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September 11, 2026

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
Attn: Filing Center
201 High Street SE, Suite 100
PO Box 1088
Salem, Oregon 97308

Re: AR 676 - Rulemaking to Establish Multi-Year Rate Plan Framework (HB 3179 & SB 688 Implementation)

Northwest Natural Gas Company, dba NW Natural ("NW Natural" or the "Company"), hereby files the Gas Distribution, Transmission & Storage (Capital) cost category Pre-Read Materials in docket AR 676.

Please address any correspondence on this matter to me, with a copy to the following:

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Rates & Regulatory Affairs
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Sincerely,

NW Natural

/s/ Maddie Pulliam

Maddie Pulliam
Rates & Regulatory Analyst

Enclosure

Capital Investment

Rate Base, Revenue Requirement, and "Return Of" and "Return On" Capital

$1 ≠ $1

Unlike O&M, a dollar of capital is not recovered in the year it is spent. It is added to rate base and recovered over the asset's useful life through a "return of" capital (depreciation) plus a "return on" capital (the authorized rate of return), along with associated taxes.

How utility investment is financed

Energy utilities are very capital-intensive businesses. Serving customers safely means continuously investing in infrastructure — pipes, storage, and resource centers that stay in service for decades. That money invested in our system is "capital," and the Company does not have it sitting in a bank account. We raise it from outside investors (i.e., the capital markets), competing with other utilities and other industries for those investors to choose to provide their limited capital to our utility.

50% / 50%
debt / equity

We finance our investments with a balanced mix of debt — money we borrow and repay with interest — and equity — money from shareholders, who expect a return on what they invest in our company. Keeping that balance is what a financially healthy, investment-grade utility looks like.

We compete nationwide for capital to flow into Oregon. Investors can put their money almost anywhere, so we compete against other utilities and every other use of a dollar. Capital flows to the most attractive risk-adjusted return — and if we are seen as riskier or less rewarding (a weaker balance sheet, a credit downgrade, or an unpredictable regulatory environment), investors demand more before they will invest. That required return is our "cost of capital". Historically, the utility sector has been viewed as a stable, predictable sector, and the types of typical equity investors reflect that — for example, long-term, income-oriented savers such as pension and retirement funds, for whom a utility is the conservative portion of a larger portfolio. They do not expect the outsized gains of a technology stock, but they do expect a return meaningfully better than a "risk-free" U.S. Treasury bond.

The basic ratemaking concept

The revenue requirement is the annual revenue the utility is authorized to collect to cover the cost of providing service and a fair return on invested capital — the starting, or "going-in," rates for a multi-year rate plan. When the Company builds or buys a long-lived asset (pipe, a compressor, a meter, a building, or software), the cost is capitalized and added to rate base, then recovered gradually over the asset's useful life. Two components of the revenue requirement do that work: depreciation expense returns the original investment, or principal (a return *of* capital), and the authorized return on rate base compensates the debt and equity investors who financed it (a return *on* capital). The table below shows the full revenue requirement; the highlighted rows are the pieces driven by capital investment.

ELEMENTS OF REVENUE REQUIREMENT

Operating & Maintenance	Day-to-day, non-capital costs of providing utility service
Depreciation Expense	Return OF capital — recovers the original investment over the asset's useful life
Return on Rate Base	Return ON capital — the authorized return (cost of debt and equity) on undepreciated rate base
Income Taxes	**Federal and state income taxes**
Other Taxes	**Property, payroll, and other applicable taxes**
Gas Costs	Commodity and upstream pipeline costs, recovered through the PGA
REVENUE REQUIREMENT	**Total annual revenue needed to provide service**

Highlighted rows are driven by capital investment and are the focus of this pre-read. NW Natural plans to discuss taxes and other items at the Gas Other Costs workshop.

