alter the Commission's regulatory practices.[50]

26 RCW 80.28.360(1) reads, as relevant:

> [i]n establishing rates for each electrical company regulated under this title, the Commission may allow an incentive rate of return on investments through December 31, 2030, on capital expenditures for electric vehicle supply equipment that is deployed for the benefit of ratepayers.

The Legislature based this statute on a finding that utilities were "traditionally responsible for understanding and engineering the electrical grid for safety and reliability" and needed to be "fully empowered and incentivized to be engaged in the electrification of [Washington's] transportation system."[51] It enacted RCW 80.28.360 and related statutes to "provide" the "clear policy directive and financial incentives" needed "for electric vehicle infrastructure build out."[52]

27 When applying RCW 80.28.360, the Commission found the Legislature's directives and policy guidance critical. In the order granting the EV accounting petition, the Commission noted that "Staff believe[d] recent legislation supports PSE's requested deferral for return on

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[48] RCW 80.28.290, referenced in RCW 80.28.280, does contain such incentives. reads:

> The commission shall identify barriers to the development of refueling stations for vehicles operating on compressed natural gas, and shall develop policies to remove such barriers. In developing such policies, the commission shall consider providing rate incentives to encourage natural gas companies to invest in the infrastructure required by such refueling stations.

(emphasis added). But, by its plain terms, RCW 80.28.290 does not apply here because the LNG facility does not provide compressed natural gas refueling services.

[49] *See generally* LAWS OF 2014, ch. 216, LAWS OF 1991, ch. 199.

[50] RCW 80.28.280(1) ("[e]xcept as provided in subsection (2) of this section, nothing in this section and RCW 80.28.290 is intended to alter the regulatory practices of the commission.").

[51] LAWS OF 2015, ch. 220, § 1.

[52] *Id*.

capital investments related to its EVSE Portfolio as a unique determination – one that, without explicit direction from the legislature and guidance from the Commission, would not otherwise warrant special consideration for cost recovery."[53] It agreed, stating that "the Company's request to defer the return on its capital investments is unique" and was warranted only by the Legislature's explicit policy guidance and the significant attention given by the Legislature to the issue.[54]

28 Whatever similarities PSE sees in RCW 80.28.280 and .360, the former lacks the critical and "unique" features of the latter that caused the Commission to allow PSE to recover deferred return on its EV infrastructure investments. RCW 80.28.280, unlike RCW 80.28.360, explicitly disclaims any intention of altering the Commission's regulatory practices. And RCW 80.28.280, unlike RCW 80.28.360, did not come with explicit policy directives and financial incentives for building certain kinds of plant. Those differences in the statutory schemes should cause the Commission to decline to consider its application of RCW 80.28.360 in Docket UE-190129 as persuasive in addressing PSE's request to recover the deferred return on here.

29 Turning to the factual reasons for denying PSE's request, PSE has done nothing that would warrant exceptional ratemaking treatment here. As Staff has explained,[55] PSE effectively asks the Commission to authorize *PSE* to recover the deferred return because of the actions of *Puget LNG*. But PSE and Puget LNG, although corporate affiliates owned by the same parent, have separate legal existences.[56] That means that the rights and obligations of

[53] *In re Petition of PSE*, Docket UE-190129, Order 01, 2 ¶ 5 (Aug. 29, 2019).
[54] *Id.* at 3 ¶¶ 9-10.
[55] Erdahl, Exh. BAE-1CT at 11:14-21.
[56] 1 W. Fletcher, Cyclopedia of Law of Private Corporations, § 31, at 514 (Rev. ed. 1999) ("the properties of two corporations are distinct, though the same shareholders own or control both"); *First Nat. City Bank v. Banco Para El Comericio Exterior De Cuba*, 462 U.S. 611, 625, 103 S. Ct. 2591, 77 L. Ed. 2d 46 (1983) ("[s]eparate legal personality has been described as an almost indispensable aspect of the public corporation") (internal quotation omitted).

each belong only to it. Puget LNG built the LNG marine-fueling facility, not PSE, something seen in the cost allocations approved by the Commission in Docket UG-151663.[57] Puget LNG's conduct should not benefit PSE given their separate corporate existences.

30 PSE counters that "[t]he Commission" in Docket UG-151663 "rejected PSE's proposal to effectuate the" Legislature's "public policy directive by offering LNG fueling service to TOTE as a regulated service,"[58] implying that PSE had tried to do what the Legislature suggested with RCW 80.28.280. PSE leaves unsaid that the Commission "rejected" PSE's proposal because it fell outside the Commission's jurisdiction,[59] meaning the Commission would have committed reversible error by granting the petition at issue.[60]

31 But, as PSE notes,[61] the Commission offered the parties to Docket UG-151663 an opportunity to explore other business models to cure the jurisdictional defects present in its proposal.[62] Given the nature of the Commission's jurisdictional decision, one option would have been for PSE to simply offer marine-LNG fueling services on a regulated basis.[63] PSE and its corporate parent, however, instead formed Puget LNG, an unregulated PSE affiliate, to share the LNG facility with.[64] This means that PSE's parent company will reap the benefits of an unregulated business if Puget LNG succeeds. But, as discussed above, it also means that PSE and Puget LNG's conduct cannot be attributed to the other,[65] which necessitates denying PSE's request that it benefit from what Puget LNG did.

