

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UG 286 & UM 1722

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

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

February 8, 2016



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_____)	

1 My name is Dr. Jaime McGovern, and my qualifications are listed in CUB
2 Exhibit 101.

3 **I. Introduction**

4 CUB agrees with utilities' characterization of the two purposes of this
5 consolidated docket— (1) to decide whether NW Natural's existing cost recovery
6 mechanism associated with its System Integrity Program ("SIP") should be extended, and

1 (2) the appropriate method of recovery for safety costs by natural gas utilities, generally.¹
2 CUB disagrees with the Joint Utilities' recommendation regarding development of a
3 recovery mechanism generally, and encourages the Commission to reject NW Natural's
4 request to renew this specific recovery mechanism as it has served its purpose.

5 UM 1722, the generic Commission investigation into Gas and Safety Costs, grew
6 out of UG 286 wherein NW Natural "requested that the Commission extend its SIP to
7 allow recovery of the Company's ongoing costs to comply with current safety and
8 reliability regulations."²

9 For its part, NW Natural would like to modify several aspects of its SIP, as well
10 as extend the program, which was scheduled to sunset on November 1, 2014^{3,4} We
11 discuss both the specific concerns related to NW Natural's request and those related to the
12 Joint Utilities' recommendation for regulatory treatment of gas safety costs.

13 We present our detailed testimony below, but organize it here.

14 I. Introduction

- 15 a. NW Natural
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17 II. Response to NW Natural's Testimony

- 18 a. The Company's request goes against the spirit of the Stipulation
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21 and Geohazard)⁵
- 22 d. Safety Costs can be recovered in rates
- 23 e. Are These Costs Properly Considered Capital Expenditures? If So, Where
24 is the Depreciation Offset

¹ Joint Utilities/100/Thompson-Andrews-Parvinen/1; NWN/100/Thompson/1-2. For clarity, CUB will use the term "SIP" to describe the actual program and SIP tracker to describe the cost recovery mechanisms associated with NW Natural's request in this case.

³ UM 1406, Joint Explanatory brief, filed 05/09/2013

⁴ Per the same stipulation and brief, Bare Steel scheduled to sunset Dec 31, 2015

⁵ UM 1406 – Stipulation at 1, filed Nov. 25, 2008.

- 1 f. The Company is getting ahead of regulation
- 2 g. Impacts on Cost of Capital
- 3 III. Response to the Joint Utilities' Testimony
- 4 a. Response to policy objectives
- 5 b. Response to claim of customer benefits
- 6 c. Response to guidelines for a cost recovery mechanism
- 7 IV. Conclusions and Recommendations
- 8 **A. NW Natural**

9 Given the origins of this docket, the history seems relevant. In 2009, in Order 09-
10 067, the Commission approved a joint stipulation wherein parties recommended the
11 development of an integrated SIP.⁶ NW Natural had previously employed a Cast Iron
12 Replacement Program and a Geohazard Program, both of which had already been
13 discontinued at the time of the joint stipulation.⁷ Some of the components of the original
14 GeoHazard Program were presumed by the ensuing federal programs, and so came in
15 under the new integrated SIP.⁸ The new SIP incorporated programs instigated by the
16 Pipeline and Hazardous Materials Safety Administration (“PHMSA”)—the Transmission
17 Integrity Management Program (“TIMP”) and the Distribution Integrity Management
18 Program (“DIMP”)—as well as NW Natural’s Bare Steel Replacement Program (Bare
19 Steel program). The Bare Steel program was originally paced for completion in 2021,
20 but following an accelerated funding plan for the Bare Steel component of SIP,⁹ Bare
21 Steel replacement was completed in 2015.^{10,11}

⁶*In re NW Natural*, OPUC Docket No. 1406, Order No. 09-067 at 1-2 (03/01/2009).

⁷ UM 1406 – Stipulation at 1, filed Nov. 25, 2008.

⁸ UM 1406 – Stipulation at 1, filed Nov. 25, 2008.

⁹ UM 1406 – Stipulation at 3, filed Nov. 25, 2008.

¹⁰ UM 1722 - NWN/100/Karney/4.

¹¹UG 221 - Second Partial Stipulation at 7, filed Oct. 2, 2012.

1 NW Natural provides a table with the program costs that they expect to incur in
2 the SIP for 2015, 2016 and 2017.¹² NW Natural also requests a renewal of its SIP
3 tracker. CUB does not see the necessity or value in the extension of the SIP, given the
4 circumstances under which it was crafted and recommended in stipulation,¹³ and
5 conversely, the current status of safety projects. CUB believes that the SIP tracker was
6 intended to be temporary and to the end of helping NW Natural get to a sustainable
7 position of maintenance and compliance with the PHMSA regulations. PHMSA is
8 moving towards management approach, and the CUB feels that NW Natural is well
9 situated to meet those expectations. CUB recommends that the Commission reject NW
10 Natural's application to extend the program, and instead allow the tracker to remain in
11 sunset, as originally intended.

12 **B. The Joint Utilities**

13 In the general investigatory docket, Avista, NW Natural and Cascade (the Joint
14 Utilities) set forth recommendations for the Commission on the recovery of safety costs
15 by the natural gas utilities. CUB disagrees with the Joint Utilities' on a number of issues,
16 including their characterization of the purpose of a "safety investment recovery
17 mechanism,"¹⁴ the relevance of FERC decisions and mechanisms in other states, and the
18 Joint Utilities' proposed scope and structure of such a mechanism. CUB believes that the
19 principles stated as fact in the Joint Utilities' testimony are self serving and overly broad.
20 Automatic adjustment clauses are a tool which the PUC can, and should, utilize only
21 under specific circumstances. The principles articulated by the Joint Utilities are overly

¹² UM 1722/NWN/100/Thompson/8.

¹³ UM 1406 – Stipulation, filed Nov. 25, 2008.

¹⁴ UM 1722 Joint Utilities/100/Thompson-Andrews-Parvinen/2.

