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September 19, 2012

VIA ELECTRONIC FILING
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Oregon Public Utility Commission
Attn: Filing Center
550 Capitol Street N.E., #215
P.O. Box 2148
Salem, Oregon 97308-2148

Re: In the Matter of Northwest Natural Gas Company – Application for a General Rate Revision
Docket No. UG-221

Dear Filing Center:

Enclosed please find an original and five (5) copies of the Northwest Industrial Gas Users' Post-Hearing Reply Brief.

Thank you for your assistance, and please do not hesitate to contact our office with any questions.

Very truly yours,

Tommy A. Brooks

TAB:sk
Enclosures

cc: UG 221 Service List

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BEFORE THE PUBLIC UTILITY COMMISSION

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OF OREGON

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UG 221

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In the Matter of	)	
	)	THE NORTHWEST INDUSTRIAL
NORTHWEST NATURAL GAS	)	GAS USERS' POST-HEARING REPLY
COMPANY	)	BRIEF
	)	
Application for a General Rate Revision	)	
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Pursuant to ALJ Hardie's Prehearing Conference Memorandum dated August 15, 2012, the Northwest Industrial Gas Users ("NWIGU") submit this Post-Hearing Reply Brief. This Post-Hearing Reply Brief provides NWIGU's response to the arguments presented in the initial post-hearing briefs of Northwest Natural Gas Company ("NW Natural" or "Company"), the Oregon Public Utilities Commission ("Commission") Staff, and the Citizens' Utility Board of Oregon ("CUB"). NWIGU's Initial Post-Hearing Brief addressed many of the issues raised by the Company, Staff and CUB, and NWIGU relies on its Initial Post-Hearing Brief as a reply to those issues in addition to the points and authorities below.

As noted in NWIGU's Initial Post-Hearing Brief, NW Natural bears the burden of proof in this proceeding. ORS 757.210(1)(a) expressly provides that "the utility shall bear the burden of showing that the rate or schedule of rates proposed to be established or increased or changed is fair, just and reasonable." To determine whether proposed rates are just and reasonable, the Commission will look to the record as a whole and make its determination on the preponderance of the evidence. Thus, a utility may fail to meet its burden of proof if an opposing party presents compelling evidence refuting the utility's proposal, or if the utility fails to present compelling evidence in the first place even if the utility's evidence is not opposed.[1]

NW Natural has not met its burden and the record does not support the Company's proposal with respect to five issues that remain unsettled in this proceeding: 1) Cost of Capital; 2) Environmental Remediation Expenses; 3) Pension Expenses; 4) Deferral and Recovery of State Tax Expenses; and 5) Prudency Issues Relating to the Company's Mid-Willamette Valley Feeder Project.

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[1] *In re Portland General Electric*, UE 228, Order No. 11-432 (Nov. 2, 2011).

I. Cost of Capital

NW Natural has requested a Return on Equity ("ROE") of 10 percent (down from its currently authorized 10.2), arguing that the operating environment for local distribution companies has become more complex and risky in the past 15 years.[2] NWIGU does not have its own expert witness on cost of capital, and instead relies on Staff's well-reasoned approach. The Commission should adopt Staff's recommended ROE of 9.4 percent for the following reasons:

- NW Natural has not met its burden of showing that its proposed ROE of 10 percent is needed for the company to attract equity investors at reasonable terms in today's capital markets and to maintain its financial integrity.
- Dr. Hadaway's surrebuttal testimony demonstrated a 9.7 percent average estimated ROE in his multistage DCF model. The 10 percent ROE requested by the Company represents an unjustified upward adjustment of 30 basis points.
- To support its request for a 10 percent ROE, NW Natural uses a 5.7 percent growth rate for U.S. Gross Domestic Product and for the dividends of NW Natural's peer utilities. These growth assumptions are excessive in this economic environment.
- NW Natural argues in part that Staff's position is unreasonable because its 9.4 percent ROE is 52 basis points lower than the 9.92 percent average gas utility ROE awarded in 2011. However, as Staff correctly noted in its post hearing brief, NW Natural's current ROE, awarded in 2003, is 83 basis points lower than the 11.03 percent average gas utility ROE awarded in 2002.

