

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1635 Phase II

In the Matter of)
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 NORTHWEST NATURAL GAS)
 COMPANY, dba NW NATURAL)
)
 Mechanism for Recovery of Environmental)
 Remediation Costs)
)
 _____)

**RESPONSE TESTIMONY OF THE
CITIZENS' UTILITY BOARD OF OREGON**

May 2, 2014



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OF OREGON
UM 1635 PHASE II

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1 My name is Bob Jenks, and my qualifications are listed in CUB Exhibit 101.

2 **I. Introduction.**

3 This docket began in November 2012, as a follow up to NW Natural’s 2012 rate

4 case, where the issue of a cost recovery mechanism related to environmental remediation

5 costs was not resolved. It has been a long process. To date, CUB alone has advocated for

6 four different recovery mechanisms for NW Natural’s Environmental Remediation costs.

7 With this testimony, CUB will add a fifth. The costs at issue in this docket are associated

8 with the production of gas decades ago when gas was manufactured from coal and

9 petroleum. These are not costs associated with the provision of current service.

10 Therefore, current Oregon customers should not be required to shoulder the burden of

11 paying the environmental remediation costs alone. CUB believes that a fair allocation of

12 these costs would require the Company, Oregon customers and Washington customers to

13 share jointly in the burden of shouldering these environmental remediation costs. Our

14 testimony on these issues will unfold as follows:

- 1 ▪ The Fairness Test: A Tale of Two Dockets. CUB discusses the issue of context
2 and fairness through consideration of two dockets that both deal with properties
3 once used to produce gas for customers - this docket and UM 1654.
- 4 ▪ Other Principles. CUB discusses other principles that should be applied to this
5 case such as: the requirement to forecast used and useful costs; that monopoly
6 regulation is a substitute for the competitive market; that reaching into customers'
7 deeper pockets should be a rare occurrence; that deferrals and automatic
8 adjustments are one sided regulatory tools; that earnings tests are critical when
9 working with deferrals and automatic adjustment clauses; that all utility earnings
10 should be included in earnings tests; that intergenerational equity matters; that
11 customers should get what they pay for; and that all principles should be applied
12 with a dose of pragmatism.
- 13 ▪ NW Natural's Proposal. CUB provides its analysis of NW Natural's latest
14 proposal and explains why it is not fair.
- 15 ▪ CUB's Previous Proposals. CUB reviews its four previous proposals.
- 16 ▪ New Proposal. CUB offers a new proposal based on netting out liabilities and
17 assets from historic properties used to supply gas to customers.
- 18 ▪ Washington allocation. CUB revisits the proposal it made for interstate allocation
19 in Phase 1.

20 **II. The Fairness Test: A Tale of Two Dockets.**

21 While CUB will discuss additional principles below, the first principle that should
22 be applied is a basic fairness test:

23 *Within the context of utility regulation in Oregon, does the proposal seem fair?*

24 To judge what is fair in one situation requires consideration of how similar
25 situations are handled. Context is important.

26 The two dockets that CUB believes need to be compared for the purpose of
27 considering fairness are this one, UM 1635, and the Mist Storage and Optimization,
28 Docket UM 1654.

29 At their core, these two dockets are similar. They both start with property that
30 was once used to produce gas for service to NW Natural's customers. The Portland
31 Harbor properties that are subject to this UM 1635 docket were used to manufacture gas

1 from coal and petroleum in the early half on the 20th century in order to provide gas to
2 retail customers. The property that is subject to UM 1654 was the site of production
3 wells used to produce natural gas for retail customers beginning in 1979.¹

4 Properties that were once used to manufacture gas from coal and oil are left with
5 hazardous waste and are liabilities to their owners. Properties that were once production
6 wells, depending on their geology, can become assets by becoming a place to store
7 natural gas.

8 So we have two properties that were once used to produce natural gas for retail
9 customers. One is now a liability, and subject to this docket, the other is an asset, and
10 subject to the UM 1654 docket.

11 On the one hand, NW Natural's position, as to its environmental remediation
12 liability, is that the liability should fall primarily on customers. The Company is willing
13 to apply excess earnings that are greater than 100 basis points above its authorized
14 earnings to this liability, but it excludes earnings related to pipeline optimization, Mist
15 storage optimization and liquids extraction. The Company clearly believes that the major
16 responsibility for this liability should belong to customers.

