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May 3, 2013

VIA ELECTRONIC FILING & U.S. MAIL

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

Re: In the Matter of Northwest Natural Gas Company –
Mechanism for Recovery of Environmental Remediation Costs
Docket No. UM 1635

Dear Filing Center:

Enclosed please find the original and five (5) copies of Direct Testimony of Michael C. Deen on behalf of the Northwest Industrial Gas Users. A copy is being served on all parties to this docket listed on the attached Certificate of Service.

Thank you for your assistance with this filing. Should you have any questions, please feel free to contact me.

Very truly yours,



Tommy A. Brooks

TAB:sk
Enclosures

cc: UM 1635 Service List

CERTIFICATE OF SERVICE
Docket No. UM 1635

I CERTIFY that I have on this day served the foregoing document upon all parties of record in this proceeding via electronic mail and/or by mailing a copy properly addressed with first class postage prepaid.

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Dated in Portland, Oregon, this 3rd day of May 2013



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Of Attorneys for the
Northwest Industrial Gas Users

Docket UM 1635
NWIGU/100
Deen

BEFORE THE
PUBLIC UTILITY COMMISSION OF OREGON

REBUTTAL TESTIMONY OF MICHAEL C. DEEN
ON BEHALF OF
THE NORTHWEST INDUSTRIAL GAS USERS

May 3, 2013

1 **I. INTRODUCTION AND SUMMARY**

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 **A.** My name is Michael C. Deen, and my business address is 900 Washington Street, Suite
4 780, Vancouver, Washington 98660. I am employed by Regulatory and Cogeneration
5 Services, Inc. (“RCS”), a utility rate and consulting firm.

6 **Q. PLEASE DESCRIBE YOUR BACKGROUND AND EXPERIENCE.**

7 **A.** I have been involved in the energy industry for over 6 years. During that time, I have
8 served as an analyst and expert on a variety of power supply, cost, ratemaking, and policy
9 topics—primarily regarding the Bonneville Power Administration and Pacific Northwest
10 utilities. I have provided testimony on behalf of the Industrial Customers of the
11 Northwest Utilities (“ICNU”) before the Oregon Public Utilities Commission
12 (“Commission” or “OPUC”) in various proceedings regarding Portland General Electric
13 and PacifiCorp. I have also provided testimony on behalf of ICNU before the
14 Washington Utilities and Transportation Commission (“WUTC”) regarding Avista,
15 PacifiCorp, and Puget Sound Energy. I have also provided testimony in natural gas
16 matters regarding Avista on behalf of the Northwest Industrial Gas Users (“NWIGU”)
17 before the WUTC. A further description of my educational background and work
18 experience can be found in Exhibit NWIGU/101.

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

20 **A.** I am testifying on behalf of NWIGU. NWIGU is a non-profit trade association whose
21 members are large users of natural gas throughout the Pacific Northwest, including
22 customers served by NW Natural (the “Company”).

1 **Q. PLEASE BRIEFLY DESCRIBE THE BACKGROUND OF THE**
2 **ENVIRONMENTAL REMEDIATION COSTS AT ISSUE IN THIS**
3 **PROCEEDING.**

4 **A.** The background of this issue has been extensively described by the Company's testimony
5 in both the UG 221 general rate case and the present docket. As a general matter, the
6 predecessor company of NW Natural operated manufactured gas plants (MGP) which
7 resulted in significant contamination along the Willamette River. As a result of this
8 contamination from legacy MGPs, the Company has undertaken environmental
9 remediation efforts under the direction of the Environmental Protection Agency ("EPA")
10 and Oregon Department of Environmental Quality ("DEQ").

11 The Company sought and received permission from the Commission in 2003 to
12 defer costs related to environmental remediation of the historical MGP sites. In docket
13 UG 221 the Company sought an automatic adjustment clause titled the Site Remediation
14 Recovery Mechanism ("SRRM") to begin amortization of the deferred amounts. The
15 Commission ordered further proceedings to address certain issues related to the
16 remediation costs and the SRRM. This included the appropriate application of an
17 earnings test and deadband to the recovery of environmental remediation costs as well as
18 the appropriate rate spread for such costs.

