EXHIBIT NO. ___(TAD-3)
DOCKET NO. UG-110723
WITNESS: TOM DE BOER

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, **Complainant,** **v.** **PUGET SOUND ENERGY, INC.,** **Respondent.**	**Docket No. UG-110723**

SECOND EXHIBIT(NONCONFIDENTIAL) TO THE
PREFILED DIRECT TESTIMONY OF
TOM DE BOER
ON BEHALF OF PUGET SOUND ENERGY, INC.

SEPTEMBER 2, 2011

American Gas Association

NATURAL GAS Rate Round-Up

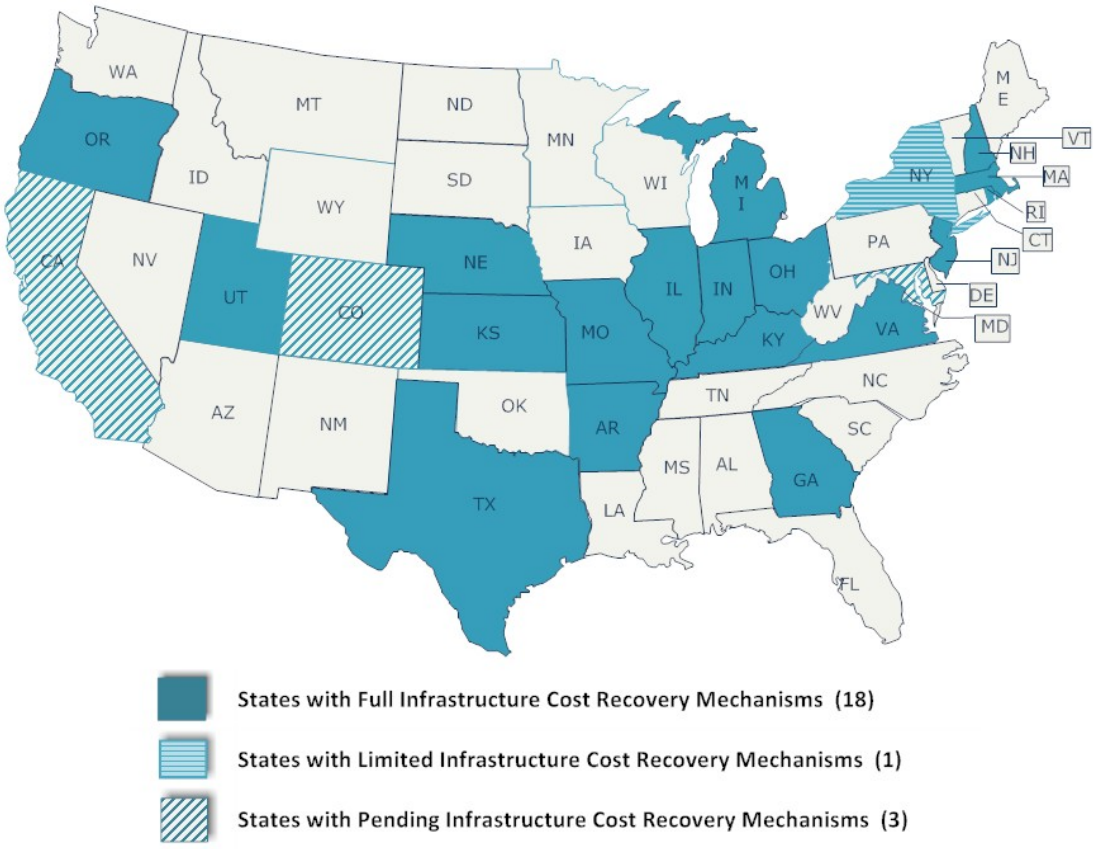
A Periodic Update on Innovative Rate Designs

May 2011

INFRASTRUCTURE COST RECOVERY

A number of states allow natural gas utilities to modify tariffs and begin to recover the costs of utility infrastructure investments incurred between rate cases. The rationale for such cost recovery is that while the investments are necessary to maintain system reliability and safety, typical ratemaking mechanisms do not allow for cost recovery until the utility files for a new rate case, which in many cases, may be several years after the costs have been incurred. This AGA Rate Round-Up describes rate designs and structures that allow recovery of the incremental costs of replacement infrastructure investments. Currently, more than 40 utilities in 19 states serving 20 million residential natural gas customers are using full or limited special rate mechanisms to recover their replacement infrastructure investments, and 6 utilities have such mechanisms pending in 3 other states. In addition, 13 utilities in 6 states serving 6 million customers are recovering these investment costs using rate stabilized tariffs.

STATES WITH INFRASTRUCTURE COST RECOVERY RATE MECHANISMS



THE CHALLENGES OF INFRASTRUCTURE COST RECOVERY

Under traditional cost of service based ratemaking, the costs of natural gas utility infrastructure investments are recovered after the investment is in the ground and the regulator has approved the costs in a rate case. This system produces a significant lag between when the dollars are spent for infrastructure replacement and when the company begins to recover these expenditures in rates. In addition, while investments made to serve new customers or to deliver additional volumes of gas generate additional revenue, expenditures made to refurbish or to replace aging infrastructure do not produce incremental revenue.

Timely cost recovery of prudently incurred safety and reliability investments is of utmost importance to the financial stability of natural gas utilities. Because traditional ratemaking allows recovery of infrastructure investments only following approval in a rate case, there is often a multi-year delay before the recovery of such investments begins. Investments that are recovered long after they are incurred cause the utility to bear carrying costs without the opportunity to recover these prudent expenditures. Credit agencies criticize companies with lag in the recovery of their costs and assign a lower credit rating to such utilities that ultimately translates into higher rates for customers. The only alternative is to file a rate case each year, which is a costly activity that also leads to higher rates for customers.

RATE DESIGN SOLUTIONS

States have been encouraging natural gas companies to increase the investment levels necessary to maximize the safety and reliability of their systems. Some state commissions allow a gas utility to use expense trackers or accounting deferrals to recover costs expended to replace infrastructure in a timely manner. These rate mechanisms reduce the costs associated with filing rate cases while reducing the regulatory lag associated with recovery of infrastructure investments. In addition, the mechanisms recognize that replacement investments will not lead to sales of additional volumes of natural gas that might otherwise have been expected to help recover the investments' cost.

Several rate design options are available for recovering expenses associated with replacing pipelines and other infrastructure that utilities incur after rates have been set. Trackers, surcharges, and rate stabilization mechanisms recover costs in the time period in which they are incurred, while deferral accounts delay the recovery of investments, and usually, carrying costs, until a future period.

