

ORDER NO.

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DEC 03 2014

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

AR 580

In the Matter of a Rulemaking to
Implement SB 844 (2013).

ORDER

DISPOSITION: RULES ADOPTED

I. INTRODUCTION

In this order, we adopt rules to establish a voluntary emission reduction program for natural gas utilities, as required by ORS 757.539. This program will allow natural gas utilities to propose projects or investments to reduce emissions that the utilities would not undertake in the normal course of business.

II. BACKGROUND

Senate Bill (SB) 844, codified as ORS 757.539, directs us to establish a voluntary incentive program for natural gas utilities to invest in projects that reduce greenhouse gas emissions.¹ We opened this rulemaking to implement the measure, which requires us to establish rules that include criteria for project eligibility, identify components for an emission reduction project application, establish a two-tiered process for our review, and set a rate cap for all projects authorized under the rules.

Staff held workshops on February 12 and 27, March 10, and May 12, 2014, and facilitated rounds of informal comments on its draft proposed rule language. On July 9, 2014, we held a workshop with stakeholders to discuss SB 844 and its implementation.

On August 8, 2014, we filed a Notice of Proposed Rulemaking Hearing and Statement of Need and Fiscal Impact with the Secretary of State. On August 15, 2014, we provided notice to all interested persons on the service lists established under OAR 860-001-0030(1)(b) and

¹ This law is related to two other statutes. In 2007, House Bill 3543 established greenhouse gas emission reduction goals for the state, with the goal of reducing greenhouse gas levels to at least 10 percent below 1990 levels by the year 2020. In 2009, Senate Bill 101 required the Commission to report biennially to the Legislature on the estimated rate impacts for Oregon's regulated electric and natural gas utilities of meeting the greenhouse gas emission goals.

to legislators specified in ORS 183.335(1)(d). We also provided copies of Staff's proposed rules to interested persons and certain legislators. Notice of the rulemaking hearing was published in the September 2014 *Oregon Bulletin*. The notice established a hearing date of September 23, 2014, and a final comment due date of October 7, 2014.

Avista Corporation, dba Avista Utilities; Cascade Natural Gas Company; Northwest Natural Gas Company, dba NW Natural; the Citizens' Utility Board of Oregon (CUB); the Northwest Industrial Gas Users (NWIGU); the Energy Trust of Oregon (ETO), and Staff attended the hearing. CUB, NW Natural, Avista Utilities, and NWIGU presented oral comments summarizing their support and concerns with the proposed rules.

On the comment due date, NW Natural and NWIGU filed written comments. Climate Solutions and NW Energy Coalition (NWE C) also filed joint written comments.

III. DISCUSSION

A. *Comments to the Proposed Rules*

All comments generally support the proposed rules. Commenters raised specific concerns regarding the project threshold, project cap, earnings test, annual reporting requirement, and treatment of emission credits. We address each issue below.

1. *Threshold for Tier-1 and Tier-2 Application Process (Proposed OAR 860-085-0650)*

a. *Background*

ORS 757.539(5) directs us to use a two-tiered process to review project applications. To differentiate the tiers, we must establish two thresholds: (1) overall project cost; and (2) cost per metric ton of reduced emissions. A project that meets both cost thresholds is a Tier-1 application. To review Tier-1 applications, we are required to use our open meeting procedures (public comment and public meeting) and issue a final order within 90 days.² A project that exceeds one or both cost thresholds is a Tier-2 application. To review Tier-2 applications, we are required to use contested case procedures (party status, testimony, evidentiary hearing) and issue a final order within 180 days.

In its proposed rules, Staff set the overall cost threshold at \$1 million and the cost per metric ton threshold at \$85 per ton.

² We note that ORS 757.539(6)(c) and (7)(b) also allow the utility to extend these deadlines and authorize a later date for Commission order.

b. Comments

NWIGU believes the cost threshold of \$85 per ton is too high. Because ratepayers will ultimately bear the costs of these projects, NWIGU believes that the cost threshold should be set to allow a more thorough Tier-2 review for any project with costs estimated to exceed the gas commodity costs (NWIGU converted current gas commodity costs to metric tons of carbon emissions). NWIGU states that a previous draft of the proposed rules contained a \$39 per ton threshold, and that this number was appropriate, insofar as projects that will pass higher costs on to customers should have a more robust review process.

