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Kathy Hunter, Acting Executive Director and Secretary
Washington Utilities and Transportation Commission
621 Woodland Square Loop S.E.
Lacey, Washington 98503

Re: U-230161—NW Natural Response to Notice of Opportunity to File Written Comments

Dear Ms. Hunter:

Northwest Natural Gas Company, dba NW Natural (NW Natural), appreciates the opportunity to respond to the Washington Utilities and Transportation Commission's (Commission) October 23, 2023, Notice of Opportunity to File Written Comments (Notice) in advance of the November 8 workshop in Docket U-230161.

NW Natural remains very supportive of the Commission addressing the potential impacts of the Climate Commitment Act (CCA) in this docket, especially guidance regarding cost recovery. As further explained in our September 7 comments, NW Natural continues to believe that Washington utilities should be permitted to recover their prudently incurred CCA compliance costs. Washington utilities must incur these costs to comply with Washington law and, therefore, should be allowed to fully recover them in rates.

Questions Posed in the Notice:

1. *For a potential CCA risk sharing mechanism, what risks associated with the CCA are under utility control? Examples may include market risk, energy procurement, conservation levels, etc.*

The CCA establishes a cap-and-invest market, where market participants, including those without a CCA compliance obligation, acquire allowances that they can either sell to another entity or use to demonstrate compliance with that law. Currently, acquiring allowances appears to be less expensive relative to other compliance options available to NW Natural. As such, NW Natural does not view acquiring allowances as a risk that it can or cannot take. Rather, it must acquire these allowances to comply with the law. NW Natural understands and accepts that its strategy to acquire allowances will be subject to a prudence review where the Commission will determine cost recovery based on the reasonableness of its actions. However, NW Natural is taking these actions to follow

Washington law, not to mitigate a risk that is under its control. NW Natural fears that any such identification of risks that fails to take this crucial point into account will result in a rate sharing mechanism that effectively penalizes utilities for taking prudent actions to follow the law.

Instead of developing a backward looking risk-sharing mechanism, the Commission should prioritize identifying risks associated with CCA compliance in forward-looking processes such as the Integrated Resource Planning (IRP) process. As part of that process, CCA compliance strategies and alternatives are considered, such as actions that directly reduce a utility's emissions, including the costs, benefits, and risks of these actions relative to purchasing allowances. As NW Natural suggested in its September 7 comments, the Commission could decide whether to acknowledge an IRP action plan in order to provide guidance for later ratemaking proceedings. Consistency with an acknowledged plan would be used as evidence in support of favorable ratemaking treatment, although the utility must still demonstrate that its actions remained prudent and reasonable in a subsequent cost recovery proceeding. Each direct action to reduce a utility's emissions will likely have its own benefits and risks relative to purchasing allowances. Through the IRP process, these alternatives could be considered independently and without a pre-existing rate sharing mechanism that may inadvertently act as a barrier to prudent utility action.

Aside from the risk associated with demonstrating the prudency of its actions, NW Natural has little control over the categories of risk described in the question above. Regarding CCA market risk, the market sets the price of allowances through auctions and secondary trading activities. These auctions and subsequent trading activities are not only open to utilities, but also other entities that are covered under the CCA and general market participants that do not have a CCA compliance obligation. Given this diffuse number of participants, including those participants that are purchasing allowances not for compliance but for financial gain, NW Natural has little control over market risk. In fact, a major factor influencing the price of allowances is the lack of linkage between the Washington market and the California/Quebec market. This factor is wholly outside the control of any market participant and whether or not these markets will link is a continuing risk.

NW Natural also has little control over the risks associated with energy procurement. As explained in our September 7 comments, the price of natural gas—like CCA allowances—is set by market forces outside of a utility's control. Similarly, the amount of natural gas that a utility must purchase is equal to its customers' demand, which is a utility obligation that NW Natural must meet. This demand is heavily influenced by weather. For example, in a warm winter, NW Natural's customer demand may decrease by up to 20 percent relative to normal weather. Conversely, customer demand may increase by approximately that amount during a cold winter. Fluctuations in demand creates risks around energy procurement, as well as how many CCA allowances that NW Natural must purchase, that is outside of our control.

The amount of conservation is set by statute. Under section 11 of HB 1257, gas utilities are required to "identify and acquire all conservation measures that are available and cost-effective" by "establish[ing] an acquisition target every two years . . . [and to] demonstrate

that the target will result in the acquisition of all resources identified as available and cost-effective." This obligation predates the CCA and the CCA prevents consigned auction revenue from being used to meet "existing requirements in statute, rule, or other legal requirements."[1] In short, the risks involved with pursuing conservation should not be part of a CCA cost recovery mechanism given that the obligation to pursue all cost-effective conservation is separate and apart from the CCA itself.

