

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Petition of  
PUGET SOUND ENERGY, INC.  
for (i) Approval of a Special Contract for  
Liquefied Natural Gas Fuel Service with  
Totem Ocean Trailer Express, Inc. and  
(ii) a Declaratory Order Approving the  
Methodology for Allocating Costs Between  
Regulated and Non-regulated Liquefied  
Natural Gas Services

Docket No. UG-151663

STAFF BRIEF ON ISSUES  
OF LAW AND FACT

**I. PROCEDURAL HISTORY**

1 On August 11, 2015, Puget Sound Energy (“PSE” or “Company”) filed a Petition for Approval of a Special Contract for Liquefied Natural Gas Fuel Service with Totem Ocean Trailer Express, Inc. (“TOTE”) and a Declaratory Order Approving the Methodology for Allocating Costs between Regulated and Non-regulated Liquefied Natural Gas Service.

2 On October 15, 2015, the Commission issued Order 03 that noted the “parties have ... identified and are working to resolve threshold questions, the resolution of which could be determinative.”<sup>1</sup> As directed by the Commission, the parties worked to reach agreement on stipulated facts, but ultimately were unable to do so. Staff relies then on the documents filed by PSE in its Petition, and the Company’s responses to formal Discovery Requests submitted by the parties in order to provide content and context of its position here.

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<sup>1</sup> In the Matter of the Petition of Puget Sound Energy, Inc. for Commission approval of a Special Contract for Providing LNG Service and a Declaratory Order Approving a Cost Allocation Methodology, UG-151663, Order 3 at 1: ¶ 3.

## II. RELIEF REQUESTED BY STAFF

3 A Commission determination that it declines to exercise subject matter jurisdiction  
over PSE's contract with TOTE, and allows PSE to form a subsidiary consistent with the  
applicable merger requirements in order to promote the development of LNG without  
creating unnecessary regulatory barriers to non-regulated parties.

## III. INTRODUCTION TO PSE'S RELATIONSHIP WITH TOTE

4 The contract for LNG fuel supply for TOTE was executed on October 27, 2014,  
nearly 10 months before PSE filed its petition for regulatory approval of its contract with  
TOTE. The contract is a 107 page document covering numerous subject areas of interest to  
the Commission, with numerous appendices. Upon examination, the Commission will  
conclude that PSE's commercial relationship with TOTE bears little resemblance to a  
regulated service. It is in fact a commercial agreement of the like commonly used for  
unregulated market transactions.

5 The contract at issue in this case resulted from a bidding process conducted by  
TOTE to secure a source of liquefied natural gas ("LNG") for its transport vessels. TOTE  
sought bids to build a LNG facility and provide it with LNG fuel at the Port of Tacoma. PSE  
was one several bidders. In the end, PSE was the bidder selected by TOTE. PSE is now well  
into the process of developing plans to build that facility to refine, liquefy, and store LNG at  
the Port of Tacoma. The facility would cost approximately \$300,000,000<sup>2</sup> and have the  
capacity to store 8,000,000 gallons of LNG.<sup>3</sup>

6 PSE offers three purposes for its LNG facility: 1) Provide Tote with LNG fuel for its  
ships travelling from the Port of Tacoma to Alaska; 2) provide other, to-be-determined

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<sup>2</sup> Garratt Direct, RG-1T at 27:11.

<sup>3</sup> Garratt Direct, RG-1T at 13:8.

commercial transportation or industrial companies with LNG fuel; and 3) provide additional peaking capability for PSE's core gas customers.

7 PSE's proposed regulatory treatment for TOTE's refueling facility is mixed. First, PSE asks the Commission to regulate all operations associated with satisfying TOTE's marine fueling requirements. Here, PSE does not propose to offer TOTE marine fuel by way of a tariff. Rather, it seeks approval of its proposed special contract.<sup>4</sup> PSE also seeks to offer what it describes as "already subscribed capacity of the Tacoma LNG facility" as regulated services.<sup>5</sup> PSE's use of the term "already subscribed capacity" in this context refers to TOTE's marine fuel needs and the estimated capacity it would require to meet system peak demands.<sup>6</sup>

8 PSE also proposes to offer other "non-regulated services" from the same facility.<sup>7</sup> Presumably, its unregulated activities would involve the marketing of any LNG capacity available after its contractual obligations to TOTE and any system peak needs have been satisfied. Here, PSE would offer LNG sales to "third parties at non-regulated prices" with certain "shared" expenses. These expenses are referred to as "use of the distribution service to serve non-regulated sales" and "corporate shared services."<sup>8</sup> PSE offers to credit these specific expenses incurred to secure and complete non-regulated sales back to core gas customers.<sup>9</sup>

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<sup>4</sup> Peaking services for PSE's distribution system and core customers would also be regulated. Services to the TBD industrial and commercial companies would be unregulated.

<sup>5</sup> See Petition of Puget Sound Energy, Inc. for Commission approval of a Special Contract for Providing LNG Service and a Declaratory Order Approving a Cost Allocation Methodology, UG-151663 at 12: ¶ 30.

<sup>6</sup> *Id.*

<sup>7</sup> *Id.*

<sup>8</sup> *Id.* at 14: ¶ 33.

<sup>9</sup> *Id.*

9 PSE's contract with TOTE provides little opportunity for the Commission to exercise its regulatory authority, even in the performance and interpretation of the agreement. For example, PSE plans to satisfy TOTE's marine fuel requirements by purchasing natural gas in the natural gas markets.<sup>10</sup> This is presumably gas held for wholesale sales offered by interstate shippers or marketers. In other words, the gas needed to supply TOTE with LNG will be priced differently than that provided core customers that purchase natural gas from PSE.<sup>11</sup> In sum, PSE will not supply the natural gas necessary to meet TOTE's marine fuel needs at prices set in its as-filed tariff.

10 Nor does PSE intend to charge TOTE for transporting its market-purchased gas supply according to the Company's natural gas transportation tariff. Instead, PSE's gas purchase scheme obligates PSE to take ownership of the TOTE-destined gas, thus shielding TOTE from PSE's tariffed transportation retail prices.<sup>12</sup> PSE states that the LNG contract has priced the transportation of TOTE's natural gas by way of a different methodology.<sup>13</sup> At this point of its analysis, it is unclear as to whether PSE's cost treatment of TOTE's transportation needs is consistent with its transportation tariff.

11 In summary, PSE proposed contract with TOTE effectively divorces TOTE from PSE's as-filed tariffs. TOTE will not take PSE's system gas according to the retail prices set forth in its tariff. In this sense, TOTE will be treated differently from any other customer taking retail service from PSE. Further, TOTE will not be considered a PSE transportation

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<sup>10</sup> Riding Direct, Exh. No. CR-1T at 15:9-12 (redacted version) and Riding Direct, Exh. No. CR-1T at 22:21-26 (redacted version) and Riding Direct, Exh. No. CR-1T at 24:4-5 (redacted version).

<sup>11</sup> Riding Direct, Exh. No. CR-1T at 15:9-12 (redacted version) and Riding Direct, Exh. No. CR-1T at 22:21-26 (redacted version) and Riding Direct, Exh. No. CR-1T at 24:4-5 (redacted version).

<sup>12</sup> Riding, Exh. No. CR-4HC, Sec. B.6.

<sup>13</sup> *Id.*

customer. Instead, the cost of transporting TOTE's natural gas requirements are rolled into the contract. Thus, TOTE will not be treated as a PSE transportation customer.

12 In the end, TOTE's contract with PSE specifies a unique relationship that bears little in common with PSE's other retail customers. Staff will point out below how these and other contract terms would affect the Commission's exercise of jurisdiction over the relationship between PSE and TOTE.

#### **IV. PSE'S PROPOSED TOTE CONTRACT STRAYS CONSIDERABLY FROM THE COMMISSION'S REGULATORY PRACTICES**

13 PSE's contract with TOTE to supply marine fuel was executed on October 27, 2014, nearly 10 months before PSE filed its petition for regulatory approval of its deal with TOTE, with numerous appendices.<sup>14</sup> The contract is a 107 page document covering numerous subject areas of interest to the Commission. Upon examination, the Commission can conclude that PSE's commercial relationship with TOTE bears little resemblance to a regulated service. It is in fact a commercial agreement expressing an unregulated and market-based relationship between PSE and TOTE, resulting from detailed negotiations between sophisticated corporate entities.

14 Importantly, the agreement creates certain obligations and protections that are not provided in a regulated environment. For example, the agreement has no place for the Commission in the event there is a dispute over performance of the agreement or interpretation of its terms. These matters are subject to binding arbitration and the courts. Furthermore, the laws of State of Washington are not expressly applicable as the agreement's legal foundation. Instead, the laws of the State of New York provide the applicable law. Other than by general inference in the definition of Governmental Authority,

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<sup>14</sup> Riding, Exh. No. CR-4HC.

the Commission and its regulatory powers are mentioned only once in the agreement.<sup>15</sup>

These and other key terms will be described below.

**A. The TOTE Agreement Requires A Specific Period Of Service, Subject To Conditions.**

15 Staff begins this section by referencing the term of the agreement. Typically, when a customer requests a utility to provide an essential service such as natural gas for use as light, heat or power, there is no requirement that the customer agree to remain a customer for a time certain. They are free to leave the system or to decline to take utility service of any kind. Staff can point to no Commission rule or order requiring a customer to take service from a utility. However, PSE and TOTE have agreed to such an arrangement.

