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December 27, 2015

VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 1088
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Re: Dockets UM 1635 - Phase II and UM 1706

Attention Filing Center:

Attached for filing in the above-captioned dockets is an electronic copy of Northwest Natural Gas Company's Reply Brief.

Please contact this office with any questions.

Very truly yours,

Wendy McIndoo

Wendy McIndoo
Office Manager

Enclosures

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1635

In the Matter of: NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL Mechanism for Recovery of Environmental Remediation Costs (UM 1635 – Phase II) and Request for Determination of Prudence of Environmental Remediation Costs for the Calendar Year 2013 and the First Quarter of 2014 (UM 1706)	**NORTHWEST NATURAL GAS COMPANY'S REPLY BRIEF**

I. INTRODUCTION

The Public Utility Commission of Oregon ("Commission") should approve Northwest Natural Gas Company's ("NW Natural" or "Company") Revised Compliance Filing. On each of the three disputed issues, the Company's interpretation of Order No. 15-049 ("Order") is the only reading that is true to the specific language in the Order, the overall evidentiary record in this case, and the Commission's underlying ratemaking policies.

First, NW Natural's implementation of the interstate allocation of environmental costs should be adopted. Contrary to Staff's and the Citizens' Utility Board of Oregon's ("CUB") arguments, nothing in the Order states or even implies that the Commission intended for NW Natural to seek to recover from Washington customers expenses to remediate facilities that served only Oregon. In fact, given that the Commission adopted an historical operations allocation approach, there is no evidence in the record supporting a methodology that allocates Oregon-only costs to Washington customers. Moreover,

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allocating costs of Oregon-only facilities to Washington is inconsistent with the equitable principles that govern the Commission's allocation of interjurisdictional costs.

Second, the Commission should approve the Company's proposal for implementing the Commission's $15 million disallowance of past deferred expenses. That disallowance was presented as a flat $15 million—based on both the unique circumstances of the deferral and a concern that a larger disallowance could compromise the long-term financial health of the Company.[1] The Revised Compliance Filing reflects the Commission's intent. On the other hand, Staff, CUB, and the Northwest Industrial Gas Users ("NWIGU") argue that the Commission actually intended a further disallowance, of accrued interest, in addition to the explicitly-stated $15 million. The parties' interpretation is inconsistent with the express language in the Order and the Commission's findings explaining its rationale for the disallowance.

Third, the Commission should adopt the Company's interpretation of how to implement the Commission-approved $5 million tariff rider as it applies to 2013, 2014, and 2015. The Company's approach, which moves $5 million from the deferral account for each of those years (2015 on a prorated basis) to the Site Remediation Recovery Mechanism ("SRRM") balance, provides for a recovery of deferred amounts for those years over time—mitigating the impact on customer rates by amortizing those amounts over five years. Contrary to CUB's claims, the rule against retroactive ratemaking is not violated by NW Natural's approach.

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[1] *Northwest Natural Gas Co. Mechanism for Recovery of Environmental Remediation Costs*, Docket No. UM 1635, Order No. 15-049 at 18 (Feb. 20, 2015).

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II. ARGUMENT

A. The Historical Allocation Must Account for Facilities that Exclusively Served Oregon.

In Order No. 15-049, the Commission dedicated one sentence to the interstate allocation of environmental remediation expense. After noting that the parties had entered into an "initial stipulation," the Commission states: "We . . . adopt the parties' initially agreed-upon interstate allocation, which relies on historical operations to determine the allocation of costs between Oregon and Washington."[2] In its Revised Compliance Filing and Opening Brief, NW Natural explained that—given the Commission's reference to the historical operations approach, and the history of the litigation—the Company understood that the historical operations allocation factor was intended to be applied to clean-up costs related to the Gasco site, which is the ***only*** manufactured gas plant ("MGP") site that historically served both Oregon and Washington customers.[3] The Company believes that the Commission intended that the costs related to the other sites—which served only Oregon customers—would be allocated to Oregon.

Staff and CUB argue that in referring to the "historical operations" approach agreed to in the stipulation, the Commission intended that ***all*** environmental remediation costs should be allocated 96.8 percent to Oregon and 3.32 percent to Washington, regardless of whether the remediated sites were ever used to serve Washington customers.[4] In so doing, they focus on the first part of the Commission's one-sentence holding (referring to the "parties' agreed-upon interstate allocation") while dismissing the second part of the sentence (explaining that the allocation is based on historical operations) altogether.[5] This approach should be rejected.