17 On the other hand, NW Natural's position on its storage/optimization asset is that
18 its benefits should fall primarily on shareholders. While some of the Mist property
19 remains in use for gas service for core customers, a significant portion is used for
20 interstate/intrastate storage and optimization, where customers receive only 20% of the
21 net income (after the Company has first recovered all of its costs). This sharing
22 percentage is not based on the fact that the asset was created by producing natural gas for
23 customers, but is instead based on the fact that the interstate/intrastate storage shares

¹[https://www.nwnatural.com/AboutNWNatural/RatesAndRegulations/RegulatoryActivities/Mist/.](https://www.nwnatural.com/AboutNWNatural/RatesAndRegulations/RegulatoryActivities/Mist/)

1 some equipment and personnel that is primarily used for core customers. If the property
2 that was once production wells for core customers was used for interstate storage and
3 optimization, but did not share the equipment and personnel that are currently used by
4 core customers, NW Natural's theory of sharing would not require customers to receive
5 any of the benefit.

6 This does not seem fair to CUB. In the past, NW Natural manufactured gas from
7 coal and oil for its retail customers. In the past, NW Natural also drilled production wells
8 at Mist to produce gas for its retail customers. One former production site is a liability.
9 One is an asset. NW Natural's current proposals in the two dockets would leave
10 customers holding almost all of the liability and shareholders holding almost the entire
11 asset. This makes little sense. Historic property used to produce gas for customers
12 should be treated in a consistent manner regardless of whether the value is positive or
13 negative.

14 **III. Other Principles.**

15 In addition to fairness, there are a number of principles that CUB believes need to
16 be considered in this docket.

17 **A. Ratemaking's Primary Function is Setting Rates Based on a Forecast of Used 18 and Useful Costs, Not Cost Recovery of Actual Costs.**

19 Rates are set based on a forecast of the prudently incurred costs associated with
20 assets and services that are used and useful to providing service. This is accomplished
21 through a forecasted test year, which sets the rates to which the utility will attempt to
22 manage its costs; the utility takes the risk of managing its costs. Fuel prices, customer

1 counts, weather related loads all will be different than forecast, but that is normally the
2 utility's risk.

3 In this docket, the costs are not used and useful for providing service to current
4 customers. These costs are associated with service that was provided many decades ago,
5 service that sold a different product - manufactured gas rather than natural gas. These
6 costs are not being forecast. Instead, the Company is proposing utilization of an
7 automatic adjustment clause which would provide the Company with a risk-free method
8 of dollar-for-dollar recovery. These costs should have been recovered during the period
9 of time that the Company was manufacturing gas. Just as PGE is charging current
10 customers a decommissioning charge for its Boardman plant while the plant is still in
11 service in order to clean up the site when the plant is no longer in service, NW Natural
12 should have charged customers for the cost of cleaning up the manufactured gas site
13 during the time it was producing manufactured gas, and customers were purchasing
14 manufactured gas.²

15 **B. Monopoly Regulation is a Substitute for the Competitive Market.**

16 Regulation of utilities is supposed to protect customers from utilities using their
17 monopoly status to overcharge customers, whereas in the competitive market,
18 competition, rather than regulation, sets rates. Economic theory says that prices will
19 reflect the marginal cost of service. If a company can recover the cost of producing the
20 next increment of a good, then economic theory says the company should produce that
21 unit. This drives the price towards marginal cost. But the company does not have the
22 ability to add a surcharge on top of the market price in order to recover a previous

² UE 283 - PGE/ 304/Tooman – Macfarlane/1.

1 liability. NW Natural's situation is not unusual. Many companies have past liabilities
2 associated with superfund sites. What makes NW Natural's circumstances different is
3 that the Company has the advantage of being a regulated monopoly and can ask
4 regulators for permission to charge customers for costs that would be borne by
5 shareholders in the competitive market.

6 **C. In Extraordinary Circumstances, Customers Have a Deep Pocket.**

7 Collectively, customers have a deeper pocket than the utility, and while it is unfair,
8 sometimes costs fall on customers because they are simply too great for the company to
9 absorb. When designing the PCAMs for electric utilities, it was recognized that utilities
10 are paid to manage risk, but that costs can sometime be so large that they fall outside of
11 what is the reasonable range that shareholders can absorb, requiring customers, with their
12 deeper pocket to share in the costs.³ In the PCAM, the level of shareholder costs that can
13 be managed by the utility is generally considered to be 250 basis points of ROE. This is
14 based on the reality that making a utility absorb too great a risk – too great a financial
15 liability – can harm the utility and its ability to finance utility service. But using
16 customers as a deep pocket should only happen in unusual circumstances and only after
17 the utility has absorbed an amount that represents the utility's expected share of risk. The
18 costs at issue in this docket add up to levels that are significant over time, but to date the
19 amount of costs in any particular year has not been extraordinary. Unlike the PCAMs,
20 NW Natural is not proposing that the Company absorb a significant level of cost before
21 allocating the remainder to customers. Customers pay all the costs, except in the
22 circumstances that NW Natural is earning more than 100 basis points above its ROE. So,

³ UE 165 - CUB/100/Jenks-Brown/19.

