BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1789/UE 311/UP 344

In the Matters of PORTLAND GENERAL ELECTRIC COMPANY, Application to Defer Revenues and Costs Related to the Environmental Remediation Costs Recovery Adjustment, Schedule 149 (UM 1789); Schedule 149, Environmental Remediation Costs Recovery Adjustment (UE 3 11); and Application for Approval of Sale of Harborton Restoration Project Property (UP 344)

TESTIMONY IN SUPPORT OF STIPULATION
OF THE
CITIZENS' UTILITY BOARD OF OREGON

November 23, 2016

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

I. INTRODUCTION

CUB is a reluctant supporter of the Stipulation. CUB believes that the stipulation brings some potential benefits (DSAY revenues) that could be used to offset the environmental remediation liabilities. At the same time, CUB believes the underlying structure of PGE's Cost Recovery Mechanism is unfair to customers. However, rejection

of that mechanism threatens the potential benefits associated with the DSAY revenues. Therefore, CUB will support the stipulation because the recovery mechanism will come up for review either in two years or in a general rate case. At that time, parties will have a chance to review the underlying mechanism, without jeopardizing the DSAY revenues in the current case.

CUB is concerned, however, that Oregon is establishing a precedent that environmental remediation is solely a customer responsibility, under nearly any circumstance.

II. DSAY REVENUES AND OTHER FACTORS THAT LEAD CUB TO SUPPORT THE STIPULATION

CUB has chosen to support the Stipulation based on the following:

(1) PGE's claims that the project will generate environmental remediation credits (DSAY credits) that will be used to offset a significant portion of the environmental remediation costs[1].

(2) PGE will hold customers harmless if the cost of the Harborton Project is greater than the DSAY revenues[2]. This clause is meant to be interpreted broadly and include costs already incurred to prepare for development of the Project, termination fees if the Project is canceled, and everything in between.

(3) PGE will still have to prove that the properties at issue "provided utility service to customers and PGE's actions with regard to the property were prudent." [3] This goes beyond just demonstrating the prudence of the remediation effort, but includes examining the history of the site.

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[1] UE 311/PGE/100/Behbehani - Brown - Stevens / 4.
[2] UM 1789 / UE 311 / UP 344 STIPULATION, page 9-10.
[3] UM 1789 / UE 311 / UP 344 STIPULATION, page 10.

(4) The underlying cost recovery mechanism will come up for review at least every two years, but it can also be reviewed when new information is available, or during a general rate case. The review will include all elements of the mechanism.[4]

CUB still has significant concerns that all utility environmental liability is being placed on customers, and that there are no standards to review the historic prudence of the individual sites. Notwithstanding these concerns, CUB has chosen to support the Stipulation because of the four element listed above -- particularly the DSAY revenues. The DSAY revenues are being created with property that is dedicated to customers, and offers customers some potential relief from the costs of this environmental clean-up. The hold harmless clause applies broadly to the Harborton restoration projects costs and benefits. Because PGE has filed these dockets as a package and claims that each is dependent on the others, there is a real danger that this value could be lost if the package of dockets is not approved.

III. THE TORTURED HISTORY OF ENVIRONMENTAL REMEDIATION DECISIONS

CUB is concerned about the precedent created by UM 1635. PGE may have erroneously believed that, based on the Commission's Orders in UM 1635, it did not need to prove that (1) the Company acted prudently in incurring its environmental liability; (2) the property related to utility service; or (3) anyone other than customers should contribute to the costs.

CUB's concerns about the UM 1635 precedent are spelled out below. It is important to recognize that CUB is not using this PGE docket to attempt to create

[4] UM 1789 / UE 311 / UP 344 STIPULATION, page 11.

reconsideration of that docket. CUB accepts the final order in UM 1635 and notes that it will come up for review no later than 2018:

> We will review our decisions regarding the deferral and amortization of future remediation expenses, as well as the treatment of remaining insurance proceeds, in three years, or when NW Natural obtains greater certainty regarding its future remediation costs, whichever occurs first. This will allow us to review how the adopted earnings test is working for the company and its customers, and to consider whether adjustments to the mechanism may be appropriate. [5]

However, CUB is concerned that the mechanism that grew out of UM 1635 has become the precedent that PGE used in creating the mechanism proposed here.