19 **Q. WHAT TOPICS WILL THIS TESTIMONY ADDRESS?**

20 **A.** This testimony will address the appropriate application and functioning of an earnings
21 test in the context of recovery of MGP-related environmental remediation costs, the
22 appropriate rate spread of such recovery, and the Company's proposed jurisdictional
23 allocation of costs.

1 **Q. PLEASE BRIEFLY SUMMARIZE YOUR RECOMMENDATIONS IN THIS**
2 **PROCEEDING.**

3 **A.** NWIGU's recommendations at this time are summarized as follows:

- 4 • **Earnings Test.** The Company's proposed earnings test would likely result in
5 customers bearing the full costs of environmental remediation efforts even in years
6 where the Company earned above its authorized return on equity ("ROE"). The
7 earnings test should be capped at the Company's authorized ROE in each year and
8 consider all of the Company's earnings. Insurance or other third party proceeds
9 should flow through directly to customers outside the earnings test. In the event the
10 Commission finds this treatment unreasonable, the Company should be allowed to
11 retain 5 percent of such revenues as an offset to previous write offs.

- 12 • **Rate Spread.** NWIGU supports the agreement in principle reached by parties
13 regarding rate spread and will file supportive testimony when that stipulation is
14 finalized.

- 15 • **Jurisdictional Allocation.** The Company's analysis of historical sales data for
16 jurisdictional allocation purposes between Washington and Oregon appears
17 reasonable.

18 **EARNINGS TEST**

19 **Q. PLEASE SUMMARIZE THE COMPANY'S PROPOSED MECHANISM FOR**
20 **RECOVERY OF THE ENVIRONMENTAL REMEDIATION COSTS.**

21 **A.** NW Natural is proposing to use an earnings test that would allow the Company to
22 recover deferred environmental remediation costs so long as the Company's earnings are
23 within 100 basis points above the return on equity ("ROE") established in its most recent
24 general rate case. For past deferred amounts, the earnings test would be conducted over
25 the historical period over which the costs were deferred. On a going forward basis, the
26 earnings test would be conducted annually. Alternatively, in the event the Commission
27 should order an earnings test that would result in some disallowance or write-off of

1 historically deferred amounts, the Company recommends that the Commission wait to
2 resolve the earnings test issues for the historical period. The Company also recommends
3 that certain sources of earnings be excluded from the earnings test both on a historical
4 and prospective basis.

5 **Q. WOULD THE COMPANY'S PROPOSED IMPLEMENTATION OF THE**
6 **EARNINGS TEST LIKELY RESULT IN CUSTOMERS BEARING ALL COSTS**
7 **OF ENVIRONMENTAL REMEDIATION FOR THE MGP SITES?**

8 **A.** Yes. As described in Exhibit NWN/100, the Company's proposed earnings test would
9 certainly result in all historically incurred costs of MGP related environmental
10 remediation being borne by customers. On a going forward basis it is also likely that
11 given the extremely high earnings test threshold and exclusion of weighted average cost
12 of gas ("WACOG") earnings would result in customers bearing all costs of
13 environmental remediation in many if not all years. Based on the historical presentation
14 of earning in Exhibit NWN/101, for the 2003 to 2011 period, the Company only earned
15 100 basis points above its authorized ROE in one instance with the inclusion of WACOG
16 incentive revenues. That year was 2009 in which the Company earned 11.21% ROE and
17 had an authorized ROE of 10.2%, equivalent to a single basis point outside of the 100
18 basis point threshold. There were no instances in which the Company's ROE exceeded
19 100 basis points above the authorized level excluding WACOG incentives.

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1 **Q. WOULD THE COMPANY'S PROPOSAL RESULT IN AN EQUITABLE**
2 **OUTCOME FOR HISTORICALLY DEFERRED AMOUNTS?**

3 **A.** No. The Company's proposal for an earning test on past amounts would allow the
4 Company to seek recovery of costs that were incurred in historical years in which the
5 Company's actual ROE significantly exceeded the authorized level.

