

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UI 451

In the Matter of

NORTHWEST NATURAL GAS
COMPANY, dba NW NATURAL,

Request for Approval of an Affiliated Interest
Agreement with Lexington Renewables, LLC.

ORDER

DISPOSITION: STAFF'S RECOMMENDATION ADOPTED WITH MODIFICATIONS

This order memorializes our decision, made and effective at our June 7, 2021 Special Public Meeting, to adopt Staff's recommendation as described in Staff's report, including the conditions listed in Attachment 1 to the report, with the modification that we replace Staff's condition 1 with the following:

A performance expectation for cost recovery is established at Northwest Naturals Gas Company's (NWN) forecasted net cost to customers per renewable thermal credit (RTC) (confidential price on page 5, line 7 of NWN's initial filing). NWN may seek recovery of prudently incurred costs that are higher than the performance expectation, up to the market price cap. The market price cap is equal to the average price per RTC of the two next lowest bids from NWN's RFP.

We direct Staff to propose a reporting requirement for NWN to report to the Commission on material deviations between actual costs of the transaction and forecasts of those costs made during UI 451.

The Staff Report with the recommendation is attached as Appendix A, and Staff's memorandum proposing alternatives to condition 1 is attached as Appendix B.

Made, entered, and effective Jun 08 2021.



Megan W. Decker
Chair



Letha Tawney
Commissioner



Mark R. Thompson
Commissioner



A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Circuit Court for Marion County in compliance with ORS 183.484.

ITEM NO. RA1

PUBLIC UTILITY COMMISSION OF OREGON
REDACTED STAFF REPORT
PUBLIC MEETING DATE: June 1, 2021

REGULAR CONSENT EFFECTIVE DATE June 2, 2021

DATE: May 26, 2021

TO: Public Utility Commission

FROM: Max St. Brown

THROUGH: Bryan Conway and John Crider **SIGNED**

SUBJECT: NORTHWEST NATURAL:

(Docket No. UI 451)

Requests Approval of an Affiliated Interest Agreement with Lexington Renewables, LLC

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (OPUC or Commission) should approve NW Natural's (NWN or Company) request for approval of affiliated interest agreement between NWN and Lexington Renewable Energy, LLC subject to the conditions attached in Attachment 1.

DISCUSSION:

Issue

Whether the Commission should approve the affiliated interest agreement between NWN and Lexington Renewable Energy, LLC.

Applicable Law or Rule, or Applicable Law or Applicable Rule

The Company filed this application with the Commission pursuant to ORS 757.490, ORS 757.495, and OAR 860-027-0040. ORS 757.495 requires a public utility to seek approval of contracts with affiliated interests within 90 days of execution of the contract. The process for submitting a contract with an affiliated interest for review is found in OAR 860-027-0040.

Docket No. UI 451
 May 26, 2021
 Page 2

An "affiliated interest" is defined for purposes of ORS 757.495 in ORS 757.012(1). Under this definition, among other circumstances, an affiliated interest exists between a public utility and "every corporation five percent or more of whose voting securities are owned by any corporation or person owning at least five percent of the voting securities of a public utility or by any person or corporation in any chain of successive ownership of at least five percent of voting securities of the utility." See ORS 757.015(3). And, as relevant here, an "affiliated interest" exists between "every corporation and person, five percent or more of which is directly or indirectly owned by a public utility." ORS 757.015(6).

The Commission reviews affiliated interest transactions to ensure they are fair and reasonable and not contrary to the public interest. ORS 757.495(3). The "fair and reasonable and not contrary to the public interest" standard is customarily applied as a "no harm" standard by the Commission.¹

When a transaction is entered into between affiliates in which services or supplies are sold to an energy utility by an affiliate, such transactions must be recorded at the lower of the affiliate's cost or the market rate. OAR 860-027-0048(4)(e). However, the Commission may waive this rule for good cause shown. OAR 860-027-0000(2).

The Commission need not determine the reasonableness of all financial aspects of the contract for ratemaking purposes, as the Commission reserves that issue for a subsequent proceeding, per Commission Order No. 11-071 in Docket No. UI 306.