1 while the electric companies have to absorb 250 basis points before charging customers,
2 NW Natural gets to keep an extra 100 basis points of ROE before making a contribution.

3 **D. Deferrals and Automatic Adjustment Clauses are One-sided Regulatory Tools.**

4 Deferrals are extremely one sided and should be the exception to normal
5 ratemaking. As such, deferrals should not lead to a more generous result for a company
6 than the company would receive through a general rate case. While in theory deferrals
7 can flow in both directions, the reality is that they are a very one-sided tool. Deferrals
8 have to be requested prospectively before the cost is incurred or shows up on the books of
9 the utility. Utilities know when costs have gone up or down, but customers do not. By
10 the time customers know that a cost has declined and a deferral would be appropriate, it
11 is usually too late to file a deferral. In addition, deferrals allow the utilities to track the
12 cost down to the last dollar of recovery. Most costs, even if they are forecast correctly,
13 are subject to over- or under-recovery since their recovery is based on a load forecast, but
14 deferrals and automatic adjustment clauses allow dollar for dollar recovery regardless of
15 loads. Because deferrals are one-sided, it is important to design them so that they are not
16 more generous than the recovery the utility would obtain in a rate case.

17 **E. Earnings Tests Are Critical for Achieving Some Level of Balance When**
18 **Ratemaking With Deferrals and Automatic Adjustment Clauses.**

19 If regulation had perfect foresight, we would forecast costs and loads such that a
20 utility recovered exactly its costs and earned exactly its allowable ROE. When a utility is
21 asking to retain earnings above its allowable ROE within a deferral, it is asking for a
22 better deal than it would get in a perfect rate case. The purpose of the earnings test is to
23 see if current rates are sufficient to allow recovery of all or part of the “deferred cost”

1 without a surcharge. If a utility's earnings are such that it can recover all of its costs,
2 including the costs subject to the deferral, and still earn a reasonable return, then rates are
3 sufficient and there is no reason to add a surcharge. If a utility is recovering its costs and
4 earning its authorized rate of return, then it has been fully compensated. There is no
5 justifiable reason to raise rates when they are sufficient to recover costs and allow a
6 reasonable return.

7 NW Natural is seeking permission to use insurance proceeds to allow it to retain
8 earnings that would otherwise be subject to the deferral earnings test and on a going
9 forward basis to allow it to earn 100 basis points above its ROE, all without contributing
10 anything towards Environmental Remediation costs. Such a result would allow NW
11 Natural to obtain greater recovery than it would in a rate case. If the Company's earnings
12 were 75 basis points above authorized ROE, all of the environmental remediation costs
13 for that year would fall on customers. On the other hand, a "perfect rate case" that could
14 accurately forecast costs would allow cost recovery but not allow the Company to retain
15 earnings above the authorized level.

16 **F. Earnings Tests Should Include All Utility Earnings.**

17 Rates are established at a level that allows a utility to earn a reasonable return on
18 the investment it makes to provide service to customers. Measurement of the utility's
19 earnings should include all earnings that the utility gained from its investments in utility
20 property, regardless of whether the source of earnings is derived directly from customers.
21 Unless there is a very good reason not to include all earnings from investments made on
22 behalf of customers in a utility's earnings test, all utility earnings should be included in

1 any earnings test.⁴ NW Natural, in this docket, wants to exempt its earnings related to
2 Mist optimization, pipeline optimization, and liquids extraction from any earnings test
3 associated with the environmental remediation recovery mechanism. This makes little
4 sense because all of these derive from the investment made to serve core customers. The
5 key issue for an earnings test is whether the utility is earning a fair return for the
6 investment it made in providing service to the customer. When a utility uses ratepayer
7 assets to earn money, any income obtained from those assets is a return on the investment
8 to provide utility service.

