

**EXHIBIT NO. ___(MM-4C)
DOCKETS UE-17___/UG-17___
2017 PSE GENERAL RATE CASE
WITNESS: MICHAEL MULLALLY**

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,**

Complainant,

v.

PUGET SOUND ENERGY,

Respondent.

**Docket UE-17___
Docket UE-17___**

**THIRD EXHIBIT (CONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF**

MICHAEL MULLALLY

ON BEHALF OF PUGET SOUND ENERGY

**REDACTED
VERSION**

JANUARY 13, 2017

Buckley Natural Gas System RFP Overview

Michael Mullally

Financial Planning and Strategic Initiatives

May 16, 2013



City of Buckley Overview

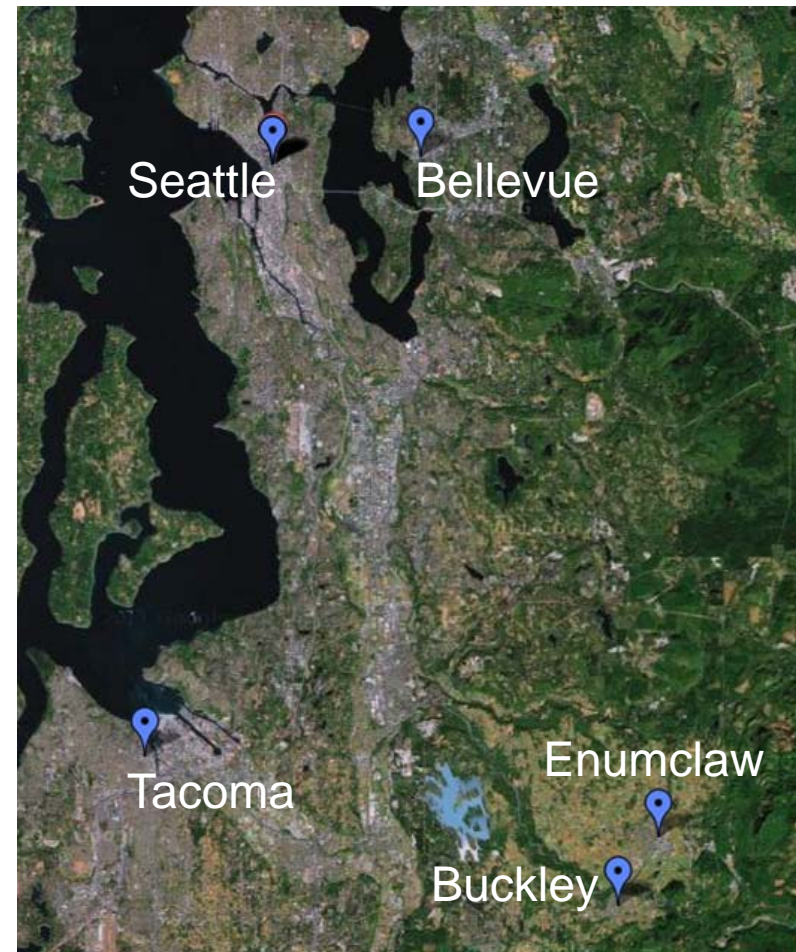
City of Buckley

- Located in East Pierce County
 - PSE serves electric customers
- 4,145 residents
- Budgetary issues led to shrinking staff and also gas system RFP (Jan 2013)

Natural Gas System

- Gas brought to City in 1957
- ~1,400 customers
 - No growth since 2008
 - PSE growth in same period = 0.8% / year
- 1.8MM Therms used annually
 - Residential consumption: 585 Therms / year (75% of PSE average)
 - 46% consumed by one customer

| | |
|------------------------------|-------|
| Total miles of main | 36.73 |
| Wrapped steel main | 23.90 |
| Polyethylene main | 12.83 |
| Number of service lines | 1,401 |
| Number of gate stations | 1 |
| Number of regulator stations | 3 |



PSE Due Diligence Team

| | |
|--|---|
| Due diligence team lead | •Michael Mullally |
| Financial analysis | •Bob Williams |
| Legal | •Sam Osborne |
| Customer experience | •Liz Norton |
| Community relations | •Gary Nomensen |
| Corporate communications | •Julia Hughes |
| Gas supply and transportation | •Bill Donahue |
| Human resources | •Susan Berry |
| Insurance | •John Chao |
| Gas engineering, operations, and integrity | •Harry Shapiro, Paul Riley, Duane Henderson, Larry Anderson |
| Rates and accounting | •Kathie Barnard, Mike Stranik, Eric Englart |
| Real estate | •Kurt Krebs |
| Project coordination | •Sheri Maynard |
| Environmental | •John Rork |

Team Deliverables

- Proforma analysis
- Due diligence findings
- EMC report and presentation
- Bid package

PSE Due Diligence Team Objectives

- Determine City of Buckley gas system condition
 - Review City documentation
 - Review WUTC reports
 - Interview gas system employees and contractors
 - Visually inspect system

- Present diligence findings and recommendation to management
 - Technical, real estate, environmental, gas supply, etc.
 - Financial proforma composition
 - EMC report and presentation

- Participate in Request for Proposal
 - Submit bid package
 - If bid selected, work with City to transition customers, system, documents, and potentially personnel

Preliminary Findings

REDACTED VERSION

Qualitative

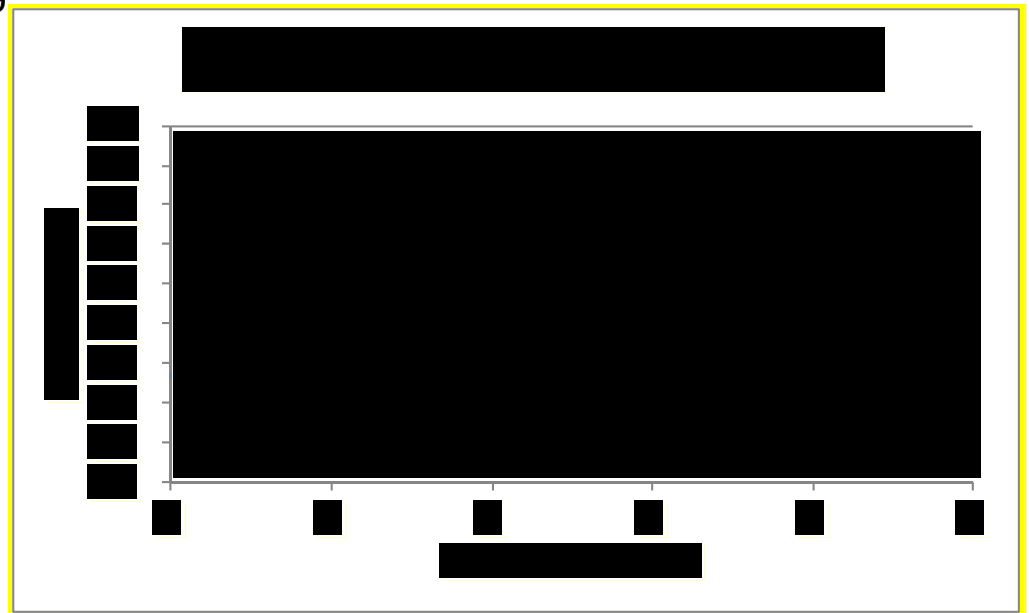
- No fatal flaws uncovered based on non-intrusive inspections
- System condition on par with PSE's
- Few initial upgrades recommended
 - SCADA, RTU, Meters
- Gas supply out-of-market hedge expires October 31, 2013; remaining contract can be assumed or terminated
 - No material impact to portfolio costs
- Northwest pipeline contract assumable and adequate
- Reasonable transport through Enumclaw

Quantitative

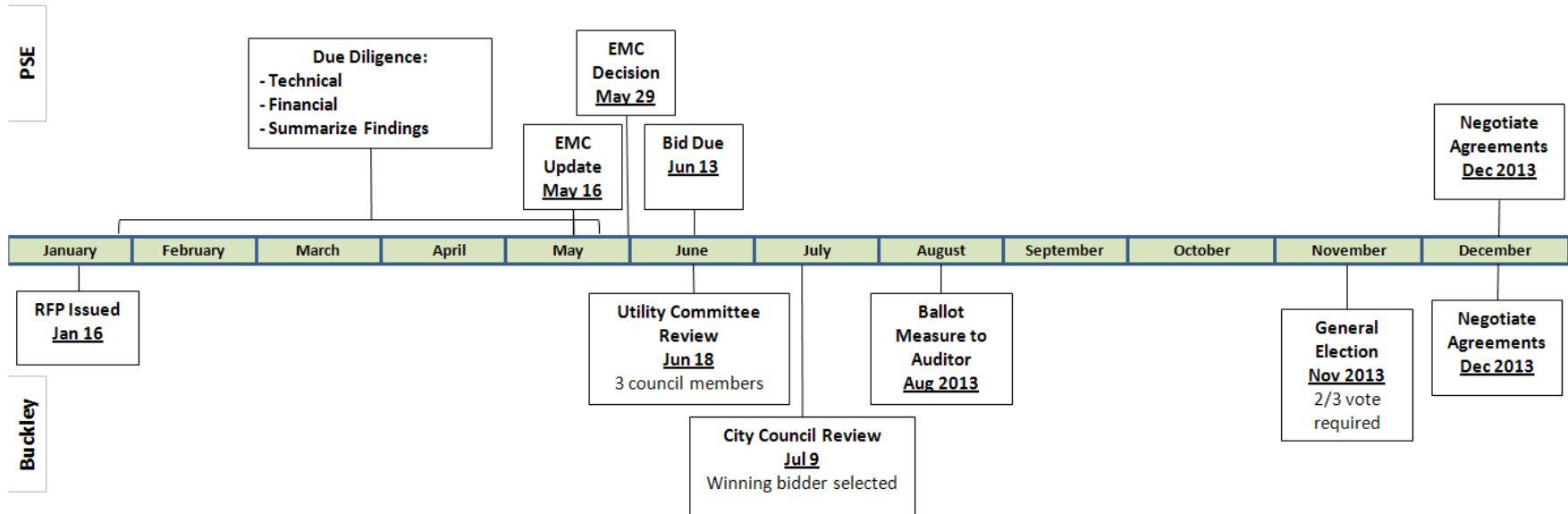
- O&M estimates based on PSE average distribution costs; ~\$100k / year

Quantitative Continued

- One time conversion charges: ~\$250k
- Revenue projections based on PSE rates and Buckley usage data
- Discounted Cash Flow analysis points to bid price between \$5 – 6 million for payback in 20 – 30 years



Next Steps



- Finalize and then summarize diligence findings
- Formulate recommendation for May 29, 2013 EMC
- Submit bid package on June 13, 2013

