

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1635 Phase II

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

**PRE-HEARING BRIEF
OF THE
CITIZENS' UTILITY BOARD OF OREGON**

July 2, 2014



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1 I. Introduction

2 The Citizens' Utility Board of Oregon ("CUB"), pursuant to ALJ Pines' Ruling of
3 February 6, 2014, herewith submits its Pre-hearing Brief in this matter. CUB views Pre-hearing
4 Briefs as providing an opportunity for the parties to identify and frame the unsettled issues -
5 discussed and responded to in testimony - that may be raised in cross-examination, in oral
6 argument, or in post-hearing briefs.

7 The costs at issue in this docket are associated with the production of gas decades ago when
8 gas was manufactured from coal and petroleum. These are not costs associated with the provision of
9 current service. Therefore, Northwest Natural's ("Company" or "NWN") current Oregon customers
10 should not be required to shoulder the burden of paying the environmental remediation costs alone.
11 CUB believes that a fair allocation of these costs would require the Company, Oregon customers and

1 Washington customers to share jointly in the burden of shouldering these environmental remediation
2 costs.¹

3 **II. THE EXTENDED PROCEDURAL HISTORY**

4 In NWN's last rate case – UG 221 – the Company proposed that the Public Utility
5 Commission of Oregon (“Commission”) adopt a mechanism for the recovery of its costs to
6 remediate environmental impacts associated with its historic manufactured gas plants (“MGP”).
7 Specifically, the Company asked for approval of a Site Remediation Recovery Mechanism
8 (“SRRM”) through which past deferred and future costs would be tracked and included in rates
9 over a five year amortization period, through the Purchased Gas Adjustment (“PGA”) process.
10 However, the Company requested a different treatment for the capital costs associated with the
11 construction of the Gasco Source Control equipment that the Company was required to install on
12 the site of its old Gasco plant by the Department of Environmental Quality. Specifically, the
13 Company proposed that once the Gasco Source Control Project was complete, the project costs
14 should be treated as an addition to rate base, to allow amortization over a longer period of time,
15 matching more closely the expected life of the facilities.

16 In its Order No. 12-437 in UG 221 entered on November 16, 2012, the Commission
17 found that the request for Gasco recovery was premature, but observed that when the plant was
18 completed that the Company might seek cost recovery through the SRRM (discussed below) or
19 through inclusion of the plant in rate base in a future rate proceeding.² However, on November
20 16, 2012, the Commission also adopted the SRRM mechanism for recovery of the Company's
21 environmental remediation deferrals. The Commission found that “[a]n earnings test with a
22 deadband will be applied” to the SRRM recoveries, but left the determination of the appropriate

¹ UM 1635 CUB/200/Jenks/1 lines 9-11 and 2 lines 1-2; UM 1635 CUB/200/Jenks/11 lines 1-17.

² UG 263 Joint Brief in Support of Stipulation/1-2; UG 221 Order 12-437 at 32.

1 deadband and application of the earnings test to a new proceeding (UM 1635 – Phase I of the
2 current proceeding). The Commission also ordered that a prudence review of the expenses NW
3 Natural deferred would take place in the new proceeding.³

4 The majority of Commissioners believe that use of an earnings test (with
5 deadband) coupled with the Commission’s ongoing prudence review will provide
6 an effective incentive for the company to manage its costs. Further, the majority
7 adopts an earnings test but no sharing mechanism. An earnings test may operate
8 as a *de facto* sharing mechanism in some years, but it is not the intent of the
9 majority to impose an explicit sharing mechanism.⁴

10
11 In Phase I of this UM 1635 docket, ALJ Hardie issued a Notice of Prehearing Conference
12 and Memorandum on December 10, 2012 that outlined the issues to be addressed as follows: (1)
13 the prudence of NW Natural's environmental remediation costs; (2) the appropriate deadband to
14 be applied to recovery of environmental remediation costs; (3) the appropriate application of the
15 earnings test ordered in Docket UG 221; and (4) the appropriate rate spread to apply to
16 recoverable costs. On April 10, 2013 the Parties filed a stipulation resolving all issues related to
17 rate spread of any amount included in the SRRM that the Commission approves for rate
18 recovery. Staff, CUB, and the Northwest Industrial Gas Users (“NWIGU”) filed rebuttal
19 testimony on the remaining issues in this docket on May 3, 2013. NW Natural filed reply
20 testimony on May 28, 2013. On April 10, May 10, and May 31, 2013 the parties to this docket
21 convened settlement conferences. As a result of those settlement conferences, the Parties
22 reached a settlement resolving all remaining issues in the docket, including: (1) the issue of the
23 prudence of NW Natural's environmental remediation costs deferred to date; (2) the appropriate
24 earnings test and appropriate deadband to be applied to recovery of environmental remediation
25 costs through the Company’s SRRM; (3) the appropriate rate treatment for the costs of the Gasco

³ *In re NW Natural Gas Company*, OPUC Docket No. UG 221, Order No. 12-437, 31-32 (Nov. 16, 2012).
⁴ *Id.* at 32.

1 Pumping Station; and (4) the appropriate state allocation factor to be applied to environmental
2 remediation costs.⁵ That Stipulation was filed on July 11, 2013.

3 On September 6, 2013, NWN filed testimony addressing the prudence of the capital costs
4 associated with constructing a water treatment plant at the Gasco site, with the intent that the
5 costs of the project be recovered in rates through the upcoming PGA. Because the Commission
6 had not yet ruled on the two previously filed stipulations, all the parties to the docket agreed that
7 NWN should file an advice filing asking for the costs to be put in rates on November 1, 2013
8 subject to refund and that a new docket be opened to determine the prudence of the Gasco costs.
9 Then on September 17, 2013, the Commission issued bench requests in UM 1635 asking the
10 parties to model how their proposed mechanism would work in actuality. The parties responded
11 jointly to these UM 1635 Bench Requests.⁶ On October 28, 2013 in the UG 263 docket, the
12 Commission adopted the Staff's recommendation to allow the Gasco costs into rates subject to
13 refund and agreed to open a separate docket to consider the prudence of those costs.⁷

14 On November 18, 2013, the Commission ruled on the two pending Stipulations in UM
15 1635. The Commission rejected both Stipulations, said the docket was too complicated to settle
16 by stipulation and ordered further process. The only guidance initially given by the Commission
17 was that the majority felt the \$7.0 million disallowance of past amounts agreed to by the
18 Company was too low.⁸ Then on December 5, 2013, ALJ Pines issued a memorandum which
19 laid out the issues that the Commission thought the parties should address in Phase II of this UM
20 1635 docket. Those issues are:

⁵⁵ UM 1635 - Prudence and Earnings Test Stipulation at 3.

⁶ Bench Request, September 17, 2013; September 20, 2013 Response to Bench Requests and October 7, 2013 Revised Response to Bench Requests.

⁷ *In re NW Natural*, OPUC Docket No. UG 263, Order No. 13-393 (Oct. 29, 2013).

⁸⁸ *In re NW Natural*, OPUC Docket No. UM 1635, Order No. 13-424,7 (Nov. 18, 2013).

1 Expenditures before December 31,2012 (Past Expenditures)

2 In Phase II, parties will be directed to address the following issues and cite to

3 Commission and any other applicable authority:

- 4 • What policy considerations should guide the Commission's adoption of an
- 5 earnings test mechanism for past expenditures?
- 6 • Should the mechanism consider past earnings and expenditures on an annual or
- 7 aggregate basis? Why or why not?
- 8 • Should revenue gains or losses from the WACOG incentive sharing mechanism
- 9 be included in earning for purposes of conducting the earnings test? Why or why
- 10 not?
- 11 • Should the mechanism include a deadband? Why or why not? If the mechanism
- 12 should include a deadband, what should be the range of the deadband? Why?
- 13 • How should the Commission determine what constitute reasonable earnings for
- 14 the utility's historical period? Should the Commission allow recovery of
- 15 environmental remediation expenses to bring earnings up to the bottom of the
- 16 deadband range, to the authorized return on equity, or to the top of the deadband
- 17 range? Why?
- 18 • How should the mechanism address insurance proceeds?