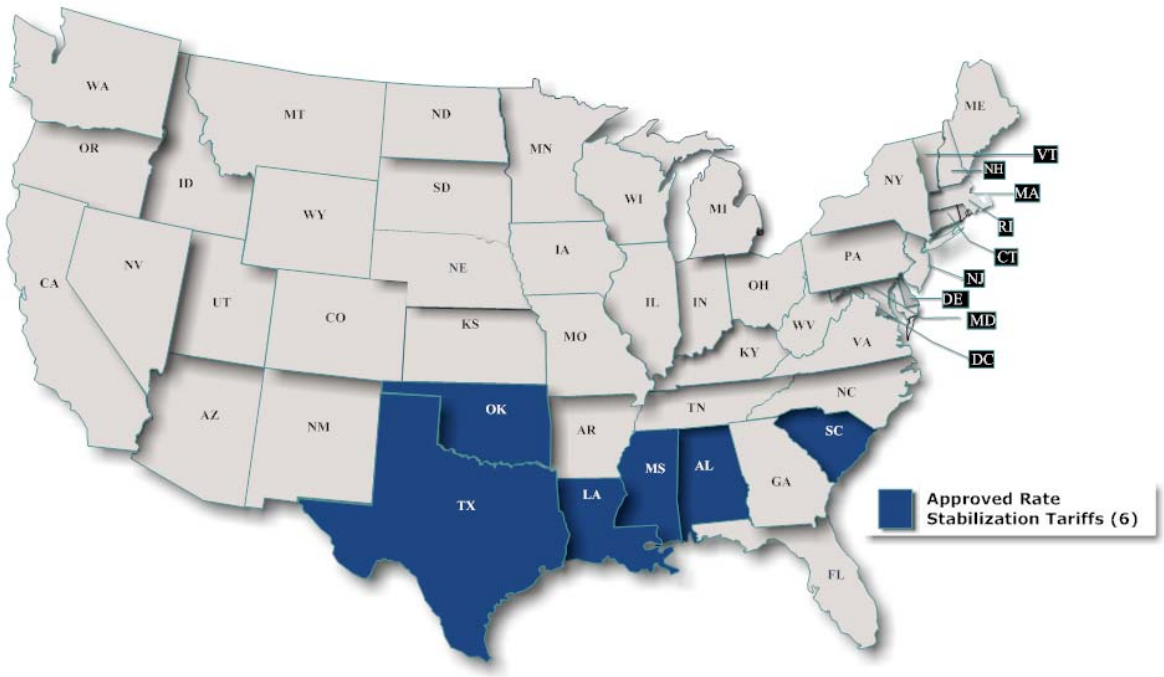
Tracker – A rate tracker is an example of an adjustment clause, a regulatory mechanism that allows a utility's rates to fluctuate in response to changes in operating costs or conditions, as they occur. Adjustment clauses have been in use since World War I, when the electric industry introduced them due to significant increases in the price of coal. Trackers may be automatic, actuated without the need for a formal rate hearing, or they may require additional regulatory review before they go into effect. Trackers allow the utility to adjust its tariff to facilitate the timely recovery of the capital costs, depreciation expense, and property taxes associated with the company's infrastructure investment program.

Surcharge to Rates – The most frequently used cost recovery method for infrastructure replacement cost programs is the surcharge to rates. A rate surcharge is a temporary adjustment to the customer bill that raises rates for a limited time by a fixed amount. Unlike the tracker, which allows the utility to recover ALL costs associated with infrastructure replacement, a surcharge limits the total amount of program cost recovery.

Deferral Account - Another option is the deferred accounting alternative. Using this approach, the utility treats infrastructure investment costs that are not included in the utility's existing rates in a segregated manner, thereby establishing a special deferred account. Generally, state authorities require a determination that the costs have been incurred prudently and have been accounted for properly. Often, these costs are deferred until the next rate case, at which time the costs are then amortized, recovered in rates, and the account balances are reduced or eliminated. In many cases, the assets in the deferral accounts accrue interest, and the interest is also amortized and recovered later in rates. The regulator may place limits on the amount or type of infrastructure costs that may be accrued, and on the time period over which the amortization may occur, and may require a showing of prudence in the incurring of specific costs.

Alternative Rate Design Method: Rate Stabilization – Rate stabilization is one of several rate designs that decouple the link between the volumes of gas consumed by a utility's customers and the revenues and cost recovery of the utility. A rate stabilization tariff operates much like a tracking mechanism since changes in ALL costs, including infrastructure investments, are tracked and flowed through to customers. With rate stabilization, rates are adjusted annually for new infrastructure replacement costs, as well as for costs for new construction. Utilities in six states, serving 6 million customers, use this option to recover the incremental costs of new and replacement infrastructure investment. AGA discussed this rate design in a previous Rate Round-Up report, ***Rate Stabilization Mechanisms***.

STATES WITH RATE STABILIZATION TARIFFS



Related Programs: Pipeline Integrity Management - Related to programs that provide for the replacement of cast iron and bare steel infrastructure are programs that recover the costs of maintaining and improving pipeline integrity. Concerned about the magnitude of pipeline integrity management costs that were mandated by the Pipeline Safety Improvement Act (PSIA) of 2002, several utilities implemented rate options similar to the trackers, surcharges,

and deferral accounts that are used to recover infrastructure investment costs. Some of these programs existed for a short time period (1-5 years) and have now expired, while other programs were wrapped into later infrastructure investment recovery programs and continue to recover expenses related to pipeline integrity management. Where pipeline integrity management program costs are still being recovered separately or have been subsumed into an infrastructure recovery program, program descriptions later in this report make a special note. AGA discussed cost recovery of these mechanisms in the report, ***Rate Round-Up: Pipeline Integrity Management Cost Recovery***.