The NW Natural Environmental Remediation that was subject to UM 1635 came before this Commission between 2011 and 2015. During that time, the Commission grappled with allocating the costs of NW Natural's environmental remediation through a series of four 2-1 votes. A review of those orders, however, demonstrates that it is difficult to determine the precedent that is being set. In addition, CUB believes that the final mechanism approved by the Commission is overly generous to the Company, and it allows the Company to achieve results through special ratemaking, which it could not get through a traditional general rate case.

In the following section, CUB provides a brief recitation of how environmental remediation developed in NW Natural's case, to illustrate the uncertain precedent with which parties grapple.

A. *UG 221*

This issue first came up in NW Natural's rate case, UG 221. NW Natural's environmental liability grew out of activities of NW Natural's predecessor between the

[5] OPUC Order No. 15-049, page 14.

mid-1800s and 1956, relating to the production of manufactured gas.[6] CUB, NWIGU, and Staff all proposed sharing mechanisms that would allocate these costs to both customers and shareholders. One reason was that these costs had no relationship to current service, or even the current product sold by the Company. Another reason was that there was no ability to go back in time and determine whether the Company acted prudently when incurring this liability.

The Commission rejected a sharing mechanism:

> The majority of Commissioners believe that use of an earnings test (with deadbands) coupled with the Commission's ongoing prudence review will provide an effective incentive for the company to manage its costs. Further, the majority adopts an earnings test but no sharing mechanism. An earnings test may operate as a de facto sharing mechanism.[7]

A footnoted noted that Commissioner Bloom dissented and would require the company to implement a sharing mechanism.[8]

Further, the Commission directed the parties to work on an earnings test with a deadband:

> An earnings test with deadbands will be applied. The parties will have the opportunity to address the appropriate deadbands and appropriate application of the earnings test in the new proceedings.[9]

While CUB was disappointed with this decision, CUB did recognize that one Commissioner supported a sharing mechanism, and two other Commissioners supported an earnings test with deadbands, which could act as a de facto sharing mechanism. There seemed to be at least some recognition that it is not fair to require customers to pay entirely for a Company's historic environmental remediation costs.

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[6] OPUC Order No. 15-049, page 2
[7] OPUC Order No 12-408, page 5.
[8] OPUC Order No 12-408, page 5.
[9] OPUC Order No 12-408, page 6.

B. *UM 1635, Phase I, Stipulation*

CUB, like other parties, worked in good faith to implement the order and focus on an earnings test. The Commission had stated that it could act as a de facto sharing mechanism, and since CUB supported a sharing of cost, it is no surprise that CUB advocated an earnings test with a deadband that acted in such a manner.

This was not an easy task. Deadbands are normally applied around a forecast, but in this case there were no reasonable forecasts associated with NW Natural's liability. In fact, in NW Natural's 2012 10-K, it dismissed the idea of providing an accurate forecast:

> Unless there is an estimate within a range of possible losses that is more likely than other cost estimates with that range, we record the liability at the low end of its range. It is likely that changes in these estimates and ranges will occur throughout the remediation process for each of these sites due to our continued evaluation and clarification concerning our responsibility, the complexity of environmental laws and regulations and the determination by regulators of remediation alternatives.[10]

The solution to how to apply deadbands arose by establishing earnings bands, with different levels of sharing. Instead of having a traditional earnings test, in which 100% of all earnings above a threshold (such as allowed ROE) will offset the costs that would otherwise fall on customers, the proposed earnings test would allow less than 100% of earnings above a series of thresholds to offset costs which would otherwise fall on customers. Allowing the Company to retain some earnings, within each band, was the way CUB tried to find an equitable solution to the call for an earnings test with deadbands.

An all-party settlement often involves trade-offs that work differently for various parties. In this case, NW Natural agreed to a mechanism that contained earnings bands

[10]NW Natural 2012 10-K.

with cost sharing within the bands, and the parties agreed to reduce the Company's liability for the costs that had already been incurred and deferred.

While no party objected to the stipulation, the Commission rejected it in another 2-1 vote.