1 broad and would allow a “safety and reliability” tracker to absorb capital investments and
2 O&M costs that are properly dealt with in a general rate case.

3 **II. Response to NW Natural's Testimony**

4 **A. NW Natural’s request goes against the spirit of the Stipulation**

5 The Company, originally states, as part of the background that:

6 While previously implemented separately, the NW Natural's Cast Iron,
7 Bare Steel, and Geohazard programs all were designed to address the
8 issues raised and regulations formulated as a result of federal legislation to
9 improve natural gas transmission and distribution system safety. Going
10 forward, it would be difficult to separate these critical programs from
11 regulations that have emerged, and will emerge in the future, from the
12 2002 and 2006 safety acts. Each individual program plays an integral part
13 in ensuring that the NW Natural complies with the legislative and
14 regulatory framework. It is also evident based upon past history that
15 variations in workload in each category will invariably occur.¹⁵

16 When NW Natural originally requested the consolidated SIP tracker, and the
17 Stipulation was crafted, CUB and Staff believed that the SIP tracker (which subsequently
18 became Schedule 177¹⁶) was intended to be temporary (as evidenced by the sunset). In
19 consideration of support for the original Stipulation, CUB considered that NW Natural
20 had been recently subject to safety regulations, and that it had a large amount of pipe
21 remediation to be completed. That is no longer the case. In the extension of the SIP
22 tracker, Staff considered that the Company was in a rate case moratorium.¹⁷ That is no
23 longer the case. In UG 221,¹⁸ Staff "recommended that the Commission discontinue the
24 tracker mechanism associated with NW Natural's SIP."¹⁹

¹⁵ UM 1406 – Stipulation at 1, filed Nov. 25, 2008.

¹⁶ [https://www.nwnatural.com/uploadedFiles/25177ai\(5\).pdf](https://www.nwnatural.com/uploadedFiles/25177ai(5).pdf)

¹⁷ Advice 14-23 - March 24, 2015 Staff Memo at pg 2.

¹⁸ which the parties signed the Second Partial Stipulation, where the SIP was extended

¹⁹ UG 221 - Second Partial Stipulation at 7, filed Oct. 2, 2012.

1 **B. NW Natural has completed physical construction related to Bare Steel**

2 NW Natural has completed its capital intensive Bare Steel Program. Parties
3 added \$13.7 million to the Bare Steel so that the Company could complete it ahead of
4 schedule.²⁰ As a safety program, NW Natural agreed that it would not track any costs
5 associated with Bare Steel into the SIP tracker after 2015.²¹ They would have, however,
6 been able to recover any costs through the standard ratemaking procedure of general rate
7 cases.

8 The Company states that the purpose of the SIP is to eliminate regulatory lag:

9 NW Natural's top priority is and has always been safety and reliability and
10 the Company will make required investments regardless of whether the
11 SIP is extended. However, normal ratemaking approaches result in
12 regulatory lag, which can pose as a disincentive to investment. Therefore,
13 policies—like the SIP—that support proactive investment in safety
14 infrastructure can mitigate this disincentive and promote and support
15 investments in a safer and more reliable system.²²

16 However, with the conclusion of the Bare Steel program, the SIP would eliminate
17 regulatory lag on on-going costs such as inspections that are necessary to satisfy existing
18 regulations. This is exactly what the normal ratemaking process is designed for. The
19 costs to continue DIMP and TIMP are costs related to managing the natural gas
20 transmission and distribution network. Moreover, for 2015-2017,²³ the forecasted SIP
21 costs for NW Natural are between \$8 million - \$9 million per year.²⁴

²⁰ UM 1406 – Stipulation at 3-4, filed Nov. 25, 2008.

²¹ UM 1406 – Stipulation at 3-4, filed Nov. 25, 2008.

²² UM 1722 NWN/100/Thompson/9.

²³ When NW Natural filed, 2015 actuals were unknown

²⁴ UM 1722 - NWN/200/Karney/3.

1 However, in UG 286, the Company is also requesting that the 'threshold', be
2 reduced from \$4 million^{25,26} to \$1 million. This means that all costs associated with SIP
3 above \$1 million up to \$9 million would be exclusively recovered in this tracker.²⁷ This
4 would provide even more protection for NW Natural. Has providing 'safe and reliable
5 service' at a cost of anything over \$1 million become extreme and significant? The
6 original threshold of \$3 million²⁸ was set because NW Natural had, years ago, already
7 been committing \$3 million annually to safety costs – some of the costs, including
8 personnel related to safety, are embedded in base rates. NW Natural is proposing to
9 change this, but has offered little or no evidence for the change from (the current) \$4
10 million to \$1 million. Does this mean that there is less spending in base rates related to
11 maintaining the gas network? CUB believes to separate the tracker from costs in base
12 rates requires a general rate case with a specific test year.

13 CUB does not see these proposed 2016 and 2017 safety costs as either (1)
14 unpredictable, (3) uncontrollable or (4) overly burdensome for NW Natural. A large
15 portion of the need for the tracker has been satisfied and funded.

16 **C. NW Natural conducted safety programs before the SIP tracker (Cast Iron and**
17 **Geohazard)²⁹**

18 NW Natural committed at least \$3 million annually to safety programs before the
19 SIP tracker was implemented. Now, NW Natural is asking the Commission to hold it
20 responsible for a smaller amount. This begs the question, how is safety spending not part

²⁵ In the original 2008 stipulation the threshold was \$3 million, then in 2013, the stipulation set the threshold at \$4 million.

²⁶ UM 1406 – Stipulation at 3, filed Nov. 25, 2008.

²⁷ UM 1722 - NWN/100/Thompson/7.

²⁸ Between 2008 and 2013, the threshold increased to \$4 million.

²⁹ UM 1406 – Stipulation at 1, filed Nov. 25, 2008.

