

ORDER NO. 04-390

ENTERED JUL 13 2004

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**BEFORE THE PUBLIC UTILITY COMMISSION**

**OF OREGON**

UM 1156

In the Matter of	)	
	)	ORDER
NORTHWEST NATURAL	)	
	)	
Application requesting to classify the Integrity	)	
Management Program costs as capital	)	
expenditures.	)	

**DISPOSITION: APPLICATION APPROVED**

On June 4, 2004, Northwest Natural Gas Company (NW Natural) filed an application requesting an accounting order for classifying Integrity Management Program (IMP) costs as capital expenditures. As a result of the Pipeline Safety Improvement Act of 2002, the Office of Pipeline Safety and the Research and Special Programs Administration issued a rule<sup>1</sup> that adds incremental requirements on the operators of transmission pipelines and requires operators to identify transmission lines in certain "high consequence areas" in order to implement written integrity management programs for such areas. A description of the requirements is detailed in Staff's Report, attached as Appendix A, and incorporated by reference. NW Natural believes classifying IMP costs as capital expenditures is appropriate and reasonable, due to the new federally mandated inspection requirements. NW Natural's plan for recovery of costs associated with IMP activities is further outlined in Staff's Report.

At its Public Meeting on July 6, 2004, the Commission adopted Staff's recommendation to classify NW Natural's Integrity Management Program costs as capital expenditures.

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<sup>1</sup> Pipeline Safety: Pipeline Integrity Management in High Consequence Areas (Gas Transmission Pipelines) 68 Fed. Reg. 69778, amended in 69 Fed. Reg. 2307 and corrected in 69 Fed. Reg. 18277.

**ORDER**

IT IS ORDERED THAT Northwest Natural Gas Company's application requesting to classify Integrity Management Program costs as capital expenditures is approved pursuant to ORS 757.120 and ORS 757.125.

Made, entered and effective \_\_\_\_\_.

BY THE COMMISSION:

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**Becky L. Beier**  
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

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ITEM NO. 5

PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: July 6, 2004

REGULAR  X  CONSENT \_\_\_\_\_ EFFECTIVE DATE  June 4, 2004

DATE: June 22, 2004

TO: Lee Sparling through Ed Busch, Bonnie Tatom and Judy Johnson

FROM: Ed Durrenberger

SUBJECT: NORTHWEST NATURAL: (Docket No. UM 1156) Request to classify the Integrity Management Program costs as capital expenditures.

**STAFF RECOMMENDATION:**

Staff recommends the Commission approve Northwest Natural Gas Company's (NW Natural, NWN or company) request to classify the Integrity Management Program costs as capital expenditures. Staff will support the company's proposed revenue recovery methodology, which has been filed separately in Advice No. 04-10.

**DISCUSSION:**

On June 4, 2004, NW Natural filed an application requesting approval of an accounting order for classifying Integrity Management Program expenditures as capital and the revenue recovery methodology pursuant to ORS 757.120 and 757.125.

New federal requirements, issued by the Office of Pipeline Safety (OPS) and Research and Special Programs Administration (RSPA) divisions of the U.S. Department of Transportation and aimed at increased safety in the operations of natural gas pipeline transmission facilities, resulted in the Pipeline Safety Improvement Act ("Improvement Act") of 2002. Accordingly, RSPA/OPS issued a rule<sup>1</sup> (the IMP Rule) on December 15, 2003.

The IMP Rule adds incremental requirements on the operators of transmission pipelines and requires operators to identify transmission lines in certain "high consequence

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<sup>1</sup> Pipeline Safety: Pipeline Integrity Management in High Consequence Areas (Gas Transmission Pipelines) 68 Fed. Reg. 69778, amended in 69 Fed. Reg. 2307 and corrected in 69 Fed. Reg. 18277.

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areas" (HCAs) in order to implement written integrity management programs for such areas. Among other mandates, the new rules require operators to: (a) begin baseline assessment by June 17, 2004; (b) complete identification of all HCAs by December 17, 2004; (c) complete baseline assessment of at least fifty percent (50%) of the highest-risk pipeline facilities by December 17, 2007; (d) complete baseline assessment of remaining covered pipelines by December 17, 2012; and (e) begin reassessment for pipeline segments every seven years after completing the baseline assessment for the life of the facilities.

The new regulations will have an incremental time and cost impact on NW Natural's current pipeline inspection and repair activities. The company has identified approximately 500 miles of its pipeline facilities that are covered by the new regulations. It estimates that about 250 miles of such facilities will be considered lines that are located in HCAs.

For 2004, NW Natural estimates the cost to complete the HCA identification, baseline assessment, inspection activities and preparation of the required written materials may be as much as five (5) million dollars. IMP program costs in subsequent years could range between five (5) to fifteen (15) million dollars annually. Based on these numbers, NW Natural's current estimate of its total IMP program expenditures ranges between fifty (50) to one hundred (100) million dollars.

Pursuant to ORS 757.120 (Uniform accounts required) and 757.125 (Duty of Utility to keep records and accounts), NW Natural requests that the Commission issue an accounting order allowing all costs associated with its IMP activities, except for the amount of O&M included in the last applicable rate case (UG 152), to be classified as capital expenditures.

NWN believes that it is appropriate and reasonable to classify the new required pipeline integrity work as capital because the new inspections will ultimately result in an extension of the useful life of the transmission lines, which would typically classify such costs as capital expenditures.

To accomplish recovery of costs associated with the IMP program, NW Natural proposes to implement the program as a series of projects and to accumulate such costs in capital accounts that would be designated exclusively to related IMP activities. The proposed tracking period would begin on October 1 and end on September 30 ("the tracking period") of each year. Each project will pass the "Used and Useful" test before being considered complete for the purposes of recovery in rates. This means the

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inspection and any repair required will be required to be completed for a project to be included as a capital expenditure for that tracking period. Any project overlapping the tracking period would be carried over for recovery beginning in the following year.

On an annual basis, through September 30, 2008, the actual IMP program costs incurred during the most recent tracking period would be used to determine the IMP program cost of service for the relevant year. These costs would be recovered through the company's annual PGA filing. An adjustment would be made to permanent rates<sup>2</sup> allocated on an equal percent of margin basis and spread within the rate schedule on a declining block basis, effective October 1, during the term of the revenue recovery period. The allocation methodology would be subject to review and revision if, after further IMP program development, a more appropriate cost-based allocation becomes evident.

IMP program costs considered for recovery in rates would be subject to an audit or other review by Staff. The company would have to demonstrate that expenditures were incremental and not already included in base rates (e.g. labor) so as to avoid double recovery from customers. The audit would provide the basis for any subsequent true-ups or adjustments to be included in costs for the subsequent tracking period. NW Natural would make relevant records available to Staff for purposes of such audit, including, but not limited to, annual project forecasts, work plans, initial and subsequent assessment plans, records of project costs, and relevant budgets. Additionally, NW Natural would keep Staff informed of the IMP program status, inspection findings and anticipated repairs.

Staff believes the proposed capitalization treatment and revenue recovery method are reasonable; CUB and NWIGU also support the proposal. The Commission, however, will be asked to approve the revenue recovery mechanism in a separate tariff filing (Advice No. 04-10).

**PROPOSED COMMISSION MOTION:**

NW Natural's request to classify Integrity Management Program costs as capital expenditures be approved pursuant to ORS 757.120 and 757.125.

NWN UM1156 IMP

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<sup>2</sup> NWN's Schedules 1-3, 31-33 and 54