Appendix

Buckley Acquisition Cost Estimate

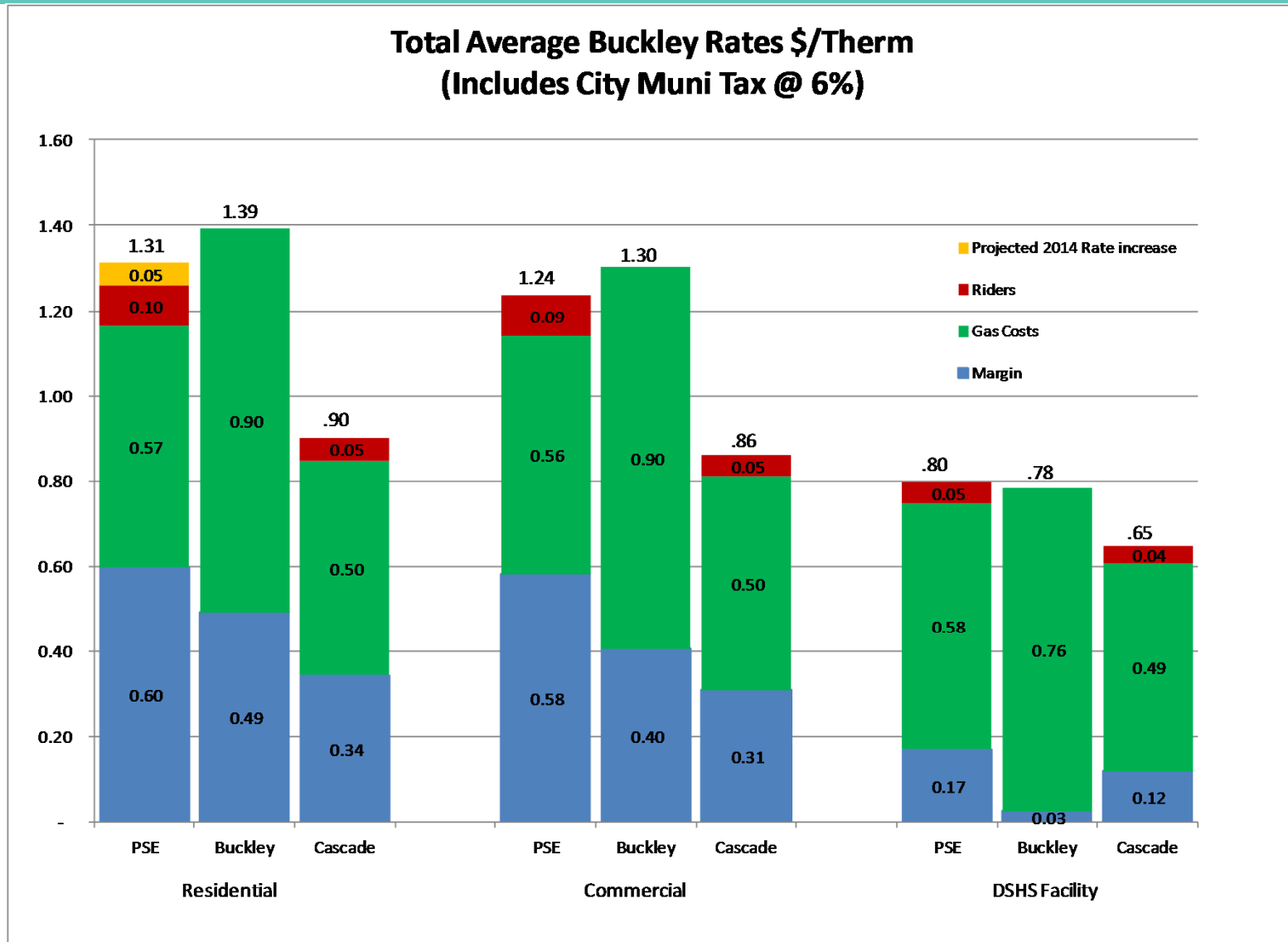
| | |
|---|---------------|
| Purchase Price (\$ - millions) | |
| Buckley Offer Price | \$5.40 |
| Legal | 0.30 |
| Contingency | 0.10 |
| Real Estate Excise Tax | 0.09 |
| Total Purchase Price | \$5.89 |
| O&M | |
| Meter Change Outs | \$0.07 |
| Acquisition and Calibration of As-Built Records | \$0.04 |
| Survey & Miscellaneous Other | \$0.01 |
| Cutomer Record Transfer | \$0.01 |
| Total O&M | \$0.13 |
| Capital Costs | |
| SCADA | \$0.10 |
| RTU Addition | \$0.01 |
| Total Capital Costs | \$0.11 |
| Total Acquisition Costs | \$6.13 |

Buckley Customer Information

| | Number of Buckley Customers | % of Total | Annual Usage (Therms) | <u>% Usage</u> |
|----------------|--|-------------------|----------------------------------|-----------------------|
| Residential | 1,189 | 86.4% | 695,733 | 38.3% |
| Commercial | 186 | 13.5% | 290,704 | 16.0% |
| Rainier School | 1 | 0.1% | 831,740 | 45.7% |
| Total | 1,376 | 100.0% | 1,818,178 | 100.0% |

| | Buckley Average Annual Usage (Therms) | PSE Average Annual Usage (Therms) | <u>Variance</u> | <u>% Variance</u> |
|----------------|--|--|------------------------|--------------------------|
| Residential | 585 | 777 | 192 | 32.85% |
| Commercial | 1,563 | 5,269 | 3,706 | 237.12% |
| Rainier School | 831,740 | 1,416,734 | 584,994 | 70.33% |

Comparison of Rates



Buckley Natural Gas System RFP Recommendation

Michael Mullally

Financial Planning and Strategic Initiatives

May 29, 2013



Recommendation to Submit Bid into Buckley RFP

Recommendation:

Authorize staff to

- 1) Submit bid package to City of Buckley for gas system purchase for up to \$5.4 million
- 2) Post collateral with City amounting to 5% of bid price, or \$270,000

City of Buckley Overview

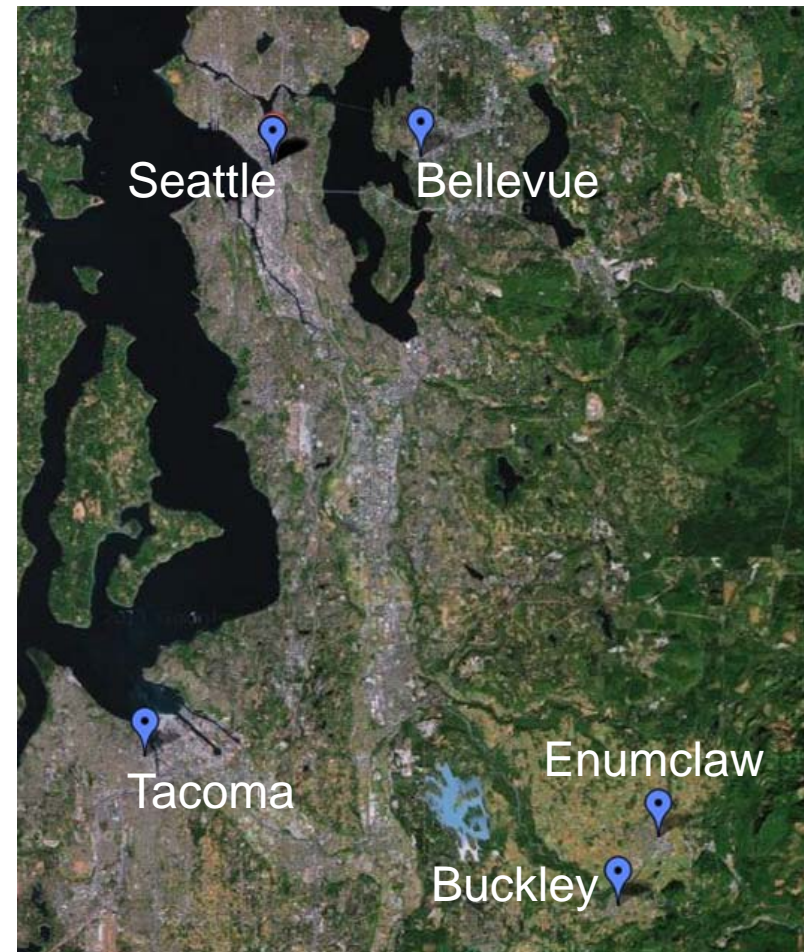
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Gas Supply and Transportation

Gas Supply

- Buckley outsourced gas supply and transportation capacity to a major gas marketer
- Agreement expires 10/31/14
- Buckley hedged supply through 10/31/13 at > current prices
- Premium of \$0.004 per Therm (\$7,200 / year) + capacity optimization benefit
- PSE can assume or terminate supply agreement

Gas Transportation

- Buckley holds firm capacity from Rockies and Sumas on NWP
 - ~2,500 Dth/day, sufficient for Buckley service area
 - Contract can be assumed by PSE
- Enumclaw transport agreement reasonably priced
 - Contains unspecified term and form of service
 - PSE will pursue contract amendments prior to and as condition to closing

Gas Supply and Transportation contracts can be seamlessly incorporated into PSE's portfolio.

Gas System Condition

Review Methodology

- Reviewed City documentation
- Reviewed WUTC reports
- Interviewed gas system employees and contractors
- Visually inspected representative sample of system

Findings

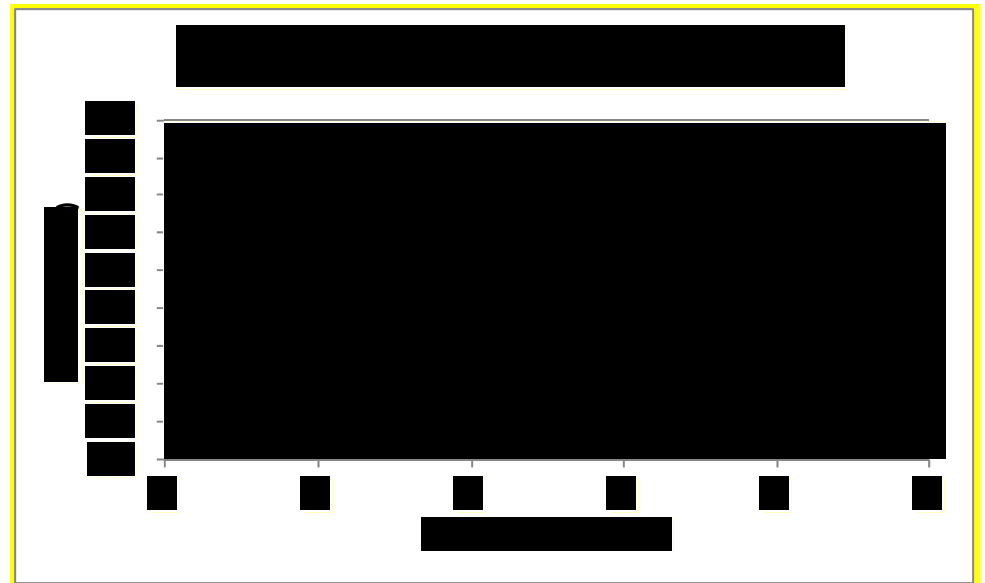
- System on par with PSE's
- Low leakage rate; recommend a leak survey
- Buckley reports 4% unaccounted for gas; recommend measurement audit
- SCADA, RTU, and meter upgrades recommended
- No material deficiencies discovered