CURRENT INFRASTRUCTURE COST RECOVERY RATE MECHANISMS

1. Ameren Missouri
2. Atlanta Gas Light - GA
3. Atmos Energy – GA
4. Atmos Energy – KS
5. Atmos Energy– KY
6. Atmos Energy – MO
7. Atmos Energy – TX
8. Avista Corp. - OR
9. Black Hills Energy – KS
10. Black Hills Energy – NE
11. CenterPoint Energy - AR
12. CenterPoint Energy -TX
13. Columbia Gas Kentucky
14. Columbia Gas Massachusetts
15. Columbia Gas Ohio
16. Corning Natural Gas - NY
17. Delta Natural Gas - KY
18. Dominion East Ohio
19. Duke Energy Kentucky
20. Duke Energy Ohio
21. Elizabethtown Gas - NJ
22. Integrys Peoples Gas - IL
23. Kansas Gas Service
24. Laclede Gas - MO
25. Missouri Gas Energy
26. National Grid Energy North - NH
27. National Grid Long Island - NY
28. National Grid Narragansett Gas - RI
29. National Grid Niagara Mohawk - NY
30. National Grid NYC
31. National Grid Massachusetts
32. New England Gas - MA
33. New Jersey Natural Gas
34. NW Natural - OR
35. Public Service Electric and Gas - NJ
36. Questar Gas - UT
37. SEMCO Energy - MI
38. South Jersey Gas
39. Texas Gas Service
40. TX - All Natural Gas Utilities May Apply
41. VA – All natural Gas Utilities May Apply
42. Vectren North – Indiana Gas
43. Vectren Ohio
44. Vectren South – SIGECO

PENDING INFRASTRUCTURE COST RECOVERY RATE MECHANISMS

1. Fitchburg Gas and Electric - MA
2. Public Service Co. of Colorado
3. San Diego Gas and Electric - CA
4. Southern California Gas
5. Washington Gas – Maryland
6. Washington Gas - Virginia

CURRENT RATE STABILIZATION TARIFFS

1. Alabama Gas
2. Atmos Energy – LA
3. Atmos Energy – MS
4. Atmos Energy – TX
5. CenterPoint Energy – LA
6. Centerpoint Energy – MS
7. CenterPoint Energy – OK
8. CenterPoint Energy – TX
9. Entergy – LA
10. Mobile Gas – AL
11. Oklahoma Natural Gas
12. Piedmont Natural Gas – SC
13. South Carolina Electric and Gas

STATES WITH LEGISLATION OR GENERIC REGULATORY MECHANISMS

1. Kansas
2. Kentucky
3. Missouri
4. Nebraska
5. New Jersey
6. Rhode Island
7. Texas
8. Virginia

SUMMARY

Maintaining the safety and reliability of the nation's natural gas pipeline system has always been the number one priority for AGA and its member utilities. Utilities annually incur billions of dollars in normal maintenance, safety, and operating expenses, and they recover these costs from customers in rates. Utilities also invest billions annually in system repairs, renovations, and new construction, but these new investments often are deferred until the next utility rate case.

Due to recent tragic pipeline incidents, Congress, the U.S. Department of Transportation, and state commissions have begun to devote greater attention to the need for additional investment in the infrastructure required to maintain and improve the safety and reliability of the distribution network. Federal and state regulators and legislators are also looking at new regulatory models and rate designs that provide for more timely recovery of prudently incurred safety and reliability investments. Eight states have implemented legislation or state wide regulatory programs to comprehensively address infrastructure issues.

A growing number of states allow utilities to recover the costs incurred between rate cases associated with replacing aging infrastructure. Rate surcharges, cost trackers, and deferral accounts specifically address infrastructure investment cost recovery, while rate stabilization is a type of rate design that is more general and recovers infrastructure investment as well as other costs incurred between rate cases. Nineteen states have implemented infrastructure cost recovery mechanisms, and programs are pending in another three states. Rate stabilization tariffs provide accelerated cost recovery in six states. Together, these programs help utilities maintain safe and reliable service to more than 26 million residential natural gas customers.

DESCRIPTIONS OF PROGRAMS AND LEGISLATION

Arkansas – CenterPoint Energy Southern Operations

CenterPoint's main replacement program is a tracker that applies to the replacement of bare steel mains, cast iron mains, and associated services. The company's Gas Main Replacement Program (GMRP) first became effective on January 1, 1988. The GMRP gave CenterPoint a return on its capital investment between rate cases as an incentive to replace, rather than repair, cast iron and other gas mains. On December 18, 1992, the program was modified to include recovery of capital investment (depreciation) and an offset to reflect O&M savings, the scope was expanded to include all cast iron gas main and related services, and the tariff was renamed the Cast Iron Gas Main Replacement Program (CIGMRP). The program was again modified to include bare steel and associated services and was renamed the Main Replacement Program, effective September 21, 2002.

The tracker is adjusted monthly with a commission filing and is collected from all classes of service through a volumetric charge. There is no true-up. A rate case is not required; however, when a general rate case is filed, expenditures are moved from tracking account to base rates. There is no term limit to the program, but the estimated completion date is 2026, based on the

assumed funding and replacement amounts as shown in the company's 2010 Main Replacement Program Annual Report.

Georgia – Atlanta Gas Light

In 1998, Atlanta Gas Light began a 15-year Pipeline Replacement Program (PRP) to replace more than 2,300 miles of bare steel and cast iron natural gas pipeline in Georgia. In the early years, the Georgia Public Service Commission annually reviewed the company's infrastructure replacement expenses from the previous year and then approved a new surcharge amount. Halfway through the program, the commission agreed to a fixed dollar amount of expense to be recovered in rates over the remaining seven years of the program.

In 2009, Atlanta Gas Light significantly expanded the replacement program to include investments for infrastructure to serve new customers and expand service. The Strategic Infrastructure Development and Enhancement program merged with the company's existing PRP and allows the company to invest $400 million over the next ten years in infrastructure improvements. Those improvements include upgrading the backbone of the utility's distribution system and liquefied natural gas facilities to improve system reliability and create a platform to meet forecasted growth. The program was further expanded in 2010 and allows Atlanta Gas Light to invest up to $45 million to extend its pipeline facilities to serve customers without pipeline access. The new program will also allow Atlanta Gas Light to install pipelines to create new economic development corridors in order to help spur growth.

No rate case is required for the programs, but every three years the company must file its plan for the upcoming three years with the Georgia PSC. The mechanism is a surcharge with the tracked over and under collection of program costs to be refunded or surcharged at program completion in 2025. The maximum monthly amount that may be surcharged to residential customers is $3.13. The maximum that may be surcharged to smaller volume general service customers (less than 5,000 therms per day) is currently $6.63 per month, rising to $7.03 per month on October 1, 2011. The maximum that may be surcharged to larger volume general service customers (greater than 5,000 therms per day) is currently $49.53 per month, rising to $49.93 per month on October 1, 2011.

Georgia – Atmos Energy

Atmos utilizes a surcharge mechanism that was implemented in 2000 to recover the costs of replacing 184 miles of cast iron pipe in 15 years and 46 miles of bare steel pipe in 20 years.

