BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 435 and UG 411

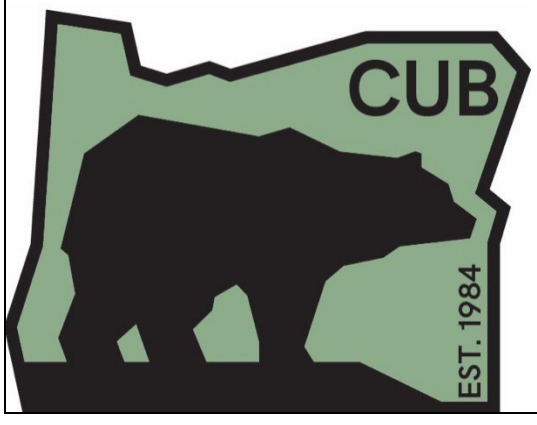
In the Matter of	)
	)
NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL,	)
	)
Request for a General Rate Revision (UG 435),	)
	)
Advice No. 20-19, Schedule 198 Renewable Natural Gas Recovery Mechanism (ADV 1215) (UG 411).	)
	)

REDACTED OPENING BRIEF

OF THE

OREGON CITIZENS' UTILITY BOARD

August 10, 2022



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In the Matter of NORTHWEST NATURAL GAS COMPANY, dba, NW NATURAL, Request for a General Rate Revision (UG 435), Advice No. 20-19, Schedule 198 Renewable Natural Gas Recovery Mechanism (ADV 1215) (UG 411).	OPENING BRIEF OF THE OREGON CITIZENS' UTILITY BOARD **(REDACTED)**

I. INTRODUCTION

A. Background and Procedural Posture

Pursuant to Administrative Law Judge (ALJ) Spruce's January 26, 2022 Amended Procedural Conference Memorandum and July 27, 2022 Ruling, the Oregon Citizens' Utility Board (CUB) hereby submits its Opening Brief in the above-captioned consolidated proceedings. In this Brief, CUB responds to arguments raised by NW Natural (NWN or the Company) throughout this proceeding. CUB also addresses arguments raised by Staff of the Public Utility Commission of Oregon (Staff), the Alliance of Western Energy Consumers (AWEC), and the Coalition of Communities of Color, Climate Solutions, Verde, Columbia Riverkeeper, Oregon Environmental Council, Community Energy Project, and Sierra Club (the Coalition).

On December 17, 2021, NWN filed a request for a general rate revision with the Public Utility Commission of Oregon (Commission) under ORS § 757.205, 757.215 and 757.220 to

become effective November 1, 2022. The proceeding was subsequently docketed as UG 435. The Company developed the case using the test year comprised of the 12 months ending October 31, 2023 (Test Year), and a historical base year of the 12 months ending December 31, 2021. The Company's initial filing requested a revision to customer rates that would have increased NWN's annual Oregon jurisdictional revenues by $73.5 million, or an approximately 9.9 percent increase over the current customer rates.[1] On February 28, 2022, NWN made an errata filing increasing the revenue requirement to $78.020 million, which would have resulted in an approximate 10.56 percent increase to revenues collected from customers' base rates, or a 17.5 percent margin rate increase.[2]

NWN filed Advice No. 20-19 on December 4, 2020 to add Schedule 198 to the Company's tariff. Schedule 198 would establish an automatic adjustment clause (AAC), as defined in ORS § 757.210. That proceeding was docketed as UG 411. The AAC would enable NWN to recover renewable natural gas (RNG) costs incurred to comply with the Oregon Department of Environmental Quality's Climate Protection Plan (CPP), as well as to meet the targets in ORS § 757.396. ALJ Spruce convened a prehearing conference on January 19, 2022, and on January 26, 2022 issued an Amended Procedural Conference Memorandum setting forth the UG 435 schedule and consolidated UG 411 with UG 435 pursuant to OAR 860-001-0600. On February 18, 2022, the Company filed its Opening Testimony in UG 411 regarding its Renewable Natural Gas Recovery Mechanism (RNG AAC) in these consolidated proceedings.

Since that time, the parties have filed multiple rounds of testimony and have issued and responded to a multitude of data requests. Settlement on several issues has been reached and these terms are contained in a Multi-Party Stipulation Regarding Revenue Requirement, Rate

[1] UG 435 – Application of NW Natural for a General Rate Revision (Dec. 17, 2021).
[2] UG 435 – ERRATA NW Natural/100/Anderson-Kravitz/17.

Spread, and Certain Other Issues filed on May 31, 2022 (First Partial Stipulation) and a Second Partial Stipulation Regarding Decoupling, Residential Customer Deposits, the Oregon Low Income Energy Efficiency Program, and COVID-19 Deferral Costs filed on June 29, 2022 (Second Partial Stipulation). As a signatory to both the First and Second Partial Stipulations, CUB finds their terms to be a reasonable compromise of relevant issues that further the public interest and result in just and reasonable rates. As such, CUB respectfully urges the Commission to adopt their terms.

The First Partial Stipulation was entered into by NWN, Staff, CUB, AWEC, and the Small Business Utility Advocates (SBUA). The First Partial Stipulation represents the settlement of all revenue requirement issues among the stipulating parties, including NW Natural's Cost of Capital.[3] The Coalition objected to certain provisions contained in the First Partial Stipulation that are subject to ongoing dispute. The Second Partial Stipulation was entered into by NWN, Staff, CUB, AWEC, and the Coalition. The Second Partial Stipulation represents the settlement of several other issues in these consolidated proceedings, including the amortization and rate spread associated with the Company's COVID-19 deferral.[4] SBUA objected to Paragraph 4 of the Second Partial Stipulation regarding the COVID-19 deferral, and that issue is also subject to ongoing dispute.

Beyond the issues contained in the First and Second Partial Stipulations, several key disputed issues remain in these consolidated proceedings for the Commission's consideration. CUB addresses several of these issues in this Brief—the Company's current Line Extension

[3] UG 435 – NW Natural-Staff-CUB-AWEC-SBUA/100/Kravitz, Fjeldheim, Gehrke, Mullins, and Kermode/4.
[4] *See* UG 435 – NW Natural-Staff-CUB-AWEC-Coalition/100/Kravitz, Wyman, Fjeldheim, Scala, Jenks, Mullins, and Fain/5.

Allowance detailed in its Schedule X, the contours of the RNG AAC, and RNG rate spread.[5] As this Brief will detail, CUB's recommendations on the remaining live issues are grounded in legally defensible ratemaking and a desire to fairly balance the interests of the Company and its customers in alignment with the Commission's core mandate to establish just and reasonable rates.[6] Further, CUB's recommendations help ensure that all Oregon utility customers are fairly contributing to Oregon's goals and mandates to decarbonize the energy sector. During a time in which customers are incurring increasing costs to further the transition to a clean energy economy, it is paramount that equity be at the forefront of the conversation to ensure no individual customer class is shouldering a disproportionate share of the burden.

The Brief will address the following:

A. Line Extension Allowance Policy;

B. RNG AAC; and

C. RNG Rate Spread.

B. Burden of Proof

In a utility dispute before the Commission, the burden of proof consists of two discrete components—the burden of persuasion and the burden of production.[7] In a utility proceeding, the burden of persuasion and the ultimate burden of producing sufficient evidence to support its claims is always with the utility.[8] Other parties to the proceeding have the burden of producing

[5] CUB's RNG rate spread proposal is designed around recovery of all RNG costs going forward, including the Lexington RNG project discussed in this proceeding.

[6] *See* ORS § 756.040(1) ("The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates."); *see also* OPUC Order No. 08-487 at 5 ("The Commission sets rates within a reasonable range that protects the competing interests of the utility and its customers. To protect customers, the rates must be set at a level sufficiently low to avoid unjust and unreasonable exactions. To protect the utility investor, the rates must provide sufficient revenue not only for operating expenses, but also for the capital costs of the business.").

