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May 29, 2014

VIA ELECTRONIC FILING AND FIRST CLASS MAIL

Public Utility Commission of Oregon
3930 Fairview Industrial Drive SE
Post Office Box 1088
Salem, Oregon 97308-1088

Attn: Filing Center

Re: Docket UM 1635-Phase II – Northwest Natural Gas Company's Mechanism for Recovery of Environmental Remediation Costs

Northwest Natural Gas Company, dba NW Natural ("NW Natural" or "Company"), files herewith Rebuttal Testimony of Alex Miller in the above-captioned docket. Enclosed are an original and five copies.

A copy of this filing has been served on all parties to this proceeding as indicated on the enclosed Certificate of Service

Please call me with any questions.

Sincerely,

/s/ Mark R. Thompson

Mark R. Thompson

enclosures

cc: UM 1635 Service List

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing REBUTTAL TESTIMONY OF ALEX MILLER, upon all parties of record in the UM 1635-Phase II proceeding by electronic mail.

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DATED at Portland, Oregon, this 29th day of May 2014.

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BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UM 1635

Phase II

NW Natural

Rebuttal Testimony of C. Alex Miller

May 29, 2014

EXHIBIT 900 – REBUTTAL TESTIMONY – RECOVERY OF ENVIRONMENTAL REMEDIATION COSTS

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I. INTRODUCTION AND SUMMARY

Q. Please state your name and position with Northwest Natural Gas Company ("NW Natural" or the "Company").

A. My name is C. Alex Miller. My current position is Treasurer and Vice President of Regulation for NW Natural. I am responsible for Rates & Regulatory Affairs, as well as Treasury operations.

Q. Are you the same Alex Miller that previously filed testimony in this docket?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

A. My rebuttal testimony addresses response testimony filed by Staff of the Public Utility Commission of Oregon ("Staff"), the Citizens' Utility Board of Oregon ("CUB"), and the Northwest Industrial Gas Users ("NWIGU").

Q. How is your rebuttal testimony organized?

A. In Part II of my testimony I will provide some context for the Company's recommendations by discussing the recent insurance recoveries and the status of NW Natural's remediation efforts. In Part III I will address the parties' recommendations for the earnings review to be applied to the Site Remediation Recovery Mechanism ("SRRM"), and the appropriate allocation of insurance proceeds to environmental remediation deferrals. In Part IV, I will address the parties' recommendations regarding the prudence review of past environmental remediation expenses. In Part V, I will address the parties' recommendations for the jurisdictional allocation of environmental remediation expenses. In Part VI, I make a suggestion for how the Commissioners may want to proceed with the process in this docket.

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Q. Please summarize your testimony.

A. In its Opening Testimony, the Company proposed an earnings review and allocation of insurance benefits that is simple, straightforward, and consistent with the Public Utility Commission of Oregon ("Commission") precedent and sound regulatory policy. Specifically, the Company recommended that the Commission adopt the following framework:

- NW Natural will apply the insurance proceeds to the deferral balance, thus offsetting both the deferred expenses and some years of future expenses. The Company will continue to offset future expenses with the remaining insurance proceeds until the deferral account has a positive balance, at which time the balance will be recovered through the SRRM adopted by the Commission.
- Going forward, the Company will apply an earnings review that would require the Company to offset environmental expenses with any earnings above 100 basis points above authorized return on equity ("ROE").

This recommendation is consistent with Commission orders requiring the Company to offset remediation expenses with insurance recoveries, and to defer only unrecovered expenses. Moreover, the proposed prospective earnings review is consistent with the Commission's framework, articulated in Order No. 93-257, allowing the Company to collect deferred expenses up to the top of a reasonable range of earnings. NW Natural's proposal would provide for an earnings test that does not undermine the general regulatory framework, and that is consistent with specific incentive mechanisms adopted by the Commission to encourage good management.

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In their reply testimonies, the parties have all made very different proposals; nevertheless their proposals suffer from many of the same flaws.

First, the parties' proposals fail to recognize that both the past and some future expenses are entirely offset by insurance recoveries, thus rendering unnecessary the controversy regarding past earnings and allocations of insurance proceeds. As summarized above, NW Natural's proposal regarding the application of insurance proceeds is simple and intuitive in that it recognizes that past expense has been wholly offset. On the other hand, the parties have proposed various complicated insurance allocation methodologies and earnings reviews applied to past earnings—all of which propose that the Commission require customers to pay for expenses that have been wholly offset by insurance. In addition, the parties' proposals unnecessarily require the Company to write off prudently incurred expenses. In the end, the parties' proposals are needlessly complicated and do not advance the Commission's precedent or policies.

***Second*,** the parties' proposals fail to recognize the nature of the expenses at issue—prudently incurred utility expenses. It is true that NW Natural's environmental remediation costs are unique in their amount and duration; however, most fundamentally, they represent prudently incurred costs required to remediate former utility plants. Utility rates regularly recover decommissioning and environmental remediation costs, including those related to plant that is no longer in service. The sharing proposals and restrictive earnings reviews proposed by the parties, which seek to disallow recovery of significant portions of these expenses, are thus inappropriate.

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Third, the parties' proposals would serve to undermine important utility incentives inherent in the regulatory compact. Fundamental ratemaking policy creates an incentive for utilities to control costs and manage their operations efficiently by allowing them to retain savings that they achieve between rate cases. This construct benefits customers when the reduced costs are built into rates in subsequent rate cases. In my Opening Testimony, I referred to this incentive as the incentive for "good management." The earnings reviews proposed by Staff and CUB would set NW Natural's earnings threshold at or below authorized ROE, thus undermining this incentive by requiring the Company to give up its savings, or, in Staff's case, actually incenting the Company to under-earn. It is true that the Company will still be incented to earn up to the effective earnings cap and the risk of prudence disallowances will provide additional incentives to efficient management. Nevertheless, the Staff and CUB proposals will meaningfully change the fundamental incentives built into the ratemaking construct.

An earnings review that cuts off earnings at or below authorized ROE imposed on the occasional one-time deferral might not be harmful to the incentive for good management. However, in this case, the environmental remediation deferrals are expected to continue for the next several years—possibly as long as10 to 20 years—and the deferrals are expected to exceed on an annual basis any "over earnings" that NW Natural could achieve. Thus, as a practical matter, the proposed earnings reviews would effectively cap NW Naturals earnings—and cap the benefits from efficiencies—for many years to come. This result has the potential of completely undermining the incentive for good management. Similarly, parties' proposals would compromise the

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Commission's incentive mechanisms designed to provide customer benefits through gas commodity procurement savings and discretionary shareholder storage investments and optimization activities.

Fourth, the consequences of the parties' earnings tests are significant and may cause real and serious harm to the Company. The parties' historical earnings tests would require the Company to write-off significant past expenses that are associated with prudent and legally-required actions. In fact, Staff's proposal would force NW Natural to shoulder approximately 90 percent—or $38 million dollars—of prudently incurred remediation expense, after applying only a small portion of insurance receipts against those expenses. This result is particularly unjust, given that the Company's earnings during the deferral period were, on average, below its authorized ROE.

The Commission should reject these proposals made by Staff, NWIGU and CUB.

II. STATUS OF INSURANCE RECOVERY AND REMEDIATION EFFORTS

Q. Please provide the Commission with an update on the Company's insurance recoveries to date.

A. Our situation has radically changed since we filed initial testimony in this docket and since the Commission rejected the parties' stipulation. When we filed our initial testimony, we had spent a total of $94.3 million in environmental remediation expenditures, which was offset by $40.7 million in insurance recoveries[1]—with no real assurance we would ultimately receive enough to offset the unrecovered balance.

[1] These figures both reflect the expense and insurance proceeds recovered through the end of 2012.

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Thus, at that time, we were looking at the potential of beginning to amortize into customer rates a total of $53.6 million over a five year period—with the knowledge that the surcharges would only grow over the years as additional remediation funds were spent.