"Return of" and "return on" in practice

A simple example makes the two components concrete. Assume the Company invests $10 million in an asset with a 40-year depreciable life:

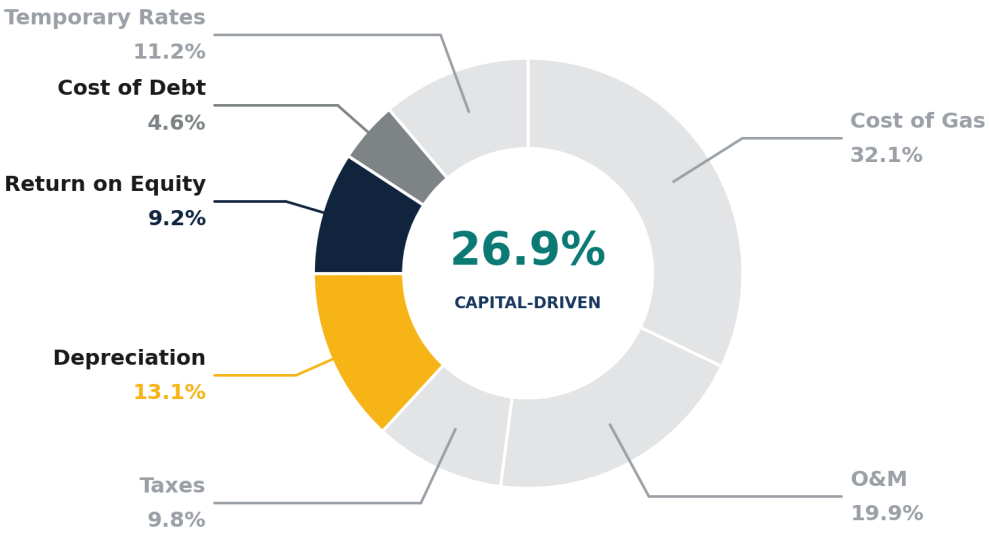
- **Return *of* capital (depreciation expense).** Roughly 1/40th (about $250,000) is recovered each year, giving the Company back the dollars it invested, spread across the years customers benefit from the asset.
- **Return *on* capital (return on rate base).** The undepreciated balance still in rate base earns the authorized return (the weighted cost of debt and equity). As the asset depreciates, that balance — and the return on it — declines over time, similar to a mortgage.

By contrast, a dollar of O&M is fully recovered in the year it is incurred and earns no return — so it adds one dollar to the going-in revenue requirement, while a dollar of capital adds only its first-year depreciation plus the return on its rate-base balance, and keeps contributing for the life of the asset.

Depreciation and asset lives. Because depreciation is the return of capital, the useful life assigned to each asset determines how quickly customers repay an investment. Long-lived assets such as distribution and transmission pipe are recovered over decades, spreading cost across the many generations of customers who benefit; short-lived assets — particularly IT and cloud software — are recovered over just a few years, which concentrates recovery and makes timely rate treatment more important. Depreciation rates are set through a formal study approved by the Commission supporting generational equity – customers pay for the assets they use.

Capital as a Percentage of Total Bill

Capital-driven costs — depreciation, return on equity, and the cost of debt — make up roughly **27% of a typical customer bill**, a larger share than O&M. The chart below uses the same illustrative bill breakout presented in the O&M pre-read, with the capital-driven components highlighted.



Note: temporary rates include deferrals and other adjustments that are typically outside of a revenue requirement determination.

