

1 **BEFORE THE PUBLIC UTILITY COMMISSION**
2 **OF OREGON**
3 **UG 435**

4 In the Matter of
5 NW Natural Gas Company,
6 Request for a General Rate Revision.
7

STAFF CLOSING BRIEF

8 **I. Introduction.**

9 **A. Staff recommends that the Commission adopt the First, Second, and Third**
10 **Stipulations executed in this docket.**
11

12 Staff has executed three stipulations that combined, resolve almost all issues related to
13 Northwest Natural Gas Company (NW Natural)’s request for a general rate increase. Most terms
14 of the stipulations are uncontested. However, the Coalition of Communities of Color, Climate
15 Solutions, Verde, Columbia Riverkeeper, Oregon Environmental Council, Community Energy
16 Project, and Sierra Club (collectively, “the Coalition”) challenge some terms of the First
17 Stipulation, arguing the Commission should impose larger disallowances than those agreed to by
18 the Stipulating Parties for certain cost categories. And, the Small Business Utility Advocates
19 (SBUA) object to the rate spread for the amortization of NW Natural’s Covid-19 deferral agreed
20 to in the Second Stipulation. NW Natural submitted extensive arguments in its Opening Brief
21 addressing the objections of the Coalition and SBUA. Staff agrees with these arguments and
22 adopts them. Staff believes the stipulations result in just and reasonable rates and recommends
23 the Commission adopt the First and Second Stipulations and reject the objections of the Coalition
24 and SBUA.

25 Since the filing of Opening Briefs, Staff, the Alliance of Western Energy Customers
26 (AWEC), the Oregon Citizens’ Utility Board (CUB), and NW Natural executed the Third

1 Stipulation resolving some issues related to NW Natural’s investment in the Lexington
2 Renewable Natural Gas (RNG) Project. Staff, AWEC, CUB, and NW Natural have agreed that
3 NW Natural’s pending requests to defer costs of the Lexington RNG Project¹ should be allowed
4 and that NW Natural should be authorized to amortize the costs over a three-year period, subject
5 to an earnings test with a benchmark of Authorized ROE, based on 2022 earnings. Under the
6 Stipulation, the deferral will earn interest at NW Natural’s authorized ROE through December
7 31, 2022, and will earn interest at the modified blended treasury rate plus 100 basis points
8 starting January 1, 2023.

9 The Third Stipulation is supported by Joint Testimony of AWEC, CUB, Staff and NW
10 Natural, which will be filed the same day as this Closing Brief. Staff believes the Third
11 Stipulation is a reasonable resolution of issues related to the deferral and recovery of Lexington
12 RNG Project costs. Although Staff does not support the deferral of future Senate Bill (SB) 98
13 (2019) costs incurred prior to the time the projects are put in rates, Staff supports the deferral of
14 the Lexington RNG Project costs because of the circumstances surrounding their deferral.

15 NW Natural filed an Advice Filing to establish an AAC under SB 98 in December 2020.
16 NW Natural agreed to postpone consideration of the Advice Filing on multiple occasions to
17 allow time for parties to review and discuss the proposed AAC, ultimately deferring
18 consideration of its proposed AAC until this general rate case. Given NW Natural’s agreement
19 to allow additional time to review its proposed AAC, Staff believes it is appropriate to allow NW
20 Natural to recover deferred costs that could have been recovered under an AAC had one been
21 established immediately after NW Natural submitted its Advice Filing in December 2020. Staff
22 does not believe the same is true for investments that occur after an AAC is established.

23 **B. Remaining contested issues.**

24 In its Opening Brief, Staff addressed what it believed to be the remaining issues not
25 resolved by stipulation – (1) NW Natural’s request to adopt an automatic adjustment clause to

26 ¹ See *In the Matter of Northwest Natural Gas Company dba NW Natural Application to Defer Cost of Service Associated with Tyson RNG Project*, Docket No. UM 2145.

1 recover costs of RNG investments under SB 98, (2) the appropriate rate spread for SB 98 costs,
2 and (3) proposals by CUB and the Coalition regarding NW Natural’s line extension policy. In
3 this brief Staff responds to arguments related to the AAC and rate spread for SB 98 projects and
4 responds to an additional argument raised by the Coalition in its Opening Brief related to the
5 prudence of NW Natural’s Lexington RNG Project.