1 of NW Natural's core business? It can be presumed that the Company has historically
2 been collecting capital safety investment below the threshold in base rates. If NW
3 Natural were to receive a renewal of the tracker, and it were to receive a reduction in its
4 threshold of \$3 million dollars (as requested), it would be necessarily appropriate for the
5 Company to reduce its base rates symmetrically, by \$3 million, to avoid double collection
6 of costs. Moreover, how can we be assured that NW Natural, during the repeated
7 extensions of this SIP tracker, is not replacing pipe that would have been replaced during
8 the normal course of business anyway, due to load growth, structural changes, age or
9 other factors? CUB does not argue that NW Natural should not be making prudent safety
10 investments, merely that it is part of NW Natural's core business and that NW Natural
11 should seek recovery through the normal ratemaking process.

12 NW Natural states that it will perform the safety measures with or without the SIP
13 tracker, and that it views safety measures as a priority.³⁰ CUB does not believe that NW
14 Natural needs a tracker to insulate it from the \$8 million worth of risk for its top priority
15 projects. CUB believes that ongoing projects such as these are better planned for in the
16 IRP and recovered through general rate cases.

17 **D. Safety costs can be recovered in rate cases**

18 NW Natural reasons that without the SIP tracker, it would necessarily come in for
19 more frequent rate cases.³¹ CUB takes issue with this statement.

20 The possibility of a general rate case to review NW Natural's earnings is not a
21 threat to CUB, and is a fundamental component of conventional ratemaking. CUB views

³⁰ UM 1722 - NWN/100/Thompson /9.

³¹ UM 1722 - NWN/100/Thompson/11.

1 the general rate case as an important part of the regulatory compact. In particular, CUB
2 has concerns that NW Natural may be earning revenues or experiencing savings in other
3 areas that may offset the safety costs. A general rate case would give parties ample
4 opportunity to investigate the projects as an integrative part of their system. As it stands,
5 NW Natural states that "SIP allows recovery of capital costs that are significant and
6 ongoing and not offset by associated revenues."³² However, CUB is concerned by this,
7 because NW Natural is only specifying 'associated' revenues here. In this case, the Joint
8 Utilities propose the Commission adopt the following language for a gas safety cost
9 tracker:

10 **Capital Investment:** The mechanism should be designed to recover
11 capital costs that are significant, and that are not offset by associated
12 revenues.³³

13 CUB finds this troublesome. NW Natural's annual revenue was over \$678 million in
14 2014.^{34,35} That means that this \$8 million/year proposed recovery mechanism is 1.1
15 percent of NW Natural's annual revenue. NW Natural has had the opportunity to file a
16 general rate case and incorporate safety investments and expenditures into rates. CUB
17 does not believe that \$8 million in annual costs of potential regulatory lag provides
18 sufficient justification to create a special mechanism for NW Natural. CUB does not
19 believe the forecasted expenditures in the current application are significant. We
20 recognize that parties may have various interpretations of the term 'significant.'

³² UM 1722 - NWN/100/Thompson/9.

³³ UM 1722 - Joint Utilities/100/Thompson-Andrews-Parvinen/3.

³⁴ Oregon-only /\$750 million System-wide

³⁵ <http://www.puc.state.or.us/docs/statbook2014WEB.pdf> at pg 53.

1 NW Natural asserts that DIMP and TIMP should be “properly characterized as capital
2 expenditures, and therefore the SIP costs in general should be recorded as capital³⁶”.
3 First, the individual projects contained in the SIP, even if they were originally capital
4 have changed from year to year. There is no guarantee that they are capital projects.
5 Secondly, if they are capital projects, then this is not a question of whether NW Natural
6 will recover the \$8 million dollars, but is an issue of timing. At what point do additional
7 capital additions, which are at least partially offset by depreciation, cause the need for the
8 Company to file a rate case to update its rate base. Depending on the amount of
9 depreciation, there could be some regulatory lag. This is not a question of whether NW
10 Natural will recover its prudent safety investments, but merely, what ratemaking
11 mechanism is used.

12 However, some of these costs seem to represent ongoing costs. When these
13 integrity management programs first appeared, NW Natural was expected to inspect a
14 great deal of pipeline relatively quickly. After that first inspection, however, there should
15 be a regular cycle of pipeline inspection (PHMSA recommends five year intervals)–
16 much like the tree trimming required by the electric utilities. The costs that NW Natural
17 proposes to recover related to “smart pig” inspection are remarkably consistent from year
18 to year, from \$1.927 million to \$2.051 million.³⁷ The variation is less than \$125,000 per
19 year. NW Natural claims that this includes the capital costs associated with making the
20 pipes 'smart pigable.'³⁸ It is not clear how this cost is divided between the actual smart
21 pigging costs, and the cost to make the pipe pigable. Neither is it clear what the

³⁶ UM 1406 – Stipulation at 1, filed Nov. 25, 2008.

³⁷ UM 1722/ NWN/200/Karney/3.

³⁸ UM 1722/ NWN/200 Karney/7.

1 appreciation to the modified pipeline would be. CUB questions whether all or part of this
2 should be considered an on-going expense covered in based rates, like tree trimming, and
3 whether the remaining capital investment is large enough to be considered “significant,”
4 as identified by the Joint Utilities’ principle.

5 **E. Are These Costs Properly Considered Capital Expenditures and If So Where is**
6 **the Depreciation Offset?**

7 Because capital investments cannot be put into rate base until they are used and
8 useful, they are subject to regulatory lag. In the case of these safety costs, it is the
9 regulatory lag associated with these capital expenditures that cause NW Natural’s desire
10 to recover these through an AAC rather than a GRC. While the cast iron and bare steel
11 pipe replacement programs were clearly capital investments, is that really true of these
12 ongoing integrity management costs. NWN claims they are considered capital
13 expenditures:

14 NWN believes that it is appropriate and reasonable to classify the new
15 required pipeline integrity work as capital because the new inspections
16 will ultimately result in an extension of the useful life of the transmission
17 lines, which would typically classify such costs as capital expenditures.³⁹

18 NW Natural has repeatedly argued that the capital costs associated with this
19 program would extend the useful life of the transmission and distribution lines:

³⁹ UM 1156 - OPUC Order No. 04-390, at 2.

