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Docket UG-120715

STATEMENT OF COMMISSION POLICY

A. Introduction

- 1 Today, each gas company subject to Commission economic regulation under Chapter 80.28 RCW replaces pipe as part of its normal operations, and recovers related costs from customers through rates. There are no statutes or rules that mandate when a gas company should replace a particular section of pipe, or a particular type of pipe. Consequently, and in general, gas companies have exercised a range of discretion regarding how to address risk of failure on their systems. As a result, some gas companies are proactive¹ in replacing pipe that presents an elevated risk of failure, while other gas companies are less so.
- 2 It is in the public interest for all gas companies to take a proactive approach to replacing pipe that presents an elevated risk of failure. The Commission expects each gas company to have a pipe replacement program plan that contains the elements discussed in this section.
- 3 Some gas companies will need to make little or no change in operations to be consistent with this policy statement. Other gas companies may need to change management focus and perhaps company culture. The Commission strongly encourages these changes, though the Commission is also realistic. For example, despite the well-documented concerns over certain types of gas pipe facilities, for some gas companies, cost considerations have been identified as a barrier to creating a more vigorous and responsive pipe replacement program.
- 4 To address this concern, the Commission will approve a special pipe replacement program cost recovery mechanism (CRM) based on the model used in Oregon with NWNG, so long as the gas company's program meets the elements in this section. A gas company seeking a CRM below may file a tariff reflecting such a mechanism as described below.

¹ "Pro-active" in this context means a gas company has a definite plan in place to replace all gas pipes that presents a demonstrated, elevated risk of failure.

5 While each gas company should have a pipe replacement program that is consistent with this policy statement,² a CRM is optional. Gas companies that can effectively manage their pipe replacement program without a special cost recovery mechanism may continue to do so.

6 Whether it seeks a CRM or not, each gas company should file with the Commission for approval a pipe replacement program plan with the supporting information identified in this section.

B. Company Pipeline Replacement Plan

7 The pipe replacement program plan should consist of three parts: (1) a “master” plan for replacing all pipes with an elevated risk of failure; (2) a two-year plan that specifically identifies the pipe replacement program goals for the upcoming two year period; and (3) if applicable, a plan for identifying the location of pipe that presents elevated risk of failure.

8 The first pipe replacement program plan should be filed by June 1, 2013, covering planned pipeline replacement through 2015. Subsequent plan filings should be filed by June 1 every two years thereafter (*i.e.*, June 1, 2015, 2017, 2019, etc.). If the company makes no changes to its master plan, it need file only the two-year plan in each filing after June 1, 2013. If the company makes a material change either to its master plan, its two-year plan or its pipe location plan, it should file plan changes with the commission within 30 days.

9 A pipe replacement program plan acceptable to the Commission (and also eligible for a CRM) should contain the following elements:

1. The pipe replacement program plan should target pipe that poses an elevated risk of failure

10 In support of its pipe replacement program plan, each gas company should demonstrate that the type of pipe to be replaced under its program presents an

² The Commission recognizes that policy statements are not rules, and thus are not enforceable as a rule. However, for gas companies that do not wish to follow this policy statement, the Commission will initiate a proceeding to evaluate a gas company’s pipe replacement program. The Commission does not predict the outcome of such a docket. However, depending on the evidence presented, the record in such a proceeding may justify Commission imposition of penalties if violations of Commission rules are proven, or a Commission order requiring the gas company to improve its practices, per, e.g., RCW 80.28.010(2), .040, and .130. There may be other related or unrelated remedies available.

elevated risk of cracking, leakage, breakage or other failure. The gas company should explain why the particular type(s) of pipe presents an elevated risk, such as the physical qualities of the pipe as manufactured (e.g., low ductile plastic pipe), the condition of the pipe as installed (e.g., poor soil conditions) or as maintained (e.g., no cathodic protection), the age of the pipe, etc.

- 11 The gas company should also provide detailed analysis and explanation demonstrating why the pipe it seeks to replace is appropriate for replacement, compared to other pipe. To the extent practical, the gas company should quantify and explain the degree to which risk of failure is elevated for such pipe, compared to other pipe.
- 12 Unless it is demonstrated otherwise, the Commission will consider a company's DIMPs and Transmission Integrity Management Plans (TIMPs) to be a fundamental source of information for evaluating elevated risk of pipe failure. However, each DIMP and TIMP should be robust and sufficiently populated with reliable data to justify conclusions regarding the risk presented by various types of pipe.