9 **G. Intergenerational Equity.**

10 Because customer base changes over time (people die, move, change fuel source,
11 etc.), the timing of costs and revenues matters. In this case, the customers who benefited
12 from manufactured gas are, in most cases, gone and unable to fund the recovery of costs
13 related to the services they received. NW Natural is now requesting to recover the costs
14 associated with manufactured gas from current and future customers, not the customers
15 who benefited from manufactured gas. This presents an equity issue. In addition, the
16 application of insurance receipts also presents an intergenerational equity problem,
17 because neither the total cost nor the time period of recovery is known. Should some of
18 the insurance receipts be held back to offset costs that may occur in 2024?

19 **H. Customers Should Get What They Pay For.**

20 If customers pay for insurance, then insurance receipts should offset the costs that
21 fall on those customers. NW Natural is proposing that the insurance receipts first go to

⁴ CUB's reference is to investments made to provide service to customers, not earnings from unrelated activity.

1 offset the historic deferrals that are subject to the earnings test, which has the effect of
2 using the insurance to protect excess earnings that the shareholders would otherwise have
3 to contribute to the cleanup. If we could forecast insurance receipts in a rate case, 100%
4 of the forecasted insurance premiums would be used to offset costs to customers – they
5 would not be used to move a utility’s earnings above the authorized level. Why should
6 that rule not apply here? Under NW Natural’s proposal, customers will likely receive a
7 smaller share of the insurance receipts than they will of the environmental remediation
8 costs. If this is how insurance receipts are allocated, then there needs to be a
9 corresponding change to how the burden of insurance premiums is allocated. If the
10 purpose is to protect earnings - and, in particular, earnings above authorized levels - then
11 shareholders should contribute to, if not outright fund, the premiums.

12 **I. These Principles Should Be Applied With a Dose of Pragmatism.**

13 In this docket, the Commission must make a decision for allocating money, and a
14 fair outcome does not preclude a bit of pragmatism. For example, in the stipulation, CUB
15 agreed to reduce the amount of historic dollars that the Company contributed from its
16 past deferrals in exchange for more generous earnings going forward (more generous
17 than what was achievable in settlement without reducing the write off, not more generous
18 than our own proposal). While this would seem to violate the principles associated with
19 the proper earnings tests for deferrals, because CUB was concerned that the future costs
20 could continue to grow and grow, it was a pragmatic trade-off that CUB was willing to
21 make.

1 **IV. NW Natural's Proposal Is Not Fair to Customers.**

2 NW Natural's proposal fails to meet a basic threshold of fairness. On a going
3 forward basis, customers pay nearly all the costs because, under NW Natural's proposal,
4 the earnings test and sharing do not kick in until the Company has substantial
5 overearnings; the proposal also excludes earnings associated with Mist Storage
6 Optimization, Pipeline Optimization and Liquids Extraction -- all of which are directly
7 derived from the utility's investment in its system to deliver gas to core customers. On a
8 retroactive basis, the proposal uses insurance receipts to wipe out the past deferrals
9 thereby protecting the Company's excess earnings that would otherwise be subject to a
10 deferral earnings test. This causes intergenerational equity problems for future customers
11 who would, as a result, see less of the insurance receipts. In the end, shareholders are
12 likely to receive a greater share of the insurance premiums than they are a share of the
13 clean-up costs. Overall, it requires customers to pay significant surcharges for costs that
14 are unrelated to current service, while allowing the Company to earn above its authorized
15 return and contribute little to the environmental liability. Customers pay more than they
16 should for existing service and shareholders earn more than they should for providing
17 that service.

18 **V. CUB Stands By the Proposals Previously Submitted to This**
19 **Commission.**

20 CUB has proposed three methods for sharing these costs. The first, in UG 221,
21 was strictly a cost-sharing mechanism. Then, in Phase 1 of this UM 1635 docket, CUB
22 proposed two other mechanisms: the first was to simply use an earnings test at allowable
23 ROE and the second to manage sharing through use of an earnings band. The third

1 method offered up in Phase 1 was the method developed through negotiation with the
2 other parties and presented in the Stipulation. That method was based on the use of
3 earnings bands. While we do not want to rehash all the arguments relating to those first
4 four proposals, CUB still believes that they would have established fair, just and
5 reasonable rates. Hence, for ease of review they are summarized below.