1 In support of its application, the Company pointed out that that the work
2 required under the 2002 Improvement Act would ultimately result in an
3 extension of the useful life of NW Natural's transmission lines...⁴⁰

4 Moreover, as with the TIMP, all actions taken in furtherance of the DIMP
5 will serve to extend the useful life of pipelines (in this case, distribution as
6 opposed to transmission)...⁴¹

7 NW Natural did a depreciation study in 2010, but as far as CUB can determine,
8 this did not translate into an extension of the any transmission or distribution asset life in
9 rates:

10 On February 27, 2012, NW Natural filed the depreciation study in UG
11 221. In UG 221, no party addressed NW Natural's depreciation study.
12 Subsequently, NW Natural's depreciation study was re-filed under a
13 newly created Docket No. UM 1628. Since that time, Staff and NW
14 Natural have discussed the status of this docket and determined that it
15 would not make sense to review the depreciation study separately at this
16 time. Instead, NW Natural will file a new depreciation study at some
17 future date, when doing so would make the depreciation study more
18 appropriately timed with a potential rate change. Staff believes that NW
19 Natural needs to file such a study by the end of 2014.⁴²

20 As these new costs get added to customers' rates, there should be an offset related
21 to the extension of the useful life of the transmission and distribution assets. But the
22 promises of extended life are being done in tracker dockets, where the useful life cannot
23 be adjusted. Treatment of safety spending through general rate cases provides the more
24 equitable and accurate result. That is, that the rate reduction generated by the useful asset
25 life extension can be timed to offset the new costs related to the safety programs. It is
26 also possible that these integrity management programs are not extending the lives of the
27 distribution and transmission assets because the integrity management programs are
28 really primarily O&M.

⁴⁰ UM 1406, Northwest Natural's Application for an Accounting Order at page 3.

⁴¹ UM 1406, Northwest Natural's Application for an Accounting Order at page 6.

⁴² UM 1628, Joint Letter Requesting Docket Be Closed, at 1.

1 **F. NW Natural is getting ahead of regulation**

2 NW Natural admits that is incurring safety costs ahead of requirements. It
3 justifies this rapid pace by stating that "all of the SIP activities planned for the next three
4 years will eventually be required."⁴³ This is exactly the sort of rationale that concerns
5 CUB. It CUB's understanding that NW Natural is not prescribed specific investments or
6 remediation measures by PHMSA, but that NW Natural must create and maintain an
7 integrated integrity management system. NW Natural must also continue to review their
8 system for risks and changes.⁴⁴ CUB feels that NW Natural, without the SIP tracker, has
9 ample opportunity to do so.

10 CUB also understands that the way the SIP tracker has worked, and, if renewed,
11 would continue to operate would be the following: NW Natural would perform projects
12 and incur costs related to SIP. It would then, at the end of the 'tracker year,' submit those
13 costs for recovery. CUB understands that:

14 NW Natural's Schedule 177 implements the SIP, under which capitalized
15 costs are reviewed in the Purchased Gas Adjustment ("PGA") process and
16 those judged prudent are included in the permanent rates beginning the
17 next PGA year.⁴⁵

18 However, as a practical matter, in the context of a general rate case, parties review
19 projects for prudence based on legal requirements, cost, need, timing, all in the interest of
20 carefully maintaining the balance between the interest of shareholders and ratepayers. In
21 recent gas general rate cases, CUB has found that determining the prudence of capital
22 projects that were already reviewed in an IRP can take multiple rounds of data requests
23 with conflicting answers. In this context, given the condensed schedule of the PGA,

⁴³ UM 1722 NWN/100/Thompson/9.

⁴⁴ PHMSA recommends 5 year intervals.

⁴⁵ UM 1722 NWN/100/Thompson/5.

1 parties will have difficulty establishing the prudence of projects that are not required by
2 law, and therefore are discretionary, but also considered by the utility to be beyond its
3 core business.⁴⁶ The theoretical basis for which these projects would be judged for
4 prudence is nebulous. In addition, given that, by the time the projects are up for prudence
5 determination, they will already be in the ground, CUB is concerned about the line that
6 will be smudged between in-service and prudent. Recently, Avista has argued that timing
7 is not relevant in the determination of prudence.⁴⁷ This slippery slope is concerning for
8 CUB.

9 CUB believes that the best place to assess the prudence of an investment, both
10 individually and in the context of NW Natural's entire system, is through a general rate
11 case.

12 NW Natural should be required to demonstrate prudence of its investments as
13 integrated components of its system. This can only be done in a fully vetted rate case.
14 CUB understands that NW Natural does not object to an earnings review if it gets
15 renewal of the SIP tracker. However, this is not sufficient. NW Natural is implementing
16 safety measures, which it speculates, will be required eventually, accordingly, prudence
17 reviews will be complicated. For projects which NW Natural is mandated to do in a
18 particular time frame, either by federal or state regulation, prudence review is vastly
19 simplified. Prudence review then only requires an examination of *how* NW Natural
20 implemented the safety measure. However, in the case where NW Natural has a wide
21 range of discretion for what safety program to implement, when to implement it as well

⁴⁶ CUB reasons that if the measures are not legally required, but considered by the Company to be core business, it would have been implementing and maintaining the programs historically as part of its system.

⁴⁷ UG 288 - Avista/1500/Webb/7.

1 as how to implement it, prudence review is complicated and does not lend itself to
2 expedited treatment for the benefit of "flexibility of plan activities"⁴⁸ or other interests of
3 NW Natural.

