

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: February 24, 2009**

REGULAR _____ CONSENT X EFFECTIVE DATE November 25, 2008

DATE: January 22, 2009

TO: Public Utility Commission

FROM: Lisa Gorsuch and Carla Owings

THROUGH: Lee Sparling, Ed Busch, and Judy Johnson

SUBJECT: NORTHWEST NATURAL: (Docket No. UM 1406) Requests adoption of the Stipulation associated with the new System Integrity Program and requests an Accounting Order to record the associated costs as capital expenditures.

STAFF RECOMMENDATION:

Staff recommends that Northwest Natural's (NWN or Company) request for the adoption of the Stipulation associated with its new System Integrity Program (SIP), agreed upon by the Citizens' Utility Board of Oregon (CUB), Northwest Industrial Gas Users (NWIGU), NWN and Staff (collectively, the Parties), and an Accounting Order to record the associated costs as capital expenditures, be approved with an effective date of November 25, 2008.

DISCUSSION:

Background

NWN has maintained multiple safety programs. These included a Cast Iron Replacement Program and Geohazard Program, both of which have been discontinued.¹ They now include the Transmission Integrity Management Program (TIMP), which was initiated in 2002 in response to the Pipeline Safety Improvement Act of 2002 (2002 Improvement Act) and PHMSA² Natural Gas Integrity Management Rule,

¹ Some of the activities that had previously been conducted under the Geohazard program will now be properly conducted under the Transmission Integrity Management Program (TIMP) and/or Distribution Integrity Management Programs (DIMP), as required by applicable federal regulations.

² US Department of Transportation Pipeline and Hazardous Materials Safety Administration.

and the Bare Steel Replacement Program (Bare Steel Program), which was approved by the Commission in 2001 and had an original completion date of 2021.

The Pipeline Inspection, Protection, Enforcement and Safety Act of 2006 (2006 PIPES Act) expands requirements of the 2002 Improvement Act by requiring PHMSA to prescribe minimum standards for Distribution Integrity Management Programs (DIMP) to cover the integrity and broader aspects of distribution mains, services, and other gas related appurtenances. In addition, the 2006 PIPES Act significantly expands the requirements of all stakeholders relative to excavation damage prevention.

While previously implemented separately, the NWN Cast Iron, Bare Steel, and Geohazard programs all were designed to address the issues raised and regulations formulated as a result of federal legislation to improve natural gas transmission and distribution system safety.

NWN has proposed changes to its current Schedule 177, Adjustments to Rates for Safety Programs. As it currently exists, Schedule 177 describes the adjustments to rates for costs associated with the three separate safety related programs described above. The Company now proposes to revise Schedule 177 to reference one integrated safety program. The new integrated program, SIP, with its three focus areas will allow for a risk-based approach to addressing system integrity issues.

NWN states the creation of the SIP will allow NWN to minimize costs and create a more risk-based approach to system integrity issues, including new distribution management issues.

Stipulation and Request for Accounting Order

On November 25, 2008, NWN filed an application for an Accounting Order, and the Joint Parties filed a Stipulation that reflects the agreements as to accounting treatments, cost recovery, cost tracking and cost of service for the new SIP.

Under the Stipulation and proposed Accounting Order, all costs associated with its SIP activities, exceeding the related operation and maintenance (O & M) expense included in the last applicable rate case, would be classified as capital expenditures.

Per the Stipulation agreed to by the Parties, NWN will track SIP costs on a project basis. Project costs would accumulate in capital accounts that would be designated as SIP activities and would be tracked by NWN on a per job basis. NWN would track the

SIP investment annually to obtain a total result for each year, with the proposed tracking period running from November 1 to October 31 (Tracker Year).

Total annual SIP expenditures would have a soft cap of \$12 million per Tracker Year, excluding 2008 where current program approvals for Bare Steel and Transmission Integrity are applicable. Program expenditures could only exceed \$12 million in a Tracker Year with the written consent of the Parties.

The actual amount eligible for recovery through cost of service would be \$8.176 million. This amount is calculated as the \$12 million cap less the following adjustments. NWN will not seek recovery through the proposed annual rate adjustment amounts for the following: 1) current O & M funding embedded in rates of approximately \$574,000 per year; 2) additional O & M costs related to DIMP damage prevention; 3) the first \$3 million in combined bare steel and leakage capital costs, and 4) an additional \$250,000 in SIP capital costs.

On an annual basis, the most recent actual SIP costs incurred during the 12-month period from November 1 prior to the Purchased Gas Adjustment (PGA) filing date through October 31 would be used to determine the SIP Cost of Service for the relevant year.³ The SIP Cost of Service would be included in NWN's PGA subject to an audit by Staff. Upon Commission approval of the SIP Cost of Service, an adjustment would be made to permanent rates (Schedules 1-3, 31, 32, 33 and 54) effective November 1 during the term of the revenue recovery period.

For each recovery period, NWN would develop a cost of service for the SIP investment which would include incremental depreciation expense, property tax, return on investment, income taxes and other costs customarily relating to utility investment. The capital structure and the cost of long term debt and preferred stock to be used in the calculation of the return on rate base would be those adopted by the Commission in NWN's most recent rate case.

The Parties agree that, subject to audit, rates would be adjusted each fall within NWN's PGA, in the same manner used for recovery of costs under the previous integrity management program, as approved in Order No. 04-390.

The Parties agree that costs would be recovered through one adjustment schedule comprised of parts for each program under Schedule 177. Per the Stipulation, the revised schedule would include the following parts:

³ A portion of the annual costs will be based on estimated activities.

- Part A will account for costs related to the Bare Steel Replacement Program. NWN will allocate 70% of the cumulative investment to Residential and Commercial firm sales and transportation customers taking service under Rate Schedules 1, 2, 3, 31, and 54 on an equal cents per therm basis. The remaining 30% will be allocated on an equal percent of margin basis to all customer classes and within a rate schedule shall be spread on a declining block basis. The cost recovery for this part shall be as agreed to in Order No. 04-390.
- Part B will account for costs related to TIMP. Part B costs will be spread to all customer classes on an equal percent of margin and within a rate schedule shall be spread on a declining block basis.
- Part C will account for costs related to DIMP. Part C costs will be spread to all customer classes on an equal percent of margin and within a rate schedule shall be spread on a declining block basis.

Each April NWN would provide the Parties with a forecast of expenses through October 31, 2011, as outlined in the Stipulation. Each August NWN would provide the Parties a report of actual expenses.

PROPOSED COMMISSION MOTION:

NWN's request for adoption of the Stipulation associated with the SIP and an Accounting Order to record the associated costs as capital expenditures be approved with an effective date of November 25, 2008.