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[2] Order No. 15-049 at 6.

[3] *See e.g.*, NWN OPUC Advice No. 15-03A / ADV18 Replacement Filing at 13-14 (Sept. 21, 2013).

[4] Staff Opening Brief Re: Compliance Filing at 3; CUB's Response Brief at 3.

[5] CUB's Response Brief at 3 (dismissing the second half of the sentence is "dicta").

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NW Natural acknowledges that the Commission directed the parties to use the method agreed upon in the initial stipulation, and that the stipulation did not specify that the interstate allocation factor would apply only to those sites that served both Oregon and Washington. However, viewed in context, the Order suggests that the Commission did not intend to apply an interstate allocation factor to costs expended to remediate MGP sites that served Oregon customers only.

1. There is No Evidence in the Record to Support the Parties' Preferred Interpretation.

The testimony in this case offered the Commission two different approaches to allocating environmental remediation costs.[6] The first was the historical operations approach, advocated by NW Natural, Staff, and NWIGU.[7] Under that approach, the Commission would apply an historical interstate allocation factor to those environmental remediation costs incurred at sites that served Oregon and Washington—which, at least to date, make up the lion's share of the deferred costs. On the other hand, Oregon customers would bear 100 percent of the costs incurred to remediate sites that served only Oregon customers.[8] Staff points out that in its Phase I Opening Testimony the Company did not specify that the historical allocation factor would apply to the Gasco plant only.[9] However, in its Phase I Reply Testimony NW Natural clarified its position, which it also clearly explained in its Phase II testimony as well.[10]

The alternative approach, proposed by CUB, was based on a current allocation factor.[11] In CUB's view, the environmental remediation costs represent current

[6] Northwest Natural Gas Company's Opening Brief at 4.

[7] Staff/100, Johnson/16 (Phase I Testimony); Staff/200, Johnson-Bahr/4 (Phase II Testimony); NWIGU/100, Deen/10 (Phase I Testimony).

[8] *See* NWN/100, Miller/26-27 (Phase I Testimony); and NWN/900, Miller/42 (Phase II Testimony).

[9] Staff Opening Brief Re: Compliance Filing at 6-7, 9-10.

[10] NWN/500, Miller/32 (Phase I Testimony).

[11] CUB/100, Jenks/21 (Phase I Testimony); CUB/200, Jenks/29-20 (Phase II Testimony).

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compliance costs required to legally operate NW Natural's business, and as such should all be shared by Oregon and Washington customers on the current approximate 90/10 allocation split, with 90 percent of the costs borne by Oregon customers and 10 percent by Washington.[12]

Thus, the Commission had before it only two proposed allocation methods—the method based on historical operations, and the method based on the current allocation factor. The fact that the Commission referenced the historical operations approach suggests it intended to approve the methodology as proposed by NW Natural. Conversely, if the Commission had intended to adopt the methodology now advanced by Staff and CUB—a methodology that ***no party was advocating***—it seems likely that the Commission would have explained its reasons for doing so. The fact that it offered no additional explanation supports the view that the Commission intended to adopt the historical operations approach described in NW Natural's testimony.

Moreover, because no party advocated for the approach now advanced by Staff and CUB, there is no evidence in the record to support it. The parties suggest that the stipulation itself provides support for their proposal in this phase of the docket. In fact, CUB's brief suggests that NW Natural is inappropriately repudiating its agreement as reflected in the stipulation.[13] This argument misses the mark. The Commission rejected the parties' stipulation; by its own terms, that rejection released all parties from supporting its provisions, and it cannot serve as precedent for any other decision.[14] Importantly, there is nothing in the testimony supporting the stipulation to suggest that the parties felt that the

[12] CUB/100, Jenks/21 (Phase I Testimony); CUB/200, Jenks/29-20 (Phase II Testimony).

[13] Specifically, CUB argues that, "NW Natural may have regrets about the bargain it struck in the settlement of this issue but to suggest that the parties' intentions at the time of the settlement were anything other than what was expressly written in the Prudence and Earnings Test Stipulation and supporting testimony is wholly disingenuous." CUB's Response Brief at 5.

[14] Prudence and Earnings Test Stipulation at ¶ 19.

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agreed-upon interstate allocation itself—isolated from the other terms of the stipulation—constituted a rational or reasonable outcome. On the contrary, while the parties were careful to point out that they believed that the terms taken as a whole would result in a fair and reasonable rates, it was clear that the settlement terms represented a compromise of competing views, and that one provision by itself could not be assumed to be fair or appropriate.[15]

2. The Parties' Proposed Interpretation is Inconsistent with the Commission's Principles Governing Interstate Allocation.

