ORDER NO. 12 437

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

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In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL, Request for a General Rate Revision.	SUPPLEMENTAL ORDER

DISPOSITION: APPLICATION FOR GENERAL RATE REVISION APPROVED AS REVISED; FURTHER PROCEEDINGS ORDERED; PRELIMINARY ORDER CLARIFIED

I. INTRODUCTION

This order addresses the request of Northwest Natural Gas Company, dba NW Natural, for a general rate revision and approval of a mechanism for recovery of certain environmental remediation costs. In a preliminary order on October 26, 2012, we adopted the two partial stipulations filed by the parties, set forth our decision on the remaining disputed issues, and approved a modified mechanism for recovery of certain environmental remediation costs.[1] The order increased NW Natural's revenue requirement by $8,716,000, representing a 1.24 percent increase to its previous rates.[2] NW Natural was directed to file new tariffs consistent with the preliminary order to be effective November 1, 2012.

We issue this supplemental order describing more fully the parties' positions in this docket and the rationale for our decisions. We also clarify two issues related to the company's environmental remediation mechanism.

II. BACKGROUND AND PROCEDURAL HISTORY

NW Natural is a public utility providing natural gas service within the State of Oregon within the meaning of ORS 757.005, and is subject to the Commission's jurisdiction with respect to the prices and terms of service for its Oregon retail customers. NW Natural provides natural gas service to approximately 674,000 retail customers in Oregon.

On December 30, 2011, NW Natural filed Advice 11-19, an application for revised tariff schedules. In its application, the company requested a 6.2 percent increase to its existing

[1] Order No. 12-408.

[2] This calculation is shown in Appendix A.

revenue requirement.[3] NW Natural stated that the primary drivers for its rate request are compliance with safety requirements, enhanced customer service, and company contributions to pension funds. In addition to requesting an increase in its revenue requirement, the company also sought Commission approval of a mechanism for recovery of various environmental remediation costs.

On January 19, 2012, the Commission suspended NW Natural's proposed tariff revisions for a period of nine months, as authorized by ORS 757.215.[4] On January 23, 2012, a prehearing conference was held and a procedural schedule was established.

During the course of the proceedings, the following were granted leave to intervene as parties: the NW Energy Coalition (NWEC); the Community Action Partnership of Oregon; the Northwest Industrial Gas Users (NWIGU); Northwest Pipeline, GP; and Portland General Electric Company. The Citizens' Utility Board of Oregon (CUB) intervened as a matter of right under ORS 774.180.

The parties conducted discovery, filed several rounds of testimony, and engaged in settlement discussions.

On July 9, 2012, the parties filed an uncontested stipulation addressing a number of issues in this docket. On October 2, 2012, the parties filed a second uncontested stipulation addressing additional issues. A number of disputed issues remained unresolved.

Parties filed prehearing briefs on August 20, 2012. A hearing was held on August 23, 2012. At the time of the hearing, the following issues remained in dispute:

(1) The company's return on equity;
(2) The reasonableness of a hedging transaction related to the company's cost of debt;
(3) The prudence of certain portions of the Mid-Willamette Valley Feeder project;
(4) The appropriate regulatory treatment of certain company contributions to pension funds;
(5) The appropriate regulatory treatment of certain state income taxes; and
(6) The company's proposed mechanism for recovery of certain environmental remediation costs.

Post-hearing briefs were filed on September 12, 2012, and post-hearing reply briefs on September 19, 2012. Oral argument was held on October 11, 2012. A preliminary order setting rates was issued on October 26, 2012.

[3] The company explained that this represents a 4 percent increase in rates when a decoupling deferral of $15.1 million already in customers' current rates is taken into account.
[4] *See* Order No. 12-011.

III. DISCUSSION

A. Disputed Revenue Requirement Issues

NW Natural's filing included a proposed capital structure of 50 percent debt and 50 percent equity. We approve this capital structure, which no party has challenged. Two elements of the company's rate of return were disputed: The company's return on equity, and its cost of debt. We address these issues in turn.

1. Return on Equity

NW Natural requests a return on equity (ROE) of 10 percent.[5] NW Natural's cost of capital witness, Dr. Samuel C. Hadaway, presented a range of ROEs from 9.4 to 10.1 percent based on his updated discounted cash flow analyses. Staff argues that the company's requested 10 percent ROE is too high. Staff proposes an ROE range from 8.8 to 9.5 percent, and recommends the Commission adopt an ROE of 9.4 percent.

a. Parties' Positions

i. <u>*NW Natural*</u>

NW Natural's requested ROE of 10 percent is based primarily on Dr. Hadaway's discounted cash flow (DCF) method analysis. NW Natural argues that its requested ROE should be adopted because Dr. Hadaway's DCF analysis is more complete than Staff's, and that his estimated growth rates are more reasonable and consistent.

NW Natural explains there are two key difference between its and Staff's DCF modeling. First, it notes, Dr. Hadaway developed results from both constant growth and multi-stage DCF models, while Staff used only the multi-stage model. NW Natural argues that, although the Commission rejected the use of single-stage DCF modeling in the past, it signaled that it was open to use of single-stage models in the future, and has, in fact, relied on the testimony of an expert in docket UE 180 who used only a single-stage model.[6] Dr. Hadaway's single-stage DCF model produced a median ROE of 10.3 percent in his direct testimony and 10.1 percent in his surrebuttal testimony update, results that NW Natural says should be given weight in the Commission's ROE determination.

The second key difference, NW Natural continues, is the application of different dividend growth rates in the parties' DCF analyses. Dr. Hadaway relied on a GDP-growth rate, which was 5.8 percent in his direct testimony and 5.7 percent in his updated analysis. Using these growth rates, NW Natural states, Dr. Hadaway's multi-stage analysis produced a median ROE of 10.1 percent in his direct testimony, and 9.7 percent in his surrebuttal testimony.

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[5] NW Natural originally requested an ROE of 10.3 percent but reduced its request in later testimony.

[6] *See In re Portland Gen. Elec. Co.,* Docket Nos. UE 180, UE 181, UE 184, Order No. 07-015 (Jan 12, 2007).

NW Natural criticizes the inconsistent growth rates reflected in Staff's testimony. One of Staff's growth rates was based on a composite of government forecasts (4.91 percent); one based on the historical real GDP growth rate since 1980 (5.48 percent); and one using Dr. Hadaway's GDP growth rate (5.8 percent). In rebuttal testimony, NW Natural argues, Staff reduced its GDP rate to 5.14 percent by changing the methodology used to determine the long-term growth rate.

According to NW Natural, Dr. Hadaway's long-term GDP rate is based on historical nominal GDP data for the period of 1950 to 2010, with more weight given to recent data. NW Natural argues that this method is consistent with the derivation of most econometric forecasts. NW Natural argues that Dr. Hadaway's data shows that in all but the most recent periods, periodic average inflation rates have been over three percent. Finally, NW Natural argues that Dr. Hadaway's 5.7 percent growth rate is consistent with Value Line's 5.65 percent growth rate.

NW Natural contends that current market conditions support an ROE at the upper end of Dr. Hadaway's DCF range. NW Natural argues that existing government policies designed to maintain low interest rates have distorted the relationship between monetary supply and demand. The models used to determine ROE, including the DCF model, do not account for this market distortion. Because income-seeking investors are looking to dividend-paying stocks like utilities, this has reduced the dividend yield percentage to historically low levels. NW Natural notes that Value Line has warned investors that industry stocks may be overvalued. For this reason, NW Natural argues, the results of traditional DCF modeling are questionable at this time. NW Natural applies an adjustment to the traditional modeling to account for what it refers to as the anomalous state of the markets.

NW Natural criticizes Staff for running only traditional analyses without considering current market conditions. NW Natural argues that Staff in rebuttal testimony based its multi-stage DCF 2 model on an analysis that modeled the sale of stock in 2052, rather than 2042, the time frame used in its original analysis. Using a shorter time period is a more reasonable approach, NW Natural argues, and results in an estimated ROE of 10.6 percent. It argues that this result should be balanced against the low results produced by traditional approached.

Finally, NW Natural argues that its business risks, which include increasing competition for residential load, ongoing environmental liabilities, unrecovered pension contributions, increased complexity in the industry, the economic slowdown, and warmer-than-normal conditions, all increase the company's risk and justify its proposed ROE. NW Natural also points out that Staff's recommended ROE is low compared to average allowed ROEs in other jurisdictions.

ii. <u>*Staff*</u>

Staff's proposed ROE range of 8.8 to 9.5 percent, and recommended ROE of 9.4 percent, is based on Staff witness Steven Storm's two multi-stage DCF models using three estimates of long-term growth in dividends for the selected peer utilities.

Staff notes that the Commission has historically favored the multi-stage DCF model over the single-stage model. According to Staff, even NW Natural agreed, in a previous docket, that the multi-stage DCF model improves on the implicit assumption in the single-stage DCF model that dividends grow indefinitely at the same rate. Staff argues there is no reason to change the conclusion that the multi-stage DCF model provides superior results.

Staff states that the multi-stage DCF models used by NW Natural and Staff produce identical results when Dr. Hadaway's 5.7 percent long-term growth rate is applied (yielding a 9.6 percent average). The key differences between the models, Staff argues, are the values used for the long-term growth rate of dividends for peer utilities, and a number of qualitative differences.[7]

Staff defends its use of a 5.14 percent long-term growth rate, the key quantitative difference between its analysis and NW Natural's. Staff explains that its long-term growth rate assumes an average annual inflation rate of 2.12 percent. This comes from, Staff states, an average of two estimates of long-term inflation: a 2.11 percent rate based on the average of forecasts for the relevant timeframe by four federal agencies and Blue Chip consensus forecasts, and a 2.13 percent average estimate based on Mr. Storm's TIPS break-even methodology. Staff argues these are credible sources.