However, in January of this year, the Company entered into settlement agreements with the remainder of the defendants in the insurance litigation, bringing total recoveries to approximately $150 million dollars.[2] NW Natural has now received all of the payments that were the subject of these settlements—which are currently recorded in a deferral account. Thus, the total insurance proceeds recorded in our deferral account for the benefit of customers exceed total environmental remediation expenditures to date by around $35 million. In short, we are in a net positive position, which is a good thing for our customers.

Q. Please describe the status of the Company's remediation efforts.

A. We have completed the construction of the Gasco Source Control facility, which is now in operation, and we have completed most of the studies that had been required by the various regulatory agencies overseeing the remediation efforts. The next major event related to the harbor cleanup is the development of a Proposed Plan, which will be followed by the Environmental Protection Agency's issuance of a Record of Decision ("ROD"). The ROD will dictate the remainder of the work to be done on the harbor. Current estimates are that the EPA will issue the Proposed Plan in 2016 and the ROD

[2] In UG 221 the Commission made clear that they wanted the Company to pursue all available insurance proceeds; the Company was pleased it was able to reach favorable settlements, even though disappointed that it took up until the scheduled trial date to do so.

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in 2017. With respect to remediation of the uplands surrounding the former Gasco plant, we expect to prepare a Feasibility Study starting later this year that will be reviewed by the Oregon Department of Environmental Quality. Once the ROD has been issued, and the uplands Feasibility Study is complete, we will have a much clearer idea as to the Company's remaining obligations and what it will cost to fulfill those obligations.

Q. Does the timing of the ROD and Feasibility Study have any implications for future cost recovery for the environmental remediation expenses?

A. Yes. Our primary recommendation has been for the Company to continue to defer environmental remediation costs and recover them through the SRRM—primarily because at this stage of the remediation effort we cannot predict the scope of the obligations that will be required. However, once we receive the ROD and complete the Feasibility Study, we will be able to much better estimate the costs that will be incurred. Therefore, at some point in the future, once the remediation expenses are reasonably known and capable of forecasting, it may make sense to build forecast amounts into base rates.

III. EARNINGS REVIEW AND ALLOCATION OF INSURANCE RECOVERIES

Q. Please address your general concerns regarding the parties' proposals.

A. The parties have offered a range of proposals, each with distinct structures and impacts. That said, many of the proposals suffer from the same flaws and raise the same concerns. In particular, the proposals: (1) fail to recognize the fact that the deferral amounts have been wholly offset by insurance recoveries; (2) fail to recognize

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that the deferred expenses are prudently incurred costs; (3) undermine important incentive mechanisms; and (4) could unreasonably harm the Company.

Q. Please explain your point that the parties' proposals fail to recognize that remediation expenses incurred to date have been fully offset by insurance recoveries.

A. Due to the receipt of the insurance settlement, the Company has no net expense today and does not expect to have a net expense for some years into the future. Thus, the Company is not requesting amortization of any of the past deferrals at this time.[3]

The parties, on the other hand, are requesting amortization today of amounts that are not necessary to collect. They propose that the Commission allocate portions of the insurance recoveries to future time periods as an offset to future remediation expenses. Thus, the parties propose that the Commission require customers to begin paying the deferred remediation expenses today, even though the Company has received sufficient insurance proceeds to offset all of the historical, deferred expenses. The parties claim that their insurance allocation proposals should be adopted because they are consistent with the notion of "intergenerational equity." However, requiring current customers to pay past deferred amounts is itself inconsistent with intergenerational equity. NW Natural's proposal, on the other hand, ensures that

[3] Because the Company is not requesting amortization at this time, it is arguably improper for the Commission to conduct an earnings review. *See* ORS 757.259(5) (deferred amounts "allowed in rates only to extent authorized by commission . . . upon review of the utility's earnings **at the time of application to amortize the deferral**.") (emphasis added). NW Natural will address this point further in its legal briefing.

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current customers pay current expenses—a straightforward approach that reasonably addresses concerns over intergenerational equity.

Q. Please explain your concern that the parties' proposals do not recognize the deferred expenses as prudently incurred costs.

A. The parties' sharing proposals are premised, in part, on the argument that customers should not pay the full environmental remediation expenses because the Company is remediating manufactured gas plant ("MGP") sites that are no longer providing service. This argument is without merit. The costs that are at issue in this case were and will continue to be incurred by NW Natural as required by *current* environmental laws to restore sites that were used to provide utility service to customers. In this way, these costs are no different than any other decommissioning costs associated with plant that is no longer in service.

Q. Are decommissioning costs typically paid by customers?

A. Yes. For example, as CUB points out, customers are currently paying the decommissioning costs related to the planned retirement of the Boardman plant. According to Portland General Electric Company's ("PGE's") filings, a portion of those costs relate specifically to site remediation.[4] Thus, customers are paying the environmental remediation expenses associated with the decommissioning of the Boardman plant.

Moreover, the two Oregon utilities incurring Boardman remediation expenses are recovering those expenses through special tariffs designed to ensure full cost

[4] *See* PGE's Advice 11-07 filings, which were docketed as UE 230.

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recovery from customers. Idaho Power, a co-owner of the Boardman plant, is recovering its share of the Boardman remediation expenses through a balancing account designed to ensure that customers pay “no more and no less that the full revenue requirement impacts of early Boardman retirement . . .” and that “the Company is provided an opportunity to experience the full recovery of Boardman-related costs by Boardman's scheduled life end of 2020”.[5] The Idaho Power balancing account does not incorporate sharing or an earnings test. PGE likewise has implemented a Boardman decommissioning tariff that will be updated periodically to reflect changes in expected decommissioning costs and depreciation rates.[6] So it appears that PGE too will receive dollar-for-dollar recovery of its decommissioning costs.

Q. Does the fact that the damage being remediated occurred years ago dictate different ratemaking treatment?

A. No. The Commission strives for rates that recover a plant’s full decommissioning costs prior to retirement; however, it is not always possible to perfectly predict the full extent of decommissioning costs, and therefore, the Commission has allowed ongoing recovery of decommissioning costs even after a plant is retired. For example, the Commission has allowed PGE’s rates to include decommissioning costs related to the Trojan plant well after that plant was retired.[7] Similarly, PacifiCorp is entitled by statute

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[5] *See Re Idaho Power Co.*, Docket UE 239, Joint Explanatory Brief at 8-9 (May 24, 2012). The stipulation was ultimately approved by the Commission in Order No. 12-235.

[6] Order No. 11-242.

[7] Order No. 07-015 (“We conclude that PGE has the authority to continue collecting money from ratepayers until decommissioning is complete.”); CUB/200, Jenks/5, n. 2 (citing to PGE testimony in

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to recover all of the decommissioning costs associated with the removal of the Klamath River dams, even costs that remain unrecovered after the dams are removed from service.[8] Therefore, it is not novel for customers to bear the remediation costs at issue in this case.

Q. Is it helpful to suggest—as CUB does—that the Company should have recovered some or all of these costs from the customers that were actually receiving service from the MGPs?

A. No. In Phase I of this docket, we filed the testimony of Andrew C. Middleton, an environmental engineer and consultant with extensive experience with environmental remediation for MGPs throughout the county. Dr. Middleton explained that during the period when the MGPs were in service, no one understood the environmental damage that was occurring; similarly, no one could have anticipated the clean-up obligations imposed by modern environmental statutes and regulations. Therefore, it makes little sense to suggest that the customers who received MGP service should have borne the environmental liabilities.

This situation is analogous to ratemaking for other costs incurred by utilities in response to current environmental regulations. For example, customers have received low cost electricity from coal plants for generations. However, due to more recently adopted environmental regulations, those same coal plants are being required to install

docket UE 283 demonstrating that PGE is still recovering Trojan decommissioning costs from customers).

[8] ORS 757.734(3) (if any decommissioning costs have "not been recovered by PacifiCorp before a dam is removed, the Public Utility Commission shall allow recovery of that amount by PacifiCorp in PacifiCorp's rates and tariffs.").