Climate Solutions and NWECA initially recommended a cost per metric ton threshold of \$36 per ton, which is the Environmental Protection Agency's (EPA) social cost of carbon. However, Climate Solutions and NWECA now support use of the ETO's proxy value for its 2013 gas measures, calculated at \$60 per ton. Nonetheless, Climate Solutions and NWECA support the proposed \$85 per ton threshold given the uncertainty of actual costs for projects under these rules, and the procedural nature of the cost per ton number. If the Commission adopts a different value, they assert the number should go no lower than the EPA's \$36 per ton value.

NW Natural did not take a position on the threshold values, but did offer clarifying edits to explain that the thresholds trigger a specific procedural process and to note that the costs being reviewed are those that would be borne by customers.

c. Discussion

We adopt the thresholds as stated in the proposed rules. A project with proposed costs equal to or less than \$1 million and \$85 per metric ton of reduced emissions is a Tier-1 project, and a project with estimated costs greater than either of these thresholds is a Tier-2 project. We also incorporate NW Natural's edits, and note that the introductory sentence in particular is helpful to supply context and explain that the designation of a Tier-1 or Tier-2 project determines the procedural process for the application.

We are not persuaded by NWIGU's concerns over the \$85 per ton value because there are two triggers for the Tier-2 process—if a project's proposed costs exceed *either* the \$1 million benchmark or the \$85 per ton measure, it will receive the additional scrutiny allowed by our contested case procedures. The statute gives us discretion to set the threshold for cost per ton, and considering the lack of any similar programs to use as benchmarks, we find the \$85 per ton figure reasonable.

2. *Project Cap and Incentives (Proposed OAR 860-085-0700 and OAR 860-085-1000)*

a. *Background*

ORS 757.539(10) directs us to establish a rate cap that limits the cost of all a utility's emission reduction projects to an amount that does not exceed a Commission-determined percentage of the utility's revenue requirement. The proposed rules provide that a utility's total authorized emission reduction projects must not exceed 4 percent of the utility's retail revenue requirement. This would cap NW Natural's projects at approximately \$30 million, Avista's at approximately \$4 million, and Cascade's at approximately \$3 million.

A separate, but related issue is the cost to ratepayers of incentives received by the utility. The proposed rules limit the overall amount of incentives paid to a utility for projects to 25 percent of the rate cap.

b. *Comments*

NWIGU opposes the 4 percent cap and prefers a 3 percent cap, or a different cap for each utility. NWIGU states that a 4 percent cap is significant, and would allow a rate increase for a particular project that exceeds many general rate increases. NWIGU believes such a large increase is inappropriate given the program's truncated and expedited review process. NWIGU recommends the Commission adopt a lower percent cap, which could be changed later if it was found to be a limiting factor. NWIGU also explains that the statute allows for a different cap for each utility, which would allow the smaller utilities to fund the programs similar to those undertaken by NW Natural.

NW Natural, Climate Solutions, and NWECA support the 4 percent cap and the proposed rule provisions limiting incentives for the utilities to 25 percent of the cap. NW Natural reasons that the Commission and stakeholders can judge each project's costs and rate impact during the review process. NW Natural believes these caps strike the appropriate balance between concerns over unreasonable returns but still allows for returns when the utility is developing projects that do not rely on significant investment by the utility.

Climate Solutions and NWECA initially supported a higher cap of 5 percent, but believe that 4 percent is a reasonable compromise that will still allow Oregon's smaller natural gas utilities to undertake meaningful projects.

c. *Discussion*

We find that a 4 percent cap is reasonable because it is sufficiently large to allow Cascade and Avista to undertake projects, but still provides a real cap on the program by including all of a utility's projects on a cumulative basis. We expect a 4 percent cap will allow a large utility like NW Natural to propose multiple projects over time.

We are not persuaded by NWIGU's concerns of rate shock. As noted, the cap includes all of a utility's projects authorized under ORS 757.539(10), and it is unlikely that any one project will cause a significant rate increase. We further agree with NW Natural that the Commission and stakeholders' review of project applications will allow for sufficient rate consideration on a project-by-project basis.

3. *Treatment of Emissions Reduction Project Incentives in the Earnings Test (Proposed OAR 860-085-0950)*

a. *Background*

Oregon's natural gas utilities make annual purchased gas adjustment (PGA) filings that are subject to an earnings review.³ The earnings review is based on recorded results of operations, adjusted for Type 1 adjustments as set forth in Order No. 99-272.⁴

One issue in this rulemaking is whether a utility's incentive payments for emission reduction projects should be included as part of its PGA earnings review. Staff proposed that the utility include incentive payments in its annual results of operations report, but that the Commission may subsequently decide to exclude the incentive amounts in an earnings test associated with the PGA or related deferrals.

b. *Comments*

NW Natural contends that incentive payments authorized under these rules should be excluded from a utility's earnings test. NW Natural believes this is an important clarification that would provide certainty that the incentive provisions of the rules will remain operative. NW Natural explains that the Commission can just as easily make a policy determination at this time on whether the incentive provisions are subject to an earnings test as it can in subsequent case-by-case determinations.