6 **II. Argument.**

7 **A. The Commission should reject the Coalition’s challenges to the prudence of**
8 **NW Natural’s Lexington RNG Project.**

9 **1. SB 98 does not require NW Natural to deliver RNG acquired under SB 98 to**
10 **retail customers in Oregon.**

11 The Coalition argues in its Opening Brief that NW Natural’s Lexington RNG Project fails
12 to comply with the requirements of SB 98 (codified as ORS 757.390-.396) and the
13 Commission’s implementing regulations. The Coalition argues that the plain language of SB 98
14 requires that RNG acquired under that bill must be delivered to Oregon customers.² The
15 Coalition asserts that the Lexington RNG Project does not satisfy this requirement because the
16 Company is not delivering RNG to its Oregon customers and instead is only acquiring renewable
17 thermal credits (RTCs). The Coalition argues that NW Natural’s decision to proceed with an
18 RNG project that does not satisfy the requirements of SB 98 was imprudent and that accordingly,
19 all costs of the project should be disallowed. The Coalition’s arguments are without merit and
20 should be rejected.

21 The Coalition’s interpretation of SB 98 is inconsistent with the Commission’s. The
22 Commission’s rules implementing SB 98 “establish a “book-and-claim” accounting system,
23 whereby a utility establishes its progress toward the RNG targets established in SB 98 with
24 RTCs.³ Under the rules adopted by the Commission, RTCs for RNG produced or acquired by
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26 ² Coalition Opening Brief, p. 28.

³ OAR 860-150-0005 – OAR 860-150-0600.

1 the utility are tracked electronically from the point in time when the RNG is injected into a
2 common carrier pipeline.⁴ The renewable natural gas itself is not tracked. In fact, it can't be.

3 Natural gas is fungible. Once it is injected into a common carrier's pipeline, it is co-
4 mingled with non-renewable gas and subject to delivery in the web of the natural gas system that
5 spans the United States. The Federal Energy Regulatory Commission (FERC) discussed the
6 futility of distinguishing between molecules of natural gas in a 1992 opinion resolving a
7 jurisdictional issue as to whether gas transmitted in a common carrier in one state is an intrastate
8 or interstate transaction:

9 The interstate pipeline system in the United States resembles a complex, spider
10 web like grid of vast proportion. Many interstate pipelines are interconnected with
11 other interstate (and intrastate) pipelines. Today's increasingly integrated grid of
12 interstate pipelines accommodates numerous receipt and delivery points
13 throughout its network. With gas constantly being injected into and withdrawn
14 from different points throughout any given system, it is not possible in most
15 instances to trace the progression of specific molecules of gas. The conceptual
16 idea of transportation from point to point does not match the physical reality.⁵

17 * * * The pressure of the "line pack", which keeps the pipeline filled, is
18 maintained by both the pressure of the gas feeding into the system and by
19 compression along the system's route. Thus, any gas leaving the system is not
20 identifiable with any gas entering the system. There is no tracing of molecules
21 from buyer to seller. The transportation service becomes one of preserving line
22 pack and pressure in the system so that withdrawals of gas by customers can be
23 maintained. Displacement of gas in the system is what effectuates transportation,
24 not the movement of gas from receipt point to delivery point.⁶

25 At one point in its Opening Testimony, the Coalition appeared to accept the book and
26 claim approach adopted by the Commission to implement SB 98 but argued Lexington Project
did not comply because NW Natural was not acquiring the physical gas and injecting into a
common carrier pipeline. The Coalition witness testified:

27 I understand that purchasing RTCs and injecting physical gas into a common
28 carrier pipeline could be considered providing a benefit to Oregon ratepayers, in
29 that the RNG would actually displace fossil gas in the pipeline. However,

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31 ⁴ *In the Matter of Rulemaking Regarding the 2019 Senate Bill 98 Renewable Natural Gas
Program*, Docket No. AR 632, Public Meeting Memo, p. 7.

32 ⁵ Williams Natural Gas Company, 59 FERC 61, 306 (1992), 1992 WL 168997, p. 15.