The Commission has identified three basic principles that govern the interstate allocation of a utility's costs.[16] *First*, the allocation methodology must allow the utility an opportunity to recover its prudently incurred costs.[17] *Second*, the allocation methodology must ensure that Oregon's share of the utility's costs is equitable in relation to other states.[18] This principle requires that "all states concerned be dealt with fairly and equally" to ensure that each state, including Oregon, pays an appropriate share of the utility's costs.[19] *Third*, the allocation methodology must meet the public interest standard.[20] The parties' proposed interstate allocation is fundamentally inconsistent with these principles.

Adoption of the parties' proposal would practically ensure the Company's inability to recover its prudently incurred costs. The Washington Utilities and Transportation Commission ("WUTC") has indicated that it will consider interstate allocation when the

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[15] Joint Testimony/100, Joint Parties/13; Prudence and Earnings Test Stipulation at ¶ 20.

[16] *PacifiCorp Request to Initiate an Investigation of Multi-Jurisdictional Issues and Approve Inter-Jurisdictional Cost Allocation Protocol*, Docket No. UM 1050, Order No. 05-021 at 6-7 (Jan. 12, 2005).

[17] Order No. 05-021 at 6.

[18] *Id.* at 6-7.

[19] *Id.* at 6.

[20] *Id.* at 7-8.

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Company requests amortization of its remediation deferrals in a rate case[21]—and it is likely that the WUTC will not adopt an allocation approach that requires Washington customers to bear the costs of remediation of sites that had nothing to do with service to Washington customers. Thus, a decision that fails to require Oregon customers to pay for all expense incurred at the Oregon-only sites will inevitably lead to under-recovery by the Company, in violation of the Commission's first principle of interstate allocations.

In addition, the parties' proposal unnecessarily creates inequities between the Company's Oregon and Washington customers by allowing Oregon customers to avoid paying their historical share of remediation costs. This proposal results in unwarranted cost-shifting from Oregon to Washington. As such, the parties' proposed allocation methodology would be inequitable and contrary to the public interest, violating the Commission's second and third principles as well.

B. The Commission Disallowed $15 Million for the Historical Period, Not $17.8 Million.

In determining the $15 million disallowance for the historical period, the Commission started by calculating the amount that would be disallowed if it were to apply the earnings review it had adopted for amounts deferred in the future.[22] By the Commission's calculation, that application would have yielded a $30.4 million disallowance. However, based upon the "unique circumstances of these deferrals" and "to protect the Company's long-term financial health" the Commission reduced this amount down to a flat, one-time disallowance of $15 million.[23] Accordingly, NW Natural implemented this disallowance by subtracting the $15 million from the deferral account as of the date of the Commission's order (February 20, 2015), after the appropriate allocation of insurance proceeds.

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[21] *See e.g.*, *Northwest Natural Gas Co.*, Docket UG-110199, Order 01 (June 20, 2011).

[22] Order No. 15-049 at 17-18.

[23] *Id.* at 18.

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Staff, CUB, and NWIGU claim that the Company's compliance filing is inconsistent with the Commission order in that it allows the Company to earn interest on the deferred amounts, before applying the $15 million disallowance.[24] Instead, the parties contend the $15 million should have been deducted from the period in which it is associated—2003 through 2012—after applying one-third of the insurance proceeds. In so doing, these parties effectively argue that in addition to the $15 million disallowance, the Commission intended to disallow an additional $2.8 million, which they claim represents the interest on the $15 million disallowance, accrued from January 1, 2013, to the date of Order No. 15-049. This interpretation must be rejected.

The Commission's order was clear—it disallowed a flat $15 million and did so based on the unique nature of these deferrals and concerns over the long-term financial health of the Company.[25] The parties' argument that the Commission actually disallowed nearly 20 percent more than the $15 million is not supported by the Commission's findings.

CUB also argues that if the Commission adopts NW Natural's approach, it will mean that utilities would be permitted to earn interest on amounts that were otherwise disallowed by the Commission.[26] This argument is not persuasive. In this unique case the Commission did not apply a specific earnings review to disallow specific expenditures made in specific years.[27] Instead, the Commission issued a flat disallowance—to be applied to principle and interest—given the unique circumstances of the case. Therefore, the Commission's action will not be precedential as to the typical deferral or earnings review.