Staff argues that Dr. Hadaway's long-term inflation rate of 3 percent is too high. It is, Staff argues, 89 basis points above the long-term inflation rate of the institutions Staff relied on (four federal agencies plus the Blue Chip consensus), and 87 basis points above the rates established by the financial markets.[8] These differences, Staff contends, explain the large difference between Staff's and NW Natural's long-term growth rates. Staff also argues Dr. Hadaway applied the long-term growth rate too early, in 2018, while Staff did not apply it fully until 2023. Staff's application makes more sense, Staff suggests, because most economists are forecasting little to no growth until late this decade.

In short, Staff believes that when comparing the quantitative differences between the parties' multi-stage DCF analyses, Staff's long-term growth rate is more credible.

In addition to challenging NW Natural's long-term growth rate, Staff challenges a number of what it calls NW Natural's "qualitative" adjustments to Mr. Hadaway's analyses. The first is referred to by Staff as NW Natural's "outboard adjustment." Both NW Natural and Staff based their average stock prices on a period spanning three months. NW Natural went a step beyond averaging the three months of prices, and further adjusted the results based on its view that such an adjustment is warranted by anomalous market conditions. Essentially, Staff argues, NW Natural's proposed ROE is 30 basis points above the 9.7 percent estimated result of Dr. Hadaway's multi-stage DCF

[7] Staff believes the differences in the parties' modeling of long-term growth rate of dividends for peer utilities in the multi-stage DCF models count for 30 basis points of the difference between the parties' 9.4 percent and 10 percent ROE recommendations.

[8] Staff is referring to the GDP Price Deflator inflation rate, derived from Mr. Storm's TIPS break-even rate of inflation.

simply because of this qualitative adjustment. Staff argues that this outboard adjustment is unwarranted because an equity investor's risk aversion is relatively low.

Staff quotes the Commission's prior statement that "[c]apital market conditions, not regulatory decisions, determine a utility's cost of equity."[9] Staff argues that, in making its outboard adjustment, NW Natural ignored capital market conditions and the valuations investors have put on the peer utilities. Staff argues the Commission should use "considerable caution" if contemplating using valuations other than those made by the market itself.

b. Resolution

Based on the evidence presented, we adopt an ROE of 9.5 percent, which falls within the ranges presented by both NW Natural and Staff. We find Staff's ROE analysis to be the more credible analysis. We are also persuaded by Staff's criticism of NW Natural's qualitative adjustments and its assessment of NW Natural's relative risk profile.

First, we give no weight to the results of NW Natural's single-stage DCF analysis. Staff relied only on multi-stage DCF modeling, for which we have expressed a preference in the past. As we have stated, multi-stage DCF modeling "improves on the implicit assumption in the single-stage DCF model that dividends grow indefinitely at the same rate."[10] We find no reason in the record of this case to reject this assumption, and therefore find it appropriate to rely on the parties' multi-stage DCF modeling in making our determination.

Second, reviewing the parties' multi-stage DCF modeling, we are not convinced that NW Natural's "outboard adjustment" is appropriate. We agree with Staff that, although the markets may go through various cycles, the parties' data should be based on capital market conditions and the valuations investors have put on peer utilities, rather than other factors.

Another key difference between the parties' analyses, in addition to NW Natural's outboard adjustment, is the difference between the inflation rates underlying the parties' GDP forecasts. The parties have derived their inflation estimates and their associated long-term growth rates from a number of sources. We find Staff's rationale for its inflation rate estimate more persuasive.

Our adoption of an ROE of 9.5 percent is further supported by our assessment of NW Natural's relative risk profile. While NW Natural argues that it is facing increasing business risks, we find that the company's business risks are mitigated by a number of risk-reduction measures we have approved for the company, including the company's

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[9] *See In re PacifiCorp,* Docket No. UE 116, Order No. 01-787 at 32 (Sept 7, 2001).
[10] *Id.* at 24.

Purchased Gas Adjustment proceedings, the SIP, the WARM program, and the company's decoupling mechanism.[11]

2. *Cost of Debt (Financial Hedge)*

In 2007, NW Natural entered into an interest rate swap intended to mitigate interest rate risk and achieve a certain target level of interest cost for an upcoming debt issuance.[12] According to the company, there was substantial market volatility as the company planned the debt issuance, so the swap was intended to lock in a target interest rate to mitigate that risk.[13] The financial crisis in 2008 and resulting market effects in 2009 adversely affected the outcome of the swap transaction, ultimately leading the company to suffer a significant loss on the transaction.[14]

Staff argues the company should be required to absorb $2,250,000 from the transaction,[15] on the grounds that the company failed to perform the proper risk analyses prior to entering the interest rate swap. Staff recommends implementing this reduction by reducing the cost of a debt issuance and lowering the company's cost of long-term debt.[16]

a. Parties' Positions

i. <u>*Staff*</u>

Staff argues that NW Natural should be required to absorb part of the hedging loss for several reasons. First, Staff argues that the company should have conducted its own probabilistic risk analysis of the hedge or used an independent third party to conduct the risk analysis. Staff notes that NW Natural hires outside consultants to evaluate the company's risk in other contexts, and that it should have done so here. Second, Staff argues that the company failed to deliver price and timing certainty at a cost proportional to the interest rate risk. Staff believes that NW Natural should have negotiated modifications to the hedge contract to contractually limit the company's exposure to losses. Third, Staff contends that the company's financial hedging standards are less stringent than Financial Accounting Standards Board FASB standards in terms of determining whether a hedge is effective.

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[11] Moreover, we have determined in this proceeding that NW Natural may begin amortizing prudently incurred environmental costs in the near future, further limiting the company's risk.

[12] In an interest rate swap, one party agrees to pay interest on the contracted amount at a fixed swap rate, while simultaneously agreeing to receive interest based on a variable swap rate, thereby allowing a party to manage exposure to interest rate fluctuations.

[13] We authorized NW Natural to use interest rate derivates such as interest rate swaps under certain specified conditions. *See In re NW Natural Gas Co. Application for Authorization for Interest Rate Hedging*, Docket No. UF 4235, Order No. 07-032 (Jan 29, 2007).

[14] For reasons of confidentiality, the details of the swap transaction have been omitted here.

[15] According to Staff, this represents approximately 22.3 percent of the actual loss of $10,096,000. The proposed disallowance represents 50 percent of the portion of the hedge loss exceeding $5,600,000 (The maximum likely loss expected at the time the company entered into the hedge contract).

[16] Staff/2300, Muldoon 4-5.

Staff recommends that some proportion of the interest rate hedge be "disallowed to reflect that NW Natural needs to do better."[17] Staff proposes a 50-50 sharing of the amount exceeding the maximum likely expected loss between NW Natural and its ratepayers, and proposes that this sharing be reflected in a reduction to the company's stipulated cost of debt.

ii. *NW Natural*

NW Natural disagrees with Staff's criticisms of the interest rate swap. NW Natural maintains that the hedge meets the Commission's standard for prudence. NW Natural believes that both its overall hedging strategy and the execution of that strategy were prudent.

The company argues that it was reasonable to enter into the transaction as a general matter. At the time, the company was concerned about the volatility in interest rates in connection with an upcoming debt issuance. Because rising interest rates could greatly increase the cost of the issuance, NW Natural contends, it made sense to explore options for mitigating this risk.

NW Natural points out that it obtained Commission authorization in 2007 to use certain interest rate hedging products to allow it to exercise precisely this type of risk mitigation. The resulting Commission order allowed the company to enter into interest rate derivatives such as interest rates swaps, caps, floors, and other such instruments, with certain dollar limitations and other requirements.

The company further argues that it engaged in a reasonable analysis of its options. NW Natural states that it spent several months evaluating potential mechanisms for hedging interest rates, and discussing its options with investment banks. After the company determined that it would use an interest rate swap, it issued a request for proposals and closely monitored swap rates. When swap rates were at the low point for the year, the company entered into the hedge. It used the bank counterparty with the lowest rate offer from a competitive bid process. As required by Commission order, the company filed documentation related to the swap on February 26, 2008.

The company explains that the financial crisis in 2008 and 2009 created a "significant, unexpected, and apparently unprecedented" variance between the AA swap rate and AA utility bond rate, which had historically been tightly correlated, to the point where the rates actually inversely correlated. According NW Natural, this type of variance was unprecedented in the history of the company's tracking such swaps.

NW Natural disagrees with Staff's assertion that the transaction should have been analyzed by a third party. The company does not believe it is common practice for a utility to hire an independent third party to analyze such hedges, and does not agree it should have done so here. The company explains that it reviewed the same independently

[17] Staff Prehearing Brief at 8. CUB agrees with Staff's assertions regarding the hedge.

verifiable information that a third party would have reviewed, and believes that review was sufficient.

NW Natural also disputes Staff's assertion that either a "probabilistic risk analysis" or a "high-impact, low-frequency" analysis was required before executing the hedge. Even if it had done so, NW Natural argues, that analysis would have led NW Natural to enter into the hedge transaction anyway.[18] The hedge would still have been expected to mitigate against any interest rate volatility if not for the highly anomalous market crash. Moreover, the company argues, although the loss from the hedge was potentially significant, it was not of the magnitude ordinarily contemplated by a "high-impact, low-frequency" event.

NW Natural also disputes Staff's assertions that the company should have negotiated modifications to the hedge contract to contractually limit the company's exposure to losses. The company explains that the interest rate hedges the company was considering were standard contracts that were competitively bid to achieve the best price. Negotiating non-standard risk mitigation terms, the company argues, would have added significantly to the cost of the hedge, an added cost that could only have been reasonable in hindsight.

Finally, NW Natural disputes Staff's assertion that its hedging policy is less stringent than FASB accounting methods when determining whether a hedge is "effective." According to NW Natural, when evaluating a hedge in accounting terms, whether a hedge is deemed effective does not depend on whether the results of the transaction were favorable. Instead, the FASB standard under Generally Accepted Accounting Principles (GAAP) provides guidance on how to account for and report hedging activities. NW Natural's practices comport with GAAP.

b. Resolution

We decline to adopt Staff's recommendation on this issue. We find the company acted consistently with its internal derivatives policy and with a Commission order authorizing it to enter into interest rate swaps. We are not persuaded that the company acted imprudently or that a disallowance is warranted. NW Natural's cost of debt is set at 6.056 percent, consistent with the parties' stipulation and unmodified by a hedging disallowance.