Proforma Overview

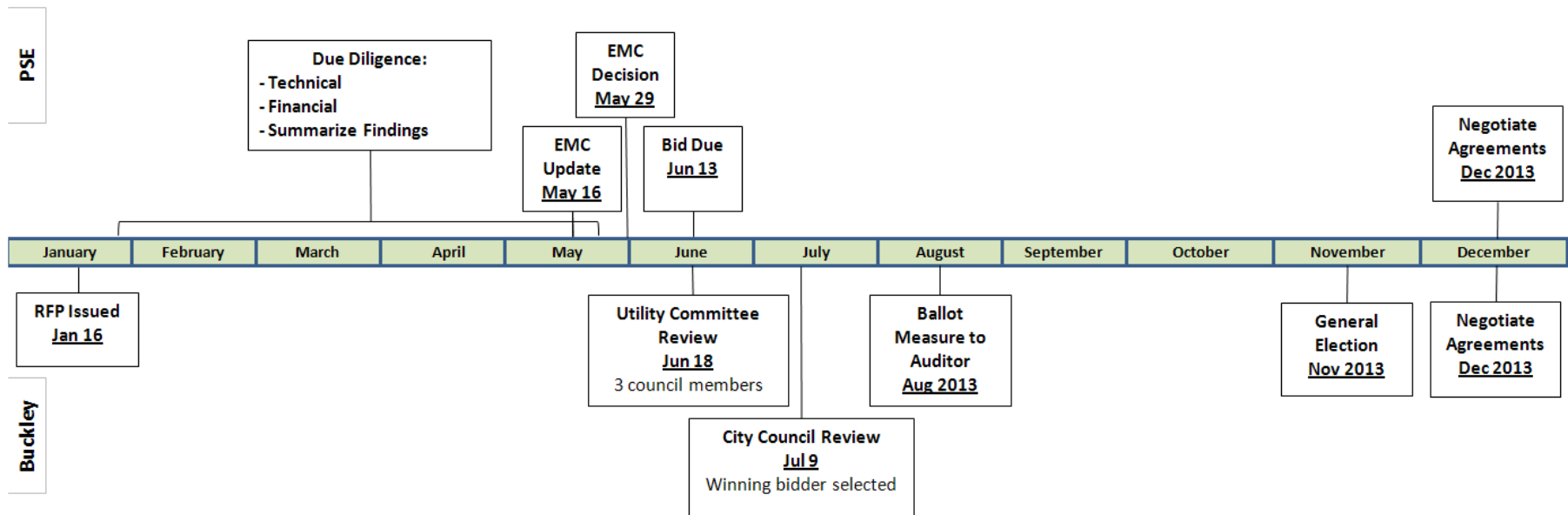
Assumptions:

- One time conversion charges ~\$250k
- One time transaction costs ~\$500k
- Revenue projections of ~\$1.9 million / year
 - Based on PSE rates and Buckley usage data
- O&M estimates based on PSE average distribution costs; ~\$100k / year
- Ongoing operations yield EBITDA of ~\$600k and Net Income of ~\$140k

- Discounted Cash Flow sensitivity suggest system value between \$5 – 6 million for payback in 20 – 30 years
- Recommend bid price of up to \$5.4 million (~22 year payback)
 - Total acquisition cost: \$6.1 million



Next Steps



- Submit bid package on June 13, 2013, pending EMC approval

Appendix

Other Diligence Observations

Real Estate

- No fee title property acquired
- Almost all equipment located on City property
- ~3 easement issues that require resolution

Human Resources

- PSE may hire one qualified gas operations employee

Rates and Regulatory

- No major regulatory issues
- City customers will be moved to equivalent PSE rate schedules
- PSE would file for Certificate of Public Convenience and Necessity to Operate a Gas Plant for Hire to serve City with WUTC
- PSE and Buckley to file Transfer of Property and Purchase of Property petitions with WUTC

Buckley Acquisition Cost Estimate

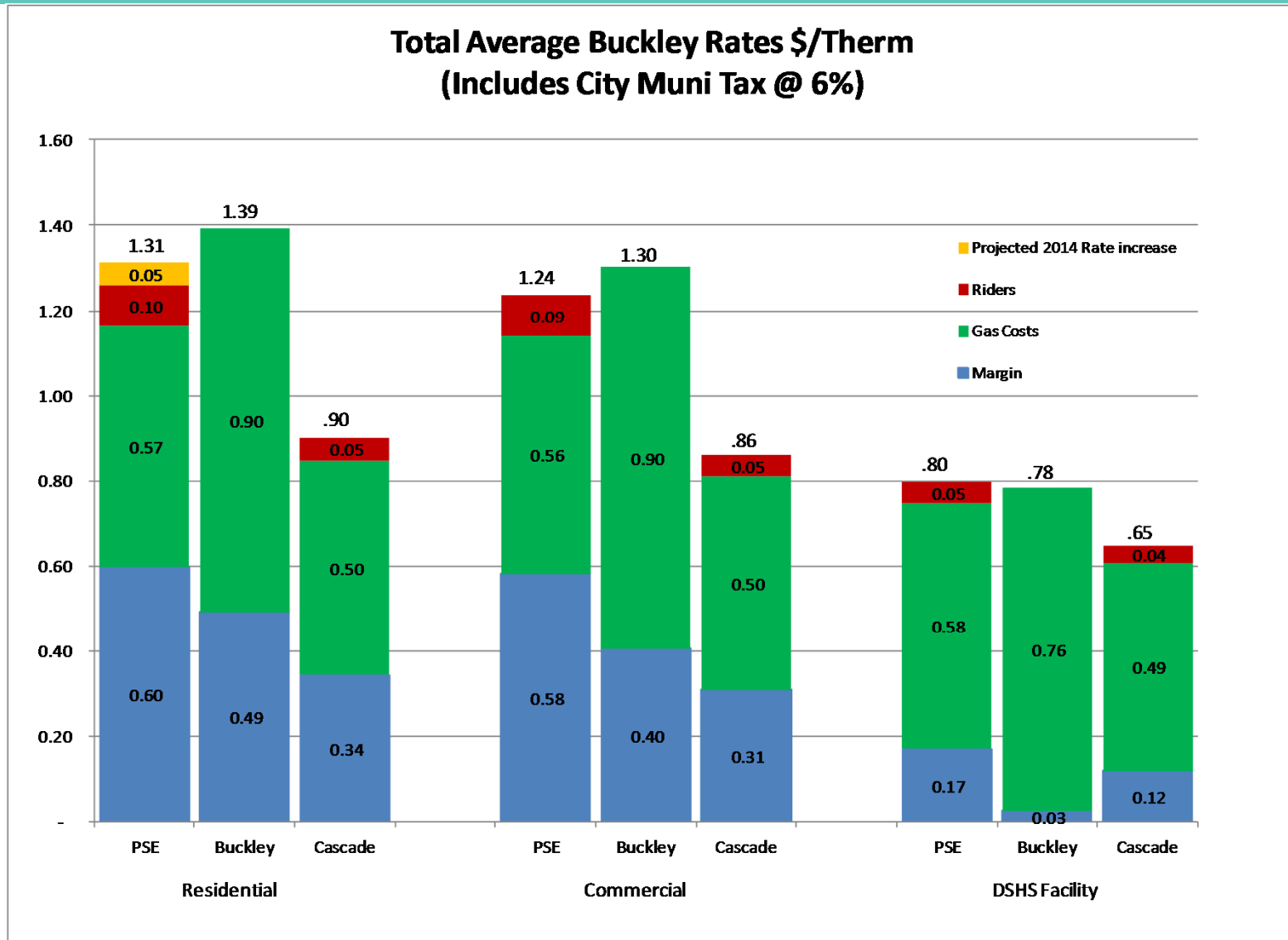
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Comparison of Rates



Why PSE is a good partner for Buckley

- Customers will enjoy safe and reliable gas service
 - PSE gas emergency responders and appliance repair in the area already
 - Back up supply from Bonney Lake as growth demands
- Customers gas bills will decrease
- Customers will find it convenient to simply add their gas usage onto their existing PSE electric bill
- Customer will have access to additional value added services
 - Gas energy efficiency programs
 - Gas emergency response and appliance repair
 - Gas renewable programs
- PSE is a good community partner and has employees living in Buckley

Benefits of owning Buckley system

- Heightened assurance of a safe distribution system in Washington under PSE management
- Efficient expansion of distribution system in growing locale
- Synergies with both the gas and electric system service territory
- Bringing robust natural gas conservation program to City

Customer Load - Stable

- Load growth in Buckley has been fairly stable
- Rainier School – expect stable load
 - Spoke with Rainier as part of due diligence
 - Staff is very confident school will be open for years to come
 - Feel it is at a stable level as far as size today
 - Could transform to include additional services for community in future (i.e.: Fircrest)

**REQUEST FOR PROPOSALS
CITY OF BUCKLEY
SALE OF NATURAL GAS UTILITY**

Sealed proposals will be received by the undersigned at the City of Buckley, 933 Main Street, P.O. Box 1960, Buckley, Washington 98321, up to 5:00 p.m. on Thursday, June 13, 2013 for purchase of the City's Natural Gas Utility in accordance with RCW 35.94, Sale or Lease of Municipal Utilities. Bidders shall be Public or Private Natural Gas Utility Companies, regulated by the Washington State Utilities and Trade Commission (WUTC) who are currently in full compliance with State and Federal regulations.

The Proposals will be considered by the City Council for a period of time following the due date. All proposals must include requested information and comply with the specifications and requirements of the RFP Document. All Proposals must be accompanied by a certified check, cashier's check, money order, or bid bond payable to the "City of Buckley" and in an amount of not less than five percent (5%) of the total amount bid. Pursuant to RCW 35.94.020, each bid shall state that the bidder agrees that if his or her bid is accepted and he or she fails to comply therewith within the time hereinafter specified, the check or deposit shall be forfeited to the city.

Potential Bidders may obtain a copy of the RFP Document, free of charge, in electronic format from the City Clerk of the City of Buckley (360) 829-1921, ext 7801. In obtaining the RFP Document, Bidders must register with company name, physical address, phone and fax numbers, and email address. Registration is required to obtain Addenda.

The City of Buckley expressly reserves the right to reject any or all Proposals and to waive minor irregularities or informalities and to Accept the Proposal of the responsive, responsible bidder as it serves the interest of the City, in accordance with the process set forth in RCW 35.94.



JOANNE STARR, DEPUTY CITY CLERK

Dates of publication: [1/16/13, 1/23/13, 1/30/13, 2/6/13]

RFP DOCUMENT

The City of Buckley owns and operates a Natural Gas Utility that serves customers within the city limits. The U.S. Department of Energy classification of the system is a Municipally Owned Distribution Company. The City is hereby requesting proposals for purchase of its Natural Gas Utility.

The City purchases its natural gas from the Williams Pipeline, wheeled through the City of Enumclaw. As of the end of 2011, the City's natural gas customers include 1,178 residential customers and 190 commercial customers. The distribution system includes four regulating stations and approximately 37 miles of gas mains.

The following information is attached as background information on the City of Buckley Natural Gas System:

- 1) Exhibit A, Revenue, 2012 Proposed Budget
- 2) Exhibit B, Expenditures, 2012 Proposed Budget
- 3) Table U.1 FTE Breakdown, Public Works, 2012
- 4) Capital Infrastructure Flowchart, 2012
- 5) USDOT PHMSA 2011 Annual Report
- 6) Natural Gas Distribution System Operations & Maintenance Manual
- 7) Natural Gas Distribution System Operator Qualification
- 8) Form EIA-176 2011 Annual Report
- 9) City of Buckley UGA and FUGA Maps

Site visits for a tour of the City's natural gas utility infrastructure may be scheduled with Mr. John Dansby, Public Works Supervisor, (253) 261-9826. The City intends to schedule a pre-bid conference 3-4 weeks after publication of this RFP. Potential Bidders who have registered with the City as outlined in the RFP advertisement will be notified of the date and time of this meeting.

Required information in the Proposal is as follows:

- 1) Bid Price: Lump sum for Natural Gas System Complete
- 2) Proposed Customer Programs (e.g. energy efficiency rebates, incentives, reduced rate classifications)
- 3) Proposed five (5) year future rate analysis for the City's system
- 4) Company Profile Information (e.g. firm qualifications and history, qualifications of key personnel, facility locations, insurance coverage's, experience with WUTC and Federal Pipeline Safety Regulations)

All bids must comply with all requirements of RCW 35.94.020, quoted below.

This RFP does not commit the City to pay any costs incurred in the preparation of a response to this RFP.