[7] *In re Portland General Electric Company Application to Amortize the Boardman Deferral*, OPUC Docket No. UE 196, Order No. 09-046 at 7 (Feb. 5, 2009).

[8] *Id*.

evidence to support their argument in opposition to the utility's position.[9] In a case in which a utility is requesting a change in rates or a schedule of rates—such as a general rate case—the utility bears the burden of showing that its proposed change will result in rates that are fair, just, and reasonable.[10]

II. ARGUMENT

A. Line Extension Allowance Policy

The evidence before the Commission conclusively indicates that the Company failed to meet its burden of proof to demonstrate that retaining its current Line Extension Allowance (LEA) policy is prudent and would result in rates that are fair, just, and reasonable.[11] The Company's current LEA was established in its 2012 general rate case.[12] Much has changed in the last decade. Notably, new customers on NWN's system now bring with them incremental CPP compliance costs. These costs alter the economics underpinning the LEA rendering the addition of new customers a net cost to existing customers.[13] NWN projects that its system will continue to grow.[14] As the system grows, the emissions reduction requirements driven by the CPP—as well as the costs to achieve these reductions—will increase.[15] CPP compliance costs are incurred in the Test Year and are therefore appropriate for examination in this proceeding. Although truly accounting for requisite carbon reduction costs would create a negative LEA,

[9] *Id*. at 7-8.
[10] ORS § 757.210(1)(a).
[11] *Id*.
[12] UG 435 – CUB/100/Jenks/16, lines 10-12.
[13] UG 435 – CUB/100/Jenks/10, lines 14-15.
[14] UG 435 – CUB/103.
[15] UG 435 – CUB/400/Jenks/12, lines 2-4.

CUB's proposal to gradually phase out the LEA over time is offered as a reasonable compromise, thereby providing fair treatment for NWN and home developers.[16]

Through investigating the Company's LEA, CUB discovered a fundamental flaw in the calculation of its Internal Rate of Return (IRR).[17] The LEA model calculates the IRR on a 30-year basis, but the IRR assumes that the LEA is amortized over a 40-year window.[18] Neither the 30-year window for the IRR calculation nor the 40-year LEA amortization window are grounded in reality. The duration of time a customer will remain on NWN's system and the useful lives of the LEA's various underlying plant both differ from the figures used in the Company's calculation.[19] At a minimum, the Commission should adopt CUB's recommendation to rectify these flaws and reduce NWN's LEA to $2,200, consistent with the pre-2012 methodology.[20] This would align NWN's LEA methodology with that of its peer utilities.[21] The Coalition agrees that LEA improvements can be made in this proceeding to rectify apparent flaws.[22]

Beyond simply addressing these flaws, the Commission possesses the requisite authority[23] to grant CUB the relief it seeks on the remainder of LEA-related issues. The record contains substantial evidence supporting a ruling in CUB's favor. To account for incremental CPP compliance costs brought by new customer growth in the Test Year and in near-term years,

[16] UG 435 – CUB/100/Jenks/17.
[17] UG 435 – CUB/400/Jenks/26.
[18] *Id*.
[19] *See* UG 435 – CUB/100/Jenks/16-17.
[20] UG 435 – CUB/400/Jenks/11, lines 9-11.
[21] UG 435 – CUB/100/Jenks/15-16 citing Public Utility Commission of Oregon, Senate Bill 32 Work Group – Study of Natural Gas Expansion to Unserved Areas, p. 9 ("Each utility currently calculates this allowance for new residential customers differently. NW Natural's construction allowance is five times the annual average margin expected from new customers. Avista's allowance is three times the estimated gross revenue expected from the new customers. Cascade's allowance is 4.5 times the estimated gross margin (gross revenue less cost of gas) to be derived from the new customer."). The description of NWN's LEA in the SB 32 Work Group details its pre-2012 general rate case LEA. This is the calculation CUB proposes to return to.
[22] UG 435 – Coalition/500/Burgess/2, 12.
[23] *See, e.g.,* OPUC Order No. 08-487 at 4 (The legislature has provided the Commission with "the broadest authority—commensurate with that of the legislature itself—for the exercise of its regulatory function.").

CUB urges the Commission to adopt its recommendation to reduce the LEA by 50% in 2024 and eliminate it in 2025.[24]

Finally, CUB requests that the Commission order NWN to demonstrate, on the record, that its growth-related investments are prudent.[25] Despite the fact that NWN's testimony in its last three general rate cases (UG 344, UG 388, UG 435) was completely devoid of any arguments related to the prudence of growth-related investments served by its LEA, NWN's LEA and associated investments were allowed into rates.[26] In order to ensure the Company's growth-related investments benefit NWN's customers—rather than merely providing a valuable profit stream for its shareholders[27]—this presumption of prudence must be eliminated.

1. ***This proceeding is an appropriate venue to address the Company's LEA.***

According to NWN, "[d]espite raising numerous concerns regarding perceived risks of the current and future gas system, neither [CUB nor the Coalition] has provided any persuasive evidence that such risks require elimination of NW Natural's LEA."[28] The Company believes that this proceeding lacks the requisite record for the Commission to address the recommended revisions to its LEA.[29] The Company is wrong. No party has questioned that the flaws apparent in NWN's LEA methodology are eligible to be addressed in this proceeding. The Company continues to conflate CUB's principled and evidence-based recommendation to reduce its LEA to $2,200 to address the flaws in its IRR methodology with a broader conversation about risks inherent to modern gas utilities.[30]

[24] UG 435 – CUB/400/Jenks/11.
[25] *Id*.
[26] UG 435 – CUB/613.
[27] UG 435 – CUB/400/Jenks/18.
[28] UG 435 – NW Natural/2400/Heiting-Bracken/1-2.
[29] *Id*. at 2.
[30] *See, e.g.,* UG 435 – NW Natural/2400/Heiting-Bracken/2 ("[T]he parties' proposals raise significant and unanswered factual questions as to Oregon's energy future, including the optimal path to decarbonization of the energy sector.").

CUB's issue is narrow—whether Test Year subsidization and current methodology flaws warrant revisiting the Company's LEA.[31] However, because the Company's LEA analysis considers revenue that will be generated from new customers over the next several decades,[32] it is also appropriate to consider future cost and risk as incremental evidence when setting the LEA. The Company's own modeling projects substantial CPP compliance costs over the amortization window of its current LEA.[33] The Commission should not be persuaded by the Company's arguments that consideration of future risks related to CPP compliance is somehow not relevant to setting its LEA. Those risks bear on the calculation of the LEA. However, even without considering costs that will be incurred during the 58-year useful life of the service drop,[34] the Commission both can and should adopt CUB's proposals in this proceeding solely due to evidence regarding the flaws in the IRR methodology and CPP compliance costs in the Test Year.[35]

CUB's recommendation is not based on "the perception of risks that are specific to concerns about NW Natural's ability to comply with the CPP."[36] CUB is not discussing the Company's CPP compliance pathway. CUB's recommendation is based on real costs in the Test Year. NWN claims with vague ambition that it can comply with the CPP "at a reasonable cost."[37] The key word is cost. New costs exist. No party disputes there are incremental CPP compliance costs included in the Test Year that were not previously incurred. The Commission

[31] UG 435 – CUB/400/Jenks/3.
[32] UG 435 – CUB/400/Jenks/19 ("We assumed a 40-year amortization life, when the amortization life of the largest LEA component is 58 years.").
[33] UG 435 – CUB/400/Jenks/13, Figure 1.
[34] UG 435 – CUB/403; CUB/400/Jenks/19.
[35] *See* UG 435 – CUB/400/Jenks/13, Figure 1.
[36] UG 435 – NW Natural/2600/Taylor/5, lines 10-13.
[37] UG 435 – NW Natural/2400/Heiting-Bracken/3.

should adopt CUB's recommendations to insulate NWN's customers from new, incremental CPP costs that are not included in the Company's current LEA analysis.[38]

In doing so, the Commission would not be precluded from opening a broader investigation should it choose to do so, as NWN, Staff, and AWEC believe is appropriate.[39] CUB's recommendations are based on the current CPP rules and the current cost of compliance tools.[40] As the cost of compliance tools change during or after a Commission investigation—should it choose to open one—the LEA can be revisited in a future rate case.[41] CUB is not recommending eliminating the LEA immediately. There is time built into CUB's recommendation to ease the effects of its proposal on both the Company and the homebuilders that utilize the LEA.[42] The Coalition similarly believes that the Commission can still open an investigation and act in this proceeding.[43]

Further, while Staff recommends that issues related to all gas utilities be addressed in a separate investigation,[44] it has not analyzed CUB's IRR recommendation or the Company's IRR methodology.[45] CUB's IRR recommendation is specific to NWN's LEA. Evidence supports CUB's recommendation to rectify flaws in the Company's IRR methodology in this proceeding without the need for a broader investigation. This is especially true since NWN's LEA is calculated differently than Cascade and Avista's[46]—there are issues relevant to NWN's LEA that are more appropriately addressed in this proceeding than in a multi-utility investigation.