6 **A. UG 221 – Sharing Proposal.**

7 In its UG 221 proposal, CUB supported applying a year-by-year earnings test to
8 the deferred amounts.⁵ On a going forward basis, CUB proposed that the costs be shared
9 50-50, noting that the costs at issue were unrelated to current service:

10 The Company is only entitled to recovery of prudent costs incurred for
11 serving *current* customers. There is no intergenerational equity here. The
12 costs at issue here were incurred because of antiquated manufacturing
13 practices and do not relate in any way to provision of service to *current*
14 customers. Today’s customers did not benefit in any way from the
15 manufacturing of gas, or the sale of MGP byproducts. They also did not
16 cause the environmental damage that needs to be remediated.⁶

17 **B. UM 1635 Phase 1 Testimony.**

18 In Phase 1 of this docket, CUB proposed a mechanism using earning bands. This
19 was in response to the Commission Order in UG 221:

20 The majority of Commissioners believe that use of an earnings test (with a
21 deadband) coupled with the Commission's ongoing prudence review will
22 provide an effective incentive for the company to manage its costs.
23 Further, the majority adopts an earnings test but no sharing mechanism.
24 An earnings test may operate as a *de facto* sharing mechanism in some
25 years, but it is not the intent of the majority to impose an explicit sharing
26 mechanism.⁷

⁵ UG 221- Citizens’ Utility Board of Oregon’s Opening Brief, page 12.

⁶ UG 221 - Citizens’ Utility Board of Oregon’s Opening Brief, page 41. “MGP” is an abbreviation for
manufactured gas plants.

⁷ OPUC Order No. 12-437 at page 32.

1 First, CUB proposed an earnings test at allowable ROE for the deferred amounts,
2 and argued that the earnings test should include all earnings made from the utility system,
3 including the PGA and core customer optimization:

4 CUB proposes that all earnings that are gained from utility assets – this
5 means earnings growing out of the PGA and earnings that are derived
6 from optimizing rate-based storage – should be included in the
7 mechanism.⁸

8 Second, on a going forward basis, CUB argued that an earnings test at allowable
9 ROE, including all earnings from the utility system, would also be a reasonable
10 mechanism going forward.

11 In addition, CUB proposed an alternative that used sharing bands to allocate the
12 costs:

13 Customers would pay 100% of the costs up to 100 basis points below
14 ROE.

15 Customers would pay 80% of the costs from 100 basis points below ROE
16 to ROE.

17 Customers would pay 10% of costs up to 100 basis points above the
18 authorized ROE.

19 Customers would pay no costs above 100 basis points above ROE.⁹

20 **C. Phase I Settlement and Stipulation.**

21 After filing testimony in this docket offering up the two proposals, CUB was
22 ultimately able to reach settlement with the other parties in Phase 1 of this docket. While
23 settlement discussions are confidential, CUB can discuss why CUB believed that the
24 settlement was a fair, just and reasonable one. CUB was – and is – concerned about the
25 potential for the environmental remediation costs to keep growing. CUB was willing to

⁸ UM 1635 - CUB/100/Jenks/13.

⁹ UM 1635 - CUB/100/Jenks/13.

1 reduce the write-off associated with the past deferrals down to \$7 million if CUB was
2 satisfied that the mechanism going forward would be robust enough to ensure that NW
3 Natural shared a significant amount of the going forward costs. It wasn't a strict sharing
4 mechanism, unlike the first option we offered the Commission, but it would have
5 guaranteed that NW Natural contributed when its earnings were within a reasonable
6 range. That settlement had a series of sharing bands depending on the Company's
7 earnings level:

8 The Parties agree that the earnings test to be applied to environmental
9 remediation expenses deferred on or after January 1, 2013, will be
10 conducted on an annual basis according to the following terms:

11 a. If the Company's results of operations ("ROO") for a given year show
12 that the Company earnings were below 75 basis points below the
13 Company's authorized return on equity in that year ("Authorized ROE"),
14 the Company will be allowed to collect all of the prudently-incurred
15 environmental remediation expenses deferred in that year.

16 b. If the Company's ROO for a given year shows that the Company's
17 earnings are between 75 basis points below Authorized ROE and
18 Authorized ROE (or at ROE), the Company will credit to the balance of
19 the SRRM, up to the amount deferred for that year net of insurance
20 proceeds or third-party recoveries allocated to that year ("Net Amount
21 Deferred"), 10 percent of its earnings between 75 basis points below
22 Authorized ROE and Authorized ROE.

