

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

**UM 1722**

In the Matters of )  
)  
PUBLIC UTILITY COMMISSION OF )  
OREGON, )  
Investigation into Recovery of Safety Costs by )  
Natural Gas Utilities (UM 1722) )  
)  
and )  
)  
NORTHWEST NATURAL GAS COMPANY )  
dba NW NATURAL, )  
Request to Continue Schedule 177, the System )  
Integrity Program Recovery Mechanism )  
(UG 286) )

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**TESTIMONY OF EDWARD A. FINKLEA**

**ON BEHALF OF NORTHWEST INDUSTRIAL GAS USERS**

**February 8, 2016**

1 **Q. PLEASE STATE YOUR NAME AND YOUR EMPLOYER.**

2 **A.** My name is Edward A. Finklea, and I am an attorney serving as the Executive Director of  
3 the Northwest Industrial Gas Users (“NWIGU”).

4 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

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6 **A.** My resume is attached as Exhibit 101 to this testimony.

7 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

8 **A.** I am appearing on behalf of NWIGU. NWIGU member companies purchase gas sales and  
9 transportation service from Oregon local distribution companies (“LDCs”).

10 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

11 **A.** The purpose of my testimony is to respond to the testimony of the Joint Utilities (Cascade  
12 Natural Gas, Avista Utilities and Northwest Natural Gas Company (“NW Natural”)) and  
13 the testimony of NW Natural witnesses regarding the consolidated dockets UG 286 and  
14 UM 1722. In these consolidated dockets the Commission will decide whether to extend  
15 NW Natural’s existing cost recovery mechanism associated with its System Integrity  
16 Program (“SIP”), and the Commission is investigating generally whether Oregon LDCs  
17 should be allowed to implement cost recovery mechanisms to address future investments  
18 in safety improvements made between general rate cases.

19 **Q. ARE THE NORTHWEST INDUSTRIAL GAS USERS CATEGORICALLY  
20 OPPOSED TO SAFETY TRACKERS FOR OREGON LOCAL DISTRIBUTION  
COMPANIES?**

21 **A.** No. There are cases where safety trackers are appropriate, and NWIGU has supported  
22 tracker mechanisms in the past for addressing extraordinary safety investment programs,  
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1 such as NW Natural's replacement of cast iron and bare steel systems. The cast iron  
2 replacement program dates back to the 1980s and was supported by NWIGU at the time it  
3 was implemented by the Commission. NW Natural's SIP was implemented starting in  
4 2001 and consisted of three distinct programs: the Bare Steel Program, the Transmission  
5 Integrity Management Program (TIMP) and the Distribution Integrity Management  
6 Program (DIMP).

7           These safety investments were needed at the time to replace very specific portions  
8 of NW Natural's system that posed an unacceptable risk to public safety. These programs  
9 are not, however, precedent for allowing all Oregon LDCs to track through to customers  
10 future investments made simply to keep their distribution systems safe and in compliance  
11 with changing federal regulations. Furthermore, given the current level of investment  
12 expected by NW Natural, the SIP program does not need to be extended into the future.  
13 The SIP program accomplished its objective and is no longer needed to give NW Natural  
14 an extra incentive to make future safety improvements.

15           The primary obligation of the local distribution companies is to safely deliver  
16 natural gas within their allocated service territories. There is nothing extraordinary about  
17 the obligation to maintain a safe and reliable system. While federal laws over time may  
18 continue to toughen the requirements imposed on the local distribution companies, stricter  
19 regulation alone is not a reason to grant the Oregon LDCs a broad tracker mechanism that  
20 enables utilities to charge customers for all safety improvements made between rate cases.  
21 To do so would unfairly burden ratepayers. If anything, the fact that the U.S. Department  
22 of Transportation has adopted a TIMP that now governs transmission pipelines and a DIMP  
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1 that now governs the operation and maintenance of distribution pipelines means that efforts  
2 to comply with these laws and regulations are an ordinary aspect of operating and  
3 maintaining a local distribution system. Unless there is compelling evidence that the  
4 compliance related expenditures are causing earnings erosion due to regulatory lag, there  
5 is no reason to have a tracker mechanism simply because there are federal safety  
6 regulations that apply to Oregon LDCs.