[38] *See, e.g.,* UG 435 – Coalition/500/Burgess/5, lines 12-14 ("this reduction in average costs is really only applicable to joint use facilities or common costs.").
[39] UG 435 – NW Natural/2400/Heiting-Bracken/2; Staff/1800/Muldoon/28-29; AWEC/200/Mullins/19.
[40] UG 435 – CUB/400/Jenks/25, lines 18-19.
[41] *Id*. at lines 19-20.
[42] UG 435 – CUB/100/Jenks/17, lines 12-15.
[43] UG 435 – Coalition/500/Burgess/2, lines 9-10.
[44] UG 435 – Staff/1800/Muldoon/26, lines 14-16.
[45] UG 435 – CUB/614.
[46] *Supra*, note 22.

Further, there is no reason to believe NWN would not slow walk a general LEA investigation. The LEA represents a valuable profit stream to the Company.[47] Meanwhile, under the current LEA, every customer who is hooked up harms the current customer base. The Company points to its Integrated Resource Plan as the proceeding that will contain the requisite analysis to conduct an LEA investigation, but it has already delayed that proceeding.[48] Given its recent advocacy, the Company will likely argue that an investigation into natural gas utility LEAs requires an analysis of both electric and natural gas systems. CUB's recommendations are appropriately addressed in this proceeding. This is a general rate case—the goal is not to set a statewide policy. It is to ensure the utility's rates are just and reasonable and to create proper incentives for utility action that furthers the public interest.

Third, the Commission has the authority to address the contours of NWN's LEA in this proceeding. NWN agrees, indicating that "general base rate proceedings are the appropriate forum to review a utility's LEA."[49] While the Company argued that the Commission lacked authority to consider CUB's LEA proposal in its Rebuttal Testimony, it did not address the issue in its Surrebuttal Testimony.[50] Nevertheless, CUB continues to believe the Commission has the authority act on its recommendations in this proceeding.[51] The Company's current LEA was created and authorized in the 2012 general rate case.[52] If the Commission can expand the Company's LEA in a 2012 general rate case, it can make reasoned changes to the LEA in this

[47] UG 435 – CUB/400/Jenks/18, Figure 2; Coalition/500/Burgess/3.
[48] UG 435 – NW Natural/2400/Heiting-Bracken/12, fn. 37.
[49] UG 435 – NW Natural/2600/Taylor/
[50] *See, e.g.,* UG 435 – NW Natural/1700/Heiting-Bracken/14, lines 1-7.
[51] *Supra*, note 20; UG 435 – CUB/400/Jenks/22-23.
[52] UG 435 – CUB/100/Jenks/16, lines 10-12.

general rate case. Further, Staff, and the Department of Justice view general rate case proceedings as appropriate venues to address LEA policy.[53]

2. *Incremental CPP compliance costs incurred in the Test Year and throughout the LEA's amortization window warrant the policy's re-examination.*

The evidence of NWN's near-term CPP compliance costs supports CUB's recommendation to phase out the Company's LEA.[54] Incremental energy efficiency costs will be incurred in the test year, and these costs are projected to increase from approximately $10 million in 2023 to approximately $140 million in 2025.[55] When considering the 58-year useful life of the Company's service drop infrastructure, the customers hooked up to NWN's system from the LEA will have assets on the Company's books until 2080. While NWN's shareholders will enjoy a rate of return on these assets for each of these years, NWN's customers will bear the burden of increased CPP compliance costs that ratchet up with each new customer.[56] NWN argues that eliminating the LEA will fail to protect the balance of fairness between new and existing customers.[57] There is nothing fair about allowing the Company to profit by adding customers that bring costs that harm all other customers on the system.

The Company's reliance on adhering to "basic regulatory principles" like fairness[58] to calculate the LEA is particularly inapt. When a layer of carbon regulation costs is added on top of the utility's system, the traditional LEA calculation that merely considers joint and common

[53] UM 2178 – Natural Gas Fact Finding Draft Report at 24 (Apr. 15, 2022) ("PUC Rates, Finance and Audit (RFA) staff and Oregon Department of Justice are to explore with gas and electric utilities an interim, easily implemented approach to line extension allowance policy in future upcoming gas and electric **rate case dockets**.") (emphasis added).
[54] UG 435 – CUB/Jenks/400/13, Figure 1.
[55] *Id*.
[56] UG 435 – CUB/Jenks/100/10; *id.* at 11 ("Even if we assume that new customers being added to the customers system are more energy efficient than the average customer's usage, the projected growth in the number of customers will increase the required GHG reductions from 50% of current load to 69% of current load.").
[57] UG 435 – NW Natural/2400/Heiting-Bracken/4, lines 7-11.
[58] *Id*.

costs is no longer applicable.[59] According to the NWN, the "best way to mitigate cost impacts to existing customers is to continue adding customers to the system."[60] It is almost as if the Company has not read the record in this proceeding. While the Company's position and the underlying analysis is true under a traditional paradigm, it is not true when new customers bring with them additional emission reduction costs that fall upon all customers.[61] Adding new customers under this paradigm does not benefit existing customers.

The Company notes that CUB and NWN share some agreement regarding the purpose of an LEA.[62] According to NWN,

> the purpose of the line extension allowance is 'to ensure equity between existing and new customers, where existing customers are *held harmless* by not paying for the portion of new service costs that are uneconomic yet benefit from the incremental revenues in excess of the cost related to the new customer's service, which contributes to paying for common costs.'[63]

CUB agrees that the LEA should be set so existing customers are held harmless from the effects of adding new customers to the system.[64] The issue is that NWN excludes CPP costs from its LEA analysis, and, instead, only focuses on the cost of connecting the new customer to the distribution system and the joint and common costs of the distribution system. New joint and common costs related to emission reductions are ignored. The Company's analysis and arguments surrounding the matching of costs and benefits therefore only tell one side of the story. The Company's argument that CUB's recommendation would harm NWN's customers by

[59] UG 435 – CUB/100/Jenks/10.
[60] UG 435 – NW Natural/2400/Heiting-Bracken/3, lines 2-4.
[61] UG 435 – CUB/400/Jenks/26, lines 6-8.
[62] UG 435 – NW Natural/2600/Taylor/9-10.
[63] UG 435 – NW Natural/2600/Taylor/10, lines 2-6 citing NW Natural/1800/Taylor/6.
[64] UG 435 – CUB/400/Jenks/25; *see also* CUB/613/2 ("[W]hen a utility receives revenues from new customers equal to or greater than the incremental cost, existing customers are either no worse off or better off. However, when the incremental cost of serving new customers outstrips the revenue collected from these new customers, existing customers are harmed. This is the paradigm that is currently occurring on NW Natural's system and will be exacerbated as CPP compliance costs continue to accelerate.").

decreasing customer additions should therefore be ignored, as it fails to consider the impact of CPP compliance costs.[65] While focusing on the benefits associated with distribution joint and common costs is appropriate under a traditional LEA methodology, again, it is not indicative of the new paradigm we are in.