23 c. If the Company's ROO for a given year show that the Company's
24 earnings are above Authorized ROE but less than or equal to 50 basis
25 points above Authorized ROE, the Company will credit to the balance of
26 the SRRM, up to the Net Amount Deferred: (1) 80 percent of the
27 Company's earnings between Authorized ROE and 50 basis points above
28 Authorized ROE; and (2) 10 percent of its earnings between 75 basis
29 points below Authorized ROE and Authorized ROE.

30 d. If the Company's ROO for a given year shows that the Company's
31 earnings are more than 50 basis points above Authorized ROE, the
32 Company will credit to the balance of the SRRM, up to the Net Amount
33 Deferred: (1) 95 percent of its earnings above 50 basis points above
34 Authorized ROE; (2) 80 percent of its earnings between Authorized ROE
35 and 50 basis points above Authorized ROE; and (3) 10 percent of its
36 earnings between 75 basis points below Authorized ROE and Authorized
37 ROE. In no case will the credit to the SRRM in a given year resulting from

1 the above earnings test be higher than the Net Amount Deferred in that
2 year.¹⁰

3 But this proposal was rejected by the Commission stating that based “on the
4 record, we believe that a disallowance of \$7 million from recovery of incurred costs through
5 the proposed SRRM is too low.”¹¹

6 **VI. CUB Offers a New Proposal Based on the Concept of Netting Out**
7 **Liabilities and Assets from Historic Properties.**

8 In offering a new proposal, CUB needs to start by updating some of the cost
9 information that was used for previous proposals. In earlier testimony, the amount that
10 had historically been spent and deferred was \$71 million, with the Company expecting an
11 additional \$58 million in costs for a total of \$129 million.¹² Today, the Company has
12 spent more than \$100 million and expects future spending to be between \$98 and \$350
13 million for a total cost of \$200 million to \$450 million.¹³

14 As CUB has stated, CUB is concerned about the potential for the future costs to
15 keep on growing. Today, the Company is projecting that these costs could be 3.5 times
16 as high as it was projecting when CUB wrote its Opening Testimony in this docket. But
17 future costs are still largely unknown and the costs could continue to grow.

18 **A. Deferred Amounts 2003-2011.**

19 The first issue in dealing with a mechanism is to deal with the historic deferred
20 amounts and the earnings test. Staff Exhibit 102 shows the impact of various ways to set
21 the earning test. Consistent with CUB’s principles, the Company should not be allowed

¹⁰ UM 1635 - Joint Testimony/100/Joint Parties/8.

¹¹ OPUC Order 13-424, page 7.

¹² UM 1635 - Staff/100/Johnson/9.

¹³ UM 1635 - NWN/800/Miller/3.

1 to recover the deferred environmental remediation costs to the extent that its ROE is
2 above authorized levels, because to do so would lead to more generous results than the
3 Company is entitled to in a general rate case. Staff Exhibit 102 shows the impact of
4 setting the earnings test at authorized ROE to require a write-off of \$24.2 million. CUB
5 is now proposing that the earnings test be run on a year to year basis with a threshold set
6 at authorized ROE, after insurance is applied. CUB proposes applying the insurance
7 receipts equally to all past and future costs, but to assume the upper end of the range of
8 costs outstanding. This is based on the intergenerational equity principle, CUB's
9 concerns that these amounts can grow significantly, and CUB's belief that future
10 customers deserve their share of the insurance proceeds.

11 NW Natural identifies the insurance receipts as \$150.5 million, which is almost
12 exactly 1/3 of the upper range of costs, \$450 million. To come up with CUB's May 2014
13 proposal, CUB took Staff Exhibit 102 and reduced the amount on line 20 by 1/3 to create
14 a new line for net environmental costs after insurance. This new amount is compared to
15 the Company earnings above authorized in each year. The end result is that the Company
16 write-off is reduced to \$21.3 million. The remaining deferred amount after the year-by-
17 year application of insurance falls on customers and would be \$26 million. (Note: CUB
18 did not update the numbers in the Staff Exhibit, which would increase the remaining cost
19 being allocated to customers due to additional interest).

20 In summary, CUB's proposal for deferred costs between 2003 and 2011 is:

21 *Apply insurance proceeds to reduce each year's deferral by 1/3.

1 *Apply a year-to-year earnings test at authorized ROE, which results in a
2 Company write-off of approximately \$21.3 million and a customer
3 allocation of \$26 million plus interest.