4 **G. Impacts on Cost of Capital**

5 CUB is becoming growingly concerned about the amount of trackers in rates,
6 generally. As more and more investments and costs by a utility become guaranteed, or
7 tracked, the shareholders are exposed to decreasing amounts of risk. In addition, as the
8 size of a utility's rate base grows, its ability to weather financial storms of a fixed size,
9 without substantial impact on its earnings, increases. To this end, CUB has noticed that
10 energy utilities under the jurisdiction of the Oregon Commission have had large amounts
11 of rate base growth in the last decade, and in addition, have successively added trackers
12 to their ratemaking. CUB believes that the utility's true cost of capital is affected by both
13 of these evolutions. CUB believes that the return on SIP investments, need ample
14 opportunity for analysis, and NW Natural's cost of capital needs to be investigated as
15 well.

16 **III. Response to the Joint Utilities' Testimony**

17 The Joint Utilities state that the gas safety cost recovery mechanisms, such as NW
18 Natural's SIP, allows a utility "to update its rate base on an annual basis to reflect certain
19 system safety investments."⁴⁹ CUB unfortunately agrees with this, and finds trouble with
20 the one sided nature of the gas safety cost recovery mechanisms described by the Joint
21 Utilities, such as the SIP, and this statement. The Joint Utilities characterize the current

⁴⁸ UM 1722 - Joint Utilities/100/Thompson-Andrews-Parvinen/13.

⁴⁹ UM 1722 - Joint Utilities/100/Thompson-Andrews-Parvinen/1.

1 "myriad" of safety regulations as "increasingly stringent."⁵⁰ CUB disagrees with this
2 characterization and finds the current safety regulations and their related costs completely
3 manageable within the context of the standard regulatory framework. We discuss this
4 below. The Joint Utilities also discuss how the recovery mechanism would suit a
5 proactive approach to safety. We discuss the flaws in this argument.

6 **A. Response to policy objectives**

7 **i. The purpose**

8 The Joint Utilities state that the purpose of a gas safety cost tracker is to eliminate
9 regulatory lag.⁵¹ CUB fundamentally disagrees with this. This objective is self
10 satisfying, and suggests that the goal of the regulatory process under the OPUC is to
11 eliminate all regulatory lag. At the same time, the Joint Utilities state that a recovery
12 mechanism would promote less frequent rate cases and that would encourage cost
13 control.⁵² However, read another way, this means that a utility would experience
14 regulatory lag on all other incremental capital investment for a longer period of time.
15 Importantly, CUB notes that this is not a problem with gas companies in Oregon.
16 Specifically, twice, parties and Commission Staff were so concerned about the long
17 period of time since the last rate case with Cascade Natural Gas that the Commission
18 ordered Cascade to come in for a full earnings review and finally a general rate case.⁵³
19 Moreover, the example that the Joint Utilities use of how a system recovery mechanism
20 functions well is exactly this one at question, NW Natural's SIP. This should

⁵⁰ UM 1722 Joint Utilities/100/ Thompson-Andrews-Parvinen /2.

⁵¹ UM 1722 Joint Utilities/100/ Thompson-Andrews-Parvinen /5.

⁵² UM 1722 Joint Utilities/100/ Thompson-Andrews-Parvinen /6.

⁵³ *In re Cascade*, OPUC Docket No. UG 224, Order No. 13-079 (Mar. 13, 2013).

1 demonstrate that parties and Commission Staff have collaborated in the interest of
2 ensuring needed safety programs were implemented and recovered.

3 The more fundamental concern CUB has with this "fundamental purpose"⁵⁴ is the
4 statement itself. The Joint Utilities state that the fundamental purpose is to "promote
5 timely utility investments designed to enhance the safety and reliability of natural gas
6 pipelines."⁵⁵ In a time of long-standing conservation and extremely low gas prices, this
7 statement is overly broad, inaccurate, and would seem to provide recovery of the only
8 growing costs on a gas utility's system. CUB believes that there is an appropriate place
9 for trackers in utility regulation. In regards to safety tracker, that would be limited to
10 safety investments *only*, and the fundamental purpose is to reduce the burden of
11 complying with unforeseen urgent safety regulations or requirements.

12 **B. Response to claim of customer benefits**

13 The Joint Utility's purport likely benefits to ratepayers such as (1) fewer rate cases
14 and (2) mitigation of rate shock.

15 When considering the impact of fewer or more frequent rate cases, it is important
16 to consider the environment under which the utility is operating. In the past decade, as
17 utilities have seen lower costs of capital, staying out of a rate case for years at a time can
18 guarantee the utility access to a higher return on equity ("ROE"), while the customers
19 would benefit from a re-evaluation of the utility's financial situation. Annual rate cases
20 can be taxing for all parties, but a utility voluntarily 'staying out' for years on end does
21 not necessarily translate to ratepayer benefit. In addition, staying out of rate cases

⁵⁴ UM 1722/Joint Utilities/100/Thompson-Andrews-Parvinen /5.

⁵⁵ UM 1722/Joint Utilities/100/Thompson-Andrews-Parvinen /5.

1 protects the utility from a review and/or update of many of its practices that only come to
2 light in a general rate case – updating decoupling metrics, review of storage and
3 optimization practices and examination of LRIC only happen in rate cases.

4 Neither is reduction of rate shock guaranteed by a gas safety cost recovery
5 tracker. In particular, in this case, the rate 'shock' would be that rates would be lower
6 until NW natural found their costs so out of line with their revenues that it felt compelled
7 to file for a general rate case. Most customers would welcome this sort of rate shock,
8 lower rates. In the case of a renewal, rates remain otherwise higher, without a full review
9 of the sufficiency of rates for NW Natural. Finally, CUB notes that significant rate
10 increases and decreases do happen to gas utilities, but it is almost always related to the
11 commodity cost and the inherent volatility of gas prices.

12 A safety cost recovery mechanism does not, inherently, bring benefits to
13 customers.

14 **C. Response to guidelines for a cost recovery mechanism**

15 *i. FERC*

16 The Joint Utilities spend a significant portion of their testimony discussing FERC,
17 and its relevance to this case.⁵⁶ CUB finds this approach disingenuous. The Joint
18 Utilities discuss their view on (1) whether FERC has adopted similar mechanisms (2)
19 whether FERC provides guidance on safety cost recovery mechanisms (3) whether FERC
20 typically allows infrastructure investment recovery through trackers (4) governmental
21 regulatory influence of FERC's treatment of safety trackers and (5) FERC standards on
22 safety trackers.