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expensive emission control equipment, which necessarily increases the cost of the electricity produced from those plants. Those additional costs are borne entirely by current and future electric utility customers despite the irrefutable fact that earlier generations of customers benefitted from lower cost coal generation.

Q. Explain your concern that the parties' proposals would undercut important incentives inherent in the regulatory compact.

A. As I explained in my Opening Testimony, fundamental ratemaking policy creates an incentive for utilities to control costs and manage their operations efficiently by allowing them to retain any savings that they achieve between rate cases. The idea behind this policy is simple. Utilities are continuously incented to achieve savings, which ultimately inure to the benefit of customers at the utility's next rate case when the savings are built into base rates. Essential to this incentive is the opportunity for a utility to achieve earnings in excess of its authorized rate of return. Unfortunately, both Staff's and CUB's proposals would cut off the Company's earnings at or below authorized ROE. Given that the environmental deferrals will likely be greater than any potential overearnings by the Company, under these proposals the Company will never be allowed to earn above its authorized ROE. Moreover, as I explained in my Opening Testimony, in fact, even if the earnings test threshold is set at authorized ROE, on average the Company will never even be allowed to earn at its authorized ROE. Thus, the parties' proposals will eliminate, or at least severely undercut, the incentive for good management.

In addition, the parties' proposals, Staff's in particular, are entirely one-sided. They eliminate the Company's ability to benefit from any savings or efficiencies

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between rate cases, and make no provision to recognize that the Company continues to assume all increased costs between rate cases, thus creating a fundamentally unbalanced ratemaking process.

Q. How do the parties' proposals undercut the WACOG incentive?

A. In the past, where the Company has earned above its authorized ROE, a significant contributor was the WACOG incentive, which beginning in 2009 has been included in the Company's results of operations pursuant to Commission order. Under CUB's and Staff's proposed earnings reviews, which set the earnings threshold for environmental deferral recovery at or below authorized ROE, NW Natural would essentially be forced to give up the WACOG incentive. This would occur not only retroactively, for the past, but also would likely persist into the future given the magnitude of environmental deferrals and the relative size of the WACOG incentive. For example, during the 11-year period ending in 2013, the average WACOG incentive was $3.9 million, with seven of the 11 years falling below that average. For the last four years, the average (excluding one anomalous year) has been $1.8 million.[9] For comparison, the Company expects that in the near term, environmental remediation expenses could well be $10 million or more annually, which would exceed any expected WACOG incentive.

Q. How do the parties' proposals undermine the incentives associated with the Company's Interstate Storage and Optimization Activities?

A. Staff, CUB, and NWIGU all recommend that the Company include in utility earnings for purposes of the earnings test the shareholder portion of the revenues generated by the

[9] 2009 was a particularly anomalous year, with the WACOG benefit equaling $15.9 million, over four times greater than the next closest year.

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Company's Interstate Storage and Optimization Activities. This means that the incentive associated with these activities will also be muted. If the Company no longer has the opportunity to earn at or above its authorized ROE then there is little incentive to invest shareholder dollars and assume shareholder risk to engage in these activities.

Q. You are suggesting that it is problematic to prevent the Company from earning above its authorized ROE. But aren't deferrals explicitly subject to earnings reviews that prevent utilities from collecting deferred amounts if earnings during the deferral period would be otherwise reasonable?

A. Yes. However, as I discussed in detail in my Opening Testimony, it is the Commission's policy to tailor the earnings review to the specific circumstance of the deferral. In the case of a one-time emergency deferral, an earnings review cutting off amortization at or even slightly below authorized ROE may be appropriate. Indeed, this is just the scenario contemplated by the Commission in Order No. 93-257 for one-time, emergency deferrals. Certainly, a limited, one-time adjustment to a utility's normal earnings opportunities is unlikely to interfere with the typical regulatory incentives. However, the SRRM presents completely different concerns. The environmental remediation expenses that the Company will be deferring on an annual basis will offset a significant portion of the Company's potential earnings, and importantly, the deferral could be in place for the next 10 to 20 years. As such, if the earnings review threshold is set either at or below authorized ROE, the incentives I have discussed would be undermined for the foreseeable future, thus significantly undercutting and perhaps eliminating the good management and other incentives for years to come.

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It is for this very reason that the Commission has recognized that the earnings test for deferrals such as this one should allow amortization up to the top of a reasonable range of ROE. Moreover, it is for this very reason that it makes sense that the legislature exempted long-term deferrals subject to an automatic adjustment clause from the earnings review requirement in the first place.[10]

Q. Will the earnings test approved in this case have broad application beyond this case?

A. No. As described above, the Company's remediation expenses—both historically and prospectively—are unique in terms of both their amount and duration. This case does not present a typical one-time deferral of emergency cost increases. Moreover it is unlike the longer multi-year deferrals that are recovered through automatic adjustment clauses, such as power cost adjustment mechanisms ("PCAMs") and purchased gas adjustment ("PGAs") mechanisms, in that there is no forecasted level of expense built into rates. Thus, the risk dynamics that must be considered when designing the prospective earnings test are different because the earnings test will impact recovery of the entire amount of remediation expenses, not a variance from a forecast.

Finally, the fact that the Company received insurance proceeds sufficient to offset both past and some future expenses changes the dynamic of the historical deferrals (because they no longer need to be recovered from customers). Those deferrals continued for as long as they did, in part, because the Company was awaiting

[10] ORS 757.259(5) ("Unless subject to an automatic adjustment clause under ORS 757.210(1), amounts described in this section shall be allowed in rates only to the extent authorized by the commission in a proceeding under ORS 757.210 to change rates and upon review of the utility's earnings at the time of application to amortize the deferral. . .").

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the receipt of the insurance proceeds. For all of these reasons the deferral in this case is exceptional and similar circumstances are unlikely to reoccur. And, regardless of what earnings test the Commission believes should be "precedential" for similar deferrals that pre-date the creation of a recovery mechanism, the Commission need not address that issue here because the receipt of insurance obviates the need to amortize deferrals from before the SRRM was adopted.

Q. Please explain your concern that the parties' proposals could harm the Company financially.

A. The parties' proposals regarding past costs would result in write-offs of a very significant portion of the total deferred amounts. The most extreme of the proposals would require the Company to write-off approximately $38.7 million, while the smallest write-off proposed would be approximately $20 million. These numbers are huge for a company of NW Natural's size. For context, the Company's average annual earnings between 2003 and 2012 were $80.1 million and the Company's 2013 earnings were $81.7 million. Therefore, the most extreme of the proposed write-offs would constitute up to half of the Company's 2013 earnings—reducing the Company's 2013 ROE to approximately 4.77percent, or 473 basis points below authorized ROE. Write-offs of the sizes proposed could significantly harm the utility, and could have negative effects on NW Natural's credit ratings by significantly altering perceptions of NW Natural's risk profile.

Going forward, the earnings test recommended by the parties will result in an effective cap on the Company's earnings. And, importantly, as a practical matter, even

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if the threshold for the earnings review is set at authorized ROE, on average the Company will earn at less than authorized ROE.

In addition, this dampening of earnings potential could very definitely harm the Company financially.

A. SPECIFIC RESPONSES TO STAFF PROPOSALS

Q. Please summarize Staff's earnings review proposal for the historical period.

A. Staff recommends an earning test that would allow the Company to collect all of its prudently incurred costs up to 50 basis points ***below*** its authorized ROE. Above that point, the Company would pay 100 percent of its remediation expenses. To calculate the Company's earnings, Staff recommends the inclusion of WACOG revenues and 90 percent of the revenues resulting from the Company's Interstate Storage and Optimization Activities. Staff also proposes that the earnings review be applied to each year of the deferral period individually, rather than looking at the entire deferral period as a whole.