Selection Process:

The proposal evaluation process implemented by the City shall be based on a "Best Overall Selection" taking into consideration price, programs offered, rate scenario(s) and background/qualifications of the bidder(s). The City reserves the right to make a selection directly from the proposal, or to require an interview of the firm(s) submitting proposals. The City's Utilities subcommittee will make recommendations to the City Council, who will then consider the proposals and subsequent committee recommendation. Subject to the provisions of RCW 35.94.020 the City Council can then award the contract

to the bid “it deems best” upon approval by 2/3’s of the Council by ordinance. The ordinance shall then be subject to a majority vote by the citizens of Buckley at the next general or special election. If approved by the voters, the ordinance shall take effect upon the mayor’s proclamation of voter approval, which is made as soon as the election results are certified.

If approved by the voters, the successful bidder will be required to enter into agreement with the City for the transfer of ownership. Terms of the agreement shall be negotiated between the parties prior to execution.

RCW 35.94.020

35.94.020. Procedure

The legislative authority of the city, if it deems it advisable to lease or sell the works, plant, or system, or any part thereof, shall adopt a resolution stating whether it desires to lease or sell. If it desires to lease, the resolution shall state the general terms and conditions of the lease, but not the rent. If it desires to sell the general terms of sale shall be stated, but not the price. The resolution shall direct the city clerk, or other proper official, to publish the resolution not less than once a week for four weeks in the official newspaper of the city, together with a notice calling for sealed bids to be filed with the clerk or other proper official not later than a certain time, accompanied by a certified check payable to the order of the city, for such amount as the resolution shall require, or a deposit of a like sum in money. Each bid shall state that the bidder agrees that if his or her bid is accepted and he or she fails to comply therewith within the time hereinafter specified, the check or deposit shall be forfeited to the city. If bids for a lease are called for, bidders shall bid the amount to be paid as the rent for each year of the term of the lease. If bids for a sale are called for, the bids shall state the price offered. The legislative authority of the city may reject any or all bids and accept any bid which it deems best. At the first meeting of the legislative authority of the city held after the expiration of the time fixed for receiving bids, or at some later meeting, the bids shall be considered. In order for the legislative authority to declare it advisable to accept any bid it shall be necessary for two-thirds of all the members elected to the legislative authority to vote in favor of a resolution making the declaration. If the resolution is adopted it shall be necessary, in order that the bid be accepted, to enact an ordinance accepting it and directing the execution of a lease or conveyance by the mayor and city clerk or other proper official. The ordinance shall not take effect until it has been submitted to the voters of the city for their approval or rejection at the next general election or at a special election called for that purpose, and a majority of the voters voting thereon have approved it. If approved it shall take effect as soon as the result of the vote is proclaimed by the mayor. If it is so submitted and fails of approval, it shall be rejected and annulled. The mayor shall proclaim the vote as soon as it is properly certified.

A strong preference will be given to firms that match the following:

- Bid price.
- Knowledge of the City’s utilities infrastructure and needs.
- Qualifications and reliability of the firm(s) natural gas background and experience.
- Long term rate projections and stability.
- Customer energy savings incentives and rebates.
- Familiarity and past compliance with WUTC and Federal Pipeline Safety Regulations.
- Firms that have facilities located within adequate emergency response distances
- Firms with Washington State Licensed Professional Engineers.

- Firms with a full complement of OQ qualified staff pursuant to 49 CFR subparts 192.801 through 192.809.
- Standard required insurances.
- Firms with a willingness and ability to absorb OQ Certified employees currently working for the City's Natural Gas System that would be displaced by a sale.
- Firms with the capability and willingness to expand the system into underutilized service areas.

Assets and Operations Due Diligence Report Buckley Natural Gas System

Introduction

Purpose

The purpose of this project is to evaluate the condition of the City of Buckley Natural Gas Distribution System.

Scope

The scope of this project is to investigate and report with respect to the condition of the system, the system performance and the risks associated with the assets. The scope of the investigation and review is summarized as follows:

- Review of O&M Manual
- Review reports of inspections and actions by the Washington Utilities and Transportation Commission
- Field inspection of above ground facilities
- Review of current maintenance records
- Discussions with operating personnel to learn about the condition and operation of the system
- Analysis of system capacity

The results of these reviews are further explained in this report.

System Description

The City of Buckley sits near the Cascade foothills and was incorporated in 1889. According to Buckley's web site, total population is approximately 4,145 and the City has a total area of 4.1 square miles.¹ Natural gas was first brought to Buckley in 1957 when the interstate pipeline system was first extended into the Pacific Northwest. The natural gas for the system is delivered by Williams Northwest Pipeline at the Enumclaw gate station. The City of Enumclaw then odorizes the gas and transports it through its high pressure distribution system to a transfer point near SR 410 and the White River.

| | |
|------------------------------|-------|
| Gas Facilities | |
| Miles of Main | 36.73 |
| Wrapped Steel | 23.90 |
| PE | 12.83 |
| Number of Services | 1,401 |
| Number of Gate Stations | 1 |
| Number of Regulator Stations | 3 |

Asset Condition

¹ Source: http://www.cityofbuckley.com/documents/about_buckley.html

A majority of the mains in the distribution system are wrapped steel, with 20 miles installed in the 1950s as part of the original system. Newer pipe installed is HDPE 3408, making up 35% of mains and 37% of service lines.

Cathodic protection was installed in 1976 when first required by CFR 49 Part 192.457. The deepwell anode bed is located at the City Shop and the rectifier is located in the city shop office. There are some bond cables that are used within the system to maintain protection to otherwise isolated wrapped steel sections.

Observations: Inspected Cathodic Protection Equipment appears to be in average to good condition, inspected records are in order; no abnormalities known.

Anodes on a cathodic protection system are consumable; the remaining life of the existing facility is difficult to estimate. PSE has the expertise to design a replacement if needed. Bond cables and cathodic protection test points are potential failure points for the connection of such cables to the steel piping system. As of a 2004 WUTC audit, there were an adequate number of test stations. There were also twelve isolated steel wrap services off of PE mains.

Maximum Allowable Operating Pressure

The MAOP of a majority of the system is currently 45 psig. It was updated in 2008 from 25 psig. Documentation in WUTC report for Docket PG-080033 states that the MAOP would be increased to ensure that a minimum of 10 psig could be maintained throughout the system so that Excess Flow Valves can be installed. The MAOP of the high pressure system is 250 psig per the O&M Manual, but a tag at the inlet of the DR at Rainier School shows 300 psig.

Observations: Inspected equipment appears to be in average to good condition, inspected records are in order. City of Buckley operating practices appear to be similar to PSE practices in this area.

We did not review the data used to establish the MAOP of the system, if such data is unavailable, alternative methods to establish or re-establish the MAOP of those segments may be required. If required, some of that work could be relatively expensive.

Gate Station

The Gate station where the gas is delivered from Enumclaw consists of a filter and a Sensus T-18 Mk II Turbo Meter. Valves are Rockwell #305's. Gas then branches in two directions, one to the inlet of the main town DR and the other feeds the HP line to the east end of town and serves Rainier School.

Observations: Inspected regulating station equipment appears to be in average to good condition, inspected records are in order. Although not identical, equipment inspection, maintenance and construction practices are similar to those at PSE.

The City of Buckley uses some equipment and materials that differ from PSE equipment in detail, but not in function. Some familiarization with existing equipment or changing of existing equipment to more familiar equipment is required.

Regulator Stations

The main town district regulator station at the gate station consists of dual runs, each consisting of two Mooney regulators. It is set to operate at 35 psig with the monitor set to limit it to 40 psig.

The Shay regulator station is above ground along a fairly quiet road in a fenced enclosure. It consists of one run of two Sensus regulators set up as worker and monitor. There is also a regulator built into the bypass run which is locked in a closed position. It delivers gas at about 25 psig.

At Rainier School there is a regulator station that consists of filters and then two Rockwell 461-57s' in parallel and a relief valve. A two inch feed goes from this station into the distribution system and the rest of the set feeds the Rainier School.

Observations: Where observed, regulating station equipment appears to be in average to good condition, inspected records are in order. Though not identical, equipment inspection, maintenance, and construction practices are similar to those at PSE.

The City of Buckley uses some equipment and materials that differ from PSE equipment in detail, but not in function. Some familiarization with existing equipment or changing of existing equipment to more familiar equipment is required. Installation of additional test points or valves may be needed to adapt existing equipment to PSE practices. If possible and practical, there may be alternative test methods used.

Customer Meters

The meter set for Rainier School is a continuation of the DR that was listed above and consists of a Turbo Meter followed by a parallel run of Mooney regulators and a relief valve. It is set to operate at about 11 psig, feeding a system with an MAOP of 15 psig (13 psig in O&M Manual, Page 66).

Residential and small commercial meter sets consist of Sensus/Rockwell/Equimeter regulators and Meters. The meters for residential are R-275 or CL-275 meters. The regulators are Sensus 143-6-182 with 1/4" or 3/8" orifice and 5-8.5" blue springs.

Observations: We are required by WAC 480-90-328 to identify each meter with a unique series of serial numbers and company name. We are also required by WAC 480-90-353 to maintain meter history records. We are recommending that all residential and small commercial meters be replaced with PSE meters and electronic meter reading devices shortly after the change in hands. Larger meters, such as at Rainier School, can be handled on a case-by-case basis.

The standard regulator used by Buckley for residential service can have either of two orifice sizes. The smaller orifice, 1/4" may be alright for the current operating pressure, but the larger, 3/8" may require regulator replacements. A waiver of PSE standards may be required to cover this equipment. A system uprate to increase the system MAOP in the future may require regulator changes to improve internal relief capacity with the higher inlet pressure, or a possible change in PSE Operating Standards to allow a higher pressure buildup during relief.

Metering equipment and facilities appear to be in average to good condition, inspected records are in order. Though not identical, equipment inspection, maintenance, and construction practices are similar to those at PSE. The City of Buckley uses some equipment and materials that differ from PSE equipment in detail, but not in function. Some familiarization with existing equipment or changing of existing equipment to more familiar equipment is required.

Some meter risers have wax tape applied. This is a typical atmospheric corrosion remediation. Actual condition of the underlying pipe is impossible to determine without removing the wax tape. While it appears there is adequate corrosion protection, additional remediation will at some point be required. Although frequency may vary, this is believed to be no different conditions than exist on the PSE system.

Excess Flow Valves

EFV's are being installed with new or replaced services. The 2011 PHMSA report shows a total of 61 with 31 installed during 2011.

Observations: None.

Casings

There are seven casings in the system, they all have test stations

Leakage

The 2012 PHMSA Annual Report lists one repaired leak on a service line caused by Excavation Damage and one system leak scheduled for repair. They had a total of 166 excavation tickets in the year. We did not review all leak records, but some WUTC audits have reviewed leaks that have occurred; it appears they have been mostly in threaded fittings above ground.

Observations: Inspected records are in order.

Unaccounted For Gas

The City reports 3.95% unaccounted for gas.

Observations: This is a fairly high number and could be caused by measurement discrepancies between what comes into the system at the town border and what is measured out to the customers. This is an area for improvement; on a volume of 192,000 MCF this amounts to an over pay or underbilling for 7,585 MCF or about 78,000 therms per year. Finding the issues would involve a measurement audit, starting with the meters at the gate station and the Rainier School (38% of the gas in the system is delivered to the Rainier School) plus a look at the overall billing system and the unaccounted for calculation methodology. The City of Buckley bills customers on a volume basis (ccf's) but is purchasing gas on an energy basis (therms). Measurement differences and errors may account for some of the lost and unaccounted for gas.

