BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 435

In the Matter of NW Natural Gas Company Request for a General Rate Revision	**STAFF OPENING BRIEF**

I. Introduction.

NW Natural filed its request for a general rate revision on December 17, 2021, seeking a $73,464,854 or 16.5% margin revenue requirement increase in its initial filing. On February 28, 2022, NW Natural made an errata filing identifying an error in its initial filing and revising its calculation to a $78,030,413 or 17.5% revenue margin increase. The Alliance of Western Energy Consumers (AWEC), the Oregon Citizens' Utility Board (CUB), the Small Business Utilities Advocate (SBUA), and the Coalition of Communities of Color, Climate Solutions, Verde, Columbia Riverkeepers, Oregon Environmental Council, Community Energy Project, and Sierra Club have intervened in this docket and all have filed testimony regarding NW Natural's requested increase.

Staff has stipulated to the resolution of almost all issues presented by NW Natural's rate filing and to a reduction to NW Natural's requested revenue requirement increase, which if approved will result in what Staff believes to be just and reasonable rates. Staff relies on NW Natural to discuss the stipulations in its Opening Brief and reserves the right to address opposition in Staff's Closing Brief. In this brief, Staff will address the issues not resolved by stipulation, which include cost recovery for NW Natural's investment in renewable natural gas and proposals by CUB and the Coalition regarding NW Natural's line extension policy.

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II. Cost Recovery of the Lexington RNG Project.

In 2019, the Oregon legislature adopted Senate Bill (SB) 98 establishing a program to encourage the acquisition of renewable natural gas (RNG), finding that renewable natural gas "provides benefits to natural gas utility customers and to the public" and that "[t]he development of renewable natural gas resources should be encouraged to support a smooth transition to a low carbon energy economy in Oregon."[1] The program is not mandatory but establishes targets for RNG investments that increase every five years. SB 98 required the Commission to adopt rules to implement the program and to establish a ratemaking mechanism for utilities to recover costs of participating in the program.[2]

The Commission adopted rules implementing SB 98 in 2020 in Docket No. AR 632.[3] The Commission's rules specify that a large gas utility may seek to recover its costs for the program through a general rate case, its Purchased Gas Adjustment (PGA) Mechanism, or through implementation of an automatic adjustment clause.[4]

NW Natural's first investment under SB 98 is the Lexington RNG Project. The Project cost approximately $8.4 million and is located at the Tyson Fresh Meats, Inc. facility in Lexington Nebraska. The facility was developed and marketed to NW Natural by two developers, BioCarbN and Cross River Partners (collectively BioCross), and acquired in an RFP procurement process. The biogas facility uses an anerobic digester to convert animal waste products from the Tyson facility into unrefined biogas. The biogas, which is a low-quality gas consisting of high proportions of carbon dioxide, hydrogen sulfide and other impurities, is processed into pipeline grade gas through a filtering system owned by a joint venture between NW Natural and the BioCross. Separately, NW Natural has a gas offtake agreement with the

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[1] SB 98 (2019) is codified at ORS 757.390 - .398.

[2] ORS 757.396(1) and (2).

[3] *In the Matter of Rulemaking Regarding the 2019 SB 98 Renewable Natural Gas Program,* AR 632, Order No. 20-227 (July 16, 2020).

[4] OAR 860-150-0300.

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joint venture, through which it purchases the processed gas from the Lexington Partnership, including the underlying Renewable Thermal Certificates ("RTCs"). Under the offtake agreement, NW Natural acquires RNG based on an escalating schedule, retains the RTCs, and subsequently sells the brown gas into the local pipeline.[5]

NW Natural proposes Schedule 198, an automatic adjustment clause (AAC), to recover costs of the Lexington RNG Project and future SB 98 projects. At issue in this rate case is whether the Lexington RNG Project meets the criteria of SB 98 and is prudent, what amount of costs are eligible for recovery by NW Natural, whether the Commission should adopt an AAC for cost recovery and if so, how should the AAC be designed, and finally, how should costs for the Project be spread across NW Natural's customers.

A. The Lexington Project is prudent and eligible for recovery under SB 98.

Staff believes the Lexington RNG project complies with SB 98 and is eligible for cost recovery under ORS 757.390 -.398 and the Commission's rules implementing those statutes.[6] No party disputes that the investment meets the criteria for meeting the target established for NW Natural under SB 98. The Coalition initially disputed the prudence of the Lexington Project on the ground it could not be used for compliance with Oregon's Climate Protection Plan (CPP). However, in its rebuttal testimony, the Coalition withdrew its arguments regarding the prudence of the Lexington RNG Project, citing the fact the Lexington Investment predated adoption of the CPP.