[2] NW Natural's Prehearing Brief, p.11, lines 12-13.

- Staff appropriately used the Commission's preferred multistage DCF model to arrive at an ROE of 9.4 percent. Staff's recommendation is appropriate because its multistage DCF models are based upon realistic and fair estimates of long term growth rates, whereas Company witness Dr. Hadaway's estimated long-term growth rates are overstated.
- Supreme Court precedent and prior decisions of this Commission establish that NW Natural is entitled to an opportunity to earn a return on equity that is sufficient to maintain its financial integrity and attract capital on reasonable terms.[3] The return should be comparable to other enterprises of corresponding risk. NW Natural is asking for a premium compared to other comparable utilities without justification.
- A just and reasonable approach to resolve these issues leads to the adoption of Staff's 9.4 percent ROE with a 50/50 capital structure. The cost of money is at an historic low point, and NW Natural's ROE must reflect that reality.

II. Environmental Remediation Expenses

NWIGU and other parties have objected to NW Natural's proposal to recover 100 percent (100%) of deferred environmental remediation costs associated with several contaminated sites. The Company proposes to establish two new rate schedules ("Schedules 183 and 184") to recover already-deferred costs as well as going forward expenditures. Proposed Schedule 184 - Special Rate Adjustment Gasco Upland Pumping Station would be specific to the costs incurred by the Company for building and maintaining a pumping station at the Gasco site. The Company is proposing to recover all other remediation costs through Schedule 183 - Site Remediation Recovery

[3] *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679, 690, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 88 L.Ed. 333 (1944); *In re Portland General Electric Co.*, UE 180, Order No 07-015 (Jan. 12, 2007).

Mechanism ("SRRM"). NW Natural's post-hearing brief makes several arguments to justify its proposal, each of which the Commission should reject.

A. It is unreasonable for the Company to avoid *any* sharing of the environmental remediation costs.

NWIGU, CUB and Staff have each proposed that the Commission require the Company to share some of the environmental remediation costs it seeks to recover. While Staff proposes that customers be responsible for 90 percent (90%) of those costs, even that amount is unfair to customers and NWIGU and CUB believe that it is more equitable for customers and the Company to split all of those costs such that customers and the Company will each be responsible for 50 percent (50%) of the costs.

The Company first asserts that *any* sharing of environmental remediation costs would cause financial harm to the Company.[4] While this is no doubt NW Natural's primary concern, the Company provides no legal basis for requiring the Commission to make a determination based on that assertion. Indeed, if prevention of negative financial impacts to the Company were the criterion for ratemaking, the Company would always be allowed to recover all of its costs and receive whatever return on equity ("ROE") it requested. Instead, the Commission's charge is to *balance* shareholders' interests in being fairly compensated for their investments with the Commission's duty to protect ratepayers from excessive rates and charges. Absent from NW Natural's testimony and briefs is any consideration of the severe financial burden customers will suffer by footing the entire bill for environmental remediation.[5]

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[4] NW Natural's Posthearing Brief ("NW Natural's Brief"), p.13.

[5] The only mention of impacts to customers in NW Natural's Brief is the unsupported statement that customers will also be harmed if the Commission requires the Company to share some of the environmental remediation costs. See NW Natural's Brief at p.14. The Commission can reject this lose-lose proposition for customers by requiring the Company to shoulder some of the burden.

B. The environmental remediation costs are not necessary and prudent for the purpose of including those costs in rates.

NW Natural next argues that no party contested the prudency of its environmental remediation costs.[6] This argument describes the scope of a prudency review too narrowly and focuses only on the *amount* the Company has incurred for environmental remediation. The complete standard for recovering costs is that they must be "necessary" and prudent or "reasonable" and prudent,[7] and utilities may recover costs for real estate only where the property is "presently used for providing utility service to the customer."[8] As NWIGU explained in its Initial Post-Hearing Brief, the Company's proposal does not account for the fact that the historic operations associated with the contamination and the present-day remediation of those sites are in no way related to the service of today's customers. Although NW Natural argues there is a "nexus" between the sites and its current operations, the Company fails to describe that alleged nexus with even a single description of the role the contaminated sites play within the utility's general operations – much less how they are specifically used for providing service to customers today.

