**ITEM NO. 1**

# PUBLIC UTILITY COMMISSION OF OREGON
## STAFF REPORT
## PUBLIC MEETING DATE: October 28, 2013

**REGULAR** __X__ **CONSENT** ____ **EFFECTIVE DATE** __November 1, 2013__

**DATE:** October 23, 2013

**TO:** Public Utility Commission

**FROM:** Erik Colville and Marc Hellman

**THROUGH:** Jason Eisdorfer, Maury Galbraith, and Aster Adams

**SUBJECT:** NORTHWEST NATURAL: (Advice No. 13-10) Adds Schedule H, Large Volume Non-Residential High Pressure Gas Service Rider.

## STAFF RECOMMENDATION:

Staff recommends approval of Northwest Natural's request for Advice No. 13-10 to become effective on and after November 1, 2013, and:

1. NWN shall provide annual reports, no later than April 1, beginning 2014, and each year thereafter this service is offered by NWN, summarizing the status of this new rate offering with respect to number of customers, general location of customers, direct costs and associated revenues.

2. NWN be required to identify and record all start-up (first time) developmental costs, and any other start-up (first time) HPGS costs, including interest, not currently included in the tariff and submit a tariff rider to go into effect, after Commission review and approval, after the first year of service for recovery from HPGS customers. Coincident with the effective date of the tariff rider, NWN defer, with interest, an equal amount of revenues collected under the rider for later refund to non-HPGS customers so as to prevent double-recovery of such costs.

## DISCUSSION:

Northwest Natural (NWN) filed Advice No. 13-10 on June 27, 2013, proposing to add Schedule H, Large Volume Non-Residential High Pressure Gas Service Rider, to its Rate Schedules 3, 31, and 32 non-residential natural gas service schedules. Revised pages incorporating input from Staff and others during review of the initial filing were filed by NWN August 13, 2013.

An informational public workshop was held on July 26, 2013, at the Public Utility Commission. During the workshop NWN presented its proposed high pressure gas service (HPGS) tariff. Workshop attendees were then provided an opportunity to ask questions and seek clarification of the NWN filing.

During the workshop representatives of the Northwest Industrial Gas Users, the Portland Area Metropolitan Service District (Metro), the Tri-County Metropolitan Transportation District of Oregon (TriMet), TechStar Energy LLC, and the Oregon Department of Energy stated their support for the proposed HPGS tariff.

Also during the workshop, and in subsequent phone conversations with Staff, Clean Energy Fuels stated its objection to NWN's proposed HPGS tariff on the grounds it introduces unfair competition in the natural gas vehicle (NGV) fueling marketplace.

The Filing

This filing introduces a new optional rider to provide HPGS through NWN owned and maintained compression equipment sited on a HPGS customer's premises. Both the costs and the revenues of this new rate rider will be treated as "above-the-line" rate regulated services. According to NWN the proposed HPGS rider responds to customer requests for utility services that would provide the infrastructure needed to support the customer's ability to fuel vehicles using compressed natural gas (CNG). In addition to responding to customer requests for utility provided HPGS, NWN notes the proposed Schedule H service also is consistent with public policy, including Governor Kitzhaber's 10-Year Energy Plan, which calls for the acceleration of a more efficient and cleaner transportation system.

NWN states that service under Schedule H provides a non-residential customer with a turn-key solution not otherwise available for providing the gas pressure required for vehicle fueling, without a significant upfront capital investment into compression facilities. The terms of service and pricing for HPGS will vary for each installation and will be laid out in the customer's HPGS Service Agreement. The customer will be billed a monthly facility charge designed to recover all equipment, permitting and siting costs. NWN proposes that the monthly facility charge be derived by multiplying the actual project costs by an annual cost recovery factor, divided by 12. The cost recovery factor is designed to recover in each year the depreciation on the HPGS equipment plus NWN's financing costs, at its authorized return, for the investment made on behalf of the customer.

In addition, NWN states the HPGS customer's monthly bill will also include a charge for scheduled maintenance, and when applicable, charges for any other services such as unscheduled maintenance or back-up gas service that NWN may provide. The charges under Schedule H will be in addition to the charges for natural gas service billed in accordance with the non-residential rate schedule on which the customer is served.