Under the CPP, NWN is required to reduce greenhouse gas emissions by 50% from a historic baseline. However, as its system grows—consistent with its predictions—NWN will have to reduce baseline emissions, by 69% to accommodate this load growth while achieving the requisite emissions reductions.[66] This increases the costs to existing customers. According to the Company's modeling, energy efficiency investments are the largest driver of these costs.[67] Revising the LEA now is reasonable because NWN's projected energy efficiency spend will increase to approximately $140 million by 2025.[68]

The Company seeks to significantly increase spending on energy efficiency incentives to reduce therms while simultaneously spending millions on capital investments through its LEA to increase therms. Each therm has the same contribution to the joint and common costs of the system. The difference between a therm from an existing customer and a therm for a new customer is twofold: the cost of the LEA and the revenue from the customer charge. Because using the $8/month customer charge to pay back the LEA will take decades, reducing therms by not subsidizing growth via the LEA is more cost effective as compared to paying incentives to get customers to reduce usage.[69] There is a cost, such as Energy Trust of Oregon incentives, to relying on energy efficiency as a way to reduce therms. Conversely, there is a net savings from

[65] UG 435 – NW Natural/Heiting-Bracken/24.
[66] UG 435 – CUB/400/Jenks/12 citing CUB/103.
[67] UG 435 – CUB/400/Jenks/13, Figure 1.
[68] *Supra,* note 51.
[69] UG 435 – CUB/400/Jenks/15.

not subsidizing growth as a way to reduce therms. Under NWN's proposed compliance path, customers would be asked to pay to both grow the system *and* to pay for energy efficiency to reduce therms. This unfair model can be addressed by adopting CUB's recommendations.

NWN has failed to rebut this argument on the record. The Company has failed to provide sufficient evidence that retaining the current LEA is reasonable in light of the new, incremental CPP compliance costs incurred during the Test Year and throughout the useful life of LEA-funded assets. It has therefore failed to meet its burden of proof.

3. *The Commission should act now to rectify flaws in NWN's IRR methodology.*

At a minimum the Commission should act in this proceeding to rectify the flaws in NWN's current LEA model. The Company's LEA model calculates the IRR on a 30-year basis, but the IRR assumes that NWN is amortizing the LEA over 40 years.[70] While this mismatch alone would make for poor ratemaking, the Company's methodology is more flawed than indicated here. As discussed, the Company's service drop—a capital investment subsidized by the LEA—has a useful life of 58 years.[71] If the Company's request is approved, this component will be financed through 2080. If the customer served by this equipment leaves NWN's system for any reason before that time, there will be a stranded cost.[72] Even without examining CUB's concerns regarding the effect of CPP compliance costs, the Company's LEA warrants re-examination. Reducing the LEA by returning to the old methodology significantly reduces the potential for stranded cost. Phasing out the LEA eliminates the potential stranded cost associated with new customer connections. Accepting CUB's recommendation on this proposal would solve this fundamental methodology flaw.

[70] UG 435 – CUB/400/Jenks/26.
[71] *Supra,* note 33.
[72] UG 435 – CUB/400/Jenks/26-27.

In Surrebuttal Testimony, NWN brought forward two separate IRR models in an attempt to address CUB's concern. In NW Natural/2601, the Company details a 30-year LEA model with a 30-year amortization window. NW Natural/2602 details a 20-year model. However, these illustrative examples do little to assuage CUB's concerns, and contain flaws themselves. In NW Natural/2601, the model calculates a 6.259 percent IRR. This represents the benefit to the system of that model if all assumptions are correct. However, this IRR diminishes significantly if the customer disconnects early, and, indeed, is negative if the customer disconnects within the first 10 years.[73] The IRR model also assumes constant usage and no decline in demand throughout the useful life of the assets.

This makes no sense when energy efficiency is a primary compliance tool, and heat pump technology is changing the efficiency of replacement heating and cooling equipment. Also, neither NW Natural/2601 nor 2602 recognize the 58-year useful life of the service drop. Even though the benefits to the system, and, thereby, the customers in the Company's model are speculative and subject to change with varying assumptions, the Company's shareholders would still be able to enjoy an authorized rate of return throughout the useful life. This is patently unfair, as customers take on the bulk of the risk. This can be rectified by reducing and phasing out the Company's LEA, as it will no longer be a valuable asset to the Company in its rate base.

Further, if the Commission does not act to solve the fundamental flaws in the Company's analysis in this proceeding, there may be stranded assets on the Company's system in the future. If approved, the Company's LEA would include capital additions on its system through 2080. If these assets become stranded, there will likely be disputes regarding the recovery of costs. By reducing the LEA now, the Commission can help insulate customers from stranded cost risk in

[73] UG 435 – NW Natural/2601/Taylor/1.

the future years of LEA assets' useful lives. While reducing the LEA reduces the stranded cost risk, this risk will not be fully eliminated until the Company's LEA is also eliminated. Given that over $25 million in capital investments are added through the LEA each year, the risk of substantial stranded assets is significant. Disputes over the recovery of these amounts creates litigation risk over the used and usefulness[74] of the assets for a wide range of parties. Meanwhile, the Company would continue to profit on assets to grow the system while cost and risk are shouldered by its customers. The more equitable solution would be to address the issue now by adopting CUB's recommendation.[75]

4. *The Commission should adopt CUB's proposal to phase out the presumption of prudence associated with NWN's LEA.*

As discussed, the Company has failed to demonstrate that the investments served by its LEA—and the LEA itself—are prudent in this proceeding or its two prior general rate cases.[76] In a general rate proceeding, NWN bears the burden to prove its proposals will result in rates that are just and reasonable.[77] Since NWN has failed to write any Opening Testimony on issues related to its LEA in the last three rate cases, yet these amounts were allowed into rates, it is reasonable to conclude that the Company's LEA has been presumed to be prudent. This is for good reason—historically, customer growth has spread the fixed costs of the Company's system more thinly, creating a benefit for existing customers. However, as the evidence CUB has presented conclusively demonstrates, this is no longer the case. The Company should have to demonstrate the prudence of its LEA and associated growth-related investments in every general rate case. As part of this demonstration, the Company should demonstrate that the investments it

[74] ORS § 757.355.
[75] UG 435 – CUB/400/Jenks/29-30.
[76] UG 435 – CUB/613/1-2.
[77] *Supra,* note 9.

proposes are unlikely to become stranded. Further, it should demonstrate that continuing to grow its system—in spite of the need to reduce therms for regulatory compliance—is reasonable.[78]

Contrary to the Company's assertion,[79] the evidentiary record before the Commission supports a ruling in CUB's favor on LEA-related issues. At a minimum, the Commission should act now to resolve the flaws in the Company's IRR model and immediately reduce the Company's LEA to $2,200—the figure based on the pre-2012 general rate case methodology.[80] However, CUB also respectfully urges the Commission to decrease the Company's LEA by 50% in 2024 and eliminating it in 2025.[81] Granting CUB the relief it seeks is an equitable solution that would help protect NWN's customers from paying to both grow the system and for additional CPP compliance costs. It would help insulate NWN's customers from stranded asset risk as well as near-term cost increases.

Further, it does not mean the Company cannot continue to grow its system—CUB is merely asking to eliminate the subsidy for growth. Builders and homeowners would still have the option of adding gas service, they would simply have to pay the costs of connection. Under traditional ratemaking principles of cost causation, these costs would be properly assigned to them in the first place. The Commission should not be persuaded by the Company's thinly-veiled attempt to protect a valuable profit stream for its shareholders at the expense of its customers.