2. The pipe replacement program plan should contain a plan for identifying the location of pipe that presents elevated risk of failure

- 13 In the course of this docket, the Commission has learned that the degree of knowledge regarding the location of each type of pipe in its system varies widely, company to company. However, most (if not all) gas companies are expending effort to acquire or refine knowledge regarding pipe location.
- 14 A prudent pipe replacement program should contain a plan for identifying the location of elevated risk pipe; to the extent the gas company does not presently know the location. The plan should include a timetable under which the gas company will know the location of its elevated risk pipe. The Commission strongly supports a gas company's efforts to enhance the knowledge of its gas pipeline systems, including the location of the types of pipe that present an elevated risk of failure.
- 15 The Commission will not require a gas company to know the location of all of its elevated risk pipe as a prerequisite for having a pipe replacement program consistent with the policy statement. A pipe replacement program may focus initially on pipe for which the gas company knows the location.
- 16 At the same time, the Commission considers a gas company's knowledge of the location of each type of pipe it uses in its system to be a basic part of gas company operations. Stated differently, a gas company's failure to know where elevated risk

pipe is located may itself present a safety risk the gas company should address and minimize. Consequently, a gas company may not include in the CRM the cost of locating pipe eligible for replacement under its pipeline replacement program.³ Such knowledge should be an essential part of utility operations, not part of an incentive program.

- 17 After the first year, a company's continued participation in the program will be contingent on its substantial progress identifying the location of its elevated risk pipe. If a Company fails to so identify the location of such pipe prior to its initial filing for cost recovery, then it must demonstrate why it cannot identify the location of its elevated risk pipe and a plan for compliance with this requirement. Without such a demonstration of progress (or legitimate reasons for lack of progress), the company's participation will be limited to recovery of its first year costs, including return. A company in this circumstance may make a compliance filing at any time during the program year and allowed to participate for the remainder of the year in question.

3. The pipe replacement program plan should be a measured and reasonable response in relation to the elevated risk and such a program must not unduly burden ratepayers

- 18 The Commission expects all gas company pipe replacement program plans to reflect a measured, fact-based response to the elevated risk which the gas company has demonstrated. The Commission understands that the significance of the effort will depend on, among other things, the nature and quantity of the pipe involved the difficulty in replacing it, and the cost of replacing it. Considerations such as weather, permitting, ground conditions, crew availability, etc., can affect the term and cost of a pipe replacement program. Accordingly, the Commission anticipates that some master plans may have terms exceeding 20 years.

- 19 In this regard, each gas company must analyze the relative costs and burdens of the plan under various time scenarios, and explain the basis for choosing a particular term. In addition, each gas company pipeline replacement program plan generally must prioritize the replacement of elevated risk pipe within the program, based on the relative level of risk presented. For example, and in general, a gas company should replace pipe located near a school, hospital or in a heavily populated area before it replaces pipe located in a sparsely populated area.

³ Nothing in this statement prevents a gas company from seeking recovery of such costs through and consistent with the traditional ratemaking process.

20 It is a reality that the prudent costs of a pipe replacement program plan will be borne
by those the plan intends to protect: the gas company's customers. At the same time,
the Commission will consider the rate impact of a pipe replacement program plan,
and expects each gas company to analyze rate impacts in each plan it files pursuant to
this policy statement.

4. The pipe replacement program plan must be in the public interest

21 The elements identified in this section are not all-inclusive of the elements the
Commission may require in the public interest. The Commission will consider other
public interest factors as they arise.

5. Commission approval of the pipe replacement program plan

22 Each pipe replacement program plan is subject to Commission approval. The
Commission will determine an appropriate approval process for each plan after it is
filed.

C. Special Pipe Replacement Program Cost Recovery Mechanism (CRM)

23 The discussion of the development of a CRM has been robust with all parties
providing quality input. After two workshops⁴ and various written comments there is
general consensus that an interim recovery mechanism would provide an incentive to
accelerate replacement of pipe that presents an elevated risk of failure. We agree that
a CRM similar to the model used in Oregon would provide a benefit but only within
in the parameters set out below and in this policy statement.

24 As presented in the August 24 Notice, the CRM would exclude all costs related to
replacement of bare steel along with any period costs such as any incremental
changes in operating and maintenance (O&M) expenses. A number of the parties
argued that the scope of the mechanism should be widened to also allow recovery of
investment in bare steel, wrapped steel pipe and other elevated-risk pipe in addition to
the so called "DuPont pipe".

25 We agree that it is in the public interest to expand the program to the other pipe types
within the constraints of the planning and pipe location identification requirements of
this policy statement.⁵

⁴ Including one workshop which was focused solely on interim cost recovery mechanisms.

⁵ However, PSE included its sewer cross bore program in the pipeline replacement plan it filed on
September 14, 2012. We do not believe that the sewer cross bore program has been sufficiently

26 The CRM would allow for the return of and return on specific identified investment with elevated risk between rate cases, as approved in a company's pipeline replacement program plan. This mechanism would minimize the time the investment is made to the time of recovery to just a few months through annual recovery.

27 The CRM would have an effective life of four years with a general rate case filing required at the end of the life to fold plant investment into base rates and adjust the CRM.