CUB prefers that the language is kept flexible to allow for project-by-project review. CUB notes that its goal throughout this rulemaking has been to ensure that the rules are broad and flexible enough to allow for a variety of projects, since stakeholders are not sure what the projects will look like. CUB maintains that the proposed language can still provide the utilities with certainty on a project-by-project basis.

³ For background information on the PGA earnings review, see generally Docket Nos. UM 903 and AR 357, as well as OAR 860-022-0070.

⁴ NW Natural also makes an annual election whether to apply a weather normalization adjustment, and by the terms of a settlement adopted in Order No. 11-176, NW Natural makes an adjustment for its joint venture to develop gas reserves with Encana Oil and Gas USA Inc.

c. Discussion

We agree with the intent of Staff's draft proposed rule language, which required the utilities to include incentive payments in their annual results of operations report, but provided the Commission the discretion to exclude the incentive amounts from an earnings test associated with a PGA or related deferral. We do not, however, adopt this language because it does not represent a change to our current PGA policy, and thus does not need to be set out in a rule.

For each application, we will make a case-by-case determination of whether a project's incentive payments should be included in a utility's earnings test. We find that a case-by-case determination is consistent with the overall program, as individual emission reduction projects may vary significantly in their costs, emissions reduced, and implementation timelines. These factors, as well as pre-application stakeholder involvement, will likely influence which cost recovery method the utility proposes in its application,⁵ as well as any incentive payments the utility requests. 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.

We also make general editorial changes to the incentives section of the rule. The largest change is that we decline to adopt the language that specified that incentive payments would be recovered within one and five years. Again, individual projects may vary significantly, and we want to preserve our discretion in determining overall cost recovery, including how quickly utilities may recover incentive payments.

4. Emission Reduction Project Report (Proposed OAR 860-085-0800)

a. Background

The proposed rules require that utilities submit an annual emission reduction project report to the Commission. The report would include updated information on each project, emission reductions achieved and anticipated, and project costs. This report is not required by the statute.

b. Comments

NW Natural and Avista believe the annual project report would be administratively burdensome given the duplication of information in that report and in the project application and emission verification reporting.

⁵ See ORS 757.539(8).

c. Discussion

We agree with NW Natural and Avista that the annual project report does not need to be included in our rules at this time. The statute requires an application to explain how the utility will provide the Commission with progress updates during the life of the project.⁶ In addition, the final rules specify that the project application must include an emission reduction verification plan that must include a monitoring plan. If necessary, we may also require a utility to provide a project report as a condition to approval. The information provided in the application and any required case-by-case reporting will allow the Commission to obtain the information needed to submit a biannual report to the legislature without overly burdening the utilities with an automatic reporting duty. Thus, proposed OAR 860-085-0800 is not adopted.

5. *Ownership and Transferability of Emission Credits When Realized*
(Proposed OAR 860-085-0850)

a. Background

The proposed rules include requirements for a utility's participation in an emission reduction credit market. The proposed rules state that a utility participating in an emission reduction credit market must: (1) retain project credits for ratepayers, (2) retire credits, (3) ensure an unbroken chain of ownership of credits, and (4) if split ownership occurs, the utility must work with the other owners to ensure retirement, registration, and an unbroken chain of custody.

b. Comments

NW Natural worked with the Climate Trust to revise this section to simplify the requirement and to allow more flexibility. Their revisions state that any potential credits and the treatment of those credits shall be addressed in a project's application. NW Natural notes that it is unclear what projects will be proposed under these rules and that Staff's proposed rule language could cause confusion since there is uncertainty about whether the program will generate reportable emission credit transfers.

c. Discussion

We will accept the revisions proposed by NW Natural and Climate Trust, with two changes. We move the language to the Project Application Requirements section set forth in OAR 860-085-0600, and we make the information mandatory by requiring the utility to explain whether the project is "able" to generate environmental credits. We find that moving the language to the project application section is appropriate because there are currently no defined emission reduction credit markets for projects subject to these rules. However, we

⁶ ORS 757.539(4)(k).

expect utilities to fully investigate whether it is possible for a project to generate revenues from environmental credits, and thus require this information in the application.