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[57] *In re Petition of PSE*, Docket UG-151663, Order 10, at 23-26 ¶¶ 56-60 & Table 1.
[58] Free, Exh. SEF-4T at 11-15.
[59] *In re Petition of Puget Sound Energy*, Docket UG-151663, Order 04, at 15 ¶¶ 27-28.
[60] RCW 34.05.570(3)(b).
[61] Free, Exh. SEF-4T at 6:19-7:3.
[62] *In re Petition of Puget Sound Energy*, Docket UG-151663, Order 04, at 16 ¶ 30.
[63] *In re Petition of Puget Sound Energy*, Docket UG-151663, Commission Staff Response Brief, at 7 ¶ 13.
[64] *In re Petition of PSE*, Docket UG-151663, Order 10, at Appx. A at 4 ¶ 9.
[65] *In re Franklin Str. Realty Corp. v. NYC Env't Control Bd.*, 34 N. Y. 3d 600, 604, 145 N. E. 2d 204 (N.Y. 2019) ("[t]he essential purpose behind corporations and other fictive entities is to give them a separate legal existence from the natural persons who own them and from other legal entities.").

32 PSE offers a number of other criticisms of Staff's contention that the Commission should not allow it to recover the deferred return on based on RCW 80.28.280. None have merit.

33 PSE first implies that Staff misrepresents the standard for a deferral by "purport[ing]" that the Commission "rarely allows a utility to book expenses into a deferral absent a showing of extraordinary circumstances."[66] The Commission frequently expresses the test in this exact way.[67] Regardless, PSE ignores Staff's actual point about which it complains, namely that allowing recovery of deferred return involves use of an exceptional ratemaking tool on top of an extraordinary ratemaking tool.[68] That sentence is, as discussed above, well-supported.

34 PSE next accuses Staff of failing to "acknowledge . . . that the Commission has already allowed PSE to recognize the deferral including the deferred return."[69] True, Staff made no such acknowledgment. But only because that fact is irrelevant. Staff, and every other party to the LNG settlement, stipulated to the recording of LNG facility costs in a deferral.[70] But the initial deferral is not at issue here – PSE's recovery of the deferred amount is.[71] PSE's petition explicitly left open the future ratemaking treatment for the deferred amounts.[72] So did the

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[66] Free, Exh. SEF-4T at 3:11-13 (staff "purports that the Commission rarely allows a utility to book expenses into a deferral absent a showing of extraordinary circumstances").
[67] *E.g.*, *Pac. Power & Light Co.*, Dockets UE-140762 & UE-140617 & UE-131384 & UE-140094, Order 08, at 114, ¶ 273 ("The costs are in no sense 'extraordinary,' a criterion that should apply to a cost deferral accounting mechanism at the time requested and at the time any recovery is sought."); *id.* at 110, ¶ 263 ("The replacement power costs in question do not qualify as extraordinary costs such as might arguably be candidates for deferral accounting."); *Wash. Utils. & Transp. Comm'n v. PacifiCorp d/b/a Pac. Power & Light Co.*, Dockets UE-050684 & UE-050412, Order 04/Order 03, 11-12, ¶¶ 305-06 (Apr. 17, 2006); *In re Petition of Puget Sound Energy*, Docket UE-011600, Order Granting Accounting Petition, 2, ¶ 6 (Dec. 28, 2001).
[68] Erdahl, Exh. BAE-1CT at 9:21-10:3.
[69] Free, Exh. SEF-4T at 3:13-15.
[70] Order 24/10 at Appx. C at 4 ¶ 18.
[71] *E.g.*, Free, Exh. SEF-1T at 2:5-10.
[72] *In re Petition of PSE*, Docket UG-210918, Petition of Puget Sound Energy, at 3 ¶ 8 ("PSE is not requesting that the Commission address . . . the final ratemaking treatment for recovery of PSE's related revenue requirement of the facility or of the deferred requested in this petition.").

settlement, which included the deferred return on as a cost[73] that the parties could challenge in a future proceeding (such as this one).[74] That cannot be surprising to PSE – this is how deferrals have always worked.[75]

35 Relatedly, PSE suggests that, through the LNG settlement, Staff waived any right to challenge the deferred amounts.[76] Again, PSE cannot square that argument with the plain text of the settlement[77] and the order adopting it,[78] which preserved "[a]ll parties . . . rights to challenge LNG costs when PSE files tariff revisions for the tracker."

36 PSE also contends that the Commission has repeatedly allowed utilities to recover deferred return on, citing two sets of cases. The first set quite literally supports the argument that Staff makes here; the second offers PSE no support at all.