NW Natural also makes the extreme assertion that the Company is entitled to a finding of prudence as a matter of law.[9] In support of that assertion, the Company cites to a Commission order that NW Natural grossly mischaracterizes as Commission policy that if a party or the Commission does not propose a change in a particular rate case item, the item is automatically adopted.[10] The language quoted in NW Natural's Brief is not a statement of Commission policy, rather, it is a statement by the Commission describing the manner in which a company might inappropriately attempt to avoid public scrutiny by including an income or expense item in its results of operation and not mentioning it in its testimony supporting the proposed rates. In that order, the Commission was expressing *concern*, not approval, that if "Staff or another party does not identify that item, the

[6] NW Natural's Brief, p.16.
[7] See, e.g., *In re PacifiCorp*, UE 116, Order No. 01-787 (Sep. 7, 2001).
[8] ORS 757.355(1).
[9] NW Natural's Brief, p.16.
[10] *In re Portland General Electric Co.*, UE 47, Order No. 87-1017 (Sep. 30, 1987).

proposal could be adopted with no public scrutiny."[11] Based on that concern, the Commission then adopted a policy requiring utilities to "identify and support in prefiled testimony in its next general rate case any transaction approved by the Commission for which ratemaking treatment has been deferred."[12] That policy statement relating to deferred costs is a far cry from any policy establishing prudency as a matter of law.

As part of its prudency argument, the Company also suggests that there is "intergenerational equity" between the costs being incurred and the customers from which the Company seeks to recover those costs.[13] The Company emphasizes that the costs are current costs imposed by current laws. NWIGU does not dispute the date the costs were incurred or the regulatory context that requires the Company to perform the environmental remediation activities that result in those costs. Those facets of the costs, however, are red herrings and do not relate to NWIGU's position, which is that NW Natural has not demonstrated how the costs are related to providing service to today's customers.

Finally, with respect to its prudency argument, the Company asserts that there is no reasonable rationale for cost sharing in part because the Company could not have anticipated the extent of the costs.[14] In support of that assertion, the Company relies on the testimony of Mr. Middleton, who states that the potential environmental consequences of manufactured gas plant ("MGP") operations were not understood at the time. A close review of Mr. Middleton's testimony, however, reveals that his statements are based only on a generalized notion of how the industry operated at the time. He makes no statement nor provides any evidence relating specifically to what NW Natural or its predecessors actually knew or did not know when they operated the MGP sites. Mr. Middleton's evidence is no more detailed than the evidence to which NW Natural

[11] Id.
[12] Id.
[13] NW Natural's Brief, p.19.
[14] NW Natural's Brief, p.18.

vehemently objects - NWIGU-CUB witness Mr. Larkin's proposal for cost sharing based on his understanding that utilities did in fact know of the dangerous properties and characteristics of MGP-related products, residuals and wastes.[15] The Commission should require the Company to present more evidence than just bare assertions of general industry operations as the justification for the prudency of the Company's specific decisions.

C. Prior Commission decisions relating to remediation costs are not comparable to NW Natural's current proposal.

NW Natural argues that prior Commission decisions relating to remediation costs did not require any sharing by the utility and, therefore, that it is Commission policy to not require sharing. Each of the prior decisions the Company relies on, however, are distinguishable from the Company's current proposal. The recovery of environmental remediation costs relating to the historical operation of MGP facilities is a matter of first impression before the Commission. Instead of having the ability to rely on precedent, the Commission will be making precedent with this decision.

The Company first cites to Order 07-375 relating to the proposed decommissioning of the Powerdale Hydro Generating Plant. At the time of that Commission order, the generating plant was in place, providing utility service to customers at that time. The utility's action before the Commission was a decision to decommission the facility three years early instead of investing in the facility to keep it running until its original decommission date. To the extent that environmental remediation costs were included in decommissioning costs, those costs were closely tied to current customers receiving service from that facility. In contrast, NW Natural's MGP

[15] NWIGU-CUB/200, Larkin/27, lines 8-11. NW Natural seeks to discredit Mr. Larkin's testimony on this point and even sought to remove this portion of the testimony through a Motion to Strike. The ALJ denied that motion. NW Natural had the opportunity to cross-examine Mr. Larkin on this point but chose not to do so. NW Natural's objection to Mr. Larkin's testimony, and his qualifications as an expert to opine in this area, is therefore without merit.

sites have already been decommissioned, and those decommissioning costs were paid for by customers at that time.