6 **Q. WHY IS THIS A PROBLEM?**

7 **A.** Utility rates are set on the basis of matching all costs and revenues for a rate period such
8 that rates will allow the utility the opportunity to earn a reasonable rate of return on its
9 investments to provide service. The Company's proposal asymmetrically harms
10 customers in that it allows the Company to unilaterally seek later recovery of costs
11 incurred during a time in which the rate equation was tipped in its favor.

12 **Q. WHAT IS NWIGU'S PROPOSED CHANGE TO THE EARNINGS TEST FOR**
13 **RECOVERY OF AMOUNTS DEFERRED DURING THE HISTORICAL**
14 **PERIOD?**

15 **A.** In establishing the amount of historically deferred environmental remediation costs that
16 should be allowed for amortization, the Commission should apply an earnings test set at
17 the level of the Company's authorized ROE on an annual basis for the historical period.

18 **Q. WHAT SOURCES OF EARNINGS SHOULD BE INCLUDED IN THE**
19 **EARNINGS TEST?**

20 **A.** All sources of earnings from regulated operations should be considered in establishing
21 the Company's ROE for a given year. This includes earnings related to WACOG
22 incentives.

1 **Q. HAS THE COMPANY PROPOSED TO EXCLUDE WACOG EARNINGS FROM**
2 **AN EARNINGS TEST?**

3 **A.** Yes. The Company's proposed earnings test would exclude WACOG incentive earnings.
4 The Company's argument for this position is that including WACOG earnings would
5 somehow undermine the operation of the Company's Purchased Gas Adjustment
6 ("PGA") mechanism.

7 **Q. IS THIS POSITION PERSUASIVE?**

8 **A.** No. To be a meaningful test of the Company's performance, the earnings test must
9 include all sources of earnings from regulated operations. Excluding sources of earnings
10 would distort the relationship between the Company's costs and revenues and place an
11 additional burden on the customer portion of environmental remediation costs at any
12 level of earnings test. Stated differently, excluding WACOG incentives or other sources
13 from the earnings test would shift risk to customers with no corresponding benefit.

14 **Q. WHAT LEVEL OF EARNINGS TEST DOES NWIGU RECOMMEND FOR**
15 **AMORTIZATION OF REMEDIATION COSTS GOING FORWARD?**

16 **A.** NWIGU recommends that the earnings test going forward should also function on an
17 annual basis and serve to cap amortization of remediation costs at the level of the
18 Company's authorized ROE. The earnings test going forward should also include all
19 sources of Company earnings from regulated operations, including WACOG incentives
20 or other sources. In other words, in any given year to the extent that the Company's
21 earnings from all regulated operations exceed the authorized ROE, those excess earnings
22 should be used to offset the costs of remediation paid by customers.

23 ///

1 **Q. WHY IS THIS AN APPROPRIATE RESULT?**

2 **A.** As a first matter, it is fundamentally unfair to expect customers to bear the full costs of
3 environmental remediation efforts for the MGP sites in years when the Company is
4 profiting beyond its authorized level. This would constitute a subsidy from ratepayers to
5 shareholders for costs that ratepayers did not cause to be incurred on property that
6 ratepayers do not own or profit from.

7 An earnings test set at authorized ROE would also not unduly burden the
8 Company. In any given year, the Company would still have every opportunity to earn its
9 full authorized ROE. Also, under this type of earnings test there will still be years (likely
10 many) in which the Company's ROE will be in a reasonable range but ratepayers will
11 bear the full costs of environmental remediation. Finally, an earnings test set at the level
12 of authorized ROE will appropriately allow the earning test to better function as a de
13 facto sharing mechanism in some years as contemplated by the Commission in Order No.
14 12-437 from the UG 221 docket.