Illinois – Integrys Peoples Gas Light & Coke

Peoples Gas Light & Coke's tracking mechanism for investments related to gas main replacement programs was authorized in 2010 and implemented in 2011. The program covers replacement mains and related appurtenances such as services, meters, regulators, measuring and regulating stations, city-gate check stations, and other ancillary infrastructure. The program is capped at 5% of a certain portion of base rates, currently $24 million a year, and replacement completion is expected in 20 years.

Indiana – Vectren North - Indiana Gas

In its most recent rate case in 2008, Vectren North (Indiana Gas) received approval to implement a tracking mechanism that allows the utility to defer expenses associated with investments in infrastructure replacement projects. Vectren defers the recovery of depreciation expense and property taxes and continues to utilize the allowance for funds used during construction (AFUDC) for 4 years from the date that each replacement was put in service. The company is allowed to defer up to $20 million per year. All projects receiving the accounting treatment at the time the company files its next base rate case continue to receive that

treatment until a base rate order is issued; projects that are included in rate base and initiated after a rate case is filed are also eligible for the deferral accounting and later recovery.

Indiana – Vectren South - SIGECO

In its 2006 rate cases, Vectren received approval of a tracking mechanism for recovery of an accelerated bare steel and cast iron pipeline replacement program for Vectren South (Southern Indiana Gas and Electric Company). The company defers the recovery of depreciation expense and continues AFUDC for period of 3 years from the in-service date of each replacement project; the accounting treatment is limited to $3 million of program investment per year. Any projects receiving the accounting treatment at the time the company files its next base rate case continue to receive that treatment until a base rate order is issued; projects that are included in rate base and initiated after a rate case is filed are also eligible for the treatment.

Kansas State Wide Legislation

In April 2006, the Kansas legislature passed the Gas Safety and Reliability Policy Act (K.S.A. 66-2201 through 66-2204) that approved the implementation of a gas system reliability surcharge for Kansas natural gas utilities. Utilities in the state may surcharge between 0.5% and 10% of revenues to recover new infrastructure replacement costs not already in rates. Rates are adjusted annually. The surcharge may continue for no more than 5 years after the last rate case and then a new case must be held if the surcharge is to be continued.

Kansas – Atmos Energy

Atmos has had a replacement program in Kansas since the 1980s. The current surcharge mechanism is authorized by the Kansas Gas Safety and Reliability Policy Act.

Kansas – Black Hills

In 2008, Black Hills implemented a surcharge mechanism under the authority of the Gas Safety and Reliability Policy Act. The mechanism covers both non-revenue producing replacement infrastructure and government mandated infrastructure relocations. The maximum amount the company is allowed to surcharge customers is an additional $0.40 per month above the base rates.

In an earlier order issued on May 4, 2005, Black Hills (then Aquila) received approval to implement a $0.2 million surcharge annually for three years for the recovery of the costs of replacing the gas main that runs parallel under pavement the entire length of 13th Street in Wichita, Kansas. At the end of the three-year period, the company was required to true-up of the actual cost of the project and the actual amount collected from customers under the surcharge.

Kansas – Kansas Gas Service

Kansas Gas Service first began collecting the Gas Safety and Reliability Policy Act surcharge in 2009. The maximum surcharge is $0.40 per month more than base rates, and only covers replacements. Currently, Kansas Gas operates under replacement criteria that are based on operating conditions, number of leaks, system geography, and other conditions that are not tied to a time specific replacement date. However, by May 1, 2011, the company will be operating under a specific time table for pipe replacements. The plan is under review by the Kansas Corporation Commission's Department of Pipeline Safety.

Kentucky State Wide Legislation

On June 20, 2005, Kentucky enacted KRS 278.509, Recovery of Costs for Investments in Natural Gas Pipeline Replacement Programs, that approved the implementation of a natural gas system replacement tracking mechanisms for Kentucky natural gas utilities.

Kentucky – Atmos Energy

On May 28, 2010, the Kentucky Public Service Commission authorized Atmos Energy to implement a pipeline replacement program cost recovery surcharge that will be used to replace all bare steel mains over a 15 year period.

Kentucky – Columbia Gas

Columbia Gas of Kentucky received approval of its Accelerated Main Replacement Program (AMRP) tracker as part of its last base rate case in October 2009. The AMRP allows for the recovery of investments to replace bare steel and cast iron mains and associated appurtenances for the previous calendar period. The revenue requirement reflects an offset of estimated O&M savings associated with the infrastructure replacement. Columbia earns a return on its investment at the rate allowed in its last base rate case proceeding, and a depreciation allowance at the most recently approved depreciation rates. The filing is made annually on March 1 to reflect cumulative programs costs, with new rates going into effect as early as June of each year.

Kentucky – Delta Natural Gas

In October 2010, the Kentucky Public Service Commission authorized Delta Natural Gas to implement a pipe replacement program (PRP) rider to facilitate recovery of certain infrastructure costs. Delta's tracking mechanism, which began in 2011, is primarily for replacements but also contains a provision for new expenditures necessary to meet current safety or operational standards. There are no caps on the amount that may be recovered through the tracker, and there is no term limit to the mechanism.

Kentucky – Duke Energy Kentucky

The company has had an accelerated main replacement mechanism in place in Kentucky since 2001. The mechanism applies to all customers receiving service under the company's sales and transportation rate schedules. The charge, which is calculated annually, is assessed monthly and is a flat fee for residential and general service customers and is volumetric for interruptible transportation customers.

Massachusetts – Columbia Gas Massachusetts

Columbia Gas of Massachusetts (formerly Bay State Gas) received approval of its Targeted Infrastructure Reinvestment Factor (TIRF) as part of its last base rate case in October 2009. The TIRF allows for the recovery of the revenue requirement associated with bare steel capital additions for the previous calendar year, including: mains, services, service tie-ins, meters, meter installations, regulators, and industrial measuring and regulating equipment. The revenue requirement reflects an offset of estimated O&M savings associated with the infrastructure replacement. The initial filing is made on May 1 of each year, with new rates going into effect each November.

The TIRF tracking mechanism costs are recovered as a component of Columbia's Local Distribution Adjustment Clause mechanism. There is a revenue recovery cap of 1% of total revenue (including gas costs). The replacement time period is expected to be 10-15 years.

Massachusetts – National Grid Massachusetts

In November 2010, the Massachusetts Department of Public Utilities (DPU) issued a decision in a rate case for National Grid Massachusetts companies Boston Gas, Essex Gas and Colonial Gas. The DPU adopted targeted infrastructure recovery factors for the companies. The TIRFs provide for the recovery of costs associated with the accelerated replacement of gas mains and the companies are allowed to surcharge customers up to 1% of total revenue.