⁵⁶ UM 1722/Joint Utilities/100/Thompson-Andrews-Parvinen/7-11.

1 CUB does not disagree that safety recovery investment mechanisms can be
2 appropriate. A testament to that fact is the recovery mechanism at issue in UG 286. NW
3 Natural felt that it was important to replace its Bare Steel, and CUB was party to the
4 stipulation that created the integrated SIP. Moreover, CUB was also party to the revised
5 SIP which accelerated implementation and recovery of the Bare Steel program. This was
6 a narrowly defined project that fit many of the ideal components of a safety recovery
7 mechanism.

8 Importantly, the Joint Utilities reference the FERC case of *Columbia Gas*
9 *Transmission*⁵⁷ where a recovery mechanism was developed to address Columbia's
10 "urgent public safety and reliability concerns." This is exactly what the OPUC did with
11 NW Natural's Bare Steel, but is not relatable to the types of projects and costs that are
12 beginning to be lumped into safety trackers.

13 One of CUB primary concerns is that these kinds of trackers tend to expand and
14 take on new costs that were not anticipated when the mechanism was developed. This
15 docket shows how that can happen. At the March 24, 2015 Public Meeting, the
16 Commission opened "a generic investigation to examine the recovery of safety costs by
17 natural gas utilities."⁵⁸

18 The Joint Utilities quickly expanded the scope to include safety and reliability and
19 propose a set of three guidelines for safety investment recovery mechanisms.⁵⁹

⁵⁷UM 1722/Joint Utilities/100/Thompson-Andrews-Parvinen /7.

⁵⁸ *In re NW Natural*, OPUC Docket No. UG 286, Order No. 15-093 at 1 (Mar. 6, 2015).

⁵⁹ UM 1722, Joint Utilities/100/Thompson-Andrews-Parvinen/3.

1 The recovery mechanism should be used to recover costs of a facilities
2 replacement or improvement plan intended to advance the safety *and/or*
3 *reliability*⁶⁰ of existing facilities.⁶¹

4 This is scope creep. Safety **and/or reliability** of existing facilities is too broad,
5 particularly considering the number of investments that utilities claim are related to
6 reliability.

7 Much of the capital investment that has been challenged in general rate cases is
8 based on a claim of advancing reliability. Avista claims that the East Medford
9 Reinforcement Project and the Ladd Canyon Gate Station were necessary for reliability
10 purposes.⁶² Those projects were discussed in the 2014 IRP and are the subject of a
11 prudence challenge in the Avista's currently pending general rate case.⁶³ NW Natural
12 claimed that the Mid-Willamette Valley Feeder project was necessary for reliability, yet
13 the Commission found it to be imprudent and rejected it in a general rate case:

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

20 NW Natural has failed, however, to provide any evidentiary support for
21 these assertions.⁶⁴

22 CUB generally believes that general rate cases are the appropriate place to review
23 a utility's costs. While deferrals, and automatic adjustment clauses are tools, those tools
24 should have limited application to specific problems which require us to go outside of
25 general ratemaking. They should not become the default mechanism for cost recovery.

⁶⁰ Emphasis added.

⁶¹ UM 1722 Joint Utilities/100/Thompson-Andrews-Parvinen/3.

⁶² UG 288, Final Brief of Avista Corporation at 15 (01/22/2016).

⁶³ UG 288, Final Brief of Avista Corporation at 15 (01/22/2016).

⁶⁴ *In re NW Natural*, OPUC Docket No. UG 221, Order No. 12-437 at 16 (Dec. 16, 2012).

1 Capital spending within a gas utility's system is often identified as necessary for
2 "reliability" purposes. Most of this is routine reinforcement of elements of the system as
3 it ages, and as the system grows. Some of these investments have been controversial,
4 coming well before IRPs say they are needed (and for different reasons). CUB believes
5 strongly that these investments need to be analyzed in an IRP and recovered in a general
6 rate case. Trackers associated with the PGA simply do not have the same level of
7 scrutiny as a general rate case. The fact that the Commission has found investments that
8 are claimed to be for reliability purposes to be imprudent suggests that these investments
9 need the scrutiny associated with a general rate case.

10 *ii. FERC departure*

11 The Joint Utilities attempt to promote a sense of urgency for any safety or
12 reliability related tracker by citing regulation that impacted FERC.⁶⁵ The Joint Utilities
13 state:

⁶⁵ UM 1722/Joint Utilities/100/Thompson-Andrews-Parvinen/9.

1 **Pipeline Safety, Regulatory Certainty, and Job Creation Act of 2011:**
2 In 2012, Congress passed this legislation, which requires the United States
3 Department of Transportation (DOT) to take various actions to reduce the
4 risk of future pipeline failures, including requiring DOT to (1) consider
5 expansion and strengthening of its integrity management regulations, (2)
6 consider requiring automatic shut-off valves on new pipeline construction,
7 (3) require pipelines to reconfirm their Maximum Allowable Operating
8 Pressures, and (4) conduct surveys to measure progress in plans for safe
9 management and replacement of cast iron pipelines.

10 **Pipeline Safety Reform Initiative:** The Pipeline and Hazardous Materials
11 Safety Administration (PHMSA) is in the process of implementing this
12 multi-year initiative to comply with the Pipeline Safety Act's mandate to
13 enhance the agency's ability to reduce the risk of future pipeline failures.

14 **Expansion of High Consequence Areas (HCA):** PHMSA is considering
15 expanding the definition of an HCA so that more miles of pipeline will be
16 subject to integrity management requirements.