Analysis

Background

On July 20, 2020, the Commission adopted administrative rules (OAR Chapter 860, Division 150) to implement a legislative policy designed to encourage utilities to supply natural gas from renewable sources (ORS 757.390-398). These renewable natural gas (RNG) rules set standards and requirements for utilities that make qualified investments in RNG or procure RNG from third parties in line with established RNG targets. The rules rely on the use of renewable thermal credits (RTCs) to track the chain of custody for RNG starting from injection into a common carrier pipeline, rather than tracking the physical gas.

NWN has identified its first opportunity to acquire RTCs from an RNG project at a Tyson Fresh Meats site in Lexington, Nebraska (Lexington Project). The Lexington Project is

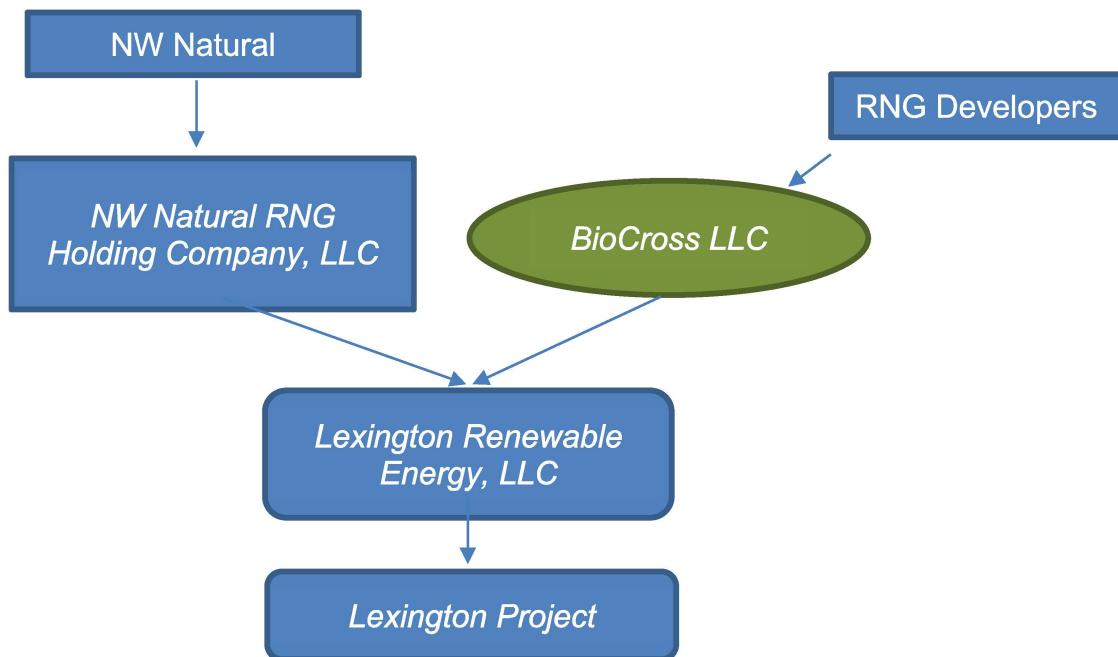
¹ See, e.g., *In the Matter of a Legal Standard for Approval of Mergers*, Commission Order No. 01-778 at 10 (September 4, 2001); *In the Matter of Mid-America Energy Holdings*, Docket No. UM 1209, Order No. 06-082 (February 24, 2006).

Docket No. UI 451
 May 26, 2021
 Page 3

co-owned by NWN and RNG developers through Lexington Renewable Energy, LLC (See Figure 1). On March 12, 2021, NW Natural filed its request for approval of an affiliated interest agreement with Lexington Renewable Energy LLC. An examination of this request also requires consideration of another related NW Natural affiliated interest, specifically that with NW Natural RNG Holding Company, LLC.

The purpose of creating the new LLCs is to acquire RTCs from the Lexington Project. The proposed relationship is illustrated in Figure 1 below:²

Figure 1. Lexington Project Ownership Structure



Project Structure

As noted above, the purpose of this affiliate structure is to acquire RTCs so that NWN can provide its customers with RNG. Under the proposed project structure, Lexington Renewable Energy, LLC will sell RTCs and the underlying gas generated by the Lexington Project to NWN. NWN will retain the RTCs and sell the gas to market. Key elements of the Lexington Project structure are as follows:

- NW Natural RNG Holding Company, LLC owns the class A shares of Lexington Renewable Energy, LLC.

² UI 451 Initial Filing at 3.