7 **Q. SHOULD NW NATURAL'S SYSTEM INTEGRITY PROGRAM BE**  
8 **CONTINUED?**

9 A. Not at this time. I have reviewed the testimony of Joe Karney on behalf of NW Natural.  
10 Mr. Karney identifies \$8.3 to \$9.2 million annually in forecasted safety investments from  
11 2015 through 2017. That spend level is approximately 1.3 percent of NW Natural's annual  
12 revenue. In NW Natural's last general rate case, the depreciation expense allowed in rates  
13 was approximately \$60 million. NW Natural's rate base underlying current rates is \$983  
14 million. So long as the projected spend level is only a small fraction of allowed  
15 depreciation, there is no compelling reason to surcharge customers between rate cases for  
16 the moneys spent on safety compliance. Arguably the company would be charging  
17 customers twice for the same expense, once through the depreciation expense and a second  
18 time through the safety tracker surcharge. If the expense can be covered under current  
19 rates without causing earnings erosion, there is no need for a surcharge.

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1 Q. **DO YOU AGREE WITH NW NATURAL’S WITNESS THOMPSON THAT A**  
2 **SAFETY TRACKER WILL REMOVE A DISINCENTIVE THAT MAY EXIST**  
3 **WITH RESPECT TO UTILITIES MAKING TIMELY IMPROVEMENTS TO**  
4 **THEIR SYSTEMS?**

5 A. No. Oregon LDCs have an obligation to maintain their systems and make necessary safety  
6 related investments, regardless of whether a tracker is in place. Oregon LDCs are granted  
7 exclusive service territories, and they have an obligation to serve and provide safe and  
8 reliable service, in exchange for the opportunity to earn a fair, just and reasonable return  
9 on their investments. A fundamental part of this regulatory compact is that the utilities  
10 must maintain their systems, and be in compliance with state and federal laws, which  
11 change from time to time. I believe it is irresponsible to link a safety tracker with an  
12 inherent obligation to make necessary and required safety improvements.

13 Q. **THE FEDERAL ENERGY REGULATORY COMMISSION (“FERC”) HAS**  
14 **PROMULGATED A NEW POLICY ALLOWING INTERSTATE PIPELINES**  
15 **COST RECOVERY MECHANISM FOR “MODERNIZATION” INVESTMENTS.**  
16 **SHOULD THE OPUC ADOPT A SIMILAR POLICY FOR OREGON LDCS?**

17 A. No. The recent regulatory changes by FERC impacting interstate pipelines are not a reason  
18 to allow open ended safety trackers for LDCs in Oregon. I am generally familiar with the  
19 policy statement issued by FERC that authorizes cost recovery mechanisms for  
20 modernization of interstate pipelines. The safety, reliability, and environmental  
21 compliance challenges facing many US interstate pipelines are much more severe than the  
22 challenges Oregon LDCs face today.

23 The pipeline system that established the precedent for the FERC cost-recovery  
mechanism is the Columbia Gas system that serves the Eastern United States. Columbia  
Gas was facing up to \$300 million in capital costs annually to address system safety and

1 reliability issues across its vast pipeline network. *Cost Recovery Mechanisms for*  
2 *Modernization of Natural Gas Facilities*, 151 FERC ¶ 61,047, paragraph 14 (April 16,  
3 2015). Columbia Gas has an aging pipeline network that includes hundreds of miles of  
4 1960s vintage high pressure pipelines, river crossings that need to be replaced, and old  
5 compressors. In sharp contrast, Oregon has proactively addressed pipeline safety on LDC  
6 systems through the past programs that leave our gas distributors facing far less of an  
7 investment than US interstate pipelines, especially those in the Eastern United States of  
8 which I am familiar. I note that the interstate pipelines serving Oregon, Williams’  
9 Northwest Pipeline and TransCanada’s Gas Transmission Northwest, have not sought cost  
10 recovery mechanisms at FERC to address modernization efforts on their systems.

11 **Q. IF THE COMMISSION DOES NOT ALLOW SAFETY TRACKERS FOR**  
12 **OREGON LDCS, WILL THAT IMPACT THE SAFE OPERATION OF THE GAS**  
13 **DISTRIBUTION SYSTEMS IN OREGON?**

14 A. No. It should be clear that the only question raised in this docket is “when” cost recovery  
15 is appropriate (either through trackers or in a rate proceeding). All Oregon LDCs have an  
16 obligation to operate safely and to make investments to secure and maintain the gas  
17 distribution systems.