33 ⁶ *Id.*

1 allowing NW Natural to purchase only RTCs, without also purchasing the physical
2 gas for injection into a common carrier pipeline, is contrary to [SB 98].⁷

3 In response to the Coalition’s argument, NW Natural testified that its Lexington
4 investment involves the acquisition of the physical gas and environmental attributes as a bundled
5 product. NW Natural explained that after NW Natural acquires the RNG, it is injected into the
6 Black Hills Energy Pipeline, which is a common carrier pipeline. After injection, NWN keeps
7 the RTCs associated with the gas and sells the brown gas to a marketer with access rights to the
8 Black Hills Energy Pipeline.⁸

9 The Coalition did not respond to NW Natural’s testimony regarding SB 98 in its Reply
10 Testimony. The only testimony the Coalition offered regarding the Lexington Project was to
11 withdraw its argument that the Lexington RNG Project is imprudent because it does not comply
12 with Oregon’s Climate Protection Plan (CPP), based on the fact the CPP came after NW
13 Natural’s investment.⁹

14 Now, the Coalition argues that to be compliant with SB 98, the Commission’s rules
15 “must be read to require delivery to Oregon customers on [a] natural gas pipeline such that the
16 physical product processed to meet pipeline standards will have been furnished to Oregon
17 customers.”¹⁰ The Coalition relies on definitions in SB 98 that a qualified investment in RNG is
18 an investment in “renewable natural gas infrastructure,” which is “all equipment and facilities for
19 the production, processing, pipeline interconnection and distribution of renewable natural gas to
20 be furnished to Oregon customers.”¹¹

21 As discussed above, the Coalition’s proposed interpretation of SB 98 would result in a
22 virtually impossible standard. NW Natural cannot ensure molecules of RNG that NW Natural

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24 ⁷ Coalition/100, Apter/19.

25 ⁸ NW Natural/2100, Chittum/9.

26 ⁹ Coalition/600, Apter/2.

¹⁰ Coalition Opening Brief, p. 28.

¹¹ SB 98, secs. 3(5)(a) and (8)

1 acquires will ultimately be the molecules of gas used to serve Oregon customers. Accordingly,
2 interpreting the statute as NW Natural suggests would essentially nullify the RNG Program
3 mandated by the legislature. Given the impossibility of tracking individuals molecules of RNG
4 and guaranteeing their delivery to particular end users, the Commission reasonably adopted a
5 methodology in which “[t]he chain of custody of the RTCs – which represent all of the
6 environmental attributes of the RNG and the rights to all environmental claims – is the
7 lynchpin.”¹² Using this methodology, the Commission can guarantee that the environmental
8 benefits of RNG will flow to Oregon customers though it cannot guarantee the individual gas
9 molecules will do so.

10 **2. Legislative history does not support the Coalition’s interpretation of SB 98.**

11 The Coalition relies on legislative history to support its interpretation of SB 98. The
12 Coalition argues:

13 According to testimony from several stakeholders, including NW Natural itself,
14 the Oregon State Legislature created the bill as a tool to promote the use of RNG
15 in Oregon-by-Oregon utility customers. After hearing this testimony, the
16 Legislature amended the proposed legislation and added the definition of
17 “renewable natural gas infrastructure” in ORS 757.392, which includes the phrase
18 “renewable natural gas to be furnished to Oregon customers.” The Oregon State
19 Legislature’s amendment, after hearing testimony by stakeholders, further
20 supports the analysis above.¹³

21 The Coalition is correct that the Senate Committee on Environment and Natural
22 Resources adopted amendments to SB 98 after hearing testimony at a public hearing. However,
23 the Chair of the Committee’s description of the amendments does not support the Coalition’s
24 argument regarding the purpose of the amendments. Instead, the Committee Chair noted the
25 amendments had been put forward by NW Natural after conferring with the Oregon Public
26 Utility Commission and representatives of RNG developers to address concerns regarding unfair

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26 ¹² See *In the Matter of Rulemaking Regarding the 2019 Senate Bill 98 Renewable Natural Gas Program*, Public Meeting Memo, p. 7.

¹³ Coalition Opening Brief, p. 27.

