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September 12, 2012

**VIA ELECTRONIC FILING  
& U.S. MAIL**

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

Re: In the Matter of Northwest Natural Gas Company –  
Application for a General Rate Revision  
**Docket No. UG-221**

Dear Filing Center:

Enclosed please find an original and five (5) copies of the Northwest Industrial Gas Users' Initial Post-Hearing Brief.

Thank you for your assistance, and please do not hesitate to contact our office with any questions.

Very truly yours,



Tommy A. Brooks

TAB:sk  
Enclosures

cc: UG 221 Service List

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**BEFORE THE PUBLIC UTILITY COMMISSION**

**OF OREGON**

**UG 221**

In the Matter of )  
NORTHWEST NATURAL GAS ) THE NORTHWEST INDUSTRIAL  
COMPANY ) GAS USERS' INITIAL POST-  
Application for a General Rate Revision ) HEARING BRIEF  
)  
)

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1 Pursuant to ALJ Hardie’s Prehearing Conference Memorandum dated August 15,  
2 2012, the Northwest Industrial Gas Users (“NWIGU”) submit this Initial Post-Hearing  
3 Brief. This Initial Post-Hearing Brief describes NWIGU’s position with respect to the  
4 contested issues that remain in this proceeding.

## 5 I. INTRODUCTION

6 Northwest Natural Gas Company (“NW Natural” or “Company”) initially filed  
7 this general rate case seeking a \$43.7 million increase in base rate charges, along with a  
8 request to recover an estimated \$91 million in additional costs and interest related to the  
9 environmental remediation of several contaminated sites owned, operated or controlled  
10 by NW Natural. At this time, the annual increase in base rate charges the Company is  
11 seeking has been adjusted to \$35.9 million, but the estimate of environmental remediation  
12 costs is unchanged. This requested rate increase comes at a time when the Company has  
13 been consistently overearning in recent years.

14 While the parties have settled many of the issues in this proceeding, the remaining  
15 issues are hotly contested. NW Natural’s position on the remaining issues does not  
16 balance the interests of ratepayers and those of the Company and its owners. Many of  
17 NW Natural’s customers - residential, commercial and industrial alike - are struggling to  
18 make ends meet and to stretch already thin budgets. A utility rate hike in this economic  
19 environment should not be taken lightly. NW Natural should look to its own  
20 opportunities to cut costs to achieve its desired rate of return rather than to simply request  
21 more money from its customers in this economic climate. As described below, NWIGU  
22 believes significant adjustments to NW Natural’s requests are warranted before any rate  
23 increase can satisfy the fair, just and reasonable standard.

24 The parties have settled many of the issues addressed in the Parties’ pre-filed  
25 testimony. NWIGU urges the Commission to approve the two active party settlements  
26

1 presented to the Commission, which NWIGU supports as they are in the public interest  
2 and a fair resolution of those issues.<sup>1</sup>

3 This brief will address the following topics: 1) Cost of Capital; 2) Environmental  
4 Remediation Expenses; 3) Pension Expenses; 4) Deferral and Recovery of State Tax  
5 Expenses; and 5) Prudency issues relating to the Company’s Mid-Willamette Valley  
6 Feeder Project.

## 7 **II. STANDARD OF REVIEW**

8 NW Natural bears the burden of proof in this proceeding. ORS 757.210(1)(a)  
9 expressly provides that “the utility shall bear the burden of showing that the rate or  
10 schedule of rates proposed to be established or increased or changed is fair, just and  
11 reasonable.” The Commission has recognized the application of ORS 757.210 to gas  
12 utilities in a general rate filing.<sup>2</sup> The Commission has also recognized that a gas utility  
13 bears the burden of proof of demonstrating that individual components of a rate are just  
14 and reasonable.<sup>3</sup> To determine whether proposed rates are just and reasonable, the  
15 Commission will look to the record as a whole and make its determination on the  
16 preponderance of the evidence. Thus, a utility may fail to meet its burden of proof if an  
17 opposing party presents compelling evidence refuting the utility’s proposal, or if the  
18 utility fails to present compelling evidence in the first place even if the utility’s evidence  
19 is not opposed.<sup>4</sup>

## 20 **III. CONTESTED ISSUES**

### 21 **A. Cost of Capital**

22 NW Natural has requested a Return on Equity (“ROE”) of 10 percent (down from  
23 its currently authorized 10.2), arguing that the operating environment for local  
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25 <sup>1</sup> See, Partial Stipulation between NW Natural, CUB, NWIGU and Staff, filed July 9, 2012 and Letter from  
Staff regarding UG 221-Settlement in principle filed August 14, 2012.