We recently addressed the issue of utility hedging in dockets UE 227 and UE 228. Those dockets addressed the hedging of electric utilities' electric supply, rather than an interest rate swap, but the analysis we applied in those dockets is applicable here. When reviewing the reasonableness of a hedging transaction, we first ask whether the

[18] NW Natural conducted its own Monte Carlo analysis during the course of this rate case. That analysis showed that within a 95 percent confidence band that the variance in the swap rate would have been expected to produce a maximum potential loss on the hedge transaction of $5.6 million, or a maximum potential gain of $7.8 million.

company's hedging strategy was prudently designed. If so, we then ask whether that strategy was prudently executed.[19]

The transaction at issue was governed by both the Commission order authorizing it and the company's own derivatives policy.[20] No party asserts that the company violated the terms of the Commission order, and the company's derivatives policy was not seriously challenged.[21] Although a Staff witness testified at hearing that the company's hedging policy was in his view, overbroad, we find Staff's challenge to the company's written derivatives policy too conclusory to form a basis for any disallowance.

We are not persuaded by Staff's other arguments. First, there is no credible evidence suggesting it is necessary or common utility practice to hire an independent third-party to analyze a transaction of this type.[22] Therefore, we cannot say the company's choice of internal review was unreasonable.

Second, we are not convinced that under the facts shown here, that the company acted unreasonably in failing to conduct the specific types of risk analysis recommended by Staff. In fact, the evidence shows that had the company conducted such an analysis, it would have acted the same way it did.[23]

Finally, we do not agree with Staff's assertion that the company should have sought modifications to the contract to limit the company's financial exposure. We agree with NW Natural that the modifications recommended by Staff would have been expensive safeguards that would have increased the costs of the standard, competitively bid contract.

Thus, we decline to adopt Staff's disallowance for the specific hedge at issue here. We remind the company that it is prudent to continue evaluating and refining its hedging policies over time.

3. *Mid-Willamette Valley Feeder Project*

The Mid-Willamette Valley Feeder (MWVF) project consists of four phases of 12-inch diameter transmission lines intended to serve the Albany-Corvallis-Philomath areas. NW Natural seeks to add two phases of this project to the company's rate base in this docket: the Perrydale to Monmouth phase and the Monmouth Reinforcement phase.

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[19] *In re PacifiCorp 2012 Transition Adjustment Mechanism*, Docket No. UE 227, Order No. 11-435 at 7 (Nov 4, 2011); *In re Portland Gen. Elec. Co. 2012 Annual Power Cost Update Tariff*; Docket No. UE 228, Order No. 11-432 at 9 (Nov 2, 2011).

[20] NW Natural's 2006 written derivatives policy details the company's method of identifying, measuring, and managing risk; its limit principles; its credit, position, transaction approval limits; and other such information.

[21] NW Natural filed documentation related to the hedge at issue on February 26, 2008. Per Order No. 07-032, the prudence review of the transaction was reserved for the company's next general rate case.

[22] Were such evidence in the record, we would have given it due consideration; there is none.

[23] That analysis showed that within a 95 percent confidence band that the variance in the swap rate would have been expected to produce a potential maximum loss on the hedge transaction of $5.6 million, or a potential maximum gain of $7.8 million.

Staff and certain intervenors seek disallowance of the project costs on the grounds that the project was constructed prematurely and thus imprudently.

a. Parties' Positions

i. <u>*Staff*</u>

Staff argues that NW Natural has failed to demonstrate that these projects were prudent, as there is no persuasive evidence that the project is needed for reliability or to meet load growth.

At the outset, Staff notes, the project was not selected in the company's most recent IRP. According to Staff, NW Natural's modified 2011 IRP concluded that additional capacity in the Willamette Valley (south of Salem), where the MWVF will serve customers, will not be needed until 2025. In alternative IRP runs, the company modeled service disruptions to assess reliability issues, and even those runs failed the select the MWVF as a needed project until 2019.[24]

Aside from the IRP issues, Staff argues, there is no evidence of any unmanageable service disruptions on the line that would demonstrate the necessity of the project. According to Staff, the evidence shows that the company has successfully managed reliability issues over the years without the MWVF.

Staff points to four major events potentially affecting reliability in the past twenty years: two significantly colder-than-normal events, one in January 2004, and another in December 2009; and two major unplanned service reductions on Grant's Pass Lateral on February 5, 1990, and January 4, 2004. During these events, Staff asserts, the company curtailed service to interruptible customers and successfully maintained firm service. Even during the January 4, 2004 service outage, which coincided with a colder-than-normal event (as well the company's highest ever daily firm demand the following day), Staff contends that the company managed to meet firm demand with its existing resources.[25]

Staff notes other evidence of the company's ability to manage disruptions. Staff points to a compressor failure at Jackson Prairie storage facility, which resulted in reduced pressure on the Grant's Pass Lateral. Again, this disruption affected only interruptible customers.[26] In short, Staff argues, the company has a history of handling reliability issues in the area, even when it is facing unplanned service reductions, unplanned outages, and cold weather days. Staff argues that the record fails to demonstrate any reliability issues that would, themselves, justify construction of the line.

Staff concedes that reliability is an important concern, but argues that even projects planned for reliability purposes require a cost-benefit analysis that demonstrates the

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[24] Staff/1100, Sobhy/10; Staff/1900, Zimmerman/5

[25] *See* Staff/1109.

[26] *See id* at 11; Staff/1111 (NW Natural response to Staff DR 359).

prudence of a given course of action. The company must show that the ratepayers' cost burden for the additional service reliability is appropriate. Because the company has successfully managed past disruptions, Staff argues, the MWVF must be compared to other alternatives to determine the most efficient and cost-effective way of addressing the problem.[27]

Yet, Staff argues, the company failed to perform any financial analyses that would provide quantitative justification for the project. Staff asked the company to provide financial analyses, cost-benefit analyses, or other studies demonstrating that the MWVF was a cost-effective way of meeting peak day demand. The company provided none; instead referring to its 2011 IRP and explaining that additional benefits of the project are qualitative in nature.

The company failed to provide the necessary financial analysis of the investment, including any of the company's underlying assumptions or its calculation of the present value of revenue requirement (PVRR).[28] The company responded that no financial analysis of the MWVF was conducted, and that the decision to invest in these projects was based on "system reliability, replacement of legacy bare steel and system reinforcement."[29] Consequently, Staff argues, it is unclear how the company decided the MWVF was cost-effective with respect to the perceived benefits. Staff believes that evidence of cost-effectiveness should be mandatory, and should include, among other things, financial studies, cost-benefit analyses, and cost-effectiveness analyses, all of which are missing here.

Finally, Staff asserts there is no evidence that the MWVF is needed to meet recent load growth. In this rate case, the company projects a test year reduction in load of almost 5 percent when compared to the base year. It also projects a net loss of nearly 1,000 residential customers in the Albany-Corvallis area.[30]

In sum, Staff asserts there is insufficient information to justify the recovery of the MWVF project through rates in this proceeding.

ii. *NWIGU and CUB*

NWIGU and CUB support Staff's assertions and raise a number of the same objections in their testimony.

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[27] Staff notes that when a project is designed for peak demand, it will likely be used for only a few days of the heating season. Despite this limited use, ratepayers will be pay for this investment and its associated depreciation, operation and maintenance and other expenses for the entire useful life of the plant. Hence, Staff argues, it is critical to demonstrate the balance of cost versus risk to justify the costs to ratepayers.
[28] Staff/1100, Sobhy/17-18; and *see* Order No. 07-047. The PVRR analysis, Staff explains, is a fundamental measure in analyzing and evaluating future resources. It is required by the Commission's IRP guidelines, and it is used as the key cost metric for selecting a portfolio of resources with the best combination of expected costs and associated risks and uncertainties.
[29] Staff/1107 (NW Natural response to Staff DR 216(b)(5)).
[30] Staff suggests this data could delay the need for the MWVF even beyond the 2011 IRP's modeling results.

iii. *NW Natural*

NW Natural disagrees with Staff's assertion that the MWVF should have been modeled in the company's last IRP. It argues that the IRP is a long-term forecast of the gas purchases and capacity contracts for bringing sufficient gas supplies to the boundary of the utility's distribution system, but it does not model system distribution or reliability.

NW Natural explains that it uses software called SENDOUT for its IRP modeling.[31] SENDOUT only evaluates the least-cost approach for acquiring supply and transporting that supply to the company's system. It does not model the distribution of the gas within the system, system expansions, or system reinforcements. Modeling the company's distribution needs, such as the MWVF, it asserts, is a separate endeavor and requires different analytical software.

NW Natural explains that the MWVF will be an intrastate pipeline within the company's service territory that will deliver retail gas to NW Natural's customers; it is not an interstate pipeline that would typically be modeled in the IRP. According to the company, its IRPs have historically included only a short discussion of distribution, modeled using Synergy software in the normal course of business rather than a formal documented process such as the IRP. The company notes that all of the IRPs it has developed under current guidelines have been acknowledged by the Commission.

The company argues that the MWVF was only included in the IRP as part of the company's attempt to address a limitation of SENDOUT. NW Natural has on-system gas storage at its Mist facility. When NW Natural performs model runs, the company explains, SENDOUT overwhelmingly chooses Mist recall as a cost effective supply-side resource. Since Mist storage is a resource within the company's system, SENDOUT does not marry this supply with available distribution delivery capacity, which is necessary if the gas is going to serve customers in the company's southern region. To address this limitation, the company explains, the MWVF was included in the company's IRP in an attempt to model an increased peak day delivery of Mist storage to the company's southern region.

The MWVF was selected as a resource in the company's 2011 IRP for two specific reasons. First, NW Natural explains, the IRP showed the project would be needed to meet the company's capacity needs in 2025. Second, NW Natural asserts, Staff asked the company to model various service disruptions, to test the reliability of the company's plan for bringing gas to its system. In order to comply, the company applied various scenarios to a model run consisting of various disruptions staggered in two-year increments. Under two service disruption scenarios, the MWVF was chosen in 2019 as the least-cost resource for delivering the needed gas requirements to the southern region. But, the company argues, this date is irrelevant: the company could have modeled that service disruption in any year and the IRP would have selected the MWVF as the

[31] NW Natural notes that Avista Corporation and Cascade Natural Gas Company also use SENDOUT for their IRPs.

preferred choice for reliability. In reality, the company explains, the reliability needs exist today.