NWN offers that because customers served under Schedule H will pay all incremental costs associated with the provision of HPGS, the addition of this service offering should have no negative cost impact on, and in fact benefit, other ratepayers. NWN notes the program is also designed in such a manner as to mitigate any risks associated with providing a new utility service.

Responsive Comments

In response to Staff's September 3, 2013, invitation fifteen organizations or persons filed written comments regarding the proposed HPGS tariff. Those filing comments in support of the proposed tariff were Gary Baldwin, Columbia Willamette Clean Cities Coalition, Con-Way Freight, Inc., Diesel Service Unit, Fuelpoint CNG Innovations, LLC, Northwest Gas Association, Northwest Industrial Gas Users (NWIGU), Oregon Department of Energy, Oregon Trucking Association, Bill Stallman, State Senator Lee Beyer, and TransEnergy Solutions. Comments opposed to the proposed HPGS tariff were Blu LNG, Citizens' Utility Board of Oregon (CUB), Integrys Transportation Fuels, LLC, and Natural Gas Vehicle Fuel Providers (NGVFP).

Comments in support of the proposed HPGS tariff centered primarily around the following points:

1. There is need for NGV fueling infrastructure.

2. The proposed HPGS complies with Governor Kitzhaber's energy plan and State of Oregon greenhouse gas reduction policy.

3. The proposed HPGS tariff should be approved as long as the service is not subsidized by other customers (NWIGU Comments at 1-2).

Comments in opposition to the proposed HPGS tariff centered primarily around the following main points:

1. The potential for unfair competition introduced by allowing regulated utility participation in the NGV fueling market.

2. The potential to undermine market development since regulated utilities enjoy a substantially lower cost of capital than non-utility competitors, and have ready access to that capital (NGVFP Comments at 3).

3. Approval of Advice No. 13-10 will harm the growth of a competitive natural gas vehicle (NGV) infrastructure market (NGVFP Comments at 13) because other market participants can provide the same service to Oregon customers (at 18).

4. The terms of the proposed HPGS Schedule and Contracts are anticompetitive because they require exclusivity and restrict information sharing (NGVFP Comments at 21).

5. There is potential of cross-subsidy by ratepayers (NGVFP Comments at 24).

6. The need for demonstrable net benefit to ratepayers from the proposed HPGS tariff (CUB Comments).

7. The Commission should open a proceeding on the NWN HPGS tariff offering and presumably suspend the tariff from going into effect. (NGVFP at page 3 and 28)

<u>Staff's Review Criteria</u>

Criteria Staff considered in reviewing and recommending whether to allow NWN to provide HPGS as a regulated utility service include:

a. Is there is a need for HPGS market development?
b. Does participation by a regulated utility impede HPGS market competition?
c. Does the proposal aid in HPGS market development?
d. Do the rates proposed cover the costs for offering the service or is it a subsidized rate?
e. Does the proposal allow an exit strategy once the HPGS market is developed?
f. Is the proposal structured to leave room for competition by unregulated entities?
g. Is there a net benefit to ratepayers?

Based on Staff's analysis and discussion below, Staff recommends allowing NWN to provide HPGS as a regulated utility service.

<u>Staff's Analysis</u>

Staff's review of the HPGS tariff filing included the filing itself, the cost of service work papers, and the revised pages filed in response to Staff and other party input. Staff did not explore alternative HPGS approaches because NWN's filing asks for approval of a specific HPGS approach.

As a way of background before addressing the criteria above, Staff looked to the Commission's conclusions in Docket No. UM 1461 Investigation of Matters Related to Electric Vehicle Charging. In Order No. 12-013 resulting from that investigation the Commission addressed whether regulated utility ownership and operation of publicly available electric vehicle service equipment in any form – even without regulated rate recovery – would permit the full development of a competitive marketplace for electric vehicle charging services. Staff considers the electric vehicle service equipment (EVSE) issue addressed in Docket No. UM 1461, analogous to the HPGS issue in this filing, in that the regulatory principles are applicable for this filing. In Order No. 12-013 (Order) the Commission concluded:

> At this early stage of development for the plug-in EV industry, we deem it paramount to allow all market players, including the electric utilities, to have flexibility to respond to emerging market demands. We do not find that allowing utilities to potentially participate in the EVSE market will necessarily impede the vibrancy of the whole market. Electric utilities should be allowed to invest in EVSE and operate EV charging stations as a non-regulated, non-rate based venture. A utility may decide how to structure its ownership and operation of EVSE and charging stations, whether below-the-line as a non-regulated utility investment, or as a utility investment. Order at 6.
>
> We will use Staffs recommended criteria[1] to analyze any future utility proposals to rate base EVSE investment, but also reserve the right to consider additional criteria, as appropriate. We expect a utility that requests rate recovery for EVSE investment to make a compelling case that the utility's ownership and operation of the EVSE is beneficial to ratepayers not just the public generally. Utilities suggest that prudence be the primary measure used to determine whether EVSE investment should be recoverable in rates. We respond that prudence, in the context of EVSE investment, requires a showing of net benefits to customers. Order at 10.

Staff recognizes that the purpose of Docket No. UM 1461 as given in the Order was to address regulated utility involvement in not just ownership but also operation of EVSE, as follows:

> Specifically, we intended this docket to address general matters related to the emergence and development of the EV charging market and industry, including

[1] The Staff recommended criteria referred to in Order No. 12-013 are found on page 4 of Staff's Closing Comments in Docket No. UM 146

> the role of electric utilities with regard to owning and operating EV service equipment (EVSE) and acting as EV service providers (EVSP).

The proposed HPGS tariff does not seek approval for NWN to operate HPGS but rather to own the HPGS equipment. Staff recognizes that this difference is significant both in terms of market impact and also applicability of the Staff recommended criteria referred to in the Order.

Below, Staff returns to the criteria considered in developing its recommendation whether to allow NWN to provide HPGS as a regulated utility service.

*a. Is there is a need for HPGS market development?*

Governor Kitzhaber's 10-Year Energy Plan Action Item for Accelerated Fleet Turnover (residential and commercial) to Alternative Fuels in Goal 3 states:

> Oregon should develop a comprehensive alternative fuel program that allows utility-ownership of refueling infrastructure and provides incentives, where appropriate, for vehicle conversions.

Based on the Energy Plan Action Item there is a need to develop the HPGS market. Staff agrees there is a need for HPGS market development given that one has not yet arisen in Oregon. All the parties filing comments agree and support the development of NGV fueling infrastructure in Oregon.

*b. Does participation by a regulated utility impede HPGS market competition?*

Goal 3 of Governor Kitzhaber's 10-Year Energy Plan Action Item for Accelerated Fleet Turnover (residential and commercial) to Alternative Fuels, stated above, contemplates regulated utility participation as an integral part of an HPGS market, at least at the outset. Based on this Action Item participation by a regulated utility does not impede the HPGS market, is consistent with and is encouraged by the Governor's energy plan.

In the Order the Commission considered the issue of whether participation by a regulated utility (owning and operating EVSE) will impede the vibrancy of an emerging competitive market. The Commission found that it is paramount to allow all market players, including the regulated utilities, to have flexibility to respond to emerging market demands. Also, the Commission did not find that allowing regulated utilities to participate in an emerging competitive market will necessarily impede the vibrancy of the whole market. The same situation is applicable here where the HPGS is an emerging market and customers have submitted comments in support of the NWN offering so as to take advantage of the HPGS service.

c. *Does the proposal aid in HPGS market development?*

Again, Goal 3 of Governor Kitzhaber's 10-Year Energy Plan Action Item for Accelerated Fleet Turnover (residential and commercial) to Alternative Fuels assumes that participation by a regulated utility in the HPGS market accelerates the transition to alternative fuels and is encouraged.

The interplay between the installation of compression equipment and NGVs argues that increasing the number of compressor stations in Oregon could result in the acquisition of more NGVs in the state. As the number of NGVs in the state increases, the opportunity for competitive service could rise, too. Regulated utility participation in developing compressor equipment could actually kick start a competitive market in Oregon.

*d.* Do the rates proposed cover the costs for offering the service or is it a subsidized rate?