26 <sup>2</sup> See, e.g., *In re NW Natural Gas Company dba NW Natural*, UM 1406, Order No. 09-067, \*5 (March 1,  
2009).

<sup>3</sup> See, e.g. *In re Avista Corp. dba Avista Utilities*, UF 4253, Order No. 08-577 (Dec. 4, 2008).

<sup>4</sup> *In re Portland General Electric*, UE 228, Order No. 11-432 (Nov. 2, 2011).

1 distribution companies has become more complex and risky in the past 15 years.<sup>5</sup> NW  
2 Natural makes this argument while trying to focus attention away from the fact that it has  
3 had extensive over-earning in particular in the last few years.

4 **1. NW Natural has not met its burden and the Commission**  
5 **should not approve an ROE of 10 percent.**

6 NW Natural has the burden of showing that its proposed ROE of 10 percent is  
7 needed for the company to attract equity investors at reasonable terms in today's capital  
8 markets and to maintain its financial integrity. NW Natural has not met its burden. There  
9 can be no question that the economy continues to struggle and that interest rates are at  
10 historical lows. Ignoring these realities, NW Natural's proposal seeks to force its  
11 customers to pay more so that NW Natural's investors can continue to over-earn  
12 compared to investors of similarly-situated utilities.

13 Supreme Court precedent and prior decisions of this Commission establish that  
14 NW Natural is entitled to an opportunity to earn a return on equity that is sufficient to  
15 maintain its financial integrity and attract capital on reasonable terms.<sup>6</sup> The return should  
16 be comparable to other enterprises of corresponding risk. An essential element of the  
17 regulatory compact is that rates should be set to allow the utility an opportunity to earn a  
18 reasonable return on its shareholders' equity investment. As the Supreme Court  
19 explained in *Duquesne Light Co. v. Barash*,<sup>7</sup> the constitutional standard is that the overall  
20 rates of a utility must provide the company with a reasonable opportunity to attract  
21 capital and earn a fair return in its investments. In *Duquesne Light, Co.*, the Supreme  
22 Court clarified that the focus for constitutional analysis is not on any one decision within  
23 the process of establishing the utility's rates, but rather on whether the final result gives

24 \_\_\_\_\_  
25 <sup>5</sup> NW Natural Prehearing Brief, p 11, lines 12-13.

26 <sup>6</sup> *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia*, 262 U.S. 679,  
690, 43 S.Ct. 675, 67 L.Ed. 1176 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591,  
603, 64 S.Ct. 281, 88 L.Ed. 333 (1944); *In re Portland General Electric Co.*, UE 180, Order No 07-015  
(Jan. 12, 2007).

<sup>7</sup> 488 U.S. 299, 307-08, 109 S.Ct. 609, 102 L.Ed.2d 646 (1989).

1 the company an opportunity to earn a reasonable return.<sup>8</sup> As explained below, Staff's  
2 recommendation meets this standard.

3 NW Natural's ratepayers are not properly protected, however, if the Company is  
4 authorized to earn a return that is higher than necessary to attract capital in today's equity  
5 markets. The Commission should employ its sound judgment and properly balance the  
6 shareholders' interests in being fairly compensated for their investments with the  
7 Commission's duty to protect ratepayers from excessive rates and charges.

8 **2. The Commission should adopt Staff's recommended ROE of**  
9 **9.4 percent.**

10 Staff ultimately recommended an ROE of 9.4 percent. NWIGU agrees with  
11 Staff's position on cost of capital as reflected in Staff's testimony. Specifically, NWIGU  
12 agrees that the Commission should authorize a ROE of 9.4 percent with a capital  
13 structure that is 50 percent debt and 50 percent equity. This proposal is well reasoned and  
14 reflects the current capital markets. Staff appropriately used the Commission's preferred  
15 multistage DCF model to arrive at an ROE of 9.4 percent. Staff's recommendation is  
16 appropriate because its multistage DCF models are based upon realistic and fair estimates  
17 of long term growth rates, whereas Company witness Dr. Hadaway's estimated long-term  
18 growth rates are overstated.

19 Staff also reviewed what other similarly situated utilities with corresponding risk  
20 were earning to arrive at its 9.4 percent ROE recommendation. NW Natural's DCF  
21 model compared itself to several electric utilities, which are by their nature more risky  
22 than a gas only utility that passes on gas costs to ratepayers. Electric utilities may be  
23 used to develop the upper range of an appropriate ROE, but should not be relied upon to  
24 increase the ROE because they are not similarly situated, and face different risks than a  
25 gas only utility.

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26 <sup>8</sup> 488 U.S. at 314.