1 competition by regulated utilities. Specifically, the Chair of the Committee described the
2 amendments as follows:

3 Colleagues, these amendments largely address the problem that we heard, when
4 we heard this bill, we had some people come and testify about unfair competition
5 with the utilities being able to invest in renewable projects and connectivity.
6 NW Natural met with the PUC and met with the advocates that brought up the
7 concern, notably the Renewable Gas Coalition or something, and have worked
8 out these amendments to a form that they are comfortable with. Not everyone is.
I will say that for the record. But the primary group is satisfied with where it is.
It's clear the utility will have to go through a competitive bidding process for any
renewable natural gas projects that are affected by this. And so with that, I feel
comfortable moving these amendments.¹⁴

9 A review of the video recordings of the legislative committee meetings reveals no
10 statement by a legislator that indicates the legislator believed SB 98 required actual delivery of
11 RNG to Oregon customers. In absence of any such statement, the Coalition's arguments
12 regarding the legislative history are unsupported.

13 **3. NW Natural reasonably relied on the Commission's rules when deciding**
14 **to proceed with the Lexington RNG Project.**

15 The question presented to the Commission is whether NW Natural's investment in the
16 Lexington Project is prudent. To determine the prudence of an investment, the Commission
17 determines "whether the company's actions and decisions, based on what it knew or should
18 have known at the time, were prudent in light of existing circumstances."¹⁵ Accordingly, the
19 question presented in this docket is not whether the Commission's rules are authorized by SB 98,
20 but is whether NW Natural appropriately relied on the Commission's rules when making its
21 investment in the out-of-state Lexington Project. The answer to this question is "yes."

22 Prior to the Coalition's Opening Brief in this case, no one challenged the Commission's
23 rules implementing SB 98. No stakeholder argued the rules are inconsistent with SB 98 and
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25 ¹⁴ Senate Committee on Environment and Natural Resources, Work Session on SB 98 (March
14, 2019), Video Recording 50:07-51:59.

26 ¹⁵ *In the Matter of PacifiCorp, dba Pacific Power, Request for a General Rate Increase*, Docket
No. UE 374, Order No. 20-473, p. 33 (December 18, 2020).

1 outside the Commission’s authority during the rulemaking process and no stakeholder petitioned
2 the Court of Appeals to review the Commission’s rules once they were final. NW Natural had
3 no reason to believe the rules did not appropriately interpret SB 98 and reasonably proceeded on
4 the assumption the rules are valid.

5 The Coalition argues acting consistently with the Commission’s rules is not sufficient to
6 establish prudence:

7 A utility exercising the appropriate standard of care would proceed cautiously in
8 implementing SB 98 and would be guided first and foremost by the statutory
9 language permitting the RNG investments. Given the unique risks presented by the
10 Lexington project—first of its kind by this utility, out-of-state, operated by a third
party—it was not sufficiently prudent for NW Natural to proceed with an
investment that does not result in the delivery of RNG to its customers.¹⁶

11 If adopted, this argument could create troubling precedent under which utilities could not rely on
12 the Commission’s administrative rules to guide their actions.

13 Notably, it is not unlawful for the Commission to allow rate recovery of an RNG project
14 that does not comply with SB 98. So, even if the Coalition is correct about the proper
15 interpretation of SB 98, this does not mean it is reasonable for the Commission to disallow the
16 costs of the Lexington RNG Project. Instead, the question is still whether NW Natural acted
17 reasonably in relying on the Commission’s previous interpretation of SB 98, under which
18 projects like the Lexington RNG Project are allowed. NW Natural reasonably relied on the
19 Commission’s rules and the Coalition’s arguments otherwise are without merit.

20 **B. Costs of SB 98 should be spread to all customers, but storage customers, on**
21 **an equal cents-per-therm basis.**

22 **1. Transportation customers benefit from SB 98.**

23 Staff, CUB, and NW Natural support spreading costs recovered under the AAC to all
24 customers but storage customers on an equal cents per therm basis. AWEC opposes this
25 proposed rate spread arguing SB 98 does not authorize the Commission to allocate costs of SB

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¹⁶ Coalition Opening Brief, p. 28.

1 98 investments transportation customers. AWEC also argues that SB 98 costs should be spread
2 to customers other than transportation customers on an equal percent of margin basis. Staff
3 disagrees with both arguments.

4 Contrary to AWEC’s argument, Staff does not assert that costs of the Lexington RNG
5 Project should be assigned to transportation customers “in light of the recently enacted Climate
6 Protection Program (“CPP”).”¹⁷ Instead, Staff’s recommendation to spread SB 98 costs to all
7 customers (except storage customers) is based on the underlying purpose of SB 98 as set forth in
8 sections 1 and 2 of the bill, which provide:

9 (1) The Legislative Assembly finds and declares that:

10 (a) Renewable natural gas provides benefits to natural gas utility customers
11 and to the public; and

12 (b) The development of renewable natural gas resources should be
13 encouraged to support a smooth transition to a low carbon energy
14 economy in Oregon.