Massachusetts – New England Gas

On March 31, 2011, New England Gas received authorization from the Massachusetts Department of Public Utilities to implement a TIRF to provide recovery of incremental expenditures associated with reinforcing the system and meeting public safety goals.

Michigan – SEMCO Energy

On Jan. 6, 2011, the Michigan Public Service Commission adopted a settlement that establishes a main replacement program rider. This mechanism will enable SEMCO Energy to recover the incremental capital-related costs associated with the accelerated removal and replacement of cast iron and unprotected steel service lines and mains. Pipe replacement begins in 2011 and the cost recovery surcharge mechanism will begin May 2012. The 2011 program will reduce the replacement time from 60 years to 25 years.

The program expires in 5 years unless extended by order in a new rate case. The surcharge is $0.25 per residential customer per month, $0.54 per month for the smallest commercial customers, and up to $500 per customer per meter for large transportation customers. A minimum of 13 miles of incremental main replacement is required (approximately $4.5 million new investment per year), and there is no cap on the amount of money or miles of pipe that may be replaced in one year.

Missouri State Wide Legislation

The Infrastructure System Replacement Surcharge (ISRS) mechanism was the result of a revision to Missouri Statute 393.1009-1015. The ISRS allows the rates of a gas utility to be adjusted twice per year to provide for the recovery of costs of eligible infrastructure system replacements. Companies using the ISRS must file a rate case at least every 3 years. The legislation requires that the Missouri Public Service Commission approve a mechanism that produces total annualized ISRS revenue of no less than one million dollars or one-half of one percent of the gas utility's base revenue level, as approved in the company's last rate case. The legislation also requires that the mechanism be capped such that total annualized ISRS revenue is no greater than ten percent of the utility's base revenue level granted in the last rate case.

Missouri - Ameren

Ameren Missouri filed its first ISRS in 2007. The program is a surcharge to rates, covers only replacement pipe, and has the rate case parameters and revenue floors and caps specified in the Missouri legislation. On Jan. 19, 2010, the Missouri Public Service Commission adopted a settlement in the company's rate case authorizing a transfer to base rates of $3.4 million that was being recovered through the infrastructure system replacement surcharge.

Missouri – Atmos Energy

Atmos implemented the ISRS mechanism in its Missouri jurisdiction in 2008. The mechanism follows the requirements of the enabling Missouri legislation.

Missouri – Laclede Gas

In 2004, Laclede Gas implemented the ISRS as a result of its 2003 rate case. In a July 9, 2007 announcement of the settlement of its 2006 rate case, Laclede agreed to transfer to base rates the $5.5 million that was the cumulative amount that had been added to rates since the 2003 rate case and that was being collected in the ISRS. In November 2007, Laclede added an additional $1.64 million of new costs to the surcharge account. In a settlement of its 2009 rate case, Laclede agreed in August 2010 to transfer to base rates $10.9 million of costs currently being collected through the ISRS.

Missouri – Missouri Gas Energy

Missouri Gas Energy's mechanism follows the requirements of the enabling Missouri legislation. As part of its 2007 rate case, Missouri Gas Energy transferred $3.7 million from the ISRS account into base rates.

Nebraska State Wide Legislation

The Infrastructure System Replacement Surcharge (ISRS) mechanism was the result of a revision to Nebraska Statutes 66-1865, 66-1866, and 66-1867, effective Aug. 30, 2009. The ISRS allows the rates of a gas utility to be adjusted twice per year to provide for the recovery of costs of eligible infrastructure system replacements. Companies using the ISRS must file a rate case at least every 5 years. The legislation authorizes a range of program cost recovery of at least one million dollars or one-half percent of the jurisdictional utility's base revenues approved by the commission in the utility's most recent general rate proceeding, up to but not exceeding ten percent of the utility's base revenues approved during the last rate proceeding.

Nebraska – Black Hills Energy

Black Hills Energy's surcharge mechanism was implemented in 2010 and recovers the costs of both non-revenue producing replacement infrastructure and new infrastructure. The mechanism adheres to the requirements of the enabling Nebraska legislation.

New Hampshire – National Grid New Hampshire - Energy North Natural Gas

Energy North Natural Gas has had a Cast Iron Bare Steel (CIBS) Replacement Program for several years. In its 2009 rate case, Energy North proposed to modify its annual CIBS rate adjustment mechanism to include public works projects and to eliminate the $0.5 million annual threshold required prior to cost recovery. However, on March 10, 2011, in a settlement, the New Hampshire PUC called for the CIBS rate adjustment mechanism, as currently structured, to remain in effect.

New Jersey – State Wide Program of the Board of Public Utilities

On April 16, 2009, the New Jersey Board of Public Utilities (BPU) approved accelerated infrastructure programs for five of the seven major utilities that had filed such plans. In aggregate, the approved plans provide for the utilities to invest $956 million in incremental infrastructure and energy efficiency programs over the next two years. For the most part the costs of these programs are to be recovered through separate adjustment mechanisms.

The proposals were tendered following discussions among state leaders and comport with then Gov. Jon Corzine's (D) economic stimulus plan. The expenditures outlined in these programs are incremental to the level of investment that the utilities had planned as part of their ongoing business operations.

New Jersey – New Jersey Natural Gas

In 2009, New Jersey Natural Gas received approval to invest $71 million in new infrastructure and system upgrades with completion of construction expected August 2011. In 2011, the BPU granted New Jersey Natural approval to invest an additional $60 million in new infrastructure and upgrades, with an expected completion date of October 2012. The recovery mechanism is not a typical tracker or surcharge. New Jersey Natural is recovering the costs of its infrastructure projects through annual adjustments to base rates outside of a full base rate filing.

New Jersey – Elizabethtown Gas

Elizabethtown Gas implemented its Utilities Infrastructure Enhancement Program in 2009. Part of the state-wide economic incentive plan, the program includes both the costs of replacing cast iron pipes and investments in specified new main extensions. No rate case is required to implement the plan, but an annual true-up filing is required and expenditures on the approved projects are subject to a prudency review. The mechanism is a surcharge, currently $0.0116 per therm.

The company's previous replacement program was a deferral account. The mechanism allowed for the recovery of up to $1.5 million of costs associated with the accelerated replacement of about 60 miles of elevated pressure 8-inch cast iron main. Those costs were rolled into rates as part of the company's 2009 rate case. In the 2009 decision, Elizabethtown Gas agreed to expend an incremental $60.4 million on infrastructure upgrades during the period. The approved projects were expected to be completed by March 31, 2011.