1 NWIGU urges the Commission to resolve the ROE and capital structure debate in  
2 this proceeding in a context reflective of the current state of the economy and capital  
3 markets and in a manner consistent with historic precedent of the Commission. A just  
4 and reasonable approach to resolve these issues leads to the adoption of Staff's 9.4  
5 percent ROE with a 50/50 capital structure. The cost of money is at an historic low point  
6 and NW Natural's ROE must reflect that reality.

7 **B. Environmental Remediation Expenses**

8 NW Natural has been deferring environmental remediation costs for several years  
9 related to the cost recovery associated with several contaminated sites – sites that NW  
10 Natural or its predecessors<sup>9</sup> owned, operated or controlled. In this proceeding, the  
11 Company is proposing to establish two new rate schedules (“Schedules 183 and 184”) to  
12 recover the deferred costs and going forward expenditures associated with environmental  
13 remediation costs. Proposed Schedule 184 Special Rate Adjustment Gasco Upland  
14 Pumping Station would be specific to the costs incurred by the Company for building and  
15 maintaining a pumping station at the Gasco site. The Company's testimony notes a  
16 capital cost range of \$10 million to \$30 million for this facility. The Company is  
17 proposing to recover all other remediation costs through Schedule 183 Site Remediation  
18 Recovery Mechanism (“SRRM”).

19 The Company has consistently earned above its authorized rate of return for the  
20 past decade. Despite this fact, under Schedules 183 and 184, the Company is seeking  
21 100% recovery of all prudently incurred expenditures applying an equal percent of  
22 margin increase to all customers, subject to any offset by third party insurance  
23 contributions. Under the SRRM, the Company would recover one-fifth of the deferred  
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25  
26

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<sup>9</sup> For ease of reference, this brief will refer to NW Natural and its predecessors collectively as “NW Natural”.



1 balance as of July 15 of each year (the “cutoff date”) through the Schedule 183 rate  
2 charges during the period of November 1 through October 31.<sup>10</sup>

3 The total cleanup cost associated with these sites will be substantial, but at this  
4 point is unknown. As of September 30, 2011, NW Natural had deferred approximately  
5 \$64 million in environmental costs, and NW Natural makes a low-end estimate of future  
6 environmental remediation costs of \$58 million.<sup>11</sup>

7 ORS 757.210 is the starting point for all proposed utility rate increases and  
8 requires that utility rates be “fair, just and reasonable.” That statute expressly places the  
9 burden of proof on the utility to demonstrate that its proposed rates are fair, just and  
10 reasonable. NW Natural has not met that burden. Based on the record in this proceeding,  
11 the Company’s proposal is unreasonable and unfair to customers because it attempts to  
12 force today’s ratepayers to indemnify NW Natural from any liability associated with  
13 these sites.

14 **1. NW Natural’s proposal inappropriately shifts the entire**  
15 **burden of historical environmental contamination to present-**  
16 **day customers.**

17 Based on the record in this proceeding, the Company’s proposal is unreasonable  
18 and unfair to customers because it attempts to force today’s ratepayers to indemnify NW  
19 Natural from any liability associated with these sites. First, the Company’s proposal does  
20 not account for the fact that the historic operations associated with the contamination and  
21 the present-day remediation of those sites are in no way related to the service of today’s  
22 customers. It is undisputed that the contaminated sites all ceased operating and were  
23 dismantled decades ago. The manufactured gas plant (“MGP”) in downtown Portland,  
24 for example, ceased operation in 1913 and was subsequently demolished.<sup>12</sup> Similarly,  
25 NW Natural ceased producing gas at the MGP site in Linnton in 1956 and began

26 <sup>10</sup> For the first year of proposed operation, the Company has proposed a cutoff date of September 30, 2012 instead of July 15, 2012.

<sup>11</sup> See NWN/1500, Miller/2 lines 13-16; NWN/1500, Miller/2 line 17 through Miller/3 line 1.

<sup>12</sup> NWN/1600, Middleton/21 line 23.

1 demolition of that facility in the 1960's.<sup>13</sup> Despite the fact that those sites have been  
2 redeveloped or lie vacant, NW Natural submitted testimony stating that “a nexus with  
3 [the MGP sites and] utility operations is indisputable.”<sup>14</sup> However, NW Natural fails to  
4 back up that bare assertion with even a single description of the role the redeveloped and  
5 vacant sites play within the utility’s general operations – much less how they are  
6 specifically used for providing service to customers today. The Company’s mere  
7 ownership of those sites is not enough to demonstrate that those sites are related to  
8 providing utility services.

9           Second, NW Natural’s investors reaped the benefits and took on the risks of  
10 the utility’s historical operations. For years, NW Natural and its investors received the  
11 upside of that risk because the Company incurred no remediation costs for the  
12 contamination it caused. Now that there is a significant and quantifiable liability for the  
13 years of contamination caused by NW Natural, the Company proposes that its  
14 shareholders be isolated from any of these costs by shifting the entire burden to  
15 ratepayers. The proposal is therefore unfair because it seeks to protect the Company’s  
16 shareholders to the detriment of its customers.