4 **B. Mechanism Going Forward.**

5 Going forward, CUB proposes netting the benefits of the property formerly used
6 for gas extraction against the costs of the property formerly used for gas manufacturing.
7 CUB would propose that we first identify the net income associated with Mist Storage
8 and Mist optimization (pipeline optimization, liquids extraction and Gill Ranch do not
9 arise out of a former production facility so those categories of earnings would not be
10 included in this proposal). This net income, as currently tracked, includes depreciation of
11 investment but not a return on that investment. CUB would propose that the Company be
12 allowed its authorized rate of return on its investment in Mist storage and optimization,
13 but that everything above the allowable rate of return be used to offset the environmental
14 liabilities – this includes customer and Company sharing. The benefit to the shareholder
15 would be that they would be allowed to earn their rate of return on interstate/intrastate
16 storage and optimization. The benefit to customers would be that net revenues are used
17 to offset the environmental liabilities.

18 Currently, these net revenues are shared with the Company getting 80% and
19 customers getting 20%. Under CUB's proposal, customers would no longer receive the
20 20% of the net revenues, and NW Natural would only be allowed to keep net revenues
21 that were equal to its authorized rate of return multiplied by its unamortized capital
22 investment in interstate storage and optimization.

1 CUB proposes that the Commission direct that this net income be placed into a
2 balancing account to be used to offset the environmental remediation costs, net of
3 insurance. This money could then be used to pay for environmental remediation costs.
4 CUB recommends that this process continue until NW Natural certifies that it is unlikely
5 to incur any more costs, or certifies that the funds already collected are sufficient to cover
6 the expected costs. At that time, the Mist sharing arrangement that comes out of Docket
7 UM 1654 would be reinstated. If the balancing account grows to more than \$50 million
8 and the Company believes that it will not rebalance within 5 years, CUB proposes that
9 there be a required review of the mechanism to determine whether it is robust enough to
10 cover the expected costs of environmental remediation.

11 **C. The Years 2012-2013.**

12 Since this docket began, additional years have been added to the deferral. CUB's
13 deferral proposal was based on the analysis that the Staff did earlier in this docket, which
14 looked at the deferrals between 2003 and 2011. Based on the Company's testimony that
15 the costs have grown to \$100 million, there are \$30 million in additional costs that are
16 neither covered by CUB's backwards approach or CUB's forward looking approach.
17 Applying insurance proceeds to this will reduce it to \$20 million.

18 CUB would be supportive of the additional costs flowing into the deferral
19 earnings test or flowing into the forward looking mechanism. The amount is not so large
20 as to overwhelm the going-forward mechanism. Therefore, directing funds into that
21 mechanism would create the advantage of eliminating additional write-offs from deferrals
22 and earnings tests. However, CUB recognizes that the Commission was not supportive

1 of the Stipulation which reduced the write-off on past amounts, so CUB would also be
2 supportive of applying an earnings test at authorized ROE as an acceptable alternative.

3 **D. One Variation We Considered.**

4 In proposing this mechanism, CUB did consider alternatives, including one option
5 that would have used insurance proceeds to wipe out all existing amounts, and seed the
6 asset/liability balancing account with a negative balance going forward. The balancing
7 account used in the proposal above would then operate to pay all costs going forward.
8 While CUB believes such a proposal would be viable, it would place a higher risk of
9 intergenerational inequity on customers. The proposal above has three sources of
10 revenues: customers and shareholders from the deferral period, insurance receipts, and
11 net revenues from Mist properties. By changing to only two sources of revenues –
12 insurance and Mist properties – there will be a greater likelihood that the costs will
13 overwhelm the mechanism causing future customers to have to pay a surcharge without
14 seeing any share of the insurance. In addition, such a mechanism would not address the
15 Commission’s concerns about the level of write-off from the deferrals. However, even
16 with some intergenerational risk going forward, CUB believes that this proposal could
17 also be viable.

18 **VII. Allocation to Washington.**

19 As part of the settlement in Phase 1, CUB agreed to an allocation to Washington
20 based on historic costs. This was part of an overall settlement that had a fairly robust
21 mechanism going forward. However, with the rejection of the Stipulation that contained
22 that proposal, CUB is concerned that the environmental remediation costs may fall
23 primarily on customers, and believes, therefore, that Oregon customers should not be

1 made to pay a larger share of these costs than Washington customers of NW Natural.
2 CUB, therefore, proposes that environmental remediation costs be allocated between
3 Oregon and Washington customers in the same manner as other costs are currently
4 allocated. CUB's reasoning for this has not changed since its Opening Testimony in
5 Phase 1:

6 CUB rejects the Company's proposal to look at historic operations to
7 determine the allocation between states. If these costs are directly related
8 to historic operations, these costs are unrelated to current service and
9 should not be placed on customers at all, at least without significant
10 sharing... If these environmental remediation costs are supposed to
11 represent a current cost associated with current decisions of environmental
12 regulators, then these costs should be assigned to states based on the
13 current allocation.