The Company next cites to Order 11-242 relating to the proposed decommissioning of the Boardman coal-fired power plant. That order, too, addresses costs related to a proposal to decommission a plant before its original decommissioning date. Based on the order, the utility was authorized to adjust its depreciation rates to collect those costs. Again, those costs are being collected from current customers for a facility currently providing service to those customers.

The Company then cites to Order 00-112 relating to the sale of the Centralia Steam Electric Generating Plant. There, the utility proposed to share some of the benefits of the sale with its investors. NW Natural attempts to use this order as evidence that the Commission treats remediation costs as items appropriate to be included in rates. As with the other two orders NW Natural relies on, the generating plant was being used to provide service to customers at the time of the proposed sale and order. The benefits of the proposed sale would go to those same customers. Order 00-112 is also distinguishable because it addressed the allocation of the sale proceeds for accounting purposes only and not for purposes of determining cost recovery or rates.

Notably, Order 00-112 does not help NW Natural because, contrary to NW Natural's statement otherwise, the Commission's stance on environmental remediation costs in that order accepts the utility's position that such costs are a risk borne by the utility rather than customers. There, the utility expressly acknowledged that it would bear "certain future risks . . .such as the cost of environmental mitigation." The Commission rejected the utility's proposal to share the sale proceeds based on that risk because it was a risk that would be avoided by the sale and, therefore, there would be no need to further compensate the utility's investors with the proceeds from the sale. The Commission does later state in that order that "those costs are recoverable in rates," but

that language refers to risks associated with replacement power, not environmental remediation costs as NW Natural suggests.

D. Regardless of the amount of sharing the Commission allows, NW Natural's cost recovery should be subject to an earnings review.

NW Natural is also inappropriately seeking to have the environmental remediation tracker excluded from any earnings review. With respect to the costs already incurred by the Company, those amounts have been deferred and, as a matter of law, their eventual recovery is subject to an earnings test pursuant to ORS 757.259(5). The Company responds that, because the proposed environmental remediation tracker is an automatic adjustment clause ("AAC"), it is immune from any cost sharing analysis.

With respect to the amounts the Company has already deferred, those amounts do not qualify for treatment as an AAC. Pursuant to ORS 757.259(5), only an AAC "under 757.210(1)" is immune from an earnings test. ORS 757.210(1)(b), in turn, defines an AAC as "a provision of a rate schedule that provides for rate increases or decreases or both, without prior hearing, reflecting increases or decreases or both in costs incurred . . . and that is subject to review by the commission at least once every two years." NW Natural seeks approval for the approximately $64 million it has already incurred and has done so through the hearing process as part of a general rate case. Those costs will not increase or decrease over time, and there would be no additional review by the Commission every two years. Therefore, pursuant to ORS 757.210(1)(b), those costs do not qualify as an AAC.

With respect to amounts incurred in the future, and as NWIGU noted in its Initial Post-Hearing Brief, the Company has been consistently earning over its authorized rate of return.[16] While ORS 757.259(5) requires that any deferral not subject to an AAC must include an earnings test, it does not prohibit the Commission from requiring an

[16] NWIGU-CUB/200, Larkin 11, Table 1.

earnings test where an AAC is in place. In light of the tenuousness with which the environmental remediation costs are related to serving today's customers, as a matter of policy the Commission should require the Company to contribute to those costs during those times that it is able to earn more than its authorized rate of return. Any other result is unreasonable.

E. The Commission should not allow the Company to collect any environmental remediation costs from Schedule 31 and Schedule 32 customers until the rates in those schedules achieve parity with the rates for other schedules.

For the first time in its post hearing brief, NW Natural objects to NWIGU's proposal that the Commission's decision should recognize that the proposed Schedules 183 and 184 *inappropriately* assign cost responsibility to Schedule 31 and Schedule 32 customers who, according to the Company's own LRIC analysis, are already paying excessive margin charges. The only basis for NW Natural's objection is the statement that "NW Natural's industrial customers also benefitted from the availability of gas from MGP operations."[17]

First, NW Natural's assertion about the benefits to industrial customers is not supported in the record. The Company attempts to describe some benefits to customers during the time period in which the MGP facilities operated, but those alleged benefits are qualitative in nature, and the Company certainly does not quantify or even describe benefits specific to industrial customers.