18 NWIGU completely supports Oregon LDCs making necessary investments to  
19 ensure that the gas distribution networks in our state are sound, reliable and 100 percent in  
20 compliance with all safety regulations, and agrees that those costs are recoverable. What  
21 has not been shown, however, is that Oregon’s ratemaking process is in any way impeding  
22 LDCs from making the necessary investments while still earning fair returns on their  
23 investments. The rate setting process grants LDCs a considerable depreciation expense at

1 the time new rates are set, and the rate base is also established. LDCs also earn on their  
2 established rate base, even though the rate base declines with depreciation. That added  
3 revenue should provide the funds necessary to make capital investments without harming  
4 the utility's earnings, even if revenues are flat. There is no showing in this proceeding that  
5 infrastructure investments in the coming years will so exceed the allowed depreciation  
6 expense and the financial incentive that comes from having a fixed rate base. Nor have  
7 the Oregon LDCs presented evidence that regulatory lag is eroding earnings due to  
8 enhanced investment in safety related improvements.

9 The simple fact that the Pipeline Hazardous Materials Safety Administration  
10 (PHMSA) is proposing new regulations does not in and of itself trigger a need for a tracker  
11 mechanism. Complying with new regulations is a cost of doing business for all businesses  
12 in our state, including our natural gas distribution companies. It is premature to allow a  
13 blanket safety tracker to pass through to customers immediately the costs of PHMSA  
14 regulatory compliance by Oregon LDCs.

15 NWIGU is open to the Oregon LDCs bringing forward specific large unexpected  
16 replacement projects that are comparable to NW Natural's cast iron and bare steel  
17 replacement programs and considering tracker mechanisms at that time. Those earlier  
18 programs had a great deal of specificity in their application and guarded against the utility  
19 being allowed to over earn while the tracker was in place. The costs of the replacement  
20 programs were extraordinary by the investment standards of the time. For NWIGU to  
21 support such a program in the future, there must be confidence that the safety tracker is  
22 addressing a real regulatory lag problem caused by specific safety issues, coupled with  
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1 protections for ratepayers. An open ended safety tracker modeled after the FERC policy  
2 statement is not warranted in Oregon at this time.

3 **Q. DID THE STATE OF WASHINGTON ADOPT A PIPELINE REPLACEMENT**  
4 **POLICY STATEMENT?**

5 A. Yes, on December 31, 2012, the Washington Utilities and Transportation Commission  
6 adopted a Policy on accelerated Replacement of Pipeline Facilities with Elevated Risk.

7 **Q. DO YOU SUPPORT SUCH A PROGRAM IN OREGON?**

8 A. No.

9 **Q. WHY IS WASHINGTON'S POLICY STATEMENT NOT APPROPRIATE FOR**  
10 **OREGON?**

11 A. First, it is important to recognize that Washington uses a historical test year for ratemaking  
12 purposes. This is very different than the ratemaking in Oregon, and makes the states'  
13 ratemaking process hard to compare. And while the Washington Commission adopted a  
14 special pipe replacement program cost recovery mechanism, it did so by setting parameters  
15 to protect ratepayers.

16 A major part of the WUTC's policy is that each company must file for approval of  
17 a pipe replacement program. This is true even if they are not seeking any kind of special  
18 recovery under a special pipe replacement program cost recovery mechanism ("CRM").  
19 The plan forces the companies to identify pipe that needs to be replaced, including its  
20 location. This was an important requirement because the utilities had the burden to show  
21 they actually had a need to replace pipes and knew where and how to do that.

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1 Annual investment in pipeline replacement that is eligible for recovery under Washington's  
2 CRM is limited to elevated-risk pipe, and the gas companies must demonstrate why the  
3 pipe it seeks to replace is appropriate for replacement compared to other pipe. That is, the  
4 utilities cannot use this in lieu of the normal capital investment process and they have to  
5 show there is a need to actually replace the pipe that is going to be subject to this special  
6 kind of cost recovery.