17           NW Natural counters this argument by stating that the Company “applied the  
18 proceeds from byproduct sales to reduce the costs of gas to customers, rather than to add  
19 to its profits.”<sup>15</sup> This statement may be true for some of the Company’s MGP activities,  
20 but the remainder of the Company’s testimony clearly indicates that it has no record of  
21 the disposition of much of the MGP byproducts from its facilities. With respect to coal  
22 gas, for example, “company records of the disposition of residuals have not been  
23 found.”<sup>16</sup> The same goes for carbureted water gas<sup>17</sup> and some oil gas.<sup>18</sup> Because of the  
24

25 <sup>13</sup> NWN/1600, Middleton/23 lines 10-13.

<sup>14</sup> NWN/2600, Miller/12 line 6.

<sup>15</sup> NWN/2600, Miller/11 lines 7-9.

<sup>16</sup> NWN/1600, Middleton/32 line 12.

<sup>17</sup> NWN/1600, Middleton/33 line 4.

<sup>18</sup> NWN/1600, Middleton/ 33 line 13.

1 lack of records, the Company can only state what the “likely” disposition of those  
2 byproducts was. There simply is not enough evidence in the record for the Commission  
3 to take at face value the Company’s assertion that NW Natural’s investors did not profit  
4 at all from its historical MGP operations.

5 **2. NW Natural’s proposal provides no incentive for cost control**  
6 **and ignores the Company’s potential for overearning.**

7 NW Natural’s proposal gives it no incentive to control costs. At its core, NW  
8 Natural is asking for a blank check that will be included in customers’ rates for the  
9 foreseeable future. Although federal and state agencies will ultimately control the  
10 outcome of the environmental clean-up process, NW Natural’s ability to work within that  
11 process is solely within its own control. The same holds true for the Company’s efforts  
12 to recover insurance proceeds. If the Company will be able to recover every single dollar  
13 of its environmental remediation costs, there is simply no incentive for the Company to  
14 keep those costs to their lowest possible level. The Company, through Mr. Miller,  
15 counters that it needs no incentive to keep costs low because all of its actions are always  
16 subject to review by the Commission.<sup>19</sup> That statement, however, is undercut by Mr.  
17 Miller’s other testimony in which he objects to cost sharing because, he says, sharing  
18 would be a *disincentive* for the Company to act prudently.<sup>20</sup> Specifically, that portion of  
19 Mr. Miller’s testimony states that “[r]ather than providing an incentive for prudent  
20 management of its cleanup obligations, sharing more likely incents a utility to avoid or  
21 delay its remediation obligations.”<sup>21</sup> That statement cannot be true, of course, if Mr.  
22 Miller’s later statement is true that the Company will always be guided by Commission  
23 oversight to act prudently. That statement also lacks any logic because, if the Company  
24 is required to share environmental remediation costs with customers, it will want to keep

25  
26 <sup>19</sup> NWN/2600, Miller/12 line10.

<sup>20</sup> NWN/2600, Miller/9 lines 20-23.

<sup>21</sup> Id.

1 its portion of those costs as low as possible, which means it will want to keep the overall  
2 costs as low as possible, too.

3 NW Natural is also inappropriately seeking to have the environmental  
4 remediation tracker excluded from any earnings review. With respect to the costs  
5 already incurred by the Company, those amounts have been deferred and, as a matter of  
6 law, their eventual recovery is subject to an earnings test pursuant to ORS 757.259(5).  
7 With respect to amounts incurred in the future, NWIGU notes that the Company has been  
8 consistently earning over its authorized rate of return.<sup>22</sup> In light of the tenuousness with  
9 which those costs are related to serving today's customers, as a matter of policy the  
10 Commission should require the Company to contribute to those costs during those times  
11 that it is able to earn more than its authorized rate of return. Any other result is  
12 inequitable.

13 **3. The Commission should require the Company to share**  
14 **environmental remediation costs with its customers and allow**  
15 **the Company to earn only a debt rate of return on the deferred**  
16 **costs.**

17 It is NWIGU and CUB's recommendation that the Commission allow the  
18 Company to recover only fifty percent of environmental remediation costs from  
19 ratepayers.<sup>23</sup> This even split will help militate against the fact that today's customers did  
20 not cause the contamination or benefit from the historic operations associated with the  
21 contamination, will recognize that the remediation activities are not related to providing  
22 service to current customers, will provide an incentive to the Company to aggressively  
23 recover insurance proceeds, and will account for the fact that the Company's earnings  
24 have been reasonable even in light of these increasing costs.