Staff also does not believe compliance with the CPP is pertinent to whether the Lexington RNG Project is prudent given the timing of the Lexington investment. Staff reviewed the details of the Lexington RNG Project to determine whether it qualifies for cost recovery under SB 98 and finds NW Natural's decision to proceed with the investment was reasonable given what NW Natural knew at the time of the investment. However, as Staff testified, Staff believes NW

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[5] NWN/100, Chittum/7.

[6] Staff/1800, Muldoon/7-8.

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Natural should ensure its future SB 98 investments can be used for compliance with the CPP prior to making the investment. To do otherwise would likely not be cost effective for customers.

B. NW Natural should be allowed to recover its forecasted revenue requirement for the Lexington Project, but not the deferred capital costs.

NW Natural calculates an annual revenue requirement for the Lexington RNG Facility of $1,911,069. However, NW Natural proposes to recover this revenue requirement plus deferred capital costs of the Lexington Project, which brings the total to $3,291,859 to be recovered through the proposed AAC. Staff believes the forecasted annual revenue requirement of $1,911,069 is reasonable and supported by evidence in the record. However, as explained more fully below, Staff opposes recovery of NW Natural's deferred capital costs through the automatic adjustment clause. Accordingly, Staff recommends the Commission authorize NW Natural to recover only $1,911.069 through the AAC.

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

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

Staff does not oppose using an AAC to recover costs of SB 98 investments but does oppose NW Natural's proposal to defer capital costs of new projects and/or change the effective of the annual update to avoid regulatory lag. Specifically, Staff recommends the Commission adopt an AAC with the following elements:

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

Staff also supports CUB's proposal regarding retired RNG plant. Under CUB's proposal, NW Natural will attest that all RNG projects are currently operating and providing utility service to Oregon customers prior to the November 1 rate change. 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 base from the mechanism and will earn the time value of money on its undepreciated capital investment.[7]

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

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

Allowing NW Natural to recover costs through an AAC allows NW Natural to manage regulatory lag with a predictable annual rate change. Further, under the AAC, the interval

[7] CUB/500, Gherke/10.

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between the on-line date of a new investment and the date NW Natural begins recovering the cost of the investment in rates can be no more than one year. In ordinary ratemaking, regulatory lag is the time between the online date and rate effective date of a general rate case, which is not necessarily less than one year. Finally, an AAC allows NW Natural to recover costs of new investment without opportunity for a full review of NW Natural's other expenditures. This means NW is allowed to increase its rates for one cost category without opportunity for staff and stakeholders to determine whether some adjustments to NW Natural's revenue requirement are appropriate to recognize cost savings or over recovery in other areas.

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

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

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

Staff disagrees with NW Natural that a deferral of capital costs from the date an RNG investment is on-line is required under SB 98 or the Commission's rules implementing SB 98. ORS 757.396(2) provides, in pertinent part:

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> (2) The 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 in subsection (1) of this section. Pursuant to the ratemaking mechanisms adopted under this subsection:
>
> (a) Qualified investments and operating costs associated with qualified investments that contribute to the large natural gas utility meeting the targets set forth in subsection (1) of this section may be recovered by means of an automatic adjustment clause, as defined in ORS 757.210.
>
> (b) Costs of procurement of renewable natural gas from third parties that contribute to the large natural gas utility meeting the targets set forth in subsection (1) of this section may be recovered by means of an automatic adjustment clause, as defined in ORS 757.210, or another recovery mechanism authorized by rule.

The Commission has previously interpreted similar language found in Oregon's Renewable Portfolio Standard (RPS) statute, ORS 469A.120(1).[8] ORS 469A.120(1) provides, in pertinent part, "[e]xcept as provided in ORS 469A.180(5), all prudently incurred costs associated with compliance with a renewable portfolio standard are recoverable in the rates of an electric company." In a 2015 investigation, Portland General Electric Company (PGE) and PacifiCorp argued that this language required the Commission to allow dollar-for-dollar recovery of costs to comply with Oregon's RPS. The Commission disagreed. The Commission concluded the statute does not mandate dollar-for-dollar recovery of costs.

The same conclusion is called for here and in 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 case or through a request for an automatic adjustment clause and can seek to recover costs of purchased RNG through its purchased gas adjustment.[9] Cost recovery under a PGA is subject to an earnings test with possible disallowances. Recovery of capital costs under a

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[8] *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).

[9] OAR 860-150-0300.

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general rate case is generally subject to regulatory lag if the new facilities do not come on-line immediately before the effective date of a general rate revision. Although automatic adjustment clauses often include a deferral, this deferral is used to capture a variance between forecasted and actual costs and is not typically used to capture costs of new plant in service prior to the time that plant is included in rates. For example, the most comparable AACs, those for RPS-compliant investments by electric utilities, do not include deferred capital costs.