Q. How do you respond to Staff's proposed earnings test for the historical period?

A. Staff's proposal fails any reasonable fairness test. The approved earnings test must be balanced, both in terms of design and result. For the historical period, Staff recommends that shareholders pay between 71 and 87 percent of past costs, after applying only one-third of insurance proceeds to offset expenses. This result is unbalanced and unfair.[11]

[11] While the remediation expenses are substantial when compared to the Company's earnings, the rate impact for the typical customer is less significant. Indeed, for every $10 million expense that is included in rates, the typical residential customer's bill will increase by only $1 per month. I make this point not to discount the impact on customers, but simply to provide perspective.

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Q. Staff's earnings test is based on their claim that the environmental remediation deferrals fall in the "emergency" category described by the Commission in Order No. 93-257 and therefore the Company should only be allowed to earn up to the bottom of a reasonable range.[12] How do you respond?

A. Staff is misinterpreting the Commission's order. The Company agrees with Staff that Order No. 93-257 provides the applicable framework for designing an earnings review as follows:

> (1) for emergency increases in costs the Commission may apply an earnings test to allow the utility to amortize the deferral up to the bottom of a reasonable range;
>
> (2) for deferrals intended to benefit customers, the Commission may apply an earnings test that would require a refund up to the amount that would bring the utility's earnings to the bottom of the reasonable range of rate of return; and
>
> (3) for deferrals of a cost intended to be borne by customers but was delayed to match costs and benefits, the Commission might apply an earnings test that would allow the utility to amortize the deferral up to the top of a reasonable range of rate of return.[13]

However, Staff's characterization of the environmental remediation expenses as most similar to an "emergency increase in cost" makes no sense. There is nothing "emergency" about the environmental remediation costs, which have been incurred for over ten years and are expected to continue for up to an additional 20 years.

On the contrary, the remediation costs at issue in this case fit squarely within the third category. Like decommissioning costs generally, the remediation costs are costs that should be borne by customers. The Commission's rejection of sharing in

[12] Staff/200, Johnson-Bahr/10.

[13] *In re Portland Gen. Elec. Co. Application for an Order Approving Deferral of Costs*, Dockets UM 445 and UE 82, Order No. 93-257 at 11-12 (Feb. 22, 1993) (emphasis added).

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docket UG 221 supports this conclusion, as does the Commission's precedent allowing utilities to collect remediation expenses even for retired plant. Therefore, the Commission should allow the Company to earn up to the top of a reasonable range, as recommended by NW Natural.

Q. Staff also recommends that the retrospective earnings test include WACOG revenues and 90 percent of the Company's historical revenues from Interstate Storage and Optimization Activities.[14] Do you agree that the Company's retrospective earnings should include these amounts?

A. First, I would point out that because the Company has no net expense, the Company is not requesting amortization of deferred amounts and there is no reason to perform an earnings review on the historical amounts. That said, in the event that the Commission does nevertheless impose an earnings review on past deferrals, it should be based on utility earnings as reflected in NW Natural's annual Results of Operations filing ("ROO"). The ROO, as reviewed and approved by the Commission each year, has never included revenues from Interstate Storage or Optimization Activities; therefore, these should not be included for the purposes of an earnings review adopted in this case through a retroactive recalculation of NW Natural's earnings. Beginning in 2009, the Commission determined that the Company should begin including its share of WACOG savings in the ROO; therefore the utility earnings prior to that date should not include WACOG sharing.

[14] Staff/200, Johnson-Bahr/13.

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As explained above, both the WACOG sharing and the sharing allocations applied to revenues flowing from the Company's Storage Services and Optimization Activities represent mechanisms approved by the Commission to incent activities that benefit customers and shareholders alike. Including these revenues in the ROO inconsistently with Commission precedent would serve as an after-the-fact "take back" of these incentives.[15]

Q. Staff recommends that the historical earnings test apply to each individual year within the deferral period, rather than the deferral period as a whole.[16] CUB supports this approach also.[17] How do you respond to this position?

A. NW Natural continues to believe that it is appropriate to aggregate years in the past deferral period. Going backward there is no principled basis for separating out earnings on a year-by-year basis. It is not unusual for a utility to over-earn in some years and under-earn in others. Indeed, the basic assumption of ratemaking is that over time the over- and under-earning will balance out (or the utility will file a new rate case or the Commission will require a new rate case). For NW Natural, this is basically what has occurred. However, by requiring the Company to credit to customers its over-earnings during the deferral period, while providing no relief to the Company for the years when it under-earned, the parties' proposals are inequitable and inconsistent with basic tenets of ratemaking.

[15] This type of "take back" violates the rule against retroactive rulemaking, which our attorneys will cover in briefs.

[16] Staff/200, Johnson-Bahr/11.

[17] CUB/200, Jenks/16.

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Q. Are there any other reasons to examine the entire historical period cumulatively, rather than year-by-year?

A. Yes. Examining the entire deferral period is consistent with the nature of this deferral. While costs were incurred in specific years, all those costs are related to a single overarching project—environmental remediation. So rather than viewing the historical period as ten individual, one year deferrals, it is more reasonable to view the entire historical period as a single deferral period. Indeed, this approach is consistent with the way the Company filed its deferral applications, which sought reauthorization to continue a single deferral rather than requesting a new deferral for every year.

It is also unreasonable to examine the deferral period in a piecemeal fashion, as other parties propose. For a deferral lasting a single year, the earnings test examines the utility's earnings over the course of the year, *i.e.*, the entire deferral period, not on a month-by-month basis. It is consistent with this approach to look at the entire ten year deferral period, not individual components of that deferral period in isolation.

Q. Staff claims that this case is distinguishable from the Idaho Power Company ("Idaho Power") case that you referred to in your Opening Testimony because in the Idaho Power case it was hard to isolate the impact of a tax refund to particular years.[18] Do you agree?

A. No. The Idaho Power case involved a tax refund Idaho Power received pursuant to two tax method changes reflected in Idaho Power's 2009 return. The refund was

[18] Staff/200, Johnson-Bahr/6.

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based on Idaho Power's ability to calculate its historical taxes going back to 1987 as if it had been using the new methods in those prior years. Idaho Power could have actually filed amended returns for all of those years and thus could have received a refund associated with each return. But, in the interest of efficiency, Idaho Power instead filed one return that reflected the cumulative impact of the tax method changes for each year.

After Idaho Power received its refund, CUB requested that the Commission include the refund in customer rates under ORS 759.259(1)(a)(A). The Commission agreed that the refund would be appropriately included in rates, subject to an earnings review, and thus the question was whether the earnings review should be performed on a year-by-year or on an aggregate basis.

In the historical period (1987-2009), Idaho Power earned near or above its authorized ROE in several years, but on average had earned below its authorized ROE. Idaho Power argued that in performing the earnings review, the Commission should consider the multi-year deferral period as a whole, instead of imposing the earnings review on a year-to-year basis—the latter of which would have resulted in disallowances for the years in which the Company earned near or over its authorized ROE. The Commission agreed with Idaho Power and used average earnings during the historical period for the earnings review.[19]

[19] *Re Idaho Power Co.*, Docket UE 233, Order No. 13-416 (Nov. 12, 2013). Commissioner Savage dissented and would have applied a year-by-year earnings test, which would have reached nearly the same result.

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In its Reply Testimony in this case, Staff argues that this case is different than the Idaho Power case. Staff claims that in the Idaho Power case there was no principled basis on which to allocate the tax refunds to individual tax years.[20] Staff is mistaken. As explained above, the refund received by Idaho Power reflected the cumulative difference between the taxes paid in each of the historical years and the taxes due under the new methodologies. As such, the Commission could identify precisely which portion of the refund was attributable to each year. Indeed, the parties to the case, including Staff and CUB, submitted stipulated facts to the Commission that set forth the amount of the tax refund associated with each individual tax year. Moreover, in that case Staff testified that, "It would be unfair to the utility to treat each year of the refund period separately and cherry-pick years where earnings were higher to return refunds to customers."[21] Staff argued in its brief that "it is appropriate to review Idaho Power's earnings over the entire Tax Period [1987-2009] to check the overall reasonableness of the results of applying a year-by-year earnings test."[22] Staff observed that over the entire period Idaho Power cumulatively under-earned and therefore should not have to credit to customers the tax refund.