25 Further, as described by NWIGU's and CUB's witness Mr. Larkin, the Company  
26 should only earn a debt rate of return on the balance reflected in the Deferred

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<sup>22</sup> NWIGU-CUB/200, Larkin 11 Table 1.

<sup>23</sup> NWIGU-CUB/100, Larkin/52 line 23.

1 Environmental Cost Account.<sup>24</sup> The appropriate rate of return should reflect the level of  
2 risk facing the company. Once the Commission has issued an order stating what amount  
3 NW Natural would recover as a reimbursement for environmental remediation costs, that  
4 amount would be a guaranteed recovery amount. Because there is no risk associated with  
5 the customer share of the environmental remediation costs, allowing the Company to earn  
6 its ROE on these amounts would be inappropriate and punitive to customers. The  
7 Commission's order would guarantee the return of the environmental remediation costs  
8 and therefore only a debt return should be recovered by the Company, because no risk  
9 would be involved in the recovery of the authorized amount.

10 **4. The Commission should not allow the Company to collect any**  
11 **environmental remediation costs from Schedule 31 and**  
12 **Schedule 32 customers until the rates in those schedules**  
13 **achieve parity with the rates for other schedules.**

13 In any final order on Schedules 183 and 184, the Commission should also address  
14 its rate spread impact and acknowledge the significant rate disparities that have existed  
15 not only for many years in NW Natural's rates, but are now severely imbalanced as  
16 evidenced in the record before the Commission in this proceeding. In particular, the  
17 Commission's decision should recognize that the proposed Schedules 183 and 184  
18 *inappropriately* assign cost responsibility to Schedule 31 and Schedule 32 customers  
19 who, according to the Company's own LRIC analysis, are already paying excessive  
20 margin charges.<sup>25</sup>

21 The revenue-to-cost ratio is a critical metric for determining an appropriate rate  
22 spread. A revenue-to-cost ratio that is greater than 100% indicates a class is paying  
23 revenues in excess of the cost of providing service to that class. Similarly, a ratio less  
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25  
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<sup>24</sup> NWIGU-CUB/100, Larkin/52 lines 24-25.

<sup>25</sup> NWIGU/100, Schoenbeck/15 lines 1-2.

1 than 100% indicates a class is not providing adequate revenue to cover its allocated costs.

2 The revenue-to-cost ratio of present rates is depicted in the following table:<sup>26</sup>

3 <b>Rate Schedule</b>	<b>Revenue to Cost Ratio of Present Rates</b>
4 1	49%
5	
6 2	85%
7	
8 3	118%
9	
10 31	223%
11	
12 32	469%

13

14 As is demonstrated by the rate schedule revenue-to-cost ratios, it is completely  
15 appropriate to exclude the environmental costs from being recovered through Schedule  
16 31 and Schedule 32 at this time. *Indeed, certain Schedule 31 and Schedule 32 customers*  
17 *are already paying \$24 million in excess of their cost responsibility each and every*  
18 *year.*<sup>27</sup> The Company's equal percent of margin approach would assign these same  
19 customers almost \$1 million per year more under Schedules 183 and 184 assuming a  
20 recovery of \$15 million per year.<sup>28</sup> To address the significant rate disparity that exists  
21 today, the Schedules 183 and 184 charges should not be applied to Schedule 31 and  
22 Schedule 32 customers. By not applying the new charges to these customers, the  
23 Commission will ensure that the existing rate disparities are not exacerbated by the  
24 outcome in this proceeding.

25

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26 <sup>26</sup> NWIGU/100, Schoenbeck

<sup>27</sup> Id. line 3.

<sup>28</sup> Id. line 9.

1 In the Company's next rate case after this proceeding, if the Company is still  
2 collecting Schedules 183 and 184 costs, the Commission can and should reassess the  
3 appropriate Schedules 183 and 184 rate spread in light of the relative costs of service at  
4 that time, but it is more than evident that Schedule 31 and Schedule 32 customers are  
5 already paying double and quadruple the amount in their rates than their respective costs  
6 of service. NWIGU does not otherwise object to an equal margin approach for all other  
7 schedules provided that Schedule 31 and Schedule 32 customers subject to these extreme  
8 disparities are excluded at this time.

