

**PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: August 21, 2007**

REGULAR  X  CONSENT \_\_\_\_\_ EFFECTIVE DATE  September 1, 2007

DATE: August 15, 2007

TO: Public Utility Commission

FROM: Ed Durrenberger

THROUGH: Lee Sparling, Ed Busch, Bonnie Tatom and Judy Johnson

SUBJECT: NORTHWEST NATURAL: (Advice No. 07-4) Introduces Schedule 400, Smart Energy Pilot Program.

NORTHWEST NATURAL: (Docket No. UM 1327) Request for Deferred Accounting Regarding Smart Energy Program Expenditures.

**STAFF RECOMMENDATION:**

I recommend that the Commission suspend Northwest Natural's (NW Natural or Company) Advice No. 07-4, Schedule 400, Smart Energy Pilot Program for investigation and take no action on UM 1327, the Company's request for deferred accounting for program expenditures, pending the outcome of the investigation.

**DISCUSSION:**

On June 29, 2007, NW Natural submitted a request to incorporate Schedule 400 into the Company's Tariff PUC. Or. 24. This Schedule describes the Smart Energy Program as a pilot program whereby residential and commercial gas customers could voluntarily offset the greenhouse gas (GHG) emissions that result from their use of natural gas.

Under the Smart Energy Program, participants elect to pay a premium each month which would be used to pay for the cost of developing projects that permanently offset GHG emissions. Residential customers could choose either a fixed monthly rate option of \$6 per month or a volumetric rate option of \$0.10486 per therm to purchase the emission offsets. In either case, the premium specified in the tariff has been calculated to be sufficient to fully offset the emissions associated with the average residential gas use based on offset costs and ongoing administrative costs as of June 29, 2007. Commercial customers would only be offered a fixed monthly rate option with a

minimum of \$10/ month. In this case, NW Natural would calculate the amount of GHG reductions a commercial customer makes based on the customer's historical gas use, the current cost of emission reductions and the amount per month they elected to pay into the program.

The company states that the GHG reductions would be through regional projects that would emphasize bringing biogas capture, either agricultural methane or landfill methane, to the region and would be accomplished through a partnership with The Climate Trust. The Climate Trust is an Oregon non-profit organization whose objective is to purchase or develop high quality project-based emission reductions. The Climate Trust would use the Smart Energy premiums, collected from the program participants, to either develop or purchase GHG offsets.

The Company's filing states that the Smart Energy program provides a number of benefits to NW Natural customers whether or not they enroll in the voluntary program. These benefits include: 1) environmental benefits from eliminating GHG emissions that accrue to all; 2) an understanding on the part of its customers, of carbon impacts and ways to reduce them; 3) development of carbon policy and company carbon strategies; and 4) access to a greater array of programs.

In conjunction with Advice No. 07-4, the Smart Energy Program Tariff, the company is requesting, in UM 1327, a deferred account to record Smart Energy Program startup costs. The company calculates the pilot program startup costs are going to be approximately \$1.2 million dollars spent over the first three years of the program. Although NW Natural has committed to paying 10% or \$130,000 of the startup costs, the application requests to defer the additional \$1.048 million spread over the first three years of the five-year pilot. The company states that it is holding the startup costs out of the general program costs because including them would raise the price of the offsets and reduce participation. The company's application is not seeking ratemaking treatment of these startup costs at this time; however, the tariff is being proposed contingent on startup costs being deferred for future amortization to all customer classes whether they participate in the Smart Energy Program or not, with the justification being that all customers benefit in some way as discussed above.

Staff Analysis:

NW Natural has developed an attractive product in its Smart Energy program. It is offering this program through a partnership with the Climate Trust and is focusing on development of GHG offset projects that help bring biogas to the region. Staff supports the concept of the Smart Energy Program. However, the company has thus far failed to demonstrate that their startup costs should be spread to all customers, including those who do not want to participate in the voluntary program.

Staff's counsel has advised that the Commission generally does not have statutory authority to impose the costs of a voluntary program on all customers, unless the utility can demonstrate that there are utility-related benefits for non-participating customers. Although the legislature has granted the Commission specific authority for similar programs through a few specific statutes--such as tree planting and portfolio options (under SB 1149)--that specific authority has not been granted for the type of program the company is proposing in Advice No. 07-4. Alternatively, the Commission has general authority under ORS 756.040 to authorize cost recovery for the purpose of establishing adequate service at just and reasonable rates.

By letter dated August 9, 2007, in response to Staff Data Request 6, NW Natural stated that "the Commission is authorized to impose on utility customers costs that are designed to avoid—or mitigate—internalization of external environmental costs." Accordingly, the company asserts that the startup costs of the Smart Energy program should be recoverable from all customers for two reasons: first, because all customers benefit from the education about climate change and the need to reduce GHG emissions; and second, because the program will contribute to its management's and Staff's education and preparedness for future CO<sub>2</sub> emissions reductions mandates, thus reducing future compliance costs that would otherwise be spread to all NWN customers.

Staff agrees the Commission can authorize a resource that appears to be more expensive on the basis that it will avoid environmental costs if they are internalized in the future—for example, renewable resources in lieu of fossil fueled resources. In this instance, Staff does not believe the company has demonstrated how the effects of the Smart Energy program will reduce NW Natural's CO<sub>2</sub> costs in the future that would otherwise be passed on to customers. Customer education regarding carbon impacts, though useful from a societal perspective, will not create a benefit related to utility service or rates. Staff also finds the company's general claim, that the program will improve its internal education and preparedness and eventually result in lower compliance costs, to be highly speculative, at best. While the company has estimated that each customer would only have to pay a total of \$1.30 to cover startup costs for the pilot program, it is not possible to determine the level of GHG reduction this would produce nor the relationship of this known cost to future unknown costs related to the reduction of GHGs, should that become mandatory.

In short, Staff does not believe the company has met the burden of showing that there will be utility-related economic benefits, either now or in the future, to non-participating customers. Because the company has made implementation of the Smart Energy Program tariff contingent on approving a deferred account for the startup costs and requiring that those costs be spread to all customers, Staff has no alternative but to

request the Commission suspend the tariff filing for up to six months for investigation, or until such time as parties can resolve the matter of program startup cost allocation.

However, if the Commission finds that there is some benefit to non-participating customers, Staff recommends a limit on authorized deferrals under the company's deferred accounting application. This application requests deferral of virtually all startup costs, estimated at \$1.048 million over three years, with approximately \$445,000 during the first 12 months. Staff's review of similar programs (such as electric portfolio options under ORS 757.603) indicates that "education" costs typically have been spread to all eligible customers, but "marketing" expense has been borne by program participants. If the Commission approves NW Natural's application, Staff recommends the Commission treat the first year of the startup costs as education costs that can be spread to all eligible customers and therefore limit the amount of the authorized deferral to \$445,000.

**PROPOSED COMMISSION MOTION:**

NW Natural's Advice No. 07-4, Smart Energy pilot program, be suspended effective September 1, 2007, and that no action be taken on the deferred accounting request in Docket No. UM 1327, until such time as the issues surrounding the allocation of startup costs are resolved.