The company argues that the reliability issues for the area are real. The service area from Sweet Home to Philomath is served through a single delivery point from Northwest Pipeline's Grant's Pass Lateral at the Albany Gate Station, the company argues, meaning there is no way to deliver gas through an alternate transmission pipeline network should a service disruption occur anywhere upstream of the gate station. The company contends that a major service interruption on the Grants Pass Lateral could impact 20,000 customers or more. Restoration of service to a large customer base could take two to three weeks even after repairs are completed. To prevent this type of outage, the company argues, it must remedy the single-feed nature of the service area. To accomplish this, the company argues, it is building the MWVF in conjunction with the replacement of bare steel along the same route.

NW Natural disagrees with Staff's assertion that it has successfully managed disruptions on Grants Pass Lateral. During the compressor failure cited by Staff at the Jackson Prairie Facility, for example, over 300 firm customers in Vancouver, Washington, lost service. Higher losses could have occurred had the affected area been in the south, where other resources were not available. Without the MWVF, the company defends, it cannot effectively mitigate the effects of service disruptions to firm sales customers in its southern region.

Moreover, the company argues, disruptions could be significantly worse than those cited in Staff's examples. The weather events cited by Staff in February 1990, January 2004, and December 2009, were actually warmer than the company's design peak day temperature.[32] If the weather were colder, the demand for gas would likely be greater. Had the events discussed above occurred on a design peak day (53 HDD), the disruptions would have been more significant.

NW Natural also argues that it has more customers in the area than it did in 2004. This indicates that its ability to meet peak demand during a similar disruption is now lower. The company notes that the number of residential and commercial customers has increased by approximately 16 percent since January 2004. It is therefore inaccurate, according to the company, to assume that its ability to serve load during the 2004 disruption would be similar to its ability today under similar conditions.

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[32] The January 4, 2004 event occurred on a 34 Heating Degree Day (HDD). Normal weather for January 4 is 24 HDD (or 41 degrees Fahrenheit), so the temperature on the day of this event was colder than normal weather, but much warmer than the design peak day of 53 HDD. Additionally, January 4, 2004 was a Sunday on a holiday weekend, when firm system loads are generally lower, indicating that the disruption would have been more severe had it occurred on a weekday or non-holiday weekend. Likewise, the December 2009 event occurred on a 44 HDD, which was colder than the average 30 HDD that is typical for December, but the day was still significantly warmer than design peak day weather. The Grants Pass Lateral disruption on February 5, 1990 occurred on a normal weather day: A typical February 5 is a 23 HDD (or 42 degrees F) and February 5, 1990 was a 24 HDD. Therefore, none of these events occurred during a time when system loads approached design conditions. NWN/2200, Yoshihara/8-9.

NW Natural asserts it was prudent to develop the MWVF in the 2012-2013 timeframe for a number of reasons. First, it argues, it needs to replace existing bare steel along the MWVF route in accordance with its bare steel program.[33] When system reinforcements are made, the company argues, it is prudent to ensure that replacement pipe is appropriately sized to meet capacity needs. Second, the company argues, it is important to enhance reliability in the region south of Salem. A 2008 study identified the Albany-Corvallis area as having the biggest potential for large-scale customer outages due to service disruptions from a single-feed system. Finally, the company argues, when it became apparent that Mist storage was the company's primary, low-cost resource, the company determined that it was important to acquire a means to bring this low-cost resource to customers in the south. The MWVF meets all three of these objectives, though none is typically modeled in an IRP.[34]

Responding to Staff's criticisms that a cost-benefit analysis should have been done, NW Natural argues that no alternatives exist to meet the reliability objectives of the MWVF. Satellite LNG storage was the only alternative resource chosen in the company's IRP for meeting incremental load growth. However, the company argues, satellite LNG storage is not a reasonable alternative to the MWVF because it is difficult to site and permit; it is too small a resource to adequately address reliability in the Albany-Corvallis area; and its intended use is for getting through limited duration, peak events. Moreover, the company argues, satellite storage, even for a peak event, would require distribution system enhancements for moving the gas, which are not modeled as part of the IRP. In short, satellite LNG cannot address a larger system reliability issue caused by the single-feed system.[35] Nor is increased use of Grants Pass Lateral a feasible alternative, the company argues, as the pipeline is fully subscribed. In any case, the area would remain to be served by an unreliable single-feed system.

The company concludes that the MWVF is the most cost-effective option to meet its needs. The best option for meeting load requirements and improving reliability, the company asserts, is to improve the distribution system to allow delivery from existing storage to the company's load centers. This is what the MWVF would accomplish. The company argues that the MWVF is an existing delivery route that simply requires system reinforcements to provide the sought-after reliability benefits.

The company states that it evaluated MWVF and found that enhancing a pipeline in an existing pipeline alignment, where the company has distribution assets and knows the ground conditions, is more cost effective than developing a new pipeline in a new pathway.[36] The MWVF already provides Mist storage delivery capability to the Salem

[33] The company states this project is scheduled for completion before 2021.

[34] NWN/2200, Yoshihara/7-8. The company points to the financial authorization of the Monmouth Reinforcement phase of the project, which explicitly states that the project will provide "[i]ncreased reliability by providing an additional supply source to Willamette Valley customers." NWN/2200, Yoshihara/12.

[35] *Id.* at 13.

[36] *See* NWN/2204. The company also evaluated alternative routes for the project and the costs associated with those alternatives prior to moving forward with the project. In 2009 NW Natural contracted for

area, and extending this delivery capability through the MWVF is the shortest possible alternative to move storage gas from Mist and Newport LNG to the Albany-Corvallis area. The MWVF also will help the company meet expected future load increases by transporting the low-cost gas from Mist to customers in the southern region.

The company notes that approximately 12 miles of the route for the MWVF is along a corridor that contains bare steel, which must be replaced under Commission order.[37] An additional five miles was installed in 2005 as a bare steel replacement project. These two components, the company states, make up nearly half of the total pipeline route. Therefore, the incremental cost to complete the MWVF for reliability purposes was substantially reduced, making it the "clear choice" for increasing reliability in the area.[38]

b. Resolution

We conclude that NW Natural has failed to demonstrate that the costs of these projects are prudent at this time. In reviewing the prudence of specific costs incurred by a utility, we review whether they are costs that a reasonable utility management would have made, in good faith, under the same circumstances, and at the relevant point in time. We make this assessment solely on the evidence in the record. Based on the evidence here, we find that NW Natural failed to demonstrate that the MWVF feeder is prudent.

NW Natural concedes that the project is not needed to meet incremental load growth until after 2020. As the company notes in its reply brief, "[a]s all parties agree, the MWVF *was* included in the IRP to model additional capacity needed to serve incremental load growth and selected on that basis for 2025."[39] Consequently, we conclude that the project is not justified at this time on grounds that it is needed to meet load.

NW Natural argues that the project is justified on reliability grounds. In a nutshell, the company's case is that a single-feed system is inherently unreliable. It asserts that a major outage on the Grants Pass Lateral could strand tens of thousands of customers in the Albany and Corvallis area without service for several weeks. Thus, NW Natural contends, the MWVF "is needed for reliability today."[40]

NW Natural has failed, however, to provide any evidentiary support for these assertions. The company conducted no comprehensive cost-benefit analysis of whether and when the investment should be built. It failed to evaluate a range of alternative build dates and its impact on reliability and customer rates, and offered no credible evidence on the likelihood of disruptions based on the historical experience on the Grants Pass Lateral. The company offered no evidence on the range of possible reliability incidents. It offered no evidence about projected loads and customers in the area. Nor did it adequately

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professional engineering services to provide potential route alignments and a feasibility report for the MWVF. *See* NWN/2203.

[37] *In re Application of NW Natural for Deferred Accounting of Safety Program Cost*, Docket No. UM 1030, Order No. 01-843 (Sept 28, 2001).

[38] NWN/2200, Yoshihara/15-16.

[39] NW Natural Reply Brief at 37 (emphasis in original).

[40] *Id.*

consider alternatives, including the use of interruptibility or increased demand-side measures to improve reliability and system resiliency.

NW Natural attempts to support its reliability assertion by citing a 2008 study it argues demonstrates the necessity of the project. That evidence consists of four pages in a response to a data request from Staff that provides only: (1) A simple ranking of single feed systems by number of customers; (2) a map; (3) a table showing NW Pipeline Interconnect Capacities for Zones 12, 9, and 8; and (4) a table of loads in the area from 2007 to 2011. These excerpts provide no plausible justification for this, or any other, project.[41]

The facts in the record simply do not support a conclusion that the investment "is needed for reliability today." The Albany-Corvallis area has been a single-feed system since at least 1931. There is no evidence that customers have experienced unreliable service on the system at any point during this entire period. The only evidence on the record of incidents related to the Grants Pass Lateral affecting the area is of two disruptions in 1990 and 2004 and two cold weather events in January 2004 and December 2009. In all four incidents, no firm customers in the Albany-Corvallis area lost service. There is no other evidence in the record related to incidents affecting reliability of service to the area over the entire history of service to the area. Nor has the company provided evidence that threat or risk levels have fundamentally changed since any of those periods related to a partial or total outage.

At the time of company's 2008 report, there were a number of other single-feed systems, which together serve more customers – including hospitals, universities, and major manufacturers – than the system at issue here.[42] If, as the company argues, a single-feed system is inherently unreliable, concerns about all of these systems could reasonably be deemed as important as the Albany-Corvallis system. There is no evidence in the record of actions that have been taken or will be taken to address the inherent risks posed by single feed systems in these areas.