Docket No. UI 451
 May 26, 2021
 Page 4

- BioCross LLC is owned by RNG developers and owns all of the class B shares of Lexington Renewable Energy, LLC.³ Not pictured in Figure 1, one of these RNG developers also owns Biocarbon Management Services Lexington LLC which manages Lexington Renewable Energy, LLC.⁴
- Lexington Renewable Energy LLC is the subject of the affiliated interest application and will transfer RTCs to NWN. Lexington Renewable Energy, LLC is headquartered in Idaho to match its management and NWN confirmed to Staff that NWN Staff are not owners of the Idaho RNG developer.
- The Lexington project is described in a separate filing (UM 2145) and proposes deferred accounting for NWN's planned investment of approximately \$8.6 million to create RNG at Tyson's Fresh Meats site in Lexington, Nebraska. NWN has proposed an RNG automatic adjustment clause in ADV 1215.

Staff notes, specific to this project, the physical gas is unlikely to flow to Oregon customers and NWN states that [BEGIN CONFIDENTIAL]

[END

CONFIDENTIAL].

Review Process

In reviewing the application, Staff investigated the following issues:

1. Terms and Conditions of the Agreement;
2. Transfer Pricing;
3. Public Interest Compliance; and
4. Records Availability, Audit Provisions, and Reporting Requirements.

After Staff's review of these issues, Staff concluded that conditions are needed to ensure that the affiliated interest agreement is not contrary to the public interest, particularly related to public interest compliance. Staff believes it would not be in the public interest for transfer pricing to occur from Lexington Renewable Energy, LLC to NWN at a price higher than that available to NWN via an RNG offtake purchase, as described further in this Staff report.

The Oregon Citizens' Utility Board (CUB) and the Alliance of Western Energy Consumers (AWEC) both intervened in this docket. On May 13, 2021, Staff met with CUB and on May 14, 2021, Staff met with AWEC. The purpose of these meetings was

³ NWN's response to Staff IR 9.

⁴ NWN's response to Staff IR 12.

⁵ NWN's Confidential Response to Staff IR 52, Attachment 1 at 35 (Requesting Response to IR 33 in UM 2145).

⁶ Id, Confidential Response to Staff IR 52, at 34.

Docket No. UI 451
 May 26, 2021
 Page 5

to discuss public interest compliance. Based on these discussions, Staff, CUB, and AWEC proposed conditions necessary to recommend approval of the affiliated interest agreement. Then, Staff, CUB, and AWEC met with NWN on May 21 and May 24, 2021, to discuss conditions of the affiliated interest agreement. NWN, Staff, CUB, and AWEC (all the intervening parties) support each condition in Attachment 1 with two exceptions:

1. Condition 1 - Performance Guarantee: NWN is unwilling to accept a performance guarantee as a condition of this filing and finds that it is more appropriate for ratemaking discussions.
2. Condition 3f – Tax Treatment: Parties have not confirmed agreement on the proposed tax treatment. Parties continue to discuss, but Staff believes that the Commission should adopt this condition.

Staff recommends approving NWN's affiliated interest agreement with all of the conditions in Attachment 1. Staff sees both conditions as important ratepayer protections for a first venture into a new and evolving market. Without the performance guarantee and tax treatment, the transaction is not in the public interest. These conditions are discussed further below.

Terms and Conditions of the Agreement

All of the proposed agreement between NWN and Lexington Renewable Energy, LLC was submitted as confidential. NWN asks for approval of the affiliated interest transaction. **[BEGIN CONFIDENTIAL]** [REDACTED]

[END CONFIDENTIAL] In

considering this arrangement, Staff reviewed the flow of cash, RTCs, and brown gas. The framework developed by NWN appropriately allows RTCs to flow to ratepayers, which allows NWN to meet its RNG targets under ORS 757.396(1).

Transfer Pricing

NWN's initial filing describes that RNG from the Lexington Project will be at a fixed price increased for inflation. Staff investigated whether this fixed price represents the lower of

⁷ NWN's confidential response to Staff IR 6.

⁸ See NWN's response to Staff IR 13.

⁹ See NWN's confidential response to Staff IR 28 (IR 28 Requesting Response to IR 9 in Docket UM 2145) and confidential response to IR 52 (IR 52 Requesting Response to IR 33 in Docket UM 2145).