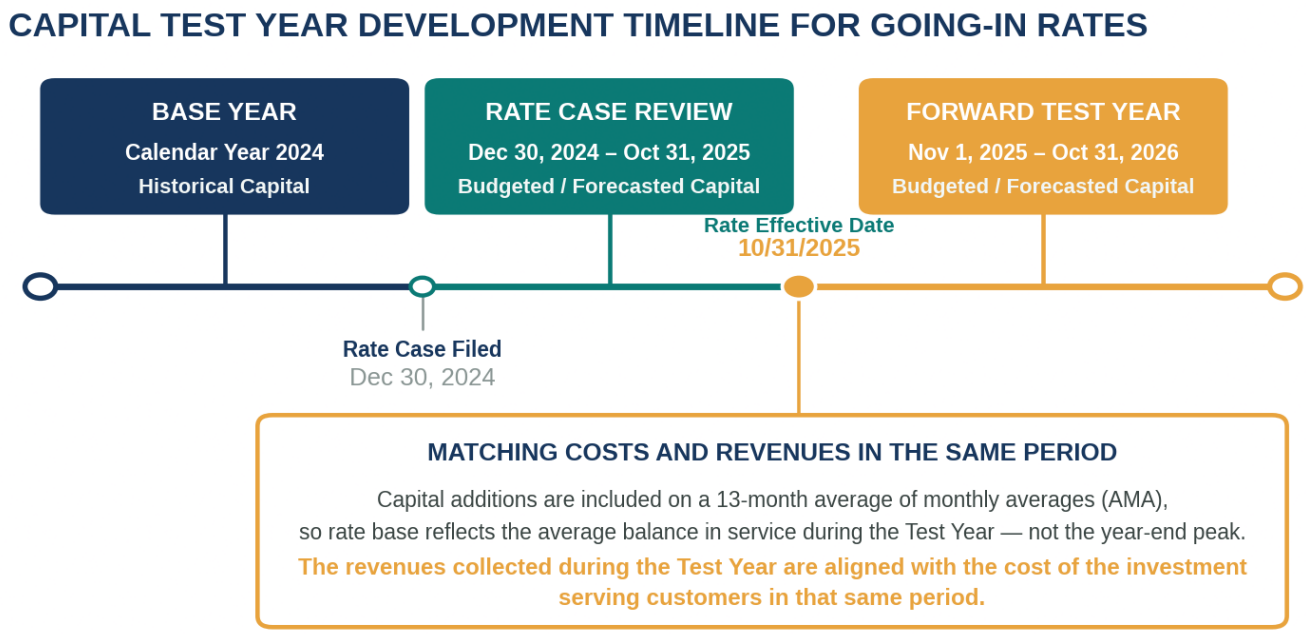
Components of rate base

Rate base is the net investment on which the Company is authorized to earn a return. As shown below, it begins with utility plant in service and is adjusted by accumulated depreciation and several other items.

Utility Plant in Service	The gross, original cost of all assets used and useful in serving customers — pipe, meters, stations, storage, facilities, and technology
Less: Accumulated Depreciation	The portion of plant already recovered from customers through depreciation. Subtracted to arrive at net plant
Less: Accumulated Deferred Income Taxes	A cost-free source of financing from timing differences between book and tax depreciation. Reduces rate base, lowering the return customers fund
Plus: Cash Working Capital	Investor-supplied funds needed to bridge the gap between paying costs and collecting revenue (set by a lead-lag study)
Plus: Materials & Supplies / Gas Inventory	Average balances of stored gas and inventory required to operate the system reliably
Less: Customer Advances & Contributions	Customer-provided funds toward construction, which reduce the Company's rate base

Test Year capital development timeline

The timeline below shows how capital moves from a historical base year, through the budgeting process, to the plant balances reflected in going-in rates.



"Test Year" capital and the used-and-useful principle

As with O&M, capital is set on a forward-looking test-year basis so rates reflect the investment in service during the period customers pay for it. One principle governs which capital enters rate base: an asset must be **used and useful** — actually in service and providing benefit to customers — before its cost may be recovered in rates.

NW Natural includes reasonably certain forecast additions in the Test Year on an Average of Monthly Averages (AMA) basis. Because assets go into service throughout the year, AMA reflects only the portion of the year that an asset is in service — so customers pay in proportion to the benefit received. In recent rate cases, the settlements have resulted in including Test-Year capital associated with our customer-growth capital.