O&M Manual

The O&M Manual appears to be complete and covers the operations that are currently being performed by the City. The manual was written by Cascade Natural Gas about ten years ago under contract to the City. The manual is in a different format that used by PSE, but it covers what is needed for their system and is a good indication of how the current system is maintained.

Observations: If acquired by PSE, the PSE manual would then be used, but it would be appropriate to confirm that specific practices used by Buckley, and within the requirements of the regulations, would be covered in PSE's manual when appropriate.

WUTC Inspections *(starting with the most recent)*

PG-110039 May 2011: Letter shows there were a "few items needing further clarification." Buckley made some proposals and the docket was closed.

PG-090050 July 2009: A Plan and Procedures Review of the Operations and Maintenance Manual was conducted. No apparent violations were noted.

PG-080033 November 2008: One procedural deficiency was identified in the O&M Manual. Gas leak records did not record all the required information on the forms. City responded and the docket was closed.

PG-090144 2007: 2007 Specialized Inspection, Public Awareness Program Review. This required the creation and adoption of a Public Awareness Program. City was brought into compliance and the docket was closed.

PG-041731 September 2004: Report shows no areas of non-compliance with codes, but does note eight areas of concern or recommendations which if not addressed could result in non-compliance with state or federal safety codes.

PG-041054 June 2004: An inspection of the Operator Qualification Program (OQ) was conducted. No violations were identified.

PG-021393 November 2002: Commission staff conducted an inspection of the City of Buckley's Drug & Alcohol Testing Policy & Program, Anti-Drug , and Alcohol Misuse Prevention Plans and associated records. Staff identified four violations and one recommendation with the Drug Abuse Policy Compliance Procedures Plan and Alcohol Misuse Prevention Plan. All issues were cleared and the docket was closed in 2004.

November 2002: PG-021026: This inspection was of the O&M manual which had recently been completed by Cascade Natural Gas. The manual "met the minimum requirements of the federal and state codes, but is lacking detailed procedures that are unique to the City of Buckley's gas system."

Observations: The violations, non-compliances, areas of concern and recommendations that have been the results of WUTC audits have been related to the O&M Manual and other documented programs and plans, and have been subsequently corrected.

Transition Plan

If PSE is selected as the successful bidder and the citizens vote to accept the proposal, then a detailed transition plan and schedule will need to be created. Some of the steps that will be required are listed below:

- Existing PSE customers that are currently City of Buckley gas customers will need to be set up as gas customers. Information from the City of Buckley billing system should be used. The customers have been billed on a volume basis rather than an energy basis, so it may be beneficial to not try to bring past usage history into the PSE system.
- The gas system should be added to the existing PSE GIS. This may be from a combination of the City's mapping system and a review of their asbuilt records.
- A leak survey should be performed for the entire gas system. Timing of the survey could be prior to the transition with the City performing any required remedial action, after with PSE performing the remedial action or some combination of the two.
- Existing meters should be read at the transition or a method should be agreed upon for how the bills during the transition would be split between the City and PSE.
- All residential and small commercial meters should be replaced with PSE meters equipped with AMR, proper identification and meter history. This should be performed as a concentrated effort with the intent of getting all meters changed during a fairly short timeframe. Customers need to be present so that light-ups can occur. It would be beneficial to perform many of these after normal business hours or on weekends in order to be more efficient and make it easier for the new customers.
- Ensure that PSE's Public Awareness programs and Emergency Responders classes include the City of Buckley.

Due Diligence and Transition Plan Report: Human Resources

City of Buckley Gas System Employees

May 3, 2013

Proposal: extend offers of employment to 1of 3 of the City of Buckley’s employees who currently work on City’s natural gas system.

Overview of City of Buckley employees:

- Union representation: International Union of Operating Engineers, Local No. 286
- Positions: Utility Worker (pay rate: [REDACTED] monthly at top step.)
Utility Lead Worker (pay rate: [REDACTED] monthly at top step.)
- Current qualifications: Operations Training staff has reviewed City of Buckley’s relevant materials and concluded that operator qualifications are substantially similar to PSE’s

Recommended PSE offer: “conditional offer” which has a history of successfully onboarding new employees at journey worker level.

Components of conditional offer for position of Fitter 1:

- New employee(s) will be covered by provisions of collective bargaining agreement with United Association of Journeymen and Apprentices of Plumbing & Pipefitting Industry (UA) with benefits per contract.
- Offer includes current rate of pay for Fitter 1 of \$32.28 (\$5,595.20/monthly) and PSE benefits per contract.
- Prospective employee submits record of completed training; PSE Ops Training staff reviews
- PSE Ops Training and Gas Operations management personnel devise training plan to provide training for training/qualifications gaps, if any, when training and qualifications are compared to PSE requirements.
- Training completed within designated time period (not to exceed 9-month probationary period)
- If training not successfully completed within 9 months, employee is not qualified and is terminated. (A Conditional Offer is extended only in circumstances such as the present one where prospective employee is highly qualified, has significant experience and there are expected to be only a few areas where training to PSE systems and procedures is required to fully meet PSE’s journey level standards.)
- Employee(s) will have PSE seniority from date of hire upon successfully completing all training and qualifications requirements.

Impacts:

- No anticipated impact to PSE’s short-term workforce plan. May have some impact for medium or longer term planning and retention.
- Onboarding, training and orientation will be the joint responsibility of Gas Operations Management, Operations Training group, Training Trust staff and HR staff.
- While the conditional offer approach has been used on the electric side of PSE Operations, both PSE’s gas system managers and employees are only familiar with the traditional training routes of employees starting at entry-level and progressing through PSE’s training programs. Integrating new employee(s) who join PSE without the benefit of the traditional training progression will likely require management time and attention to ensure success.

1. Introduction

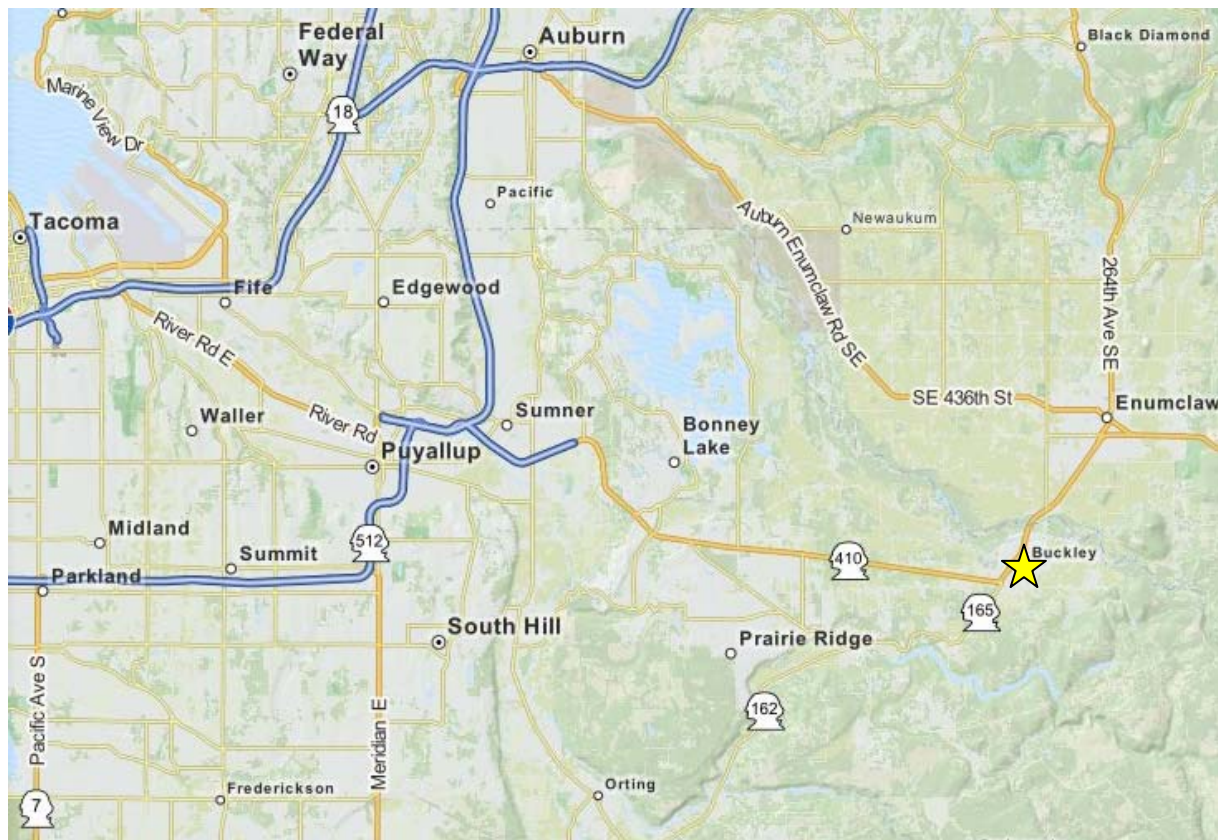
The purpose of this report is to recommend that the Energy Management Committee authorize Puget Sound Energy (“PSE”) staff to submit a bid of \$5.4 million, to purchase the City of Buckley’s natural gas distribution system. The total acquisition cost to PSE, including transaction and integration costs, would be \$6.1 million. The system is currently owned by the City of Buckley (“Buckley” or “the City”), which is seeking to sell it through a competitive bidding process, referred to hereafter as the Buckley Request for Proposals (“RFP” or “Buckley RFP”). This report and the associated attachments summarize the business case for acquiring the system and describes the analysis of its benefits, costs and risks, and due diligence conducted by PSE staff.

2. Overview

City of Buckley

The City of Buckley was incorporated in 1889. The town, which sits near the Cascade foothills, was originally established as a lumber and shingle mill community that also had some coal mines. Buckley is located in East Pierce County, south of Enumclaw and east of Bonney Lake.

Figure 1. City of Buckley located in Pierce County, Washington¹



¹ Source: www.mapquest.com

According to the City of Buckley's web site, total population is approximately 4,145,² with 48 percent of residents between the ages of 25 and 54. Seventy-two percent of housing units are owner occupied and 47 percent of homes were built before 1970.

The City of Buckley owns and operates a natural gas utility that serves customers within the city limits (a total area of roughly 4.1 square miles). The system is classified by the U.S. Department of Energy as a municipally owned distribution company.

