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October 25, 2021

SENT VIA WUTC WEB PORTAL
Amanda Maxwell
Executive Director and Secretary
Washington Utilities and Transportation Commission
621 Woodland Square Loop SE
Lacey, WA 98503

Re: *Consideration of whether to continue to use the Perpetual Net Present Value Methodology to calculate natural gas line extension allowances,*
Docket UG-210729

Dear Director Maxwell:

The Public Counsel Unit of the Washington State Attorney General's Office ("Public Counsel") respectfully submits these comments in advance of the October 28, 2021, Open Meeting. These comments are in response to Chair Danner's motion to consider whether natural gas utilities should continue to use the Perpetual Net Present Value (PNPV) methodology to calculate natural gas line extension allowances.[1]

Public Counsel's Recommendation

Public Counsel recommends the Washington Utlities and Transportation Commission ("Commission" or "UTC") determine that the PNPV methodology is inconsistent with state policy and that natural gas utilities should not continue to use PNPV to calculate natural gas line extension allowances.

Background on Natural Gas Line Extension Allowances

A natural gas line extension allowance is the amount of funding a utility will provide toward extending distribution services to a new customer. These allowances are paid for by existing customers through rates. The cost differential between the allowance and the total cost of construction is the new customer's responsibility. Providing an allowance to new natural gas

[1] Notice of Opportunity to File Written Comments, *Consideration of Whether to Continue to Use the Perpetual Net Present Value Methodology to Calculate Natural Gas Line Extension Allowances*, Docket UG-210729 (filed Sept. 21, 2021).

customers effectively encourages natural gas use, as it makes it more feasible for a new customer to enter the system.

When a utility receives revenues from new customers that is at least equal to the incremental cost, existing customers are not harmed by the allowance. Conversely, if a new customer does not provide the anticipated revenues, existing customers subsidize new customers through the socialized cost of the allowance that is not recovered. The goal, then, when calculating allowances should be for the result to be economical and minimize cross-subsidization.

WAC 480-90-033 requires each gas utility to file, as part of its tariff, a distribution line extension rule setting forth the conditions under which it will extend its facilities to make service available to an applicant. In this filing, utilities discuss how they calculate allowances.

Currently, Avista, Puget Sound Energy (PSE), and Cascade Natural Gas (Cascade) use the PNPV method to calculate allowances. Under the PNPV method, the maximum level of "economical" investment a utility will make for line extensions equals the annual distribution margin divided by the required rate of return. The method assumes that the recovery period approaches infinity.[2] As noted by Avista in the collaborative Docket UG-143616, this perpetual assumption assumes that once service is established, "service will be permanent."[3]

During the 2014 Legislative session, H.B. 2177 would have directed the UTC to conduct a process to allow customers and utilities to submit proposals for financing and building natural gas infrastructure, with a particular focus on rural and underserved areas.[4] While that bill was not passed by the Legislature, the UTC opened Docket UG-143616 to discuss natural gas expansion. The PNPV methodology for calculating allowances was first approved by the Commission in Docket UG-152394, when Avista proposed to pilot the methodology on a three-year term. Subsequently, Cascade and PSE proposed the use of this methodology in their rate cases, Dockets UG-160967 and UG-161268, respectively.

The utilities have used a number of methodologies to determine economically feasible line extension investments. In Washington, prior to adopting the PNPV methodology, PSE used a facilities investment analysis, which provided an allowance based on the estimated annual revenue from the customer. To estimate this revenue, PSE considered factors such as the square footage of the house, the use of natural gas powered appliances, whether the extension required a

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[2] Ken Costello, *Line Extensions for Natural Gas: Regulatory Considerations* (Nat'l Regul. Rsch. Inst. Feb. 2013), https://pubs.naruc.org/pub/FA86B6C6-E91D-FF76-882F-04081293B088 (Report 13–01).
[3] Avista Line Extension Policy at 6, *In re. Investigation of Nat. Gas Distribution Infrastructure Expansion*, Docket UG-143616 (filed Sept. 21, 2015).
[4] H.B. 2177 63rd Leg. 2014 Sess. (Wash. 2014).

main extension or a service extension, and whether there would be new customers served if on a main extension.

Avista's former methodology provided an allowance equal to three times the estimated annual revenue from the customer. This is a widely used methodology nationwide, wherein the utility designates a minimum payback period, in Avista's case three years, and multiplies that number by the estimated annual net revenue for a particular customer. According to an American Gas Association survey, about half of the utilities reporting used this simple revenue test.[5]

Utilities have used other methodologies including the internal rate of return (IRR) method. Using IRR, utilities calculate the discount rate at which the present-value distribution margins equal the present value incremental costs. The utility estimates the annual margins and costs over the service life of a new line or some other specified time. If the discount rate is greater than the utility's cost of capital, then the utility would consider the new line economically feasible.[6]

Some utilities use a net present value method, similar to Washington's PNPV method, but which applies a discrete time period instead of a perpetual time period. Indeed, the use of a discrete time period is the key difference between Washington's PNPV method and other methodologies, including methods used by Washington utilities prior to adopting PNPV.