19 Forward-Looking Mechanism (expenditures after December 31, 2012)

20 In Phase II, parties will be directed to address the following issues and cite to Commission

21 and any other applicable authority:

- 22 • Should the Commission provide an incentive for NW Natural to minimize environmental
- 23 remediation costs and pursue insurance remedies? Why or why not? If we should provide
- 24 such an incentive, how should we provide it? Why?
- 25 • What policy considerations should guide the Commission's adoption of an earnings test
- 26 mechanism for expenditures after December 31, 20 12? Why?
- 27 • How should the Commission address such issues as the inclusion or not of WACOG
- 28 earnings in earnings calculations, average versus aggregate earnings tests, treatment of
- 29 insurance proceeds, earnings deadbands, and all other factors relevant to the design of the
- 30 earnings test? Why?

31 Inclusion in Rates

32 In Phase II, parties will be directed to address the following issues and cite to

33 Commission and any other applicable authority:

- 1 • Should the Commission continue to defer all environmental remediation
2 expenses, or place a certain amount in rates each year on a forward-looking basis
3 without subjecting that amount to deferral? Why?
- 4 • If the Commission should place a certain amount of expenses in rates each year
5 without subjecting that amount to deferral, what should the amount be or what
6 process should the Commission use to determine that amount?

7 Meanwhile, in February 2014 the parties settled the Gasco site issues. The parties agreed
8 first that the capital costs presented by the Company in its September 6, 2013 testimony of
9 \$19,048,300 were prudently incurred, and that these costs which were placed into rates on
10 November 1, 2013 should no longer be subject to refund and interest pursuant to ORS 757.215.
11 Second, that \$2.5 million in insurance proceeds should be applied to the Gasco costs included in
12 rates (approximately 10% of the forecasted insurance proceeds received by NWN for
13 environmental remediation in 2013) and third, that the \$2.5 million in insurance proceeds should
14 be subject to interest at the Commission established ROR and that the insurance proceeds plus
15 interest would then be applied to offset Gasco costs included in rates with the subsequent PGA
16 filings.⁹

17 **III. THE UNSETTLED ISSUES**

18 CUB recognizes that in the UM 1635 Memorandum issued on December 5, 2013, by ALJ
19 Shani Pines, parties were advised that the Commission had “no concerns with the parties’
20 settlement” on the issues of prudence, rate spread and jurisdictional allocation. However, the
21 UM 1635 Stipulations entered into by the parties were integrated documents, negotiated
22 compromise settlements with many moving parts. While CUB may ultimately choose to stick
23 with portions of the original settlement, for now, due to the rejection of both UM 1635
24 Stipulations by the Commission, it is CUB’s position that all issues in the UM 1635 docket

⁹⁹ UG 263 Gasco Stipulation/4 lines 10-22.

1 remain unsettled. CUB has attempted in its testimony, and in summary in this brief, to address
2 all of the issues listed by the ALJ in her December 5, 2013 memorandum.

3 The issues that this brief will specifically focus on are as follows:

4 Principles That Should Be Considered In This Docket

- 5 i. What NWN is Asking For is Not Normal Ratemaking
- 6 ii. Monopoly Regulation is a Substitute for the Competitive Market
- 7 iii. Customers Pockets Must Not Be Abused
- 8 iv. Deferrals and Automatic Adjustment Clauses are One-sided
- 9 v. Earnings Tests Are Critical to Maintain Balance When Using Deferrals and Automatic
10 Adjustment Clauses
- 11 vi. Earnings Tests Should Include All Earnings
- 12 vii. Intergenerational Equity
- 13 viii. Customers Should Benefit from the Insurance They Paid For

14 Positions With Regard To The Unsettled Issues

- 15 A. The issue of the prudence of NWN's environmental remediation costs deferred through
16 December 31, 2012.
- 17 B. Whether the Gasco rate spread should be applied to the remaining environmental
18 remediation costs in this docket.
- 19 C. If Gasco is not an appropriate rate spread model then what should the rate spread for the
20 SRRM be based on; should the rate spread change over the life of the SRRM.
- 21 D. The appropriate earnings test and deadbands to be applied to recovery of environmental
22 remediation costs through the Company's SRRM.
- 23 E. Whether insurance proceeds or other third party recoveries should be allocated on the same
24 basis as surcharges are allocated.
- 25 F. What interest rate should be applied to insurance proceeds.
- 26 G. The appropriate state allocation factor to be applied to environmental remediation costs.
- 27 H. Whether the insurance proceeds received must as CUB asserts be applied to both forward
28 and backward looking environmental remediation costs.
- 29 I. If \$7 million is too small of a disallowance what is the right number?
- 30 J. Whether the Commission should plan to review the SRRM on a regular basis.
- 31 K. Whether NWN needs to be incentivized to keep its environmental remediation costs down.
- 32 L. Were the MGP environmental remediation costs incurred in the same manner as Boardman,
33 the Klamath dams and Trojan decommissioning costs.
- 34 M. Whether the Commission Should Be Taking An Entirely Different Approach: Fairness And
35 The Tale Of Two Dockets.

1 IV. THE STANDARD OF REVIEW

2 As noted in the Procedural History section above, this docket was opened for several
3 specific purposes and will require application of several different standards of review. The
4 purposes for which the docket was opened include: (1) reviewing the prudence of NW Natural's
5 environmental remediation costs; (2) development of the appropriate deadband to be applied to
6 recovery of environmental remediation costs; (3) determining the appropriate application of the
7 earnings test ordered in Docket UG 221; (4) determining the appropriate rate spread to apply to
8 recoverable costs; (5) determining the jurisdictional cost allocation, and 6) reviewing the
9 prudence of the Gasco site costs. (As noted in the Procedural History section above, a new
10 docket was opened for Gasco (UG 263) and that matter has been resolved).

11 Prudence: It is not CUB's intent to stray from the agreement on prudence reached in the
12 UM 1635 Phase I Prudence and Earnings Test Stipulation related to the prudence of the
13 environmental remediation costs at issue in this docket¹⁰ but, in case other parties do decide to
14 challenge the prudence of these costs, CUB respectfully reserves the right to argue these issues
15 under the prudence review standard set forth in Docket UE 246 Order No. 12-493 pages 25-27.

16 Earnings Test and Deadbands: In UG 221 Order 12-437, the Commission ordered that an
17 earnings test with a deadband would be applied through new proceedings (UM 1635).¹¹ The
18 fundamental purpose of an earnings test is "to determine whether the utility could have absorbed
19 *some or all* of the deferred amounts" and still have earned a reasonable ROE.¹² Each earnings

¹⁰ UM 1635 Prudence and Earnings Stipulation/3 Section 9.

¹¹ ORS 757.259(2)(e) "Identifiable utility expenses or revenues, the recovery or refund of which the commission finds should be deferred in order to minimize the frequency of rate changes or the fluctuation of rate levels or to *match appropriately the costs borne by and benefits received by ratepayers.*"(emphasis added)

¹² *In re PacifiCorp*, OPUC Docket No. UE 127, Order No. 01-881 at 8 (Oct. 22, 2001). (emphasis added).

1 test should be tailored to the circumstances of the case.¹³ NWN wants “the backward – looking
2 earnings test . . . to judge amortizations against the aggregate or average Company earnings over
3 the total deferral period.”¹⁴ Staff, NWIGU and CUB all think that the backward-looking
4 earnings test should be applied to individual years as should the forward-looking test.¹⁵

5 CUB notes that in the last major earnings test case, in which it was involved and lost, the
6 Commission’s order stated that “[w]hether to apply an earning test on an annual or average basis
7 depends on the unique circumstances of each case.”¹⁶ In that case, the Commission found that it
8 was appropriate to average the Company’s earnings over the accrual period for two reasons: first,
9 the monies subject to deferral did not accumulate through annual requests by the utility; and
10 second, the Company was significantly under-earning throughout the entire deferral period.
11 Neither of those facts applies to NWN. In this docket, the monies subject to deferral were
12 deferred by the Company on an annual reauthorization basis and during the deferral period NWN
13 was in a significant over-earnings position for close to 50% of the time. CUB respectfully
14 requests that the UE 233 earnings test criteria discussed above be applied in this docket but
15 asserts that such application should, based on the facts in this docket, lead to the conclusion that
16 the earnings test should be applied on an annual basis.