9 The Company apparently does not disagree with NWIGU's rate spread proposal  
10 for any approved environmental remediation cost recovery. CUB, however, does  
11 disagree with that proposal.<sup>29</sup> Specifically, CUB argues that there is no fair way to  
12 distribute historic costs to current customers consistent with principles of cost-causality.  
13 CUB's argument is a red-herring. CUB does not dispute the significant rate disparities  
14 that exists between today's customers. It is undisputed that industrial customers have  
15 subsidized the rates of residential and commercial customers for many years. While  
16 CUB's statement that the environmental remediation costs are not related to serving  
17 today's customers is technically true – the only customers that are available to pay these  
18 costs are current and future customers. If Schedules 183 and 184 costs become part of  
19 the overall rate structure, and that rate structure unfairly burdens Schedule 31 and  
20 Schedule 32 customers by requiring those customers to subsidize other customer classes  
21 even further to the tune of another \$ 1 million every year, the rate structure is rendered  
22 even more inequitable and not fair, just and reasonable. By approving NWIGU's  
23 proposal, the Commission can reduce the long standing subsidies and move toward  
24 realigning the rate disparities that exist between customer classes. It is inequitable to  
25 allow such disparities to continue year after year.

26  

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<sup>29</sup> CUB's Prehearing Brief at p.36.

1           **C.      Pension Expenses**

2           NW Natural proposes to add unrecovered pension plan contributions from  
3 investors to rate base. The Company seeks to add nearly \$22 million to rate base in part  
4 to recover contributions made to pension funds *prior* to the test year. This proposed  
5 recovery of such contributions is improper and constitutes retroactive ratemaking.

6           NW Natural’s traditional approach to recovering pension expenses has been  
7 through the Financial Accounting Standard 87 (“FAS 87”) accounting methodology.<sup>30</sup>  
8 Using that methodology, the Company determines pension liabilities and expenses based  
9 on assumptions regarding employee compensation, retirement ages, and life expectancies,  
10 as well as assumptions regarding long-term interest rates and market performance.<sup>31</sup>  
11 Differences between actual and estimated results are not immediately recognized and,  
12 instead, are amortized over an extended period of time.<sup>32</sup> Because of changes in federal  
13 law that require the Company to actually ensure that its pension plan is fully funded<sup>33</sup> and  
14 poor market conditions that decreased the value of the Company’s pension plan assets,<sup>34</sup>  
15 the Company made several larger contributions to fund its pension plan from 2009  
16 through 2011.

17           Pursuant to ORS 757.259(1)(a)(B), the only prior expenses a utility may recover  
18 are those the Commission has allowed the utility to defer. It is undisputed that these  
19 contributions included payments in 2009 and 2010 prior to the test year.<sup>35</sup> It is also  
20 undisputed that the Commission has not authorized the Company to defer any pension  
21 expenses beyond the Company’s FAS 87 expenses. The Commission, therefore, should  
22 not allow NW Natural to recover the 2009 and 2010 expenses because to do so would  
23 constitute retroactive ratemaking.

24 \_\_\_\_\_  
25 <sup>30</sup> NWN/400, Feltz/21 line 14.

26 <sup>31</sup> NWN/400, Feltz/22 lines 4-15.

<sup>32</sup> Id.

<sup>33</sup> NWN/400, Feltz/23 line 7.

<sup>34</sup> NWN/400, Feltz/23 line 17.

<sup>35</sup> NWN/400, Feltz/24 lines 2-4.



1 The Company asserts that the recovery of these prior pension expenses is not  
2 retroactive ratemaking because the Company believes these expenses would not qualify  
3 for deferral.<sup>36</sup> This assertion, however, contradicts the live testimony of NW Natural  
4 witness Mr. Feltz who stated “yes, it’s true that we could have – we had the ability to go  
5 file for a deferral order.”<sup>37</sup>

6 The Company also asserts that the prior pension expenses are not “accounting  
7 expenses” but rather should be viewed as “pre-paid costs – investments that are financed  
8 by the Company like any long-term asset.”<sup>38</sup> The Company provides no explanation for  
9 why the expenses it incurs through the FAS 87 process are any different than the  
10 contributions it made in excess of its FAS 87 expenses. Both expenses are used to pay  
11 current benefits or are invested to satisfy future benefits.<sup>39</sup> The Company could have  
12 chosen to treat its pension plan contributions in the same manner as its FAS 87 expenses  
13 – by amortizing those costs over an extended period of time. It simply chose not to do so.

14 The Commission should reject the Company’s attempt to treat the prior pension  
15 costs as rate base items similar to pipes and storage facilities. Unlike pipes and storage  
16 facilities, the prior pension payments do not create any tangible asset. When faced with  
17 that fact, Company witness Mr. Feltz flatly acknowledges that the Company’s attempted  
18 analogy comparing pension payments to plant is a flawed one.<sup>40</sup>

19 Mr. Feltz attempts to minimize the Company’s failed analogy by noting that the  
20 Commission may have allowed another utility to include the pre-payment of insurance  
21 premiums (also an intangible asset) in rate base. The comparison of pension payments to  
22 insurance premiums, however, is also flawed. It is common that a utility will not know  
23 the exact cost of an insurance premium until the payment is actually due for a specific  
24 policy. At some point in time, however, that payment becomes fixed and a prepayment

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25 <sup>36</sup> NWN Prehearing Brief [cite]

26 <sup>37</sup> TR Feltz 15:12.