37 As PSE notes, the Commission has approved the company's recovery of deferred return on investment in three cases over roughly the last decade. In each of those cases, which addressed, in part, PSE's recovery of deferrals related to its Mint Farm, Lower Snake River, and Wild Horse facilities, the Commission allowed recovery of the deferred return on because the Legislature made special provision for such recovery.[79] Again, Staff recognizes that the

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[73] Order 24/10 at Appx. C at 4 ¶ 18 (listing the return on as a cost in the table showing estimated costs for the deferral).
[74] *Id.* ("[a]ll parties retain all rights to challenge LNG costs when PSE files tariff revisions for the tracker.").
[75] *E.g.*, *Wash. Utils. & Transp. Comm'n v. Avista Utils.*, Dockets UE-090134, UG-090135 & UG-060518, Order 11, (Jan. 6, 2010); *Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Dockets UE-061546 & UE-060817, Order 08 (June 21, 2007); *accord Office of Consumers' Counsel v. Pub. Util. Comm'n*, 6 Ohio St.3d 377, 378-79, 453 N. E. 2d 673 (Ohio 1983); *State ex rel. Office of Pub. Counsel v. Pub. Serv. Comm'n*, 858 S.W.2d 806, 813 (Miss. Ct. App. 1993).
[76] Free, Exh. SEF-1T at 4:10 – 5:4 (noting that Staff settled on terms that authorized the deferral and that the settlement provided that PSE would amortize the deferred costs through the tracker).
[77] Order 24/10 at Appx. C at 4 ¶ 18; *id.* at 114-15 ¶ 393 ("the Settlement allows the parties to review the prudency and reasonableness of costs incurred after" the point at which PSE's board prudently approved the LNG project).
[78] *Id.* at 114-15 ¶ 393 ("the Settlement allows the parties to review the prudency and reasonableness of costs incurred after that point").
[79] Ms. Free's testimony identifies the statute at issues as RCW 80.80.060(d), *see* Free, Exh. SEF-4Tr at 10:1-7, but Staff understands her to mean RCW 80.80.060(6). If PSE's briefing indicates that Staff is incorrect, it will address the issue in reply.

Legislature's specific provision for deferred return on investment authorizes exceptional ratemaking.[80] PSE's problem is that the Legislature has made no such provision that applies here,[81] as discussed above.

38 As PSE also notes, in two other cases the Commission has allowed PSE to treat deferred amounts as if they were eligible for recovery under RCW 80.80.060, even though they were not. It authorized that treatment pursuant to settlements containing terms making them non-precedential.[82] Those orders thus offer PSE no aid here. Even if the Commission did give them some kind of precedential effect, they stand only for the proposition that recovery of deferred return on is appropriate when a full or multiparty settlement provides for that treatment. No such settlement is in place here.

39 Finally, PSE contends that any disallowance of its deferred return on would incent it to pursue other means of satisfying demand, since those other means allow it to recover a return on. PSE offers the wrong comparators. PSE will recover return on the LNG plant for most of its life; it just should not recover it for the deferral period as explained above. Regardless, PSE should always pursue the lowest reasonable cost means for satisfying demand. If it does not, it faces the disallowance of, at the very least, the cost between the lowest reasonable cost alternative and the alternative it selects through a prudence review. The consequences of imprudent action should prevent PSE from choosing an option for providing capacity based on whether it can maximize its return on.

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[80] *E.g.*, *In re Petition of PSE*, Docket UE-190129, Order 01, at 2 ¶ 5.

[81] RCW 80.80.060(6) the statute cited by Ms. Free, applies to electrical facilities, making it irrelevant to PSE's recovery of deferred return on natural gas plant.

[82] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034, Order 08, Appx. B at 36 ¶ 127 (Dec. 5, 2017) ("The Settling Parties agree that this Settlement Agreement does not serve to bind the Commission when it considers any other matter not specifically resolved by this Settlement in future proceedings."); *In re Petition of PSE*, Dockets UE-130583, UE-130617, UE-131099, UE-131230, Order 06, Appx. A at 12 ¶ 29 (Oct. 23, 2013) ("This Settlement may not be cited as precedent in any other proceeding other than a proceeding to enforce the terms of this Settlement.").

b. Nothing about the size of PSE's investment or regulatory lag therefrom warrant the use of exceptional ratemaking tools here.

40 PSE offers a second reason to allow it to recover the deferred return, namely, some combination of: (i) the size of the investment at issue, (ii) the length of time between the plant entering service and PSE's recovery of its costs, and (iii) PSE's deteriorating financial situation. The Commission should reject this basis for recovery of the deferred return on.

41 PSE's argument as to the magnitude of the investment speaks to the question of whether to allow the deferral, not whether to allow recovery of deferred return on. The Commission requires companies to show extraordinary circumstances involving material amounts of money are involved before it will grant a petition for an accounting order. And, as discussed above, the Commission requires a showing of exceptional, indeed, "unique," circumstances to allow the recovery of deferred return on. The Commission has always carefully separated the questions of whether to allow a deferral and whether to allow recovery of deferred amounts, and it should not conflate them here.