> With regard to all remaining issues, we conclude that the parties' proposed stipulations do not fairly and prudently resolve whether and how NW Natural's environmental remediation costs should be shared with its customers. Based on the record, we believe that a disallowance of $7 million from recovery of incurred costs through the proposed SRRM is too low. Further, the environmental remediation costs at issue raise significant public policy considerations about how the Commission should address the sharing of costs, earnings reviews, deadbands, and other proposals made by the parties to apportion costs fairly. We believe that these issues should not be resolved through a stipulation, but rather through a more thorough examination of the facts and policy standpoints. [11]

Chair Ackerman dissented:

> I would accept the stipulations, and so dissent from my colleagues' conclusions. The settlement requirement that the company absorb $7 million of the historical period's deferrals seems insufficient to my colleagues. This number, however, is within a range of acceptable resolutions that are available to the Commission based on the evidence and reasonable interpretations of applicable law. The going forward settlement appears fairly restrictive to the company based on Commission precedent governing gas utility earnings reviews, but it, too, is within a range of acceptable resolutions. Therefore, it appears that the parties balanced these two periods in reaching their overall stipulation. The overall balance struck seems reasonable given the facts of this case, and I would therefore accept the stipulations.[12]

The order notes that the cost sharing, earnings reviews and deadbands are significant issues that the Commission should address. However, the only element of the stipulation that the Order and dissent reference, as the basis for the Commission's rejection, was that it reduced NW Natural's incurred liability for what has already been deferred down to $7 million. There was no specific criticism of the earning test/earning band mechanism,

[11] OPUC Order No. 13-424, page 7.
[12] OPUC Order No. 13-424, page 8.

except to the extent that Chair Ackerman called it "fairly restrictive" but "within the range of acceptable resolutions."

C. *UM 1635, Phase II*

In Phase II, the parties offered testimony and let the Commission decide. This led to two more 2-1 decisions.

The Commission order required customers to pay $5 million per year as a tariff rider (customers pay regardless of earnings or actual environmental remediation cost). Secondly, the Commission required that $5 million in insurance proceeds be allocated each year. Third, the Commission required that if costs were below $10 million, the surplus would roll over into the next year, and it would be used against the next year's expense. Because the earnings test applied to costs that are not offset in any year, the rollover expands the opportunity for the Company to overearn and not be subject to an earnings test.[13]

> Finally, the Commission found in a 2-1 vote that this was a fair application of the earnings test: We find no justification for an earnings threshold above NW Natural's ROE. We agree with CUB that allowing future expenses to be amortized when NW Natural's earnings are above its allowed ROE could give the company a better result than it might have achieved in a rate case. NW Natural's proposed threshold at 100 basis points above its ROE could effectively guarantee the company dollar-for-dollar recovery of its environmental expenses.[14]

CUB, however, does believe that this mechanism provides the Company a better result than it would receive in a rate case. By requiring the application of the tariff rider, the insurance proceeds and carry-over before the earnings test, the Commission allows the Company to overearn by a minimum of $10 million each year, without making any contribution to these costs. In a rate case, the costs would be covered and the Company's

[13] OPUC Order No. 15-039, pages 11-13.
[14] OPUC Order No. 15-049, pages 12-13.

ROE would be set at authorized levels. In addition, by requiring customers to pay $5 million per year, even when costs are below $5 million, and have the excess roll over and be added to the $10 million deadband in the following year, the Company is allowed to avoid the deadband while overearning. The problem is that the Company is using money that customers paid for the purpose of environmental remediation. For example, in a general rate case, if there were $8 million in costs, and $5 million of allocated insurance proceeds, customers would pay $3 million, and the earnings would be established at authorized ROE. The UM 1635 mechanism instead has customers paying $5 million, with the extra $2 million being rolled forward. This would expand the Company's insulation from the effects of an earnings test. The earning test exemption would therefore grow from $10 million to $12 million.

From CUB's perspective, this mechanism will likely increase the amount of environmental remediation costs that customers pay on a going forward basis, as compared to the all-party settlement which was rejected.

The all-party settlement was rejected because it reduced too much of the Company liability for the historic deferred amounts. However, the Commission imposed decisions also to reduce the Company's liability for the historic deferred amounts. On another 2-1 vote, the Commission reduced the amount that the Company was responsible for the historic deferred costs from more than $30 million to $15 million.

D. *Why This Makes a Bad Precedent*

From a customer perspective, the rejected all-party settlement was the best option put before the Commission. It was rejected because the parties agreed to cut the historic

deferred amounts, yet in the end, the Commission cut the historic deferred amounts anyway.