New Jersey – Public Service Electric and Gas

In April 2009, Public Service Electric and Gas Co. (PSE&G) received BPU approval of an infrastructure investment program. The settlement identified several qualifying projects totaling $273 million of investments over a 24-month period. The recovery mechanism, the Capital Adjustment Charge (CAC), is a deferral account that is adjusted each January based on forecasted program expenditures. Between adjustment periods, over and under-recovered program balances are subject to interest at the short-term debt rate, net of tax.

PSE&G spent $83 million on approved infrastructure projects in 2009 and collected approximately $5.7 million through the CAC. The CAC was adjusted on a provisional basis on January 1, 2010. At the conclusion of PSE&G's base rate case in July 2010, the infrastructure projects that were placed in service through the end of 2009 were removed from the deferred account and rolled into rate base, and the CAC was adjusted accordingly, again on a provisional basis. PSE&G spent $170 million on approved infrastructure projects and collected approximately $11.6 million through the CAC in 2010.

In November 2010, PSE&G made its second annual filing to update the CAC to cover the remaining infrastructure investments under the program. The company also filed for an extension of the Capital Stimulus program, seeking BPU approval for an additional $78 million in infrastructure investments from May 2011 through April 2012. The company proposed to remove from the deferred account the unrecovered Capital Stimulus expenditures for projects that would be placed in service by June 30, 2011 and roll into base rates the associated costs. If approved, PSE&G expects the roll-in will result in an increase in base rates of $22 million, with a corresponding reduction in the CAC. A decision is expected soon.

New Jersey – South Jersey Gas

In April 2009 the New Jersey Board of Public Utilities approved the Capital Investment Recovery Tracker (CIRT) mechanism for South Jersey Gas. At that time, the BPU approved an

investment of $103 million to be made in specific infrastructure projects that were incremental to the company's 2009 and 2010 capital budgets.

As part of a base rate case order in September 2010, South Jersey rolled into rate base approximately $81 million of completed CIRT investments. This resulted in an increase to base rates and a tracker reduction. The rate case order also provided for a Phase II proceeding in which the remaining $23 million of projects are to be rolled into rate base in October 2011. The rate case order created a nexus between the CIRT and base rate case proceedings.

On March 31, 2011, the BPU approved the continuation of the accelerated infrastructure programs for South Jersey Gas. The company will invest approximately $60 million to accelerate previously planned capital projects that must be completed by October 31, 2012. These CIRT–II projects are scheduled to be rolled into rate base on October 1, 2011 and January 1, 2013. In March 2011 order, the BPU extended Phase II of the base rate case to facilitate the CIRT–II roll-in.

The criteria for CIRT–I and CIRT–II projects are the same: 1) they must assist the company in providing safe, adequate and proper service to customers; 2) project expenditures must be incremental to SJG's annual capital budget; 3) and they must support New Jersey's economic stimulus objectives, including creating jobs in New Jersey. Projects being rolled into rate base will be subject to a prudency review. The CIRT programs reduce the time period over which infrastructure is replaced from 46 years to 20 years.

New York – Corning Natural Gas

Corning Natural Gas has had a limited pipeline replacement cost recovery mechanism since 2006. The company has replaced nearly 36 miles of older mains and 1,900 services. The company replaces about 7 miles of pipe per year, and expects the program to require another 10-15 years to complete. The company is also relocating gas meters that are inside the house to a location on the outer wall of the structure that is as close to the main as possible and safe.

New York – National Grid Long Island

National Grid Long Island has had a limited infrastructure replacement tracker program since 2008. The program allows the utility to track only the costs of new or replacement infrastructure that is necessitated by city and state construction projects. These costs are rolled into rates and recovered from customers. No other infrastructure investment costs are allowed this treatment. There are no caps on the amount of money that may be recovered through the mechanism, and no rate case is required to implement the program.

New York – National Grid NYC

The limited infrastructure replacement tracker at National Grid NYC is similar to the one at National Grid Long Island. The program has been in place since 2008 and covers only those costs that are necessitated by city and state construction projects.

New York – National Grid Niagara Mohawk

Niagara Mohawk has had a limited pipeline replacement cost recovery mechanism since 2008. Prior to that time, the company had replaced approximately 20 miles of leak-prone pipe annually. The limited program, which was scheduled to run for 5 years, ordered the company to replace a cumulative total of at least 150 miles of pipe and not less than 25 miles in any one year. Failure to meet the cumulative or any of the annual minimum targets would result in a revenue adjustment of $840,000.

The costs to achieve the incremental 10 miles of annual pipe replacement are being deferred until the company's next rate filing, while the costs to replace the first 20 miles of pipe annually

are included in the utility's base rates. This metric does not apply if leak-prone pipe is being replaced due to interference projects and/or city or state construction requirements; those costs are also recoverable through the mechanism. The program extends through 2012.

Ohio – Columbia Gas of Ohio

Columbia Gas of Ohio received approval of its Infrastructure Replacement Program (IRP) tracker as part of its last base rate case that was approved December 2008. The IRP allows for the recovery of calendar year investments to replace: 1) bare steel and cast iron mains and associated service lines, 2) prone to fail risers, 3) hazardous customer service lines, and 4) installation of automated meter reading devices. The IRP also allows for recovery of post-in-service carrying costs, property taxes, and depreciation, and reflects O&M savings as a result of the program. Columbia earns a return on its investment at the rate allowed in its last base rate case and is subjected to rate caps, set at the anticipated investment level projected by the company. The initial filing is made each November 30 of the investment year, with actual data filed on February 28 of the recovery year. New rates go into effect each May.

Columbia's IRP is a fixed surcharge capped at the following amounts for small general service customers: $1.10 per month in year 1; $2.20 per month in year 2; $3.20 in year 3, $4.20 in year 4; and $5.20 in year 5. The cap on small commercial customers (less than 300 Mcf/month) is the same as the small general service customer. There is no cap on customers taking more than 300 Mcf per month.

The IRP is authorized for an initial five year period, and no rate case is required. Columbia may request the IRP be renewed through the filing of a base rate case or pursuant to an alternative rate design method as provided for in Section 4929.05 of the Revised Code of Ohio.

Ohio – Dominion East Ohio

Dominion East Ohio's existing Pipeline Infrastructure Replacement tracker program was approved in the company's rate case on October 15, 2008 for costs associated with infrastructure replacements starting July 1, 2008. The program primarily covers replacements, but ongoing infrastructure investments may be included provided the rate cap is not exceeded. On March 31, 2011, Dominion East Ohio filed a motion with the Ohio Public Utilities Commission requesting approval to modify the program due to an increase in the identified scope of the program and in response to recent increased national concern about pipeline safety. The company's proposed modification is an increase in annual investment from approximately $100 million per year to more than $200 million per year. A rate case is not required for the proposed modification of the program.