14 (2) The Legislative Assembly therefore declares that:

15 (a) Natural gas utilities can reduce emissions from the direct use of natural
16 gas by procuring renewable natural gas and investing in renewable
17 natural gas infrastructure;

17 (b) Regulatory guidelines for the procurement of renewable natural gas and
18 investments in renewable natural gas infrastructure should enable the
19 procurements and investments while also protecting Oregon consumers;
20 and

19 (c) Renewable natural gas should be included in the broader set of low
20 carbon resources that may leverage the natural gas system to reduce
21 greenhouse gas emissions.

21 The legislature’s findings and declarations make clear that the purpose of SB 98 is to
22 encourage investments in RNG to reduce carbon emissions. The benefits of carbon reduction
23 apply equally to all customers of NW Natural. Accordingly, there is no reason to not allocate
24 costs of the program to transportation customers

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¹⁷ AWEC Opening Brief, p. 7.

1 As discussed in Staff’s Opening Brief, AWEC asserts the Commission is restricted from
2 allocating costs to transportation customers under SB 98, arguing NW Natural is only allowed to
3 acquire RNG for the purpose of meeting the targets in SB 98 sec. 5(1), and those “targets are for
4 “gas purchased by the large natural gas utility for distribution to retail natural gas customers in
5 Oregon that is renewable natural gas”.¹⁸ Staff disagrees with AWEC’s interpretation. The
6 legislature used the volume of gas purchased by a natural gas utility for delivery to establish the
7 target for the RNG Program. However, for reasons discussed above, the Commission has
8 reasonably interpreted SB 98 to not require that delivery of RNG to retail customers. It makes
9 no sense to conclude the costs of the RNG Program should be allocated to end user customers
10 just because the targets are based on the annual amount of gas acquired for end use customers.
11 All customers benefit from the acquisition of the RNG and all customers should bear the costs.

12 This interpretation is borne out by another subsection in SB 98, sec. 5. SB 98, sec. 5(6)
13 provides, in pertinent part:

14 The total incremental annual cost to meet the targets of the large renewable natural gas
15 program must account for:

16 (a) Any value received by a large natural gas utility upon any resale of renewable
17 natural gas, including any environmental credits that the renewable natural gas producer
18 chooses to include with the sale of the renewable natural gas to the large natural gas
19 utility[.]

20 Under the subsection above, revenue from the wholesale sale of RNG must be included as
21 an offset in the calculation of a large utility’s total incremental costs to meet the SB 98 target. If
22 the revenue from selling RNG at wholesale is an offset to large utility’s incremental annual costs
23 under SB 98, the cost to acquire that RNG must be part of the total annual costs. However,
24 under AWEC’s interpretation of SB 98 sec. 5(1), costs to produce any RNG that is ultimately
25 sold at wholesale cannot be included in the recoverable SB 98 costs because the costs are not
26 incurred for distribution to retail customers in Oregon.

¹⁸ AWEC/100, Mullins/33.

1 Staff agrees that the commodity costs of RNG should not be borne by transportation
2 customers. Here, NW Natural is offsetting the cost of its RNG investment with revenue from the
3 sale of brown gas, so transportation customers will not bear the commodity cost of gas produced
4 by the Lexington RNG Project. To the extent this offset does not occur for any future RNG
5 project under SB 98, Staff agrees some adjustment should be made to ensure transportation
6 customers are not allocated the commodity cost of the RNG. Staff believes this adjustment can
7 addressed when and if this situation arises.