Second, NW Natural's reliance on the historical benefit of MGP operations is a notable departure from the remainder of the Company's arguments, which try hard to convince the Commission that environmental remediation costs are "*current* costs, imposed by *current* laws."[18] If the Commission agrees with that reasoning, then it must also look to all of the other current costs related to serving current customers. As the

[17] NW Natural's Brief, p.28.
[18] NW Natural's Brief, p.19 (emphasis original).

Company does not dispute, there is a significant rate disparity between Schedules 31/32 and the Company's other customer classes. NW Natural's Brief does not address the magnitude of that disparity or the value of achieving parity. Instead the Company's proposed equal margin application further compounds the imbalances between the rates of various customer classes.[19]

F. The Commission should allow the Company to earn only a debt rate of return on the deferred costs.

As explained in NWIGU's Initial Post-Hearing Brief, and as described by NWIGU's and CUB's witness Mr. Larkin, the Company should only earn a debt rate of return on the balance reflected in the Deferred Environmental Cost Account.[20] NW Natural's Brief does not address these specific arguments. Rather, the Company responds only to Staff's proposal that deferred amounts should earn at the Modified Blended Treasury Rate instead of the Company's authorized rate or return. NWIGU reiterates its position that the appropriate rate of return should reflect the level of risk facing the company. Once the Commission has issued an order stating what amount NW Natural would recover as a reimbursement for environmental remediation costs, that amount would be a guaranteed recovery amount. Because there is no risk associated with the customer share of the environmental remediation costs, allowing the Company to earn its full ROE on these amounts would be inappropriate and punitive to customers. The Commission's order would guarantee the return of the environmental remediation costs and therefore only a debt return should be allowed for recovery by the Company.

III. Pension Expenses

NWIGU and other parties have also objected to NW Natural's proposal to add out-of-period pension plan contributions from investors to rate base. The proposed

[19] CUB also objects to NWIGU's rate spread proposal for environmental remediation costs but relies only on its pre-hearing brief in support of its objection. NWIGU addressed that objection in its Initial Post-Hearing Brief.

[20] NWIGU-CUB/100, Larkin/52, lines 24-25.

recovery of such contributions is improper and constitutes retroactive ratemaking.

A. The Commission did not authorize the Company to defer its out-of-period pension contributions.

As noted in NWIGU's Initial Post-Hearing Brief, the only prior expenses a utility may recover under ORS 757.259(1)(a)(B) are those the Commission has allowed the utility to defer. It is undisputed that these contributions included payments in 2009 and 2010 which occurred prior to the test year.[21] Until NW Natural filed its post hearing brief, it was also undisputed that the Commission has not authorized the Company to defer any pension expenses beyond the Company's FAS 87 expenses. The Company now asserts that the Commission did authorize the Company to defer those expenses in Docket UM 1293.

The application and resulting order in Docket UM 1293 are not related to the pension contributions now at issue and did not authorize the Company to defer those contributions for later recovery. First, NW Natural's application in that docket was a request for an accounting order to allow the Company to record a regulatory asset or liability necessitated by the requirements of FAS 158. As explained in the Staff report adopted by the order in UM 1293, the "FAS 158 financial standard changes FAS 87 by requiring that the funded status of postretirement plans be recorded on the balance sheet based on the Projected Benefit Obligation (PBO) rather than the Accumulated Benefit Obligation (ABO) as had previously been used." As the Staff report further explained, without the accounting change in the request, the Company would experience an immediate reduction in its common equity ratio, potentially impacting its credit rating and cost of capital. In other words, the Company's request at that time addressed only how the Company reported the overfunding/underfunding of its benefit plan on its

[21] NWN/400, Feltz/24, lines 2-4.

balance sheet and did not relate in any way to whether or how the Company would make contributions to its pension plan.