Thus, Staff's argument here is without basis.

Q. The parties express concerns over NW Natural's historical over-earnings during the deferral period. How do you respond to this concern?

[20] Staff/200, Johnson-Bahr/6.

[21] *Re Idaho Power Co.*, Dockets UM 1562/1582, Staff/100, Garcia/9 (July 13, 2012).

[22] *Re Idaho Power Co.*, Docket UE 233, Staff's Opening Brief at 10 (July 16, 2013).

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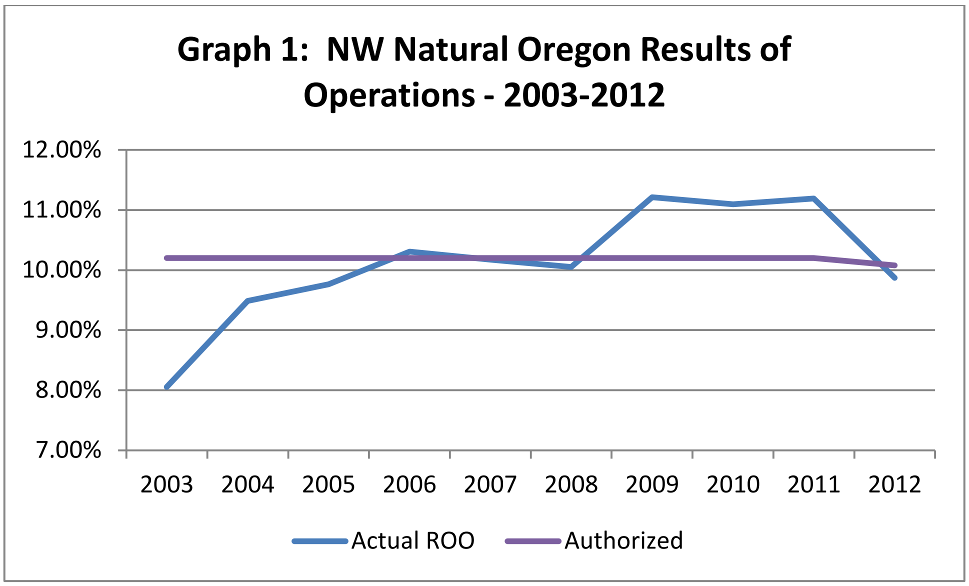
A. The concern is unwarranted. The Company earned greater than its authorized ROE in only four years of ten. Indeed, the simple average of the Company's ROE during these years was 7 basis points less than its average authorized ROE. The following graph demonstrates how the Company's earnings fluctuated during the deferral period and makes clear that the over-earning was neither unusual nor persistent:



Graph 1: NW Natural Oregon Results of Operations - 2003-2012

Q. How have the deferred remediation expenses impacted the Company's historical earnings?

A. The deferred remediation expenses have had no impact at all on the historical earnings as reported above. The Company's regulated earnings as reflected in the ROO did not include either the expense or recovery of the environmental remediation costs. Therefore, the remediation expenses have had no impact at all on historical earnings.

To be clear, this means that if the Company were to recovery the entire remediation expenses, its historical earnings would not be increased at all because the

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increased revenue from the recovery of the expenses would be exactly offset by the expenses.

On the other hand, if the Company is unable to recover some or all of the historical deferred amounts, then the Company will be required to write-off some or all of the expenses. Although this write-off will occur in the current year, if the amounts written-off were applied to the deferral period, the Company's historical earnings would effectively decrease. Indeed, if the Company were required to bear all of the remediation expenses during the deferral period, then the Company's effective ROE during that period decreases significantly—averaging only 9.25 percent as opposed to its authorized earnings during that period of 10.2 percent.

Q. Does the fact that there were some years of over-earning suggest that customers were unfairly treated?

A. No. As I explain above, it is not unusual for a utility to over-earn in some years and under-earn in others and that the basic assumption of ratemaking is that over time the over- and under-earning will balance out.

Q. Please comment on the financial harm that could be caused to the Company through the application of Staff's earnings review proposal to current deferral amounts.

A. Staff recommends that the Company write-off $38.7 million of its historical remediation expenses. As I have described above and in previous testimony in this case, a write-off of that magnitude would have a significant impact on the Company's financial health and would likely result increase the Company's financial risk, as perceived by

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investors, and could negatively affect the Company's credit rating. This could harm customers as well, increasing the Company's borrowing costs.

Q. Staff suggests that the Commission should not be concerned about the financial impacts to the Company by forcing write-offs of past year earnings, arguing that such write offs result from NW Natural's unusual accounting. Staff claims that Oregon utilities "typically" do not recognize recovery of a deferred expense until amortization is approved.[23] How do you respond?

A. I disagree. Staff's testimony demonstrated a lack of understanding of the generally accepted accounting policies in the United States (US GAAP) that govern how NW Natural accounts for regulatory assets.

Q. What was the basis for Staff's conclusion that the Company accounts for its deferrals in a different manner than other Oregon utilities?

A. Through a data request the Company requested that Staff provide the basis for its conclusion. Staff responded as follows:

> Staff mistakenly made the statement that "The Company's treatment of deferred costs differs from the way regulated utilities in Oregon typically account for deferred costs." Staff has subsequently done more research and discovered that this is an inaccurate statement. Accounting treatment of deferred costs seems to be consistent across utilities and NW Natural does not account for its deferred costs differently from other utilities.[24]

Therefore, it appears that Staff no longer believes that NW Natural has acted different from any other Oregon utility.

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[23] Staff/200, Johnson-Bahr/18-19.

[24] Staff's Response to NW Natural's DR 5

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Q. For the prospective SRRM, Staff proposes both an earnings review and sharing. Specifically, Staff proposes that if the Company earn more than its authorized ROE, the Company pays the environmental remediation expenses incurred in that year. In addition, Staff proposes that the Company bear 10 percent of remediation expenses incurred in the future.[25] CUB and NWIGU also propose sharing going forward.[26] How do you respond to the prospective earnings review?

A. Like Staff's historical earnings test, the prospective earnings test is also fundamentally unbalanced. Staff recommends an all or nothing approach—if the Company's earnings exceed its authorized ROE by any amount, the Company assumes the remediation expenses in that year. However, Staff's proposal appears to lack a floor that would ensure the financial integrity of the Company in the event that environmental remediation expenses are substantial in a particular year when the Company's earnings modestly exceed its authorized level. Without a balanced approach, Staff's proposal is completely unreasonable and can lead to absurd results. For example, if the Company were to exceed its authorized ROE by 1 basis point, it would apparently be required under Staff's proposal to pay all of the remediation expenses (after applying the insurance proceeds and deducting the minimal amount Staff recommends to include in base rates) regardless of the impact on its ROE of assuming the remediation expenses. On the other hand, if the Company were to under-earn by 1 basis point, customers would assume all of the remediation expenses (less the

[25] Staff/200, Johnson-Bahr/20.

[26] NWIGU/200, Gorman/5; CUB/200, Jenks/12.

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insurance proceeds and the amount paid by NW Natural through the sharing proposal). This proposal creates an incentive for the Company to actually under-earn because doing so can allow the Company a greater overall return. Attached to my testimony as NWN/901 is an example modeled on Staff/201 demonstrating the absurd results that can occur if Staff's earnings test is adopted.

Q. Will Staff's proposal allow the Company to earn its authorized ROE going forward?

A. No. Staff's proposal would effectively ensure that the Company cannot earn its authorized ROE going forward. When the Company earns greater than its authorized ROE, it would be required to apply those revenues to environmental remediation expenses. However, when the Company earns less than its authorized ROE in a particular year, there would be no mechanism to bring the Company's earnings up to its authorized ROE. Although Staff claims that the Company can still earn greater than its authorized return, this claim lacks support. Staff presents no analysis demonstrating the conditions that must exist for this to occur. In fact, if we assume the Company incurred $10 million in remediation expense in a particular year, which is not unlikely, then the Company would have to exceed its authorized ROE by 120 basis points in order to retain any over-earnings after the application of Staff's proposal. Since 2003 the Company has never earned more than 120 basis points above its authorized ROE.