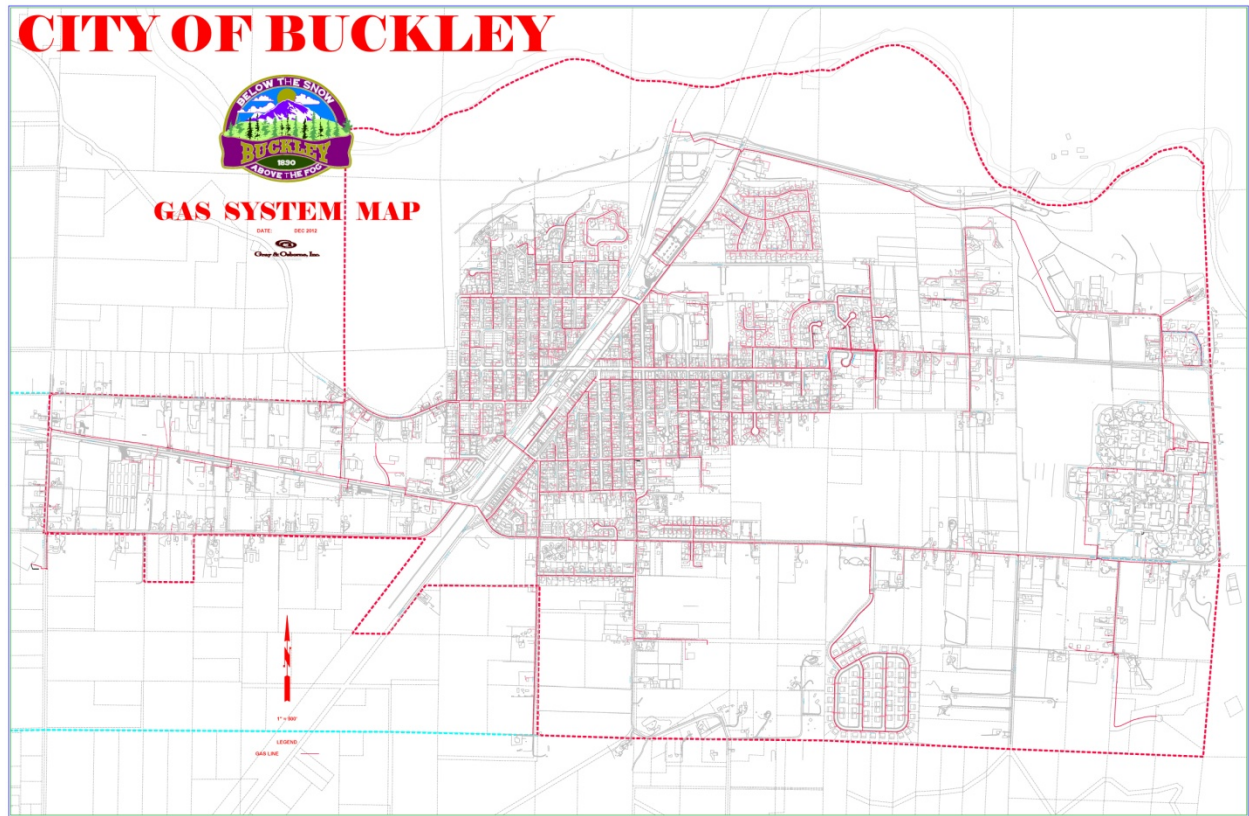
Buckley Natural Gas System

Buckley's natural gas utility was established by the City in 1957 when construction of an interstate pipeline system first brought natural gas to the Pacific Northwest (the predecessor of Northwest Pipeline). Currently, Buckley purchases natural gas from a large marketer and then transports the gas to its system via Northwest Pipeline and the Enumclaw system. The City of Enumclaw ("Enumclaw") in King County odorizes the gas and transports it to Buckley through its high pressure distribution system to a transfer point near SR 410 and the White River.

The overall condition of the Buckley natural gas system is believed to be comparable to PSE's existing system. It consists of 36.73 miles of distribution lines (or "mains"). Most of the system is comprised of wrapped steel mains, 20 miles of which were installed in the 1950s as part of the original system. Newer sections of pipe are made of high density polyethylene ("HDPE") 3408. Currently, the newer HDPE pipe installations make up 35 percent of the system's mains and 37 percent of service lines.

² Source: http://www.cityofbuckley.com/documents/about_buckley.html

Figure 2. Gas System Map



The system includes one gate station (where the gas is delivered from Enumclaw) and three regulator stations. Figure 3 offers a snapshot of Buckley’s natural gas system facilities.

Figure 3. Summary of Buckley Natural Gas Distribution Facilities

| | |
|--------------------------------------|-------|
| Total miles of main | 36.73 |
| Wrapped steel main | 23.90 |
| Polyethylene main (“PE”) | 12.83 |
| Number of service lines ³ | 1,401 |
| Number of gate stations | 1 |
| Number of regulator stations | 3 |

³ This is the number of service lines in the system as reported in the “Annual Report for Calendar Year 2011 Gas Distribution System” to the Department of Transportation.

Historical relationship with PSE

PSE and the City of Buckley share a long and amicable history. PSE (and its predecessors) has been the sole provider of electric service to Buckley since the original town was incorporated in 1889. In addition to providing the City's electric service, PSE has developed a strong bond with Buckley through government, community, and civic partnerships. Many local residents have enjoyed hunting and recreation on PSE's previously-owned White River properties. Additionally, while PSE does not currently serve the City of Buckley as a natural gas provider, the Company maintains a strong local presence by serving the gas resource needs for communities such as the City of Bonney Lake, located just 1.5 miles from Buckley.

Overview of RFP

The City Of Buckley released a Request for Proposals to sell its natural gas utility in January 2013. Bids along with a bond of not less than 5 percent of the total bid amount are due to the City of Buckley no later than 5:00 p.m. on June 13, 2013.

According to the RFP, bids must include the following required information: 1) bid price, 2) proposed customer programs (e.g., energy efficiency rebates, incentives, reduced rate classifications, etc.), 3) proposed five-year future rate analysis for the City's system, and 4) company profile information (e.g. firm qualifications and history, qualifications of key personnel, facility locations, insurance coverage, experience with WUTC and Federal Pipeline Safety Regulations). Additionally, all bids must comply with all requirements of RCW 35.94.02 as quoted on pages 2 and 3 of *Attachment C. RFP for the Sale of the Buckley Natural Gas Utility*.

The following table reflects the City of Buckley's tentative schedule for the bidding and approvals process.

Figure 4. Tentative bidding and approval schedule for the Buckley gas distribution system

| Timing | Event |
|--|---------------------------------------|
| June 13, 2013 | Bid proposals due to City of Buckley |
| June 18, 2013 | City Council Utility Committee review |
| June 25 or July 9 | City Council consideration |
| August 2013 | Ballot measure to County Auditor |
| November general election | Ballot measure to voters |
| <i>If proposed sale is approved by voters,</i> | |
| December 31, 2013 | Transfer and Sale Agreement drafted |

RFP Background

Buckley’s natural gas system is run by three gas utility employees. Record-keeping tasks are performed by the City of Buckley’s Department of Administration. The Washington Utilities and Transportation Commission (WUTC) questioned the recordkeeping practices for the gas utility during their last several audits. The City Administrator has mentioned several times that increasing regulatory requirements from the WUTC have created additional recordkeeping tasks that have taxed Buckley’s limited personnel, leaving the City unable to stay current with these requirements. The City Administrator believes that Buckley would, at a minimum, need to hire an engineer dedicated to the gas system and potentially also a gas operations manager to meet regulatory requirements for the utility.

The City of Buckley has experienced fairly severe economic conditions since the financial crisis that peaked in 2008 leading to a global recession. In its 2013 budget, the City was forced to make the tough decisions to close their jail and dispatch center, and to lay off eleven employees.

Over the years, the City has considered selling their natural gas system; however, previous efforts have resulted in bids that the City Council believed to be too low to consider. To avoid a similar outcome, this time the City Administrator presented to the City Council a proposal to

sell the gas system through an RFP process as part of a broader presentation on actions needed to balance the budget. Buckley's City Council agreed to endorse an RFP to sell the gas system, if public support of the sale could be demonstrated. A public poll was undertaken in an effort to demonstrate support. Of the 1,781 surveys that were distributed, 266 surveys were returned (14.9%). Two hundred three of the returned surveys (76%) favored selling the gas system. On January 8, 2013 the City Council unanimously approved a resolution to issue an RFP.

3. Due Diligence

Evaluation Overview

From January to mid-May 2013, a cross-functional team of PSE evaluators came together to review and discuss the Buckley natural gas system and to consider whether it made sense to recommend to PSE management that the Company submit a bid to purchase the system. The team included representatives from functional groups throughout PSE, such as engineering and operations, gas supply and transportation, community and customer relations, legal, insurance, real estate, rates and accounting, human resources, and financial planning and strategic initiatives. As part of its evaluation process, the team reviewed RFP materials initially provided by the City of Buckley, submitted data requests and sought publicly available information as needed, spoke with City employees to address questions and toured the above-ground gas utility facilities.

Overall, PSE staff found the condition of the Buckley natural gas system to be comparable to the Company's existing system and no fatal flaws were uncovered that would prevent acquiring the system. The following discussion summarizes the findings for several key areas of the review process. Additional information about PSE's evaluation and findings is included in *Section 4. Risks and Mitigations, Section 5. Summary of Benefits, Section 6. Financial Analysis and in the Appendices.*

Gas engineering, operations, and integrity

PSE's gas engineering and operations group conducted a review of the condition of the gas system, the system's performance and the risks associated with the system's assets. To perform this review, PSE staff reviewed a variety of materials supplied by the City of Buckley, including the O&M manual, inspection and WUTC action reports, as well as current maintenance records. PSE staff also performed a field inspection of the above-ground facilities,

analyzed the system's capacity, and discussed the condition and operation of the system with operating personnel. No fatal flaws were identified during the course of this evaluation. For a summary of risks identified during the engineering and operations review, refer to *Section 4. Risks and Mitigations*. For detailed information about the gas system assets and operations review, or for findings related to specific components of the gas system, refer to *Attachment D. Gas System Assets and Operations Review*.

Gas Supply and Transportation

The City holds a long term firm pipeline contract on Northwest Pipeline for 2,469 decatherms ("Dth") per day, which is an amount believed to be sufficient to cover the current and future needs of the customer base. The City holds a contract with IGI Resources to manage the pipeline capacity and provide gas supply at a fixed price (hedged above current market price at \$5.25 per Dth) through October 31, 2013. This above market hedged price is one of the primary reasons that the City's current rates are higher than PSE's rates.

The City has extended the supply and pipeline management contract through October 31, 2014, but has not elected to hedge (or lock-in) gas supply costs. The result is that gas supply costs default to pricing at market as a mix of Rockies (87 percent) and Sumas (13 percent) supply to match the pipeline capacity. The gas supply arrangement provides a mark-up of four cents per Dth to IGI Resources as a management fee. While the supply and capacity contract is not onerous, PSE has been assured by IGI Resources (with which PSE conducts considerable business) that it would be willing to dissolve the agreement and step away, should PSE be the winning bidder. If terminated at purchase or not renewed effective October 31, 2014, gas costs would be reduced by \$.004 per therm.

The existing pipeline and supply agreements are assignable. The evaluation team recommends that PSE require such assignment as a condition of closing. PSE is confident that the contracts could be absorbed into PSE's current gas supply and transportation portfolio seamlessly without any negative impact on existing PSE customers.

Enumclaw Transportation Agreement

The City's gas is delivered by Northwest Pipeline into the distribution system of the City of Enumclaw. The gas is then transported through Enumclaw's system to the northern end of Buckley. The City of Buckley has held a contract with the City of Enumclaw for "best efforts" transportation service since 1957. The original 30-year agreement was replaced in 1972 with a new contract comprised of substantially the same terms, with one notable exception. Contract duration was changed to extend through "the existing term of Enumclaw's bonded indebtedness" or any additional debt related to upgrades designed to increase service to Buckley.

The 1972 agreement was amended in 1983 and again in 1995 to adjust the transportation rate charged by Enumclaw. The current transportation rate of 2.1 cents per therm is adjustable only by mutual consent and with 60 days notice. There is no demand charge; however, Buckley is obligated to pay unit rate to Enumclaw as long as Enumclaw has bonded debt related to the pipes built to serve Buckley. It is unclear if there is a minimum annual payment obligation.

Due to the many vague terms and uncertainties contained in the Enumclaw transportation agreement, PSE's bid (or any potential Closing) should be contingent upon execution of a new long-term contract for transportation with the City of Enumclaw. Any new agreement with Enumclaw should provide flexibility for PSE to reduce or terminate service from Enumclaw in the event that regional gas system growth provides other more effective methods of delivering gas to Buckley.