A key consideration in answering this question is to analyze the rates proposed by the Company given that the rate offering is an "above-the-line" service. The answer to this question involves a comparison of the NWN incremental costs associated with this offering as compared to the revenues received. A rate is subsidized if the rate does not fully recover the incremental costs associated with the offering. As the HPGS tariff is structured the HPGS customer will be billed a monthly facility charge designed to fully recover all capital (equipment, permitting and siting) costs. NWN proposes that the monthly facility charge be derived by multiplying the actual project costs by an annual cost recovery factor, divided by 12. The cost recovery factor is designed to recover in each year the depreciation on the HPGS equipment plus NWN's financing costs, at its authorized return, for the investment made on behalf of the customer.

Staff confirmed with NWN that the scheduled maintenance charge a HPGS customer will pay monthly as a result of receiving Schedule H service includes cost recovery for billing, accounting, management, and general administration, some of which are allocated joint costs and hence make a contribution to covering joint costs. This situation is alluded to in Schedule H by using "administrative services" in the wording for the Scheduled Maintenance Charge. In response to CUB's data request DR 34, NWN provided a work paper showing that administration and billing costs are included in the maintenance charge for the HPGS.

As for marketing expenses, NWN communicated during the workshop that it does not intend to execute a marketing campaign for the HPGS. Following the workshop NWN communicated in email to Staff that it used the term "marketing" as related to advertising efforts. Further, NWN communicated to Staff that it does expect to undertake a branding effort specific to HPGS that will be paid for using shareholder dollars. In regard to advertizing expenses, Staff expects that the parameters established in OAR 860-026-0022 for cost recovery of advertising expenses will safeguard ratepayers from inappropriate advertizing expenses in their rates.

Staff identified two other potential ratepayer subsidies: HPGS development and the company's activities to promote the service to the Public Utility Commission (PUC), and HPGS feasibility study preparation. According to Staff communications with NWN, the labor required for HPGS development and promotion to the PUC, and preparation of the feasibility study (covered by the HPGS Feasibility Agreement) are provided by NWN resources that are in base rates. NWN believes this is appropriate because HPGS is a rider to Schedule 3, 31, or 32 natural gas services. A new large non-residential gas service customer is normally addressed by NWN staff, as part of regulated services, to assess whether a new or revised tariff is needed, or a new customer is a good candidate for the gas service they are requesting, and how the related facilities can be sited. Since the impact on the NWN system of a HPGS customer is the same as a new large non-residential customer (i.e. natural gas flows increase in either case), NWN views the HPGS development and promotion to the PUC, and feasibility study preparation as no different than assessing other new large non-residential customers.

For purposes of ensuring that this service fully recovers costs, Staff does not agree with NWN that it is reasonable to use base rate NWN resources to develop and promote the HPGS tariff to the PUC, including preparing the HPGS feasibility study. In order to ensure the HPGS is not subsidized, Staff agrees in concept with the NWIGU proposal that NWN track all direct expenses and revenues related to HPGS being offered by NWN such that "if there is a revenue deficiency [from HPGS] shown in the next rate case, the rates for the compression service should be adjusted upward to cover the shortfall." NWIGU Comments at 2. Addressing this concern NWN stated in its comments that "The HPGS program is designed so that HPGS customers bear the costs related to the service." NWN Comments at 3. Further, in its comments NWN affirmed that "the costs of HPGS compression equipment will be directly assigned to the customers taking such service, which essentially accomplishes the same goal as having a separate rate class." NWN Comments at 7. Again, Staff agrees in concept with NWIGU. Therefore, Staff recommends NWN be required to identify and record all first time developmental costs, such as initial legal, general pricing review and marketing; and any other HPGS costs, including interest, not currently included in the proposed tariff and submit a tariff rider to go into effect, after Commission review and approval, after the first year of service for recovery from HPGS customers. Coincident with the effective date of the tariff rider, NWN should be required to defer, with interest, an equal amount of revenues collected under the rider for later refund to non-HPGS customers so as to prevent double-recovery of such costs. This will ensure that the start-up developmental costs will be recovered from the HPGS customers. The refunding of those revenues to non-HPGS customers will ensure NWN does not double-recover those costs as NWN states that such costs are already included in base rates. Staff has drafted a condition for Commission consideration in approving the tariff that addresses the one-time start up costs as discussed above.