42 PSE's argument about the length of time between when it finished the facility and when it went into service fares no better. PSE controls the timing of its rate cases,[83] and it controls whether or not it will settle a rate case once filed. PSE filed its 2022 rate case when it did, and it settled on terms that deferred cost recovery. Given those facts, the company is in no position to complain about regulatory lag. Regardless, any plant can have lag built into cost recovery unless carefully timed with a rate case or a rate plan, making any argument that exceptional circumstances are present here untenable.

[83] *Wash. Utils. & Transp. Comm'n v. Am. Water Res., Inc.*, Docket UW-000405, Final Order Affirming Initial Order, 5 ¶ 25 ("A regulated company that makes a tariff filing exercises considerable control over the proceeding. Relevant information is often within the exclusive control of the regulated entity. Further, the company is able to organize its information prior to filing its request and to choose when to file.").

43 Finally, as to PSE's under-earning, the way PSE couches its argument creates two problems. Initially, PSE is basically urging the Commission to engage in retroactive ratemaking.[84] "In essence, the rule against retroactivity is a cardinal principle of ratemaking: a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle."[85] Any claim that PSE under-earned for 2022, and that the Commission should therefore allow amortization of the deferral, amounts to both a claim that the rates for 2022 were not fair, just, reasonable and sufficient, and a request that the Commission set yet-to-be-in-force rates to make up for those infirmities.

44 Further, even if not an invitation to retroactive ratemaking, PSE's argument, that it has under-earned, constitutes a collateral attack on the final order in PSE's last general rate case as it necessarily implies that the Commission approved insufficient rates. But PSE cannot make that argument because, as a settling party, PSE agreed to those rates, and thus lacks standing to complain about them.

2. The Commission should reduce the deferral amounts booked for 2022 to reflect that the LNG facility's full capacity was not used and useful during 2022.

45 The Commission must "ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state by or during the rate effective period."[86] For purposes of the valuation statute, "'[u]sed is defined as 'employed in accomplishing something'; 'useful' is defined as 'capable of being put to use: having utility: advantageous: producing or having the power to produce good: serviceable for a

[84] The Commission should note that Staff does not argue that authorizing PSE to defer costs or authorizing the recovery of such deferred amounts constitutes retroactive ratemaking. Staff simply argues that PSE is framing its argument for recovery of the deferred amounts in a way that raises retroactivity concerns.
[85] *City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979).
[86] RCW 80.04.250(2).

beneficial end of object.'"[87]

46 As noted above, PSE designed the LNG facility to provide 85,000 dekatherms of gas per day for peak shaving purposes. But PSE's distribution system could not, at first, absorb the full 85,000 dekatherms per day of gas.[88] PSE later eliminated that constraint, seemingly in early 2023, by making upgrades that connected a wider customer base to the LNG facility so that its customer base could make full use of the facility's designed capacity.[89] But until PSE made those upgrades, the Tacoma LNG facility could only supply (via vaporization and diversion) 69,000 dekatherms of usable gas on peak shaving days.[90] That constitutes roughly 81 percent of the total capacity the LNG facility was built to provide.[91]

47 Given those facts, the Commission should adjust the deferral in two ways. First, it should reduce the deferred depreciation expense booked for 2022 by 19 percent to reflect the fact that only 81 percent of the facility's output was useful to customers. Second, if the Commission accepts PSE's arguments concerning its ability to recover the deferred return on its investment (and it should not, as discussed above), the Commission should reduce the deferred return on booked for 2022 by that same 19 percent, again to reflect the constraints on the facility's ability to provide vaporized gas.

48 PSE contends that the LNG facility was used and useful because it could operate at nameplate capacity for all of 2022.[92] It then cites the Commission's determination that "'capacity is, by itself, a used and useful resource for customers'" and contends that this means

[87] *People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n*, 104 Wn.2d 425, 430, 679 P.2d 922 (1984) (quoting Wester's Third New Int'l Dictionary 2524 (1976)).
[88] Erdahl, Exh. BAE-1CT at 14:13-19.
[89] Erdahl, Exh. BAE-1CT at 15:13-16:2.
[90] Erdahl, Exh. BAE-1CT at 14:16-19.
[91] Erdahl, Exh. BAE-1CT at 14:16-19.
[92] RJR-11T at 5:14-19.

that "[a] facility is either used and useful or it is not."[93] There are two main problems with this argument.

49 First, PSE asks the Commission to accept that capacity that customers cannot use can be used and useful for the provision of service to those customers. The Commission should not twist itself into knots performing the mental gymnastics that accepting that premise requires. The capacity-demand mismatch in place in 2022 meant that some 19 percent of the plant was not used and useful. Staff's recommended deferral adjustment reflects that simple reality.

50 Second, PSE's all-or-nothing view of the phrase "used and useful" is incompatible with the relevant law. The valuation statute, for example, provides the Commission with wide latitude for determining the "fair value" of the property "used and useful for service" in Washington."[94] The valuation statute further authorizes the Commission to graduate into rates property that becomes used and useful after the rate-effective date, as happened here when PSE made the distribution system upgrades.[95] And sister states have repeatedly recognized the ability of their public service commissions to embed only the used and useful percentage of a facility in rates.[96] The "fair" value"[97] for 2022 is the portion of the plant's capacity that PSE's customer could use, and the Commission should adjust the deferral to reflect as much.