Docket No. UI 451
 May 26, 2021
 Page 6

cost or market. NWN states that “the RNG will be sold at cost to NW Natural.”¹⁰ Recognizing that there is not a market for RTCs that comply with Oregon’s RNG program, Staff compared the total price of RNG in the Lexington Project to the price of alternative sources of RNG – in a “build versus buy” comparison. In its initial filing, the Company describes that “the Lexington project was one of the least-cost, least-risk opportunities available to begin building our RNG portfolio.”

Based on Staff’s review of three marketplaces for RNG, Staff agrees with NWN that the Lexington Project, as proposed, is one of the lower cost RNG sources available to the Company. First, the Lexington project compares favorably to the RFP bids received by the Company in its 2020 RFP for RNG. Second, the Lexington Project compares favorably to the price of RINs (Renewable Identification Numbers) over the short-term in the Federal Renewable Fuel Standard program.¹¹ Third, the Lexington Project compares favorably to the prices paid in California’s Low Carbon Fuel Standard program. To the extent these reference points can be said to be representative of a nascent RNG market, the fixed price is likely lower than the current market.

Under these circumstances, Staff finds it appropriate that the Commission waive the requirements of OAR 860-027-0048(4)(e) and allow NWN to record the costs incurred pursuant to this agreement at the contracted fixed rate. Such costs will be reviewed in a future ratemaking proceeding before including in customer rates.

Public Interest Compliance

As noted previously, NWN may make qualified investments to meet its RNG targets under ORS 757.396(1). These targets were established by the legislature, which found that RNG “provides benefits to natural gas utility customers and to the public” and that development of RNG resources “should be encouraged to support a smooth transition to a low carbon energy economy in Oregon.”¹² As indicated in the Transfer Pricing section above, if NWN can acquire RTCs at the forecasted price from the Lexington Project, then it is likely one of the lowest-cost RTC opportunities for the Company.

NWN’s affiliated interest with Lexington Renewable Energy, LLC presents unique risks for customers because the project is the first of its kind undertaken by the utility, it is located out of state, it involves affiliated entities that are not themselves utilities, and the project will be managed by a third party. Staff, CUB, and AWEC have a major concern with the proposed affiliated interest relationship of Lexington Renewable Energy, LLC transferring RNG to NWN without additional conditions. The concern is that the per-unit

¹⁰ NWN’s response to Staff IR 6.

¹¹ See NWN’s response to Staff IR 5: “D5 RINs... would indicate RTC prices anywhere from about \$4.70 to \$17.60 per RTC.”

¹² ORS 757.390(1).

Docket No. UI 451
May 26, 2021
Page 7

cost of RTCs in the Lexington Project will increase if less RNG, and therefore fewer RTCs, is produced. Because the favorability of the Lexington Project hinges on its per-unit cost, and successful operations, Staff recommends the Commission adopt the conditions set forth in Attachment 1. Attachment 1 includes a condition specifying that the price NWN pays to Lexington Renewable Energy, LLC be subject to a performance guarantee. All of the proposed conditions are supported by CUB and AWEC. NWN does not support a performance guarantee. With adoption of all of these recommended conditions, Staff believes a framework of sufficient protections for customers will be established to meet the “no harm” standard.

Records Availability, Audit Provisions, and Reporting Requirements

NWN’s affiliated interest with Lexington Renewable Energy, LLC presents unique risks related to accountability because the project is out of state and will be managed by a third party. As a condition of approval in Attachment 1, Staff recommends that Lexington Renewable Energy, LLC be subject to the same information sharing requirements as NWN.¹³

NWN Response to Conditions of Approval

NWN does not support one of the proposed conditions in Attachment 1: the performance guarantee to protect ratepayers, and has indicated it believes the issue is more appropriately considered in the context of a prudence review. Without the performance guarantee condition, Staff does not support NWN’s affiliated interest application. This performance guarantee can be contrasted from the typical “no preapproval of capital investments” position. While a future prudence review of NWN’s Lexington Project would examine the buy-versus-build trade off and look at things such as the decision to lock in a fixed price for RNG, the performance guarantee condition is proposed here in recognition that a finding that the affiliated interest agreement is in the public interest is contingent on that the per unit price of RNG is not significantly underestimated.