B. RNG AAC

CUB respectfully urges the Commission to adopt its proposal to create a balanced RNG AAC that enables the Company to recover prudently-incurred costs while treating NWN's

[78] UG 435 – CUB/400/Jenks/34.
[79] UG 435 – NW Natural/2400/Heiting-Bracken/2.
[80] UG 435 – CUB/400/Jenks/33, lines 19-20.
[81] UG 435 – CUB/400/Jenks/11, lines 11-12.

customers fairly.[82] CUB's proposal is brought in the spirit of compromise. NW Natural cannot claim that an AAC is necessary under any statutory or regulatory requirement. Senate Bill (SB) 98 contains no provision requiring an AAC for RNG-related procurement made under its standards.[83] RNG assets acquired under the CPP will flow through this mechanism, yet those costs have no statutory or regulatory underpinning guiding cost recovery.[84] Further, the Commission has held that "natural gas utilities already have processes that could allow them to fully recover costs associated with RNG programs through existing rules."[85] Although it is clear that NWN does not require an AAC to recover RNG costs acquired under SB 98 and the CPP, CUB brought a proposal forward as a reasonable compromise that balances the interests of the utility and its customers in furtherance of the Commission's mandate[86] and promotes judicial efficiency.[87]

CUB continues to advocate for an RNG AAC that includes the following provisions:

- All costs associated with RNG investments will be tracked separate from base rates in the RNG cost recovery mechanism.

[82] UG 435 – CUB/500/Gehrke/8.

[83] *In re Rulemaking Regarding the 2019 Senate Bill 98 Renewable Natural Gas Programs*, OPUC Docket No. AR 632, Order No. 20-227 at 14 (Jul. 16, 2020) ("The legislature directed us, in ORS 757.394(3), to adopt rules to establish a *process* for natural gas utilities to fully recover the costs associated with a large or small renewable natural gas program, with the legislature further mandating, in ORS 757.396(2), that our adopted ratemaking mechanisms, which *may* include an AAC (as specified in ORS 757.396(2)(a)), permit recovery of the costs that a large natural gas utility incurs to meets the statute's targets in ORS 757.396(1). We do not agree with NW Natural that ORS § 757.394(3)(b) and ORS § 757.396(2) change the latter statute's use of the word "may" to "must" with regard to use of an AAC.") (emphasis in original).

[84] UG 435 – CUB/500/Gehrke/13, lines 12-14.

[85] OPUC Order No. 20-227 at 14.

[86] *Supra,* note 5.

[87] *See generally* UG 435 – CUB/500/Gehrke. CUB's proposal to allow for true-ups only in circumstances where the utility's earnings exceed a 100 basis point deadband will ease the procedural requirements necessary to conduct annual true-ups and prudence determinations under NWN's proposal. Further, by limiting rate changes to November 1 of each year, RNG AAC proceedings can be adequately planned for by the Commission and all affected stakeholders.

- NWN will file to update RNG investment costs using a forward test year on February 28 of each year. The February 28 filing will include the cost of new RNG projects that are not included in rates. The rate effective date for costs in the mechanism will be November 1. This process will give the stakeholders adequate time to review proposed RNG qualified investments.
- NWN will file an update on August 1, which allows the Company to update the cost of existing RNG projects.
- NWN will include the projected revenue requirement associated with new RNG assets and will annually update the forecasted cost of previously approved RNG projects in rates.
- NWN will only be allowed to add new RNG assets on November 1 of each year.
- Prior to changing rates on November 1, NWN will attest that all RNG projects are currently operating and providing utility service to Oregon customers. If a project is no longer producing and is retired while there is still undepreciated capital investment associated with the project, NWN will remove that project from the calculation of its return on rate base from the mechanism. If the Commission finds that the project was removed from service in the public interest, then the Company would be allowed to recover the remaining undepreciated capital investment and earn the time value of money on its undepreciated capital investment.
- The Company will not be allowed to file for a deferral between the in-service date of the RNG project and the rate effective date.

- The Company will be allowed to defer differences between forecasted and historic RNG costs and actual costs, subject to an earnings test. The earning test eliminates any annual RNG cost adjustment if the Company earn within a one hundred basis points deadband around its allowed return on equity (ROE).
- Once NW Natural expects to meet the cost cap in SB 98, NW Natural will meet to discuss changes to the mechanism, and address how ratemaking should occur once the cost cap is reached.[88]

CUB's proposal offers the utility a fair opportunity to recover its prudently-incurred RNG costs while ensuring the totality of risk associated with procuring these new assets is not shifted to customers.[89] In providing NWN the opportunity to recover its prudently-incurred RNG costs, CUB's mechanism aligns with the Commission's stated ultimate ratemaking goal[90] while also furthering ORS § 757.396(2), even though only a portion of costs that flow through the RNG AAC will be procured under that statute.[91]

NWN continues to take issue with several elements of CUB's proposal despite its fair and collaborative nature. The Company continues to erroneously assert that ORS § 757.396(2) from SB 98 requires dollar-for-dollar recovery of RNG-related costs.[92] However, there are also several elements of the RNG AAC upon which Staff, CUB, and the Company agree.[93] The Company accurately described the remaining sources of disagreement in its Surrebuttal Testimony:

[88] UG 435 – CUB/500/Gehrke/8-9.
[89] *See, e.g,* UG 435 – CUB/200/Gehrke/22, lines 16-19.
[90] OPUC Order No. 08-487 at 7 (According to the Commission, its "ultimate goal is to set rates that provide the utility the opportunity to collect enough revenue to recover reasonable operating expenses and to earn a reasonable rate of return on investments it had made to provide service.") (emphasis added).
[91] UG 435 – CUB/500/Gehrke/13, lines 9-16.
[92] UG 435 – NW Natural/2500/Kravitz/10; CUB/500/Gehrke/10, lines 13-16.
[93] UG 435 – NW Natural/2500/Kravitz/3-4.

- Whether the Company can file for a deferral for the period between the in-service date of the RNG project and the rate effective date and, if so, whether that deferral should be subject to an earnings test.
- Whether the Company can add new RNG assets on a date other than November 1.
- Whether the Company can file for a deferral for differences between forecasted RNG costs and actual RNG costs from year to year, and if so, whether that deferral should be subject to an earning test.[94]

CUB continues to oppose the Company's request to file a deferral for the period between the in-service date and the rate effective date. Additionally, the Company should only be able to add new RNG assets to rates on November 1 in order to provide certainty to its customers, the Commission, and affected stakeholders. CUB is sensitive to NWN's concerns regarding the ability to true-up forecasted and actual RNG costs. CUB's proposal provides a balanced alternative that enables the Company to true-up actual RNG costs in years that its earnings deviate outside the range of reasonableness.[95]

1. ***A deferral between the rate effective date and in-service date is not legally required and would result in poor ratemaking policy.***

According to the Company, a deferral between the rate effective date and in-service date is necessary to comply with the cost recovery requirements in SB 98.[96] Additionally, NWN asserts that such a deferral is "appropriate to ensure that the AAC is fairly balanced between the

[94] UG 435 – NW Natural/2500/Kravitz//4, lines 10-18. CUB and NW Natural agree that, if a project is no longer producing and is retired while there is still undepreciated capital investment associated with the project, NW Natural will remove that project from its calculation of its return on rate base from the mechanism and it will earn the time value of money on its undepreciated capital investment. CUB agrees that it is not necessary to determine how to measure the time value of money in this proceeding. This determination can be made if an RNG project is retired early. *See* UG 435 – NW Natural/2500/Kravitz/4, fn. 6.
[95] UG 435 – CUB/500/Gehrke/18, lines 8-10.
[96] *See* UG 435 – NW Natural/2500/Kravitz/9-10.

Company and its customers."[97] CUB strongly disagrees with the Company's position on these issues and will address each in turn.

First, the Company's legal conclusions provided in testimony are misplaced, out-of-step with Oregon statutory construction precedent, and inappropriately parse Commission language in a manner that departs from its intent. According to the Company, "the Commission has already interpreted SB 98 and determined legislative intent."[98] As evidence for this incorrect assertion, NWN points to Commission language from Order No. 20-227 where the Commission adopted SB 98 administrative rules. There, the Commission stated that, "[t]he legislature directed us, in ORS § 757.394(3), to adopt rules to establish a process for natural gas utilities to fully recover the costs associated with a large or small renewable natural gas program . . . ."[99] The Company inaccurately portrays the Commission's language as a determination of legislative intent, although the Commission was merely paraphrasing the relevant SB 98 section and undertook no legal statutory interpretation analysis.