[93] Free, Exh. SEF-4T at 8:12 (emphasis omitted).
[94] *See* RCW 80.04.250(2).
[95] RCW 80.04.250(3).
[96] *E.g.*, *Illinois Power Co. v. Ill. Comm. Comm'n*, 626 N.E.2d 713, 719, 725 (Ill. App. Ct. 1993), *modified upon denial of rehearing* (Jan. 14, 1994); *State ex rel. Utils. Comm'n v. Carolina Water Serv., Inc. of N.C.*, 401 S.E.2d 353, 355 (N.C. 1991); *Kansas Gas & Elec. Co. v. Kansas Corp. Comm'n*, 720 P.2d 1063, 1082-87 (Kansas 1986); *Citizens of Fla. v. Fla. Pub. Serv. Comm'n*, 488 So.2d 112 Fla. (Dist. Ct. App. 1986).
[97] RCW 80.04.250(2).

3. The Commission should disallow the incremental costs associated with the redesign of the LNG facility's pre-liquefaction equipment because the redesign was not needed to serve customers other than Puget LNG and was thus imprudent.

51 Regulated utilities bear the burden of demonstrating the prudence of their investments.[98] The Commission evaluates the prudence of a utility action by looking to whether "a reasonable board of directors and company management" would have made the decision at issue "given what they knew or reasonably should have known to be true at the time" of the decision.[99] This reasonableness test generally looks at four points: (1) the need for the project, (2) the evaluation of alternatives, (3) the involvement of the board or management and the communications of those entities with the utility's staff, and (4) contemporaneous documentation of the decision-making process.[100]

52 The needs of PSE's sales customers did not drive the redesign of the liquefaction train, and PSE has frankly admitted as much. During discovery, Staff asked the company "[i]f the facility were being used only for liquefaction and LNG storage later to be vaporized to meet peak-shaving needs, would" the redesign "have been necessary?"[101] PSE answered with "[n]o."[102]

53 That succinct answer recognizes that the redesign was driven by the requirements of Puget LNG's customers. A contract between Puget LNG and one of its customers requires the company to supply LNG with minimum composition limits.[103] The changing composition of

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[98] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order 12, 33 ¶ 94 (Sept. 1, 2016).
[99] *Id.* at 33 ¶ 94 (internal quotation omitted).
[100] *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-111048 & UG-111049, Order 08, 148 ¶ 409 (May 7, 2012).
[101] Erdahl, Exh. BAE-5.
[102] Erdahl, Exh. BAE-5.
[103] Erdahl, Exh. BAE-1CT at 1:23-18:2.

gas risked breach of the contract,[104] and the liquefaction train redesign was intended to prevent that breach.[105]

54 Accordingly, the Commission should find that the incremental costs associated with the redesign of the pre-liquefaction equipment were imprudently incurred. Any prudence analysis looks first to the need for the plant or expense at issue. The redesign was, for customers of PSE's service, unneeded.[106] Given the imprudent incurrence of the costs, the Commission should disallow their recovery.

55 PSE argues that Staff is precluded from raising the issue of the redesigned pre-liquefaction equipment because the Commission addressed the issue in Order 24.[107] But in Dockets UE-220066, UG-220067 and UG-210918, only the question of whether the Commission should approve the settlements resolving PSE's GRC was before it. As discussed above, the question of PSE's cost recovery was deferred to a later proceeding.[108] The statements about the redesigned flare in Order 24 are thus definitionally obiter dicta[109] that the Commission may "respect[]," but which "ought not to control the judgment in [this] subsequent suit, when the very point" of PSE's cost recovery "is presented for decision" on a fully fleshed out record.[110] The reason for that rule is simple: parties may not contest an issue not before a tribunal because they wish to contest the issue at the appropriate time. That is exactly the position Staff found itself in during the GRC and now finds itself in here. The Commission should adjudicate the issue on the full record presented by all parties.

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[104] Erdahl, Exh. BAE-1CT at 17:20-18:6.
[105] *See* Erdahl, Exh. BAE-5.
[106] *See People's Org. for Wash. Energy Res. v. Wash. Utils. & Transp. Comm'n*, 104 Wn.2d 798, 810, 711 P.2d 319 (1985).
[107] Free, Exh. SEF-4T at 13:14-14:1; Roberts, Exh. RJR-11T at 30:1-5.
[108] Order 24/10 at Appx. C at 4 ¶ 18.
[109] Black's Law Dictionary (11th ed. 2019) (defining dictum).
[110] *Williams v. U.S.*, 289 U.S. 553, 568, 53 S. Ct. 751, 77 L. Ed. 2d 1372 (1933).