There are other instances in which this type of performance guarantee has been adopted to protect ratepayers from the risk of underestimation of costs in the pre-construction stage. In NWN’s Post Carry wells arrangement: “if the cost of gas from the post-carry wells is above \$4.725 per dekatherm, the company is solely responsible for the additional cost.”¹⁴ And there is a similar aim to protect ratepayers from the overestimation of benefits prior to facility construction as discussed in the Commission’s

¹³ OAR 860-150-0600 describes the RNG reporting requirements for NWN.

¹⁴ *In the Matter of Application for Prudence Review of Costs of Post-Carry Wells*, Docket UM 1717, Order No. 15-297 at8, Appendix A at 4.

Docket No. UI 451
May 26, 2021
Page 8

recent review of PacifiCorp's wind investments in Docket UE 374.¹⁵ The performance guarantee does not shift all risk off of ratepayers. A significant remaining risk is the price that NWN can receive for the brown gas portion of the RNG (the RNG being split into brown gas and the RTC retired on ratepayers' behalf). But Staff believes the adoption of the performance guarantee condition will be sufficient to meet a "no harm" standard for approval of the affiliated interest.

In addition, NWN has not yet taken a position of support on condition 3f related to tax treatment. Staff finds this condition important to hold ratepayers harmless to the extent that the partnership tax allocations result in a limitation of the amount of tax deductions or tax benefits that may be claimed with respect to Lexington Renewable Energy, LLC. Parties continue to discuss this condition in hopes of reaching agreement.

Staff continues to believe that the Commission should approve the affiliate interest application with the full suite of conditions in Attachment 1. RNG is a new and evolving market and it is important to protect ratepayers as utilities explore opportunities to serve their customers from renewable sources. This is particularly important as the first investment under the RNG program involves ownership of a project, rather than procurement from a third party.

Conclusion

With appropriate controls in place, NWN's affiliated interest agreement for Lexington Renewable Energy LLC to transfer RNG to NWN meets the purpose of ORS 757.390-398. The LLC will supply NWN with RNG at a price that is likely representative of the nascent RNG market, or lower. At present, there is still some uncertainty in that price since the LLC has only one project under development and there is little history of RNG market price to draw on.

Since at present the delivered price seems reasonable compared to market, and assuming Staff conditions adopted to mitigate ratepayer risk, the affiliate transaction between NWN and Lexington Renewable Energy, LLC does not appear to harm ratepayers.

Staff and stakeholders retain the ability to review the costs in a future ratemaking proceeding and the project will be subject to a prudence review.

¹⁵ *In the Matter of PacifiCorp Request for a General Rate Revision*, Docket UE 374, Order No. 20-473 at 50-55.

Docket No. UI 451
May 26, 2021
Page 9

PROPOSED COMMISSION MOTION:

Approve NW Natural's affiliated interest application between NWN and Lexington Renewables, LLC subject to the conditions attached in Attachment 1.

NWN UI 451

Docket No. UI 451
May 26, 2021
Page 10

Attachment 1

Conditions of Approval

1. Performance guarantee

- a) NWN shall be restricted by a performance guarantee so that in any proceeding in which project costs are included in rates, ratepayers shall recover the costs of RNG production shortfalls below the forecasted amount of RNG from the site, as measured on a calendar year basis. The price per RTC that is subject to ratemaking shall match the price forecasted by NWN when the project produces as forecasted. Ratepayers shall be protected from underproduction of RNG. Such production shortfalls include but are not limited to produced RNG that is unsellable or does not meet Black Hills Energy's applicable pipeline injection standards. With a performance guarantee, NWN will keep the benefit of RNG production exceeding its forecast.

2. Environmental Risks including contamination to the site

- a) NW Natural agrees to report to the Commission any environmental liability or cleanup obligation by Lexington Renewable Energy, LLC exceeding \$100,000 within 10 days of the time it becomes aware of such an issue
- b) NWN agrees to establish and maintain safety standards and policies for Lexington Renewable Energy, LLC substantially comparable to or better than the NWN's current standards and policies
- c) For the purpose of determining whether NW Natural may recover any costs associated with Lexington Renewable Energy, LLC, NW Natural must demonstrate that it, NW Natural RNG Holding Company, LLC, and Lexington Renewable Energy, LLC acted prudently in the construction and management of the Lexington biogas facility, including NW Natural's oversight of entities involved in the construction and management of the Project. NW Natural will keep documentation sufficient to demonstrate its prudent management, and will have the burden of proof to demonstrate that the project was prudently constructed and managed
- d) NW Natural agrees to provide Staff with a summary of the in-force liability insurance coverage(s) prior to the facility's commercial operation date for each of NW Natural, NW Natural RNG Holding Company, LLC, and Lexington Renewable Energy, LLC
- e) NW Natural agrees to observe and respect corporate formalities between NW Natural RNG Holding Company, LLC and Lexington Renewable Energy, LLC. These include but are not limited to prohibiting commingling of assets,