Dominion East Ohio's program specifies a fixed monthly surcharge for most rate schedules and a volumetric charge for the industrial class; annual adjustments require an application supported by rate schedules and involve an expedited procedural schedule. The monthly surcharge for residential and small commercial customers may be more than $1.12 per customer in year 1, with annual increases in the monthly charge of no more than $1.00 thereafter. With the proposed growth in annual investment, Dominion East Ohio has requested an increase to the annual adjustment cap of $2.00 initially, the sufficiency of which would be evaluated subsequently. Although there is not a specified cap in miles, the miles of replacement are limited by the cap on the associated cost recovery charge.

The proposed time period for full infrastructure replacement, which is pending as of the company's March 31, 2011, filing, is less than 25 years; this is a decrease from the original estimate of 25 years. Program cost recovery was approved for an initial period of five years. In its recently filed proposal, Dominion East Ohio has requested reauthorization for a five-year period commencing with approval of the modified program.

Ohio – Duke Energy

Duke Energy (previously Union Light Heat and Power) has had an accelerated main replacement tracker in place for all sales and transportation customers in Ohio since 2000. All customers except interruptible transportation customers are assessed a monthly charge in addition to the customer charge component of their applicable rate schedule. Interruptible customers are assessed a throughput charge in addition to their commodity delivery charge for accelerated main replacement. The maximum monthly charge for any interruptible transportation customer is $500.00 per account. The tracking mechanism is updated annually in order to reflect the impact on the company's revenue requirements of net plant additions, as offset by operations and maintenance expense reductions during the most recent twelve months ended December.

Ohio – Vectren Ohio

In 2009, the Public Utilities Commission of Ohio approved the establishment of a tracking mechanism for Vectren Energy Delivery of Ohio that allows for the recovery of costs associated with an accelerated bare steel and cast iron pipeline replacement program. The program is in effect for 5 years or until rates are approved in a subsequent rate case, whichever occurs sooner. The mechanism covers: 1) bare steel and cast iron pipeline replacements; 2) replacement of certain types of risers that had previously been determined as "prone to failure" in Ohio; 3) expenses that have been previously deferred during the company's investigation of those risers; and 4) incremental costs attributable to the company assuming responsibility for service lines. Prior to 2009, the portion of the service line from the property line to the meter was owned and maintained by the customer. That ownership continues until the service line is actually replaced by the company, but Vectren has assumed maintenance responsibility for all service lines. The costs of the mechanisms are offset by O&M savings realized as a result of retirement of the older infrastructure.

The program was proposed in the company's last rate case as a 20-year program, during which all cast iron mains and bare steel mains and service lines would be replaced. There is a cap on cost recovery. Residential customers pay a fixed charge per month under the rider, and the annual increase to the monthly charge is limited to $1.00 per month.

Oregon – Avista

The Oregon Public Utility Commission's March 10, 2011, settlement of Avista's 2010 rate case provides for deferred accounting treatment for two capital additions. The two projects include the second phase of the Roseburg Reinforcement Project and the Medford Integrity Management Pipe Replacement Project that is to be completed by Nov. 1, 2011. A subsequent incremental rate adjustment of approximately $0.6 million will be made on June 1, 2012, to recover the costs of the two projects.

Oregon – NW Natural

The NW Natural program is a tracker that adjusts rates to recover the costs of the acceleration of bare steel pipe replacement during the most recent 12-month period October 1 through September 30. The adjustments to rates are made at the same time as the company's annual purchased gas adjustment filing. The company is required to allocate 70% of the cumulative investment to residential and commercial firm sales and transportation customers. The program is capped at $12 million per year, with $8.2 million of that considered incremental and recoverable through the tracking mechanism.

The program also incorporates the company's Pipeline Safety Improvement Act cost recovery mechanism that covers transmission pipeline integrity costs (since 2002) and distribution

pipeline integrity costs (since 2009) until October 31, 2011. The bare steel replacement tracker is in effect through December 31, 2021.

Rhode Island – National Grid Narragansett Gas

Narragansett Gas' replacement program began in 2009. A new program that covers both replacement and new infrastructure and is slated to go into effect April 2011 was established legislatively. There is no cap on the dollars that may be recovered through the surcharge mechanism, and while there is no cap on the miles of pipe that may be replaced, the plan must be reviewed before the start of the program. No rate case is required.

Texas – State Wide Legislation[1]

The Gas Reliability Infrastructure Program (GRIP) statute became effective for all Texas natural gas utilities on September 1, 2003. The legislation allows a gas utility to file with the regulatory authority a tariff that provides for an adjustment to the utility's rates. The adjustment is implemented through changes to the monthly customer charge or meter charge, but a utility can choose to adjust the first consumption block as an alternative. The tariff may be implemented without action by the regulatory authority. The tracking program allows for the recovery of new infrastructure investment, as well as the recovery of costs associated with replacement investments.

There is no cap on the amount of investment that may be recovered. However, if a gas utility's annual earnings monitoring report shows that it is earning a return on invested capital of more than 75 basis points above the return authorized for it in the area in which the interim rate adjustment was implemented, a report to the commission is required as to why rates are not unreasonable or in violation of law. After the first GRIP filing, the utility must file a rate case within the next 5 years.

Texas - Atmos Energy

Atmos implemented the GRIP program in its Mid-Tex service territory in 2004. Capital related costs are recovered on the change in net investment from year-to-year. The mechanism covers replacement pipe, new pipe, pipeline integrity capital and any other capital investment. The adjustment is interim in nature and subject to refund until the next general rate case, which must be filed every 5 years.

In addition to the GRIP program, Atmos has a separate surcharge mechanism that was implemented in 2010 pursuant to a rate order for the purpose of replacing 100,000 high priority steel service lines over a two year period. The surcharge may be used with an annual true-up mechanism.

Texas – CenterPoint Energy

CenterPoint made its first GRIP filing on March 31, 2011 for the company's Houston Division. The GRIP tracker amount changes annually, is applied to the customer charge (subject to refund), and is trued up in the next general rate case.

Texas – Texas Gas Service

Texas Gas Service implemented its program under the Texas GRIP statute in 2003. State law limits the amount of infrastructure cost that may be recovered in a year to the amount of new infrastructure investment in the previous year, that is, the mechanism tracks the level of new investment.