17 In terms of the review and handling of other unsettled issues in this docket, CUB requests
18 that the Commission apply the standard set forth in ORS 757.210(1) because CUB believes that

¹³ *In re Portland Gen. Elec. Co. Application for an Order Approving Deferral of Costs*, OPUC Docket Nos. UM 445 and UE 82, Order No. 93-257 at 11 (Feb. 22, 1993)([T]he earnings test should be designed to further the purpose of the deferral in the first instances . . .the earnings test could well vary with the circumstances of each case In the future, the Commission intends to tailor earnings tests to fit the type of deferral.)

¹⁴ UM 1635 NWN/800/Miller/6 lines 22-24.

¹⁵ OAR 860-027-0300 (“The period selected for the earnings review will encompass all or part of the period during which the deferral took place or must be reasonably representative of the deferral period.”)

¹⁶ *In re Idaho Power Company* OPUC Docket No. UE 233, Order No. 13-416, 12 (Nov. 12, 2013).

1 the Company should be required to carry the burden of persuasion throughout the proceeding to
2 prove that the position it argues for will result in rates that are fair, just and reasonable.¹⁷

3 **V. PRINCIPLES THAT SHOULD BE CONSIDERED IN THIS DOCKET**

4 ***i. What NWN is Asking For is Not Normal Ratemaking***

5 Rates are set based on a forecast of the prudently incurred costs associated with assets
6 and services that are used and useful to provide service to current customers. NWN is not
7 forecasting costs for provision of services to current customers. Instead, NWN is asking for a
8 risk-free dollar for dollar recovery of costs that should have been recovered during the time that
9 the Company was manufacturing gas at the plant and causing the pollution.¹⁸

10 ***ii. Monopoly Regulation is a Substitute for the Competitive Market***

11 Many companies have past liabilities associated with superfund sites, but many are in
12 competitive industries which prevent companies from simply raising prices to cover a past
13 liability. NWN, unlike a company in the competitive market, can ask for permission to charge
14 customers for costs that would be borne by shareholders in competitive markets – but would that
15 be the right thing to do here?¹⁹

16 ***iii. Customers Pockets Must Not Be Abused***

17 When designing the power cost adjustment mechanisms (“PCAMs”) for electric utilities, it
18 was recognized that utilities are paid to manage risk, but that costs can sometime be so large that they
19 fall outside of what is the reasonable range that shareholders can absorb, requiring customers, with

¹⁷ ORS 757.210(1); *Pacific Northwest Bell Tel. Co. v. Sabin*, 21 Or App 200, 213-214 (1975) (“Any increase in rates must be preceded by the submission of ‘revised schedules,’ and is dependent upon a showing by the utility that the proposed rates are ‘just and reasonable.’” *citing to* ORS 757.210); UE 115 Order No. 01-777 at 6 (Aug. 31, 2001); UE 196 Order No. 09-046 at 7-8 (*emphasis added*); UE 228 Order No. 11-432 (Nov 2, 2011)(*emphasis added*). *See also In Re Northwest Natural Gas Company*, Docket No. UG 132, Order No. 99-697 at 3 (Nov 12 1999) *In Re PGE, Application to Amortize the Boardman Deferral*, Docket No. UE 196, Order No. 09-046 at 7-8. Although the burden of production shifts, the burden of persuasion is always with the utility.

¹⁸ UM 1635 CUB/Jenks/200/4-5.

¹⁹ UM 1635 CUB/Jenks/200/6.

1 their deeper pockets, to share in the costs. In the PCAM, the level of shareholder costs that can be
2 managed by the utility is generally considered to be 250 basis points of ROE. This is based on the
3 reality that making a utility absorb too great a risk – too great a financial liability – can harm the
4 utility and its ability to finance utility service. But using customers as a deep pocket should only
5 happen in unusual circumstances and only after the utility has absorbed an amount that represents the
6 utility’s expected share of risk.²⁰

7 But in this docket, NWN is asking for customers to absorb all costs up to the point where
8 NWN is earning more than 100 basis points above its ROE. This is not fair. Current customers
9 are being asked to pay for services that provided no benefit to them, that NWN was earning
10 enough to cover.²¹ CUB questions the logic as to why, in years of good earnings and even
11 overearnings, NWN’s shareholders should make no contribution while its customers are forced
12 to carry the bag.

13 ***iv. Deferrals and Automatic Adjustment Clauses are One-sided***

14 Because deferrals are one-sided, it is important to design them so that they are not more
15 generous than the recovery the utility would obtain in a rate case.²² NW Natural’s proposal to
16 allow it to earn 100 basis points above its authorized ROE and still recover the deferred expenses
17 expressly gives it a better deal than a rate case (rates are based on costs plus ROE, not costs plus
18 ROE plus an additional 100 basis points).

19 ***v. Earnings Tests Are Critical to Maintain Balance When Using Deferrals and Automatic***
20 ***Adjustment Clauses***

21 When a utility is asking to retain earnings above its allowable ROE within a deferral, it is
22 asking for a better deal than it would get in a perfect rate case. The purpose of the earnings test

²⁰ UM 1635 CUB/200/Jenks/6 lines 12-17.

²¹ UM 1635 CUB/100/Jenks/12 lines 17-19.

²² UM 1635 CUB/200/Jenks/7 lines 15-16.

1 is to see if current rates are sufficient to allow recovery of all or part of the “deferred cost”
2 without a surcharge. If a utility’s earnings are such that it can recover all of its costs, including
3 the costs subject to the deferral, and still earn a reasonable return, then rates are sufficient and
4 there is no reason to add a surcharge. If a utility is recovering its costs and earning its authorized
5 rate of return, then it has been fully compensated.²³ The Hope Case stated that fair ratemaking is
6 based on the overall result rather than individual items within that ratemaking.²⁴ This means that
7 if the overall result is the utility has covered its costs and earned its authorized return, then there
8 is no basis for it to complain about lack of fair compensation.

9 ***vi. Earnings Tests Should Include All Earnings***

10 In this docket, NWN wants to exempt its earnings related to Mist optimization, pipeline
11 optimization, and liquids extraction from any earnings test associated with the environmental
12 remediation recovery mechanism – this would be unfair. All of these profits derive from
13 investments made to serve core customers.²⁵ Earnings made from investments to provide service
14 to core customers are required to be included in any earnings test – the customers paid for the
15 assets that permitted the earnings. “The Commission should have access to all the Company’s
16 revenue in order to make a decision regarding application of the earnings test. Should customers
17 be forced to pay for environmental remediation if the company is earning large returns on its
18 Optimization Program? Staff believes the answer is no.”²⁶

19 ***vii. Intergenerational Equity***

20 Because customer base changes over time (people die, move, change fuel source, etc.),
21 the timing of costs and revenues matters. In this case, the customers who benefited from

²³ UM 1635 CUB/200/Jenks/8 lines 1-4.

²⁴ [Federal Power Comm'n v. Hope Natural Gas Co., 320 US 591, 64 S Ct 281, 88 L Ed 333 \(1944\).](#)

²⁵ UM 1635 CUB/200/Jenks/9 lines 1-8.

²⁶ UM 1635 Staff/200/Johnson-Bahr/14 lines 3-7.

1 manufactured gas are, in most cases, gone and unable to fund the recovery of costs related to the
2 services they received. Some have yet to be born. NWN is now requesting to recover the costs
3 associated with manufactured gas from current and future customers, not the customers who
4 benefited from manufactured gas long ago. This presents an equity issue. In addition, the
5 application of insurance receipts also presents an intergenerational equity problem, because
6 neither the total cost nor the time period of recovery is known. Should some of the insurance
7 receipts be held back to offset costs that may occur in 2024?²⁷

8 ***viii. Customers Should Benefit from the Insurance They Paid For***

9 If customers pay for insurance, then insurance receipts should offset the costs that fall on
10 those customers. NW Natural is proposing that the insurance receipts first go to offset the
11 historic deferrals that are subject to the earnings test, which has the effect of using the insurance
12 to protect excess earnings that the shareholders would otherwise have to contribute to the
13 cleanup.²⁸ CUB believes that this approach would raise a question as to whether a portion of
14 insurance premiums should be funded by shareholders.