Docket No. UI 451
May 26, 2021
Page 11

maintaining separate books and records, and maintaining sufficient capitalization

3. Other Risks

- a) NW Natural agrees to report to the Commission, any event that materially impacts the operations and cost structure of the project within 10 days of becoming aware of such an event
- b) NW Natural agrees that Commission approval of the transaction extends only to the base term of the agreement filed in this docket, and NWN will obtain Commission approval before agreeing to any extension
- c) Staff and the Commission will review for prudence all costs impacting amounts to be amortized as part of the review of any future NW Natural request to amortize any deferred costs associated with the Lexington Project
- d) All costs attributable to Lexington Renewable Energy, LLC will be auditable by Staff and the origin of such costs among the companies must be demonstrable, so as to be specifically identified, tracked for the Commission
- e) NW Natural agrees to account for personnel time for the Lexington Renewable Energy, LLC project following the same policies and practices of NW Natural's accounting for capital projects
- f) Ratepayers will be held harmless to the extent that the partnership tax allocations result in a limitation of the amount of tax deductions or tax benefits that may be claimed with respect to Lexington Renewable Energy, LLC

4. Regulatory Controls

- a) NW Natural commits that it will ensure Lexington Renewable Energy, LLC will not, without the approval of the Commission:
 - i. Make loans or transfer funds (a) to another member or the manager, or (b) other than dividends and payments pursuant to the operating agreement or project contracts;
 - ii. Assume any obligation or liability as guarantor, endorser, surety, or otherwise (a) for another member or the manager, or (b) other than a reasonable obligation or liability pursuant to project contracts;
 - iii. Transfer any of its project assets or property (a) to another member or the manager, or (b) other than (1) sales of products generated by the project or (2) assets or property that is worn out, obsolete, no longer necessary or useful for the operation of the project, or in the reasonable judgment of NW Natural should be disposed of or replaced;

Docket No. UI 451
May 26, 2021
Page 12

- iv. Pledge or seek to pledge project assets or securities backing for any hedging, indebtedness, or securities (a) to another member or the manager, or (b) other than as reasonably undertaken pursuant to project contracts;
- v. Enter into cross-default provisions with NW Natural or its subsidiaries (other than NW Natural RNG Holding Company, LLC); and
- vi. Participate in a money pool (unless with NW Natural or its subsidiaries)

- b) NW Natural will report to the Commission, within 10 days of the time it becomes aware of such an issue, any debt obligation or liability as guarantor, endorser, surety, or otherwise undertaken by BioCross LLC related to the project.
- c) In the event that the Commission adopts conditions from other jurisdictions, the Commission will re-open and re-issue the Order approving these conditions to add those conditions accepted or ordered in another state jurisdiction.
- d) Headquarters for Northwest Natural RNG Holding Company, LLC will be in the state of Oregon.
- e) The venue for all disputes related to the endeavors of NW Natural RNG Holding Company, LLC will be Oregon. For Lexington Renewable Energy, LLC, NW Natural RNG Holding Company, LLC will, as reasonably practicable, cause venue for all dispute provisions set forth in project contracts to be Oregon. Where the existing operating agreement requires settlement by arbitration, NWN will provide parties access to all submissions and the final order in the arbitration, subject in all respects to confidentiality or similar rules that are not reasonably within the control of NW Natural.