28 A pipe replacement cost recovery mechanism acceptable to the commission must conform to the following elements:

1. Filing for a CRM

29 A company seeking a CRM would elect this option when it files its pipe replacement program plan June 1, 2013. Any company electing a CRM will prepare and submit the information described in this section of the policy statement with its program plan.⁶ A company that does not request a CRM by June 1, 2013, may do so June 1 of any subsequent year.

2. Investment

30 Annual investment in pipeline replacement that would be eligible for recovery under the CRM is limited to elevated-risk pipe. The pipe must be readily identifiable in the company's pipeline replacement program plan by both location and timetable. Costs recoverable under the CRM must not include: (1) the costs of locating pipe eligible for replacement; (2) pipeline costs associated with normal growth, system expansion, and repair and replacement of pipe damaged by third parties; and (3) the cost of pipe that a company is required to replace by a Commission order or approved settlement.

developed for the company to sufficiently document the risk presented by such occurrences at this time. It still may be eligible for recovery through the normal rate setting process and for inclusion in a future CRM filing when results from its pilot program have been analyzed and presented, and reviewed by the Commission.

⁶ If a company files for a CRM at the same time it files its Pipeline Replacement Plan on June 1, 2013, the Commission anticipates a concurrent review process with the final approval of the CRM contingent upon the approval of the Pipeline Replacement Plan as outlined in Section B.

3. Accounting Treatment

31 A company would maintain its accounting records consistent with normal accounting. The proposed mechanism would not provide for deferrals of costs, or the accrual of interest on that cost, for later recovery. The CRM is intended to provide recovery of both a return on and a return of investment between general rate proceedings through annual rate increases.

4. Cost Recovery

32 A CRM would recover the return on the prior year's plant investment and recover depreciation expense associated with a company's elevated-risk pipe replacement investment program plan approved pursuant to Section B above. An operations and maintenance offset for the reduction in accelerated leak surveys or related expense will be considered.

33 For 2013, a company would be allowed to recover through the CRM approved replacement program costs incurred for the twelve month period November 1, 2012, to October 31, 2013. Recovery would be effective November 1, 2013, consistent with the company's annual purchased gas adjustment (PGA) filing and tariff. By looking retrospectively at a company's elevated risk replacement program, we ensure that improvements actually in service are included in rates, and that program investments are consistent with a company's replacement plans.

34 On June 1 of each year a company that participates in a CRM must file actual and projected investment for that program year. The June 1 filing would include investment incurred from November 1 of the previous year to April 30 of the current year and projected costs from May 1 through October 31st consistent with the approved replacement plan. Every month thereafter the company will update the projected costs with actual investment incurred prior to the November 1 effective date. This process should give reasonable recognition of the proposed tariff's effective date and the *used and useful* constraint.⁷

⁷ Whether the Commission will allow into rates the costs associated with a resource acquisition requires utilities to demonstrate that the acquisition is "used and useful" in the service of providing electricity to customers. RCW 80.04.250; see Leonard S. Goodman, *The Process of Ratemaking* 799 (1998). To the extent any estimated costs for the final month are different for those embedded in the CRM, the company will adjust the subsequent period CRM to either recover or refund the difference.

35 After the initial year, the CRM will require a separate revenue requirement
calculation by program year considering changes to net rate base, depreciation, and
operations and maintenance offsets. After the Commission has approved a CRM for a
company, any general rate case filing must include all plan investment in base rates
and reset the tariff to exclude any CRM recovery.

5. Cost of Service

36 Each company will develop a cost of service considering investment and related
elements provided for in the CRM. The capital structure and cost of equity should be
those used in its most recent general rate case.

6. Tariff and Billing

37 A company must file tariffed rates designed to recover the revenues reflected in the
company's developed cost of service study for the rate year at least two months prior
to the effective date of the company's PGA. The company will include and identify
separate recovery.

38 The Commission will determine how the increase in customers' rates will appear on
bills when the company makes its tariff filing.

7. Cap on Amount Considered for Recovery

39 In its filing, each company will propose and support a cap for annual expenditures
recoverable through the CRM for an elevated-risk pipe replacement program under
this policy. Companies may consider a percent of rate base, percent of revenues, total
expenditures or other basis for its cap. As part of that proposal the company will
address expected rate impact on customers and other factors supporting the cap.

8. CRM Life and General Rate Case Filing Requirement

40 The CRM will have a life of up to four years before including the investment covered
by the program in base rates. If a company does not file a rate case during the four
year period, it should file a rate case with a rate year effective date closely following
the completion of the final year of the CRM. In this case CRM investment would be
included in base rates. If a company files a general rate case within the four year life
of the CRM, the process will commence within the framework of that general rate
case.

9. Other Factors

41 The elements identified in this section are not all-inclusive of the elements the Commission may require in the public interest. The Commission will consider other public interest factors as they arise.

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