The main buckets of capital

NW Natural's capital investment falls into a set of functional categories that make up gross plant and, ultimately, rate base.

Transmission Integrity Management Program ("TIMP")
Distribution Integrity Management Program ("DIMP")
Federally mandated pipeline-integrity programs supporting the safety and reliability of the transmission and distribution systems; driven by inspection, assessment, and replacement needs.

Public Works
Mandatory projects required to support public-infrastructure projects. Driven by city, state, or federal projects.

System Betterments / Reinforcement Typically, large, discrete projects that are long-planned; Betterments are often associated with investments in our storage assets (Portland LNG, Newport LNG, and Mist). Reinforcements address capacity/pressure issues on our distribution system or improve system performance.	**Relocates** Projects that move existing pipeline facilities for safety, compliance, or to accommodate external construction. Forecast using historical trends.
Information Technology & Services Technology, communications, software, and hardware supporting operations. Driven by modernization of IT platforms and cybersecurity. These projects are a mix of large, discrete projects and routine technical refreshes (non-discrete).	**Customer Acquisitions (Growth)** Capital required to serve new customers. Driven by customer growth.
Transportation and Equipment Vehicles, fleet, and equipment needed to operate and maintain the system safely. Driven by replacement cycles and asset condition.	**Land & Structures** Land, buildings, and facilities housing crews and operations.

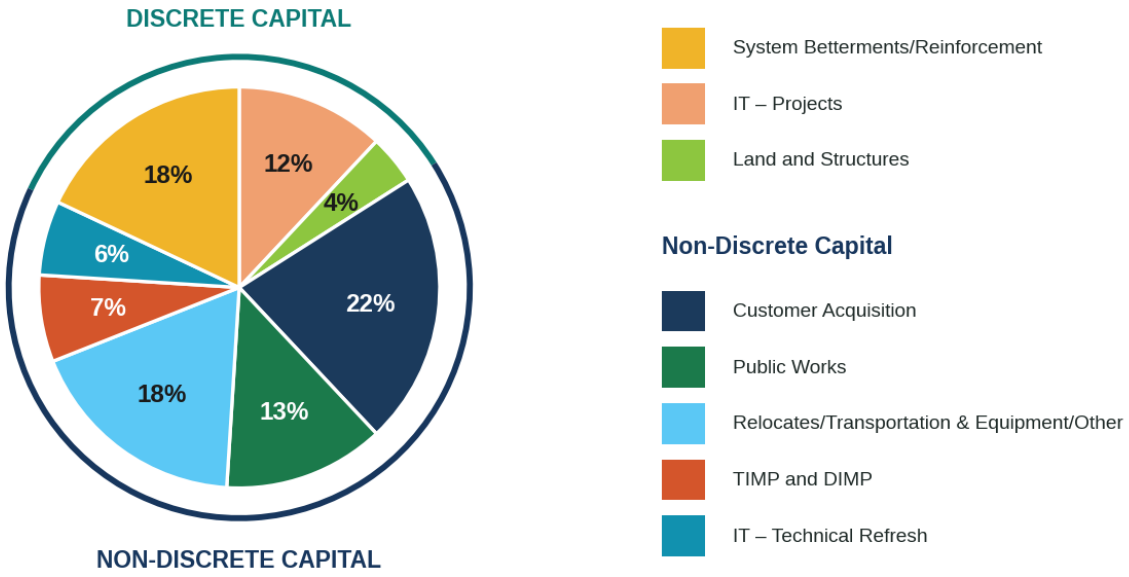
DISCRETE VS. NON-DISCRETE CAPITAL

- **Discrete investments.** Projects the Company proposes to meet a specific operational aim or system issue — System Betterments, System Reinforcement, IT projects, and Land & Structures. These tend to be lumpy: large, uneven, and concentrated in particular years rather than recurring at a steady level.
- **Non-discrete investments.** Recurring, steady-level spend over which the Company has little discretion — Public Works, Relocates, Damages, Transportation & Equipment, Tools, Technical Refresh, Leakage, Customer Growth, and the federally mandated TIMP and DIMP programs.