15 **VI. POSITIONS WITH REGARD TO THE UNSETTLED ISSUES**

16 **A. The issue of the prudence of NWN’s environmental remediation costs deferred through**
17 **December 31, 2012.**

18 As noted above, it is CUB’s position that all issues are once again unsettled and fair game
19 for litigation.

20 CUB chose not to write on prudence in its testimony in either UM 1635 Phase I or Phase
21 II of this docket and will not, therefore, pursue that issue now unless a party raises additional

²⁷ UM 1635 CUB/200/Jenks/9 lines 10-18.

²⁸ UM 1635 CUB/200/Jenks/9 lines 19-21 to 10 lines 1-11.

1 issues related to NWN’s prudence. CUB’s position remains where it was in the Phase I
2 Prudence and Earnings Stipulation.²⁹ CUB agrees that the work done through December 31,
3 2012 was prudent with the exception of the \$33,400 in costs previously identified by Staff as
4 being not fully supported by evidence.

5 CUB understands that additional monies have now been spent and whereas in earlier
6 testimony, the amount that had historically been spent and deferred was \$71 million, with the
7 Company expecting an additional \$58 million in costs for a total of \$129 million, today, the
8 Company has spent more than \$100 million and expects future spending to be between \$98 and \$350
9 million for a total cost of \$200 million to \$450 million.³⁰ Obviously, CUB’s support for prudence
10 does not extend to monies that were spent after December 31, 2012. CUB reserves its rights at
11 hearing, in post hearing briefs or oral argument to respond to issues raised by others related to
12 the prudence of the costs at issue in this docket. If prudence becomes an issue, it should be
13 addressed pursuant to the standard of review set forth in UE 246 Order No. 12-493 pages 25-27.

14 **B. Whether the Gasco rate spread should be applied to the remaining environmental**
15 **remediation costs in this docket.**

16 The Gasco Stipulation was a negotiated settlement and as stated in the Stipulation, “[n]o
17 party shall be deemed to have agreed that any provision of this Stipulation is appropriate for
18 resolving issues in any other proceeding, except as specifically identified in this Stipulation.”³¹
19 No such identification was made in the UG 263 Stipulation. The Gasco Stipulation has no legal
20 effect on the issues at play in this UM 1635 Phase II docket.

²⁹ UM 1635 Prudence and Earnings Stipulation/3 Section 9.

³⁰ UM 1635 CUB/200/Jenks/15 lines 8-13.

³¹ UG 263 Stipulation/5 Section 16 lines 20-22.

1 **C. If Gasco is not an appropriate rate spread model then what should the rate spread for**
2 **the SRRM be based on; should the rate spread change over the life of the SRRM.**

3 In the UM 1635 Phase I Rate Design Stipulation, the parties, in an integrated settlement
4 subsequently rejected by the Commission, agreed that the SRRM rate spread allocation would be
5 based on an equal percent of margin basis reflecting the final rate allocation in Docket UG 221.
6 The parties also agreed that the basis for calculating the rate spread would not change from an
7 equal percent of margin basis during the period over which costs were collected through the
8 SRRM.³² The parties further agreed that to the extent amounts were refunded to customers based
9 on the receipt of insurance proceeds, or other recoveries from third parties that cover NWN's
10 environmental expenditures, the same basis would be used in allocating such refunds. And that
11 to the extent that insurance proceeds or other recoveries from third parties reduce the amounts
12 changed to customers through the operation of the SRRM, those receipts would reduce costs to
13 each customer class based on the same equal percent of margin basis as well.³³

14 However, the stipulation discussed above also stated that "if the Commission rejects all
15 or any material portion of this Stipulation or imposes additional material conditions in approving
16 this Stipulation, any Party shall have the right to withdraw from the Stipulation."³⁴ CUB hereby
17 exercises that right.

18 CUB's support for the stipulated rate spread (as well as the stipulated interstate
19 allocation) in this docket was in the context of a robust earnings sharing mechanism on a going-
20 forward basis and a fair allocation of insurance proceeds. The Company's proposal in this phase
21 of the docket would eliminate nearly all contributions from the Company on a going-forward
22 basis and it would use the insurance proceeds to eliminate any Company sharing after the

³² UM 1635 Phase I Rate Spread Stipulation/2 sections 6 and 7.

³³ UM 1635 Phase I Rate Spread Stipulation/3 section 8.

³⁴ UM 1635 Phase I Rate Spread Stipulation/3 section 11.

1 application of the earnings test. This is a very different proposal than was contained in the
2 stipulation; this proposal places a great deal of the costs onto customers. Combining these
3 changes with the proposed interstate allocation and the rate spread means that residential
4 customers are bearing a huge burden for several years.

5 CUB has two concerns with the rate spread in this docket. The first is the disconnect
6 between the rate spread between customer classes and the rate spread between states. For
7 customer classes, the proposal is to use the equal percent of margin, which is typically how we
8 allocate costs today. But the proposed allocation between states does not use the current
9 methodology, but instead goes back in time to look at how the gas that was manufactured was
10 used historically. If the basis of allocating the costs between states is historic usage, why was
11 that not used to allocate costs between customer classes? In earlier testimony in this docket,
12 CUB proposed using current allocation practices for interstate allocation.³⁵ While we agreed to
13 move our position on the interstate allocation in the stipulation, it was in the context of the
14 stipulated mechanism.

15 Second, CUB is concerned that this is a gas commodity cost and is being allocated on
16 equal percent of margin – when margin is essentially everything but the gas costs. For example,
17 small residential customers use more distribution pipes than large industrial customers; this
18 additional use of distribution pipes will cause residential customers to bear more of the historic
19 gas commodity cost. On the electric side of utility regulation, we functionalize revenue
20 reconciliation, so energy costs are not allocated on the use of the distribution system. CUB does
21 not believe that equal percent of margin is the correct approach for gas commodity costs.

³⁵ UM 1635 CUB/100/Jenks/20 Lines 4-10.

1 However, in recognition of the fact that we were making sausage, not artwork, CUB was
2 willing to accept equal percentage of margin in Phase I because of the expectation that a robust
3 sharing mechanism would be adopted.³⁶ In addition, CUB recognized, and recognizes, that
4 allocating gas commodity costs from a time before there were transport customers to customers
5 today brings its own challenges. CUB recognizes that these costs are unrelated to current
6 service, so there is no cost causality principle to apply to rate spread. Finally, CUB recognizes
7 that equal percentage of margin is typically how we allocate non-gas commodity costs on the gas
8 system.

9 The outcome of this docket needs to be fair to all customer classes, and fair to customers
10 of both states, and be fair to customers and shareholders. CUB believes that this requires
11 contributions from all segments. Without knowing the outcome of this docket with regard to
12 shareholder contributions, insurance proceeds and interstate allocation, CUB is unable to answer
13 the question of whether an equal percent of margin is still a reasonable approach.

14 **D. The appropriate earnings test and deadbands to be applied to recovery of**
15 **environmental remediation costs through the Company's SRRM.**

16 Whatever the appropriate earnings test is, it is not the one proposed by NWN. NWN's
17 earnings test would allow NWN to retain all earnings up to 100 basis points above its authorized
18 return on equity.³⁷ The Company claims that this is fair because it does not always earn its ROE.

19 CUB finds the Company's proposal to be allowed to earn 100 points above its ROE
20 before any sharing of remediation costs to be a giant leap away from where the Company was
21 last year. NWIGU witness Gorman thinks allowing NWN to earn up to 100 basis points over the

³⁶ UM 1635 - Rate Spread Stipulation/2 Section 6.