15 **Q. WHAT IS THE CORRECT TREATMENT OF PROCEEDS FROM INSURANCE**
16 **CLAIMS OR OTHER THIRD PARTY SOURCES RELATED TO MGP**
17 **ENVIRONMENTAL REMEDIATION?**

18 **A.** Given that customers bear essentially unbounded risk for what could be massive
19 environmental remediation costs, it is appropriate for customers to receive the full benefit
20 of any insurance claim or third party revenue received as an offset to the remediation
21 costs. NW Natural has estimated that the low end potential for environmental
22 remediation costs is now \$70 million and actual expenses could be much higher. In

1 testimony in this docket the Company cited its 10-K filing which states that the upper
2 range for remediation at the Gasco/Siltronic site alone could be \$350 million.

3 **Q. HOW SHOULD INSURANCE BE ACCOUNTED FOR IN THE CONTEXT OF**
4 **THE EARNINGS TEST?**

5 **A.** Given the fundamental asymmetry of risk borne by customers for these costs, the
6 earnings test for any Company portion of costs in each year should be conducted before
7 the application of insurance or third party proceeds. This is a fair result given that under
8 NWIGU's proposed earnings test, the Company will never have to absorb environmental
9 remediation costs in a manner that would result in the Company earning less than its full
10 authorized ROE.

11 **Q. IF THE COMMISSION SHOULD FIND THIS TREATMENT OF INSURANCE**
12 **COSTS INAPPROPRIATE, DOES NWIGU HAVE ANY OTHER**
13 **RECOMMENDATIONS?**

14 **A.** Yes. An alternative would be to apply the earnings test for expenses in each year as
15 described above but to allow the Company to use a portion of insurance or third party
16 offsetting revenues to offset previous write offs made by the Company under NWIGU's
17 earnings test proposal. NWIGU recommends that this amount be set at 5 percent of any
18 offsetting insurance or third party revenue to recognize the overwhelming risk taken by
19 customers while still giving the Company an incentive to aggressively pursue third party
20 cost recovery. The Company's retention of these amounts would be capped at the level
21 of write offs borne by the Company up to the point the offsetting revenue was received.

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1 **Q. CAN YOU PROVIDE AN EXAMPLE OF HOW THIS PROPOSAL WOULD**
2 **FUNCTION?**

3 **A.** Yes. Assume for example the Company had written off \$10 million in remediation costs
4 from the historical period. If in 2014 the Company received a \$100 million insurance
5 settlement, the Company would be allowed to retain \$5 million of that settlement to
6 offset the previous write offs. This would leave \$5 million in historical write offs.

7 If at a later time the Company received a further \$120 million settlement, 5
8 percent of that amount would be \$6 million. However given that the Company had only
9 \$5 million remaining in previous write offs, the remaining \$1 million would flow back to
10 customers.

11 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE**
12 **APPROPRIATE FUNCTION OF AN EARNINGS TEST FOR THE MGP**
13 **ENVIRONMENTAL REMEDIATION COSTS AT ISSUE IN THIS**
14 **PROCEEDING.**

15 **A.** The earnings test should be conducted on an annual basis for both the historical period of
16 deferred costs and prospectively. The earnings test cap should be set in each year at the
17 Company's authorized level of ROE and should include all earnings from the Company's
18 regulated operations. The earnings test should also be conducted prior to the application
19 of any insurance or third party offsetting revenue and all such proceeds should be
20 refunded directly to customers. If the Commission wishes to provide an additional
21 incentive to the Company to aggressively pursue third party cost recovery in the context
22 of NWIGU's recommended earnings test, the Company could be allowed to retain 5

1 percent of such third party proceeds as an offset to any write offs made up to that point
2 under NWIGU's recommended approach.

3 **RATE SPREAD**

4 **Q. WHAT IS NWIGU'S RECOMMENDATION REGARDING RATE SPREAD IN**
5 **THIS PROCEEDING?**

6 **A.** NWIGU and other parties to this docket have reached an agreement in principle
7 regarding rate spread issues. When that agreement is finalized NWIGU will file
8 supporting testimony.