17 **Expanded Pipeline Repair Criteria:** PHMSA is considering new rules
18 related to repair criteria, including applying the integrity management
19 repair criteria to non-HCAs; reassessing the repair criteria in areas where
20 the population has grown since the pipeline was constructed; requiring
21 methods to validate in-line inspection tool performance and qualifications
22 of personnel; and implementing risk-tiering such that repairs in an HCA
23 have priority over repairs in a non-HCA

24 **Expanded Pipeline Assessment Requirements:** PHMSA is considering
25 changes to its requirements that pipelines perform baseline and periodic
26 assessments of pipeline segments in an HCA through one or a
27 combination of in-line inspection, pressure testing, direct assessment of
28 external and internal corrosion, or other technology demonstrated to
29 accurately assess the condition of a pipe.

30 **Greenhouse Gas (GHG) Concerns:** FERC noted growing concerns
31 about the emissions of GHG in the production and transportation of
32 natural gas.⁶⁶

33 CUB notes that FERC affirmatively requires DOT to develop a plan to identify and safe
34 management and replacement of cast iron pipe, which NW Natural has already done.

35 However, CUB also notes that much of the regulation discussed above is PHMSA's
36 consideration of new regulation. CUB finds it inappropriate for a safety recovery

⁶⁶UM 1722/Joint Utilities/100/Thompson-Andrews-Parvinen/9-10 (emphasis added).

1 mechanism to be designed to prematurely anticipate that regulation. Prudence would be
2 difficult to assess without the scrutiny and time dedicated to a general rate case, given
3 that these safety measures are not required. Moreover, if the utility guesses incorrectly as
4 to what the specifics of what those upcoming safety regulations are, and the actual
5 regulations necessitate further and redundant measures, customers are left holding the
6 bag.

7 *iii. Review and prudency determination*

8 The Joint Utilities only pay lip service to prudence review and earnings review.

9 They state:

10 In the interests of full transparency, the Joint Utilities recommend that any
11 utility plan covered by a safety investment recovery mechanism be
12 reviewed by the Commission, Staff, and interested stakeholders. The plan
13 could be subject to a formal approval process—although the process
14 *ideally could be conducted on an expedited basis*, and the approval would
15 allow for some flexibility in plan activities.⁶⁷ (emphasis added)

16 It appears disingenuous for the Joint Utilities to pledge to transparency and then in the
17 same paragraph state that parties could "ideally" expedite the review process of a project
18 that the utility would have been developing for months or even years. This lack of a level
19 playing field in the guise of transparency is disconcerting to CUB.

20 Similarly, the Joint Utilities discount FERC's "first standard"⁶⁸ that base rates
21 must have been recently reviewed. Beyond CUB's concern that the Joint Utilities might
22 view the term 'recently' too loosely, they provide such a surface level interpretation of the
23 term "reviewed." Of course, it is obvious that if the utility is earning above its authorized
24 ROE, analysis may find that rates are sufficient to compensate the utility for its safety

⁶⁷ Joint Utilities/100/Thompson-Andrews-Parvinen /13.

⁶⁸ Joint Utilities/100/Thompson-Andrews-Parvinen /16.

1 investments. This fact may be somewhat straightforward to establish in a properly
2 conducted earnings test. However, this does not complete the story.

3 Given that the utility would know that it had an annual safety tracker, and that it
4 would be subject to an earnings review, it could have an incentive to spend excess
5 revenues if it knew towards the end of the year that it would earn above its ROE. That is
6 not to say that those expenditures would not be spent within the utility, but the
7 expenditures could be on remodeling executive offices or on executive bonuses or on
8 advertising campaigns aimed at the corporate image. However, between rate cases, there
9 is no methodology to determine what the utility is spending that money on, and whether
10 those expenditures are prudent. Put frankly, the utility has an incentive to spend down
11 excess revenues between rate cases if it knows it is subject to an earnings test, thus
12 obscuring the lens of the earnings test, and reducing the value. Hence, an earnings test as
13 a measure of rate sufficiency is important for ratemaking between rate cases, but should
14 not be seen as equivalent.

15 Finally, a revenue requirement is not the end-all be all for a utility's rates. Rate
16 spread and rate design are key issues in an environment where the residential customers,
17 who have historically been burdened with the lion's share of the pie, have consistently,
18 through conservation and other means, been using less, while large commercial and
19 industrial customers are driving growth in LDC service territory. This has been a
20 contested issue in Avista's current rate case. Additionally, Avista's LRIC, which has been
21 used to help influence rate spread and rate design, is also contested. In NW Natural's
22 SIP, residential and small commercial customers shouldered 70% of the Bare Steel

1 investment.⁶⁹ DIMP and TIMP costs were allocated on an equal percentage of margin.⁷⁰
2 This was set when the program first began and has not been analyzed and revised since.
3 In order to properly allocate safety costs in the context of an evolving gas system, one
4 needs to use all relevant information. Again, this is information that is available only in a
5 general rate case.

6 **D. CUB's Recommendations**

7 While CUB believes that there is a place for deferrals and automatic adjustment
8 clauses (AACs) in utility ratemaking, CUB does not believe that NWN's SIP is a good
9 example. While some AACs, such as power costs or PGAs become permanent parts of
10 ratemaking, CUB offers a set of principles for limited duration AAC that relate to a
11 specific program rather than a permanent mechanism.

12 *i. Principle 1: The mechanism should be restricted to a discrete capital investment*
13 *that is spread over several years, predictable and clearly identifiable.*

14 Rather than broad categories, such as safety and reliability, automatic adjustment
15 clauses should be limited to discrete programs or investments that are clearly identifiable,
16 predictable and take place over several years. For example, the Cast Iron program largely
17 met this principle. It was identifiable – pipes are either cast iron or not. Replacing of
18 these pipes required an extended time period and NW Natural could budget and plan for
19 each year's costs.

⁶⁹ UM 1406 - Parties' Brief in Support of Stipulation at 9, filed Nov. 25, 2008.

⁷⁰ UM 1406 - Parties' Brief in Support of Stipulation at 9, filed Nov. 25, 2008.