B. The Commission Should Reject PSE's Allocation of the Four-Mile Distribution Pipe as Divorced From Apportionment Principles and Instead Accept Staff's Allocation

56 The Commission uses its informed discretion and the generally accepted three-step process used to determine customers' share of plant costs.[111] Under that process, plant is first categorized based on the broad function it serves. In the second step, the functionalized plant is classified based on whether it varies according to things like the amount of customer demand or the number of customers. The classified plant is then either directly assigned to a specific customer or class or allocated among multiple customers classes based on appropriate factors.

57 Here, Staff recommends allocating 70.4 percent of the $27.4 million in rate base related to the four-mile distribution pipeline to Puget LNG, with the remaining 29.6 percent of the cost allocated to the relevant PSE customers. This results in allocating $19.29 million to Puget LNG and $8.11 million to PSE. The allocation of this rate base is used to determine how much of the $3 million in revenue requirement related to the four-mile pipe should be paid for by PSE sales customers versus Puget LNG.

58 Staff arrived at this allocation based on two things: the direct assignment of costs directly assignable to one class of customers and also the use of the facility by PSE and Puget LNG.

59 Staff first directly assigned the cost difference between 12- and 16-inch pipes to customers other than Puget LNG.[112] Puget LNG does not use gas vaporized at the facility, and the need to deliver high volumes of vaporized gas required the use of a 16-inch pipe rather than

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[111] WAC 480-85-060; *e.g., Wash. Utils. & Transp. Comm'n v. Puget Sound Power & Light Co.*, Cause No. U-85-53, 1986 Wash. UTC Lexis 37, 74 P.U.R.4th 536 (May 16, 1986) ("[e]ach cost of service study has three steps: 1) Functionalization of plant and expenses between production, transmission, and distribution plant; 2) Classification among demand, energy, and customer categories; and 3) Allocation between classes").
[112] Erdahl, Exh. BAE-1CT at 24:8-13.

a 12-inch one that would have sufficed for Puget LNG's needs.[113] Accordingly, the Commission should allocate the cost difference between a 12-inch and a 16-inch pipe, $4.1 million, directly to the non-Puget LNG customers.[114]

60 Staff then allocated shared costs based on usage. In this regard, the permit restrictions imposed by the PSCAA have a significant effect.[115] Staff assumed that PSE would use the pipe to transport out from the facility the maximum amount allowed under the permit, 660,000 dekatherms per year.[116] Staff then added that amount to the total amount liquefied on non-vaporization days, or 7,597,000 dekatherms per year, resulting in a total flow of gas in and out of the facility of 8,257,000 dekatherms.[117] Given those numbers, Staff allocated 92 percent of the cost of the 12-inch pipe to customers using the pipe to transport gas to the facility and 8 percent to the customers using the pipe to transport gas out of the facility.[118]

61 In allocating the costs of the pipe to customers using it to transport gas to the LNG facility, Staff applied the capital cost allocations that the Commission approved in Docket UG-151663, which represent the customers' usage of the liquefaction equipment.[119] Those allocations provide for a 90/10 split of costs between Puget LNG and PSE, respectively.[120] Staff accordingly, allocated 90 percent of the inbound pipeline costs to Puget LNG, and 10 percent to PSE.[121] This resulted in a rate base allocation of $19.29 million to Puget LNG and $2.14 million to PSE.[122]

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[113] Erdahl, Exh. BAE-1CT at 24:8-13.
[114] Erdahl, Exh. BAE-1CT at 24:8-10.
[115] Erdahl, Exh. BAE-1CT at 23:9-18.
[116] Erdahl, Exh. BAE-1CT at 24:14-16.
[117] Erdahl, Exh. BAE-1CT at 24:17-21.
[118] Erdahl, Exh. BAE-1CT at 25:1-5.
[119] Erdahl, Exh. BAE-1CT at 25:6-12.
[120] Erdahl, Exh. BAE-1CT at 25:9-12.
[121] Erdahl, Exh. BAE-1CT at 25:9-12.
[122] Erdahl, Exh. BAE-1CT at 25:9-12.

62 In allocating the costs of the pipe to customers using it to transport gas from the facility the calculation is much simpler. Puget LNG does not use the pipe for that purpose so the costs may be allocated solely to PSE's natural gas sales customers.[123] This resulted in allocating $1.86 million in costs to those customers.[124]

63 PSE urges the Commission to reject Staff's allocation based on several contentions. None should sway the Commission.

64 First, PSE argues that Staff has inappropriately skipped the functionalization step of cost allocation.[125] That argument might have force if there were some dispute as to whether the pipe at issue is distribution pipe. But every party here agrees this is distribution pipe.[126] And, for the record, the Commission has also characterized it as such.[127]

65 Relatedly, PSE contends that Staff's failure to properly functionalize the pipe introduced an error into its allocation because the pipe should be functionalized separately for each direction of flow, and that this error propagates down through Staff's cost allocation.[128] But utility property is functionalized based on broad categories such as production, transmission, distribution or storage.[129] PSE, for example, cites the functionalization of the