The PNPV Method Does Not Align with State Policy

State policy has changed significantly since the Commission approved the use of the PNPV method. For example, since the collaborative Docket UG-143616 and subsequent general rate case filings, Washington has set rigorous greenhouse gas emissions targets. These new guidelines contain multiple interim targets with the ultimate goal of reducing emissions levels to 95 percent below 1990 levels and achieving net zero emissions.[7] Additionally, while the Clean Energy Transformation Act (CETA) applies to electric generation and not natural gas utility service, CETA expresses a clear policy directive favoring nonemitting resources and which ultimately moves Washington away from fossil fuels.

Assuming a "perpetual" timeline for a new natural gas connection does not seem to align with Washington's current energy and emissions policies. Washington's policies seem to indicate that a reduction, rather than expansion, of natural gas usage is expected over time. As a result, the original assumption of permanent service is no longer valid.

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[5] Ken Costello, *Line Extensions for Natural Gas: Regulatory Considerations* at 20-21 (Nat'l Regul. Rsch. Inst. Feb. 2013), https://pubs.naruc.org/pub/FA86B6C6-E91D-FF76-882F-04081293B088 (Report 13–01).
[6] *Id* at 2.
[7] Dep't of Ecology, *Tracking greenhouse gases*, *Greenhouse Gas Emission Limits* table, https://ecology.wa.gov/Air-Climate/Climate-change/Greenhouse-gases (last visitied Oct. 20, 2021); RCW 70A.45.020 (2020).

Additionally, Public Counsel understands that using the PNPV method results in a relatively higher allowance than other methods. As such, PNPV calculated allowances provide greater incentive to new customers to join the natural gas system, contrary to the State's greenhouse gas emission reduction goals. Furthermore, higher allowances carry more risk for cross-subsidization from existing customers, as the utility would have to collect a higher amount of revenue from new customers to hold existing customers harmless. With policy shifts away from fossil fuels, revenue under-collection seems especially risky.

One benefit of the PNPV method is that it is simple, and that was one factor weighing in its favor when the Commission initially adopted the method. Other methods provide similar simplicity, such as using a net present value method tied to a specific time period. Additionally, the Commission could reasonably consider other methods because the utilities are familiar with more complex methodologies, as recently noted by Chair Danner.[8] While Public Counsel does not recommend a particular methodology, it is clear that PNPV should be replaced and that the Commission has a number of reasonable options to consider.

Other Considerations

Strongly encouraging expanding natural gas usage raises general concerns for Public Counsel. Two factors impact Public Counsel's level of concern. First, natural gas prices have been volatile. Second, Washington's energy and emissions policies clearly favor nonemitting resources.

At the time of the collaborative Docket UG-143616 and for the past several years, the Henry Hub Natural Gas Spot price was relatively low.[9] More recently, gas prices have been steadily rising, and analysts predict that winter prices this year could be the most expensive in 13 years.[10] Customers bear the risk of this volatility as evidenced by the utilities' most recent purchased gas adjustment filings. These adjustments, if approved,[11] result in the following average residential bill increases:

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[8] *WUTC v Puget Sound Energy*, Dockets UE-190529 and UG-190530 (*Consol.),* Final Order 08, at 210, ¶ 7 (July 8, 2020) (Dissenting Opinion of Chair Danner, noting that although previous methodologies were more complex, PSE was familiar with them because they were used within the last three years before Order 08 was entered.)
[9] U.S. Energy Info. Admin., *Henry Huby Natural Gas Spot Price* (Oct. 20, 2021), https://www.eia.gov/dnav/ng/hist/rngwhhdm.htm.
[10] Patti Domm, *Natural gas prices are rising and could be the most expensive in 13 years this winter*, CNBC, Updated Sep. 10 2021, https://www.cnbc.com/2021/09/09/natural-gas-prices-are-rising-and-could-be-the-most-expensive-in-13-years-this-winter.html.
[11] Each Docket is scheduled for the October 28, 2021, Open Meeting.

Cascade Natural Gas (UG-210711)	14.4%
Puget Sound Energy (UG-210721)	5.4%
Northwest Natural Gas (UG-210701)	9.8%
Avista Corp. (UG-210672)	10.0%

This volatility should be considered in relation to how strongly customers should be encouraged to seek new natural gas connections.

Public Counsel recognizes that natural gas will continue to play a role in Washington's transition to clean energy. That role is still being defined and is likely to change over time, but natural gas remains cleaner than some other sources of heating energy, such as wood burning or oil. Instead of heavily incentivizing natural gas usage, Public Counsel encourages the Commission to require utilities to provide allowances that minimize the socialized costs of line extensions while still providing adequate access to natural gas for new customers.

Public Counsel appreciates the opportunity to submit these comments. We will be present at the October 28, 2021, Open Meeting and look forward to participating in the discussion in this docket. If you have any questions about this filing, please contact Shay Bauman at (206) 389-3040 or via e-mail at Shay.Bauman@ATG.WA.GOV, or Lisa Gafken at (206) 464-6595 or via e-mail at Lisa.Gafken@ATG.WA.GOV.

Sincerely,

/s/ Lisa W. Gafken

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