5. Access to information

- a) NW Natural will have the ability to access all records and information related to the construction and operation of the Lexington biogas facility in the possession of NW Natural RNG Holding Company, LLC and Lexington Renewable Energy, LLC and respond to Commission request at any time for such records and information. In response to a discovery request that is made in accordance with Commission rules, NW Natural will provide the parties with information to the regulatory review of the project. In agreeing to this provision, NW Natural is not waiving any of its rights under applicable law or regulations to prevent or limit disclosure of certain information due to confidentiality, privilege, or any other basis established in law or Commission rules. Upon request from parties during a regulatory review, NW Natural will also undertake reasonable efforts to obtain relevant information related to the construction and operation of the Lexington

Docket No. UI 451
May 26, 2021
Page 13

biogas facility that is in the possession of entities that are not affiliated with NW Natural. NW Natural shall ensure that Lexington Renewable Energy, LLC is subject to the same information sharing as NW Natural, including but not limited to access to books and records and meeting minutes

- b) NW Natural agrees to make NWN Natural RNG Holding Company, LLC managing board members available to appear before the Commission

NW Natural: (Docket No. UI 451) Requests Affiliated Interest with Lexington Renewables, LLC

At the June 1, 2021 Public Meeting, the Commission deliberated on NWN's filing. Parties described the points of agreement related to conditions of approval. Parties did not agree on the performance guarantee, which is reproduced below:

Original Condition of Approval
1. Performance guarantee

NWN shall be restricted by a performance guarantee so that in any proceeding in which project costs are included in rates, ratepayers shall recover the costs of RNG production shortfalls below the forecasted amount of RNG from the site, as measured on a calendar year basis. The price per RTC that is subject to ratemaking shall match the price forecasted by NWN when the project produces as forecasted. Ratepayers shall be protected from underproduction of RNG. Such production shortfalls include but are not limited to produced RNG that is unsellable or does not meet Black Hills Energy's applicable pipeline injection standards. With a performance guarantee, NWN will keep the benefit of RNG production exceeding its forecast.

Should the Commission find that the proposed Performance Guarantee is potentially problematic, the Commission could determine the Transfer Price in this docket and set out its expectations for how deviations from the project description will be handled in future proceedings. Some of the Commissioner concerns raised during the public meeting included the appropriateness of fixing the amounts that could be recovered in rates for a project that benefits ratepayers, difficulty in applying a performance guarantee to a wide range of scenarios such as capital build cost overruns versus early termination of the project, and incentives of the Company if it is allowed to benefit from a sharing mechanism. In light of these raised concerns, Staff identified two alternative concepts to address the main issue raised in Staff's Report: "Staff believes it would not be in the public interest for transfer pricing to occur from Lexington Renewable Energy, LLC to NWN at a price higher than that available to NWN via an RNG offtake purchase."

If NWN can acquire RTCs at the forecasted price from the Lexington Project, then it is likely one of the lowest-cost RTC opportunities for the Company. The representations of expected costs and benefits suggest a project that meets the Affiliated Interest rules regarding Transfer Pricing at the lower of cost or market. However, if the Company's forecasts are overly optimistic and fail to come to fruition, then the Transfer Price would no longer be one of the lowest and therefore may not meet the lower of "cost or market standard."

NWN describes that the RNG facility has a 30-year expected useful life. If the project is terminated prior to its expected lifetime, then the per-unit price of RNG will increase. The structure of the affiliate and related LLCs appears to isolate NWN from risks by shifting operational risks to customers (i.e., customers bear the risk of lower priced sales of brown gas, inefficiencies associated with RNG production, etc.)

As an alternative recommendation to a Performance Guarantee, the Commission could approve NWN's application with one or a combination of the following two alternative conditions:

First Alternative condition of approval
Recovery of prudent costs capped at market price

The Transfer Price is established at NWN's forecasted net cost to customers per RTC (confidential price on page 5, line 7 of NWN's initial filing), which establishes a performance expectation for cost recovery. NWN may seek recovery of prudently incurred costs that are higher than the default transfer price, up to the market price cap. The market price cap is equal to the average price per RTC of the two next lowest bids from NWN's RFP.¹

A second alternative reflecting these concerns is to review costs above the forecast in future general rate cases.

Second alternative condition of approval
rate case review of costs exceeding initial filing

The Transfer Price is established at NWN's forecasted net cost to customers per RTC (confidential price on page 5, line 7 of NWN's initial filing), which establishes a performance expectation for cost recovery. Only prudently incurred costs equivalent to or lower than the transfer price may be included in the AAC, and costs above the transfer price cannot be deferred. NWN may seek recovery of prudently incurred costs higher than the transfer price in a general rate case.

¹ There is no existing market for RTCS that are compliant with Oregon's SB 98 (2019). Although market is difficult to estimate, a reasonable surrogate for market is the average of the two lowest priced RTC offtake bids described in NWN's response to Staff IR 46 and NWN's response to Staff IR 24.