³⁷ UM 1635 NWN/800/Miller/11, lines 7-17; UM 1635 NWIGU/100/Gorman/8 lines 11-12; UM 1635 CUB/100/Jenks/7 lines 14-19.

1 authorized returns on equity would in fact be an indication that “NW Natural’s rates are
2 excessive and should be reduced.”³⁸ In addition, the Commission highlighted its concern that the
3 \$7 million allocated to the Company through the application of the historic earnings test was too
4 low,³⁹ so the Company proposed no Company sharing.⁴⁰ The Company wants to keep its historic
5 over-earning and to keep its future over-earning and still have customers pay the cost of the
6 environmental remediation that is unrelated to current service. This is simply not fair. CUB has
7 now proposed five SRRM alternatives across two dockets with multiple phases in response to
8 NWN’s proposal. Those proposals included the following:

9 *i. UG 221 proposal.*

10 First, in its UG 221 testimony, CUB supported applying a year-by-year earnings test to
11 the deferred amounts. On a going-forward basis, CUB proposed that the costs be shared 50-50,
12 noting that the costs at issue were unrelated to current service.⁴¹

13 *ii. UM 1635 Phase I Proposal*

14 Second, in CUB’s UM 1635 Phase 1 Testimony, CUB proposed a mechanism using an
15 earnings test. CUB proposed an earnings test at allowable ROE for the deferred amounts, and
16 argued that the earnings test should include all earnings made from the utility system, including
17 the PGA and core customer optimization. Then, on a going forward basis, CUB argued that an
18 earnings test at allowable ROE, including all earnings from the utility system, would also be a
19 reasonable mechanism going forward.⁴²

³⁸ UM 1635 NWIGU/100/Gorman/9 lines 4-6.

³⁹ Order No. 13-424 at page 7 Section D. Resolution.

⁴⁰ UM 1635 NWN/800/Miller/5 lines 19-23 (“The earnings review originally proposed by NW Natural in Phase I comports with each of these policy considerations; therefore the Company’s recommendation in this Phase II is consistent with its initial proposal. NW Natural refers to, and incorporates its testimony from Phase I of this docket, and for that reason does not repeat all of the points made there.”)

⁴¹ UG 221 – Citizens’ Utility Board of Oregon’s Opening Brief, page 32-35.

⁴² UM 1635 CUB/100/Jenks/14, line 1 to 17 line 24.

1 **iii. UM 1635, Phase I Alternative**

2 Third, in addition in its UM 1635 Phase I testimony, CUB also proposed an alternative
3 that used sharing bands to allocate the costs: customers would pay 100% of the costs up to 100
4 basis points below ROE. Customers would pay 80% of the costs from 100 basis points below
5 ROE to ROE. Customers would pay 10% of costs up to 100 basis points above the authorized
6 ROE. Customers would pay no costs above 100 basis points above ROE.⁴³

7 **iv. UM 1635 Settlement**

8 Fourth, there was then the Joint Parties Prudence and Earnings Stipulation and the
9 proposal set forth there. That settlement had a series of sharing bands depending on the
10 Company's earnings level: the Parties agreed that the earnings test to be applied to
11 environmental remediation expenses deferred on or after January 1, 2013, would be conducted
12 on an annual basis according to the following terms:

- 13 a. If the Company's results of operations ("ROO") for a given year show that the
14 Company earnings were below 75 basis points below the Company's authorized
15 return on equity in that year ("Authorized ROE"), the Company will be allowed
16 to collect all of the prudently-incurred environmental remediation expenses
17 deferred in that year.
- 18 b. If the Company's ROO for a given year shows that the Company's earnings are
19 between 75 basis points below Authorized ROE and Authorized ROE (or at
20 ROE), the Company will credit to the balance of the SRRM, up to the amount
21 deferred for that year net of insurance proceeds or third-party recoveries

⁴³ UM 1635 CUB/100/Jenks/17 line 25 to 19 line 5.

1 allocated to that year ("Net Amount Deferred"), 10 percent of its earnings
2 between 75 basis points below Authorized ROE and Authorized ROE.

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

10 d. If the Company's ROO for a given year shows that the Company's earnings are
11 more than 50 basis points above Authorized ROE, the Company will credit to the
12 balance of the SRRM, up to the Net Amount Deferred: (1) 95 percent of its
13 earnings above 50 basis points above Authorized ROE; (2) 80 percent of its
14 earnings between Authorized ROE and 50 basis points above Authorized ROE;
15 and (3) 10 percent of its earnings between 75 basis points below Authorized ROE
16 and Authorized ROE. In no case will the credit to the SRRM in a given year
17 resulting from the above earnings test be higher than the Net Amount Deferred in
18 that 1 year.⁴⁴

19 This Joint Party proposal was soundly rejected by the Commission which stated that based “on
20 the record, we believe that a disallowance of \$7 million from recovery of incurred costs through
21 the proposed SRRM is too low.”⁴⁵

⁴⁴ UM 1635 – Joint Testimony/100/Joint Parties/8.

⁴⁵ Order No. 13-424 at 7, Section D. Resolution.

1 **v. *UM 1635 Phase 2, Netting of Assets and Liabilities***

2 Fifth - CUB was forced back to the drawing board in UM 1635 Phase II. This time, CUB
3 proposed netting out liabilities and assets from several historic properties.

4 CUB believes that there is a direct parallel between this docket dealing with the liabilities
5 associated with properties that were formerly used for production of gas, and the storage and
6 optimization docket that deals with properties that were formerly used to produce gas but are
7 now assets. CUB proposed that the assets and liabilities be netted against each other:

8 CUB would propose that we first identify the net income associated with Mist
9 Storage and Mist optimization (pipeline optimization, liquids extraction and Gill
10 Ranch do not arise out of a former production facility so those categories of
11 earnings would not be included in this proposal). This net income, as currently
12 tracked, includes depreciation of investment but not a return on that investment.
13 CUB would propose that the Company be allowed its authorized rate of return on
14 its investment in Mist storage and optimization, but that everything above the
15 allowable rate of return be used to offset the environmental liabilities – this
16 includes customer and Company sharing. The benefit to the shareholder would be
17 that they would be allowed to earn their rate of return on interstate/intrastate
18 storage and optimization. The benefit to customers would be that net revenues are
19 used to offset the environmental liabilities.⁴⁶

20 This amounts to a sharing proposal. Customers would contribute the revenue credits that
21 customers receive from the Mist Storage and Mist Optimization activities. The Company would
22 contribute the earnings in excess of allowable ROE that it currently retains. CUB believes that
23 this mechanism, along with insurance proceeds would produce enough revenue to cover the
24 environmental remediation costs. CUB proposes that the costs of environmental remediation and
25 the net revenues from Mist Storage and Optimization be placed into a balancing account to offset
26 each other. This would continue until the Company certified that the balancing account had

⁴⁶ UM 1635/CUB/200/Jenks/17

1 enough revenue to cover the expected remaining costs or until the balancing account grew to
2 greater than \$50 million and the Company certified that it would not rebalance in 5 years.⁴⁷

3 Consistent with CUB's principles, the Company should not be allowed to recover the
4 deferred environmental remediation costs to the extent that its ROE is above authorized levels,
5 because to do so would lead to more generous results than the Company is entitled to in a general
6 rate case. Staff Exhibit 102 shows the impact of setting the earnings test at authorized ROE to
7 require a write-off of \$24.2 million. CUB is now proposing that the earnings test be run on a
8 year to year basis with a threshold set at authorized ROE, after insurance is applied. CUB
9 proposes applying the insurance receipts equally to all past and future costs, but to assume the
10 upper end of the range of costs outstanding. This is based on the intergenerational equity
11 principle, CUB's concerns that these amounts can grow significantly, and CUB's belief that
12 future customers deserve their share of the insurance proceeds.⁴⁸