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

NW Natural asserts the Commission indicated its support NW Natural's preferred form of AAC by noting at the time it adopted rules implementing SB 98 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[.]"[10] However, as discussed above, a review of the rules adopted by the Commission shows the Commission was not intent on ensuring dollar-for-dollar recovery of SB 98-compliant investment. Instead, the Commission adopted rules that authorized traditional mechanisms that include regulatory lag (general rate case) and disallowances when a utility's earnings are sufficient (PGA). The fact the Commission used the term "fully recover" in its order adopting the rules does not change their substantive effect.

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[10] NWN/2500, Kravitz/9 (emphasis in original).

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

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

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

E. Costs of SB 98 should be spread to Transportation Customers.

Staff, CUB, and NW Natural support spreading costs recovered under the AAC to all customers but storage customers on an equal cents per therm basis. AWEC opposes this proposed rate spread arguing NW Natural is not authorized to spread costs of SB 98 investments to transportation customers. AWEC also argues that SB 98 costs should be spread to all other customers on an equal percent of margin basis. Staff disagrees with both arguments.

AWEC argues that NW Natural is not allowed to spread SB 98 costs to transportation customers because NW Natural is only allowed to acquire RNG for the purpose of meeting the targets in ORS 757.396(a) and those "targets are for "gas purchased by the large natural gas

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utility for distribution to retail natural gas customers in Oregon that is renewable natural gas".[11] AWEC argues Senate Bill 98 did not provide NW Natural with authority to purchase RNG for transportation customers and NW Natural is not otherwise authorized to purchase gas requirements, renewable or otherwise, for transportation customers.

Staff disagrees with this argument. The appropriate cost allocation for investments authorized by SB 98 should not depend on how the investment targets are measured but on the purpose of the investments and the benefits they provide. SB 98 includes the following legislative findings and declarations:

> (1) The Legislative Assembly finds and declares that: (a) Renewable natural gas provides benefits to natural gas utility customers and to the public; and (b) The development of renewable natural gas resources should be encouraged to support a smooth transition to a low carbon energy economy in Oregon.
>
> (2) The Legislative Assembly therefore declares that:
>
> (a) Natural gas utilities can reduce emissions from the direct use of natural gas by procuring renewable natural gas and investing in renewable natural gas infrastructure;
>
> (b) Regulatory guidelines for the procurement of renewable natural gas and investments in renewable natural gas infrastructure should enable the procurements and investments while also protecting Oregon consumers; and
>
> (c) Renewable natural gas should be included in the broader set of low carbon resources that may leverage the natural gas system to reduce greenhouse gas emissions.

The legislative findings make clear the legislature's goals for the RNG Program are not to directly benefit NWN's distribution customers with service of a particular kind of gas, but to promote lowered carbon emissions for "natural gas utility customers and the public." There is no reason that costs of these intended benefits should be exclusively borne by NWN's distribution customers.

The fact the targets described in SB 98 are based on how much gas NW Natural purchases for distribution to retail customers does not change who benefits from NW Natural's

[11] AWEC/100, Mullins/33.

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investment in the Lexington Project. NWN's customers are not being served with the Lexington Project. The costs to acquire the RNG gas from Lexington are offset by revenues the utility acquires from selling the brown gas to other buyers. Accordingly, the costs to be allocated in this proceeding are costs incurred to acquire the renewable attributes of RNG.

NWN's distribution customers do not receive some benefit from Lexington Project that transportation customers do not. Instead, to the extent distribution customers receive benefits from NWN's Lexington project, the benefits are as described by the legislature -- reduced emissions and the transition to low carbon energy economy in Oregon -- no different than benefits received by transportation customers.

F. Costs recovered through the SB 98 AAC should be recovered on an equal cents per therm basis.

Staff, NW Natural, and CUB support allocating costs recovered through the SB 98 AAC on an equal cents per them basis from all customers but storage customers. Staff believes this allocation methodology is appropriate given the generally applicable nature of the benefits of RNG investment as they are described in the legislative findings and declarations of SB 98.

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

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

Staff recommends the Commission find that the issues raised by the Coalition and CUB are complex matters applicable to all natural gas utilities, and more appropriately handled in a separate docket. Staff believes there is considerable benefit to a common decision-making

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framework applicable to all three natural gas utilities. Further, Staff does not think it is appropriate to make a policy issue in this docket regarding gas utility line extension policies without first providing Avista and Cascade Natural Gas Company opportunity to participate in the discussion.

DATED this 10th day of August 2022.

Respectfully submitted,

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