2. How should a potential CCA risk sharing mechanism be structured?

Although risks in complying with the CCA largely remain outside of a utility's control, the utility nonetheless controls its response to these outside risks. Cost recovery should depend on whether those responses are prudent given the information available to the utility at the time. Utilities bear the risk of demonstrating that the actions they took to comply with the CCA are prudent. If they cannot make that demonstration, they face a disallowance of some or all of their CCA compliance costs, and potentially penalties under the CCA for non-compliance. If, however, utilities can demonstrate that the costs they have incurred are prudent, they can recover such costs in rates. In this way, risk is shared between customers and the utilities. Customers are not at risk of paying for utilities' imprudent decisions and utilities are not at risk of a disallowance for their prudently incurred costs.

Given that the CCA requires utilities to incur compliance costs, NW Natural continues to believe that such a ratemaking mechanism appropriately balances the risks between the customer and the utility. It prevents a disallowance of prudently incurred costs that utilities must incur to comply with Washington law, while ensuring that customers do not pay for any imprudent decisions that a utility may make.

If the Commission, however, seeks to adopt another type of risk sharing mechanism, then NW Natural reiterates the importance of symmetry. As explained in our September 7 comments, a risk-sharing mechanism should not result in the utility only bearing the downside risks of CCA compliance. Instead a utility should share in these benefits if it mitigated these compliance risks successfully.

3. What should the Commission consider when assessing utility actions for prudency as they relate to the CCA?

The Commission should continue to apply its existing prudency standard. That standard requires utilities to "establish that it adequately studied the question of whether to purchase these resources [or, in this case, take a certain CCA compliance action] and made a reasonable decision, using the data and methods that a reasonable management would have used at the time the decisions were made."[2] Under this standard, a utility's actions are evaluated without the benefit of hindsight and instead reflect what the utility either knew or should have known at the time the action was taken. As explained in the response to the first question, NW Natural also believes that consistency with an acknowledged

[1] RCW 70A.65.130.
[2] Wash. Util. & Trans. Comm'n v. Avista, Order 5, UE-150204, UG-150205 at P.170 (Jan. 6, 2016).

IRP action plan should be able to be used as evidence in support of favorable rate treatment, although it does not relieve the utility from demonstrating prudency in a cost recovery proceeding.

Satisfying this standard includes: 1) establishing the utility's CCA compliance obligation, 2) identifying the CCA compliance alternatives to satisfy this obligation, 3) each alternative's corresponding costs and risks, and 4) how the utility evaluated those alternatives, including whether the utility's evaluation was reasonable given what it should have known at the time the decision was made. This evaluation does not mean there is one "right" alternative that the utility should have selected, nor does it mean that the Commission should substitute its judgment for that of the utility's. Instead the analysis should focus on whether "reasonable management" may have selected that alternative.

In applying this standard to the CCA in the near-term, the Commission should also take into account that the CCA is a new program and there remains material unknowns, such as if the Washington market will link with the California/Quebec market.

4. When should the risk sharing mechanism allow for prudency determination? Every auction, yearly, every four-year compliance period, or another frequency?

NW Natural recently made a separate tariff filing seeking to recover CCA costs and to allocate consigned CCA allowance revenue for customer benefit (UG-230819). In this filing, NW Natural proposed to use a balancing account to track the difference between actual collections and program costs to the amounts forecasted into rates over time. These annual CCA compliance costs would be subject to an annual retrospective prudence review based on costs actually incurred. Annual review limits the deferral balance of CCA costs that must eventually be recovered in rates. If cost recovery is delayed, the deferral balance will increase, exacerbating the eventual rate impact of the CCA. As such, annual review strikes the right balance between ensuring relatively prompt cost recovery while limiting the administrative burden of prudence reviews. If, for instance, the Commission reviewed prudence after every quarterly auction, the deferral balance would be somewhat less than it would be under a single annual review, but the administrative burden of quarterly prudence reviews and multiple rate changes a year far outweighs this benefit. Conversely, if a prudence review was held once every four years, it would materially delay cost recovery and increase financing costs. This would likely cause significant rate volatility and create a mismatch in the timing of the costs and benefits of the CCA compliance activities for utilities' customers.

To adequately review the prudency of a utility's CCA compliance costs, the Commission also does not need to wait until the four-year CCA compliance period is complete. As stated above, the Commission's prudency standard is conducted without the benefit of hindsight. Therefore, it would be inconsistent with that standard to determine whether a utility's costs were prudent based on events that occurred after that utility incurred those costs. To the extent that a utility must take actions in the last year of the compliance period to assure compliance throughout the entire four-year compliance period, the Commission can evaluate the prudency of those actions during that year's annual review.

5-7. CCA Dispatch Cost Modeling Questions

NW Natural believes that these questions are solely directed at the electric system and, therefore, defers to electric utilities and other interested parties. To the extent that these questions apply to gas utilities, NW Natural reserves its right to answer these questions in subsequent comments.

NW Natural appreciates the opportunity to provide these comments and looks forward to participating in the upcoming workshops and further comment requests.

Please address questions and correspondence on this matter to the following:

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Sincerely,

NW Natural

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