Second, the Commission's order, in adopting the Staff report, makes it clear that the Commission approved the application only for accounting purposes. The report expressly stated that approval "does not impact the level of pension expenses included in the company's cost of service or net income, nor does it constitute authorization of any future ratemaking treatment of those costs associated with the regulatory asset." The report goes on to state that "Staff and NW Natural both acknowledge that there should be no rate change, now or in the future, associated with the requested regulatory asset."

B. Without a deferral order, the recovery of out-of-period pension contributions constitutes retroactive ratemaking.

NW Natural's Brief re-asserts that the recovery of its prior pension expenses is not retroactive ratemaking because the Company believes these expenses would not qualify for deferral.[22] As explained in NWIGU's Initial Post-Hearing Brief, this assertion contradicts the live testimony of NW Natural witness Mr. Feltz who stated "yes, it's true that we could have – we had the ability to go file for a deferral order."[23]

NW Natural's Brief also implies that all "prepaid assets" represent an investment of funds generally included in rate base.[24] In support of that argument, NW Natural cites to Robert L. Hahne's *Accounting for Public Utilities*.[25] A closer review of that authority, however, reveals that NW Natural is attempting to stretch that authority beyond its reasonable bounds. For example, that authority notes that prepayments are "generally" included in rate base, but it does not define the type of prepayments it is referring to. Instead, it simply states that "[p]repayments are made in advance of the period to which they apply and include items such as prepaid rents, insurance, and taxes."

[22] NW Natural's Brief, p.33.
[23] TR Feltz 15:12.
[24] NW Natural's Brief, p.34.
[25] NWN/4311.

The prepayments at issue here are nothing like rents, insurance or taxes. Each of those types of payment become fixed, corresponding to a specific time period. Pension plan contributions, on the other hand, may correspond to several time periods and be used to pay for current or future pension expenses.[26] To the extent that the contributions correspond to any specific time period, that time period is the same time period when the contributions are made, which is when the Company is required by law to meet specific funding levels for its pension plan. In other words, the contributions were necessitated by changes in federal law that require the Company to actually ensure that its pension plan is fully funded[27] and poor market conditions that decreased the value of the Company's pension plan assets.[28] Those contributions are *not* necessitated by the actual future payments of pension benefits, which may come from several different sources and contributions. Pension contributions are therefore not in the same category as other prepayments that may be appropriate to include in rate base.

IV. Deferral and Recovery of State Deferred Income Taxes

NWIGU and other parties oppose the Company's proposal in its filing to include a reduction to miscellaneous revenues relating to an incremental change in state tax rates in 2009. The record reflects that this reduction in revenue is improper.

A. The Commission never authorized the Company to establish a regulatory asset and defer the effect of the state tax rate changes on its deferred taxes.

The revenue reduction exists in the form of an unauthorized regulatory asset the Company initially created on its own in 2009.[29] The regulatory asset relates to grossed up changes in the deferred tax balance.[30] It is undisputed that the Company neither sought nor obtained permission from the Commission to establish the regulatory asset

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[26] See, e.g., NWN/400, Feltz 22 line 17.
[27] NWN/400, Feltz/23, line 7.
[28] Id., line 17.
[29] NWN/1900, Siores/24, lines 2-4.
[30] NWN/300, McVay-Siores/8, lines 8-10.

relating to the change in the deferred tax balance.[31]

In its post hearing brief, NW Natural claims that ORS 757.259 does not require the Company to seek a deferral order for its deferred taxes.[32] The basis for the Company's statement is its continued characterization of deferred taxes as "future tax liabilities."[33] Contrary to the Company's statement, the purpose of deferred income tax accounting is to recognize, *in the period in which it occurs,* the tax timing differences between deductions on the books and deductions on the tax return. Thus, the increase in expense occurs at the time the tax timing difference occurs, not at some future period. It is that increased expense that occurred prior to the test year that the Company seeks to move forward and recover in rates. That expense is therefore being deferred for later recovery and falls squarely within the scope of ORS 757.259.

Because neither the Company nor any ratepayer applied to the Commission for a deferral order, and because the Commission never issued an order authorizing the deferral, there is simply no legal basis for the Company to now seek recovery of the amounts deferred.

B. The proposed revenue deduction is improper because it constitutes single-issue and retroactive ratemaking.

NWIGU further objects to recovery of the deferred state income taxes because to allow such recovery would constitute single-issue ratemaking and retroactive ratemaking. NW Natural's Brief does not address the single-issue ratemaking component of its proposal.