14 In addition, it should be recognized that if the desire continues to be to
15 look back at historic usage of manufactured gas many decades ago, then
16 residential customers will complain loudly as they would have to take a
17 significantly lower share than anticipated by the rate spread stipulation.
18 CUB's research suggests that historically, street lighting, commercial
19 service, and industrial service made up a much more significant share of
20 NW Natural's load than they do today. If historic allocations are to be
21 used, those historic allocations must be used consistently.

22 CUB did not insist on this strict allocation using historic customer loads
23 when we negotiated the stipulation on rate spread for these costs. There,
24 CUB agreed to spread the costs on equal percent of margin, recognizing
25 that this is how current costs are generally allocated. CUB proposes the
26 same for interstate allocation: use the methodology that is current used for
27 most costs.

28 Using the work papers from NW Natural's UG 221, the allocations should
29 be 90.07 to Oregon and 9.93 to Washington.^{14 15}

30 **VIII. Conclusion**

31 With this testimony, CUB has attempted to be responsive to the Commission's
32 concerns about the earlier settlement. While CUB believes that all of the proposals it has

¹⁴ UG 221 - Workpapers NWN 300-312, McVay-Siores Revenue Requirement, TME 201109 master state IS allocation (2).xlsx.

¹⁵ UM 1635 - CUB/100/Jenks/20.

1 presented to the Commission concerning these liabilities would represent reasonable
2 results, CUB now favors its fifth proposal – that the mechanism developed for this docket
3 be developed in the context of other property that was once used to produce gas for
4 customers. The application of the principles of fairness; the requirement to forecast used
5 and useful costs; the principle of monopoly regulation being a substitute for the
6 competitive market; that reaching into customers’ deeper pockets should be a rare
7 occurrence; that deferrals and automatic adjustments are one-sided regulatory tools; that
8 earnings tests are critical when working with deferrals and automatic adjustment clauses;
9 that all utility earnings should be included in earnings tests; that intergenerational equity
10 matters; that customers should get what they pay for; and that all principles should be
11 applied with a dose of pragmatism, all steer CUB in this direction.

12 CUB is now proposing that the earnings test be run on a year-to-year basis with a
13 threshold set at authorized ROE, after insurance is applied. CUB proposes applying the
14 insurance receipts equally to all past and future costs, but to assume the upper end of the
15 current range of costs outstanding. This is based on the intergenerational equity
16 principle, CUB’s concerns that these amounts can grow significantly, and CUB’s belief
17 that future customers deserve their share of the insurance proceeds. In summary, CUB’s
18 proposal is:

19 1. Deferred Costs (2003-2011)

20 *Apply insurance proceeds to reduce each year’s deferral by 1/3.

21 *Apply year-to-year earnings test at authorized ROE which results in a
22 Company write-off of approximately \$21.3 million and a customer
23 allocation of \$26 million plus interest.

1 2. Future Costs (2014 and beyond)

2 *Costs remaining after insurance be placed in balancing accounting where
3 they are offset with net revenues earned from Mist Storage and Mist
4 Optimization after allowing the Company to earn its authorized ROE on
5 its investment in Mist Storage.

6 *This would continue until the costs were fully paid, the fund was
7 sufficient to pay the remaining anticipated costs, or the balancing account
8 had grown to more than \$50 million and the Company believed that it
9 would not rebalance in 5 years.

10 3. Costs Incurred Between These Periods (2012-2013)

11 *Apply either of the approaches above after the application of insurance
12 receipts.

13 CUB respectfully requests that the Commission adopt CUB's proposal.

UM 1635 – CERTIFICATE OF SERVICE

I hereby certify that, on this 2nd day of May, 2014, I served the foregoing **RESPONSE TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON** in docket UM 1635 upon each party listed in the UM 1635 PUC Service List by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending one original and five copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

(W denotes waiver of paper service)
(HC denotes highly confidential)

(C denotes service of Confidential material authorized)

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Respectfully submitted,

A handwritten signature in black ink, appearing to read "Sommer Templet". The signature is written in a cursive, flowing style.

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