Statutory interpretation requires discerning the intent of the legislature.[100] The first step in doing so is examining "both the text and context of the statute."[101] If the legislature's intent is not clear from the text and context inquiry, the next step is considering legislative history.[102] If legislative intent is still unclear, the next step is to apply maxims of statutory construction.[103] In *State of Oregon v. Gaines*, the Oregon Supreme stated:

> ... there is no more persuasive evidence of the intent of the legislature than "'the words by which the legislature undertook to give expression to its wishes.'" *State ex rel Cox v. Wilson,* 277 Or 747, 750, 562 P2d 172 (1977) (quoting *U.S. v. American Trucking Ass'ns*., 310 US 534, 542-44, 60 S Ct 1059, 84 L Ed 1345 (1940)). Only the text of a

[97] *Id*. at 5, lines 2-5.
[98] *Id*. at 9, lines 10-11.
[99] *Id*. at 9, lines 11-15 citing OPUC Order No. 20-227 at 14 (Jul. 16, 2020).
[100] *Portland Gen. Elec. Co. v. Bureau of Labor & Indus*., 317 Or 606, 610 (1993) citing ORS § 174.020.
[101] *Id*.
[102] *Id*. at 611.
[103] *Id*. at 612.

> statute receives the consideration and approval of a majority of the members of the legislature, as required to have the effect of law. Or Const, Art IV,§ 25. The formal requirements of lawmaking produce the best source from which to discern the legislature's intent, for it is not the intent of the individual legislators that governs, but the intent of the legislature as formally enacted into law.[104]

Under Oregon law, the text and context of the statute in question are given the primary weight in the three step *State v. Gaines* statutory interpretation process.[105] When examining a statute's text and context, the Commission gives words of common usage "their plain, natural, and ordinary meaning."[106]

Contrary to the Company's assertion, the Commission did not evaluate the SB 98's plain meaning in Order No. 20-227, nor examine the statutory text in context. Nowhere in Order No. 20-227 does the Commission reference the prevailing statutory interpretation analysis articulated in *State v. Gaines.* This is appropriate, since AR 632 was a rulemaking proceeding wherein the Commission acted in a quasi-legislative capacity to adopt and implement rules to govern nascent RNG programs. A legal determination to discern the legislature's intent must be made in a contested case or declaratory ruling proceeding where parties can make legal arguments for the Commission to rule upon in its quasi-judicial capacity. Contrary to the Company's assertion,[107] the Commission should find that it has not conducted a statutory interpretation analysis of SB 98 and its related provisions. The statutory interpretation of SB 98's provisions is therefore an issue of first impression for the Commission.

The Commission's statutory interpretation inquiry should end after an examination of the plain meaning of the relevant text and context. ORS § 757.396(2) provides, in pertinent part,

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[104] *State v. Gaines*, 346 Or 160, 171 (2009).
[105] *In re Portland General Electric Company, Application for Transportation Electrification Programs*, OPUC Docket No.UM 1811, Order No. 18-054 at 7 (Feb. 16, 2018); *in re PacifiCorp, dba Pacific Power*, *Petition for Declaratory Ruling Regarding ORS 757.480*, OPUC Docket No. DR 47, Order No. 14-254 at 4 (Jul. 8, 2014).
[106] OPUC Order No. 14-254 at 4 citing *Portland Gen. Elec. Co. v. Bureau of Labor & Indus*., 317 Or 606, 859 (1993).
[107] UG 435 – NW Natural/2500/Kravitz/9-10.

that "[t]he commission shall adopt ratemaking mechanisms that ensure the *recovery of all prudently incurred costs* that contribute to the large natural gas utility's meeting the targets set forth . . . ."[108] As CUB alluded to in testimony, the Commission has already conducted statutory interpretation analysis of strikingly similar language. The Commission opened an investigation into the recovery of costs incurred to comply with the Renewable Portfolio Standard as authorized by ORS § 469A.120(1) in Docket No. UM 1662.[109] The language in ORS § 469A.120(1) provides that "*all prudently incurred costs* associated with complying with ORS 469A.005 to 469A.210 *are recoverable* in the rates of an electric company."[110] Both ORS § 469A.120(1) and ORS § 757.396(2) enable the utilities procuring resources under the RPS and RNG standards, respectively, to recover all prudently incurred costs associated with meeting these targets. This is the language the Commission should interpret when considering whether it requires dollar-for-dollar cost recovery, as the Company posits.[111]

In applying *State v. Gaines* to ORS § 469A.120(1) in Order No. 15-408, the Commission held that, "[b]ased on our plain reading of the statute, we agree . . . that ORS 469A.120(1) does not mandate dollar-for-dollar recovery of all RPS costs, but rather allows the utilities the *opportunity* to recover their variable costs."[112] The Commission should similarly conclude that the plain meaning of the nearly identical language in ORS § 757.396(2) does not mandate dollar-for-dollar cost recovery. While the Company is correct that the AAC under ORS § 469A.120 does enable a deferral between the in-service date and rate effective date of RPS resources,[113] NWN would be effectively granted dollar-for-dollar cost recovery if its RNG-related investments

[108] *See* UG 435 – CUB/500/Gehrke/11-12 (emphasis added).
[109] *Id*. at 12
[110] Emphasis added.
[111] UG 435 – CUB/500/Gehrke/10, lines 13-16; NW Natural/2500/Kravitz/9-10.
[112] OPUC Order No. 15-408 at 6-7 (emphasis added).
[113] UG 435 – NW Natural/2500/Kravitz/10, lines 7-11.

were granted the same deferral in this proceeding along with RNG AAC contours it seeks.[114] CUB's proposal aligns with the statutory directives in ORS § 757.396(2) by providing the utility the opportunity to recover its prudently incurred RNG costs.

Further, the Commission should not be persuaded by the Company's attempt to use language from CUB's AR 632 comments to bolster its position.[115] There, CUB stated that, "[a] plain reading of this language [SB 98] demonstrates that the Commission is mandated (i.e. 'shall') to adopt ratemaking mechanisms to ensure the recovery of the utility's prudently incurred costs."[116] NWN is inaccurately parsing CUB's position. In that quotation, CUB was merely recognizing that the use of "shall" means that the Commission "must" *adopt ratemaking mechanisms*. CUB was not indicating that the Commission must grant NWN dollar-for-dollar RNG cost recovery. Also, according to the Commission, "natural gas utilities already have processes that could allow them to fully recover costs associated with RNG programs through existing rules."[117] Therefore, by the Commission's logic, SB 98's requirements around cost recovery have already been met. Again, CUB's proposal was brought forward as a reasonable compromise that is sensitive to the Company's concerns.