13 NW Natural identifies the insurance receipts as \$150.5 million, which is almost exactly
14 1/3 of the upper range of costs, \$450 million. To come up with CUB's Phase II proposal, CUB
15 took Staff Exhibit 102 and reduced the amount on line 20 by 1/3 to create a new line for net
16 environmental costs after insurance. This new amount is compared to the Company earnings
17 above authorized in each year. The end result is that the Company write-off is reduced to \$21.3
18 million. The remaining deferred amount after the year-by-year application of insurance falls on
19 customers and would be \$26 million. (Note: CUB did not update the numbers in the Staff
20 Exhibit, which would increase the remaining cost being allocated to customers due to additional
21 interest). In summary, CUB's proposal for deferred costs between 2003 and 2011 is:

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

⁴⁷ UM 1635/CUB/200/Jenks/18

⁴⁸ UM 1635/CUB/200/Jenks/16

1 *Apply a year-to-year earnings test at authorized ROE, which results in a Company
2 write-off of approximately \$21.3 million and a customer allocation of \$26 million
3 plus interest.⁴⁹

4 Needless to say, NWN does not like this proposal calling it “a complete departure from
5 any fair understanding of an earnings test in that it focuses only on earnings NW Natural receives
6 through incentive mechanisms designed to encourage shareholders to assume risk and invest in
7 storage facilities.”⁵⁰ CUB disagrees with NWN’s assessment of the CUB proposal. CUB’s
8 proposal still allows the Company to earn a return on its investment in storage facilities, it just
9 limits that return to allowable ROE. NW Natural ignores the fact that what makes Mist valuable
10 is that it is a former production facility for natural gas for core customers. But so are Gasco and
11 the Portland Harbor sites. NW Natural wants to reap the benefits of having used Mist to produce
12 gas, while leaving the liabilities associated with producing gas at Gasco and Portland Harbor
13 with customers. NWN states that “[u]sing revenue generated by discretionary shareholder
14 investments to offset costs that should properly be included in rates is fundamentally unfair and
15 unreasonable.”⁵¹ NWN conveniently ignores the fact that, as argued by CUB in the UM 1654
16 docket, NWN is using customer assets on which to base its interstate storage and optimization
17 profits. CUB is not proposing to use revenues generated by discretionary shareholder
18 investments in Gill Ranch because this is not a former production facility for core customers.
19 The primary difference between Mist and Portland Harbor is one is an asset and one is a liability.

20 *vi. Other party proposals*

21 In terms of the proposals made by other parties, as noted in CUB’s Rebuttal Testimony,
22 any of those proposals would be better than the one proposed by NWN. Staff Exhibit

⁴⁹ UM 1635/CUB/200/Jenks/16

⁵⁰ UM 1635 NWN/900/Miller/35 lines 13-16.

⁵¹ UM 1635 NWN/900 Miller/35 lines 21-23.

1 301/Johnson-Barr/1 does a nice job of summarizing all of the parties' positions, and CUB
2 commends it to the Commission for review.

3 While CUB stands by all of CUB's proposals and believes that any one of them would
4 provide fair, just and reasonable rates, CUB hopes that the Commission will ultimately select its
5 fifth and final proposal as being the fairest and most just of all.⁵² And, while CUB likes its own
6 fifth and final proposal best, CUB simply hopes the Commission will choose/devise something
7 more equitable than the proposal made by NWN.

8 **E. Whether insurance proceeds or other third party recoveries should be allocated on the**
9 **same basis as surcharges are allocated.**

10 NWN argues in regard to soon to be received insurance proceeds that, "we might soon
11 know whether we would have sufficient insurance proceeds to entirely offset past deferrals,
12 making a backward-looking earnings review unnecessary."⁵³ Adopting NWN's proposal could
13 lead to the writing off of all prior deferrals with little benefit going to future customers whereas
14 future customers, if NWN's proposals are adopted, would end up paying all the surcharges going
15 forward.

16 The costs of environmental remediation will fall across many years.⁵⁴ But the insurance
17 receipts which are designed to offset these liabilities, are in the process of being fully settled.
18 NW Natural's proposal to use the bulk of the insurance proceeds to wipe away the costs that
19 have already been deferred⁵⁵ serves the purpose of eliminating the need for an earnings test and
20 some allocation of the deferrals to the Company. But it fails to provide any benefit to customers
21 in the future who will continue to pay the costs of the environmental remediation for services

⁵² UM 1635 CUB/200 Jenks/15-19.

⁵³ UM 1635 NWN/800/Miller/2 lines 9-11.

⁵⁴ UM 1635 NWN/800/Miller/3 lines 10-11.

⁵⁵ UM 1635 NWN/800/Miller/7 lines 2-6.

1 from which they received no benefit. CUB's position is that the insurance proceeds received
2 should be utilized to take into consideration the position of both current and future customers.⁵⁶
3 This means that some portion of the insurance proceeds should be allocated to the historic
4 liabilities and some should be retained to pay for future liabilities. CUB believes that because
5 there is a risk that the costs could continue to grow, the best way to allocate the insurance
6 proceeds is to allocate them based on the upper end of the current projection of costs (\$450
7 million). Under this proposal, 1/3 of the insurance would be applied to the deferred amounts and
8 2/3 to future liabilities.⁵⁷

9 While it is impossible to completely match the allocation of insurance proceeds with the
10 allocation of costs when the insurance proceeds are known and the costs will not be fully known
11 for several years, it is possible to try to create a fair allocation of insurance based on what is
12 known today.

13 **F. What interest rate should be applied to insurance proceeds.**

14 Staff found, and CUB agrees, that the appropriate interest rate should be the Company's
15 authorized rate of return. This interest rate parallels the rate at which deferral costs accrue
16 interest.⁵⁸

17 **G. The appropriate state allocation factor to be applied to environmental remediation**
18 **costs.**

19 As part of the settlement in Phase I, CUB agreed to an allocation to Washington based on
20 historic costs.⁵⁹ This was a compromise on CUB's part, as we argued in Phase I testimony that

⁵⁶ UM 1635 CUB/200/Jenks/16 lines 4-10.

⁵⁷ UM 1635 CUB/200/Jenks/17 line 21.

⁵⁸ UM 1635 Staff/200/Johnson-Bahr/5 lines 16-20.

⁵⁹ UM 1635 Prudence and Earnings Stipulation/6 Section 16; UM 1635 Joint Testimony/100 Joint Parties/12 lines 5-9.

1 the current interstate allocation should be used. The compromise was part of an overall
2 settlement that had a fairly robust mechanism going forward. However, with the rejection of the
3 Stipulation that contained that proposal, CUB is concerned that the environmental remediation
4 costs may fall primarily on customers, and believes, therefore, that Oregon customers should not
5 be made to pay a larger share of these costs than Washington customers of NW Natural. CUB,
6 therefore, proposes that environmental remediation costs be allocated between Oregon and
7 Washington customers in the same manner as other costs are currently allocated. CUB's
8 reasoning for this has not changed since its Opening Phase I Testimony.⁶⁰

9 CUB rejects the Company's proposal to look at historic operations to determine the
10 allocation between states and to use current practices to spread the costs between classes. If
11 these costs are directly related to historic operations, these costs are unrelated to current service
12 and should not be placed on customers at all, at least without significant sharing. If these
13 environmental remediation costs are supposed to represent a current cost associated with current
14 decisions of environmental regulators, then these costs should be assigned to states based on the
15 current allocation. In addition, it should be recognized that if the desire continues to be to look
16 back at historic usage of manufactured gas many decades ago, then residential customers will
17 complain loudly. CUB's research suggests that historically, street lighting, commercial service,
18 and industrial service made up a much more significant share of NW Natural's load than they do
19 today. If historic allocations are to be used, those historic allocations must be used consistently.
20 And if as NWN now states, the Portland Gas Manufacturing plant did not provide service to

⁶⁰ UM 1635 CUB/200/Jenks/19 lines 18-23 to 20 lines 1-29.

1 Washington customers,⁶¹ then customers other than Oregon’s residential customers are the ones
2 that should be required to step up to the plate.