8 **2. Special contract customers receive the same benefits as other customers and**
9 **should be allocated SB 98 costs.**

10 Special contract customers are transportation customers that have demonstrated a
11 competitive alternative to service from NW Natural and received a special contract.¹⁹ AWEC
12 argues the Commission should not allocate SB 98 costs to these customers because (1) it has not
13 been demonstrated that special contract customers have throughput that increased in 2022
14 compared to the baseline established in 2017, 2018 and 2019 resulting in any incremental CPP
15 compliance costs to NW Natural; (2) each special contract is unique, subject to different terms
16 and conditions established under different circumstances and amending each contract in light of
17 one RNG project would require consultation with each contracting customer; and (3) new costs
18 do not necessarily require modification of a contract because costs are typically fixed subject to
19 an inflationary escalator.²⁰

20 AWEC's arguments are not persuasive. Staff's recommendation regarding the allocation
21 of SB 98 costs is based on the purpose of SB 98, not the CPP. Given the purpose of SB 98 as
22 articulated in the legislative findings and declarations in the bill, special contracts customers
23 benefit from RNG to the same extent as any other customer served by NW Natural. Whether a
24 special contracts customer's throughput has increased since 2017, 2018, or 2019 is not pertinent
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26 ¹⁹ AWEC Opening Brief, p. 14.

²⁰ AWEC Opening Brief, p. 14.

1 to whether the special contract customer benefits from the reduction of carbon emissions under
2 SB 98.

3 NW Natural's argument it would be cumbersome to modify each special contract
4 certainly cannot be a reason to not allocate costs associated with SB 98 to special contracts. The
5 purposes of SB 98 are important. NW Natural customers should not be allowed to avoid costs to
6 achieve these purposes because of inconvenience. Finally, the fact special contracts prices vary
7 with inflation does not mean special contracts need not be adjusted for SB 98 costs. SB 98 costs
8 are a new cost independent of inflation.

9 **3. Costs recovered through the SB 98 AAC should be recovered on an equal**
10 **cents-per-therm basis.**

11 Staff, NW Natural, and CUB support allocating costs recovered through the SB 98 AAC
12 on an equal cents per therm basis from all customers but storage customers. As discussed in
13 Staff's Opening Brief, Staff believes this allocation methodology is appropriate given the
14 generally applicable nature of the benefits of RNG investment as they are described in the
15 legislative findings and declarations of SB 98.

16 **C. The Commission should adopt an AAC for NW Natural with the**
17 **modifications proposed by Staff.**

18 Under NW Natural's proposed AAC, NW Natural would make a filing by February 28 of
19 each year with its forecasted RNP costs, including costs of new projects, and any rate changes
20 would be effective November 1 of each year, unless NW Natural seeks a different rate effective
21 date. Under NW Natural's proposal, it would be allowed to defer and amortize actual costs of
22 new capital projects once the projects are in service to avoid any regulatory lag and would defer
23 the variance between its annual forecast of costs and actual costs and recover that variance
24 through the AAC.

25 Staff does not oppose using an AAC to recover costs of SB 98 investments but does
26 oppose NW Natural's proposal to defer capital costs of new projects and/or change the effective

1 of the annual update to avoid regulatory lag. Specifically, Staff recommends the Commission
2 adopt an AAC with the following elements:

- 3 • Annual filing of forecasted RNG costs submitted by February 28 of each year;
- 4 • February 28 filing must include details of any new projects though projects may
5 be in service after February 28;
- 6 • Updates to forecasted costs filed on August 1 of each year.
- 7 • RNG projects must be operational by October 1 for cost recovery;
- 8 • Updates to rates under AAC to occur on November 1, only;
- 9 • No deferrals for capital costs of new projects;
- 10 • Deferral of variance between forecasted and actual costs (other than capital costs
11 associated with new investments) and amortization in future update subject to
12 following limitations:
 - 13 ○ Earnings test with benchmark set to authorized ROE minus 100 bps;
 - 14 ○ No recovery of deferred amounts within a deadband equal to +/- 50 basis
15 points of ROE to incent the company to operate efficiently.

16 Staff also supports CUB's proposal regarding retired RNG plant. Under CUB's proposal,
17 NW Natural will attest that all RNG projects are currently operating and providing utility service
18 to Oregon customers prior to the November 1 rate change. If a project is no longer producing
19 and is retired while there is still undepreciated capital investment associated with the project,
20 NW Natural will remove that project from its calculation of its return on base from the
21 mechanism and will earn the time value of money on its undepreciated capital investment.²¹

22 **D. Staff does not support recovery of deferred capital costs of future
23 projects or altering the effective date of any rate change under the AAC.**

24 **1. An AAC without a deferral is a reasonable cost-recovery mechanism that
25 balances interests of NW Natural and its customers.**

26 _____
²¹ CUB/500, Gherke/10.