Second, contrary to NWN's claim,[118] CUB's proposal more fairly balances the interests of the Company and its customers. The deferral NWN seeks between the in-service and rate effective date of RNG projects only applies to the first year of the given project's operation. In the first year, and in each subsequent year, CUB's proposal will enable the Company to update RNG costs on August 1 and will enable it to recover the difference between the RNG forecast

[114] UG 435 – CUB/500/Gehrke/11, lines 12-15
[115] UG 435 – NW Natural/2500/Kravitz/9-10.
[116] *Id*. citing 7 *in re Rulemaking Regarding the 2019 Senate Bill 98 Renewable Natural Gas Programs,* OPUC Docket AR 632, CUB Comments at 2 (April 27, 2020) (available at: https://edocs.puc.state.or.us/efdocs/HAC/ar632hac162912.pdf).
[117] OPUC Order No. 20-227 at 14.
[118] *Supra,* note 92.

and actuals when specific parameters are met. NWN's argument that it should avoid regulatory lag on the front end of RNG investments because depreciation is updated annually is unpersuasive.[119] CUB's proposed mechanism is already more favorable to the Company than RNG cost recovery under traditional ratemaking would be, and the Commission has signaled that traditional ratemaking treatment aligns with the spirit of SB 98.[120]

CUB's proposal provides NWN the opportunity to recover its prudently incurred RNG costs. The primary tool that the Commission uses to allow recovery of prudently incurred costs is forecasting those costs and setting rates that are sufficient to recover that forecasted cost. SB 98's language does not indicate that the Company is required to enjoy dollar-for-dollar cost recovery.[121] Further, SB 98 requires that NWN recover RNG costs consistent with its approved cost of capital, including its rate of return, approved in its most recent general rate case.[122] According to the Commission, "the rate of return set in a general rate case for each utility . . . reflect[s] an assessment of the overall level of financial risk faced by the utility with regard to forecasted costs and revenues."[123]

Under the Company's proposal, it would face little to no risk surrounding RNG cost recovery, yet it would enjoy a profit margin set at a rate of return meant to compensate it for incurring risk. For example, if an RNG facility failed to operate due to normal business risk during the winter heating season and the RNG facility did not produce expected gas sales revenue, under NWN's proposal, the Company's shareholders would be guaranteed to earn their ROE associated with the RNG facilities.[124] Meanwhile, NWN's customers would be exposed to

[119] UG 435 – NW Natural/2500/Kravitz/6.
[120] OPUC Order No. 20-227 at 14.
[121] UG 435 – CUB/500/Gehrke/10-11.
[122] ORS § 757.396(3).
[123] *In re Public Utility Commission of Oregon, Staff Request to Open an Investigation Related to Deferred Accounting*, OPUC Docket No. UM 1147, Order No. 05-1070 at 14 (Oct. 5, 2005).
[124] UG 435 – CUB/500/Gehrke/15.

production risk and would bear the brunt of the revenue shortfall. In addition, NWN's customers will be exposed to a number of risks associated with RNG procurement since this is a new venture into RNG production for the historically distribution-centric company.[125]

NWN's proposal for a deferral to track RNG costs between the in-service date would result in an inequitable distribution of cost and risk, with the Company's customers holding the short end of the stick. The Company's proposal is not grounded in any legal obligation and should be rejected.

2. ***CUB's proposal for a November 1 RNG rate effective date is reasonable.***

CUB continues to urge the Commission to adopt its proposal to require a November 1 rate effective date for RNG costs as it will provide price certainty to NWN's customers and ease the administrative burden on the Commission and stakeholders. Absent the deferral between the in-service and rate effective dates that it seeks, NWN argues that the rate effective date of RNG assets should be flexible.[126] NWN's proposal would lead to an influx of rate changes affecting its customers and would be difficult to track. The Company acknowledges that it anticipates making rate changes on November 1 of each year.[127] CUB offers this proposal to minimize the frequency of rate changes experienced by NWN's customers, and the November 1 date aligns with rate changes experienced by the Purchased Gas Adjustment and recent NWN rate cases.[128] The Commission should adopt CUB's proposal and reject the Company's attempt to pursue dollar-for-dollar cost recovery by shifting the November 1 rate effective date to serve its interests. Adopting NWN's proposal would benefit the Company while burdening its customers and stakeholders.

[125] UG 435 – CUB/200/Gerke/22; CUB/500/Gehrke/16.
[126] UG 435 – NW Natural/2500/Kravitz/11.
[127] UG 435 – NW Natural/2500/Kravitz/11.
[128] UG 435 – CUB/500/Gehrke/20, lines 14-16.

3. *An earnings test set at 100 basis points above or below the Company's authorized ROE for the true-up deferral is reasonable.*

CUB continues to urge the Commission to adopt its proposal to set an earnings test at 100 basis points above or below the Company's authorized ROE for the deferral that tracks differences between forecasted and actual RNG costs. CUB's proposal is again brought in the spirit of compromise to dispel NWN's concerns around RNG cost recovery. Both Staff and CUB agree that an earnings test is important to incent the Company to operate efficiently.[129] The Company would otherwise have no incentive to keep RNG costs in check, since it would be eligible to recover all actual RNG costs. The Company's argument that it retains an incentive to operate efficiently by virtue of the fact that it must demonstrate prudence should be rejected.[130] An earnings test set at 100 basis points above or ROE preserves this important incentive and aligns with Commission precedent.

While a specific targeted ROE is usually established to set rates in a general rate case, returns for a utility are considered reasonable if they are within a range.[131] The Commission stated the following when ordering a 100 basis point earnings test for Portland General Electric Company's Power Cost Adjustment Mechanism—another mechanism that uses a forecast and a subsequent true-up if certain parameters are met:

> An earnings test serves to protect customers from paying for higher-than-expected [ ] costs when the utility's earnings are reasonable, while it protects the Company from refunding [ ] cost savings when it is underearning. We establish an earnings deadband of ± 100 basis points around the company's allowed ROE, for two reasons. First, although we use a specific ROE to set rates, there is a range of acceptable returns on equity. *See Duquesne Light Co. v. Barasch*, 488 US 299, 312 (1989). Second, an earnings review does not determine a company's actual ROE with the same accuracy as a full rate case, because the company's costs are not examined as thoroughly in the earnings review.[132]

[129] UG 435 – Staff/1800/Muldoon/22.
[130] UG 435 – NW Natural/2500/Kravitz/19, lines 12-15.
[131] *Duquesne Light Co. v. Barasch*, 488 US 299, 312 (1989).
[132] *In re Portland General Electric Company,* OPUC Docket Nos. UE 180, UE 181, UE 184, Order No. 07-015 at 26 (Jan. 12, 2007).

CUB's earnings test proposal therefore provides valuable protections to both the Company and its customers. Further, because the Company will be adding RNG costs in between general rate cases while using the cost of capital authorized in its last general rate case, a 100 basis point deadband provides a sufficient buffer to account for changes in the utility's system that would affect its return since its last general rate case. CUB's proposal is also durable and can accommodate changes in the utility's ROE over time. The Commission has held that a similar earnings test was appropriate to provide an incentive and protect both the Company and its customers in a similar mechanism, and it should do so here.

NWN offered an alternative in Surrebuttal Testimony that had not been previously addressed on the record. The Company proposed that, rather than subjecting this deferral to an earnings test, it would only seek to defer the difference between the forecasted and actual revenues of physical gas sales from its RNG projects.[133] CUB opposes the Company's proposal. Even though it was arguably procedurally proper, CUB was unable to analyze the Company's proposal on the evidentiary record in this proceeding since it was brought so late. Further, the Commission has held that an earnings test applied to natural gas purchases and sales provides a meaningful incentive for gas utilities to minimize their gas costs.[134] Under its Purchased Gas Adjustment Mechanism, NWN's earnings test is set to 100 basis points above or below its ROE.[135] The Commission should apply this on-point precedent from the PGA to RNG sales and purchases that would flow through the RNG AAC.

[133] UG 435 – NW Natural/2500/Kravitz/20, lines 6-10
[134] *In re Public Utility Commission of Oregon*, OPUC Docket No. UM 1286, Order No. 08-504 at 17-18 (Oct. 21, 2008).
[135] *Id*.

In addition, the purpose of an earnings test is not to deny recovery of deferred costs, but to see if rates are already sufficient. An earnings test aims to examine the utility's level of earnings while also considering the additional cost sought to be recovered. If the earnings are reasonable, there is no basis to raise rates to ensure recovery of the cost. Current rates would therefore already be sufficient to allow recovery of prudently incurred costs.

CUB's earnings test proposal treats both the Company and its customers fairly and is grounded in fact and established Commission precedent.