Real estate

PSE would not acquire any fee title property as part of the contemplated transaction. According to the City of Buckley Administrator and technical staff, all of the City's gas system including its gas mains, service lines, three regulator stations and one gate station are located within City of Buckley owned property, which includes streets, alleys, parks, etc. The only exception is an easement granted to the City of Buckley by Puget Sound Power & Light

Company in 1972 for a gas main that was installed to serve the existing Rainier School campus. The City acknowledges that there may be additional gas service beyond the Rainier School, which utilizes the pipeline that crosses the campus (property owned by the State of Washington). If this is the case and the Rainier School campus were to close or if the land is redeveloped such that the gas lines would be impacted, there could be a potential future conflict. This appears to be a very small risk.

The City of Buckley believes it has all necessary operating rights for continued operations of its gas system. However, the City also acknowledges there are two service lines in place on private property for which they do not have appropriate easements; the City is not aware of any additional easement issues.

If PSE's bid is successful, the Company will need to obtain an appropriate franchise agreement with the City of Buckley prior to the acquisition of the City's natural gas system to use and occupy Buckley's property for current and future gas operations.

Human Resources

The City of Buckley currently has three gas utility employees, a utility lead and two utility workers. Employees are represented by the International Union of Operating Engineers, Local No. 286. Upon request, materials such as job descriptions, an operator qualification manual and information about the union were provided to PSE. After reviewing the relevant information from the City, PSE operations training staff concluded that Buckley's operator qualifications are substantially similar to PSE's operator qualifications.

PSE plans to extend a "conditional offer" of employment to one of the three employees who currently work for the City of Buckley's gas utility. For more information about PSE's human resources transition plan and the proposed conditional offer, see *Section 8. Transition Plan and Schedule*.

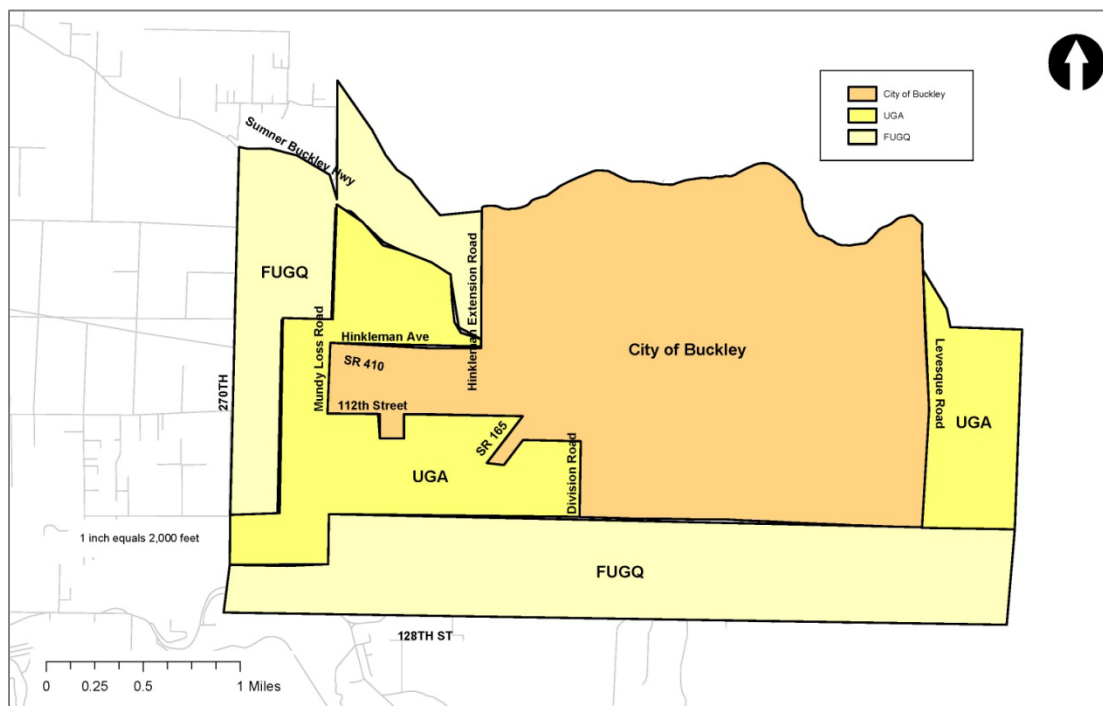
Customer Experience

Buckley's gas utility customer breakdown includes 1,178 residential customers and 190 commercial customers. Thirty-eight percent of the City's total gas load comes from the state-run Rainier School, which is a residential school for mentally disabled children. The school employs 1,000 people, more than 300 of whom live in the City of Buckley. The Rainier School is the major employer in the City. The school is further discussed in *Section 4. Risks and Mitigations*.

Growth Potential

Preliminary plats for 300 new homes have been pre-approved by the City. Gas mains for a new neighborhood called Elk Heights have already been installed. In the current economic climate, build-out of the Elk Heights development is estimated to be five years.

Figure 5. City of Buckley Proposed Urban Growth Areas



Accounting

If PSE’s bid is selected, the transaction will be recognized as a business combination and accounted for under the acquisition method. This requires PSE to record the fair value of identifiable assets acquired, the liabilities assumed, and any non-controlling interest in Buckley’s gas system as of the acquisition date (i.e., the day PSE takes control of Buckley’s gas system). The difference between the entire consideration PSE pays and the fair value recorded above is recognized as Goodwill at the acquisition date.

Rates and Regulatory

No major regulatory issues were identified that would preclude a transaction taking place. A discussion of the regulatory plan for incorporating the Buckley natural gas system into PSE’s system is included in *Section 8. Transition Plan and Schedule*.

Commercial

A few issues surfaced during the due diligence process that could likely be addressed prior to closing a potential purchase transaction with the City. PSE would likely seek resolution to the following items as conditions precedent to closing for a sale:

1. Negotiate acceptable termination language for the Enumclaw gas transportation agreement.
2. Request that the City cure the three real estate defects by obtaining appropriate easements.
3. Consideration for system conditions not discovered during initial diligence, but discovered in a subsequent leak survey.

4. Risks and Mitigations

Competition

Cascade Natural Gas Corporation (“Cascade”). Based on company strategy and footprint, Cascade is a likely bidder for the City of Buckley’s gas system. If Cascade’s bid is selected, it would open the door for the company to apply to serve the certifiable area west of Buckley towards the City of Bonney Lake. The foothold in Buckley would also strengthen Cascade’s position as a potential bidder for the City of Enumclaw’s gas system, should that opportunity present itself in the future. Cascade is a strong potential bidder, with rates lower than PSE’s. Cascade’s parent company, MDU Resources Group, Inc., has a track record of overpaying for gas systems. PSE should be able to distinguish itself, relative to Cascade, in the areas of customer service and proximity to emergency response resources; however, it may be difficult to completely offset the impact of rate differences.

City of Enumclaw. PSE staff has received no indication that the City of Enumclaw is interested in purchasing the Buckley system. Enumclaw’s gas operations manager has communicated some interest in the system to Buckley staff; however, we have confirmed that the Enumclaw City Council has not authorized any due diligence studies nor has their staff presented any indication that they are preparing a proposal for consideration.

Rainier School

Forty-six percent of the total gas load comes from the Rainier School. This school and all residential habilitation centers (“RHC”) for individuals with developmental disabilities have been a topic of discussion for several decades at the State legislature. Some legislators believe that the RHCs, including the Rainier School, should be shut down in favor of community services. There is a strong political advocacy contingent led by State Senator Pam Roach and the

Mayor of Buckley that supports keeping this school open. The political outcome of this issue is difficult to predict; however, it is highly unlikely that the school would close in the near future.

The school is a major employer in Buckley and the City would be economically impaired if the State were to close the facility. Similarly, the City's natural gas provider would also be adversely affected by a school closure. While this is a potential risk that needs to be monitored, as mentioned above, the risk of the school closing in the near future is low. The City Administrator believes that if the State were to close the school, another State function would likely be moved into the building. Alternately, the State might elect to sell the excess land due to budget considerations.

System conditions

- **Leakage.** The 2012 Pipeline and Hazardous Materials Safety Administration ("PHMSA") Annual Report lists one repaired leak on a service line caused by Excavation Damage and one system leak scheduled for repair. The Buckley gas system had a total of 166 excavation tickets during 2012. PSE staff did not review all leak records; however, some WUTC audits have reviewed leaks that have occurred. Most leaks appear to have occurred in above-ground, threaded fittings. PSE staff recommends that a leak assessment of the entire Buckley gas system and any needed remedial action be performed, if PSE is the winning bidder. The leak assessment is estimated to cost \$7,000. See the Leak Survey line item in *Section 8. Transition Plan and Schedule*.
- **Unaccounted for Gas.** The City reports 3.95 percent unaccounted for gas. This is a fairly high number that could be caused by measurement discrepancies between the gas coming into the system at the town border station and the gas measured out to customers. This is an area for improvement. On a volume of 192,000 Mcf⁴, this amounts to overpayment or under-billing for 7,585 MCF, or about 78,000 therms⁵ per year. The

⁴ MCF equals the volume of 1,000 cubic feet (cf) of natural gas.

⁵ One therm equals 100,000 British thermal units (Btu).

value of the unaccounted for gas is estimated to be roughly \$35,000, which is about \$25,000 to \$30,000 more than the value of unaccounted for gas one would typically expect to see on PSE's system.

To address this leakage, PSE recommends a measurement audit, starting with the meters at the gate station and the Rainier School, as well as a review of the overall billing system and the methodology for calculating unaccounted for gas. The City of Buckley bills customers on a volume basis (CCFs⁶) but is purchasing gas on an energy basis (therms). Measurement differences and errors may account for some of the lost and unaccounted for gas.

⁶ CCF equals the volume of 100 cubic feet (cf) of natural gas.

5. Summary of Benefits

Why is the City of Buckley's natural gas system attractive to PSE?

Other than the City of Buckley, PSE is the only natural gas utility serving Pierce County. Natural gas growth in the County is moving east from the Tacoma area and suburbs toward Buckley. The neighboring City of Bonney Lake—just 1.5 miles from Buckley's city limits—has already seen substantial growth in recent years. The addition of Buckley's approximately 1,400 customers would add top-line business growth to PSE's system equivalent to 2.5⁷ months of growth in a normal year. This is an excellent opportunity for PSE to increase its natural gas distribution system in a growing area of our region.

The City of Buckley gas system is also attractive to PSE given its proximity to other PSE assets. PSE owns a service facility in Enumclaw that could be used to serve Buckley, though a more likely option in the near term would be to utilize the Puyallup operations and maintenance offices, equipment, and staff. In other words, incorporating the Buckley gas assets would not require an incremental investment in infrastructure to adequately serve the residents of the City.

Another benefit to the system is Buckley rates. PSE anticipates it would be able to transition residents to existing rate schedules that are either at parity with or, in most cases, below Buckley rates. In short, PSE will be able to continue offering residents great service, but at a lower price than they are currently paying.

⁷ Based on average gas customer growth from 2011 to 2012 as detailed in PSE's 2012 10K filing with the Securities and Exchange Commission.

6. Financial Analysis

Proforma

The overall bid price recommendation for the Buckley natural gas system before transaction costs is \$5.4 million. The total acquisition cost to PSE would be \$6.1 million, which includes transaction costs of \$0.5 million, and \$0.2 million to fully integrate Buckley's system into PSE's system. Integration costs include replacing meters, adding SCADA and converting the customer and mapping data to PSE's system, as described in *Section 8. Transition Plan and Schedule*.