<sup>38</sup> NWN Prehearing Brief at 37:15-17; NWN/2000, Feltz/27 lines 15-20.

<sup>39</sup> See, e.g., NWN/400, Feltz 22 line 17.

<sup>40</sup> NWN/3100, Feltz/15 lines 8-9.

1 will apply to a very specific period of time that the policy covers. Unlike insurance  
2 premiums, the funding of a pension plan appears to be a moving target and the Company  
3 has to constantly alter its contributions in response to workforce and market conditions.  
4 There simply is no specific period to which pension “prepayments” apply and, therefore,  
5 such expenses are not in the same category as other prepayments that may be appropriate  
6 to include in rate base.

7 NW Natural’s proposal to recover pension expenses seeks to shift the risks  
8 associated with pension funds to customers. The evidence in the record demonstrates that  
9 NW Natural’s proposal is unlawful because it seeks to obtain recovery for deferred  
10 expenses that the Commission never authorized the Company to defer. The Commission,  
11 therefore, should reject NW Natural’s proposed recovery of those expenses.

12 **D. Deferral and Recovery of State Deferred Income Taxes**

13 The Company’s filing includes a reduction to miscellaneous revenues relating to  
14 an incremental change in state tax rates in 2009. The record reflects that this reduction in  
15 revenue is improper.

16 **1. The Commission never authorized the Company to adjust its**  
17 **deferred taxes.**

18 The revenue reduction exists in the form of a regulatory asset the Company  
19 initially created on its own in 2009.<sup>41</sup> The regulatory asset relates to an adjusted deferred  
20 tax balance.<sup>42</sup> The Company candidly acknowledges that it did not seek a deferral order  
21 from the Commission for this deferred tax balance.<sup>43</sup> On that basis alone, the  
22 Commission should reject the Company’s proposal.

23 ORS 757.259 sets forth the amounts, if any, that a utility may recover on a  
24 deferred basis. More specifically, ORS 757.259(2) states that the Commission “by order”  
25

26 <sup>41</sup> NWN/1900, Siores/24 lines 2-4.

<sup>42</sup> NWN/300, McVay-Siores/8 lines 8-10.

<sup>43</sup> NWN/3000, Siores/16 lines 7-12.

1 may authorize the deferral of certain amounts upon “application by a utility or ratepayer  
2 or upon the commission’s own motion.” The statutes provide no other basis for creating  
3 a deferral mechanism. Because neither the Company nor any ratepayer applied to the  
4 Commission for a deferral order, and because the Commission never issued an order  
5 authorizing the deferral, there is simply no legal basis for the Company to now seek  
6 recovery of the amounts deferred.

7                   **2. The proposed revenue deduction is improper because it**  
8                   **constitutes retroactive ratemaking.**

9           The Commission cannot approve the recovery of the deferred amount because to  
10 do so would constitute retroactive ratemaking. The Company attempts to counter this  
11 aspect of its proposal by describing the deferred tax balance as pertaining to future  
12 expectations of taxes due and, therefore, as future rather than past activities.<sup>44</sup> However,  
13 the Company’s own testimony is inconsistent on that aspect of the deferred amount. For  
14 example, the Company flatly states that “[t]he adjustment reflects a five-year  
15 amortization of this **increased cost the Company has already recorded on its books.**”<sup>45</sup>  
16 In other words, the event for which the Company is seeking recovery occurred prior to  
17 the test year, including adjustments to deferred taxes in 2007 and 2008.<sup>46</sup> Moreover, it is  
18 disingenuous for the Company to assert that the real activity here is a future tax payment  
19 in light of the fact that it is unlikely the Company will ever make tax payments based on  
20 the deferred amounts.<sup>47</sup>

21                   **3. The proposed revenue deduction is improper because it**  
22                   **constitutes single issue ratemaking.**

23           The Commission cannot approve the recovery of the deferred amount because to  
24 do so would constitute single issue ratemaking. As noted above, the deferred amount

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26 <sup>44</sup> NWN/300, McVay-Siores/14 lines 6-10.

<sup>45</sup> Id. lines 10-11 (emphasis added).

<sup>46</sup> NWIGU-CUB/100, Larkin 29 lines 6-9.

<sup>47</sup> NWIGU-CUB/200, Larkin/5 line 17 to Larkin/6 line 12.