Because of the series of 2-1 votes, here is what we know:

One Commissioner explicitly supported sharing. One Commissioner (a different one) supported earnings bands that were a de facto sharing mechanism. Two Commissioners rejected the earnings band that were a de facto sharing mechanism, because of cuts to the historic deferrals amounts that the Company should pay, under a traditional application of an earnings test. Two Commissioners supported cutting the historic deferrals amounts that the Company should pay, under a traditional application of an earnings test.

The Commission's precedent has been that parties should not cut the amount of the historic deferral allocated to the Company as much as the all-party settlement. Instead, the amount allocated to the Company should be cut significantly – just not as much. In essence, this is a Goldilocks precedent. The all-party stipulation did not allocate enough of the deferral to the Company, but the traditional earnings test allocated too much of the deferral to the Company. In this case, $15 million was just right.

As to the going forward mechanism, the precedent is also not clear. The order rejecting the all-party settlement suggests that its infirmary was its application of the earnings test to the historic deferred amounts. If the parties had somehow managed to get that element just right, and therefore correct that infirmary, the stipulation might have been adopted.

Much of the controversy in UM 1635 related to how the earnings test should be applied to the historic deferral, and clearly that was a struggle for the parties, and for the

Commission. Because a sizable historic deferral does not exist here, the facts are different. Yet, somehow UM 1635 is being seen as the precedent for how to treat these costs. The UM 1635 mechanism is temporary – it comes up for review in 2018. Because it was first unveiled in the Final Order, no party has had a chance to comment on its elements. For example, CUB opposes using the roll-over to increase the amount of earnings that were exempt from the earnings test, rather than pay for costs that would otherwise fall on customers.

But this mechanism will come up for a review again, and this will give parties a chance to reexamine it. Did it act in any manner as a de facto sharing mechanism? Did the Company get better results than it would have achieved in a rate case? If so, how much more generous were the results?

IV. WHY IT IS UNFAIR FOR CUSTOMERS TO PAY 100% OF THESE COSTS

CUB continues to believe that it is unfair for customers to pay 100% of these costs. While CUB recognizes that collectively customers have deep pockets, CUB maintains that costs should be shared either directly through a sharing mechanism, through well-designed earnings tests, or through allocation of other revenues (such as our proposal to use Mist revenues).

A. *Utilities Cannot Prove that the Costs are Associated with Prudent Behavior*

A key reason for our objection is that it will be difficult for utilities to establish that these environmental liabilities were prudently incurred. Oregon has established no standards as to what a utility should demonstrate in order to receive compensation for these liabilities. Should the utility have to show that it was following best practices at the

time, or standard business practices of the day? In this case, PGE did not even feel it needed to show that the properties at issue were used for utility service.[15]

We do not have a standard of prudence related to environmental liability. Nevertheless, traditional utility regulation requires a utility to meet a burden of proof, to demonstrate that it took into consideration prudency. Allocating some costs to the utility would be a way to recognize that the utility's burden is difficult to overcome, when dealing with environmental damage created decades ago.

B. *Intergenerational Equity -- Costs Are Not Related to Current Service*

The environmental damages are often decades old. They were not incurred to meet current service to current customers. In the case of NW Natural, most customers were not alive when the costs were incurred. This creates a true intergenerational equity issue. Current customers are being asked to clean up environmental liability that was incurred to serve our grandparents.

C. *Align Interests*

Finally, cost sharing aligns interests. CUB believes that these cost recovery mechanisms will lead to utilities managing the costs to the mechanism, rather than trying to minimize costs. The mechanisms create a budget. Managing the costs to the annual budget becomes the primary consideration and does not reduce the costs overall.

V. CONCLUSION

In this case, CUB supports the stipulation. There is a potential to offset some of the liability through the creation and sale of DSAYs. This may bring real benefits for customers. In addition, the stipulation requires that PGE utility must show that the

[15] UM 1789/UE 311/UP 344/CUB/100/Jenks/4.

properties were related to utility business, and that the Company acted prudently. Finally, the mechanism will be reviewed regularly.

However, without the DSAY revenues, CUB would have evaluated this mechanism differently, because the underlying mechanism places too much of the burden on customers.

CUB notes that this mechanism and the NW Natural mechanism are short term and will be reevaluated. CUB will endeavor to avoid a circular precedent, such that PGE points to NW Natural's mechanism as precedent, and similarly, when up for review, NW Natural points to PGE's. Instead, CUB will use those reviews to further examine the fairness of these mechanisms, and we advocate for mechanisms that more fairly allocate these costs.