Scale of investment. NW Natural's capital profile is substantial and relatively steady — roughly $310 million in 2023, $377 million in 2024, $353 million in 2025, and $361 million in 2026 on a system basis (Oregon & Washington). Each year's additions raise gross plant and therefore raise both the depreciation (return of) and the return on rate base (return on) that flow into the revenue requirement. The chart below breaks the annual program into its main categories.

2023–2026 Average Capital Expenditure Mix

% Share of total • Discrete vs. Non-Discrete Capital



Why an index-based revenue cap does not fit all capital

An index is a reasonable starting point for capital that recurs at a predictable level. It is not a good fit for every category. Some capital is mandated, statutory, or lumpy— and may move well above or below any formulaic escalator. The amount of discrete investments changes from year to year, while the non-discrete capital is steady.

Capital driver	Why an index may not fit	Potential Approach
Discrete, extraordinary projects	Large projects such as projects at Mist and our LNG storage tanks, large reinforcement projects, and IT re-platforms are lumpy and uneven. An index escalating a historical average will not fund a project placed in service mid-plan.	**Targeted forecasted capital into the MRP or Supplemental Capital Funding Mechanism (SCFM)**
Statutory RNG investment	SB 98 establishes a separate statutory recovery mechanism that falls outside of general rate cases.	**Existing statutory Automatic Adjustment Clause**
Cybersecurity and TSA directives	Federally mandated, frequently amended, and security-sensitive. Scope continues to evolve and cannot be forecast reliably at the start of a plan.	**Deferral (UM 2192)**
Short-lived technology assets	IT and cloud assets are recovered over a few years, so recovery is concentrated. Delay produces substantial under-recovery rather than timing lag.	**Targeted forecast capital into MRP or SCFM**
Capital-to-O&M accounting shifts	Cloud migration moves spend from capital to O&M, changing the balance between the two without any change in the underlying work.	**SCFM includes associated O&M**

Capital recovered through trackers and deferrals

Not all capital flows through base rates. Some investments are recovered through targeted trackers or deferrals that provide timely, closely matched recovery of costs that are statutorily mandated or policy-driven. NW Natural uses two today:

SB 98 Renewable Natural Gas capital tracker (statutory)	Oregon SB 98 (ORS 757.392–757.396) lets large gas utilities make qualified RNG investments and recover them through a dedicated tracker, subject to an annual cost cap expressed as a percentage of revenue requirement, with annual compliance reporting (OAR 860-150-0600).
Cybersecurity / TSA Security Directive tracker (deferral)	Costs to comply with the federal TSA Pipeline Security Directive — ransomware mitigation, a contingency and response plan, and a security architecture design review — are captured through deferred accounting (UM 2192, ORS 757.259) for later ratemaking.

Capital under a multi-year rate plan

An index-based revenue cap escalates allowed revenue by a formula and does not, by itself, capture large, lumpy capital additions placed in service mid-plan. Staff's Phase 1 proposal contemplates a supplemental capital funding mechanism for discrete, extraordinary projects. Three points follow for AR 676:

- **Capital is the largest single driver of the bill.** At roughly 27% of a typical bill, capital-driven costs exceed O&M. Any index that does not track capital accurately will compound quickly.
- **Timing lag is a real cost.** Unrecovered investment drives financial underperformance and does not disappear — it produces a larger reset at the next rebasing.
- **Utilize SCFM alongside the index.** Supplemental capital funding should be preserved for discrete, long-planned investments that will not be captured by an index from going in rates.

In short, aligning capital recovery with the revenue support provided during a plan term — while preserving used-and-useful and prudence review — allows continued safe, reliable investment without a large reset at the next rebasing.