Staff also explored potential costs and risks for ratepayers as additional aspects of cross-subsidization. In Staff's review of potential cost and liability risks for ratepayers the following were identified: 1) HPGS equipment rehabilitation costs before redeployment, site work costs (earthwork, underground utilities, equipment foundations, paving, landscaping, etc); 2) liability from site and equipment sizing, and; 3) liability from vehicle fueling activities.

1) HPGS equipment may need to be rehabilitated before redeployment if a HPGS customer defaults on the Gas Service Agreement with NWN. In addition, if HPGS equipment were to be redeployed, the associated site work would be left behind on the customer's site. As the HPGS tariff is structured the cost for the equipment rehabilitation would be paid for by a new HPGS customer, if one is found, but site work costs could be passed on to ratepayers. Rate Schedule H Special Condition 8 and Gas Service Agreement Article 8 require potential HPGS customers to undergo a credit review and provide financial assurance if found to be credit deficient. Given the credit review process Staff finds it unlikely that HPGS customers will default on the Gas Service Agreement with NWN. In addition, for resulting costs to be passed on to ratepayers, NWN would be required to justify in a rate case[2] that the costs were prudently incurred and that the associated activity is used and useful to ratepayers. While there is a possibility of the equipment rehabilitation and site work costs being passed on to ratepayers Staff considers it remote. As a result, Staff concludes this risk is minimal and reasonable.

2) According to NWN, site size is dictated by physical limitations of the equipment and National Electric Code, National Fire Protection Association Publications 52 and 30A, Oregon Building Code, and Oregon Mechanical Code requirements. Given the extensive code requirements to be met Staff concludes the possibility for incorrectly sizing the HPGS site is remote. While there is a possibility for costs associated with incorrect site sizing to be passed on to ratepayers, NWN would be required to justify in a rate case[2] that the costs were prudently incurred and that the associated activity is used and useful to ratepayers. As a result, Staff concludes this risk to ratepayers is minimal and reasonable.

   HPGS equipment sizing (capacity and pressure) errors are a possibility. Given that the HPGS equipment will be sized based upon HPGS-customer-provided information, and that the HPGS customer must agree to the equipment sizing when executing the Site Design and Permit Evaluation Agreement with NWN Staff concludes the potential for ratepayer risk is limited. In addition, NWN filed revised Site Design and Permit Evaluation Agreement sheets with clarifying wording that design specifications and operating specifications may be different. While Staff agrees there is a possibility for costs associated with incorrect equipment sizing to be passed on to ratepayers, NWN would be required to justify in a rate case[2] that the costs were prudently incurred and that the associated activity is used and useful to ratepayers. With the revised Agreement wording Staff concludes this risk to ratepayers is minimal and reasonable.

3) Liability related to HPGS customer fueling activities could potentially put ratepayers at risk for associated costs. The basic HPGS excludes the devices that connect to a natural gas vehicle for fueling, those devices being the responsibility of the HPGS customer. The Gas Service Agreement Article 1 includes an optional provision for NWN to supply, install and maintain (but not own) the vehicle fueling devices. Staff identified this optional provision as a potential source of liability related to HPGS customer fueling activities. To address Staff's concern NWN filed revised Gas Service Agreement Article 1 wording for non-standard, customer owned equipment. The revised wording clarifies that NWN is not liable for damage to or damage caused by the non-standard customer owned equipment. In addition, NWN directed Staff to Gas Service Agreement Article 12 Liability and Indemnification as being a reasonable reliance for associated liability concerns. Also, for costs related to vehicle fueling liability to be passed on to ratepayers, NWN would be required to justify in a rate case[2] that the costs were prudently incurred and that the associated activity is used and useful to ratepayers. With the revised Agreement wording Staff agrees with NWN that ratepayer risk for vehicle fueling liability is sufficiently mitigated.

Following exploration of costs, and risks to ratepayers Staff concludes the potential benefit discussed below is sufficient compensation to ratepayers for the small amount of risk and costs.