16 PSE has agreed to provide LNG to TOTE for a period of ten years, commencing on or after January 1, 2019 (subject to actual delivery on that date) and ending January 1, 2029.<sup>16</sup> The agreement can be extended for an additional five-year term<sup>17</sup>, subject to possible adjustments of the Fixed Facility Charge.<sup>18</sup> The agreement does not require Commission approval of a change in the Fixed Facility Charge. According to the agreement, any change in payment would be agreed upon by the parties. As is common in most complex and risky commercial agreements, either PSE or TOTE can exercise off-ramps to avoid performance of the agreement.

17 First, if either party fails to satisfy the express conditions precedent set forth in Section 2.3.1, including a “reasonably acceptable” order from the Commission, either TOTE

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<sup>15</sup> See Riding, Exh. No. CR-4HC at p. 23, Section 2.3(d). This section would require a final non-appealable order approving the TOTE contract as a condition precedent. This section applies only to Sections 3 and 24 of the agreement. This deadline for this satisfaction of this condition precedent is January 1, 2017. See Section 2.3.5.

<sup>16</sup> Riding, Exh. No. CR-4HC at p. 22, Section 2, and p. 11, Section 1.1.

<sup>17</sup> Riding, Exh. No. CR-4HC at p. 22, Section 2.2.

<sup>18</sup> Riding, Exh. No. CR-4HC at p. 13, Section 1.1.

or PSE can terminate the agreement. If this should occur, neither party will be liable to one another for termination under this circumstance.<sup>19</sup> Further, the parties can terminate the agreement in the event one is engaged in voluntary or involuntary bankruptcy proceedings.<sup>20</sup>

18 TOTE can also terminate the agreement in the event “fuel oil” and “ultra-low diesel fuel” hit certain prices, so long as TOTE can actually use the fuel and other conditions are met.<sup>21</sup> In the agreement, these are referred to as Commodity Price Triggers 1 and 2.<sup>22</sup> If TOTE triggers its right to terminate under these sections, it must pay a termination fee to PSE, as set forth in Exhibit D.<sup>23</sup> Once the right of termination is triggered by TOTE, PSE has the right to match (lower) the Contract Price to the Commodity Price Trigger in order to avoid termination.<sup>24</sup> All of these events could occur without Commission oversight, as there are no provisions in this section calling for Commission approval of any termination of service or change in price.<sup>25</sup>

## B. Dispute Resolution

19 The agreements Dispute Resolution provisions follow a path familiar to commercial agreements. After “friendly consultations” are attempted, the dispute is elevated to “senior management for further consultation.”<sup>26</sup> If such consultations do not resolve the issue(s), then after 30 days, the parties are free to seek arbitration of the dispute.<sup>27</sup> The agreed upon

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<sup>19</sup> Riding, Exh. No. CR-4HC, at p. 24, Section 2.3.7(c).

<sup>20</sup> Riding, Exh. No. CR-4HC, at pp. 59-61, Section 19.1.

<sup>21</sup> Riding, Exh. No. CR-4HC, at 61-63, Section 19.2.

<sup>22</sup> Riding, Exh. No. CR-4HC, at 61, Section 19.2.1 and Exhibit C.

<sup>23</sup> Riding, Exh. No. CR-4HC, at 62, Section 19.2.2(d).

<sup>24</sup> Riding, Exh. No. CR-4HC, at 63, Section 19.2.4.

<sup>25</sup> PSE and TOTE reserve the right to suspend service if either fails to pay and after notice of non-payment.

<sup>26</sup> Riding, Exh. No. CR-4HC, at 64, Section 20.1.

<sup>27</sup> Riding, Exh. No. CR-4HC, at 64, Section 20.1.

rules for binding arbitration are set forth in Section 20.4.<sup>28</sup> However, each party reserves the right to seek injunctive or equitable relief under Applicable Laws<sup>29</sup> should there exist a material breach or default, whether actual or threatened.<sup>30</sup> Again, the agreement provides for no Commission oversight over the dispute or its resolution.

20 As the Commission is well aware, Special Contracts are considered substitutes for applicable tariffs.<sup>31</sup> A tariffed customer is afforded the opportunity of bringing a complaint to the Commission for resolution. In this circumstance, the Commission would interpret the applicable tariffs and determine the proper relief, drawing on its experience and expertise in the interpretation and enforcement of tariffs. The Commission will have no such power here. Instead, PSE prefers an arbitrator over the Commission, who will apply AAA rules and render a binding decision according to New York’s laws.<sup>32</sup> In fact, the agreement would effectively foreclose the Commission from exercising any of its judicial authority over this agreement by requiring that disputes between the parties be brought to federal or state courts located in Seattle, Washington - again applying the laws of the State of New York.<sup>33</sup>

21 The effect and apparent intent of the above contract clauses are to prevent the Commission from reviewing the ongoing relationship between the parties or to provide necessary relief according to its regulatory practices. PSE obviously seeks to keep the Commission out of its LNG business with TOTE. This a fatal inconsistency that may be unresolvable, unless PSE’s agreement with TOTE is unregulated.<sup>34</sup>

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<sup>28</sup> See Riding, Exh. No. CR-4HC, at 66, Section 20.4.5. The arbitrator is “empowered to award any remedy available under the laws of the State of New York.”

<sup>29</sup> The laws of the state of New York. See Riding, Exh. No. CR-4HC, at 66, Section 20.4.5.

<sup>30</sup> Riding, Exh. No. CR-4HC, at 65, Section 20.3.

<sup>31</sup> WAC 480-80-143(3) (“Essential terms and conditions of all contracts filed pursuant to this section are considered a part of the gas, electric or water company’s filed tariffs . . .”)

<sup>32</sup> Riding, Exh. No. CR-4HC, at 65, Section 20.4.1 and 20.4.5.

<sup>33</sup> Riding, Exh. No. CR-4HC, at 68, Section 22.1 and 22.2.

<sup>34</sup> PSE’s proposal seeks the benefits of the regulatory compact with none of the burdens.



### C. Interim Gas Supply

22 The agreement requires PSE to deliver LNG fuel to TOTE from LNG sources other than PSE's proposed Tacoma project. Clearly, PSE's agreement to supply TOTE LNG fuel from alternative LNG suppliers is a testament to the availability or expected availability of LNG in the unregulated market.

23 For example, prior to the construction of the proposed Tacoma LNG plant, the agreement recognizes TOTE's need for LNG fuel prior to January 1, 2018.<sup>35</sup> Here, the agreement calls for PSE to "develop and provide an interim supply solution" for TOTE.<sup>36</sup> The sourced LNG contract would operate to pass-through to TOTE any "risks, liabilities and obligations" incurred by PSE as result of providing TOTE with alternative-sources of LNG fuel.<sup>37</sup> Thus, the agreement contemplates the availability of alternative sources of LNG to meet TOTE's LNG fuel demands prior to construction of the Tacoma facility. Under these terms, PSE would have to source and deliver an alternative supply of LNG to TOTE until January 1, 2021.<sup>38</sup>

24 After deliveries of LNG to TOTE begin, PSE can again perform its fuel delivery obligation to TOTE by providing it LNG from a source other than the Tacoma Facility.<sup>39</sup> This is a right expressly reserved by PSE.<sup>40</sup> This performance obligation is subject to a

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<sup>35</sup> Riding, Exh. No. CR-4HC, at 25, Section 2.4.1.

<sup>36</sup> Riding, Exh. No. CR-4HC, at 25, Section 2.4.1. "The Parties will cooperate in good faith to work with Third Parties to develop and provide an interim supply solution for Buyer, including mutually acceptable and commercially reasonable Interim Purchase Agreement(s) that Seller would enter into and a mutually acceptable and commercially reasonable Interim Supply Agreement between Seller and Buyer."

<sup>37</sup> Riding, Exh. No. CR-4HC, at 25, Section 2.4.1.

<sup>38</sup> Riding, Exh. No. CR-4HC, at 25, Section 2.4.1.

<sup>39</sup> Riding, Exh. No. CR-4HC, at 29, Section 4.1.2.

<sup>40</sup> Riding, Exh. No. CR-4HC, at 29, Section 4.1.2. "Seller shall have the right, but not the obligation, upon reasonable notice to Buyer, to supply, or cause to be supplied by Seller's designee, LNG to Buyer from an alternate source to meet the Seller's obligations to supply LNG to Buyer hereunder ...."

number of conditions, including the requirement that any non-PSE LNG be compatible with TOTE's LNG specifications.<sup>41</sup> PSE will be free to source such an alternative LNG fuel from any LNG producer. But, it is contractually bound to sell the alternative LNG to TOTE at the price called for in the contract.<sup>42</sup> Thus, its cost to purchase and deliver the alternative fuel is immaterial to the performance of the agreement. It appears that PSE would bear the risk or reap the reward created by the difference between the purchase price and the contract price.

