

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1744

In the Matter of

NORTHWEST NATURAL GAS
COMPANY dba NW NATURAL,

Application for Approval of an Emission
Reduction Program

NORTHWEST INDUSTRIAL GAS
USERS' POST-HEARING BRIEF

Pursuant to the Administrative Law Judge's Ruling in this matter dated November 24, 2015, Northwest Industrial Gas Users ("NWIGU") submits this Post-Hearing Brief.

I. Introduction

As noted in its Prehearing Brief, NWIGU participated both before the Legislature during its consideration of Senate Bill 844 ("SB 844") and before the Public Utility Commission ("Commission") when it promulgated the rules implementing SB 844. While NWIGU continues to support the carbon-reduction policies contained in the legislation and in the Commission's implementing rule, NWIGU's support is based on the fundamental concept that approved SB 844 programs will ensure a least-cost approach that results in actual carbon savings and that incentives awarded to customers and the Company (which are paid for by existing ratepayers) are no more than is necessary to create a successful program. As currently designed, Northwest Natural's ("NW Natural" or "Company") proposal does not promote those concepts and NWIGU urges the Commission to revise the proposal accordingly.

From a broad perspective, the combined heat and power (“CHP”) program the Company proposes appears consistent with the intent of SB 844. The Legislature appropriately recognized that natural gas can be used to reduce carbon dioxide emissions by transitioning some customers from reliance on traditional electric service to generating their own electricity from natural gas. Northwest Natural’s proposal provides incentives for customers to make that transition. The record in this matter, however, does not provide a sufficient basis for the Commission to approve the proposal as presented by the Company. If the Commission approves the filing, it must revise the proposal to better protect ratepayers from unnecessary incentives and risks. Specifically, the Commission should reduce the level of incentive payment that goes to the Company, and the Commission should require the program to be re-assessed in the event Oregon adopts more comprehensive carbon regulation measures. The Commission should also subject deferrals to an earnings test.

II. Company Incentive Payment

Northwest Natural’s filing includes an incentive payment to the Company in the amount of \$10 per metric ton of reduced carbon (“ton”). NW Natural asserts that a \$10/ton Company incentive is appropriate for this particular program and as a baseline for future SB 844 projects.¹ NW Natural’s explanation of the incentive, however, focuses more on the latter consideration rather than the former, and the record is not adequate for justifying a \$10/ton payment to the Company as an incentive for the proposed CHP program.

As an initial matter, the Commission should recognize that the authorizing legislation – ORS 757.539 – does not call specifically for an incentive payment to the Company. Rather, that statute provides that the Commission “shall establish a voluntary emission reduction program for

¹ Northwest Natural Gas Company’s Pre-Hearing Brief (“NWN Prehearing Brief”) at 12:9.

the purposes of incentivizing public utilities that furnish natural gas to invest in projects that reduce emissions....”² Broadly speaking, an incentive that “incentivizes” is any measure that incites action and is not limited to just payments to the Company. Instead, it is the Commission’s rules which contemplate that one incentive to the Company might be a payment to the Company.³ Those rules similarly does not require an incentive payment to the utility as part of an SB 844 project. The Commission recognized this optional approach to incentive payments in its final order adopting the SB 844 rules, opting instead to make the determination on a case-by-case basis:

Moreover, the statute does not require that we grant any incentive payments, and it is thus reasonable for the Commission to determine in its review whether incentives should be granted in addition to cost recovery, and whether incentives should be excluded from the utility's earnings test.⁴

NW Natural, as it must, acknowledges that neither SB 844 nor its implementing rules guaranty any company incentive payments.⁵ Nevertheless, the Company argues that the \$10/ton incentive is justified because it is approximately 25% of the total program cost and, therefore, tied to the maximum incentive allowed by the SB 844 rules.⁶ The Company also asserts that a CHP program is likely to be the cheapest SB 844 program and, therefore, that \$10 per metric ton will be a smaller percentage of future (more expensive) programs.⁷ In other words, the Company is arguing that the Commission should approve a maximum incentive payment for this program

² ORS 757.539(2).

³ OAR 860-085-0750(2).

⁴ Order 14-417 at p.6.

⁵ Summers, Transcript at 16:6.

⁶ NWN Prehearing Brief at 12:16.