With respect to retroactive ratemaking, the Company first re-asserts that the deferred tax balances "reflect" taxes that will be paid at some point in the future.[34] NWIGU does not dispute that one aspect of deferred tax accounting involves recording

[31] NWN/3000, Siores/16, lines 7-12.
[32] NW Natural's Brief, p.49.
[33] Id.
[34] NW Natural's Brief, p.46.

an estimate of taxes that may be paid in the future. However, the actual expense the Company seeks to recover here is not the future tax payment. Instead, it is the increased expense the Company has already recorded.[35] The events which caused the changes in the state deferred tax balance occurred in prior years that are outside of the test year. In other words, the Company is taking a prior period expense and carrying it forward. It is that aspect of the proposal that constitutes retroactive ratemaking.

The Company also argues that the fact that the Company never actually paid any increase in state tax as a result of changes in the tax law is actually support for its claim that its proposal is not retroactive ratemaking.[36] This statement mischaracterizes NWIGU's testimony regarding this issue. As explained in the testimony of NWIGU-CUB witness Mr. Larkin, in 2009 the amount of deferred income tax that the company recorded was larger than it would have been had the income tax rate remained the same. At that time, the Company did not pay any additional state taxes, but it was able to make an accounting entry that increased the income tax expense *in that period* and increased deferred state income tax on the Company's balance sheet.[37] It is the recovery of that increased expense, along with the others recorded prior to the test year, that constitutes retroactive ratemaking.

C. The case law NW Natural cites is not relevant to this proceeding.

In support of its proposal to recover deferred state income tax expenses, the Company relies on decisions from three other states the Company alleges resolve the retroactive ratemaking issue in the Company's favor. As explained in more detail below, those decisions should be ignored because they do not address the same proposal the Company has presented to the Commission for approval in this proceeding: recovery

[35] NWN/300, McVay-Siores/14, lines 10-11.
[36] NW Natural's Brief, p.49.
[37] NWIGU-CUB/200, Larkin/4, lines 11-17.

from ratepayers for an unauthorized regulatory asset pertaining to a change in state tax rates which occurred outside the test year.

The Company first cites to a decision by the Court of Appeals of Texas.[38] The Company incorrectly describes that decision as addressing a change in deferred tax balances resulting from a past change in tax rates.[39] In fact, there is no evidence in that decision that the utility faced a past change in tax rates. Rather, the proposal under review by the Court related to a change in accounting practices from a flow-through method to a normalization system.[40] Based on that accounting change, the court approved a one-time adjustment to the utility's total cost of service to put the utility in the same position it would have been if the normalization system had been used all along.[41] This adjustment was made as part of a general rate case going forward and the court expressly noted that it was for the purpose of allowing the utility "to obtain from present and prospective ratepayers its ***actual*** current and future tax expenses."[42] In contrast, NW Natural's proposal is to obtain from present and prospective ratepayers an expense that it already booked prior to the test year based on changes in a tax rate that also occurred prior to the test year.

NW Natural next relies on a Vermont case addressing the refund of an accumulated deferred income tax.[43] NW Natural again incorrectly describes that case as addressing the adjustment of a deferred tax balance.[44] In fact, the decision before the court in that case resolved whether and how funds that had been collected from ratepayers should be returned to ratepayers.[45] Specifically, the funds were for an expense

[38] *El Paso v. Pub. Util. Comm'n of Texas*, 839 SW 2d. 895 (Tex.App. 1992).
[39] NW Natural's Brief, p.47.
[40] *El Paso v. Pub. Util. Comm'n of Texas*, 839 SW 2d. at 930.
[41] Id.
[42] Id. at 931 (emphasis added).
[43] *In re Appeal of Investigation into Existing Rates of Shoreham Telephone Co., Inc.*, 915 A.2d 197 (Vt. 2006) ("*Shoreham*").
[44] NW Natural's Brief, p.47.
[45] *Shoreham*, 915 A.2d at 71.

that the utility "did not and will not incur."[46] Because those funds were unrelated to an actual expense, the court determined that they were unrelated to any excess profit or past losses and, therefore, that the doctrine of retroactive ratemaking was not applicable to that situation.[47] In contrast, NW Natural's deferred state taxes relate to an expense that did indeed occur. The Vermont case, therefore, does not apply to NW Natural's proposal.