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In sum, the TOTE agreement's alternative fuel supply provisions make clear that alternative LNG supplies are or will be available to the parties - with or without the agreement. TOTE contemplates fuel delivery by January 1, 2019. PSE would either stand ready to serve on that date or be required to develop and deliver an alternative source of LNG for TOTE. The contemplated availability of alternative LNG supply sources argues against Commission regulation of the product. Said another way, regulation is not needed to ensure the development of transportation compatible LNG fuel supplies. By granting a monopoly to PSE for this purpose, the Commission could indeed hinder such development.

#### **D. TOTE's Contract Price And The Fixed Cost Cap.**

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TOTE's contract price terms are described in Article 11 and Exhibit B of PSE's proposed marine fuel contract.<sup>43</sup> As Staff understands, the agreed upon pricing arrangement significantly deviates from cost of service rate making. This is evident by the contractually imposed cap on the fixed-costs charged to TOTE.<sup>44</sup> PSE states that it had to agree to this cap in order to be competitive with other regional marine fuel providers.<sup>45</sup> This provides

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<sup>41</sup> Riding, Exh. No. CR-4HC, at 29, Sections 4.1.2(a).

<sup>42</sup> Riding, Exh. No. CR-4HC, at 29, Sections 4.1.2(d).

<sup>43</sup> See Riding, Exh. No. CR-4HC.

<sup>44</sup> Ibid. See also Riding Direct, Exh. No. CR-1HCT (Highly Confidential) at 15:13-25.

<sup>45</sup> Riding Direct, Exh. No. CR-1HCT (Highly Confidential) at 15:13-25.

further evidence that the special contract arrives at pricing that does not resemble cost of service as understood by Staff. Included in this fixed-cost cap are PSE's return on and of the capital used to construct TOTE's portion of the facility, the fixed O&M costs, and the short-term contract premium used to accelerate recovery of plant allocated to TOTE over the first 10-year term.<sup>46</sup>

27 As noted above, the TOTE agreement contemplates completion of the Tacoma facility prior to January 1, 2019, which is referred to as the "delivery term."<sup>47</sup> According to Section 11.1.1, if the Tacoma facility begins operation before January 1, 2019, pricing for TOTE would be based on an "average expected cost." Staff believes that this terms refers to the cost estimates PSE used to derive a negotiated contract price with TOTE. As a result, TOTE will be treated differently than core gas customers. To illustrate this difference, any allocation of the proposed peaker plant's fixed cost cannot be included in rate base until the Commission has determined its prudence. Here, PSE has determined TOTE's allocation of fixed cost by way of its negotiated agreement. It is unclear to Staff whether these estimates are compensatory or if they under or over recover PSE's costs during this interim period.<sup>48</sup>

28 The amount of plant assigned to TOTE and used by PSE to calculate the contract price is described in Section 2.3.1(c) of the TOTE agreement.<sup>49</sup> Here, it is set at an amount no greater than 110 percent of the estimate arrived at by PSE by way of its engineering and design study completed in August of 2013.<sup>50</sup> PSE's direct testimony and presentations to

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<sup>46</sup> *Ibid.*

<sup>47</sup> Riding, Exh. No. CR4-HC, at 11.

<sup>48</sup> Riding, Exh. No. CR-4HC, at 84, Exhibit B, Section B.7 appears to describe how this estimate was determined.

<sup>49</sup> CITE

<sup>50</sup> Exhibit No. CR-4HC refers to an amount that is "not in excess of one hundred and ten percent of the aggregate pricing estimate included in the front end engineering and design study completed in August of 2013 by Chicago Bridge and Iron. PSE's response to NWIGU's DR No. 27, Confidential Attachment, page 39. The

Staff have referred to estimates for this facility in the range of \$300 to \$350 million.

However, the actual construction costs are largely unknown and subject to change. Without a known amount, there is no way for the Commission to know whether the allocation of fixed costs set forth in the agreement will be compensatory.

29 PSE attempts to ameliorate the cap on TOTE's costs by using estimates of its sales through the unregulated portion of its business.<sup>51</sup> It appears to Staff that it intends offset any deficiency in TOTE's fixed cost recovery by its unregulated sales, as described in PSE's market study.<sup>52</sup>

30 Staff is concerned that core gas customers will ultimately be expected to backstop PSE's risk of under-recovery relative to its TOTE contract. As PSE's construction cost estimates are largely unknown at this time, Staff cannot determine whether the price caps in the TOTE agreement will allow PSE to recover its costs and return. Further, any material deviation from the facility's estimated costs could erode whatever benefits PSE expects from the peaker portion of the plant. Finally, Staff is concerned that the agreement's price caps only benefit TOTE, and could result in an unlawful subsidization specifically prohibited in statute.<sup>53</sup>

**E. The TOTE Contract Sets Aside Certain Commercial Preferences Preferences For TOTE's Affiliates.**

31 The TOTE agreement allows TOTE to resell the LNG marine fuel it receives from PSE. As set forth in Section 10, any of TOTE's unnamed affiliates can purchase fuel from

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plant assumptions for the study show an amount of \$266 million. Even at 110 percent, Staff believes that TOTE fixed cost cap already sets the stage for significant under recovery.

<sup>51</sup> Riding, Exh. No. CR-1HCT at 16:5 through 17.

<sup>52</sup> Bartos, Exh. No. MFB-3HC.

<sup>53</sup> See RCW 80.28.280(2).

PSE under the same terms given TOTE. Further, TOTE is allowed to resell this fuel under certain conditions, which appears to violate WAC 480-90-108(5).

32 Importantly, any sales made to such affiliates would appear to be on PSE's proposed unregulated side of the business. Under the agreement, TOTE would receive 100 percent of the benefit from use of its berthing facilities by PSE for sales to unregulated marine fuel customers. This "most favored nation" departs significantly from the regulated cost of service model. Furthermore, the application of this pricing clause appears to subsidize the LNG price unregulated sales to TOTE's affiliates by offering it at a lower cost than future market rates.

## **V. APPLICABLE STATUTES**

33 Staff's recommendation in this case is based upon two lines of reasoning. First, Staff will address its opinion that PSE's LNG service is a competitive enterprise, and does not need regulation to either encourage its development or to protect the consumer. Next, Staff contrasts the Commission's legal framework for the regulation of natural gas with the LNG service proposed by PSE. Here, Staff concludes that LNG service falls outside the Commission's express statutory authority. To regulate LNG, the Commission would have to broadly interpret its enabling statutes to include LNG service. These statutes include the very definition of natural gas service and a natural gas plant. In the end, Staff cautions against reading the statutes so broadly so as to include LNG.

34 PSE should show a compelling reason why it is necessary to regulate LNG in Washington, but it does not do so. The "regulated service" PSE seeks amounts to what is in essence a behind-the-meter service that is not a traditional utility service. PSE has

manufactured a behind-the-meter business opportunity with its TOTE contract. Regulation is not necessary for it to fulfill its agreement with TOTE. The contract has already been executed, and PSE is moving forward to develop the project. PSE made these commitments without regulation. It does not need the protection of regulation to perform them. In the end, PSE's filing presents no compelling reason why the Commission should step in to regulate LNG service in Washington. Staff will discuss all these issues below.

**A. The Commission's General Authority**

35 The Commission's general regulatory authority stems from RCW 80.01.040, wherein the legislature set forth the boundaries of its jurisdiction. Its jurisdiction and authority is limited to "persons . . . supplying any utility service or commodity to the public for compensation."<sup>54</sup> Whether "any person or corporation is conducting business subject to regulation . . . [by the Commission is] a question of fact to be determined by the commission."<sup>55</sup> These statutes give the Commission discretion to determine what entities and enterprises are subject to regulation as a utility service or commodity.

**B. The Distribution Of LNG As A Transportation Fuel Is A Competitive Enterprise**

36 In industries, like the utility industry, where few enterprises can coexist efficiently, the government must provide and impose "the necessary regulation which competition has

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<sup>54</sup> RCW 80.01.040 ("The utilities and transportation commission shall: . . . (3) Regulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation.")

<sup>55</sup> RCW 80.04.015 ("The commission may consider any and all facts that may indicate the true nature and extent of the operations or acts and may subpoena such witnesses and documents as it deems necessary.")

been unable to provide.”<sup>56</sup> The regulatory compact is the “most basic underpinning[] of utility regulation.”<sup>57</sup>

This compact, or understanding, between utilities and those who regulate them is necessary because utilities generally are regarded as being natural monopolies. They are capital intensive to the point that it is economically inefficient for more than one firm to build, operate and maintain the infrastructure necessary to provide service in the public interest. . . .  
*Governmental oversight, such as provided by the Commission, prevents utilities such as PSE from exercising monopoly power, with regulation substituting for competition as the determiner of price.*<sup>58</sup>

37 In Washington, the Commission is allowed broad authority to regulate the monopoly services offered by utilities.<sup>59</sup> The regulatory compact is not applicable to services offered in a competitive market where a monopoly provider is not needed to protect the public. Competitive services and monopoly services can be considered natural opposites: where there is competition no monopoly can exist.<sup>60</sup> Where there is no monopoly, no regulation by the Commission is necessary.