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[123] Donahue, Exh. WFD-5T at 5:20-6:2.
[124] Erdahl, Exh. BAE-1CT at 25:16-18.
[125] Erdahl, Exh. BAE-1CT at 25:16-18.
[126] E.g., Order 24/10 at 119 ¶ 407 (PSE's witnesses referring to the pipe as distribution pipe); Donahue, WFD-1T at 2:15-3:9; Erdahl, Exh. BAE-1CT at 19:7-20:15. There is similarly no dispute about the proper classification of this pipe. By rule, distribution pipe is classified on a demand basis. WAC 480-85-060 Table 4.
[127] *E.g.*, Order 24/10 at 120 ¶ 410.
[128] Donahue, Exh. WFD-5T at 6:5-12.
[129] *E.g.*, *N. Ind. Public Service Co. v. FERC*, 782 F.2d 730 (7th Cir. 1986) ("[c]ost functionalization consists of separating the pipeline's cost by the major functions performed by the pipeline system: production and gathering, storage, and transmission."); *in re Application of the Potomac Edison Co.*, Case No. 9490, 2019 WL 1380402 at *48 (Md. P.S.C. Mar. 22, 2019) ("[f]unctionalization is the process of assigning utility revenue requirements to specified utility functions, such as production, transmission, distribution, customer, and general."); *in re DPUC Review of Nat. Gas Cos. Cost of Serv. Study Methodologies*, No. 990328, 2000 WL 1341275 (Con.. D.P.U.C. Aug. 9, 2000) ("[t]he new COSS standard will consist of four categories: (1) Functionalization (production, storage, balancing, distribution, and on-site"); *in re E. Nat. Gas Co.*, Case No. 95-488-GA-AIR, 1996 Wl 130786 (Ohio P.U.C. Mar. 1, 1996) ("[i]n functionalization, Applicant assigns plant and associated investment to the

Jackson Prairie storage facility in its last rate case, which shows as much: the facility was allocated broadly on the basis of its storage and system balancing functions, then classified and allocated to PSE's customers accordingly.[130] PSE's subdivision of the pipe here into two categories of distribution is inconsistent with this general principle and the Commission's application of it in recent cases. It is also inconsistent with the fact that, at root, this pipe serves a single purpose: it distributes gas.

66 PSE's subdivision, in fact, improperly conflates functionalization and allocation, with downstream consequences for PSE's ultimate allocation of the pipeline. The "functions" that PSE argues the pipeline was intended to serve are actually proxies for customer usage: flow to the facility stands in for Puget LNG's use of the pipe and flow from the facility stands in for PSE's other customers' use of the pipe. By "functionalizing" in the manner that it did, PSE artificially allocated the pipe on an equal basis between PSE and Puget LNG, then further allocated those shares based on other factors during the allocation step. The resulting allocation

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functional areas (production, etc.) on the basis of the federal energy regulatory commission plant accounts."; *In re Foothills Water Co.*, Docket No. 91-2010-01, 1992 Wl 501201 (Utah Pub. Serv. Comm'n Nov. 30, 1992) ("[i]n the traditional regulatory literature (Bonbright, NARUC Cost Allocation Manual) costs are treated in a three-step process: functionalization, classification, and allocation. Functionalization is the assignment of costs into the functional categories of production, transmission, or distribution."); *In re Interstate Natural Gas Pipeline Rate Design*, Docket No. PL-91-2-000, 1991 WL 11261669 (F.E.R.C. July 22, 1991) ("[i]n the first step ('functionalization'), the pipeline's costs are divided between its major operations or functions, such as transmission, production, and storage."); *In re Colonial Gas Co.*, D.P.U 86-27-A, 1988 WL 391471 (Mass. D.P.U. Feb. 11, 1988) ("[t]he first task is functionalization, or the grouping of costs by function. In this task, costs are defined as being related to the production, transmission, or distribution function of providing service."); *In re Application of Dickens Elec. Coop., Inc.*, Docket No. 7556, 1987 WL 470349 (Tex. P.U.C. Nov. 30, 1987) ("[t]he cost of service studies performed by DEC and staff both followed the traditional development: 1. Functionalization of costs according to their major function (transmission, distribution, customer, and general support."); *Pa. Public Util. Comm'n v. Duquesne Light Co.*, No. R-842583 (Pa. P.U.C. Jan 25, 1985) ("[f]unctionalization is the separation of plant and costs into the major functions such as power production, transmission or distribution."); *In re Southwest Gas Corp.*, Docket Nos. 82-398, 82-480, 1982 WL 994862 at *24 (Nev. P.S.C. Nov. 24, 1982) (""functionalization is a process whereby investment, revenue, and expenses are assigned to an appropriate operating function. The major functions are production, storage, transmission, and distribution."); *In re Wisc. Mich. Power Co.*, Docket No. E-7026, 31 F.P.C. 1445, 1452, 1964 WL 81056 (Fed. Power Comm'n June 9, 1964) ("[f]unctionalization is the grouping of plant and related costs according to functions they perform as, *e.g.*, generation, transmission, and distribution.").