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[24] CUB's Response Brief at 8; Staff Opening Brief Re: Compliance Filing at 11-12; Northwest Industrial Gas Users' Response to NW Natural's Opening Brief at 2-3.

[25] Order No. 15-049 at 18.

[26] CUB's Response Brief at 9.

[27] Order No. 15-049 at 18 (recognizing the unique factual circumstances of this deferral).

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C. CUB's Opposition to the Company's Proposed Base Rate Adjustment is Without Merit.

In Order No. 15-049, the Commission differentiated the treatment of deferred amounts based on whether they are past deferrals (incurred between 2003 and December 31, 2012) or future deferrals (incurred from January 1, 2013, forward). Regarding future deferrals, the Commission directed the Company to collect $5 million per year in a special tariff rider that will be used to offset expenses incurred in that year.[28] The purpose of this tariff rider was to "help prevent the accumulation of an excessively large deferral balance."[29]

In NW Natural's initial Compliance Filing, the Company proposed to effectuate the Commission's direction through an initial tariff filing by which it would collect $5 million each year for 2013 and 2014, and a prorated amount for 2015 (for a total of $13.8 million) . However, certain parties objected to the proposed collection method. Moreover, given the passage of time, the schedule for the initially-proposed collection method became moot. Therefore, in the current filing the Company proposes an alternative methodology that effectuates the Commission's desire to offset amounts deferred in 2013, 2014, and the first part of 2015, while mitigating the effect on customers. Specifically, the Company proposes to implement the Commission's directive by moving an equivalent amount ($13.8 million) into the SRRM amortization account, to be amortized over five years. The Company's proposal is true to the Commission's stated intent for the tariff rider, while also smoothing out the rate impact by amortizing the amounts over five years, rather than collecting the full $13.8 million in one year.

CUB argues that the Company's handling of the tariff rider issue contravenes the Commission's order by applying the tariff rider to 2013, 2014, and part of 2015, and

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[28] *Id.* at 11.

[29] *Id.*

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violates the rule against retroactive ratemaking.[30] CUB's opposition to the Company's proposal is misplaced and its legal and policy arguments make little sense.

First, the Company's proposal complies with the Commission's order, which explicitly directs the Company to include $5 million in base rates for "future environmental remediation" expenses, which the Commission defined as "amounts incurred [after December 31, 2012]."[31] Thus, the Commission's adoption of a $5 million tariff rider for future years applies to 2013, 2014, and the first part of 2015.

As explained in the cover letter accompanying the Revised Compliance Filing, the Company's tariff proposal does not add to the amount that will be recovered from customers. Rather, the amounts that will be collected pursuant to the rider for 2013, 2014, and 2015, will be applied against and reduce environmental deferrals for those years.

Second, CUB's retroactive ratemaking argument is off-base because all of the amounts at issue have been deferred.[32] The Commission authorized the Company to defer the environmental remediation expenses incurred in 2013, 2014, and the first part of 2015 and the only issue now is the schedule for amortization. By adopting an amortization schedule that allows recovery of $13.8 million for 2013, 2014, and the first part of 2015, through the SRRM, the Commission acted squarely within its legal authority and did not violate the prohibition against retroactive ratemaking.

Third, the effect of CUB's complaint is unclear. CUB states no remedy that it wishes the Commission to apply, and does not point out how it believed the Company has erred. Unless CUB is suggesting that the Company be disallowed recovery of $5 million for each

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[30] CUB's Response Brief at 10-11.

[31] Order No. 15-049 at 6 ("Amounts incurred after [December 31, 2012], including the costs from 2013 and the first quarter of 2014 . . . will be treated as future costs."); *id.* at 7.

[32] *See Portland Gen. Elec. Co.*, Dockets Nos. DR 10, et al., Order No. 08-487 at 38-39 (Sept. 30, 2008), *upheld on appeal*, *Gearhart v. Publ. Util. Comm'n*, 356 Or 216 (2014) (explaining that deferred accounts are exception to prohibition on retroactive ratemaking).

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of the years 2013, 2014, and 2015, it is unclear that CUB is even arguing for any substantive difference from what the Company has proposed.

III. CONCLUSION

Based on the foregoing, the Commission should approve the Company's Revised Compliance Filing.

Respectfully submitted this 17th day of December, 2015.

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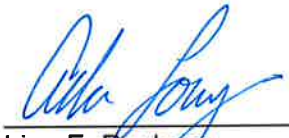

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