38 The Commission’s regulatory authority exists to protect Washington consumers from the lack of effective competition and the resulting monopoly power that utilities can wield. The regulatory compact also benefits the regulated utility by ensuring compensation for the services it offers to the public. But this compact is unnecessarily and unreasonably imposed in a competitive industry that naturally offers protection to consumers against the exercise of

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<sup>56</sup> *Tanner Elec. v. Puget Sound*, 128 Wash.2d 656, 682 (1996) (citing George E. Turner, *Trends and Topics in Utility Regulation* 267 (1969)). See also Charles F. Phillips, Jr., *The Regulation of Public Utilities* 5 (1984).

<sup>57</sup> See *In the Matter of the Petition of Puget Sound Energy For an Order Approving the Allocation of Proceeds of the Sale of Certain Assets to Public Utility District #1 of Jefferson County*, Docket UE-132027, Order 04 at 11 (Sept. 11, 2014).

<sup>58</sup> *Id.* at 11.

<sup>59</sup> *Tanner Elec. Co-op v. Puget Sound Power & Light Co.*, 128 Wn.2d 656, 666 (1996).

<sup>60</sup> *State v. Central Lumber Co.*, 24 S.D. 136, 159 (S.D. 1909). See also *N. Sec. Co. v. United States*, 193 U.S. 197, 317 (1904) (explaining the policy of the United States to disfavor monopoly that deprives “the public of the advantages that flow from free competition.”); *Lear, Inc. v. Adkins*, 395 U.S. 653, 663 (1969) (explaining that granting monopoly power to a patent owner is an “exception to the general federal policy favoring free competition.”).

monopoly power. This is particularly true where two sophisticated corporate entities engage in arms-length bargaining, such as the agreement at issue.

39 As it concerns the LNG Fuel Supply Agreement between PSE and TOTE<sup>61</sup>, no actual monopoly is apparent. The contract was secured by way of a competitive bidding environment, where other capable bidders<sup>62</sup> also sought the contract with TOTE. It is through this bidding process that PSE pursued and secured TOTE's LNG business.<sup>63</sup> The competitive environment exhibited by the bidding process clearly indicates that the commercial marketplace was attracted to developing an LNG facility in Tacoma for TOTE. The bidding process and the number of capable respondents shows the competitive nature of the LNG industry.

40 Given the commercial market's response to TOTE's LNG business, Staff believes that Commission regulation is not required to support the development of TOTE's LNG fueling facility. LNG facilities such as that sought by TOTE have been built throughout the country by a number of unregulated entities.<sup>64</sup> To this point, Staff is unaware of any regulated utility company in this country that is serving LNG as a regulated transportation fuel.<sup>65</sup> In fact, PSE identified Shell as its greatest competitor in the commercial scrub over

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<sup>61</sup> See Riding, Exh. No. CR-4HC.

<sup>62</sup> Declaration of David C. Gomez.

<sup>63</sup> Declaration of David C. Gomez.

<sup>64</sup> PSE Response to Public Counsel DR 002, Attachment A (C), *Liquefied Natural Gas Strategic Assessment: Board of Directors Summary*, Puget Sound Energy (May 2012) at page 17. "Clean Energy Fuels operates both LNG production and fueling stations." *Id.* "Prometheus Energy, based out of Redmond WA, offers a variety of services related to LNG production and distribution. . . . Prometheus Energy is privately held by Shell Technologies Venture Fund 1 B.V. and Black River Asset Management." *Id.* Applied Natural Gas Fuels (Applied) owns a liquefaction facility in Arizona "from which they serve various industrial and transportation markets primarily in California." *Id.* PSE Response to Public Counsel DR 002, Attachment A (C), *Board Update: Liquefied Natural Gas Development Strategy*, Puget Sound Energy (Jan. 2013) at page 9-10. Here, PSE identifies its major competitors for the development of an LNG fueling facility in Puget Sound and their relevant experience with developing such facilities, naming: FortisBC, Cheniere, and Shell. *Id.*

<sup>65</sup> PSE Response to Public Counsel DR 002, Attachment A(C) *Liquefied Natural Gas Strategic Assessment: Board of Directors Summary*, Puget Sound Energy (May 2012) at page 19. Some companies in the United



TOTE's LNG business.<sup>66</sup> To Staff, the robust competition for TOTE's business and this country's history of developing LNG fueling projects without commission intervention demonstrates that this Commission can take no action, and allow the competitive market to decide what entities invest in the development of LNG fueling facilities in Washington. As noted, above PSE has already executed its agreement with TOTE. This act was completed without engaging the Commission by seeking its approval. PSE has by contract committed to move forward with the TOTE project and its development activities at the Tacoma site stands as proof of its commitment. It has not needed the Commission to take these steps. It also does not need the Commission to complete it, as an unregulated enterprise. By acknowledging the competitive market for LNG development, the Commission would stay in step with the legislature.

41 Washington's enunciated policies argue against awarding a competitive advantage to one company over another for providing natural gas and LNG as a transportation fuel.<sup>67</sup> To this end, the legislature has stated that: "it is sound tax policy to provide uniform tax treatment of natural gas used as a transportation fuel . . . so as to prevent any particular entity from receiving a competitive advantage. . . ."<sup>68</sup> Thus, the legislature expressed its

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States have built LNG facilities *as peaking facilities*, including: New York State Electric and Gas Corporation (which used funds granted by the Department of Energy); Alagasco (which has two); Integrys Energy (through its subsidiary, Peoples Gas); AGL Resources (operating several in the southeast); and, Pacific Gas and Electric, teamed with Idaho National Labs. "AGL has created an unregulated subsidiary, Pivotal LNG which is attempting to further utilize the LNG peaking facilities, owned by AGL, to serve the transportation and industrial markets." *Id.* "Through a subsidiary, the Utah gas utility Questar has partnered with Applied LNG technologies to be exploring ways to expand LNG market opportunities in Utah." *Id.* Staff is unsure of the structure or organization of these companies regarding their involvement with LNG.

<sup>66</sup> PSE Response to Public Counsel DR 002, Attachment A (C), *Board Update: Liquefied Natural Gas Development Strategy*, Puget Sound Energy (Jan. 2013) at page 10. CITE FORMAT "Shell may present the greatest credible threat of developing a new small-scale LNG facility in the Puget Sound region. Shell has been actively chasing large LNG customers in the region and has approached the Port of Tacoma with plans to develop a facility there. The Port has since refused its proposal in favor of PSE's proposed project. Shell has been operating large LNG facilities for decades." *Id.*

<sup>67</sup> Laws of 2014, ch. 216, § 101(1).

<sup>68</sup> *Id.*

desire to avoid tax policies that could impair the development of a competitive market for LNG serving as a transportation fuel. This direction informs Commission’s discretion to regulate LNG development.<sup>69</sup> Staff believes that the competitive market will advance the market development for LNG much faster than treating it as a regulated service.

42           The legislature has also spoken to the development of LNG and the environmental benefits expected from the expected reduction of transportation emissions. Here, the legislature made clear that “well-developed and convenient refueling stations” would be necessary to promote LNG’s use by the public.<sup>70</sup> It went on to declare that the development of such refueling stations to be in “the public interest.”<sup>71</sup> Importantly, the legislature also made clear that its pronouncement of policy did not “alter the regulatory practices of the commission.”<sup>72</sup>

43           When dealing with such pronouncements of legislature-directed policy, the Commission should apply the general rules of statutory construction to reconcile any inconsistencies in interpretation. Here, the Commission would turn to the pronouncement’s plain language, and only if necessary, resort to other evidence such as “legislative history or other evidence” to determine its meaning.<sup>73</sup>

44           The primary goal of statutory interpretation is to ascertain and implement the

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<sup>69</sup> In particular, it should strive to avoid giving PSE a direct advantage over unregulated companies.

<sup>70</sup> See RCW 80.28.280(1).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.*

<sup>73</sup> *Cf. Whatcom County v. Bellingham*, 128 Wn.2d 537, 546, 909 P.2d 1303 (1996) and *Vita Food Prods., Inc. v. State*, 91 Wn.2d 132, 134, 587 P.2d 535 (1978), as applied in *City of SeaTac, et al. v. Puget Sound Energy, Inc.*, Third Suppl. Order at ¶ 13, Docket Nos. UE-010891 and UE-011027 (January 28, 2002). *See also, City of Kent, et al. v. Puget Sound Energy, Inc.*, Third Suppl. Order at ¶ 17, Docket Nos. UE-010778 and UE-010911 (January 28, 2002) and *Air Liquide America Corp. v. Puget Sound Energy, Inc.*, Docket No. UE-981410, Fifth Supplemental Order Granting Complaint, Ordering Refunds and Other Relief, at 5-6 (Aug. 3, 1999).

legislature's intent.<sup>74</sup> The first step, a plain meaning analysis, requires a court to look to not only the specific statutory text but also everything the legislature has said in related statutes to disclose its intent.<sup>75</sup> If the statute is subject to more than one reasonable interpretation, then it is ambiguous and courts look beyond statutory language to historical context and legislative history.<sup>76</sup>

45           In this case, RCW 80.28.280 documents the legislature's general support for the development of LNG facilities in Washington while leaving the commission's regulatory practices unaltered, with one exception.<sup>77</sup> That one exception provides that the Commission is to ensure that any rate charged for LNG as a transportation fuel by a gas company to a public entity that operates marine vessels, such as the Washington State Ferries, should not be greater than the rate charged to a private customer that operates marine vessels.<sup>78</sup> No other exception is made. Thus, the legislature's directive is clear - the Commission is to continue with the same regulatory practices it currently has in place.