6. *Editorial Changes*

NW Natural circulated edits prior to the hearing with extensive changes to the rules for clarity. At the hearing CUB did not object to these edits, and Avista stated that it supported the changes. We adopt the majority of these changes as reflected in Appendix A, and describe some of these changes below. In addition, we make specific revisions to definitions as suggested by Avista and Climate Solutions, and adopt further changes to improve organization and readability.

a. Definitions

NW Natural and Avista raised concerns over the proposed definition of “project boundary” containing both geographic and emissions measurement elements. NW Natural proposes to strike the definition and instead allow the utility to define the project boundary in its application. We agree with this change and adopt it.

Climate Solutions and NWECA suggest a simpler definition of “leakage.” We adopt their proposal, which uses a definition similar to that used in California: “a reduction in greenhouse gas emissions within the project that is offset by an increase in greenhouse gas emissions outside the project.” Since this term is used just once, we also move this definition to the Emission Reduction Verification Plan (now combined with the Project Application Requirements), where the term is used. Similarly, we move other definitions to the rules where they are used, or delete them if not actually used in the rules.

b. Project Criteria

Avista requested that the statutory eligibility criteria be included in the criteria section at OAR 860-085-0550. Avista acknowledges that it is not the agency’s practice to include verbatim statutory language in its rules, but asserts that inclusion here will help with clarity. We will not adopt this change because we find that our rules must be read in conjunction with the statute. Instead, we add a sentence preceding the definition section that directs the reader to ORS 757.539. We also retain the Project Eligibility Criteria section as proposed, which references the statutory requirements.

Finally, we agree with NW Natural and decline to adopt the proposed additional criteria that the project be related by similar type of measure. We find the six statutory criteria are sufficient to outline the parameters of a project.

c. Consolidation to Project Application Requirements Section

We revise the Project Application Requirements rule (860-085-0600) to consolidate all requirements for the project application. Specifically, we move and renumber provisions discussing the Emission Reduction Verification Plan (proposed OAR 860-085-0750), and consolidate in OAR 860-085-0600 the information from proposed rules 860-085-0500 and 860-085-1000 related to requests for cost recovery.

d. Consolidation of Utility Incentives Cap and Structure Rules

We consolidate and renumber the utility incentive cap, structure, and ineligibility due to noncompliance provisions from proposed rules 860-085-0900 and 860-085-1000 into OAR 860-085-0750.

B. Resolution

We adopt the rules as shown in Appendix A. We believe the adopted rules are consistent with ORS 757.539 in that they follow the statute's directives, and that the adopted rules also provide flexibility to allow utilities to propose a range of emission reduction projects.

IV. ORDER

IT IS ORDERED that:

1. OAR 860-085-0500 through 860-085-0750, as shown in Appendix A attached, are adopted.

ORDER NO.

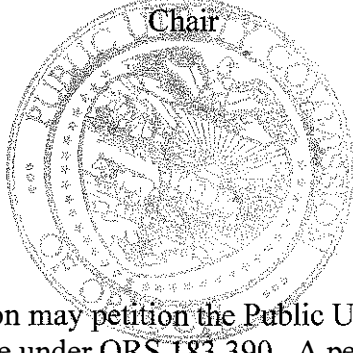
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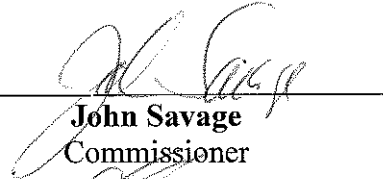
2. The rules become effective upon filing with the Secretary of State.

Made, entered, and effective DEC 03 2014.



Susan K. Ackerman
Chair





John Savage
Commissioner



Stephen M. Bloom
Commissioner

A person may petition the Public Utility Commission of Oregon for the amendment or repeal of a rule under ORS 183.390. A person may petition the Oregon Court of Appeals to determine the validity of a rule under ORS 183.400.

860-085-0500**Voluntary Emission Reduction Projects**

OAR 860-085-0500 through 860-085-0750 are established under ORS 757.539 and are to be read in conjunction with that statute. For purposes of these rules, “Emission Reduction Project” or “Project” means a single or set of voluntary measures, including all labor, equipment, materials, items, or actions, designed to reduce anthropogenic greenhouse gas emissions within a defined boundary that would not otherwise occur.

Stat. Auth.: ORS Ch. 183, 756, 757

Stats. Implemented: ORS 757.539

Hist.: NEW

860-085-0550**Project Eligibility Criteria**

To be eligible for Commission approval, the Project must satisfy the minimum criteria set forth in ORS 757.539(3).