First year additional revenue generated from Buckley customers is expected to be approximately \$1.9 million. PSE's analysis assumes no growth in the Buckley customer count because the area has experienced no growth within the last five years. The O&M calculation is based on PSE's average distribution costs per customer, which equates to \$0.1 million annually. Excluding one-time acquisition charges in the first year, EBITDA⁸ is expected to be approximately \$0.6 million annually.

Scenario Analysis

PSE staff modeled various purchase price scenarios to determine the impact on earnings and the payback period. The price range for a 20- to 30-year payback period is between \$5 and \$6 million. PSE staff recommends that PSE offer a bid of \$5.4 million, which has a 22-year payback period and is just above the lower end of the range of possible bid prices that take into account projected revenues, expenses, depreciation, and return requirements of PSE.

⁸ Earnings before interest, taxes, depreciation and amortization.

7. Bid Overview

Rate Schedule

- PSE offers a sufficient variety of natural gas service offerings to cover the City of Buckley's customer classes. City of Buckley residents would be placed on, or select, the appropriate tariff schedule for service. Upon transition, PSE would waive the billing initiation charge for customers transferring from City of Buckley service.
- The majority of Buckley residential and commercial customers would see a drop in the overall price for their natural gas service.
- Based on a comparison of residential natural gas rates, an average residential customer may pay up to 10 percent less under PSE rates than they would under current City of Buckley rates.
- Based on a comparison of commercial natural gas rates, an average commercial customer would pay about 6 percent less under PSE rates than they would under current City of Buckley rates.
- The Rainier School facility would pay about the same rate overall.
- Right now PSE's average natural gas commodity costs are about 60 percent lower than the City of Buckley's costs.

Value Proposition to the City of Buckley

- PSE makes safety its number 1 priority.
- Online bill payment and customer information.
- PSE would offer convenient combined billing for customers with both natural gas and electric bills –1 bill, 1 payment.

- PSE offers rebates for energy efficient home and water heating, as well as other incentives.
- PSE offers convenient, optional budget payment plans to reduce the volatility of customers' monthly energy bills by spreading the costs over a 12-month period.
- In most cases, Buckley customers would pay lower rates with PSE, but in all cases rates would at least be at par with current rates offered by the City.
- The City of Buckley will be able, at its discretion, to tax residents who are PSE natural gas customers, consistent with state statutes up to 6 percent, just as it does currently (City Ordinance 31-89) for City of Buckley residents who are PSE electric customers.
- PSE provides comprehensive and timely emergency response capabilities from nearby operating bases.
- PSE could offer fire training to City emergency responders.
- PSE could extend offers of employment to at least one of the City of Buckley's current gas utility employees.
- PSE offers diagnostic and repair services for customer-owned gas appliances.

Amicable history with PSE

When PSE stopped generating electricity at its White River Project in January 2004, PSE spent many years in a collaborative process with the City of Buckley and several other government entities to find a mutually acceptable solution that would maintain the viability of Lake Tapps and offer PSE a reasonable settlement for our investment. PSE subsequently entered into a complex land agreement with the City of Buckley, which purchased 154 acres of undeveloped property. It was the largest property acquisition in City history. Through this process, the City developed a special trust in PSE. Both parties negotiated with integrity and in good faith. PSE has been assured that if it is the successful bidder, City staff will recognize our long-standing

relationship and work with PSE staff to establish a prompt, amiable process for franchise negotiations, permitting, and other considerations.

8. Transition Plan and Schedule

The evaluation team has identified the following preliminary list of next steps to be completed in the event PSE's bid is successful.

Negotiate or assign contracts

- **Purchase/sale agreement.** PSE would work out high level sale terms and conditions with the City, ultimately leading to an Asset Purchase Agreement detailing the contractual obligations of both buyer and seller.
- **Enumclaw gas contract extension/assignment.** PSE would begin a dialogue with the City of Enumclaw to develop a new long-term transportation agreement that would provide greater certainty about the level of service price. Any new agreement with Enumclaw should provide flexibility for PSE to reduce or terminate service from Enumclaw in the event that regional gas system growth offers other more effective methods of delivering gas to Buckley.
- **Franchise agreement.** PSE would work to craft an acceptable franchise agreement with the City of Buckley.

Gas engineering and operations

- **Customer billing.** Use information from the City of Buckley's gas customer billing system to convert current Buckley gas customers to PSE gas customers. Unlike PSE's customers, City of Buckley customers have historically been billed on a volume basis rather than on an energy basis, so it may not make sense to try to import past customer usage information into the PSE system.

- **Mapping transition.** Add the Buckley gas system to PSE’s geographic information system (“GIS”). Source materials may include a combination of the City’s mapping system and as-built records.
- **Leak survey.** Perform a leak survey for the entire Buckley gas system. The survey could be conducted in one of three ways: 1) prior to closing with the City performing any required remedial action, 2) after closing with PSE performing any remedial action, or 3) some combination of the two.
- **Meter reading.** Existing meters should be read upon transition or a method for splitting bills between PSE and the City of Buckley during the transition should be established by the two parties prior to the transition.
- **Meter replacement.** WAC 480-90-328 requires utilities to identify each gas meter with a unique series of serial numbers and company name. Additionally, WAC 480-90-353 requires utilities to maintain meter history records. To accomplish this, PSE should replace all existing residential and small commercial meters with PSE meters equipped with automatic meter reading (“AMR”) capabilities, proper identification and meter history. Efforts should be made to replace all meters expeditiously. Customers must be present at the time of installation to complete the appliance relighting process. Scheduling installations after normal business hours or on weekends would likely make the process more convenient for new customers.
- **Public benefit programs.** Ensure that PSE’s Public Awareness programs and Emergency Responders classes include the City of Buckley.

Employment offer(s)

Extend a “conditional offer” of employment to at least one of the three employees who currently work for the City of Buckley’s gas utility. A “conditional offer” is made when a prospective employee is highly qualified, has significant experience and there are expected to be minimal areas where PSE systems or procedures training is required to fully meet PSE’s

journey level standards. After comparing a record of the prospective employee's completed training with PSE's requirements, PSE's Operations Training and Gas Operations management personnel will develop a plan to address any training or qualification gaps. If training is not successfully completed within a nine-month probationary period, the employee is considered ineligible to continue employment with PSE and is terminated.

PSE recommends this type of conditional offer because it has proven to be a successful tool in supporting PSE's efforts to hire new employees at the journey worker level. The new employee(s) will be covered by the provisions of the collective bargaining agreement with the United Association of Journeymen and Apprentices of Plumbing & Pipefitting Industry (UA) with benefits according to the contract. Employees will have PSE seniority from the date of hire upon successfully completing all training and qualifications requirements. Additional information about PSE's staffing proposal, recommendations and impacts is provided in confidential *Attachment E. Staffing Proposal, Recommendations and Impacts*.

Insurance

If acquired, the Buckley natural gas system would be added to PSE's existing property, liability and workers compensation insurance policies. As is typical in the current insurance market, we would anticipate the following insurance costs to either remain flat, or increase in the range of zero to five percent annually upon renewal.

PSE insurance reviewers considered the following four basic areas of insurance associated with the proposed acquisition.

- **Automobile.** The sale of the Buckley natural gas system does not include any vehicles. PSE would use existing fleet vehicles to service this system. This will not impact existing PSE insurance premiums.

- **General Liability.** PSE currently has a \$2 million self-insured retention. Aegis provides the first layer of coverage up to \$35 million. PSE's total excess liability insurance limit is \$200 million.
- **Property.** PSE currently has a \$5 million self-insured retention, with coverage up to \$500 million through carrier FM Global. FM Global will seek a system inspection as part of their underwriting process. This may occur pre- or post acquisition.
- **Workers Compensation.** It is possible that PSE will absorb one or all three of the Buckley Gas System employees. This would have little, if any, impact on our current workers compensation insurance program.

Regulatory Process

PSE would have to file for a Certificate of Public Convenience and Necessity to Operate a Gas Plant for Hire to serve in the current City of Buckley Certificated Area. The timing of such filing would likely coincide with either of the City of Buckley's selection of PSE and negotiations commencing or after such negotiations conclude.

RCW 80.28.190: *(1) No gas company shall, after January 1, 1956, operate in this state any gas plant for hire without first having obtained from the commission under the provisions of this chapter a certificate declaring that public convenience and necessity requires or will require such operation and setting forth the area or areas within which service is to be rendered; but a certificate shall be granted where it appears to the satisfaction of the commission that such gas company was actually operating in good faith, within the confines of the area for which such certificate shall be sought, on June 8, 1955. Any right, privilege, certificate held, owned or obtained by a gas company may be sold, assigned, leased, transferred or inherited as other property, only upon authorization by the commission. The commission shall have power, after hearing, when the applicant requests a certificate to render service in an area already served by a certificate holder under this chapter only when the existing gas company or companies*

...serving such area will not provide the same to the satisfaction of the commission and in all other cases, with or without hearing, to issue the certificate as prayed for; or for good cause shown to refuse to issue same, or to issue it for the partial exercise only of the privilege sought, and may attach to the exercise of the rights granted by the certificate such terms and conditions as, in its judgment, the public convenience and necessity may require.

Additionally, PSE would likely have to file for a Purchase of Property under WAC 480-143-130.

WAC 480-143-130: *Purchase of property - A public service company may not acquire any franchise, property, facility, capital stock, or bonds of another public service company unless it first applies for, and obtains, commission approval. Applications must describe the proposed acquisitions in detail and include the public service company's current financial statements and copies of all transfer instruments.*

In conjunction with the PSE filing, it appears the City of Buckley would have to file for a Transfer(s) of Property under WAC 480-143-120. It is likely PSE and the City of Buckley could make a joint filing.

WAC 480-143-120: *Transfers of property - A public service company may not complete a transfer of property necessary or useful to perform its public duties unless the company first applies for, and obtains, commission approval. Transfers include sale, lease, assignment of all or part of a public service company's property, and merger or consolidation of a public service company's property with another public service company. Certain telephone utility leases are exempt under WAC 480-143-200. Applications must describe transfers in detail and must include the public service company's current financial statements and copies of all transfer instruments.*

The following definitions of “Public Service Company” and “Gas Company” are provided as a reference:

RCW 80.04.010: (23) *"Public service company" includes every gas company, electrical company, telecommunications company, wastewater company, and water company. Ownership or operation of a cogeneration facility does not, by itself, make a company or person a public service company.*

RCW 80.04.010: (14) *"Gas company" includes every corporation, company, association, joint stock association, partnership and person, their lessees, trustees or receiver appointed by any court whatsoever, and every city or town, owning, controlling, operating or managing any gas plant within this state.*

9. Recommendation

A multifunctional team of PSE employees evaluated the City of Buckley's natural gas system to assess the merit of submitting a bid for the system in the City's formal RFP process. The findings of the due diligence process were positive or neutral in all regards. Based on PSE's evaluation of the risks and benefits associated with the proposed transaction, PSE staff recommends that the Energy Management Committee authorize a formal bid offer of \$5.4 million to acquire the City of Buckley's natural gas distribution system, and approve a total acquisition cost to PSE of \$6.1 million including transaction and integration costs.

List of Attachments

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| Attachment A. | Presentation to Energy Management Committee on May 16, 2013: Informational Progress Update |
| Attachment B. | Presentation to Energy Management Committee on May 29, 2013: Bid Recommendation to Management |
| Attachment C. | RFP for the Sale of the Buckley Natural Gas Utility |
| Attachment D. | Gas System Assets and Operations Review |
| Attachment E. | Staffing Proposal, Recommendations and Impacts (Confidential) |