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November 25, 2008

VIA ELECTRONIC FILING AND FIRST CLASS MAIL

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket UM _____ – Application for an Accounting Order

Enclosed for filing is the original and one copy of Northwest Natural's Application for an Accounting Order. A copy of this filing has been served on the parties indicated on the attached certificate of service.

Very truly yours,

A handwritten signature in black ink, appearing to read "Amie Jamieson".

Amie Jamieson

Enclosure

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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in this proceeding on the following named person(s) on the date indicated below by email and/or first-class mail addressed to said person(s) at his or her last-known address(es) indicated below.

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**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM _____

In the Matter of
NORTHWEST NATURAL'S Application For
Accounting Order Regarding System
Integrity Pipeline Program Expenditures

**NORTHWEST NATURAL'S
APPLICATION FOR AN ACCOUNTING
ORDER**

Pursuant to Sections 757.120 and 757.125 of the Oregon Revised Statutes, NW Natural Gas Company ("NW Natural" or "Company") hereby files this Application with the Public Utility Commission of Oregon ("Commission") for an Order authorizing the Company to record as capital expenditures the costs associated with its new System Integrity Program ("SIP").

I. INTRODUCTION

In its Stipulation with Citizen's Utility Board of Oregon, Commission Staff, and Northwest Industrial Gas Users filed contemporaneously with this Application, NW Natural has proposed changes to its current Schedule 177, Adjustments to Rates for Safety Programs. As it currently exists, Schedule 177 describes the adjustments to rates for costs associated with three separate safety related programs: Bare Steel Replacement Program ("Bare Steel Program"), the Geohazard Repair and Risk Mitigation Program ("Geohazard Repair") and Transmission Integrity Management Program ("TIMP").¹ Pursuant to Commission orders and practice, the costs associated with all of these programs are recorded as capital expenditures. The Company now proposes to revise Schedule 177 to reference one integrated safety program which combines the existing Bare Steel and TIMP

¹ This program has previously been referred to as the Integrity Management Program. The Company has renamed the program in order to distinguish it from the DIMP, discussed below.

1 programs with a newly developed Distribution Integrity Management Program (“DIMP”).²
2 Because the costs associated with the DIMP, like the costs associated with the TIMP and
3 Bare Steel programs, are properly characterized as capital expenditures, the Commission
4 should issue the requested accounting order allowing the costs of the integrated SIP to be
5 treated as capital expenditures.

6 **II. BACKGROUND**

7 NW Natural's Bare Steel Replacement Program

8 In 2001, the Company initiated its current Bare Steel Program, which includes the
9 accelerated replacement of the Company's bare steel distribution and transmission
10 facilities.³ The costs associated with this program have been recorded as capital
11 expenditures and have been reflected in Draft Revised Schedule 177.

12 NW Natural's Transmission Integrity Management Program

13 In 2002, Congress passed the Pipeline Safety Improvement Act (“2002
14 Improvement Act”) and, in accordance with its terms, the Office of Pipeline Safety and the
15 Research and Special Programs Administration issued a new rule that added incremental
16 requirements on the operators of transmission pipelines —Pipeline Integrity Management in
17 High Consequence Areas (the “IMP Rule”).⁴ In particular, the IMP Rule requires operators
18 to identify transmission lines in certain “high consequence areas” and to implement written
19 integrity management programs for such areas.

20 To carry out the work required under the IMP Rule, NW Natural developed its TIMP.
21 In UM 1156, the Company filed an application requesting an accounting order classifying

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23 ² The Geohazard Program no longer exists, and will be deleted from the schedule. As further
24 described in the Parties Brief in Support of Stipulation filed contemporaneously with this Application,
25 the activities formerly taken in furtherance of the Geohazard Program will be absorbed in the TIMP
and DIMP.

26 ³ See Advice No. 01-20.

⁴ 69 Fed. Reg. 2307 and corrected in 69 Fed. Reg. 18277.

1 the TIMP costs as capital expenditures. In support of its application, the Company pointed
2 out that that the work required under the 2002 Improvement Act would ultimately result in
3 an extension of the useful life of NW Natural's transmission lines,⁵ and further, was required
4 to continue operation of covered sections of NW Natural's transmission pipeline without
5 pressure reductions.⁶ The Company also explained that the work required under the IMP
6 Rule was incremental to pre-existing safety regulations and therefore was incremental to
7 and not duplicative of pre-existing safety costs.⁷ Staff supported the Company's
8 application,⁸ and in Order 04-390 the Commission approved NW Natural's request.⁹

9 NW Natural's Distribution Integrity Management Program

10 In 2006 Congress passed the Pipeline Inspection, Protection, Enforcement and
11 Safety Act ("2006 PIPES Act") which expands the scope of the 2002 Improvement Act, by
12 requiring the Department of Transportation Pipeline and Hazardous Material Safety
13 Administration ("PHMSA") to prescribe minimum standards for Distribution Integrity
14 Management Programs ("DIMPs") for distribution mains, services, and other gas related
15 appurtenances. In addition, the PIPES Act significantly increases the requirements of all
16 stakeholders relative to excavation damage prevention. Based on the Congressional
17 mandate, PHMSA issued a Notice of Proposed Rulemaking ("NOPR") for "Pipeline Safety:
18 Integrity Management for Gas Distribution Pipelines" on June 25, 2008.¹⁰ The DIMP NOPR
19 prescribes a high level, flexible regulation that will require operators of natural gas

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21 ⁵ See NW Natural's Application filed in UM 1056, p. 5.