3 If the basis of assigning this cost to customers is that it is a current liability caused by
4 government environmental regulations, then it should be allocated to all customers in all states
5 just as any other cost would be allocated. Using the work papers from NW Natural’s UG 221, the
6 allocations should be 90.07 to Oregon and 9.93 to Washington.⁶²

7 **H. Whether the insurance proceeds received must as CUB asserts be applied to both**
8 **forward and backward looking environmental remediation costs.**

9 NWN states that it should be allowed to apply all insurance proceeds received to the
10 existing deferral amount:

11 February 3, 2014, the Company settled the last remaining insurance claims and as a
12 result, will receive a total of \$150.5 million in insurance proceeds. This means that
13 the company will receive more insurance money than the amounts that have been
14 deferred and that customers do not need to pay for the past deferred amounts. . . .As
15 such, it is neither necessary nor appropriate for the Company to seek amortization of
16 amounts deferred to date.⁶³

17 However you look at it, over the past deferral period, customers did not pay the
18 remediation expense, and nothing we do now will change that. But, given where we
19 are now, it makes the most sense to have future customers pay for future expense –
20 as it is incurred. In that way, those future customers will pay for what will be then –
21 current expense, but will not be saddled with the past expense that past customers did
22 not pay.⁶⁴

23 This issue is an equity issue for CUB’s residential customers⁶⁵ who are being asked to
24 foot the bill for ancient costs. On a retroactive basis, NWN’s proposal would use insurance

⁶¹ UM 1635 NWN/900/Miller/42 lines 8-10.

⁶² UM 1635 CUB/200/Jenks/20 lines 28-29 citing to UM 1635 CUB/100/Jenks/20 citing to UG 221 – workpapers
NWN 300-312/McVay-Soires Revenue Requirement, Time 201109(2).xlsx.

⁶³ UM 1635 NWN/800/Miller/7 lines 3-6 and 11-12.

⁶⁴ UM 1635 NWN/900/Miller/31 lines 19-20 and 32 lines 1-4.

⁶⁵ It is also a serious equity issue for NWIGU’s customers. “Insurance settlement proceeds will be allocated entirely
to the benefit of retail customers.” UM 1635 NWIGU/100/Gorman/3 lines 25-26.

1 receipts to wipe out the past deferrals thereby protecting the Company’s excess earnings that
2 would otherwise be subject to a deferral earnings test. This causes intergenerational equity
3 problems for future customers who would, as a result, see less of the insurance receipts. As noted
4 by Staff, “future customers should not bear more inequality than necessary to pay for the costs of
5 benefits received in the past; they are entitled to a fair share of the insurance proceeds for future
6 environmental remediation costs.”⁶⁶

7 If NWN’s proposal is adopted, shareholders are likely to receive a greater share of the
8 insurance premiums than they are a share of the clean-up costs. Overall, it would require
9 customers to pay significant surcharges for costs that are unrelated to current service, while
10 allowing the Company to earn above its authorized return and contribute little to the
11 environmental liability. Customers pay more than they should for existing service and
12 shareholders earn more than they should for providing that service.⁶⁷ As noted by Staff, “[t]he
13 Company’s proposal to use insurance proceeds to pay the historic costs would only exacerbate
14 the intergenerational equity issue and leave shattered the principle of matching costs and
15 benefits.”⁶⁸

16 The insurance proceeds need to be applied fairly on both a backward and forward looking
17 basis.

18 **I. If \$7 million is too small of a disallowance what is the right number?**

19 CUB does not have a “right” number. CUB felt the \$7 million number was reasonable,
20 but only in light of the robust forward looking mechanism. CUB has approached this docket as a
21 whole, trying to arrive at overall results that seem fair, rather than becoming overly entrenched

⁶⁶ UM 1635 Staff/200/Johnson-Bahr/2 lines 15-17.

⁶⁷ UM 1635 CUB/200/Jenks/11 lines 7-17.

⁶⁸ UM 1635 Staff/200/Johnson-Bahr/2 lines 17-20.

1 on one specific aspect at the expense of others. The right number is one that balances past and
2 future costs in a manner that is fair, just and reasonable – a manner that ensures the Company has
3 skin in the game. Under CUB’s last and most favored proposal, application of a year-to-year
4 earnings test at authorized ROE would result in a Company write-off of approximately \$21.3
5 million and a customer allocation of \$26 million plus interest. CUB thinks this is a good proxy
6 for the “right” number.

7 **J. Whether the Commission should plan to review the SRRM on a regular basis.**

8 The parties to the original Stipulations agreed that the SRRM should be reviewed on a
9 regular basis and CUB believes that any order from this docket should likewise provide for such
10 a review. This is because the Company anticipates that future environmental remediation costs
11 will be substantial and will continue for many years into the future.⁶⁹ It is also because CUB
12 anticipates that no matter what mechanism is adopted, and is applied to substantial amounts of
13 money over a substantial period of time, circumstances could change knocking the mechanism
14 out of whack and resulting in unintended consequences. Allowing now for regularly scheduled
15 review would be wise.

16 Staff agrees that a regular review period would be wise. Staff suggests that the SRRM be
17 reviewed in five years or when expenditures reach \$100 million, whichever comes first.⁷⁰

18 **K. Whether NWN needs to be incentivized to keep its environmental remediation costs**
19 **down.**

20 NWN does not think that there is any point to consider an incentive for chasing insurance
21 benefits since “the Company has settled with virtually all existing insurers.”⁷¹ In regard to the

⁶⁹ UM 1635 NWN/800/Miller/3 lines 10-11.

⁷⁰ UM 1635 Staff/200/Johnson-Bahr/21 lines 16-23.

⁷¹ UM 1635 NWN/800/Miller/27 lines 7-11.

1 actual clean up, NWN makes a couple of arguments. First, the Company states it has little
2 control over the costs it will have to incur.⁷² But it still believes that it should be incentivized to
3 apply what little control it has.⁷³ It then goes on to state that the current incentives it has are
4 sufficient.⁷⁴ At first CUB was puzzled by this statement until it realized that this was a request
5 by NWN for NWN to keep all the incentives it already has – some of which are under litigation
6 in NWN’s other dockets such as UM 1654.

7 There is no doubt, in CUB’s opinion, that the best way to incentivize NWN to keep its
8 environmental remediation costs down is to ensure that it has plenty of skin in the game – all of
9 its excess earnings need to be subject to the earnings test. As stated by NWIGU witness
10 Gorman, “[u]nder an earnings test, NW Natural may be asked to forgo an opportunity to earn
11 more than its authorized return on equity, but the excess earnings will be used to contribute to the
12 ERC recovery. This will mitigate NW Natural’s financial exposure, and strengthen its financial
13 position. Also, while it may forgo earnings in excess of its authorized return on equity, it will
14 retain the cash flows produced by these excess earnings which will be used to pay down the
15 ERCs.”⁷⁵ By switching the recovery to CUB’s netting of assets and liabilities from former
16 production sites, CUB believes the Company would retain an incentive to minimize costs
17 because the Company’s return on its Mist Storage would be capped at its ROE until such time as
18 the costs are paid off and then the cap would be removed.

19 In addition, if the Commission does not support CUB’s netting proposal, it is important
20 that any forward looking earnings test include 100% of WACOG and 100% of Optimization

⁷² UM 1635 NWN/800/Miller/27 line 14.

⁷³ UM 1635 NWN/800/Miller/27 lines 19 - 21.

⁷⁴ UM 1635 NWN/800/Miller/28 lines 3-4.

⁷⁵ UM 1635 NWIGU/100/Gorman/15 lines 5-10.

1 earnings in the earnings test⁷⁶ This would provide a greater incentive to keep the environmental
2 remediation costs down especially if the Company was not permitted to keep earnings under its
3 proposal up to 100 basis points above ROE. In addition, requiring that all earnings gained from
4 investments in the utility system to be included in the ROO is important to transparency.
5 Oregon’s regulatory model should be judged on its overall results according to the Hope
6 Standard.⁷⁷ But one cannot know the overall results, if they are not reported.