⁷ NWN Prehearing Brief at 13:14.

because, if it does not, NW Natural will never “hit the max” incentive available for all programs.⁸

A major flaw with NW Natural’s approach for calculating the proposed incentive payment to the Company is that it is based on a mathematical approach for calculating the Company’s maximum incentive allowed under the rule for all SB 844 programs and is completely untethered to any evidence that the incentive payment is necessary to incentivize the Company to implement the specific CHP program at issue in this docket. NW Natural witness Barbara Summers acknowledged that the Company did not perform any analysis regarding the appropriate amount of the company incentive, for example by considering alternative incentive payments such as \$9/ton or \$11/ton.⁹ Ms. Summers further stated that there is probably a point at which NW Natural’s “CEO would say it’s not worth looking at this 844 program or other 844 programs,” but that “I don’t know what that level is – I don’t know whether it’s \$9, \$7 or \$10 – but I’m sure there is one.”¹⁰ To state that more simply, NW Natural cannot tell the Commission what incentive it needs in order to implement the CHP program proposed in this docket, it can only state that the maximum incentive allowed by the rule is acceptable to the Company.

Another flaw with NW Natural’s approach for calculating the proposed incentive payment to the Company is that NW Natural has relied on the incentive as rewarding the Company for its “ongoing effort” to reduce carbon, even though the costs of such an effort are already recovered. In response to a question from the Commission regarding what NW Natural will be doing to “earn” the \$10/ton incentive, Ms. Summers responded that there is a lot of technical work the Company must undertake to “break down some of the barriers that make it

⁸ Summers, Transcript 48:4.

⁹ Summers, Transcript 19:11 to 20:4.

¹⁰ Summers, Transcript 21:17.

complex and difficult to implement CHP in this state.”¹¹ Such work includes technical and economic evaluations, quarterly monitoring, and constant data review.¹² But as Ms. Summers later acknowledged, the costs the Company incurs from those efforts are O&M costs that become part of the program costs and, therefore, are already recovered.¹³ Indeed, they are recovered even if there is zero company incentive payment and the costs she described are “not linked” to the Company incentive.¹⁴

Perhaps the best example of the inadequacy of the record in this regard is a comparison of how NW Natural treats the Company incentive with how it treats the customer incentive. As proposed, the customer incentive is based on the metric tons of carbon that are reduced as a result of the customer’s CHP use.¹⁵ The amount of reduced carbon actually achieved is based on the use of the “eGrid” number that converts reduced electricity use to reduced carbon emissions.¹⁶ One aspect of the eGrid number is that it may get updated frequently.¹⁷ When that happens, NW Natural proposes that it would adjust the customer incentive accordingly. That is, if the eGrid number increases (meaning more carbon is deemed to have been reduced for each megawatt of electricity that is reduced), the customer incentive payment would decrease so that a new CHP customer would essentially receive the same overall payment currently contemplated.¹⁸ The purpose of keeping the overall payment the same is to maintain the simple payback period the Company has calculated is necessary to make the program successful.¹⁹

¹¹ Summers, Transcript 36:20.

¹² Summers, Transcript 37:2-10.

¹³ Summers, Transcript 53:10-14.

¹⁴ Summers, Transcript 53:20.

¹⁵ Northwest Natural Gas Company’s Post-Hearing Brief (“NWN Post-Hearing Brief”) at 5:8.

¹⁶ NWN Post-Hearing Brief at 15:8.

¹⁷ NWN Post-Hearing Brief at 18:8.

¹⁸ Summers, Transcript 26:6-10.

¹⁹ Summers, Transcript 26:20; NWN Post-Hearing Brief at 19:8.

In contrast, if the eGrid number is adjusted upward, the total Company incentive payment could also increase,²⁰ but NW Natural has not proposed to make any corresponding adjustments to that incentive payment amount to keep the total incentive the same.²¹ Since the Company incentive payment would not be adjusted, the Company would end up receiving a larger overall incentive payment, or at least an incentive payment that accrues faster, if the increased eGrid numbers were used. Either way, the Company would benefit to a greater extent from an upwardly-revised eGrid number while in the same scenario the CHP customer is remaining in a static position (because the customer incentive would be revised downward). NW Natural is aware of the disconnect with this approach and has therefore indicated it would keep the Company incentive keyed to the original, un-revised eGrid numbers. But the fact that NW Natural would take this approach (having one eGrid number for the customer incentive and one for the Company incentive) is because it has not identified the minimum amount of the incentive it needs to make the program successful. If it had done such an analysis, it would be able to adjust the amount of the Company incentive to comport with a revised eGrid number just as it proposes to do with the customer incentive. Instead, NW Natural's approach is simply to maximize its incentive payment regardless of the specific scenarios it encounters while implementing the program.