In short, nothing in the record supports the company's assertion that a single-feed system is inherently unreliable, or that this system, in particular, is unreliable.[43] The company has failed to provide evidence of unreliability or the type of quantitative analysis or resource comparison that would allow us to conclude, based on the record evidence, that the project was prudent.[44]

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[41] Staff/1115, Sobhy/1(Request GR1-OPUC-DR 340).

[42] *Id.*

[43] Simply having a witness testify, in conclusory fashion, that all other options were inferior, is not adequate to justify a major investment. Nor is it sufficient to simply state that the timing for expansion was right given the replacement of bare steel pipes on other segments, without any quantification of the perceived benefits or any comparison to alternatives.

[44] Because the parties have raised issues about the significance of the company's 2011 IRP to this docket, we make three brief points here: First, all major pipeline investments should go through a rigorous IRP review. Equipment such as pipelines and power lines are singled out in our IRP guidelines and rules as items for inclusion in an IRP. Classifying them as "distribution" equipment does not eliminate this requirement, and the argument that "reliability is different" does not pass muster. Second, our IRP guidelines are, of course, guidelines; a company need not include a project in an IRP to seek its recovery in

We make one last point. The company not only failed to fully evaluate this project in its IRP, it failed to even tell the Commissioners during the IRP process that it was already actively building the line, instead classifying it as a possible future project in IRP documents. We find this lack of transparency unacceptable.

Our conclusion here – that the company has failed to demonstrate the prudence of the project – is based on the company's assertion that the project is currently needed for reliability purposes. If facts change, if, for example, the incremental loads in the area start growing faster, and the company makes an evidence-based showing of need, we would be willing to consider the depreciated costs of the project for inclusion in rates on an alternative basis.

4. Pension Costs

Since 1986, the Commission has allowed regulated utilities to recover in rates its pension expense based on an actuarial calculation of the utility's "Net Periodic Pension Cost," using the standards established by the Federal Accounting Standards Board in its Financial Account Statement (FAS) 87. NW Natural asks the Commission to change its policy to allow it to recover not only its FAS 87 pension expense, but also to determine that its pension contributions made in excess of FAS 87 expense should be included in rate base, and allow the company both recovery of and recovery on the rate-based asset.

a. Parties' Positions

i. NW Natural

The company seeks recovery of its FAS 87 expense in rates, as is customary, but it also asks the Commission to include in the company's rate base some significant cash contributions the company has made in recent years to its employee pension funds.[45] NW Natural argues that it has been required to make these cash contributions to its pension funds to comply with federal law. It argues that the FAS 87 expenses it collects in rates are insufficient to allow it to recover these contributions, contributions shareholders have made from 2003 through the test year.

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rates, but we "give considerable weight to utility actions which are consistent with acknowledged IRPs," and require explanations for actions that are inconsistent with an IRP. *See In re NW Natural Gas Co. 2008 Integrated Resource Plan*, Docket No. LC 45, Order No. 09-005 at 6 (Jan 12, 2009). Third, when a company is seeking ratemaking treatment of a significant project that has not been included in an IRP, we will hold the company to the same level of rigorous review required by the IRP to demonstrate the prudence of the project.

[45] The company asks the Commission to amortize the amount of its "prepaid pension asset" over eight years, during which time the company would receive both a "return of" and "return on" its investment. This would be $21,930,000 net of deferred taxes, which represents contributions that NW Natural made to its defined benefit plans in the years 2004 through the test year. It asks to include in rates an annual revenue requirement for the return of unrecovered investor contributions amortized over eight years, which it estimates at $4,569,000.

NW Natural notes that a number of regulatory commissions have allowed utilities to recognize such assets in rate base, referred to for accounting purposes as "prepaid pension assets." NW Natural also observes that its cash contributions have lowered the company's FAS 87 expense, thus providing a benefit to ratepayers. It argues that retroactive ratemaking issues do not bar recognition of the assets in rate base, because the rule against retroactive ratemaking does not apply to the addition of assets to rate base.

ii. Staff

Staff argues the Commission should deny the company's request and maintain the status quo. According to Staff, the Commission should allow NW Natural to collect its 2013 test year pension expense according to FAS 87, and should allow the company to continue using the balancing account established in docket UM 1475. This balancing account, Staff notes, allows NW Natural to account for and earn a rate of return on the differences between pension costs in rates and the company's actual pension costs.

Staff argues that granting NW Natural's request would require a significant change to the Commission's long-standing pension policy, a policy change that would affect all regulated utilities in Oregon. Such a far-reaching change, Staff argues, should not be made in a single utility's rate case. Staff suggests that if the Commission wishes to revisit its policies on the ratemaking treatment of pension costs, it should open a generic docket and conduct a broader analysis that would allow the Commission to better understand the impacts of utilities' various policy choices and the impacts those choices would have on regulated utilities across the state.

Staff also argues that NW Natural's request should be rejected because it amounts to improper "cherry picking" of utility costs. Staff notes that ratemaking is holistic in nature. Rates are set prospectively to cover all utility costs, and once they are set, they remain in place until the Commission changes them. When costs fluctuate between rate cases, Staff argues, both the company and its ratepayers gain or lose with respect to various categories, as some costs go up, while others go down.[46] It is inappropriate to allow the company to recover its "excess" costs for one specific cost category, while ignoring all other categories. Moreover, Staff argues, the costs were incurred during a time when the company was financially stable and healthy.

iii. CUB

Like Staff, CUB argues that pension costs are categorized by Commission policy as expenses, not as rate base assets. Expenses are recoverable in rates only if they are incurred during the test year or if they have been authorized by a deferral order.[47] Because the company did not have a deferral order in place when cash contributions were

[46] For example, Staff argues, after NW Natural's last rate case in 2003, NW Natural restructured and reduced levels of full-time equivalent employees. Ratepayers did not receive refunds, even though they were paying for a higher number of employees than the company actually employed.
[47] ORS 759.259; OAR 860-027-0300(5).

made, CUB argues, granting NW Natural's request would constitute retroactive ratemaking.

CUB concedes that if the prepaid pension costs were considered rate base assets, which they have not historically been under Oregon law, the company could avoid the retroactive ratemaking problem. But, CUB points out that the Commission does not treat pension costs as rate base assets. It treats them as expenses, and it did so during the time period when the cash contributions were made. Consequently, CUB argues, the rules governing expenses apply, and, in effect, bar the company's request.

CUB also agrees with Staff that NW Natural's request amounts to inappropriate "cherry picking" of costs. CUB argues that it is inappropriate to allow recovery of specific prior expenses without fully examining all expenses and revenues for that period. Otherwise, CUB argues, an adjustment in the company's favor might result in the company earning more than its authorized ROE for a past period.[48]

CUB concedes that some regulatory commissions have adopted policies that recognize prepaid pension costs in rate base, but it questions whether this Commission should do so, noting that other commissions continue to treat pension costs as expenses. The mere fact that pension expenses may be considered "prepaid," CUB argues, is not a good argument for including them rate base. While the Commission has allowed some specific types of prepaid assets to be included in rate base, such as certain prepaid insurance, the large pension costs at issue here are different in both kind and magnitude.[49]

Like Staff, CUB argues that if the Commission wishes to revisit its policies on the appropriate ratemaking treatment of pension costs, it should do so in a generic docket.

iv. *NWIGU*

NWIGU agrees that the company's proposed recovery of past pension contributions is improper and constitutes retroactive ratemaking.

NWIGU reiterates that the FAS 87 accounting method is the only method approved by the Commission for recovery of pension costs. Using that methodology, the company determines pension liabilities and expenses based on assumptions regarding employee compensation, retirement ages, and life expectancies, as well as assumptions regarding long-term interest rates and market performance. Differences between actual and

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[48] CUB argues that the company was, in fact, earning in excess of its authorized ROE from 2004 to 2010.

[49] CUB notes that while the Commission has allowed Pacific Power to recognize some prepaid assets in rate base, such as certain prepaid insurance and taxes, the company does not include prepaid *pension* assets in its rate base in any of the six states in which it operates. CUB argues that Pacific Power's total Oregon allocated share for all prepaid assets included in rate base is just over $5.9 million dollars, yet NW Natural seeks in this docket to include tens of millions of dollars to its rate base for pensions alone. CUB argues that intangible assets such as prepaid insurance premiums tend to be small amounts associated with known and measurable recurring expenses that are sometimes funded in advance—traits that pension contributions do not share.

estimated results are not immediately recognized and, instead, are amortized over an extended period of time.

NWIGU argues that under this methodology, pension costs are treated as expenses, and a utility is not permitted to recover prior expenses in rates unless the Commission has issued a deferral order regarding those costs.[50] Here, NWIGU argues, NW Natural failed to file for one. NWIGU argues that the expenses the company incurs through the FAS 87 process are no different than the expenses it incurred as cash contributions made in excess of its FAS 87 expense. Both expenses are used to pay current benefits or are invested to satisfy future benefits, and both could be subject to deferral. In short, NWIGU argues, by failing to seek a deferral order, the company lost its chance to recover these expenses.