1 *ii. Principle 2: An automatic adjustment clause should only be implemented with a*
2 *general rate case reviews both the program that is proposed for the AAC and the*
3 *costs of the utility.*

4 One of the problems with the NW Natural SIP is that it has continued to change
5 and have new costs have been added outside of general rate cases. Because it was
6 outside a general rate case, there was less opportunity to examine the programs being
7 added or NW Natural's costs. General rate cases are where we get to review all elements
8 of costs and programs of a utility. They have a schedule that accommodates multiple
9 rounds of discovery. Without a doubt, this is where the utility is subject to real scrutiny,
10 which makes it not surprising that utilities would like to move ratemaking out of general
11 rate cases. There are three reasons to begin an AAC with a general rate case.

12 The first is to examine the specific program that is being proposed by the utility.
13 Our first principle was that it should be spread over several years, predictable and clearly
14 identifiable. The way to ensure that it meets the first principle is to require it begin in a
15 general rate case so stakeholders have the time and ability to give it the proper scrutiny. It
16 also helps ensure that the utility is less likely to overuse this tool.

17 Most importantly, a general rate case will help ensure that the program is
18 examined closely and that the utility's claims can be proven. In its application, NW
19 Natural claims that it is making investments ahead of what will be required but that "all
20 of the SIP activities planned for the next three years will eventually be required."⁷¹ It
21 also claims that these expenditures will extend the life of the distribution and
22 transmission system. A general rate case provides the time and scope for parties to be

⁷¹ UM 1722/NWN/100/Thompson/9.

1 able to examine the evidence and make a judgment as to whether the claims made are
2 supported by the evidence.

3 The second reason is to examine the revenue requirement and rates of the utility.
4 AACs – particularly if they include an earnings test – are best used when base rates
5 reflect the utility’s costs. If a utility’s rates are too high to begin with, it makes little
6 sense to add a surcharge, even if it is offset by an earnings test. If the utility’s rates are
7 too low, then a general rate case can better examine where there is a revenue deficiency.

8 The third reason is to examine the intersection between the program that is in the
9 AAC and the costs that are in the utility’s base rates. When CUB examined NW
10 Natural’s interstate storage, it found that interstate storage used assets, personnel and
11 natural gas that were already in core customer rates.⁷² Quite frankly, CUB does not know
12 whether there have been any assets or personnel that are already in base rates that have
13 also been recovered through NW Natural’s SIP. The way to ensure this does not happen
14 is to require that the AAC begin in a general rate case where we can look at the assets and
15 personnel that are being included in each. A single test year that includes both the
16 revenue requirement and the costs that will be recovered in the AAC will allow parties to
17 ensure that there is no double counting of costs.

18 ***iii. Principle 3: AAC’s should include an earnings test.***

19 While the Joint Utilities and NW Natural talk about earnings tests and “earnings
20 reviews,” they do not always define them. CUB is unsure what an earnings review
21 necessarily entails. An earnings test is clearer. An earnings test is designed to see if

⁷² UM 1654 – Citizens’ Utility Board of Oregon’s First Post-hearing Brief at 17-22.

1 current rates are sufficient to recover the cost. If rates are sufficient, then the new cost has
2 failed the earnings test and no rate change is necessary.

3 CUB believes that earnings tests are generally a fundamental part of ratemaking
4 between general rate cases. In a general rate case, a utility's rates will be set to give the
5 utility a reasonable opportunity to recover its expected costs and earn a reasonable return
6 based on a test year. With an AAC, the utility is seeking cost recovery outside of that test
7 year. The earnings tests looks at the utility's earning and asks the question of whether the
8 utility needs to raise its rates to absorb the cost associated with the AAC, or whether its
9 rates are sufficient. If current rates are sufficient to recover the utility's costs and to
10 provide it a reasonable return, then there is no need to add a surcharge to customers' bills.

11 ***iv. Principle 4: AACs should have a limited duration.***

12 An AAC set up for cost recovery related to a specific program should have a
13 limited life that is associated with the program. This life would be a consideration in the
14 general rate case that first establishes an AAC.

15 ***v. Principle 5: AACs should not be renewed, expanded or significantly altered***
16 ***outside of a general rate case.***

17 The review of the program in a general rate case is an important element to
18 establishing an AAC. If there are significant changes, those should also be examined in a
19 general rate case. And, under no circumstances should an AAC be extended outside of a
20 general rate case.

21 The reasons are similar to the reasons to ask for a GRC to begin an AAC. There
22 is a need to scrutinize the program. What has changed? Why has it changed? There is a

1 need to examine the revenue requirement to make sure rates and costs are aligned and
2 there is a need to ensure that the Company is not double counting costs.

3 **IV. Conclusion**

4 CUB recommends that the Commission deny NW Natural's request to renew the
5 SIP tracker. The most recent stipulation and extension made it clear that all parties
6 besides NW Natural opposed continued use of this tracker. NW Natural has the ability to
7 plan for and manage these costs in the context of its overall system, and has the ability to
8 file for a general rate case.

9 CUB understands that some recovery mechanisms have value, and it is clear that
10 CUB has supported specific safety investment recovery mechanisms. However, NW
11 Natural's proposal is not consistent with the principles CUB has laid out. CUB
12 recommends that the Commission, if it is seeking to establish a standardized approach to
13 (1) determining when such a mechanism is necessary and (2) how it will be constructed,
14 define the mechanism and circumstances narrowly and require that the mechanism be
15 consistent with the principles CUB has identified. The Joint Utilities propose that the
16 Commission develop a standardized pathway for such mechanisms, but approve and
17 construct them on a case by case basis. CUB sees this as a blank check for the Joint
18 Utilities, allowing them to claim precedence but also being allowed to tailor the size and
19 scope of the mechanism to suit each individual utility, while not inherently contradicting
20 the treatment of other members of the Joint Utilities. This gives the Joint Utilities the
21 upper hand over customers. CUB recommends that the Commission reject NW Natural's
22 application in this case, and if the Commission makes a ruling on the general structure or
23 allowance of recovery mechanisms, that it be consistent with CUB's principles.

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