Although NW Natural couches the Company incentive payment in terms of a reward for its effort, the Commission should recognize that the incentive to the Company is pure additional profit, provided to the Company independently of any of the other costs or benefits of the program. When the Company incurs costs for implementing its program, those costs are fully

²⁰ Summers, Transcript 25:22 to 26:4.

²¹ Summers, Transcript 27:3.

recovered in rates as part of the overall program, and the Company's receipt of an incentive will be in addition to the recovery of those costs.

It may be that at some level the expected profit from the Company incentive payment is not worth the "hassle" of proposing or implementing a specific program, but NW Natural carries the burden to demonstrate that the incentive payment it proposes here is reasonable and necessary for its participation. NW Natural has not made such a showing. The Company could have very easily analyzed the impact of various levels of incentive and explained why lower incentive payments would prevent it from implementing the CHP program. In fact, the Company's filing implies that it would participate in the program at a lower incentive because it "hopes to find" an "incentive level that the stakeholders and Commission can agree would make sense going forward." Instead, the Company is leaving the Commission with a choice of either approving the \$10/ton Company incentive as proposed, or guessing whether some other incentive might be okay.

NWIGU's witness has proposed that the Company incentive be reduced to no more than \$5 per ton of reduced carbon. This reduction has multiple benefits. NWIGU's proposal, for example, recognizes that Northwest Natural needs little additional incentive itself to participate in a program like this and that the true "need" to break through development barriers is the need for an appropriate customer incentive that will incite participation in the program. Further, as Staff noted, the Company has an incentive to participate in this program even without the additional incentive payment, because it will benefit from increased load on its system. NWIGU's proposal also retains the Company's ability to obtain a large amount of additional revenue, while reducing the overall program cost by millions of dollars. Of course, it is possible that these same benefits would exist if the Company incentive were reduced even lower to \$4/ton

and that the Company would still implement the program. The problem is that NW Natural has not told the Commission if that is the case. The record developed by NW Natural demonstrates only that the proposed incentive payment does not exceed the maximum incentive payment allowed by the rules.

In addition to the lack of substantial evidence to support a \$10/ton Company incentive for the CHP program specifically, the record clearly does not support any finding that \$10/ton is an appropriate baseline incentive for all future SB 844 programs NW Natural brings forward. As noted above, the Commission has already determined that an incentive to the utility, if there is to be one at all, should be determined on a case by case basis. Each case will present its own set of circumstances on which an incentive payment should be based. Although NW Natural expresses pessimism that it will be able to implement any other SB 844 programs, other programs may get developed and, when they do, broad factors such as economics and the state of technology will likely be different than what currently exists. Specific program components, too, such as the level of rate base investment required to make a program work, will be an issue for consideration. Notwithstanding that these factors may justify a different level of incentive, NW Natural urges the Commission to ignore those fact-specific considerations and instead give it some certainty regarding the level of benefits that can be achieved.²² That burden, however, should fall on the Company, which has the burden of demonstrating the incentive payment is reasonable and necessary, and not the Commission, which has not been provided with an analysis by the Company of the size of the incentive that is needed.

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²² NWN Post-Hearing Brief at 23:2.

III. Statewide Carbon Regulation

If the Commission approves NW Natural's CHP program, it should retain the right to revisit the program during the course of its implementation and not just if the program is able to incentivize 240,000 tons of reduced carbon. It is clear from the record that the parties are not in agreement regarding the level of customer incentive payment that is necessary to make the program successful. NWIGU believes that the Commission can determine the appropriate size of the customer payment based on the current record, but only for so long as the assumptions underlying that record remain the same.