[130] Taylor, Exh. JDT-8T at 12:16-13:5.

is divorced from the kind of actual use and benefit that is supposed to drive cost allocation, and the Commission should reject it.

67 PSE also maintains that Staff failed to follow the Commission's guidance because it did not directly assign costs to PSE. The costs at issue, the costs of a 16-inch pipeline, less the difference between 16- and 12-inch pipelines, used by both PSE's sales customers and Puget LNG, cannot be directly assigned because they are shared.[131]

68 Further, PSE contends that Staff's theory of allocation would produce unreasonable results in some cases, specifically offering as an example a main-extension used by an industrial customer. Staff's allocation methodology applies in cases like the one present here, where multiple users share a distribution main on a zero-sum basis and a permitting agency limits the use of one of them. In those cases, it is reasonable for any allocation to recognize the zero-sum nature of the pipe's use and the permit restrictions. The case PSE offers would involve the direct assignment of all costs of the main to a single customer that does not share the pipe with anyone. It is not comparable to the situation here, and PSE's argument does not show that Staff's methodology produces unreasonable results.

69 Finally, PSE argues that Staff's allocation ignores the flow of boil off gas. But PSE acknowledges that the need to deal with boil off gas in no way acted as a cost causer. It is, accordingly, irrelevant to the allocation of costs.

70 If the Commission accepts Staff's allocation, and it should, it should also require PSE to rerun its Rule 6 calculation to determine whether Puget LNG must make a contribution in aid of construction.[132]

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[131] *See Wash. Utils. & Transp. Comm'n v. Cascade Nat. Gas Corp.*, Cause No. U-86-100, 1987 Wash. UTC Lexis 99 (May 20, 1987) ("joint and common costs, by definition, cannot be traced directly to specific customers and customer classes").

[132] Erdahl, Exh. BAE-1CT at 26:11-28:3.

71 PSE contends that the Commission should not require a rerun of the Rule 6 calculation because any comparison of incremental costs and revenues should be done once, and when the "incremental facilities are . . . first needed for the provision of utility service." That argument is baffling. The four-mile pipeline has been only provisionally included in PSE's rate base. This is the first proceeding where the Commission is making a determinative decision about the incremental costs incurred to serve Puget LNG, and it will make that determination based on the allocation of the costs of the four-mile pipe.

72 PSE also argues that Staff's recommendation that PSE refund the provisionally collected rates confuses revenue requirement amounts with rate base amounts. Staff's allocation of rate base determines how much of the $3 million in revenue requirement related to the four-mile pipe should be collected from PSE sales customers versus Puget LNG. Staff's response to Bench Request 6 provides the supporting calculation and documentation of allocation of the revenue requirement. Staff's allocation of rate base results in $2 million of the $3 million revenue requirement being assigned to Puget LNG. Additionally, since the four-mile pipe rates are provisional, it stands that Puget LNG should provide PSE sales customers with a refund.

C. The Commission Should Require PSE to Seek to Renegotiate its Contracts with the Operator of the LNG Facility and Copy the Commission When it Reports Permit Violations to the PSCAA to Allow for Meaningful Oversight of PSE's Operations at the LNG Facility

73 The Commission is, as it has often put it, primarily an economic regulator. But pursuant to a legislative delegation of authority, the Commission must regulate, in the public interest, persons or entities providing utility service within the state of Washington. The "public interest" encompasses "environmental health and greenhouse gas reductions, health and safety

concerns, . . . and equity."[133]

74 Since the LNG facility went into operation, PSE has committed a number of violations of the facility's air quality permit, incurring no less than $46,000 in penalties. Some of these violations relate to releasing toxic air pollutants from the facility without treatment through bypassing the flare; others to release of partially treated toxic air pollutants due to the flare operating at less than full efficiency. But all of them involve the release of toxic air pollutants into an overburdened air shed. These releases affect nearby communities that already bear heavy socio-environmental burdens.

75 To address concerns about the possibility of future permit violations, the Commission should take two steps. First, it should direct PSE to renegotiate its contract with the facility's third party operator to "assign[] greater weight to the environmental factor component" of the contract's incentive provision or to add a provision carrying greater penalties for future violations.[134] Second, the Commission should require PSE to audit the facility's performance monthly and copy the Commission whenever it reports permit violations.[135] This will ensure the Commission has the information necessary to evaluate whether PSE has acted prudently with regard to the operation of the facility, and to take action if the Commission determines that it has not.

IV. CONCLUSION

76 The Commission should disallow PSE's recovery of the return on, the 2022 deferral amounts, and the incremental costs of the flare redesign for the reasons discussed above. It should also adopt Staff's proposed allocation for the four-mile pipe and require PSE to

[133] RCW 80.28.425(1).
[134] Erdahl, Exh. BAE-1CT at 32:6-13.
[135] Erdahl, Exh. BAE-1CT at 32:2-5.

renegotiate the contract for operating the LNG facility and to notify it when it alerts the PSCAA to any air permit violations.

RESPECTFULLY SUBMITTED this 8th day of December, 2023.

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