7 NWN argues in its Rebuttal Testimony that the ROO has only included WACOG savings
8 since 2009 and that it has never included interstate storage or optimization.⁷⁸ Quite frankly,
9 CUB believes this is the product of an oversight, not a thoughtful decision. CUB was shocked to
10 learn that optimization revenues, which are earned directly from the Company’s regulated
11 investment in utility operations, are not included in its ROO. As stated by the Commission,
12 “[t]he majority of the Commissioners believe that use of an earnings test (with a deadband)
13 coupled with the Commission’s ongoing prudence review will provide an effective incentive for
14 the company to manage its costs.”⁷⁹ CUB’s only addition to this is that the earnings test needs to
15 include all of the Company’s earnings. Earnings tests are “an important check against over-
16 earning”⁸⁰

⁷⁶ Note: It is important to note that CUB’s proposal on netting out liabilities and assets was based on properties that were once used to produce gas so includes interstate storage and storage optimization, but not pipeline optimization and liquids extraction. CUB’s proposal on earning in the ROO and earnings test includes all earnings that are derived from the investment in the utility system, including pipeline optimization, liquids extraction, and Mist Core Optimization, but not interstate storage

⁷⁷ *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 US 591, 602-03, 64 S Ct 281, 288, 88 L Ed 333 (1944).

⁷⁸ UM 1635 NWN/900/Miller/19 lines 14-20.

⁷⁹ Order 12-437 at 32.

⁸⁰ Order 12-437 at 28, referring to Staff’s position.

1 **L. Were the MGP environmental remediation costs incurred in the same manner as**
2 **Boardman, the Klamath dams and Trojan decommissioning costs.**

3 NWN argues that the MGP costs should be treated like the decommissioning costs for
4 Boardman, the Klamath dams and Trojan.⁸¹

5 NWN misses one enormously important factor – at the time of their closure and the
6 resulting remediation, Trojan, Boardman and the Klamath dams were all operational and were, or
7 are, still serving today’s customers providing today’s customers with benefits.

8 Decommissioning costs (sometimes called “negative salvage value”) should be collected over
9 the life of a plant, so the customers who benefit from the plant pay the costs of decommissioning.

10 With Boardman, after its closure was announced, the PUC adjusted the amortization schedule to
11 ensure that the remaining investment and decommissioning costs will be recovered.⁸² With

12 Trojan, the plan was to collect decommissioning before closure, but the plant closed early and
13 the costs associated with a closed plant, including depreciation, continue to be the subject of

14 litigation.⁸³ Under the Klamath Dam agreement, the agreement places a cap on any

15 environmental remediation costs and ensures that those costs are collected before the dams are
16 removed.⁸⁴ With Boardman and Klamath, there are not expected to be environmental

17 remediation costs left for future ratepayers. With Trojan there were costs remaining but after
18 nearly 20 years of ongoing litigation, it is hard to hold that up as a model.

19 In addition, the Commission has routinely interpreted decommissioning costs to apply to
20 costs incurred from transitioning a plant currently or very recently serving customers to

⁸¹ UM 1635 NWN/900/Miller/3 lines 15-22.

⁸² *In re Portland General Electric*, OPUC Docket No. UE 230, Order No. 11-242 at 1 (July 5, 2011).

⁸³ *In re Portland General Electric*, OPUC Docket No. UE 88, Order No. 95-322 at 6-7 (Mar. 29, 1995).

⁸⁴ *In re PacifiCorp Application to Implement the Provisions of Senate Bill 76*, OPUC Docket No. UE 219, Order No. 10-364 (Sept. 16, 2010).

1 shutdown.⁸⁵ But manufactured gas certainly does not fit the category of currently or recently
2 serving customers.

3 **M. Whether the Commission Should Be Taking An Entirely Different Approach: Fairness**
4 **And The Tale Of Two Dockets.**

5 As detailed in Mr. Jenks’ UM 1635 CUB/200 testimony, to judge what is fair in one
6 situation requires consideration of how similar situations are handled. Context is important. The
7 two dockets that CUB believes need to be compared for the purpose of considering fairness are
8 this one - UM 1635, and the Mist Storage and Optimization Docket - UM 1654. At their core,
9 these two dockets are similar. They both start with property that was once used to produce gas
10 for service to NW Natural’s customers. The Portland Harbor properties that are subject to this
11 UM 1635 docket were used to manufacture gas from coal and petroleum in the early half on the
12 20th century in order to provide gas to retail customers. The property that is subject to UM 1654
13 was the site of production wells used to produce natural gas for retail customers beginning in
14 1979. Properties that were once used to manufacture gas from coal and oil are left with
15 hazardous waste and are liabilities to their owners. Properties that were once production wells,
16 depending on their geology, can become assets by becoming a place to store natural gas.

17 It is CUB’s position that the Commission should delve deeply into why NWN has taken
18 different positions in these two dockets, dockets in which former production sites have on the

⁸⁵ See e.g. *In re Portland General Electric*, OPUC Docket No. UE 88, Order No. 95-322 at 6-7 (Mar. 29, 1995)(Commission clarified that decommissioning costs for Trojan were “costs of physically dismantling the plant and packaging and storing the radioactive components of spent fuel.”); *In re PacifiCorp Application for an Accounting Order Regarding Closure of the Powerdale Hydro Generation Plant*, OPUC Docket No. UM 1298, Order No. 07-375 (Aug. 23, 2007)(Commission approved PacifiCorp’s request for an accounting order regarding the early shutdown and pending decommissioning of the Powerdale Hydro Generating Plants prior to actual decommissioning); *In re PacifiCorp Request for a General Rate Revision*, OPUC Docket No. UE 246, Order No. 12-493 (Dec. 20, 2012)(Commission approved stipulation that would allow PacifiCorp to include in rates decommissioning costs associated with the early retirement of PacifiCorp’s Carbon thermal generation plant in 2015).

1 one hand become an asset and on the other a liability. NW Natural's position, as to its
2 environmental remediation liability, is that the liability should fall primarily to customers. NW
3 Natural's position on its storage/optimization asset is that its benefits should fall primarily on
4 shareholders. This does not seem fair to CUB. NW Natural's current proposals in the two
5 dockets would leave customers holding almost all of the liability and shareholders holding
6 almost the entire asset. It is CUB's position that historic property used to produce gas for
7 customers should be treated in a consistent manner regardless of whether the value is positive or
8 negative.⁸⁶

9 **VII. CONCLUSION**

10 The Commission should adopt a mechanism from the smorgasbord offered by CUB, Staff
11 and the Intervenors. Any one of these alternate proposals would lead to a better result than the
12 Company's proposal.

13 In terms of CUB's specific proposals, while CUB believes that all of the proposals it has
14 presented to the Commission concerning these environmental remediation costs would represent
15 reasonable results, CUB now favors its final proposal – that the mechanism developed for this
16 docket be developed in the context of other property that was once used to produce gas for
17 customers. The application of the principles of fairness; the requirement to forecast used and
18 useful costs; the principle of monopoly regulation being a substitute for the competitive market;
19 that reaching into customers' deeper pockets should be a rare occurrence; that deferrals and
20 automatic adjustments are one-sided regulatory tools; that earnings tests are critical when
21 working with deferrals and automatic adjustment clauses; that all utility earnings should be
22 included in earnings tests; that intergenerational equity matters; that customers should get what

⁸⁶ UM 1635 CUB/200/Jenks/2-4.

1 they pay for; and that all principles should be applied with a dose of pragmatism, all steer CUB
2 in this direction. CUB is now proposing that the historic earnings test be run on a year-to-year
3 basis with a threshold set at authorized ROE, after insurance is applied. CUB proposes applying
4 the insurance receipts equally to all past and future costs, but to assume the upper end of the
5 current range of costs outstanding. This is based on the intergenerational equity principle,
6 CUB's concerns that these amounts can grow significantly, and CUB's belief that future
7 customers deserve their share of the insurance proceeds. In final summary, CUB's proposal is:

8 1. Deferred Costs (2003-2011)

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

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

12 2. Future Costs (2014 and beyond)

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

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

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

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

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Dated this 2nd day of July, 2014.

Respectfully submitted,



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UM 1635 – CERTIFICATE OF SERVICE

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

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(HC denotes highly confidential)

(C denotes service of Confidential material authorized)

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