Stat. Auth.: ORS Ch. 183, 756, 757

Stats. Implemented: ORS 757.539

Hist.: NEW

860-085-0600**Project Application Requirements**

In addition to the information required by ORS 757.539(4)(a) - (k), a Project application must include:

(1) General information:

(a) A description of how the Project satisfies the minimum eligibility criteria described in ORS 757.539(3)(a)-(f);

(b) A discussion of all Project measures being employed to reduce emissions;

(c) The estimated Project measure life;

(d) A description of the Project boundary and scope;

(e) A discussion of the emission reduction strategy used, and why the approach is appropriate, timely, and merits approval; and

(f) Whether the Project is able to generate environmental credits or certificates and any potential revenues associated with their sale or use. The utility must explain the rationale for the proposed treatment of any credits and refer to any appropriate protocols, certification systems, regulatory regimes, or other rules for generating, trading, and retirement of such credits or certificates;

(2) Cost recovery information:

(a) A requested method for cost recovery as described in ORS 757.539(8);

(b) A showing of the Project benefits received and the allocation of benefits for each type of ratepayer. “Project benefits” means those benefits that accrue to ratepayers of the utility when such benefits can reasonably be attributed to the Project;

(c) A description of any requested incentive payments, and requested recovery that complies with OAR 860-085-0750. A utility may propose an incentive structure with its initial Project proposal that can then be applied to subsequently approved Projects; and

(d) Any required tariffs; and

(3) An Emissions Reduction Verification Plan that includes;

(a) The methodology used to calculate the projected emission reductions. The methodology must identify:

(A) A Project baseline; that is, an estimate of the emissions that would occur under the ordinary course of business or set of conditions reasonably expected to occur within the defined boundary and scope of an Emission Reduction Project in the absence of the Emission Reduction Project, taking into account all current laws and regulations, as well as current economic and technological trends;

(B) Emission leakage and Project emissions, which must be deducted from the emission reductions generated by the Project activity. "Emission leakage" means a reduction in greenhouse gas emissions within the Project that is offset by an increase in greenhouse gas emissions outside the Project. "Project emissions" means any emissions attributable to the implementation of an Emission Reduction Project; and

(C) How the emission reduction verification methodology was developed; and

(b) A plan for monitoring emission reductions, including the ongoing collection and retention of data for determining the Project baseline, Project emissions, and emissions reductions that are attributable to the Project. With the plan, the utility must describe the methods and equipment used, and identify the anticipated costs of monitoring and verifying emission reductions.

Stat. Auth.: ORS Ch. 183, 756, 757

Stats. Implemented: ORS 757.539

Hist.: NEW

860-085-0650

Project Threshold

For the purpose of determining whether an application will be subjected to the procedural process described in either ORS 757.539(6) or (7), Tier-1 and Tier-2 Projects are defined as follows:

(1) A Tier-1 Project is one that has projected costs that would be borne by the ratepayers of the utility proposing the Project that are equal to or less than \$1 million and has an overall project cost of less than \$85 per metric ton of reduced emissions.

(2) A Tier-2 Project is one that has projected costs that would be borne by the ratepayers of the utility proposing the Project that are greater than \$1 million or has an overall project cost of equal to or greater than \$85 per metric ton of reduced emissions.

Stat. Auth.: ORS Ch. 183, 756, 757

Stats. Implemented: ORS 757.539

Hist.: NEW

860-085-0700**Project Cap**

Projected costs to ratepayers of all Emission Reduction Projects must not exceed 4 percent of the utility's last approved retail revenue requirement, inclusive of all revenue collected under adjustment schedules. The costs of incentives the utility proposes to recover under this rule will be included in the determination of the costs to ratepayers under this cap.

Stat. Auth.: ORS Ch. 183, 756, 757

Stats. Implemented: ORS 757.539

Hist.: NEW

860-085-0750**Utility Incentives for Applicable Projects**

- (1) The Commission may grant incentive payments for an Emission Reduction Project.
- (2) The total costs to ratepayers of all incentives received by the utility may not exceed 25 percent of the project cap specified in 860-085-0700;
- (3) The Commission may structure incentives such that the amounts allowed:
 - (a) Are linked to the amount of emissions reduced; or
 - (b) Vary depending on whether a Project is recovered as an expense or an investment placed in rate base.
- (4) The Commission may discontinue or reduce the incentives to be paid to the utility if a Project is out of compliance with any requirements of the Commission's approval order.

Stat. Auth.: ORS Ch. 183, 756, 757

Stats. Implemented: ORS 757.539

Hist.: NEW