1 exists as a regulatory asset the Company created outside of the test year. The Company  
2 now seeks special cost recovery for this item.<sup>48</sup> It is true that the Company is making its  
3 request as part of a general rate proceeding, but that fact does not destroy the single issue  
4 nature of the Company's request. The Company's proposal isolates the effect of one  
5 component of the Company's corporate taxes from a prior period<sup>49</sup> instead of looking at  
6 all of the revenues and expenses associated with the test year.<sup>50</sup> It is that facet of the  
7 Company's proposal that makes it single issue ratemaking and, therefore, serves as the  
8 basis for the Commission to reject the proposal.<sup>51</sup>

9 Based on the evidence in the record, the Commission should disallow the  
10 Company's proposed \$895,966 reduction to miscellaneous revenue because that  
11 reduction is not authorized by law and would constitute both retroactive and single issue  
12 ratemaking.

13 **E. Prudency Issues Relating to the Mid-Willamette Valley Feeder**  
14 **Project**

15 NW Natural's Mid-Willamette Valley Feeder ("MWVF") project is composed of  
16 four components: 1) Perrydale to Monmouth; 2) Monmouth Reinforcement; 3)  
17 Willamette Crossing; and 4) South of Perrydale Bare Replacement. Although the  
18 settlement process addressed some of the ratemaking treatment related to this project,  
19 NWIGU disagrees with the Company with respect to the prudence of the Perrydale to  
20 Monmouth and Monmouth Reinforcement components.

21 It is undisputed that NW Natural did not conduct a financial analysis of the  
22 investment for these two components of the MWVF project.<sup>52</sup> Much of the information  
23 NW Natural provided with respect to its decision to pursue the MWVF project is

24 \_\_\_\_\_  
25 <sup>48</sup> WNIGU-CUB/100, Larkin/28 line 20.

26 <sup>49</sup> NWIGU-CUB/200, Larkin/8 lines 3-5.

<sup>50</sup> NWIGU-CUB/200, Larkin/7 lines 17-21.

<sup>51</sup> See *In re Portland General Electric*, UE 88, Order No. 04-597 (Oct. 18, 2004) (noting that a proper review of rates must consider all factors, not an isolated rate component).

<sup>52</sup> NWIGU-CUB/100, Larkin/10 lines 4-9.

1 qualitative in nature.<sup>53</sup> As Staff witness Sobhy pointed out, the Company’s modified  
2 Integrated Resources Plan contemplates the need to perform financial analyses to ensure  
3 that future distribution system investments are prudent.<sup>54</sup> Without such financial  
4 analyses, the Commission cannot approve the recovery of any costs related to these  
5 project components, because there is no basis for determining the prudence of the  
6 project.<sup>55</sup>

#### 7 **IV. CONCLUSION**

8 In summary, NWIGU respectfully requests that the Commission:

- 9 1. Set NW Natural’s ROE at 9.4 percent with a capital structure that is 50 percent  
10 equity and 50 percent debt as reflective of the capital markets and Commission  
11 precedent;
- 12 2. Reject NW Natural’s proposal on Schedules 183 and 184, and instead allow the  
13 Company to recover 50 percent of environmental remediation costs from ratepayers,  
14 subject to an earnings review;
- 15 3. Allow the Company to earn a debt rate of return on the balance reflected in the  
16 Deferred Environmental Cost Account rather than its ROE;
- 17 4. Reject NW Natural’s equal percent of margin approach on Schedules 183 and  
18 184, and instead exclude Schedule 31 and Schedule 32 customers from any such charges  
19 to address the extreme rate disparities of these schedules relative to other customers;
- 20 5. Reject NW Natural’s proposal to add nearly \$22 million to rate base associated  
21 with contributions made to pension funds prior to the test year;
- 22 6. Reject NW Natural’s proposal to amortize a regulatory asset on state taxes made  
23 prior to the test year;

24  
25  
26 <sup>53</sup> Staff/1100, Sobhy/15 lines 21-23.

<sup>54</sup> Staff/1100, Sobhy/16 lines 2-5.

<sup>55</sup> In addition to the points made here, NWIGU adopts the reasoning in Staff’s testimony and Staff’s Prehearing Brief demonstrating that the Company has proven the prudence of these project components.

1 7. Reject NW Natural's attempt to recover prematurely built segments of the  
2 MWVF project until NW Natural has met its burden to show that these projects are  
3 justified and prudent; and

4 8. Approve the global settlement agreements negotiated in this docket.

5  
6 Dated this 12th day of September 2012.

7 Respectfully submitted,

8 /s/Chad Stokes

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**CERTIFICATE OF SERVICE**

I hereby certify that I caused to be served the foregoing *NWIGU'S INITIAL POST-HEARING BRIEF* via electronic mail and, where paper service is not waived, via postage-paid first class mail upon the following parties of record:

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