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[1] Title 3. Gas Regulation; Subtitle A. Gas Utility Regulatory Act; Chapter 104. Rates and Services; Subchapter G. Interim Cost Recovery and Rate Adjustment; Sec. 104.301. Interim Adjustment for Changes in Investment.

Utah – Questar Gas

On June 3, 2010, the Utah Public Service Commission authorized Questar Gas to implement a three-year pilot Infrastructure Replacement Adjustment (IRA) mechanism to track and recover between rate cases the costs associated with the replacement of high-pressure natural gas feeder lines. The approved IRA mechanism is to be adjusted at least annually and has an annual budget cap of $55 million, adjusted for inflation. While operating under the mechanism, the company is required to file a general rate case at least every three years.

Virginia – State Wide Legislation

In Virginia, legislation supporting infrastructure investment was enacted on March 11, 2010. The SAVE (Steps to Advance Virginia's Energy Plan) Act allows utilities to petition the State Corporation Commission for a separate rider to recover a return on and of certain investments, including natural gas facility replacement projects that enhance safety and reliability, or have the potential to reduce greenhouse gas emissions by reducing system integrity risks.

The SAVE Act provides for prospective recovery of eligible infrastructure replacement costs, including a return based on the weighted average cost of capital established in the utility's last base rate case proceeding. The recovery also includes an allowance for income taxes; bad debt expense; depreciation; property taxes; and carrying costs on the over- or under-recovery of the eligible infrastructure replacement costs. No other O&M adjustments are included in the revenue requirement calculation.

Investment means costs incurred on eligible infrastructure replacement projects including planning, development, and construction costs; costs of infrastructure associated therewith; and an allowance for funds used during construction.

At the end of each 12-month period the SAVE rider is in effect, the utility reconciles the difference between the recognized eligible infrastructure replacement costs and the amounts recovered under the SAVE rider, and submits the reconciliation and a proposed SAVE rider adjustment to the Commission to recover or refund the difference, as appropriate, through an adjustment to the SAVE rider.

PENDING INFRASTRUCTURE COST RECOVERY RATE MECHANISMS

California – San Diego Gas and Electric

On Dec. 15, 2010, San Diego Gas & Electric filed a request with the California Public Utilities Commission for a gas base rate increase. In addition to the base rate increase, the company proposes a post-test-year ratemaking mechanism for the three years, 2013 through 2015, under which the company's revenue requirement would be adjusted to reflect increases in capital-related and other expenses.

California – Southern California Gas

On Dec. 15, 2010, Southern California Gas filed a request with the California Public Utilities Commission for a gas base rate increase. In addition to this base rate increase, SoCal proposes a post-test-year ratemaking mechanism for the three-year period 2013 through 2015, under which the company's revenue requirement would be adjusted to reflect increases in capital-related and other expenses. The company did not request specific rate increases under the mechanism.

Colorado – Public Service Co. of Colorado

On Dec. 17, 2010, Public Service Company of Colorado filed with the Colorado Public Utilities Commission for authority to implement a pipeline system integrity adjustment tracker to recover

costs associated with reliability improvements and compliance with certain federal safety regulations. As proposed, much of the program would cover replacement pipe, but some upsizing pipe for transmission lines and changes to increase pressure systems (from inches to 60 psi systems, as an example), are also included. The proposed mechanism would be adjusted annually on January 1, based on the projected costs of eligible programs/projects during the upcoming calendar year, and no rate case would be required.

Illinois – State Wide Legislation

On Feb. 16, 2011, House Bill (H.B.) 14 was assigned to the Illinois House of Representatives' Public Utilities Committee for consideration. Under H.B. 14, utilities that commit to make investments in their distribution systems would be permitted to file for Illinois Commerce Commission approval of an alternative rate design in lieu of full base rate proceedings for purposes of determining the utility's rates.

The bill would provide for the state's local gas distribution companies to invest at least $500 million, over a ten-year period, in distribution and transmission upgrades, as well as certain modernization and compliance projects. Regarding the provisions of H.B. 14 that relate to the use of an alternative rate design, any utility that commits to making the aforementioned infrastructure investments would be permitted to file for a rate stabilization tariff that would annually adjust the utility's base rates premised on its actual costs of service, utilizing the prior year's expense levels and plant additions (both actual and forecasted for that particular year). The rate stabilization adjustment, which would be trued-up annually, would 1) reflect the utility's actual capital structure, excluding goodwill; 2) incorporate a "legislatively-set formula" for purposes of calculating the allowed return on equity; 3) provide for recovery of pension- and pension-related costs; and, 4) reflect projected plant additions and a depreciation reserve adjustment.

Maryland – Washington Gas

Washington Gas Light filed a base rate case on April 15, 2011 with the Maryland Public Service Commission. As part of that case, Washington Gas seeks to implement a tracking mechanism for recovery of replacement infrastructure investment costs. The company has proposed a five year transmission and distribution pipeline replacement schedule, and has requested approval for a return on the associated capital investment equal to that ultimately approved in the rate case.

Massachusetts – Fitchburg Gas and Electric

On Jan. 14, 2011, Fitchburg Gas and Electric filed with the Massachusetts Department of Public Utilities a base rate case. As part of the filing, Fitchburg is seeking to implement a targeted infrastructure recovery factor (TIRF) for its gas operations designed to reflect incremental expenditures associated with the replacement of cast-iron and steel mains and associated facilities.

Texas – State Wide Program of the Railroad Commission

The Texas Railroad Commission is currently considering a steel pipe replacement rule that in its current form, provides for recovery of replacements under the rule via a deferral mechanism. The link above provides the latest version of the as yet un-passed rule, with comments from the Commission staff. This is in addition to the Texas GRIP statute of 2003 that provides for annual interim rate increases for a utility's infrastructure investment in excess of annual depreciation with no requirements as to replacement of pipe.

Virginia – Washington Gas

Washington Gas has filed an application with the Virginia State Corporation Commission for permission to implement a tracking mechanism for recovery of replacement infrastructure investment costs as authorized by the Virginia SAVE legislation. The company has proposed a 15 year infrastructure replacement program and has requested approval for cost recovery for five years of plan expenditures with varying capital expenditures in any given year. The company proposes to update the per therm surcharge amount annually, as well as to implement an annual true-up mechanism. There is no proposed cap on the amount of cost that may be recovered over the 5 years. The application is pending, with an expected commission order on April 23, 2011.

ADDITIONAL INFORMATION

If you would like more information about a particular program or would like to speak to another AGA member regarding the details of the program, please contact: Cynthia Marple, AGA director of rates and regulatory affairs, cmarple@aga.org or 202-824-7228.