46           Regarding LNG for use as a marine transportation fuel, such practices do not exist but for the application of the Commission's well-developed general authority.<sup>79</sup> Therefore, the Commission statutory authority has not changed, except in the single instance where it is

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<sup>74</sup> *State v. J.M.*, 144 Wash.2d 472, 480 (2001).

<sup>75</sup> *Dep't. of Ecology v. Campbell & Gwinn, LLC*, 146 Wash.2d, 1, 11 (2002).

<sup>76</sup> *Dep't. of Ecology v. Campbell & Gwinn, LLC*, 146 Wash.2d, 1, 12 (2002). Washington courts have also turned to the public policy of a statute for the statute's meaning. *Dep't of Natural Res. v. Marr*, 54 Wash. App. 589, 593 (1989).

<sup>77</sup> RCW 80.28.280(1). "Except as provided in subsection (2) of this section, nothing in this section and RCW 80.28.290 is intended to alter the regulatory practices of the commission or allow the subsidization of one ratepayer class by another." *Id.*

<sup>78</sup> RCW 80.28.280(2). "When a liquefied natural gas facility owned by a natural gas company serves both a private customer operating marine vessels and the Washington state ferries or any other public entity, the rate charged by the natural gas company to the Washington state ferries or other public entity may not be more than the rate charged to the private customer operating marine vessels." *Id.*

<sup>79</sup> Staff will address the application of the Commission's statutory authority in the following sections of this brief.

important to ensure that Washington's public marine vessels get as good or better of a deal on rates when purchasing LNG as a transportation fuel. The legislature could have easily added LNG to the services regulated by the Commission or to the definition of gas facilities to clarify its intent that LNG be a regulated service, but it did not.

47           RCWs 80.28.280 and 80.28.290 do seem to contemplate that the Commission would have a role ensuring that LNG development is not impaired by PSE's gas delivery practices or would otherwise favor itself over other possible LNG developers. In other words, the Commission could have a role to maintain the existing marketplace and ensure no distribution operator discriminates against LNG as a whole or its head-to-head competitors for LNG development. RCW 80.28.280(2) should not be read as a directive to establish monopoly power for PSE or extend regulatory jurisdiction into an existing competitive marketplace. In fact, extending a regulatory regime to displace a competitive market could be the exact type of barrier the legislature intended to remove when promulgating RCW 80.28.280, RCW 80.28.290, and RCW 82.38.030.

48           To the extent the legislature's intent is unclear in RCW 80.28.280 and RCW 80.28.290, the Commission can look to ensure consistency with a relevant enabling statute. The legislative findings included in RCW 82.38.030 note the legislature's goal of treating all natural gas transportation fuel providers uniformly and securing optimal pricing for LNG.<sup>80</sup> The legislative goals of uniform treatment and securing optimal pricing both go against creating regulated treatment for one fuel provider. With the current state of the LNG market, the statutory regime does not envision the Commission establishing a regulated monopoly or benefitting one provider at the expense of what is already a competitive market.

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<sup>80</sup> RCW 82.38.030 Findings – Tax preference performance statement – 2014 c 216(1) and 2(c).

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Staff understands that PSE was the only regulated utility to engage in the competitive bidding process for TOTE's LNG business.<sup>81</sup> In fact, PSE contemplated using its status as a regulated utility to create a competitive edge over the other competitors for the TOTE contract.<sup>82</sup> The Commission's regulatory power shields Washington ratepayers from the exercise of monopoly power by utility companies like PSE.<sup>83</sup> This same power should not be used to allow PSE to use its status as a regulated utility to suppress competitors in the heretofore unregulated industry of LNG transportation fuel distribution. A recent change to RCW 80.28.280 expresses the legislature's intent to promote LNG as a transportation fuel.<sup>84</sup> By granting PSE a LNG market advantage by way of regulation of LNG service, the Commission's decision could result in the suppression of LNG market entrants. The Commission should avoid this result, and follow the guidance expressed by the legislature.

**C. The Commission's Authority - Natural Gas Distribution And Natural Gas Facilities.**

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As noted, the Commission's general regulatory authority stems from RCW 80.01.040(3), wherein the legislature set forth the boundaries of its jurisdiction.<sup>85</sup> Key here is the mandate that the Commission's jurisdiction be limited to "persons ... supplying any

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<sup>81</sup> Declaration of David C. Gomez.

<sup>82</sup> PSE Response to Public Counsel DR 002, Attachment A (C), *Liquefied Natural Gas Strategic Assessment: Board of Directors Summary*, Puget Sound Energy (May 2012) at page 45. CITE FORMAT "Based on PSE's cost of capital and regulated business model, we can offer the service at a very competitive price. Most of the competitors in the marketplace price LNG on a diesel minus basis, where PSE would price it on a cost-of-service basis. This should make PSE the lowest cost provider." *Id.*

<sup>83</sup> RCW 80.01.040. *See also, e.g. Inland Empire Rural Electrification v. Dep't of Pub. Serv.*, 199 Wash. 527 (1939) (describing the nature of the public service laws).

<sup>84</sup> "... liquefied natural gas motor vehicle refueling stations and vessel refueling facilities are in the public interest." RCW 80.28.280(1).

<sup>85</sup> "The utilities and transportation commission shall: ... (3) Regulate in the public interest, as provided by the public service laws, the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation." RCW 80.01.040.

utility service or commodity to the public for compensation.”<sup>86</sup> The Commission’s authority in this regard has been broadly construed.<sup>87</sup> To conclude that the PSE’s contract with TOTE is indeed jurisdictional, the Commission must conclude that furnishing LNG for use as a marine fuel is a regulated utility service or commodity offered to the public generally.

51           The parameters of the Commission’s authority over *natural gas* service are outlined, in part, by RCW 80.04.010. Here, the terms “Gas Company” and “Gas Plant” are defined.<sup>88</sup> As to PSE, it is clearly a gas company as defined in the statute. The statute goes on to define “Gas Plant” to include “real estate, fixtures and personal property . . . used for or in connection with the transmission, distribution, sale or furnishing of natural gas, or the manufacture , transmission, distribution, sale or furnishing of other type of gas, *for light, heat or power.*”<sup>89</sup>

52           Importantly, PSE has not contracted to deliver *natural gas*<sup>90</sup> to TOTE as the end product sold by PSE. Rather, PSE will deliver LNG for TOTE’s end use, which is nearly pure methane created from natural gas after significant additional refining to remove impurities, other combustibles, and corrosive agents such as sulfur compounds and water.<sup>91</sup> While the Commission could construe LNG to be a *form* of natural gas, the Commission has not attempted to regulate the general sales of other forms of natural gas, such as propane and

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<sup>86</sup> *Id.*

<sup>87</sup> *E.g. POWER v. Wash. Utils. & Transp. Comm’n*, 104 Wash.2d 798 (1985) (discussing the agency’s broad discretion).

<sup>88</sup> RCW 80.04.010(14) and (15), respectively.

<sup>89</sup> *See* RCW 80.04.010(15) (Emphasis added).

<sup>90</sup> Staff does not intend to debate chemistry. The point is that the end-product PSE will sell to TOTE is chemically distinct and in a different physical state from the natural gas PSE delivers to core customers through its distribution system. *See* Hogan Direct, Exh. No. JPH-1T at 6:12-20 (“although natural gas is primarily methane, it also may contain a few percent of other chemicals . . . These chemicals are removed before the gas stream is cooled.”)

<sup>91</sup> Hogan Direct, Exh. No. JPH-1T at 2:14-21 and 6:12-20.

butane.<sup>92</sup> Furthermore, the Commission has no regulatory authority over sales of other combustibles used as marine fuels, such as diesel and gasoline. More importantly, transportation fuels such as these are generally not used for the production of “light, heat or power.”<sup>93</sup>

53           The Commission’s authority to regulate gas plants is specifically and unambiguously limited to those used for the production of “light, heat or power.”<sup>94</sup> PSE’s contract with TOTE provides for none of these statutory purposes. PSE’s will deliver to TOTE marine fuel in the form of LNG.

54           The legislative definition of gas plant cannot be logically construed to include marine propulsion as being within the commonly understood frameworks of “light, heat or power.” Certainly, the Commission has not attempted to exercise jurisdiction over gasoline or diesel fuels sold in Washington just because they may be used to power automobiles or for that matter run an electric generator. Moreover, such use does not lead to the conclusion that the Commission has jurisdiction over diesel fuel prices. The Commission’s commonly understood regulatory authority is over monopolies that deliver electricity or natural gas *to the public* for its use as “light, heat or power” and nothing more.

55           In contrast, marine fuels are not economically regulated and for good reason. The cost to deliver such fuels to the public are not so burdensome or capital intensive as to require regulation as the platform for ensuring that transportation fuel is available to the public. This is also true for LNG, as demonstrated by the bidders competing with PSE for

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<sup>92</sup> The Commission often does have jurisdiction as it relates to safety and pipeline engineering standards for pipelines within the state that carry these substances. *See generally* RCW 81.88 and WAC Chapter 480-93.