Finally, NW Natural cites to an Illinois case which the Company suggests found that it is appropriate to adjust a deferred tax balance to account for changes in a tax rate.[48] The Illinois case addressed a 1986 federal tax rate reduction.[49] The tax rate reduction in that case benefitted ratepayers because it reduced the utility's overall expenses. The specific question before the court in that case was the period of time for which the utility should amortize the excess deferred taxes in order to return those funds to ratepayers. The Illinois utility did not set up an unauthorized regulatory asset and attempt to recover a cost from ratepayers as NW Natural does here, nor did the court's decision approve such a recovery for out-of-period expenses.

V. Prudency Issues Relating to the Mid-Willamette Valley Feeder Project

NWIGU and other parties disagree with the Company with respect to the prudence of the Perrydale to Monmouth and Monmouth Reinforcement components of the Mid-Willamette Valley Feeder project ("MWVF"). It is undisputed that NW Natural did not conduct a financial analysis of the investment for these two components of the MWVF project.[50] NW Natural now claims that such an analysis would be contrary to Oregon law because its only duty is to provide reliable service.[51] The Company also

[46] Id.
[47] Id.
[48] *Bus. and Professional People for the Public Interest v. Ill. Commerce Comm'n*, 146 Ill.2d 175 (1991).
[49] Id. at 257.
[50] NWIGU-CUB/100, Larkin/10, lines 4-9.
[51] NW Natural's Brief, pp.42-43.

complains that a Staff witness did not have a good proposal for how to conduct such an analysis.

It is impossible to accept NW Natural's argument that it is not required to do any financial analysis to measure the benefit of a reliability project in terms of dollars. Under that reasoning, the Company would be able to recover the costs of any reliability project no matter how lavish its expenditures were to develop that project. Such an outcome, of course, is truly contrary to Oregon law, which prevents a utility from collecting excessive charges from its customers. While NW Natural does have a duty under ORS 757.020 to furnish adequate service, that same statute requires that the charges for such service must be reasonable and just. Without a financial analysis describing the costs and benefits of a reliability project, the Commission cannot possibly determine if the charges for service relating to that project are reasonable and just.

Nor should the Commission give any weight to NW Natural's argument that Staff has not offered a good proposal for how to conduct a financial analysis. It is NW Natural's burden to provide that evidence for the Commission and other parties to review. There are no doubt several methods available to the Company for conducting a financial analysis, the sufficiency of which must be addressed on a case-by-case basis. The only financial analysis guaranteed to be insufficient is the lack of a financial analysis at all.

VI. CONCLUSION

In summary, the record does not support NW Natural's proposals and NWIGU respectfully requests that the Commission:

1. Set NW Natural's ROE at 9.4 percent with a capital structure that is 50 percent equity and 50 percent debt as reflective of the capital markets and Commission precedent;

2. Reject NW Natural's proposal on Schedules 183 and 184, and instead allow the Company to recover a maximum of 50 percent of environmental remediation

costs from ratepayers, subject to an earnings review;

3. Allow the Company to earn a debt rate of return on the balance reflected in the Deferred Environmental Cost Account rather than its fully authorized ROE;

4. Reject NW Natural's equal percent of margin approach on Schedules 183 and 184, and instead exclude Schedule 31 and Schedule 32 customers from any such charges to address the extreme rate disparities of these schedules relative to other customers;

5. Reject NW Natural's proposal to add nearly $22 million to rate base associated with contributions made to pension funds prior to the test year;

6. Reject NW Natural's proposal to amortize and recover from ratepayers an unauthorized regulatory asset relating to a change in the state tax rate that occurred prior to the test year; and

7. Reject NW Natural's attempt to recover prematurely built segments of the MWVF project until NW Natural has met its burden to show that these projects are justified and prudent.

Dated this 19th day of September 2012.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I caused to be served the foregoing ***NWIGU'S POST-HEARING REPLY BRIEF*** via electronic mail and, where paper service is not waived, via postage-paid first class mail upon the following parties of record:

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