NWIGU also challenges the company's assertion that prepaid pension costs are like other "prepaid assets" the Commission has previously recognized in rate base. The analogy is flawed, NWIGU argues, because at some point in time the prepayment for a specific insurance policy becomes fixed, and will apply to a very specific period of time covered by the policy. Pension plan funding, on the other hand, appears to be a moving target, as the required contributions change in response to workforce and market conditions. There simply is no specific period to which pension "prepayments" apply, making them different from prepayments that may be appropriate to include in rate base.[51]

b. Resolution

As Staff and others have noted, the Commission has used the same methodology for calculating a utility's pension costs since 1986. That method, which allows the utility to collect its FAS 87 expense in rates, treats pension costs as ordinary, recurring expenses, rather than assets to be included in rate base. NW Natural, like all regulated utilities in Oregon, recovers its pension expenses using this FAS 87 methodology. In addition to recovering FAS 87 expense in rates, NW Natural also uses a Commission-approved balancing account to track differences between its FAS 87 expense and the amount recovered through rates.[52]

We agree with Staff and intervenors that, so long as the Commission continues treating pension costs as expenses, there is a retroactive ratemaking problem with respect to the company's attempt to recover its out-of-period pension contributions that occurred prior to an application for deferral or accounting order. The cash contributions the company was required to make were not technically "FAS 87" expenses, as they were not

[50] *See* ORS 757.259(1)(a)(B).
[51] NWIGU also rejects the company's attempt to treat the prior pension costs as rate base items "similar to pipes and storage facilities." They are not analogous, NWIGU argues, for various reasons, including the fact that the company begins depreciating plant when plant goes into service, not when the next general rate case takes place.
[52] In this balancing account, NW Natural records its FAS 87 expense, net of amounts recovered in rates for pension expense, and the account accrues interest at NW Natural's currently authorized rate of return. *See In re NW Natural Gas Co. Application to Defer Pension Costs,* Docket No. UM 1475, Order No. 11-051 (Feb 10, 2011).

calculated under the FAS methodology. They were, however, properly considered "expenses" under existing Commission policy. To the extent NW Natural believed these expenses should have been recognized in rates, the company could have filed for a deferral order coincident with the timing of expense incurrence. If the application had been granted, the company could have begun deferring its expenses on the date of the deferral application.[53] Having failed to do so, the company waived the opportunity to collect these pre-application amounts as expenses and amortize them in rates.[54]

NW Natural asks the Commission to take a different tack with respect to pension costs, by allowing the company to include prepaid pension costs in rate base, thus avoiding the retroactive ratemaking problem. We decline to adopt a new methodology for the ratemaking treatment of pension costs in this docket.

Since we adopted our existing policy, there have been a number of changes to federal law and in the markets that make it appropriate to revisit our policies on the ratemaking treatment of pension costs. We are not, however, willing to adopt a specific policy change in this docket. While we are willing to explore the possibility of new methodologies, we are not yet convinced that a change to the Commission's existing policy is warranted. Moreover, even if we were convinced a change was warranted, there are a number of potentially appropriate ways to treat pension costs (including the policy we currently have in place),[55] and we are not persuaded that NW Natural's proposal is the most appropriate. Because any policy change would affect all utilities, we believe a generic docket is the appropriate place to address such a far-ranging policy issue.

We will open a docket to review the treatment of pension expense on a general, non-utility-specific basis. NW Natural's proposal to include its prepaid pension costs in rate base is denied. NW Natural will continue to recover its existing FAS 87 expense, and to use the balancing account established in docket UM 1475 as it currently exists.

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[53] The Commission may grant deferrals "in order to minimize the frequency of rate changes or the fluctuation of rate levels or to match appropriately the costs borne by and benefits received by ratepayers." ORS 757.259(2)(e). Amounts deferred are subject to a prudence review and an earnings review prior to amortization.

[54] The same problem exists with respect to the company's alternative proposal for relief. We note that the company was prohibited by a past stipulation from filing a new rate case from 2007 to 2011. *See In re NW Natural Gas Co. Application for a General Rate Revision,* Docket Nos. UG 152, UG 163, Order No. 07-426 (Sept 26, 2007). To the extent NW Natural was under-recovering its FAS 87 expense in rates during that time period, however, nothing prohibited the company from seeking deferral of any excess FAS 87 expense. The company actually did file for deferral in March 2010, and a balancing account was established to track the company's FAS 87 expense. This was, however, the earliest deferral application the company filed with respect to any pension expenses.

[55] As NW Natural notes, other regulatory commissions handle pension costs a number of ways. Some use FAS 87 or some alternative method of calculating allowable expenses; some allow deferral of certain cash contributions; some allow inclusion of "prepaid pension assets" in rate base; and still others use some combination of these methods. Even when prepaid pension assets are allowed into rate base, there are intricacies to calculating the appropriate amount to be included in rate base. The record here fails to provide a convincing rationale for adopting any specific change to this Commission's policies at this point in time.

The Commission may conclude during the generic investigation that including such assets in rate base is an appropriate policy to apply to all utilities going forward. Should that occur, NW Natural would be able to seek inclusion of an appropriate prepaid pension asset in rate base in a future rate proceeding.

5. *State Income Tax*

Oregon state tax rates changed effective with the 2009 tax year. To recognize the tax increase, NW Natural booked for accounting purposes a regulatory asset of $4.48 million —representing the $2.7 million change in its deferred tax balance, plus a gross-up for taxes. In its filing, NW Natural seeks to amortize this $4.48 million amount over a five-year period. Staff and NWIGU-CUB propose removing this amount on the basis that these deferred taxes were booked in prior periods, yet the company sought no deferral order, rendering its request impermissible retroactive ratemaking. They also argue that the request amounts to inappropriate single-issue ratemaking.

a. Parties' Positions

i. NW Natural

NW Natural argues that even though the changes in the tax rate happened in the past, the deferred taxes represent future tax liability, so the concept of retroactive ratemaking does not apply. The company explains that the rule against retroactive ratemaking prohibits utilities from including past profits or losses in future rates, but the tax balances at issue will be paid in the future, making the concept inapplicable. Thus, the company argues, it was not required to seek deferred accounting for these tax amounts.

NW Natural argues that income taxes reflected in rates are "fair, just and reasonable if the rates include current and deferred income taxes and other related tax items that are based on estimated revenues derived from the regulated operations of the utility."[56] Excluding these deferred taxes from rates, it argues, would contravene this requirement.

ii. Staff

Staff argues that NW Natural is improperly attempting to collect in a future test year a regulatory asset created in 2009, without any Commission approval or a request for deferred accounting. This is inappropriate, Staff argues, because the purpose of the current rate case is to set future rates, not to reconcile previous rates.

According to Staff, the company is seeking authority to amortize a regulatory asset (a book expense) that NW Natural decided to create, without a Commission-authorized deferral. Like out-of-period pension contributions, Staff argues, this amounts to single-issue ratemaking. The company's tax expense, which is reflected on the company's books but not actually paid to a taxing authority, occurred between rate cases. As a matter of policy, Staff argues, a utility should not be able to cherry-pick an expense that

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[56] *Citing* ORS 757.269(1).

went up between rate cases and seek future recovery of that past expense in a context that avoids an earnings test.

Finally, Staff argues, SB 408 was in effect at the time the company's regulatory asset was created. The resolution of the company's SB 408 proceeding, with its automatic adjustment clause, established the appropriate amount of taxes to be included in NW Natural's rate for that period of time. In short, Staff argues, the company should not be allowed to move $4.48 million from that past period into future periods.

iii. <u>CUB</u>

CUB agrees with Staff that NW Natural is inappropriately seeking recovery of past expenses in future rates. CUB argues that the company did not have an order from the Commission giving it the right to record the tax balance in question as a regulatory asset in 2009. Thus, CUB argues, the request amounts to retroactive ratemaking.

CUB also agrees that the company's request is a request for single-issue ratemaking, as the company is reaching back into past periods to request special cost recovery for a single item. CUB argues that the company earned at or over its authorized return on equity in 2009, the year of the tax change, when the company was enjoying record earnings. Thus, CUB argues, the company had the financial capability to absorb the effect of the non-cash tax change in that year.[57]

Finally, CUB agrees with Staff that SB 408, with its automatic adjustment clause mechanism, established the appropriate amount of taxes to include in rates during these past periods.[58] Thus, CUB argues, the company has no legitimate basis on which to seek recovery of these deferred taxes.

iv. <u>NWIGU</u>

NWIGU argues that a company can create a "regulatory asset" on its books, but that does not mean the company is authorized to recover the amount of that regulatory asset in rates. In this case, NWIGU argues, the accounting entry relates to an adjusted deferred tax balance that required a deferral order in order for the company to recover the amount in rates. Because the company never sought or obtained a deferral order, NWIGU argues, the company may not recover the excess taxes in rates.

According to NWIGU, the company argues that the prohibition against retroactive ratemaking does not apply here because the deferred tax balance relates to future expectations of taxes due, not "past activities." However, NWIGU argues, the company's testimony is inconsistent on this point. It states, for example, that its adjustment "reflects a five-year amortization of this increased cost the company has

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[57] CUB also argues that the company's request is based on accounting entries and not upon any cash payment to the State of Oregon. Thus, granting the request would give the company a double recovery, according to CUB.

[58] *See In re NW Natural Gas Co., Annual Tax Filings under ORS 757.268*, Docket No. UG 170(4), Order No. 11-117 (Apr 11, 2011).

already recorded on its books." In other words, NWIGU argues, the event for which the company is seeking recovery did occur prior to the test year.

NWIGU also argues that regulated utilities are unlikely to ever make actual tax payments on its deferred taxes, making the company's assertion that the important activity is a "future tax payment" additionally untenable.

Finally, NWIGU agrees with Staff and CUB that the proposed revenue deduction is improper because it constitutes single-issue ratemaking. The amount of deferred taxes for which the company seeks recovery as a regulatory asset was created outside of the test year. The company now seeks special cost recovery for this item. This proposal, NWIGU suggests, isolates the effect of one component of the company's corporate taxes from a prior period, instead of looking at all of the revenues and expenses associated with the test year. This facet of the company's proposal, NWIGU argues, makes it single-issue ratemaking.

v. *NW Natural Reply*

NW Natural explains that the concept of retroactive ratemaking is not relevant here because, as Staff, CUB, and NWIGU all agree, the deferred tax balance does not reflect taxes that the company has previously paid. Rather, the change in the deferred tax balance reflects a calculation of taxes that will be paid in the future. Events that occur in the past that result in changes to costs in the future are, contrary to NWIGU's assertions, in fact, reflected in rates.

NW Natural also disagrees with the assertion that it is "cherry picking" a past expense for recovery. Contrary to Staff's position, NW Natural believes that the deferred tax balance is not an expense, like current taxes, that was previously included in rates. The regulatory asset was established to properly estimate the deferred taxes the company will pay in the future, not to reconcile taxes paid in the past. The company is proposing to use an accurate deferred tax balance to set rates, not a deferred tax balance that fails to reflect the tax law change, which is what the other parties propose.