7 The pipe must be readily identifiable in the company's pipeline replacement  
8 program plan by both location and timetable. Costs recoverable under the cost recovery  
9 mechanism must not include: (1) the costs of locating pipe eligible for replacement; (2)  
10 pipeline costs associated with normal growth, system expansion, and repair and  
11 replacement of pipe damaged by third parties; or (3) the cost of pipe that a company is  
12 required to replace by a Commission order or approved settlement.

13 A third component of Washington's approach is that if a company files a CRM,  
14 that mechanism is only good until the utility's next general rate case, at which time the  
15 costs will fold plant investments into base rates. Moreover, if a CRM is in place, the  
16 company is required to file a general rate case within four years.

17 **Q. DO TRACKERS UNFAIRLY BURDEN RATEPAYERS AND FAVOR**  
18 **SHAREHOLDERS?**

19 A. Yes, safety trackers and other similar mechanisms unfairly burden ratepayers and benefit  
20 the utility and its shareholders. I have attached a simple example to illustrate this point.

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Base Rate Versus Tracker Recover (\$ Millions)				
Description	Test Year	Additions	Post TY	Tracker
	(1)	(2)	(3)	(4)
Rate Base				
GPIS	\$25,000	\$1,000	\$26,000	\$750
ACC Dep	7,500	638	8,138	9
Net Plant	17,500	363	17,863	741
Working Capital	500	-	500	-
Less: ADIT	<u>1,125</u>	<u>75</u>	<u>1200</u>	<u>1</u>
Rate Base	\$16,875	\$288	\$17,163	\$739
Net Operating Income (10%)	\$1,688		\$1,716	\$74
Income Tax	\$422		\$429	\$18
Depreciation Exp. (2.5%)	\$625	\$25	\$650	\$19
Revenue Req. Increase	\$2,734	\$61	\$2,795	\$111
			2.2%	4.1%

In this example, base rates are set in year 1 through a rate case. The rates are set to recover the utility's net rate base investments.

Then we move to the year following the year 1 rate case, and the system safety additions are added in two different ways (Option 1—Rate Case), Option 2 (Tracker). Option 1 continues base rate cost recovery with the safety improvements through a rate case filing as shown in the second column from the right. In Option 2 base rates do not change but a tracker filing for new safety investments has been put into place (no rate case), as shown in the last column on the right.

In option 1, the incremental plant investment is added to rate base and accumulated depreciation reserve and ADIT are reducing rate base. The "net" increase in rate base reflects the rate base additions net of reductions. Rates are set based on net plant changes.

1 In Option 2, base rates are not changed and no rate proceeding is assumed to take place. A  
2 tracker charge is imposed for all incremental or new plant investment. Here, the  
3 combination of base rate set in the last rate case and the addition of the tracker surcharge  
4 results in customers paying more than the "net" change in the utility's plant  
5 investment. The reduction in plant caused by increases in accumulated depreciation and  
6 ADIT are not reflected in either base rates or the tracker. The tracker is intended to capture  
7 all increases in new safety investments, without any offset. In other words, in Option 2,  
8 base rates and the tracker reflect plant additions, but do not reflect plant reductions.

9 In summary, customers pay more through trackers than they would have paid  
10 through rate case recovery because all charges are not synchronized to accurately reflect  
11 changes in "net" plant. Absent extraordinary circumstances that warrant a safety tracker,  
12 this is not fair, just or reasonable.

13 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

14 **A.** Yes.

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**TESTIMONY OF EDWARD A. FINKLEA**

**ON BEHALF OF NORTHWEST INDUSTRIAL GAS USERS**

**February 8, 2016**

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## Edward A. Finklea

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### **Primary Professional Experience**

Lead counsel for the Northwest Industrial Gas Users (“NWIGU”) from 1986 until 2008 in all regulatory interventions concerning Williams Gas Pipeline West and TransCanada Gas Transmission Northwest, and before state regulatory commissions concerning regulation of the five regional natural gas local distribution companies (“LDCs”).

Represented NWIGU before the Federal Energy Regulatory Commission in interstate pipeline rate and certificate proceedings, before the Oregon Public Utility Commission in natural gas rate and other regulatory proceedings, before the Washington Utilities and Transportation Commission in natural gas rate, safety and other regulatory proceedings and in proceedings before the Idaho Public Utility Commission..