*e. Does the proposal allow for an exit strategy once the HPGS market is developed?*

NWN's participation in the HPGS market as a regulated utility will be subject to rate case proceedings. While not planning or committing to do so the Commission has wide discretion to observe, modify, and end NWN's participation in the HPGS market, as provided for in ORS 756.568.

*f. Is the proposal structured to leave room for competition by unregulated entities?*

As discussed above, the Governor's 10-Year Energy Plan and the Commission's Order conclude that regulated utility participation in an emerging market does not necessarily impede market development. Also, the HPGS tariff is structured to amortize the capital costs over a ten-year period rather than over the life of the equipment (customarily twenty or more years). This short amortization period, which is less than the economic life of the HPGS, raises the rate above incremental costs and thereby provides opportunity for competition to amortize the service over longer periods of time thereby potentially reducing the monthly facility charge.

In addition, according to NWN, while its proposal is addressing a demonstrated need for gas compression infrastructure among its customers (NWN Comments at 3), NWN is not proposing to operate NGV fueling stations. Thus, competitors for this service can offer customers other competing services including bundling of HPGS with operation of NGV fueling stations. Also, in response to comments from NGVFP (Comments at 21) NWN revised its filing to eliminate the exclusivity clause in HPGS Feasibility Agreement Article 9. Lastly, because of the high initial investment required for HPGS, Staff is convinced that customers seeking HPGS are motivated and sophisticated enough to study the market before signing a long-term contract with a single service provider.

*g. Is there a net benefit to ratepayers?*

The proposed HPGS tariff establishes rates that recover not only the direct incremental costs of the tariff offering but also includes recovery of common and joint costs thereby providing margins lowering rates for other NWN customers. The condition Staff proposes regarding recovery on the initial first-time developmental costs will also ensure the rates fully recover the costs NWN incurs to provide the service. Therefore the tariff provides a net benefit to NWN ratepayers.

<u>Conclusion</u>

Staff identified three potential paths for going forward:

1. Approve the HPGS tariff filing, as revised by NWN on August 13, 2013;
2. Suspend the HPGS tariff filing and open a brief, focused investigation; or
3. Suspend the HPGS tariff filing and open a contested case docket,

All the parties that filed comments agree and support the development of NGV fueling infrastructure in Oregon. In addition, Governor Kitzhaber's 10-year Energy Plan and Commission's Order encourage regulated utility participation in emerging alternative fuel vehicle "fueling" markets. Also, Staff's analysis and the discussion above show the proposed HPGS tariff satisfies reasonable regulatory criteria. Staff therefore recommends that NWN be allowed to provide HPGS as a regulated utility service.

After considering the HPGS tariff filing, the cost of service work papers, the revised pages filed in response to Staff, and interested party input, Staff concludes the NWN proposed tariff should be allowed to go into effect and no further proceedings are warranted. While some parties have requested the Commission hold further proceedings on this tariff filing, ORS 757.210(1)(a) states: *the commission **may**, either upon written complaint or upon the commission's own initiative, after reasonable notice, conduct a hearing to determine whether the rate or schedule is fair, just and reasonable.* Staff recommends the Commission not use its discretion to conduct further proceedings.

So that the Commission can monitor this tariff offering, Staff has proposed a condition that requires the Company to report annually on the status of this tariff.

**PROPOSED COMMISSION MOTION:**

Northwest Natural's request for Advice No. 13-10 to become effective on and after November 1, 2013, be approved, and:

1. NWN shall provide annual reports, no later than April 1, beginning 2014, and each year thereafter this service is offered by NWN, summarizing the status of this new rate offering with respect to number of customers, general location of customers, direct costs and associated revenues; and,

2. NWN be required to identify and record all start-up (first time) developmental costs, and any other start-up (first time) HPGS costs, including interest, not currently included in the tariff and submit a tariff rider to go into effect, after Commission review and approval, after the first year of service for recovery from HPGS customers. Coincident with the effective date of the tariff rider, NWN defer, with interest, an equal amount of revenues collected under the rider for later refund to non-HPGS customers so as to prevent double-recovery of such costs.