Finally, as discussed above, Staff's approach will create a perverse incentive whereby the Company will be incented to under-earn because it will then recover its

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remediation expenses from customers, while if the Company over-earns—by whatever amount—it will bear all of the remediation expenses.

Q. In your Opening Testimony you recommended that the Commission adopt an SRRM earnings test that maintains the fundamental ratemaking incentives encouraging good utility management. Does Staff's proposal support this consideration?

A. No. As discussed above, Staff's earnings test undermines the Company's incentive to control costs and efficiently manage itself by effectively capping the Company's ROE at less-than-authorized. In addition, by including the WACOG, Interstate Storage and Optimization revenues in the earnings test, Staff's proposal also undermines the incentives the Commission has specifically adopted.

Q. Staff distinguishes this case from the Company's PGA mechanism, where the earning test allows the Company to earn up to 100 basis points above its authorized ROE.[27] Why did you rely on the earnings test in the PGA to support the Company's proposal in this case?

A. The Company is not claiming that the SRRM and the PGA are identical. Indeed, there are important differences between the PGA that make direct comparisons inapt. However, the definition of a reasonable range of earnings should not differ from mechanism to mechanism. Therefore, if earnings up to 100 basis points above the Company's authorized ROE reflect the top of a reasonable range of ROEs for the

[27] Staff/200, Johnson-Bahr/10.

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purposes of the PGA, those same earnings should reflect the top of a reasonable range of ROEs for purposes of this earnings review.

Q. How do you respond to the parties' sharing proposals?

A. The parties' sharing proposals should be rejected. The parties offer several justifications for their sharing proposals. CUB argues that sharing is appropriate because the environmental remediation expenses relate to MGPs that are no longer providing utility service.[28] Staff claims that sharing is necessary to incent the Company to control remediation costs.[29] Neither of these arguments justify sharing. Both these arguments were made in docket UG 221 and in that case the Commission rejected sharing.[30] As I discussed above, the environmental remediation expenses represent prudently incurred decommissioning expenses, and consistent with Commission precedent, they should be included in rates.

Q. How do you respond to the argument that sharing is necessary to incent the Company to control the remediation expenses?

A. I disagree. First, the Company already has incentives to keep the remediation costs as low as possible, in order to ensure that they are judged prudent and in order to keep customer rates at a competitive level. That said, as described in the testimony of Robert Wyatt, the type of remediation work that will be required, the timeline for the work, and the required outcome of the remediation efforts will all be dictated by federal

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[28] CUB/200, Jenks/12.

[29] Staff/200, Johnson-Bahr/20.

[30] *See e.g.*, *Re Northwest Natural Gas Co.*, Docket UG 221, Staff/200, Johnson/8 (May 3, 2012); *Re Northwest Natural Gas Co.*, Docket UG 221, CUB's Opening Brief at 26 (Sept. 9, 2012).

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and state agencies, and it is these factors that will largely drive the expense. Given these facts, the Company agrees with the Commission's conclusions in docket UG 221 and does not believe that additional incentives are necessary or helpful.

Q. Do you agree with Staff's recommendation to include \$3 to \$5 million for remediation expenses in base rates?[31]

A. No. Staff's proposal has no rational relationship to the Company's actual forecast of remediation expenses, other than it appears to be designed to include expenses that fall well below actuals. If the Commission is inclined to include some amount of remediation expenses in base rates, it should do so based on actual forecasts of expected expenses as it does for all other utility expenses.

Q. Staff recommends allocating the insurance proceeds proportionally to the time period in which the remediation costs have been and will be incurred.[32] CUB and NWIGU also recommend that a portion of the insurance proceeds be allocated to the future remediation expenses.[33] How do you respond to this approach?

A. These recommendations are needlessly complicated and difficult to justify. We currently have more than enough insurance proceeds to cover the accumulated deferral balance. Therefore, we see no reason to begin charging customers for costs now, only so that we can credit them with insurance proceeds in the future.

However you look at it, over the past deferral period, customers did not pay the remediation expense, and nothing we do now will change that. But, given where we

[31] Staff/200, Johnson-Bahr/22.

[32] Staff/200, Johnson-Bahr/4.

[33] CUB/200, Jenks/16; NWIGU/200, Gorman/3.

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are now, it makes the most sense to have future customers pay for future expense—as it is incurred. In that way, those future customers will pay for what will be then-current expense, but will not be saddled with the past expense that past customers did not pay.

Q. Staff claims that the Company's recommendation to use the insurance proceeds to wipe out the historical deferrals creates intergenerational inequity.[34] Do you agree?

A. No. It is true that past customers did not pay for remediation expenses as they were incurred over the past ten years. But, it makes little sense to require today's customers to pay for those past expenses under the theory of intergenerational equity, especially when the utility has more than sufficient funds from insurance receipts. Staff's proposal simply would require customers today to prepay the utility for future remediation expenses, by withholding the insurance application from the amounts to be collected. This does little to alleviate any inequity. And, it also leads to an unnecessary rate impact to current customers, who will have to bear the brunt of past remediation expenses that can be covered by insurance.

The below graph illustrates the difference in the shape of rate recoveries that would result under a hypothetical future spending scenario between NW Natural's proposal and Staff's. The hypothetical assumes that spending continues for the next 20 years, and that it goes from $10 million over the next few years, up to around $13 million for the following years. The graph illustrates that Staff's proposal will result in

[34] Staff/200, Johnson-Bahr/4.

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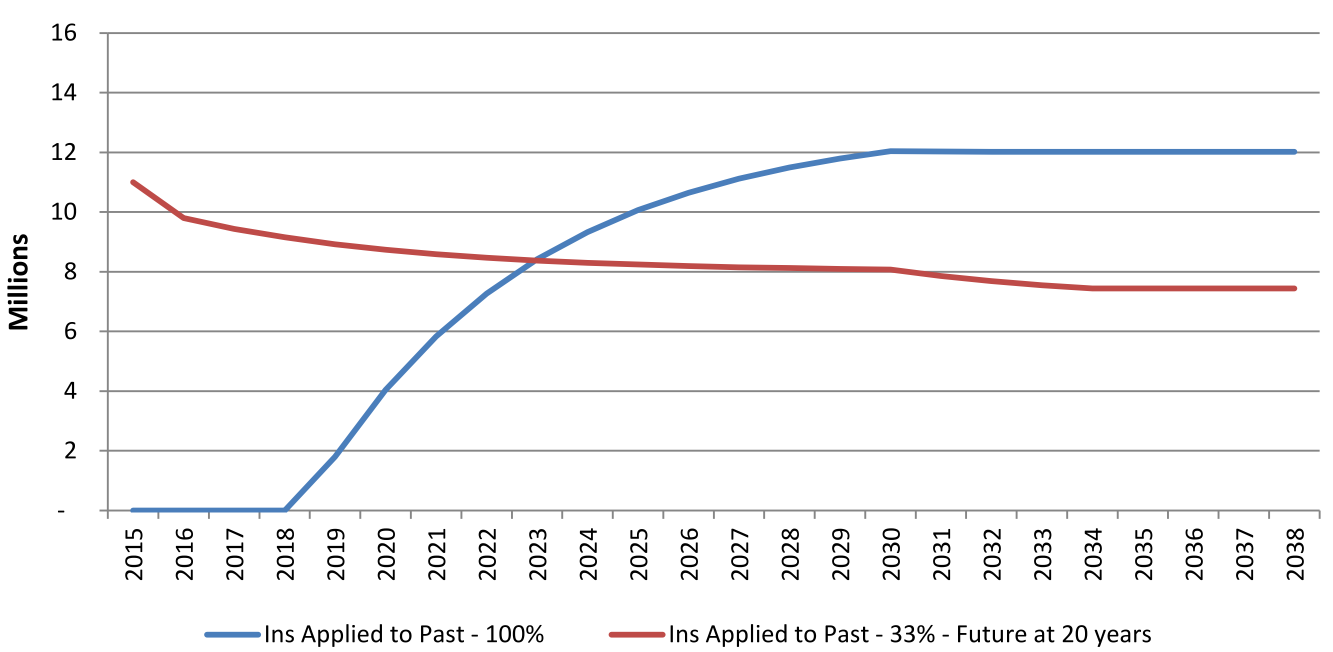
an immediate rate impact to customers that may be able to otherwise be avoided and that NW Natural's proposal leads to a more gradual impact on rates. Although the spend pattern is necessarily hypothetical at this point, the shape of the two curves relative to one another will likely remain consistent regardless of the actual spend pattern.