### **Employment History**

Executive Director for the Northwest Industrial Gas Users, August 2012 to present

Adjunct Professor at Northwestern School of Law, Lewis and Clark College “Law and Economics” Current

Senior Counsel, NiSource Corporate Services Inc.  
Regulatory counsel to interstate pipeline, representing company before Federal Energy Regulatory Commission and advising company on federal regulatory compliance and business transactions. November, 2009 to November, 2011

Executive Director, Energy Action Northwest. Organization advocated for siting and permitting of interstate pipelines, liquefied natural gas terminals, and high voltage transmission projects in Oregon and Washington.

Represented organization before state legislature and in media relations. July, 2008 to October, 2009

Partner, Cable Huston Benedict Haagensen & Lloyd. Private law practice specializing in energy law. 2004 until July 2008.

Managing Partner, Energy Advocates LLP. Founded firm with offices in Portland, Oregon and Washington D.C. 1997-2003

Partner, Ball Janik LLP. 1994-1997

Partner, Heller Ehrman White & McAuliffe. 1990-1994

Partner, Tonkin Torp Galen Marmaduke & Booth. 1986-1990

Associate, Garvey Schubert. 1986-1988

Assistant General Counsel to Northwest Natural Gas handling state regulatory matters and providing counsel to the company on energy projects, including a landfill gas project. 1984-1986

Counsel to the Bonneville Power Administration litigating electric rate issues in administrative hearings and defending BPA before the Ninth Circuit Court of Appeals. 1982-84

Trial Attorney for the Federal Energy Regulatory Commission in hydroelectric licensing and co-generation regulation. 1981-82

Law Clerk for the Council on Wage and Price Stability, Executive Office of the President of the United States. 1980-81

**Summary of  
Professional  
Engagements**

Represented Columbia Gulf Transmission in general rate proceeding before the Federal Energy Regulatory Commission.

Represented applicants in proceeding before Federal Energy Regulatory Commission seeking authorization to provide incentive fuel mechanism and natural gas hub services.

Represented industrial gas consumers in contract negotiations for the purchase of natural gas commodity and interstate pipeline services.

Counsel to a medical center interconnecting a cogeneration plant with an investor-owned utility and advising client on long-term gas purchasing arrangement for electric generation.

Represented numerous clients to secure direct connections to interstate pipelines, addressing all regulatory issues involving certification of connecting facilities and operations of private pipelines.

Represented liquefied natural gas developer in governmental relations associated with securing federal and local permits for development of an energy project.

Represented customers in negotiating special contracts for purchasing natural gas distribution services from local utilities.

Represented public port authority in a pipeline siting issue.

Represented Eugene Water and Electric Board in select issues concerning Bonneville Power Administration.

Represented irrigation farmers in electric rate dispute involving FERC-licensed hydroelectric project before the Oregon Public Utility Commission.

Represented clients in trial court and appellate litigation on energy-related issues.

Represented industrial customer in anti-trust litigation and FERC refund proceedings stemming for 2000-2001 Western Energy Crisis.

Represented industrial electric customers in the restructuring of electric utilities in Oregon.

Represented an oil company shipper on an intrastate oil pipeline in rate proceeding before the Washington Utilities and Transportation Commission.

Individual clients while in private practice in addition to NWIGU included Alcoa, Armstrong World Industries, Blue Heron Paper, Boeing, ESCO, James River Paper (now Georgia Pacific) JR Simplot, Legacy Health Systems, MicroChip Technology, NorthernStar Natural Gas, Texaco Gas Marketing, Valley Medical Center, WaferTech, Wah Chang, West Linn Paper, and Weyerhaeuser.

## **Education**

BA in Political Science from the University of Minnesota  
1974

J.D. Northwestern School of Law, Lewis and Clark College  
1980

## **Professional Memberships**

Admitted to practice law in the States of Oregon and Texas and before several Federal district and appellate courts.

Adjunct Professor at Northwestern School of Law, Lewis and Clark College "Northwest Energy Law". 1984 to 2005

Past Chairman of "Energy, Telecom and Utilities" section of the Oregon State Bar.

Member of the Federal Energy Bar Association.

Lecturer: Buying and Selling Electric Power in the West, Law Seminars International Conference. Presentations on natural gas industry. 2004 to 2009.