<sup>93</sup> *See* RCW 80.04.010(15).

<sup>94</sup> *Id.*

TOTE's business.<sup>95</sup> The fact that companies like Shell and Fortis were in the mix effectively demonstrates the intensity and robustness of the competition and interest displayed by those seeking to sell LNG to TOTE.

56 In summary here, PSE is proposing to deliver to TOTE a product that is much different than the "natural gas" delivered to PSE's other customers. It is a highly refined product requiring significant refining and pre-treatment to produce the nearly pure methane required by TOTE, as demonstrated by the approximately \$300-\$350 million dollar cost of PSE's proposed refining and storage facility. Furthermore, TOTE is not using the fuel to produce "heat, light or power" as commonly defined in the statute. Simply put, TOTE seeks a replacement for the diesel it uses for vessel propulsion. The legislature could have expressly authorized the Commission to regulate marine fuels or LNG when it enacted RCW 80.28.280, but it did not.<sup>96</sup> These fuels are subject to market-based regulation and have been left to free market. The same should be true for TOTE's LNG.

#### **D. Distribution of LNG Is Not A Utility Service**

57 Staff is not convinced that PSE's agreement to supply TOTE with LNG is truly a utility service falling under the regulatory authority of the Commission. RCW 80.01.040 expressly limits the Commission's jurisdiction to *utility services* provided to the public for compensation. To recap, PSE proposes to sell TOTE LNG for use as a marine transportation fuel. Staff believes this is a step beyond the Commission's authority to regulate natural gas for the purpose of providing "light, heat or power."<sup>97</sup>

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<sup>95</sup> Declaration of David C. Gomez.

<sup>96</sup> RCW 80.28.280 did not amend RCW 80.04.010. In fact, the statute made clear that "... nothing in this section and RCW 80.28.290 is intended to alter the regulatory practices of the commission or allow the subsidization of one ratepayer class by another." See RCW 80.28.280(1).

<sup>97</sup> RCW 80.04.010(15)



## 1. The Character Of The Business Is Not A Utility Service

58 When deciding whether PSE's TOTE proposal is jurisdictional, the Commission should base its decision on character of the service to be provided by PSE. As noted in a number of cases involving the Commission's authority, a utility service determination should be based upon the "character of the business actually carried on."<sup>98</sup> In other words, just because the service is offered by a utility is not determinative as to whether the service is indeed a utility service. For example, no company providing a utility service may escape regulation by the Commission simply because it characterizes its business as a private enterprise. Likewise, PSE cannot ensure regulation by the inverse characterization. As this state's Supreme Court has noted, "what [the utility] does is the important thing, not what it, or the state, says that it is."<sup>99</sup>

59 Under RCW 80.01.040(e), the Commission has jurisdiction over utility services offered to the public for compensation. Although the legal precedent focuses largely on the "to the public" portion of Commission jurisdiction, it is important to recognize that the nature of the service is also a statutory prerequisite for Commission authority.<sup>100</sup> This makes both intuitive and legal sense. If the Commission's jurisdiction depended only on whether a corporation held out its business for public use, every convenience store in the state would fall within the Commission's jurisdiction.

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<sup>98</sup> *Cushing v. White*, 101 Wash. 172, 181-82 (1918). See also *W. Valley Land Co. v. Nob Hill Water Assoc.*, 107 Wash.2d 359, 364-66 (1986), *Inland Empire Rural Electrification v. Dep't of Pub. Serv.*, 199 Wn. 527, 536-38 (1939).

<sup>99</sup> *Inland Empire Rural Electrification v. Dep't of Pub. Serv.*, 199 Wash. 527, 538 (1939).

<sup>100</sup> Indeed, although *Inland Empire* enunciated the devoted to public use test, that same opinion also plainly states "Regulation by the department is predicated upon the proposition that the service rendered is public service" and "the public service commission law relates to public service properties and utilities."

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History and ratemaking theory best define a utility service. Utility services have two components.<sup>101</sup> The first is a public necessity or essential nature of the service for modern life.<sup>102</sup> This “public service” of a utility generally means inelastic demand and a lack of available alternatives.<sup>103</sup> Second, a utility service is a natural monopoly because the technical requirements of the business necessitate massive economies of scale and capital investments.<sup>104</sup> Multiple providers of the service within the same physical area is thus either infeasible or detrimental. Hence, there are rarely multiple providers of the same utility service within the same geographic region. Multiple providers of the same service suggest a functioning marketplace, and those markets usually no longer qualify as utility services in need of regulation under the public service statutes.

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PSE’s proposed contract to supply LNG to TOTE cannot be characterized as a utility service. First, the provision of LNG fuel is neither irreplaceable nor a public necessity for modern life. Several alternatives to LNG fuel exist;<sup>105</sup> indeed, TOTE’s ships, and the majority of large sea vessels on this planet, currently run on another fuel.<sup>106</sup> The Commission can also look to PSE’s testimony discussing the importance of the projected price spread between natural gas and oil.<sup>107</sup> The basic truth is that alternatives to LNG exist and demand for LNG is indisputably elastic.<sup>108</sup>

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<sup>101</sup> JAMES C. BONBRIGHT ET. AL., *PRINCIPLES OF PUBLIC UTILITY RATES* at 14-15 (2d. Ed. 1988).

<sup>102</sup> BONBRIGHT ET. AL., at 14 (“the first is the special public importance or necessity of the types of service supplied by utility enterprises”).

<sup>103</sup> BONBRIGHT ET. AL., at 15.

<sup>104</sup> BONBRIGHT ET. AL., at 15 *and* 17-22.

<sup>105</sup> See TOTE agreement provisions described in ¶¶ 18 and 24 above.

<sup>106</sup> See Garratt, Exh. No. RG-1T at 6-7 *and* Riding, Exh. No. CR-1T at 14:3-4.

<sup>107</sup> Garratt Exh. No. RG-1T at 8:10-16 (citing to Wood Mackenzie study in Testimony of Harold York), at 9:6-7 (“demand for LNG will be driven by the price spread between low-sulfur diesel and natural gas.”)

<sup>108</sup> See TOTE agreement provisions described in ¶¶ 18 and 24 above.

62           Lastly, and probably most important, the production and provision of LNG service is not a monopoly. TOTE conducted a competitive bidding process for this project.<sup>109</sup> There are several providers for this same service in this same geographic region. To Staff’s knowledge, no other bidders for this project sought to become regulated utility providers. Commercial sale of LNG as fuel is not a utility service because it is neither “essential” nor a monopoly.

**2.       PSE’s Proposal For Supplying TOTE Is Not Devoted to Public Use**

63           In *Inland Empire Rural Electrification v. Dep’t of Public Service (Inland)*, the Supreme Court of Washington set out a legal framework for determining the Commission’s jurisdiction.<sup>110</sup> If a company meets the definitions listed in RCW 80.04.010, the inquiry then turns to whether the entity has devoted its property to public use.<sup>111</sup> The public use requirement is met where the corporation holds itself out to supply its service to the *public generally* rather than offering its service only to specific individuals of its own choosing.<sup>112</sup>

64           In *West Valley Land Company, Inc. v. Nob Hill Water Association (Nob Hill)*, the Supreme Court of Washington found that, against the assertion of West Valley Land Company, Inc., Nob Hill Water Association (“Nob Hill”) was not a public service company subject to Commission regulation.<sup>113</sup> It explained that although Nob Hill “would come within the scope of the regulatory provisions in RCW 80.04” under the literal definitions of “a ‘water company’ operating a ‘water system,’”<sup>114</sup> the inquiry into whether the

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<sup>109</sup> Riding, Exh. No. CR-1T at 14:1-3 (redacted version).

<sup>110</sup> *Inland Empire Rural Electrification v. Dep’t of Pub. Serv.*, 199 Wash. 527 (1939).

<sup>111</sup> *Inland Empire*, 199 Wash. at 535-36.

<sup>112</sup> *Inland Empire*, 199 Wash. at 537.

<sup>113</sup> *W. Valley Land Co. v. Nob Hill Water Assoc.*, 107 Wash.2d 359, 366, 370 (1986).

<sup>114</sup> *W. Valley Land Co.*, 107 Wash.2d at 364.

Commission had jurisdiction did not end with these definitions. It must also consider the character of what the company actually does.<sup>115</sup> In its reasoning, the Supreme Court articulated that the character of Nob Hill’s business was selective (in that it chose “to serve particular individuals of its own selection”<sup>116</sup>), not for profit “at the expense of a consuming public,”<sup>117</sup> and that it was not, ultimately, within the Commission’s “ambit of regulation.”<sup>118</sup>

65           In the instant case, PSE’s service may or may not meet the definition of a “gas company” in RCW 80.04.010, but its proposed service to TOTE fails the “devoted to public use” test established in *Inland* and *Nob Hill*. The portion of the proposed LNG facility for fueling TOTE’s ships is, by definition, devoted exclusively to one customer. One customer cannot possibly meet the legal requirement for devotion to public use. PSE’s proposal to serve TOTE fits precisely within the court’s description of non-jurisdictional practices. Here, PSE’s service to TOTE “merely serves the particular individuals of its own selection.” Indeed, the entire bidding process and project is dedicated to serving a particular individual. Therefore, PSE’s proposal for the Commission to regulate LNG sales to TOTE falls outside the Commission’s jurisdictional authority as enunciated by the courts of this state.