NW Natural additionally argues the deferred tax balance is simply not a prior period expense. NW Natural points out that it has cited to Commission precedent, Internal Revenue Service guidance, Federal Energy Regulatory Commission guidance, and case law in other states supporting the company's arguments. The other parties have cited no supporting precedent at all.

Finally, NW Natural argues, the suggestion that SB 408 took care of the deferred tax issue in prior years is not accurate. NW Natural states it did not recover through SB 408 the change in deferred taxes that was caused by the Oregon state tax law change. Moreover, no party has testified that NW Natural's deferred tax change should properly have been included in the company's 2009 SB 408 filing.

b. Resolution

We deny NW Natural's request for amortization of these deferred tax amounts. Our denial is not based on the grounds that the request would constitute retroactive ratemaking. The deferred taxes at issue have qualities that make them challenging to categorize. On one hand, they represent taxes the company has not yet paid, but may be required to pay in the future. On the other hand, the liability for the taxes was incurred (and booked) in a past period, between rate cases. The parties mostly argue past one another on this point, with the company explaining why the deferred taxes should be categorized as future expenses, while Staff and intervenors arguing that they should be past expenses (because they were booked in prior years). The proper treatment of deferred taxes is a complex issue, yet no party engages in a discussion of how the tax changes here fit into the broader ratemaking treatment of deferred taxes.

In the end, regardless of whether the request constitutes retroactive ratemaking, we conclude that granting recovery of the "excess" deferred taxes would inappropriately allow special cost recovery of one element of the company's overall taxes. Concerns about single-issue ratemaking are grounded in the idea that the ratemaking formula is designed to determine a company's revenue requirement based on the aggregate costs and demands of the utility. Except in limited circumstances, it is improper to consider changes to components of the revenue requirement in isolation. As Staff notes, a change to one item of the revenue requirement is often offset by a corresponding change in another item. If rates are increased based solely on the fact that one type of expense is higher than expected, without considering changes to other elements of revenue requirement, the company's reasonable revenue requirement could be overstated.[59]

B. Environmental Remediation Costs

Since 2003, NW Natural has been deferring costs associated with environmental cleanup efforts related to the historic operation of manufactured gas plants (MGP). As of September 30, 2011, NW Natural had deferred about $64.5 million in environmental costs, and conservatively estimates its future environmental remediation liability to be an additional $58 million.

The company asserts that the deferred costs have been prudently incurred, and asks the Commission to approve a mechanism for recovery of these costs through rates. The company proposes establishing two new rate schedules, Schedules 183 and 184, to recover the deferred costs and future expenditures associated with the cleanup. Schedule 184 would be specific to costs incurred for building and maintaining a pumping station at the company's Gasco site. Schedule 183, which the company refers to as the Site Remediation Recovery Mechanism (SRRM), would be used for recovery of all other environmental costs at issue here.

[59] Oregon's deferral statute recognizes this issue and mitigates the problem by requiring the Commission to conduct an earnings review of deferred amounts prior to amortization. ORS 757.259(5). The deferral statute is also a statutory exception to the rule against retroactive ratemaking. 1992 Ore. AG LEXIS 19 (1992).

a. ***Parties' Positions***

i. *NW Natural*

Although NW Natural has been deferring environmental cleanup costs since 2003, it argues that it is appropriate to start recovery of the costs now. First, the company explains, the amount of deferred costs is large and is growing, and further delay will only increase the burden on customers. Second, the company argues, timely recovery of the costs is important to NW Natural's financial health and stability, as the company has been financing all of the costs itself. Third, starting recovery now furthers the goal of providing for intergenerational equity by more closely matching the time when the expenditures are made and the time they are collected.

Under the company's proposed SRRM, the company would continue deferring environmental remediation expenses, as it has been doing since 2003. Any proceeds recovered from insurance companies or other third parties would be booked as an offset to these deferred expenses, for the benefit of customers. Each year, one-fifth of those deferred expenses (after offset) would be reviewed for prudence and put into an SRRM account for amortization.[60] Any under- or over-collection of the balance in the SRRM account at the end of the amortization period would be used to adjust the amount amortized into rates in the next amortization period.

The company argues that it has demonstrated that the environmental costs incurred to date are prudent. It argues that NW Natural should be able to collect 100 percent of the deferred environmental remediation costs in rates. It asks the Commission to implement an automatic adjustment clause as part of the SRRM, and asks it be allowed to amortize prudent costs without the need for an earnings review. NW Natural argues that an earnings test is inappropriate because the environmental costs are ongoing expenses, rather than one-time expenses, imposed upon the utility.[61]

The company asks the Commission to apply the company's authorized rate of return to the deferred amounts prior to amortization, and asks that the Modified Blended Treasury Rate (MBTR) be used during amortization phase. This application of interest rates, NW Natural notes, is consistent with existing Commission policy.

ii. *Staff*

Staff supports NW Natural's recovery of prudently incurred environmental costs, but proposes some changes to the company's proposed SRRM. Staff also asks that the

[60] The company proposes amortizing during the period of November 1 through October 31 of each year one-fifth of the amount of deferred balance as of July 15 of each year. For the first year of operation, the company proposes a cutoff date of September 30, 2012, rather than July 15.
[61] Under ORS 757.259, an earnings review must be conducted prior to amortization of deferred amounts, unless those amounts are subject to an automatic adjustment clause.

prudence review for those costs already incurred take place in the future, in a new proceeding.[62]

Staff supports NW Natural's use of an automatic adjustment clause in the context of the SRRM, but argues that an earnings review should be required prior to amortization of any costs. Staff argues that if NW Natural were not proposing an "automatic adjustment clause," it would be required to seek recovery through a general rate case or using traditional deferred accounting. Under either of those regulatory methods, Staff notes that an earnings review would be conducted. An earnings review is an important check against overearning, Staff contends, and should be implemented even if an automatic adjustment clause is used.[63]

Staff disagrees with the company's assertion that it should earn interest on the SRRM at its authorized rate of return until amounts are put into an amortization account. Staff agrees that the proposal comports with the Commission's ordinary treatment of deferred accounts, but argues that this is not an ordinary mechanism. Based upon the totality of circumstances, Staff argues, the MBTR should apply to the entirety of the deferral and to the amortization account as part of the SRRM.[64]

Staff also recommends that the environmental costs (net of insurance proceeds) be shared, with 90 percent of the costs paid for by ratepayers and 10 percent borne by NW Natural's shareholders.[65] Staff argues that a number of other state commissions have ordered sharing of environmental remediation costs. Staff argues that a sharing mechanism would provide an incentive for the company to prudently manage its environmental costs and continue its pursuit of insurance proceeds.

iii. *NWIGU and CUB*

NWIGU and CUB filed joint testimony and separate testimony addressing the SRRM.

In their joint testimony, NWIGU and CUB recommend that the Commission allocate 50 percent of the company's environmental remediation costs to shareholders. According to NWIGU and CUB, the company should not be exempted from liability simply because it exists in a regulated environment. In a competitive environment, owners of property cannot simply collect environmental remediation costs from their customers. Owners of contaminated land are held responsible for its cleanup by federal law. This is appropriate, they argue, because the owners are the ones who profited from the use of the

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[62] Staff explained at the hearing that it was not clear to Staff that NW Natural was seeking a prudence review at this time; Staff believed the company was seeking approval of the recovery mechanism, with the prudence review to take place at a later date.

[63] More specifically, Staff argues that even if the Commission adopts an automatic adjustment clause mechanism, an earnings test is legally required for amounts already deferred; the Commission would have the discretion to require an earnings review for costs that will be incurred in the future.

[64] Staff argues that if its conditions for the SRRM are not adopted, it would prefer the Commission required NW Natural to recover its environmental remediation costs through a standard deferred accounting proceeding. Under that approach, Staff would agree that the deferred account balance should accrue interest at the company's authorized rate of return prior to amortization.

[65] Staff proposes that insurance proceeds be shared the same way.

land and had control over its condition. They argue that the company's return on equity reflects a component related to risk, including the risk that remediation costs will be assessed against the owners of contaminated land. For this reason, they argue, NW Natural should be responsible for at least some of the environmental remediation costs.

Moreover, NWIGU and CUB argue, there is no intergenerational equity involved with NW Natural's proposal. Today's customers, they argue, did not cause the contamination of the sites, nor did they benefit from the historic operations associated with the contamination. It is unfair, they argue, to isolate the company's shareholders from any of these costs by shifting the entire burden to ratepayers.

Like Staff, NWIGU and CUB argue that a sharing mechanism will create an incentive for the company to control costs, to the extent that it has the ability to do so. CUB also points out that numerous state commissions have ordered the sharing of environmental remediation costs.

NWIGU and CUB argue that the company should only earn a debt rate of return on its deferral balance. Once the Commission determines what amount NW Natural should recover, they argue, that order would be a tantamount to guaranteed recovery with little associated risk.

Finally, NWIGU and CUB both agree with Staff that an earnings review should be conducted prior to collection of any amounts in rates.

iv. *CUB*

In separate testimony, CUB also opposes the company's proposed recovery in rate base of an estimated $11 to $30 million for construction of a pumping station at the company's Gasco site. For one thing, CUB argues, the proposed pumping station constitutes environmental remediation for gas supply that is no longer used and useful. In this sense, CUB argues, the site is no different than the company's other environmental costs, which CUB argues should be shared with shareholders. But even if the Commission were to agree with the company that the pumping station were an appropriate item to include in rate base, CUB argues, the company's request is premature because the pumping station is not yet built. In other words, CUB argues, the company is asking the Commission to preapprove a rate base item before it is used and useful.

v. *NWIGU*

In its separate testimony, NWIGU challenges the rate spread proposed by the company for recovery of environmental remediation costs. NW Natural proposes applying an equal percent of margin to all customer classes for recovery of environmental costs. NWIGU argues that Schedule 31 and Schedule 32 customers[66] are paying $24 million per year in excessive margin charges. Because these customers are already paying excessive

[66] Schedule 31—Non-Residential Firm Sales and Firm Transportation Service; Schedule 32—Large Volume Non-Residential Sales and Transportation Service.

amounts in rates, NWIGU argues, they should be exempted from additional responsibility for the company's environmental remediation costs.