C. RNG Rate spread

CUB continues to urge the Commission to allocate RNG costs on an equal cents per therm basis to all customers, including special contracts customers.[136] NWN and CUB agree this treatment is appropriate because the CPP made the Company the single point of regulation for all emissions on its distribution system, including those driven by special contracts customers.[137] All NWN customers will be driving emissions through natural gas end use that, in turn, drive up CPP compliance costs for the entire system.[138] It is therefore appropriate for all of NWN's customers to bear the costs of this government-mandated program under the basic ratemaking principle of cost causation. Equitable considerations further dictate that CUB's proposed allocation is proper. The Commission should not be persuaded by AWEC's attempt to avoid these costs for a subset of the customers it represents.

AWEC's position on this issue is narrowly focused on rate spread for the Lexington RNG project.[139] NWN and CUB's proposals would establish rate spread for RNG projects generally—an approach that would obviate the need to litigate RNG rate spread in future

[136] UG 435 – CUB/500/Gehrke/1-2.
[137] *Id*. at 2.
[138] UG 435 – CUB/400/Jenks/12-13.
[139] UG 435 – AWEC/200/Mullins/3.

proceedings. According to AWEC, since the Lexington RNG facility was procured for SB 98 purposes its costs should only apply to sales customers.[140] AWEC's simplistic argument fails to account for the fact that Oregon's carbon regulatory regime has changed dramatically since Lexington was originally conceived. With the advent of the CPP, carbon emissions and attendant costs are being driven by all customers on NWN's system within the Test Year. Further, the Company "expects that the Lexington RNG project will assist it in complying with [the CPP]."[141]

According to AWEC, the CPP is not a reason to depart from the requirements of SB 98.[142] AWEC also asserts that the Lexington RNG project will have "an immaterial contribution toward meeting CPP compliance obligations."[143] AWEC's assertion is provided without citation and fails to address the core issue of CUB and NWN's RNG rate spread proposal—all customers are driving compliance costs, so all customers should pay for resources that help meet compliance obligations. The magnitude of Lexington's effect towards CPP compliance is not at issue. Nor is NWN's overall CPP compliance strategy. Rather, here, the exercise is to set a reasonable and durable rate spread proposal that will be used for RNG assets going forward. AWEC's proposal also ignores the fact that utility assets routinely evolve over time. Just because Lexington was originally acquired for SB 98 does not mean that its costs should be allocated accordingly for its lengthy useful life.[144]

AWEC's argument that it is not practicable to reopen special contracts in this proceeding is similarly unpersuasive.[145] First, no party has advocated for changing the terms of the special

[140] *Id*. AWEC notes that SB 98 only applies to "gas purchased by the large natural gas utility for distribution to retail natural gas customers." ORS § 757.396(a).
[141] UG 435 – NW Natural/1100/Chittum/6, lines 1-2.
[142] UG 435 – AWEC/200/Mullins/6.
[143] *Id.* at 6-7.
[144] UG 435 – CUB/500/Gehrke/5.
[145] UG 435 – AWEC/200/Mullins/7

contracts in this proceeding. The Company has indicated it can simply defer the revenue requirement until the contracts can be amended—it is a straightforward process.[146] Further, every special contract contains terms that **[Begin Confidential]** [redacted] **[End Confidential]** NWN is a party to all of these contracts and does not indicate that the challenges AWEC perceives are insurmountable. The Commission retains tremendous authority to establish just and reasonable rates,[148] and can alter NWN's regulatory and cost recovery regime to meet this mandate. The Commission should not be persuaded by AWEC's attempt to evoke fictitious contractual limitations to achieve a desired regulatory outcome.

The proposal offered by CUB and NWN fairly allocates the government-mandated costs of decarbonizing the Company's system to all customers. All customers are driving emissions reduction costs and all should contribute to the RNG assets developed to meet Oregon's climate mandates. Enabling a subset of the Company's customers to avoid these costs would result in inequity. Large gas customers are able to switch between transport and sales service.[149] If transport customers were allowed to sidestep these costs, there could be an influx of customer load seeking transport service, which would require NWN's remaining customers to shoulder the burden of decarbonizing for all customers. CUB has consistently advocated for this position

[146] *Id*. at 7-8.
[147] *See* UG 435 – CUB/601/8 CONF; CUB/601/19 CONF; CUB/602/9 CONF; CUB/605/1-2 CONF; CUB/606/6 CONF; CUB/609/7 CONF; CUB/610/7 CONF; CUB/611/7 CONF; CUB/612/6 CONF.
[148] *Supra,* note 21.
[149] *See in re Natural Gas Transportation Services*, OPUC Docket No. UG 23, Order No. 89-406 at 5 (Mar. 23, 1989) ("The Commission's goals in this proceeding have been to . . . protect core customers from unwarranted cost shifts by making them indifferent to a discretionary customer's selection of transportation service or its return to sales service.").

since the enactment of the CPP, and respectfully requests that the Commission adopt its proposal.

III. CONCLUSION

For the foregoing reasons, CUB respectfully recommends that the Commission adopt its proposals in this proceeding

Dated this 10th day of August, 2022.

Respectfully submitted,

Michael P. Goetz, OSB #141465
General Counsel
Oregon Citizens' Utility Board
610 SW Broadway, Ste. 400
Portland, OR 97205
T. (503) 227-1984
E. mike@oregoncub.org

UG 435 and UG 411 – CERTIFICATE OF SERVICE

I hereby certify that, on this 10th day of August, 2022, I served the **Confidential Opening Brief of the Oregon Citizens' Utility Board** in docket UG 435 upon the Commission and each party designated to receive confidential information pursuant to Order 21-461 through a secure, encrypted attachment to an e-mail.

AWEC	
CHAD M STOKES **(C) (HC)** CABLE HUSTON LLP	1455 SW BROADWAY STE 1500 PORTLAND OR 97201 cstokes@cablehuston.com
CUB	
WILLIAM GEHRKE **(C) (HC)** OREGON CITIZENS' UTILITY BOARD	610 SW BROADWAY STE 400 PORTLAND OR 97206 will@oregoncub.org
MICHAEL GOETZ **(C) (HC)** OREGON CITIZENS' UTILITY BOARD	610 SW BROADWAY STE 400 PORTLAND OR 97205 mike@oregoncub.org
EARTHJUSTICE	
KRISTEN L BOYLES **(C) (HC)** EARTHJUSTICE	810 THIRD AVE STE 610 SEATTLE WA 98104 kboyles@earthjustice.org
ADAM HINZ **(C) (HC)** EARTHJUSTICE	810 THRID AVENUE STE 610 SEATTLE WA 98104 ahinz@earthjustice.org
JAIMINI PAREKH **(C) (HC)** EARTHJUSTICE	810 THIRD AVENUE STE 610 SEATTLE WA 98104 jparekh@earthjustice.org
NW NATURAL	
ERIC NELSEN **(C) (HC)** NORTHWEST NATURAL	250 SW TAYLOR ST PORTLAND OR 97204 eric.nelsen@nwnatural.com
JOCELYN C PEASE **(C) (HC)** MCDOWELL RACKNER GIBSON PC	419 SW 11TH AVE STE 400 PORTLAND OR 97205 jocelyn@mrg-law.com
SBUA	

DIANE HENKELS **(C)** SMALL BUSINESS UTILITY ADVOCATES	621 SW MORRISON ST. STE 1025 PORTLAND OR 97205 diane@utilityadvocates.org
DANNY KERMODE **(C)** No Business Name	5553dkcpa@gmx.us
STAFF	
STEPHANIE S ANDRUS **(C) (HC)** PUC STAFF--DEPARTMENT OF JUSTICE	BUSINESS ACTIVITIES SECTION 1162 COURT ST NE SALEM OR 97301-4096 stephanie.andrus@doj.state.or.us
MATTHEW MULDOON **(C) (HC)** PUBLIC UTILITY COMMISSION OF OREGON	
CARRA SAHLER **(C)** LEWIS & CLARK LAW SCHOOL	10101 S TERWILLIGER BLVD PORTLAND OR 97219 sahler@lclark.edu

Respectfully submitted,

Thomas Jerin
Operations Manager
Oregon Citizens' Utility Board
610 SW Broadway, Ste. 400
Portland, OR 97205
503.227.1984
dockets@oregoncub.org