

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 25, 2001**

REGULAR X CONSENT EFFECTIVE DATE October 1, 2001

DATE: September 19, 2001
TO: Phil Nyegaard through Lee Sparling
FROM: Bonnie Tatom
SUBJECT: NW Natural Advice No. OPUC 01-20

SUMMARY RECOMMENDATION:

I recommend the Commission: (1) allow the tariff sheets filed in Advice No. 01-20 to go into effect on October 1, 2001, (2) approve the rate spread used to spread the costs of the Bare Steel Replacement Program, (3) approve the company's deferred accounting application for its safety program costs (the Bare Steel Replacement and the Geohazard Risk Mitigation and Repair programs), and (4) approve the Stipulation, dated August 3, 2001, between NW Natural and Staff regarding rate treatment for NW Natural Safety Programs. This filing does not change the company's annual revenues at this time.

DISCUSSION:

On August 29, 2001, NW Natural submitted Schedule 177, "Revision of Charges for Bare Steel Replacement Program." The purpose of the filing is to include in the company's tariff, a schedule designed to recover costs associated with the company's accelerated bare steel replacement program. The company also included an application for deferred accounting of its safety program costs.

History

Over the last year, NW Natural, Staff, Citizens' Utility Board (CUB), and Northwest Industrial Gas Users (NWIGU) met to discuss the appropriate treatment of costs associated with the company's safety programs. These programs include the accelerated replacement of the company's bare steel distribution and transmission facilities and geohazard risk mitigation. The two significant issues concerning NW Natural's safety programs were (1) whether the company should accelerate bare steel replacement and how customers should pay for the company's investment and costs associated with the accelerated program, and (2) whether the company should pursue geohazard risk

mitigation and how customers should pay for those activities. Following is a brief synopsis of these two issues:

Bare Steel Replacement

Early this year, Staff met with NW Natural to discuss its safety programs. PUC Safety & Reliability staff have been concerned for some time that the company's normal time frame for replacing corrosion-subject bare steel would likely result in higher costs of detecting and repairing leaks, and more importantly, impair the company's excellent service quality and safe distribution system. The bare steel has been in the ground for many years—some since the 1940s. With its current schedule, the company would not have completely replaced its bare steel system until roughly 2038. The company proposed a Stipulation that would allow the company to cut nearly in half the time frame necessary to replace the bare steel to the end of 2021. NW Natural is currently investing about \$3 million annually in bare steel replacement activities. The Stipulation allows the company to invest as much as \$6 million in its bare steel replacement activities, with the incremental \$3 million considered as accelerated bare steel replacement costs. The Stipulation further defines how these costs may be included in rates. At the time of the annual Purchased Gas Adjustment (PGA) filing, or some other suitable filing, NW Natural may include in rates, the cost of service associated with the entire accelerated bare steel replacement for the most recent 12-month period. Exhibit A to the Stipulation shows how the company will develop a cost of service for each year's accelerated bare steel replacement program costs.

Geohazard Risk Mitigation and Repair

Another concern to PUC Safety Staff is the health and safety risk associated with geohazards, defined as risk to distribution infrastructure from such things as landslide, washout and earthquake. These are not new risks; the company experienced several washouts due to wetter than normal conditions in 1999 that jeopardized the integrity of some portions of the company's distribution system. The Stipulation provides for a 5-year treatment of the cost to NW Natural of assessing geohazard risk, minimizing risk where possible, and repairing damage to facilities caused by geohazards. Staff and other parties were particularly concerned that the company could incur costs and request cost recovery for costs not associated with geohazard risk. The Stipulation specifies the types of risk that are covered, and the rate treatment that may be used depending on the nature of the work performed to repair geohazards. Specifically, under the Stipulation the company would not request cost recovery for what are typical O & M costs (that are already included in base rates) incurred to maintain and repair its distribution system, and would request cost recovery for assessing, mitigating or repairing geohazard risks.

Rate Spread and Rate Design

NW Natural engineers estimated that the company's distribution and transmission facilities in Oregon included about 100 miles of uncoated steel plant. About 70 percent of the facilities are mains and services that serve principally residential and commercial customers. The remaining 30 percent consists of medium- and high-pressure facilities that serve all customers on the company's system. Using this engineering analysis, Staff and the other parties agreed that the company will allocate 70% of the cumulative investment to residential and commercial customers, spread on an equal cents per therm basis to those customers, and will allocate the remaining 30% of the cumulative investment to all customers, spreading this amount on an equal percent of margin basis. The initial rate changes that will occur as a result of the safety programs will be on or after October 1, 2002. The Stipulation is silent on the rate spread for the Geohazard Risk Mitigation and Repair Program. Rate spread will be addressed when NW Natural files for rate recovery of those costs.

The Stipulation

On August 3, 2001, NW Natural and Staff entered into a Stipulation which will allow the company to replace its bare steel distribution and transmission facilities within twenty years, and monitor and minimize "geohazards" such as landslide and washout that may damage distribution and transmission facilities and thereby cause service disruption or present safety problems. The Stipulation provides for recovery of program costs; Schedule 177 implements cost recovery for the bare steel portion of the Stipulation. The Stipulation contains provisions for Staff audit of the company's safety programs and annual reporting of progress on each of the programs. A copy of the Stipulation is attached as Exhibit A.

Proposed Safety Program Costs

The company included with its filing a worksheet showing an estimate of the cost of service for the bare steel replacement program. Assuming the entire \$3,000,000 in incremental bare steel replacement investment is made in a given year, the approximate cost of service associated with this investment is \$505,000. Under the terms of the Stipulation, residential customers on Schedule 2 would have a rate increase of .104 cents per therm. Commercial customers on Schedule 3 would have a rate increase of .098 cents per therm, while industrial customers on Schedule 91 (transportation customers) would see a rate increase of .003 cents per therm.

Deferred Accounting Application

Pursuant to ORS 757.259(2)(e), the company has requested deferred accounting treatment as necessary or required to record in appropriate sub-accounts of Account 186 any expenses eligible for rate treatment under the terms of the Stipulation for later treatment in rates in accordance with this filing. Deferred accounting is warranted in order

to "match appropriately the costs borne by and benefits received by ratepayers." NW Natural estimates that through September 30, 2021, the company will spend approximately \$3 million per year in program costs for accelerated bare steel replacement and an undetermined amount for geohazard risk mitigation and repair. Deferrals will begin October 1, 2001. NW Natural's request is consistent with the requirements of ORS 757.259, OAR 860-027-0300, and the terms of the Stipulation. Staff recommends approval.

STAFF RECOMMENDATIONS:

I recommend the Commission take the following action regarding the NW Natural filing:

1. Allow the tariff sheets filed in Advice No. 01-20 to go into effect on October 1, 2001 (there are no rate changes in the tariff at this time).
2. Approve the rate spread used to spread the costs of the Bare Steel Replacement Program.
3. Approve the company's deferred accounting application for its safety program costs.
4. Approve the Stipulation, dated August 3, 2001, between NW Natural and Staff regarding rate treatment for NW Natural Safety Programs.