9 **JURISDICTIONAL ALLOCATION**

10 **Q. HAVE YOU REVIEWED THE COMPANY'S PROPOSAL FOR**
11 **JURISDICTIONAL ALLOCATION OF ENVIRONMENTAL REMEDIATION**
12 **COSTS RELATED TO THE MGP SITES?**

13 **A.** Yes. The Company is proposing to use historical data of gas sales from 1925 through
14 1956 with reasonable extrapolations to allocate costs between its Washington and Oregon
15 customers. The jurisdictional allocation is based on proportional volume of gas sold.
16 The Company's approach appears reasonable.

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

18 **A.** Yes.

Docket UM 1635
NWIGU/101
Deen

BEFORE THE
PUBLIC UTILITY COMMISSION OF OREGON

QUALIFICATION STATEMENT OF MICHAEL C. DEEN
ON BEHALF OF
THE NORTHWEST INDUSTRIAL GAS USERS

May 3, 2013

1 **QUALIFICATION STATEMENT OF**

2 Michael Deen

3 **Q. PLEASE STATE YOUR NAME, EMPLOYER, AND BUSINESS ADDRESS.**

4 **A.** My name is Michael C. Deen, and my business address is 900 Washington Street, Suite
5 780, Vancouver, Washington 98660. I am employed by Regulatory and Cogeneration
6 Services, Inc. (“RCS”), a utility rate and consulting firm.

7 **Q. IN WHAT CAPACITY ARE YOU EMPLOYED?**

8 **A.** I am a consultant for the Northwest Industrial Gas Users (“NWIGU”) and other
9 consumers. NWIGU is a non-profit trade association whose members are large users of
10 natural gas served by utilities throughout the Pacific Northwest, including Puget Sound
11 Energy.

12 **Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND.**

13 **A.** I received a B.A. in Psychology from Reed College in May 2006. I have completed
14 coursework in statistics, data analysis, research design, and economics.

15 **Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.**

16 **A.** After graduating from Reed, I was employed as a Research Analyst at McCullough
17 Research, a consulting firm in Portland, Oregon specializing in energy policy and
18 litigation support. While at McCullough Research, my duties included the modeling and
19 analysis of both Western and national energy markets. I also provided analysis for use in
20 several proceedings surrounding Enron’s role in the Western Energy Crisis of 2000-2001.

21 From November 2007, through July 2011, I was employed as a policy analyst at
22 the Public Power Council (“PPC”). PPC is a non-profit trade association representing the

1 interests of consumer-owned utilities buying wholesale power and transmission services
2 from the Bonneville Power Administration (“BPA”). At PPC, I worked extensively on
3 computer modeling relating to the Residential Exchange Program and other BPA rate
4 issues. I also provided analysis and commentary for PPC in a variety of BPA processes.
5 I also was involved in modeling efforts surrounding the potential economic impacts of
6 various greenhouse gas mitigation proposals on Western electricity markets.

7 Since joining RCS in July 2011 I have served as an analyst and expert witness on
8 a variety of power supply, cost, ratemaking, and policy topics primarily regarding the
9 Bonneville Power Administration (“BPA”) and Pacific Northwest utilities.

10 **Q. PLEASE STATE YOUR EXPERIENCE AS A WITNESS IN PREVIOUS**
11 **PROCEEDINGS.**

12 **A.** I have previously testified in the BPA WP-07 Supplemental, WP-10, TR-10, BP-12 and
13 REP-12 rate proceedings. I have also testified on behalf of the Industrial Customers of
14 Northwest Utilities (“ICNU”) before the Washington Utilities and Transportation
15 Commission in proceedings regarding Puget Sound Energy, PacifiCorp, and Avista as
16 well as before the Oregon Public Utility Commission in proceedings regarding Portland
17 General Electric and PacifiCorp. Lastly, I have also testified as an expert on behalf of
18 NWIGU in proceedings related to Avista and Puget Sound Energy regarding natural gas
19 issues.

20 **Q. DOES THIS CONCLUDE THIS TESTIMONY?**

21 **A.** Yes.