1 Allowing NW Natural to recover costs through an AAC allows NW Natural to manage
2 regulatory lag with a predictable annual rate change. Further, under the AAC, the interval
3 between the on-line date of a new investment and the date NW Natural begins recovering the
4 cost of the investment in rates can be no more than one year. In ordinary ratemaking, regulatory
5 lag is the time between the online date and rate effective date of a general rate case, which is not
6 necessarily less than one year. Finally, an AAC allows NW Natural to recover costs of new
7 investment without opportunity for a full review of NW Natural’s other expenditures. This
8 means NW is allowed to increase its rates for one cost category without opportunity for staff and
9 stakeholders to determine whether some adjustments to NW Natural’s revenue requirement are
10 appropriate to recognize cost savings or over recovery in other areas.

11 The factors described above benefit NW Natural. Adding a deferral to the annual update
12 to allow NW Natural to recover capital costs from the day an investment comes on-line tips the
13 balance too much toward NW Natural to be a fair balance between customers and the utility.
14 Accordingly, Staff opposes allowing NW to defer capital costs of new projects from the date
15 they become commercially operational.

16 For similar reasons, Staff opposes an AAC with a flexible rate effective date. Essentially,
17 NW Natural would like the flexibility to change the effective date of an update to rates to avoid
18 regulatory lag. This proposal fails to take into account the limited resources of the Commission
19 and intervenors and the importance of ensuring there is sufficient time for both Commission and
20 intervenors to review proposed rate changes. Allowing NW Natural to update rates for RNG
21 investments on an annual basis in a single-issue rate case with a specified timeline for filings and
22 review is a sufficient concession. Allowing NW Natural the opportunity to use the single-issue
23 ratemaking process under the AAC to seek an update to rates for RNG investment at any time is
24 unprecedented and unbalanced.

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1 **2. SB 98 does not mandate dollar-for-dollar recovery of capital costs.**

2 Staff disagrees with NW Natural that a deferral of capital costs from the date an RNG
3 investment is on-line is required under SB 98 or the Commission’s rules implementing SB 98.
4 SB 98, sec. 5(2) provides, in pertinent part:

- 5 (2) The commission shall adopt ratemaking mechanisms that ensure the recovery
6 of all prudently incurred costs that contribute to the large natural gas utility’s
7 meeting the targets set forth in subsection (1) of this section. Pursuant to the
8 ratemaking mechanisms adopted under this subsection:
- 9 (a) Qualified investments and operating costs associated with qualified
10 investments that contribute to the large natural gas utility meeting the
11 targets set forth in subsection (1) of this section may be recovered by
12 means of an automatic adjustment clause, as defined in ORS 757.210.
- 13 (b) Costs of procurement of renewable natural gas from third parties that
14 contribute to the large natural gas utility meeting the targets set forth in
15 subsection (1) of this section may be recovered by means of an automatic
16 adjustment clause, as defined in ORS 757.210, or another recovery
17 mechanism authorized by rule.

18 The Commission has previously interpreted similar language found in Oregon’s
19 Renewable Portfolio Standard (RPS) statute, ORS 469A.120(1).²² ORS 469A.120(1) provides,
20 in pertinent part, “[e]xcept as provided in ORS 469A.180(5), all prudently incurred costs
21 associated with compliance with a renewable portfolio standard are recoverable in the rates of an
22 electric company.” In a 2015 investigation, Portland General Electric Company (PGE) and
23 PacifiCorp argued that this language required the Commission to allow dollar-for-dollar recovery
24 of costs to comply with Oregon’s RPS. The Commission disagreed. The Commission
25 concluded the statute does not mandate dollar-for-dollar recovery of costs.

26 The same conclusion is called for here and in fact, it appears the Commission has already
reached this conclusion given the three choices for a cost recovery mechanism authorized under
OAR 860-150-0300. Under the rules adopted by the Commission to implement SB 98, a large
natural gas utility can seek to recover costs of a capital investment through either a general rate

²² See *In the Matter of the Portland General Electric Company and PacifiCorp dba Pacific Power Request for Generic Power Cost Adjustment Mechanism*, Docket No. UM 1662, Order No. 15-408 (December 18, 2015).

