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September 14, 2012

Mr. David W. Danner
Executive Director and Secretary
Washington Utilities and Transportation Commission
1300 South Evergreen Park Drive S.W.
P.O. Box 47250
Olympia, WA 98504-7250

Subject: Docket No. UG-120715
Commission Investigation into the Need to Enhance the Safety of Natural Gas Distribution Systems
Comments of Puget Sound Energy, Inc.

Dear Mr. Danner:

In Response to the Commission's Notice of Opportunity to Comment on Proposed Interim Cost Recovery mechanisms, dated August 24, 2012 in Docket UG-120715, Puget Sound Energy, Inc ("PSE" or the "company") offers the following comments.

Commission Staff has proposed two alternative cost recovery mechanisms that would be used to address the Pipeline Replacement Program Plans that are to be filed with the Commission by September 28th. PSE has also included its proposed Pipeline Replacement Plan that will address the two areas of higher risk pipe on PSE's system under both a current scenario and a future scenario with an appropriate accelerated recovery mechanism.

A. Capital Cost Deferral and Recovery Mechanism (CCDR)

Under Staff's proposal the CCDR mechanism would permit a company to defer its allowed net of tax return on eligible replacement projects for recovery at some later date. This mechanism as proposed is severely flawed for two major reasons: 1) it provides no actual

cash flow associated with the increased level of spending; and 2) it ignores the majority of the incremental costs associated with pipe replacement projects, such as, the increase in depreciation expense and property taxes¹ associated with the higher valued assets. Recovery of rate of return would still be dependent on the approval of the balances in a general rate case (“GRC”). From a financial accounting perspective the recognition of the deferral of the allowed net of tax return would be limited to the interest component of the rate of return and therefore provides limited financial reporting benefit to a utility. The equity component is allowed to be recorded for financial reporting purpose only if the amount is included in customer rates. Without recovery of the underlying assets and with limited earnings impact this mechanism is overly restrictive and of little value in assisting a company to expand its pipeline replacement programs.

The Company is unclear why Staff has recommended to exclude depreciation expense and property taxes from this proposal. If Staff’s assumption is that these expenses would remain unchanged, that is simply an incorrect assumption.

Additionally, it is unclear from Staff’s proposal whether the CCDR mechanism would include all pipeline integrity projects, or merely those above and beyond a “normalized amount.” Again, it appears that this CCDR mechanism falls short of providing *any* incentive to accelerate the utilities’ pipe replacement plans beyond what is currently in place to maintain minimum requirements for safe and dependable service.

B. Interim Pipeline Replacement Cost Recovery mechanism (IPL-CRM)

Staff’s second mechanism provides a more realistic cost recovery mechanism that could expedite further investment in pipeline replacement. The general description states that the mechanism would be comparable to the method adopted by the Public Utility Commission of Oregon in Order No. 09-067 and includes the incremental O&M costs, income taxes, property taxes, depreciation and related return on investment associated with the pipeline replacement above a normalized level (“Oregon Mechanism”). In general, PSE believes the Oregon Mechanism could provide the necessary cost recovery to accelerate replacement of higher risk pipes, beyond the existing levels currently occurring to provide safe and dependable service, providing there is clarification as to how the various elements of the Oregon Mechanism would be implemented.

For example, the mechanics of the mechanism should be based on a simple cost-of-service calculation. A simple calculation such as the one shown in Attachment 1, should be adopted to ensure that the calculations are transparent, easily calculated and understood by all parties. This would facilitate Staff and potential intervening parties’ review of the materials

¹ If property tax recovery is moved to a rider as proposed by the Commission in PSE’s 2011 GRC this element of cost could be removed from a pipeline replacement mechanism.

and would provide consistency between the utility filings. The revenue requirement calculation should include the annual depreciation expense, property taxes and income taxes associated with the program investment and the program should also allow the opportunity to recover program specific incremental O&M expenses that improve the overall system safety that are not currently included in the Company's rates. For example, PSE's proposed new pipeline replacement plan includes expenses to aid in the identification of sewer cross bores, a limited program that has been tried only on a pilot basis, but should this type of recovery mechanism be adopted, could be expanded significantly. The return on investment calculation should be based on a simple calculation of the incremental pipeline investment, after excluding the normalized baseline investment level, net of accumulated depreciation and deferred taxes as demonstrated in Attachment 1.

If required, PSE believes that the "normalized investment level" should be based on the spending level in a company's most recently approved GRC for the higher risk pipe being replaced, for example, the baseline level of replacement associated with pre-1986 DuPont pipe.

Regarding the proposed accounting treatment, PSE agrees with including investments above the normalized investment (as clarified above) however, it believes that incremental O&M expenses should be allowed for recovery within the mechanism. The Oregon Mechanism includes incremental O&M to the extent the program specific O&M is above the baseline level currently recovered in rates. PSE believes a similar approach should be adopted in Washington. Some pipeline replacement programs, such as a sewer cross bore replacement program, may have significant costs associated with them that would not be eligible for capitalization. PSE believes the Commission should not limit the mechanism outright, but rather like the normalized investment, determine the "normalized O&M" from the company's last GRC for the specific replacement program. Once the normalized O&M level was determined, program-specific O&M that exceeds the normalized level would be included in the recovery mechanism.

PSE agrees that Staff's approach of truing up only the investment dollars is reasonable and will streamline both the development and review of the annual filing.

PSE believes that the mechanism's soft cap on program expenditures should be utility specific. The cap should be based on both the level of higher risk replacement necessary as well as the utility's customer rather than a one-size fits all approach. The gas utilities in Washington vary widely in terms of number of customers and levels of higher risk pipe. PSE believes the Commission should consider both the customer base and the utilities' service territory characteristics to minimize rate impacts for the customers, while still

addressing the level of higher risk pipe needing replacement. For a utility the size of PSE, an annual soft cap of \$35 million would be a reasonable starting point.

From a rate-design standpoint, PSE agrees that Staff's approach of spreading recoverable costs on an equal percent of margin is likely the most streamlined approach to rate design. PSE would recommend that the rate be calculated on a per customer/month basis rather than on a volumetric basis. A per month charge will spread the costs evenly between the customer rate class and would provide a consistent, predictable bill impact throughout the year.

One area that Staff's proposal does not address, however, was an issue in PSE's PIP filing, is minimizing customers' confusion. In UG-110723, the Commission questioned whether the costs being recovered through a separate line item on customer bills could be potentially confusing to ratepayers. Additionally, the Commission expressed concern about the amount of the charge increasing as new investments were made but then being reset to a lower level when the investments were rolled into base rates after a subsequent rate case. To address such concerns, PSE recommends that the IPL-CRM costs be reflected as a separate line item on the bill that would not be reset during a general rate case. Similar to costs associated with PGA, in a general rate case the costs would be kept separate, and the revenue requirement associated with the IPL-CRM would be excluded from any revenue requirement deficiency used to calculate base rates. The purpose of retaining the IPL-CRM dollars separately would be to maintain the transparency of the costs associated with the Pipeline replacement program. The proposed approach would provide the added benefit that customers would easily see the charges they were paying just for the enhanced safety programs. PSE appreciates the opportunity to present its viewpoint on these issues and looks forward to further discussions on this topic. Please direct any questions regarding these comments to Kathie Barnard at (425) 462-3716 or the undersigned at (425) 462-3495.

Sincerely,

/s/ Tom DeBoer

Tom DeBoer
Director – Federal & State Regulatory Affairs