Graph 2: Insurance Application Scenarios



In the end, it makes no sense develop involved allocations of insurance proceeds and earnings reviews to promote intergenerational equity, when such proposals do little to serve that goal. Such an approach also leads to the untenable result of requiring customers to prepay the utility for environmental expenditures when that is not necessary.

Q. Does NW Natural's proposal advance intergenerational equity?

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A. Yes. NW Natural's proposal ensures that going forward customers will not be saddled with expenses incurred in the past and will instead bear only then current environmental remediation expenses as they are incurred. Under any proposal that requires amortization of past amounts, customers during the amortization period will bear historical deferred expenses. As noted above, this rate impact can be significant, depending on the amount amortized.

Further, by recovering more of the remediation expense from future customers, the Company's proposal will spread the recovery to more customers. NW Natural's current load forecast indicates that the Company expects to add customers year over year. Passing through rates future expenses in future rates makes sense from an intergenerational perspective, and also lessens the burden on any individual ratepayer.

Q. Staff also recommends that the insurance proceeds allocated to future years be levelized. Do you support this proposal?[35]

A. It makes little sense to levelize the insurance proceeds unless the remediation expenses are also levelized. Levelization of insurance proceeds can produce absurd results whereby customers could receive a credit for insurance proceeds in a year where the Company incurred little or no expense, while in years when the expense was substantial the insurance proceeds may be insufficient because portions were allocated to years with little expense. Staff specifically rejected levelization of the historical insurance proceeds for this reason.[36]

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[35] Staff/200, Johnson-Bahr/20.

[36] Staff/200, Johnson-Bahr/7, 20.

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Q. Please comment on the financial harm that Staff's prospective proposal could inflict on the Company.

A. The overly restrictive earnings test proposed by Staff will result in an effective cap on earnings. Moreover, because Staff's proposal has no floor to limit the potential impact of its earnings test, the Company might be required to absorb significant remediation expenses even if its earnings only modestly exceed its authorized ROE. Such a result will create significant risks to the Company's financial health going forward and will likely be viewed adversely by the investor community.

B. <u>SPECIFIC RESPONSES TO CUB</u>

Q. How do you respond to CUB's recommendation to use future Mist storage revenues to offset the environmental remediation expenses?

A. NW Natural appreciates CUB's attempt to "think outside the box." However, this proposal is not supportable. First, the proposal represents a complete departure from any fair understanding of an earnings test in that it focuses only on earnings NW Natural receives through incentive mechanisms designed to encourage shareholders to assume risk and invest in storage facilities. As described above, the Commission has adopted incentive sharing mechanisms related to the provision of Interstate Storage and the Optimization of storage resources. This sharing has allowed NW Natural shareholders to receive a portion of the revenue generated by these activities as an incentive for shareholders to invest their money to allow the Company to provide these services. Using revenue generated by discretionary shareholder investments to offset costs that should properly be included in rates is fundamentally unfair and unreasonable.

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Second, CUB's proposal would require the Company to use revenues from the shareholder build-out of Mist to offset prudently incurred utility expense. The Commission has already determined an appropriate sharing of these revenues to compensate customers for the use of shared resources, and is currently reviewing that sharing in docket UM 1654. However, CUB's proposal would force the Company transfer to customers that portion of the revenues that currently is allocated to the shareholders, which would arguably constitute a "takings." In the end, CUB presents another proposal requiring NW Natural to share the costs of prudently incurred, and in fact required, environmental remediation costs.

Q. CUB suggests that NW Natural is trying to use its monopoly status to foist costs on customers that the competitive market would not allow.[37] How do you respond to this claim?

A. This position is unfair and incorrect. If natural gas distribution operated in a competitive market, NW Natural would be competing with other natural gas distributors, all of whom would have had to rely on manufactured gas for their customers during the same time period that NW Natural relied on manufactured gas. Therefore, NW Natural's competitors would likely have similar MGP clean up obligations, because they would be subject to the same current laws and regulations, and the market costs for gas would arguably include remediation expenses as current business costs. Otherwise these gas LDCs would not be financially viable.

[37] CUB/200, Jenks/5-6.

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In addition, CUB presents no evidence to suggest that competitive markets do not pass through to customers costs associated with environmental regulations, and, in fact, the opposite is true. For example, as CUB has acknowledged in the past, the costs of natural gas may well increase in the future if the claimed environmental costs associated with fracking become internalized.[38] The Commission has also observed that utility rates are increasingly reflecting societal costs that have been internalized.[39]

Q. CUB also argues that the Company is seeking a better outcome with its automatic adjustment clause than the Company would receive in a rate case.[40] How do you respond?

A. CUB supports its position by pointing out that in a rate case the Company could achieve no greater than its authorized ROE, assuming all of the costs and revenues were perfectly forecast, while here, the Company is proposing an earnings test that would allow it to earn greater than its authorized ROE. CUB's logic is not persuasive. The Company is requesting to recover only those environmental remediation expenses actually incurred—no more, and no less. So in that sense the result is exactly the same as if we perfectly forecast the costs in a rate case. However, CUB's argument fails in assuming that if costs are perfectly forecast the Company has no opportunity to

[38] http://oregoncub.org/news/posts/no-panacea-in-shale-gas-growth

[39] *Re Least-cost Planning for Resource Acquisitions*, Docket UM 180, Order No. 89-507 (Apr. 20, 1989) ("The Commission has noted that many costs which were once external (*i.e.,* borne by others) are now being internalized (*i.e.,* borne by utilities). Mitigation of hydro-electric damage to fish and wildlife, installation of expensive stack scrubbers at coal-fired power plants to reduce emissions, a boost in the liability ceiling for a single nuclear power accident from $710 million to $7 billion, **and inclusion of power plant decommissioning costs in rates are all examples of internalized costs that push the price of energy to more nearly reflect social costs**.") (Commissioner Katz concurring) (emphasis added).

[40] CUB/200, Jenks/8.

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achieve earnings above authorized ROE. In fact, the Commission has adopted incentive mechanisms that are intended to allow the Company to improve earnings above authorized, *e.g.*, WACOG sharing and Interstate Storage Services and Optimization Activities. Thus, our request is consonant with the rate case treatment CUB contemplates.

Q. CUB points to PGE's treatment of the Boardman decommissioning costs as an example of how to properly recover remediation expenses from the customers actually receiving the service.[41] How do you respond?

A. As described above, at the time our customers were receiving manufactured gas, the Company's obligation to clean up the MGPs did not exist. It is only because current environmental policy requires cleanup of these sites that the Company is obligated to do so. Therefore, unlike Boardman, at the time these MGPs were operational it would have been impossible to foresee these expenses and include them in rates.

Moreover, once PGE decided to close Boardman in 2020, it commissioned a new study specifically to analyze the knowable and potential liabilities associated with site remediation.[42] Thereafter, PGE updated the remediation expenses included in rates to reflect the updated cost estimates. In other words, PGE's historical rates did not necessarily reflect the actual decommissioning costs ultimately required to decommission the plant. And it is possible that once remediation efforts begin, the costs will exceed the amounts recovered in rates prior to 2020.