66           Further, and as noted above, PSE sought and won a competitive bidding process to secure TOTE’s business, and agreed to supply TOTE with LNG for its use as a transportation fuel. Instructed by *Nob Hill*, the Commission should not conclude that the mere existence of the agreement between PSE and TOTE makes the TOTE service jurisdictional, despite the fact that PSE is, by definition, a gas company. Like *West Valley*, PSE has selectively chosen to serve TOTE. To Staff’s knowledge, there are no customers

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<sup>115</sup> *W. Valley Land Co.*, 107 Wash.2d at 364-66.

<sup>116</sup> *W. Valley Land Co.*, 107 Wash.2d at 367.

<sup>117</sup> *W. Valley Land Co.*, 107 Wash.2d at 368.

<sup>118</sup> *W. Valley Land Co.*, 107 Wash.2d at 370.

other than TOTE requesting PSE to provide LNG marine fuel at this location. PSE does however, propose to offer unregulated LNG service at the same location - all the while claiming that the TOTE agreement is jurisdictional. Staff cannot distinguish between PSE's purportedly unregulated marine fuel service and its TOTE service. Both require delivery of a refined product to a customer. On the regulated side, PSE has chosen this customer. On the unregulated side, PSE, it seems, would offer the service to the public generally. To Staff, PSE's proposed unregulated business seems more akin to a regulated service than that offered to a single customer - TOTE.

**E. Application of the Commission's Special Contract Analysis to PSE's TOTE Agreement**

67           The Commission's legal framework for evaluating special contracts is composed of two parts. First, the Commission has laid out a process and set of basic requirements in its administrative rules. The relevant administrative rule serves more or less as a checklist.<sup>119</sup> Second, Commission precedent gives an analytical methodology for evaluating a special contract's fairness. Both the administrative rule and the Commission's analytical framework must be satisfied for approval of a special contract. PSE's proposal to serve TOTE under a special contract does not fit into the Commission's traditional legal framework for special contracts. PSE's proposal can be described as an attempt to insert a "square peg" of a market transaction into the "round hole" of utility regulation.

68           The administrative rule for special contracts is set out in WAC 480-80-143. The rule requires a utility to complete a series of processes and file certain documents. For example, portions of WAC 480-80-143 require that a utility provide a copy of the contract, specify effective dates, demonstrate cost recovery, show compliance with RCW 80.028.090 and.

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<sup>119</sup> See WAC 480-80-143.

RCW 80.28.100,<sup>120</sup> explain the basis and purpose for the contract, and state the applicable time period. Two provisions are particularly relevant to this case

69 First, the language in WAC 480-80-143 expressly limits itself to contracts for *utility services*.<sup>121</sup> Limiting the special contracts to utility services makes sense both legally and intuitively. From a legal standpoint, the Commission’s regulatory authority only extends to persons offering a utility service to the public for compensation.<sup>122</sup> From a common sense standpoint, the Commission’s economic oversight is unnecessary in a functioning marketplace for *non-utility* services.

70 Second, RCW 80.28.050 requires utilities’ tariffs and contracts to be available for public inspection, and WAC 480-80-143(7), in turn, requires that the company must not designate the essential terms and conditions of a special contract as confidential. It is worth highlighting that PSE has designated almost the entire contract with TOTE as “highly confidential.”<sup>123</sup> A special contract designated as highly confidential has the effect of suppressing customer and competitor access to business and trade secrets. This treatment strongly suggests a competitive marketplace and not a traditional utility function.

71 The Commission also has a significant amount of precedent for special contracts. The relevant precedent involves a fact-specific and case-by-case analysis of the proposed agreement. The first question addressed is whether the industrial customer could

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<sup>120</sup> RCW 80.28.090 prohibits unreasonable preference and RCW 80.28.100 prohibits price discrimination.

<sup>121</sup> WAC 480-80-143(1) and WAC 480-80-143(1)(b)

<sup>122</sup> RCW 80.01.040(3).

<sup>123</sup> Based on the availability of TOTE’s contract price to TOTE’s affiliates, the only parties that can avail TOTE’s terms and conditions are its affiliates.

legitimately bypass the utility's distribution system.<sup>124</sup> This is generally noted as "the bypass threat." If a true bypass threat exists, the next step is to evaluate the economics and costs associated with the proposed special contract.<sup>125</sup>

72           The basic question is whether the contract customer will cover its own marginal costs to the system and provide some contribution to the overall distribution costs that would otherwise be lost if that customer bypassed the utility entirely. It's an academic way of asking if ratepayers will benefit from having the large customer on the system or whether ratepayers will actually end up paying more to subsidize that customer.

73           Here, PSE is not facing any form of traditional "bypass threat." There is simply no utility service to bypass. The provision of LNG is not an essential service and the business of LNG as transportation fuel is wholly separate from PSE's business operating a gas distribution system.<sup>126</sup> Further, the mechanics of the proposed fuel service make it nearly impossible to bypass PSE's distribution system, anyway. As Mr. Garratt testifies, the marine and trucking fuel markets require steady liquefaction of natural gas.<sup>127</sup> For access to a steady supply of natural gas, PSE's proposed facility will be fed by a four-mile pipe connected to

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<sup>124</sup> *Wash. Utils. & Transp. Comm'n. v. The Wash. Water Power Co.*, Docket UG-901459, Third Supplemental Order (Final Order) at 22-26 (Mar. 9, 1992); *Wash. Utils. & Transp. Comm'n. v. Puget Sound Power & Light Co.*, Docket UE-960299, Sixth Supplemental Order Granting In Part Motion to Compel (Aug. 1, 1996); *Wash. Utils. & Transp. Comm'n. v. Cascade Nat. Gas Corp.*, Docket UG-930511, Fourth Supplemental Order (Final Order) at Section IV.A. (April 29, 1994).

<sup>125</sup> *See, e.g., Wash. Utils. & Transp. Comm'n. v. The Wash. Water Power Co.*, Docket UG-901459, Third Supplemental Order (Final Order) at 22-23 (Mar. 9, 1992) (describing the "Bonbright pricing principles" for competitive pricing); *Wash. Utils. & Transp. Comm'n. v. Cascade Nat. Gas Corp.*, Docket UG-930511, Fourth Supplemental Order (Final Order) at Section IV.B. (April 29, 1994) (titled "Does the BP Contract Comply with the Special Contract Rule and Commission Guidelines?" and discussing the Commission's reliance on Bonbright principles and long run incremental costs plus a contribution to the system)

<sup>126</sup> PSE has partitioned its LNG plant into three categories: 1) peaking service for the distribution system, 2) fuel service to Tote, and 3) fuel service to other industrial customers. Thus, even PSE recognizes the distribution system is operationally and functionally distinct from its proposed fuel services.

<sup>127</sup> Garratt Direct, Exh. No. RG-1T at 5:10 and 32:3-4 (redacted version)

PSE's distribution system.<sup>128</sup> Thus, both the nature of the fuel service and its mechanics show that PSE's separate business enterprise - to sell LNG fuel to TOTE - cannot pose any legitimate bypass threat.

74 TOTE is also not a captive customer in need of regulatory protection. TOTE is a large entity that requested and received bids from numerous potential LNG providers. If anything, TOTE, as the requesting bidder with several proposals to choose from, had the advantage in negotiations. TOTE chose PSE's proposal and the parties negotiated an arms-length contract. An open bidding process and subsequent negotiations between two large entities appears to be a fair and reasonable manner to negotiate a commercial agreement. This is not how a regulated service is established. TOTE has no need for Commission oversight as a substitute for a fair market when the market is already competitive and fair.<sup>129</sup>

75 As noted above, the Commission role in regulation is inextricably tied to the economic protection of users of a regulated service. While this is true, such protection is most needed where the two parties have unequal bargaining positions. For example, the exercise of monopoly power over households that have no other option for the service provides a common example of why the Commission is empowered to act on their behalf. However, this is far from such a situation. Here, the Commission finds two sophisticated corporate entities that have negotiated and entered into a comprehensive and complex contract for LNG service. The TOTE agreement can be characterized as a classic commercial agreement, including a complex price methodology, pricing options for TOTE's

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<sup>128</sup> Garratt Direct, Exh. No. RG-1T at 11:2-4 and Figure 3 at 11 ("Tacoma LNG Facility Location (new high pressure pipeline shown in blue)").

<sup>129</sup> As discussed in Section IV., above, the terms of the contract such as mandatory arbitration and selecting New York for the choice of laws provision show that neither PSE nor Tote need or want Commission oversight of their relationship.



affiliates, price point off-ramps, dispute resolution provisions, and the ability for either party to terminate the agreement. Certainly, it is unlike anything PSE requires of regulated customers. This is not a situation where the Commission should be concerned about the bargaining power of either.