22 ⁶ *Id.*

23 ⁷ *Id.*, p. 6.

24 ⁸ See Staff Memorandum.

25 ⁹ At the same time, the Commission approved NW Natural's request for recovery of costs associated
with the program through the company's annual Purchased Gas Adjustment (PGA) filing. The rate
recovery treatment approved by the Commission in Order 04-390 was proposed to expire as of
September 30, 2008.

26 ¹⁰ 49 CFR Part 192, Docket No. PHMSA – RSPA-2004-19854.

1 distribution systems to implement a Distribution Integrity Management Program that
2 includes seven defined elements, including:

- 3 1) Knowledge of the characteristics of the system
- 4 2) Identify threats
- 5 3) Evaluate and prioritize risk
- 6 4) Identify and implement measures to address risk
- 7 5) Measure performance and evaluate effectiveness of the Program
- 8 6) Periodic evaluation and improvement
- 9 7) Report results of performance metrics to regulators¹¹

10 To comply with these proposed regulations, operators will gather and integrate data
11 from a wide range of sources, including: incident and leak history; corrosion control
12 records; continuing surveillance records; patrolling records; maintenance history and “one
13 call” and excavation damage experience.¹² The data from these sources must be mined
14 and integrated into a single database that allows operators to conduct a relative risk
15 analysis to identify facilities or groups of facilities that are subject to higher risk. The data
16 mining and integration may involve extensive efforts and/or new computer software or
17 programming. After completion of the relative risk ranking, operators will be required to
18 implement additional or accelerated measures to address risks.¹³ At a minimum, operators
19 will be required to implement two risk reduction strategies: an effective leak management
20 program and an enhanced damage prevention program.¹⁴ The Gas Piping Technology

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24 ¹¹ 73 Fed. Reg. 36015, 36021 (June 25, 2008).

25 ¹² *Id.* at 36033.

26 ¹³ *Id.*

¹⁴ *Id.*

1 Committee developed guidance in parallel with the DIMP NOPR to provide operators with
2 additional examples of compliance with the proposed rule.¹⁵

3 NW Natural is currently developing a DIMP program for the Company so that it will
4 be prepared to comply with the final Rule, once it is adopted.

5 NW Natural's New System Integrity Program

6 In an effort to increase efficiency, the Company is now proposing that all actions
7 taken pursuant to the TIMP, DIMP and Bare Steel Replacement Programs be combined
8 into one integrated System Integrity Program ("SIP"). Creation of a new, integrated
9 program will allow NW Natural to minimize costs and create a more complete, risk-based
10 approach to system integrity issues, including new distribution integrity management
11 issues.

12 **III. ACCOUNTING ORDER REQUEST**

13 In this Application, pursuant to ORS 757.120 and 757.125, NW Natural requests
14 that the Commission issue an accounting order that all costs associated with its SIP
15 activities¹⁶, except for O&M included in the last applicable rate case (UG 152 or any
16 successor), would be classified as capital expenditures. In support of this request, NW
17 Natural submits the following information:

18 **A. The Classification of Costs as Capital is Consistent with Commission**
19 **Precedent.**

20 The Commission has already agreed that the costs associated with NW Natural's
21 TIMP Program should be recorded as capital expenses.¹⁷ For all of the same reasons, the
22 Commission should find that the costs associated with the DIMP should be accorded
23 similar treatment.

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25 ¹⁵ *Id.* at 36024.

26 ¹⁶ Subject to the terms and conditions set forth in a Stipulated Agreement attached as Exhibit 1.

¹⁷ See Order No. 04-390

1 First, like the TIMP costs, the DIMP costs will be incurred as a result of complying
2 with Federal regulations, and are therefore necessary to the Company's continued
3 operations. Moreover, as with the TIMP, all actions taken in furtherance of the DIMP will
4 serve to extend the useful life of pipelines (in this case, distribution as opposed to
5 transmission) and related facilities.

6 The Oregon Attorney General's office has defined "capital expenditure" as an
7 "expenditure for long-term additions or betterments properly chargeable to a capital
8 asset."¹⁸ The expenses that will be incurred under the SIP quite clearly fall within this
9 definition and are properly capitalized.

10 **B. Minimal Overlap Exists with Current Inspection Requirements**

11 The costs the Company is requesting be considered as capital would not include
12 the amount of O&M included in UG 152. Accordingly, the new DIMP and the ongoing
13 pipeline integrity management activities are incremental to the safety and inspection
14 requirements recovered in base rates; therefore the costs for SIP activities will not be
15 duplicative of any other inspection costs that currently exist. The costs for existing pipeline
16 inspection requirements will continue to exist. Costs for NW Natural's O&M work will
17 continue, unchanged by the Company's compliance to Federal regulations.

18 In summary, NW Natural requests the Commission issue an accounting order as
19 part of its decision on this Application that allows NW Natural to classify its SIP costs as
20 capital within the same FERC account(s) as that of the pipeline(s) requiring work.

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26 ¹⁸ Letter from Donald C. Arnold, Chief Counsel, General Counsel Division, Oregon Dept. of Justice,
to Catherine E. Pollino, Director, Audits Division, Oregon Secretary of State, 3-4 (May 28, 2002).

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IV. CONCLUSION

For reasons set forth above, NW Natural respectfully requests that the Commission issue an order granting (i) its request to classify all SIP expenses as capital, except for the O&M amount included in the Company's last general rate case.

Dated: November 25, 2008

Respectfully submitted,

McDOWELL & RACKNER PC



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