1 case or through a request for an automatic adjustment clause and can seek to recover costs of
2 purchased RNG through its purchased gas adjustment.²³ Cost recovery under a PGA is subject to
3 an earnings test with possible disallowances. Recovery of capital costs under a general rate case
4 is generally subject to regulatory lag if the new facilities do not come on-line immediately before
5 the effective date of a general rate revision. Although automatic adjustment clauses often
6 include a deferral, this deferral is used to capture a variance between forecasted and actual costs
7 and is not typically used to capture costs of new plant in service prior to the time that plant is
8 included in rates. For example, the most comparable AACs, those for RPS-compliant
9 investments by electric utilities, do not include deferred capital costs.

10 NW Natural's argument the Commission has interpreted SB 98 to require special
11 ratemaking treatment to eliminate potential non-recovery of costs through regulatory lag is
12 undermined by the Commission's determination that a general rate case is an appropriate
13 mechanism for cost recovery. The same is true of the Commission's decision NW Natural's
14 PGA can be used to recover SB 98 investment costs given the adjustments contemplated by that
15 mechanism.

16 NW Natural asserts the Commission indicated its support NW Natural's preferred form
17 of AAC by noting at the time it adopted rules implementing SB 98 that "[t]he legislature directed
18 us, in ORS 757.394(3), to adopt rules to establish a process for natural gas utilities to *fully*
19 recover the costs associated with a large or small renewable natural gas program[.]"²⁴ However,
20 as discussed above, a review of the rules adopted by the Commission shows the Commission was
21 not intent on ensuring dollar-for-dollar recovery of SB 98-compliant investment. Instead, the
22 Commission adopted rules that authorized traditional mechanisms that include regulatory lag
23 (general rate case) and disallowances when a utility's earnings are sufficient (PGA). The fact the
24 Commission used the term "fully recover" in its order adopting the rules does not change their
25 substantive effect.

26 ²³ OAR 860-150-0300.

²⁴ NWN/2500, Kravitz/9 (emphasis in original).

1 **3. Recovery of the variance between forecasted and actual costs should be**
2 **subject to a deadband and earnings test.**

3 NW Natural also seeks to defer and amortize the variance between its forecasted costs
4 recovered under the AAC and its actual costs. Staff acknowledges that such a deferral is used in
5 other AACs for non-capital costs. Staff supports deferral of the variance of non-capital costs
6 under the SB 98 AAC. However, if NW Natural is allowed to defer the non-capital cost
7 variance, NW Natural's recovery of the variance should be subject to a deadband equal to +/- 50
8 basis points of NW Natural's ROE. Meaning, to the extent NW Natural's deferred costs are less
9 than an amount that is equal to 50 bp of ROE, NW Natural would not be allowed any deferred
10 costs. If they are greater, NW Natural would only be allowed to defer the portion of the deferral
11 that exceeds 50 basis points. This deadband is like those included in electric utilities' power cost
12 adjustment mechanisms and is appropriate to incent careful management of costs.

13 Staff also recommends that recovery of any deferred amounts be subject to an earnings
14 test using a benchmark of NW Natural's authorized ROE minus 100 basis points. This will
15 ensure NW Natural is not allowed to collect additional revenues through the extraordinary
16 ratemaking mechanism when NW Natural's earnings are already sufficient.

17 **III. The Commission should defer consideration of NW Natural's line extension policy**
18 **to a general investigation involving all stakeholders and gas utilities.**

19 The Coalition and CUB propose changes to NW Natural's line extension policy. They
20 consider the carbon reduction costs for a new customer over a 20-year period and changes in
21 green-house gas (GHG) emissions and climate policy since residential line-extension policy was
22 last revised. While the Company acknowledges that utility customer costs will be directly
23 impacted by compliance with the CPP and HB 2021, NW Natural disagrees with both CUB's
24 and the Coalition's findings and proposes no change to its Schedule X.

25 Staff recommends the Commission find that the issues raised by the Coalition and CUB
26 are complex matters applicable to all natural gas utilities, and more appropriately handled in a

1 separate docket. Staff believes there is considerable benefit to a common decision-making
2 framework applicable to all three natural gas utilities. Further, Staff does not think it is
3 appropriate to make a policy issue in this docket regarding gas utility line extension policies
4 without first providing Avista and Cascade Natural Gas Company opportunity to participate in
5 the discussion.

6 DATED this 22nd day of August 2022.

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Respectfully submitted,

ELLEN F. ROSENBLUM
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