**F. The Inclusion Of “Green” Elements Does Not Make It A Utility Service**

76 As made apparent by PSE’s initial filing, the Company places significant emphasis on the environmental benefits associated with LNG, including TOTE’s requirements to improve the emission profiles of its fleet. However, the environmental benefits associated with a customer’s use of LNG or any other unregulated fuel should not be the specific concern of the utility. PSE’s *own* environmental impacts and emissions’ profile are its only concern, and only to the extent that these matters would impact the utility services provided to its customers.<sup>130</sup>

77 As an example, PSE offers gas and electric service to customers who request it. The utility bears no responsibility for what the customer does with these products after they are delivered to the meter. If these products are used to conduct an illegal activity, PSE is not complicit in the crime. Nor is it responsible for the number and type of appliances that may be used by a customer.

78 Each customer receives the same *service* from PSE - gas and/or electricity. These *are* the services that define PSE as a utility. The inherent nature of PSE’s gas and electric service does not change with a customer’s usage pattern. For this reason, other than enabling certain conservation measures, controlling a customer’s activities behind the meter is

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<sup>130</sup> For example, the emissions profile of a PSE subsidiary has no impact on the utility and should not be a direct concern of the Commission.

generally not the business of the utility.<sup>131</sup> The same is true for the environmental benefits or impacts enjoyed or created by a utility customer. As a result, the Commission should not consider the environmental benefits associated with TOTE's potential use of LNG as material evidence in this case.

79           The very question of whether a utility's pursuit of a customer's environmental benefits could be considered an element of utility service was addressed by the Washington Supreme Court in *Okeson v. Seattle City Light*.<sup>132</sup> Here the court ruled that "combating global warming is not a proprietary utility service."<sup>133</sup>

80           The *Okeson* line of cases dealt with three activities of Seattle City Light (SCL); the provision of street lighting by the utility<sup>134</sup>, the purchase of art for display in the city<sup>135</sup>, and the acquisition of environmental benefits to offset emissions created by utility operations.<sup>136</sup> In each instance, the reviewing court determined that the activity pursued by the utility fell outside the ambit of SCL's utility service. The most applicable here is *Okeson III*, as it dealt directly with SCL's program to "pay public and private entities to reduce those entities' emissions."<sup>137</sup>

81           SCL's emissions reduction program responded to Resolution 30144 and 30359, adopted by the Seattle City Council in 2000 and 2001, respectively. Resolution 30144

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<sup>131</sup> PSE performs laudably when it assists customers who wish to deploy conservation behind the meter. Such conservation provides benefits to both the customer and the utility, as it helps control resource costs for both. Said another way, conservation directly impacts PSE's delivery of electricity and gas service to its customers, and in doing so conservation is inextricably tied to the services provided by PSE. *See also* RCW 19.285.

<sup>132</sup> *See Okeson v. City of Seattle*, 159 Wash.2d 436 (2007) (*Okeson III*). *See also Okeson v. City of Seattle*, 150 Wash.2d 540 (2003) (*Okeson I*); and *Okeson v. City of Seattle*, 130 Wash. App. 814, 125 P.3d 172 (2005) (*Okeson II*).

<sup>133</sup> *See Okeson III*, 159 Wash.2d 436 at 439.

<sup>134</sup> *See Okeson I*, 150 Wash.2d 540.

<sup>135</sup> *See Okeson II*, 130 Wash. App. 814.

<sup>136</sup> *See Okeson III*, 159 Wash.2d 436.

<sup>137</sup> *See Okeson III*, at 439.

directed the City of Seattle to “reduce greenhouse gas emissions in its own operations and through community actions ... by mitigating or offsetting greenhouse gas emissions associated with any fossil fuels used to meet load growth.”<sup>138</sup> Resolution 30359 directed SCL to pursue “paying others to reduce their emissions in order to offset [SCL’s] own contributions to global greenhouse gas.”<sup>139</sup> SCL then entered into contracts with other entities, such as King County Metro and Washington State Ferries, to “use cleaner fuels, and, in return, to receive the credit for ... the greenhouse gas reductions.”<sup>140</sup>

82           To reach its decision rejecting SCL’s use of ratepayer monies to purchase greenhouse gas offsets, the court examined whether the contracts at issue “were closely related to the purpose of supplying electricity to ... [SCL] customers.”<sup>141</sup> It determined they were not. The court concluded that the greenhouse gas offsets did not bear a “close nexus” to SCL’s statutory purpose - to supply electricity to its customers.<sup>142</sup> It went to conclude that such a “close nexus to supplying electricity” would only exist “when the action benefits the utility and its customers, but not when it benefits the general public.”<sup>143</sup>

83           The *Okeson* decisions guide the Commission. PSE supplies electricity and natural gas to its customers. It is not in the business of distributing third-party greenhouse gas emission reductions. Nor does any environmental objective, as laudable as it may be, imbue electricity or natural gas service with an environmental purpose.<sup>144</sup> The purpose of PSE’s natural gas service is clear - to provide for “light, heat, and power.” To this end, do the

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<sup>138</sup> See *Okeson III*, at 439-40.

<sup>139</sup> See *Okeson III*, at 441.

<sup>140</sup> See *Okeson III*, at 441.

<sup>141</sup> See *Okeson III*, at 451.

<sup>142</sup> See *Okeson III*, at 451.

<sup>143</sup> See *Okeson III*, at 451.

<sup>144</sup> Unless, its specific purpose is provide direct benefits to the utility in its provision of service. For example, purchasing greenhouse gas emissions credits to offset carbon emissions from a utility-owned coal plant.

environmental benefits associated with TOTE's use of LNG as a marine fuel benefit PSE - the utility? The short answer is no. PSE would receive none of the environmental benefits expected by TOTE. Would PSE's natural gas ratepayers receive such benefits? Again, the answer is no. TOTE alone would receive a benefit from the availability of a more environmentally-friendly fuel.

84           What truly matters is the economic cost of natural gas delivered by PSE as a utility service. This is the extent of the Commission's authority - to set utility *service* rates that are "fair, just, reasonable and sufficient."<sup>145</sup> The Commission's authority rests in its purpose and duties. As noted in *Okeson III*, reducing greenhouse gas emissions is a *governmental* function, and not the responsibility of PSE. Therefore, the Commission should give little weight to PSE's claims of environmental benefits expected from its TOTE project. And, certainly not conclude that such benefits can offset any infirmity in how PSE proposes to offer its LNG product. In the end, the Commission's core duty is to set rates.<sup>146</sup>

## VI. CONCLUSION

85           Staff's analysis herein this brief reflects the facts presented by PSE in its initial filing, and reflects the Commission's current practices and legal authority. To Staff, the facts presented indicate that LNG used as marine transportation fuel is indeed a competitive service that needs no Commission intervention in order to prosper. The TOTE contract's inception demonstrates that the current market for LNG has interested and capable entrants

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<sup>145</sup> RCW 80.01.040(3). The paramount objective of the Legislature in creating the commission "was to secure for the public safe, adequate, and sufficient utility services at just, fair, reasonable, and sufficient rates." *See, State ex rel. PUD 1 v. Department of Pub. Serv.*, 21 Wn.2d 201, 209, 150 P.2d 709 (1944).

<sup>146</sup> *See also, Jewell v. Wash. Utilities & Transp. Comm'n*, 90 Wash.2d 775, 585 P.2d 1167 (1978). Here, the court rejected as arbitrary and capricious the Commission's approval of charitable contributions in rates, concluding that such contributions in rates were unrelated to the utility's provision of "prompt, expeditious and efficient service." In other words, the Commission's statutory authority is limited by its legislative directive to ensure the utility delivers "prompt, expeditious and efficient service." (at 777).

waiting to serve. In fact, the contract terms expressly envision the availability of LNG for TOTE to use as an interim fuel supply before the Tacoma facility is operational.

86 PSE's requested outcome would have the Commission regulate its LNG service to TOTE. But, that same agreement forecloses any Commission role in the performance of the agreement. Further, the agreement expressly circumvents the Commission general authority to oversee and decide disputes between the parties.

87 Other than approval of the agreement, PSE wants nothing more from the Commission. PSE's agreement with TOTE is transparent in its intent regarding the Commission - to be left alone to provide LNG marine fuel to TOTE; according to its commercial contract and without Commission oversight and control. This appears to be PSE's desired outcome, and the Commission can enable this outcome by finding that LNG to service to TOTE, as expressed in the TOTE agreement, is a competitive service.

88 Finally, Staff points out that if the Commission determines LNG to be a regulated service, then any other LNG providers doing business in Washington now and in the future would be included under the Commission's regulatory umbrella. This is not, in Staff's opinion, the intent of the legislature. The role of the Commission should be to ensure the availability of LNG but not go so far as to regulate the service. The legislative pronouncements make clear that it seeks to ensure that market entrants to the LNG business are not discriminated against by company's currently under regulation.

89 PSE can be an LNG market entrant. Its contract with TOTE certainly indicates its desire to do so. There are other interested parties waiting and willing to make LNG investments. PSE's special contract is not needed to make LNG markets develop. It can compete in the market without Commission approval, and is required by contract to perform

as agreed. It can pursue such performance on the unregulated side of its corporate structure. Staff would support the idea of PSE offering unregulated service to TOTE, so long as the corporate subsidiary is properly ring-fenced to protect PSE's ratepayers.

DATED this 24<sup>th</sup> day of November 2015.

Respectfully submitted,

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