NWIGU recommends that the company's base rate spread proposal be applied to environmental remediation costs.

vi. *NW Natural Reply*

NW Natural disagrees with the assertion that an earnings test should be required as part of the SRRM. The company's environmental expenses will be amortized many years into the future, the company argues, so an earnings test would function as a cap on earnings. It would be inappropriate to effectively cap earnings at a maximum level for many years, the company argues, particularly when there is no earnings floor.

If the Commission does impose an earnings test, the company argues, it should consider as part of the earnings review remediation expenses and other deferred amounts that the company expended in the years at issue, because the company paid them even if they were not recognized. This is appropriate, the company argues, if the goal of the earnings test is to determine whether the company could have absorbed the environmental remediation expenses in a given year and remained at its authorized ROE.

The company also objects to Staff and intervenors' proposal that relatively low interest rates should be applied to the deferred amounts. According to NW Natural, the parties have not shown that the company's risk of recovery is lower for the deferred environmental costs than for any other types of deferrals. Moreover, the deferrals are to be recovered over a long period of time, warranting a higher rate than the MBTR proposed by Staff or the "debt rate" proposed by CUB and NWIGU.

NW Natural strongly contests the parties' assertions that shareholders should be required to bear some portion of the environmental remediation costs. The company argues that all customers benefitted from the MGPs, which were used to provide service to customers, and the byproducts of these plants were sold for customers' benefit.[67] Moreover, the company argues, there is no credible evidence that NW Natural was aware of the possible environmental effects or future costs associated with MGP operations at the time of their operation. The assertion that there is no intergenerational equity in this case, the company argues, is also wrong. The environmental remediation costs at issue here, the company argues, are current costs, imposed by current laws.

Finally, the company argues, no sharing mechanism is needed as an incentive to keep environmental remediation costs down. If the company's costs are not well managed and prudent, the company argues, the Commission will disallow them. In short, the company argues, no party has proposed an appropriate basis for requiring a sharing mechanism.

[67] NW Natural notes that, in addition to its own testimony on this point, Staff testified that byproduct revenues were treated as part of regulated activities after 1946 and assumes that byproduct sales were treated similarly between 1911 and 1946.

With respect to CUB's objection to including the Gasco pumping station in rate base, the company notes that as stated by Schedule 184, "The pumping station shall be considered in service for rate recovery purposes on the date that the Company submits an attestation to the Commission that the Pumping Station is completed and operational." In other words, NW Natural argues, the pumping station will be included in rates only after it is complete. The company states that Schedule 184 was intended to benefit customers by allowing costs associated with this facility to be recovered over a 30-year period, rather than the five-year period contemplated by the SRRM.

Finally, NW Natural disagrees with NWIGU's assertion that Schedule 31 and Schedule 32 customers should be exempted from the costs of environmental remediation. Because NW Natural's industrial customers benefitted from the availability of gas from MGP operations, the company argues, they should be included in the recovery of the costs associated with remediation.

2. *Resolution*

We approve certain elements of NW Natural's requested SRRM and modify others. We agree with the company that deferral of environmental remediation expenses should continue as they are now, with appropriate offsets when insurance proceeds are recovered.

The recovery mechanism will operate as follows:

- The prudence review for the $64.5 million in environmental costs already deferred shall be conducted in the future. New proceedings will be opened to ensure this review begins promptly.
- Each year, one-fifth of the company's deferred expenses (off-set by any proceeds received) will be put into an account for amortization during the November 1 through October 31 period, after the Commission has an opportunity to review those costs and ensure that they were prudently incurred.
- No sharing mechanism will be applied.
- An earnings test with a deadband will be applied. The parties will have the opportunity to address the appropriate deadband and appropriate application of the earnings test in the new proceedings.
- The following rates of return will be applied to the deferred amounts: Deferred costs that have not been reviewed for prudence will accrue interest at the company's rate of return. Amounts that have been moved into an amortization account each year will accrue interest at the MBTR. Amounts that have been reviewed for prudence, but have not yet been moved into an amortization account, will accrue interest

> at the average of the five-year Treasury rates used in calculating the MBTR for the applicable year, with an added 100 basis points.[68]

The majority of Commissioners believe that use of an earnings test (with a deadband) coupled with the Commission's ongoing prudence review will provide an effective incentive for the company to manage its costs. Further, the majority adopts an earnings test but no sharing mechanism. An earnings test may operate as a *de facto* sharing mechanism in some years, but it is not the intent of the majority to impose an explicit sharing mechanism.[69]

We also address the Gasco issue raised by CUB, an issue inadvertently omitted from the preliminary order. We agree with CUB that it is inappropriate to authorize rate-base treatment for this plant. In addition to the fact that the plant will not be used and useful by the rate-effective date, no prudence review has been conducted, nor is one yet possible. The plant has not yet been constructed, and the company can only estimate the costs of construction. For these reasons, we find inclusion of the plant in rate base inappropriate at this time. When the plant is completed, the company may seek cost recovery through the SRRM or through inclusion of the plant in rate base in a future rate proceeding.

C. Stipulations

A First Partial Stipulation was filed by the parties on July 9, 2012. A Second Partial Stipulation was filed on October 2, 2012. We adopted these stipulations in our preliminary order, and confirm those decisions here.

IV. CONCLUSION

We find that our decisions in this docket will result in rates that are fair, just, and reasonable.

[68] In our preliminary order, we inadvertently omitted the reference to the additional 100 basis points. NW Natural filed a motion for reconsideration or clarification on this point. The additional of the additional 100 basis points reflects our original intent of applying to this category of costs an interest rate higher than the MBTR. *See In re Staff Request to Open an Investigation Related to Deferred Accounting,* Docket No. UM 1147, Order No. 08-263 at 15 (May 22, 2008).

[69] Commissioner Bloom would require the company to implement a sharing mechanism, and dissents on this point.

V. ORDER

IT IS ORDERED that:

1. We adopt and reaffirm our decisions in Order No. 12-408, and adopt in addition the two clarifications added in this order on the issue of environmental remediation costs.

2. Northwest Natural Gas Company, dba NW Natural, will file new tariffs consistent with the clarification on the Gasco site, by December 1, 2012.

Made, entered, and effective NOV 16 2012.

Susan K. Ackerman
Chair

John Savage
Commissioner

<u>Commissioner Bloom concurring in part and dissenting in part:</u>

I agree with Staff and intervenors that NW Natural should bear some level of responsibility for the company's environmental remediation costs. As CUB notes, the owner of contaminated land is ordinarily held responsible for cleaning it up. In my view, a regulated company's return on equity reflects a certain level of risk, including the risk of this type of liability. I also believe there is an intergenerational equity argument to be made in favor of a sharing mechanism. NW Natural's current customers neither caused the environmental contamination nor benefited financially from the company's historic MGP operations. Finally, I believe that a sharing mechanism would create a strong incentive for the company to pursue all available insurance proceeds on behalf of customers. For these reasons, I dissent from the majority's decision on this point.

Stephen M. Bloom
Commissioner

A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480 through 183.484.

ORDER NO. 12 437

APPENDIX A
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NORTHWEST NATURAL GAS COMPANY
UG 221
Twelve Months Ended October 31, 2013
(000)

		SUMMARY SHEET	October 2013 Results Per Company Filing (1)	Adjustments (2)	October 2013 Adjusted (3)	Required Change for Reasonable Return (4)	Results at Reasonable Return (5)
1		**Operating Revenues**					
2		General Business	$682,996	$3,411	$686,407	$8,716	$695,123
3		Transportation	12,871	0	12,871	0	12,871
4		Other Revenues	3,429	1,390	4,819	0	4,819
5		**Total Operating Revenues**	$699,296	$4,801	$704,097	$8,716	$712,813
6		**Operating Expenses**					
7		Gas Purchased	$395,039	$1,161	$396,200	$0	$396,200
8		Uncollectible Accrual for Gas Sales	2,110	11	2,121	27	2,148
9		Other O & M Expenses	118,219	(7,694)	110,525	0	110,525
10		**Total Operation & Maintenance**	$515,368	($6,522)	$508,846	$27	$508,873
11							
12		Depreciation & Amortization	60,094	(35)	60,059	0	60,059
13		PENSIONS	0	0	0	0	0
14		Taxes Other than Income	42,927	89	43,016	227	43,243
15		Income Taxes	22,441	5,891	28,332	3,380	31,712
16		Miscellaneous Revenue and Expense	0	0	0	0	0
17		**Total Operating Expenses**	$640,830	($577)	$640,253	$3,634	$643,887
18		**Net Operating Revenues**	$58,466	$5,378	$63,844	$5,082	$68,926
19		**Average Rate Base**					
20		Gas Plant in Service	$2,227,108	($43,520)	$2,183,588	$0	$2,183,588
21	Less:	Accumulated Depreciation & Amortization	(990,862)	0	(990,862)	0	(990,862)
22		Accumulated Deferred Income Taxes	(329,082)	9,266	(319,816)	0	(319,816)
23		Accumulated Deferred Inv. Tax Credit		0	0	0	0
24		**Net Utility Plant**	$907,164	($34,254)	$872,910	$0	$872,910
25		Plant Held for Future Use	$0	$0	$0	$0	$0
26		PENSIONS	21,930	(21,930)	0	0	0
27		Working Capital	0	0	0	0	0
28		Gas Inventory	48,008	(35,326)	12,682	0	12,682
29		Materials & Supplies	7,422	(633)	6,789	0	6,789
30		Customer Advances for Construction	(1,994)	(5,381)	(7,375)	0	(7,375)
31		Leasehold Improvements	1,155	0	1,155	0	1,155
32		Prepayments	0	0	0	0	0
33		Misc. Deferred Debits	0	0	0	0	0
34		Misc. Rate Base Additions/(Deductions)	0	0	0	0	0
35		**Total Average Rate Base**	$983,685	($97,524)	$886,161	$0	$886,161
36		**Rate of Return**	5.94%		7.20%		**7.78%**
37		**Implied Return on Equity**	5.83%		8.35%		**9.50%**

10/26/2012