[41] CUB/200, Jenks/5.

[42] *See* PGE's Advice 11-07 filings, which were docketed as UE 230.

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Q. CUB faults NW Natural for seeking a risk free, dollar-for-dollar recovery of these remediation expenses.[43] How do you respond?

A. CUB supported and the Commission approved precisely that type of cost recovery mechanism for Boardman. As discussed above, CUB's position here is at odds with their position related to Boardman decommissioning costs where CUB supported a mechanism that allows a risk-free, dollar-for-dollar recovery, without sharing and without an earnings test.[44]

Q. CUB analogizes this automatic adjustment clause to PCAMs, but claims that unlike PCAMs NW Natural is unwilling to absorb some of the risk.[45] Is that analogy apt?

A. No. The significant amount of the environmental remediation expenses and their ongoing, long-term nature do make these expenses similar to expenses that are addressed with other automatic adjustment clauses such as PGAs or PCAMs. However, PGAs and PCAMs build forecasted amounts into rates and savings are achieved as often as or more often than excess costs are incurred. So, there is a basic fairness to allowing amortization of excess expense up to the bottom of a reasonable range because just as often the Company will refund down to the top of a reasonable range. Here, the Company's historical rates have not included environmental

[43] CUB/200, Jenks/5.

[44] *See Re Idaho Power Co.*, Docket UE 239, Joint Explanatory Brief at 8-9 (May 24, 2012) ("the Stipulating Parties agree that the Company's proposed balancing account is reasonable and will ensure that customers pay no more and no less than the full revenue requirement impacts of early Boardman retirement over the remaining nine years of the plant's life, and will ensure that the Company is provided an opportunity to experience the full recovery of Boardman-related costs by Boardman's scheduled life end of 2020."). The stipulation was ultimately approved by the Commission in Order No. 12-235.

[45] CUB/200, Jenks/6.

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remediation expenses and the amounts deferred are all costs, not savings. Therefore, this automatic adjustment clause will apply to the total environmental remediation expenses, not just a variance from the amount in rates, and the automatic adjustment clause will lack reciprocity.

C. SPECIFIC RESPONSES TO NWIGU

Q. What is your overall impression of NWIGU's testimony and recommendations?

A. Before critiquing the specifics of NWIGU's proposals, I wanted to first note that NWIGU's testimony and recommendations are in certain respects more reasonable, in NW Natural's view, than either Staff's or CUB's.

First, NWIGU recognizes the important incentive to minimize costs and rates inherent in the regulatory construct.[46] Therefore, to preserve this incentive NWIGU's earnings test allows NW Natural to earn greater than its authorized ROE. This is an aspect of ratemaking that is entirely ignored or contravened by Staff and CUB.

Second, NWIGU recognizes that the nature and extent of the remediation costs are unique and that the treatment of these expenses will impact investor expectations and NW Natural's financial risk.[47] The Company disagrees with NWIGU's specific earnings test threshold to address financial risk. However, we appreciate NWIGU's concern with the financial consequences of its proposal.

Third, if the Commission is inclined to include some portion of the remediation expenses in base rates, NWIGU's proposal is the correct approach. NWIGU recommends including in base rates a forecast of the expected remediation expenses

[46] NWIGU/200, Gorman/14.

[47] NWIGU/200, Gorman/4, 15.

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over the next five years.[48] Contrary to Staff's proposal to simply include some minimal amount in rates, NWIGU's proposal is principled and consistent with general ratemaking approaches.

Despite the foregoing, NWIGU's recommendations are nonetheless flawed. In particular, NWIGU's sharing recommendations, which amount to an effective 80/20 sharing of prudent expenses, are unreasonable.

Q. How are NWIGU's sharing recommendations flawed?

A. NWIGU recommends two-tiered sharing. First, NWIGU recommends the allocation of a portion of the remediation expenses to non-regulated affiliates of NW Natural. This proposal is unreasonable and lacks any factual or theoretical support. The MGPs provided regulated service to NW Natural's customers and therefore the decommissioning costs associated with those plants are unrelated to NW Natural's unregulated operations. Second, NWIGU recommends 90/10 sharing of prudent expenses, which is also unreasonable, as I have discussed above and in previous testimony.

IV. PRUDENCE

Q. Staff concludes that the Company's remediation costs incurred between 2003 and 2012 were prudent, except for $33,400.[49] Do you agree with Staff's conclusions?

A. Yes.

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[48] NWIGU/200, Gorman/2-3.

[49] Staff/200, Johnson-Bahr/3.

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V. INTER-JURISDICTIONAL COST ALLOCATION

Q. CUB recommends that Washington customers pay their share of remediation expenses based on the current interstate allocation percentages.[50] How do you respond to CUB's recommendation?

A. The Company continues to support its original position, which is that Washington customers should bear the remediation costs consistent with the amount of service they received from the MGPs. Therefore, the use of a historical allocation factor is appropriate for the Gasco site. For the Portland Gas Manufacturing site, however, all of the remediation costs should be allocated to Oregon because that plant served only Oregon customers during its historic operation.

VI. PROCESS RECOMMENDATION

Q. Earlier you stated that you have a recommendation for how the Commissioners may want to approach the process in this docket. Please explain.

A. In Phase I of this docket, the parties reached a stipulation resolving the issues in this case. In Order No. 13-424, a majority of the Commissioners rejected the stipulation, stating that they did not believe that the earnings review agreed upon by the parties was appropriate, and that they did not believe the parties should try to settle the issues in the case. The Commissioners also stated that they did not believe that the stipulation's past write-off was sufficient. However, beyond these brief comments, the Commission did not state what type of earnings review it did believe was appropriate;

[50] CUB/200, Jenks/20.

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nor did the Commission provide guidance on the principles or facts it believed to be most important to its deliberations.

As can be seen by the disparate recommendations in this case, the parties are far apart in their positions. NW Natural is concerned that this is, in part, a result of the fact that the parties, including NW Natural, are not clear on what principles and facts the Commissioners believe are most relevant to the policy considerations in this case. And the parties have been hesitant to engage in discussions about the docket in light of the Commissioners' statements discouraging settlement. This has made it difficult to determine whether there is any common ground that could be offered to the Commissioners for consideration, and if there are ways that the Company can modify its proposal to address the Commissioners' concerns. In light of this, NW Natural believes it would be helpful for the Commissioners to hold a workshop with the parties to discuss the issues in this docket. Such a workshop would provide an opportunity to better understand the issues that are of the most importance to the Commissioners.

Q. Does this conclude your testimony?

A. Yes.

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BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UM 1635

Phase II

NW Natural

Rebuttal Testimony of C. Alex Miller

Exhibit 901

May 29, 2014

NW Natural
Analysis of OPUC Staff Proposal
($000's)

		201X	201X
Earnings Test Result			
1	**Net Operating Revenue**	$81,750	$81,650
2	**Total Rate Base**	$1,050,000	$1,050,000
3	**Return on Rate Base**	7.79%	7.78%
4	**Earnings Test - Return on Equity**	9.51%	9.49%
5	**ROE Threshold for each year's Spring Earnings Test**	9.50%	9.50%
6	**Overearning / (Underearning)**	0.01%	-0.01%
Environmental Cost Recovery			
7	**Environmental deferrals subject to Earnings Test**	$5,000	$5,000
8	**Company absorbs environmental costs**	$5,000	
9	**Customers absorb environmental costs**		$5,000
Earnings Test Result - Post Environmental Absorption			
10	**Net Operating Revenue**	$78,750	$81,650
11	**Total Rate Base**	$1,050,000	$1,050,000
12	**Return on Rate Base**	7.50%	7.78%
13	**Earnings Test - Return on Equity**	8.94%	9.49%
14	**ROE Threshold for each year's Spring Earnings Test**	9.50%	9.50%
15	**Overearning / (Underearning)**	-0.56%	-0.01%