One fundamental assumption of SB 844, and NW Natural's calculation of the customer incentive, is that there is no comprehensive carbon regulation in Oregon such as a carbon tax or cap and trade program. Indeed, support for SB 844 was given as a way to reduce carbon *in lieu* of such regulations. As the testimony from Climate Solutions states, "[t]he prevailing point of view among many of the other stakeholders in 2013 was that an incentive-based voluntary program was worth doing; something short of mandatory action that could lead to emission reduction projects that would otherwise not occur without the incentives provided."²³

Oregon may nevertheless consider new comprehensive carbon regulation. Although she could not recall the specifics of a bill, NW Natural witness Ms. Summers stated that there may be another discussion in the Legislature "about whether there should be a carbon tax in Oregon."²⁴ Staff witness Jason Salmi Klotz similarly stated that he was aware of a specific bill that "seeks to put into place some sort of carbon cap and trade system."²⁵

²³ Climate Solution/10, Gravatt/1.

²⁴ Summers, Transcript at 15:13.

²⁵ Salmi Klotz, Transcript at 88:18.

NW Natural's calculation of the proposed customer incentive was performed on the specific premise that comprehensive carbon regulation does not exist in Oregon.²⁶ Although NW Natural has not analyzed the specific impact of carbon regulation on the calculation of the customer incentive payment, NW Natural witness Ms. Summers stated that if a CHP customer "were offsetting a tax that they would otherwise pay by reducing their carbon emissions, it would affect their economics" and, therefore, the factors that go into calculating the customer incentive.²⁷ Staff witness Mr. Salmi Klotz also agreed that carbon regulation could impact that calculation and stated if there was a carbon market in place, "the market would send a different signal than is present currently, and it might change the economics of [] this particular project and therefore might change Northwest Natural's assessment about what is necessary to give as an incentive."²⁸

Because NW Natural's proposed CHP program will be in place for a number of years, the Commission's approval of the program should expressly retain the Commission's ability to review the program whenever major assumptions change. Otherwise, NW Natural customers may be forced to pay large customer incentives even when a reduced incentive, or no incentive, might be justified.

IV. Earnings Test

The Citizens' Utility Board of Oregon ("CUB") has urged the Commission to apply a deferral earnings test to the Company's CHP program. NWIGU supports any approach that captures the intent of CUB's proposal, which is to prevent the Company from raising rates to cover costs when current rates are already sufficient for that purpose. Doing so will avoid

²⁶ Summers, Transcript 10:24 to 11:4

²⁷ Summers, Transcript 11:5 to 12:11.

²⁸ Salmi Klotz, Transcript 88:1.

placing an additional, unnecessary burden on ratepayers when the Company is in an overearning situation.

NW Natural now states that it will not implement its proposed CHP program if the Commission imposes any earnings test.²⁹ NW Natural makes this extreme demand based on an argument that an earnings test is contrary to the traditional regulatory compact that otherwise encourages utilities to reduce costs. While it is understandable that NW Natural would oppose a mechanism that subjects the Company's incentive payment to an earnings test on that basis, its argument is not sound with respect to the remainder of program costs. Despite NW Natural's assertion that an earnings test somehow violates the traditional regulatory compact, earnings tests are a tool this Commission has used on several occasions to protect ratepayers. Moreover, NW Natural fails to recognize that the entire SB 844 process is outside the scope of the traditional regulatory company and allows the Company to increase its revenue requirement by up to four percent for a voluntary program that is not otherwise necessary for the prudent operation of the utility. Indeed, NW Natural goes to great lengths to make sure the Commission knows the program is voluntary and not part of its normal course of business.³⁰

It is the fact that an SB 844 project is outside the scope of a utility's normal course of business that should justify additional ratepayer protections like an earnings test. If an earnings test can be structured in a way to allow NW Natural to keep the Company incentive while not forcing ratepayers to pay additional costs for a voluntary program when the Company is overearning, NWIGU urges the Commission to adopt such a test.

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²⁹ NWN Post-Hearing Brief at 28:15.

³⁰ NWN Post-Hearing Brief at 31:23.

V. Conclusion

Based on the foregoing, NWIGU supports the proposed CHP program, but with a reduced Company incentive, a requirement to review the program if Oregon adopts comprehensive carbon regulation, and the imposition of an earnings test.

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Respectfully submitted,



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