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July 2, 2014

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

Oregon Public Utility Commission  
Attn: Filing Center  
3930 Fairview Industrial Drive SE  
PO Box 1088  
Salem, OR 97308

Re: In the Matter of Northwest Natural Gas Company dba NW Natural  
Mechanism for Recovery of Environmental Remediation Costs  
**Docket No. UM 1635**

Dear ALJ Pines and other Parties:

Enclosed please find the original and five (5) copies of Northwest Industrial Gas Users' Phase II Pre-Hearing Brief in Docket No. UM 1635.

Very truly yours,



Tommy A. Brooks

TAB:sk  
Enclosures

cc: UM 1635 Service List

1 **BEFORE THE PUBLIC UTILITY COMMISSION**

2 **OF OREGON**

3 **UM 1635**

4 In the Matter of

5 NORTHWEST NATURAL GAS  
6 COMPANY, dba NW NATURAL

7 Mechanism for Recovery of  
8 Environmental Remediation Costs.

NORTHWEST INDUSTRIAL GAS  
USERS' PHASE II PREHEARING  
BRIEF

9 **Introduction**

10  
11 Pursuant to Administrative Law Judge Shani Pine's Ruling dated February 6,  
12 2014, Northwest Industrial Gas Users ("NWIGU") files this Prehearing Brief in Phase II  
13 of this docket. As explained in more detail below, NWIGU urges the Commission to  
14 reject Northwest Natural's ("NW Natural" or "Company") proposed earnings test for  
15 sharing environmental remediation costs, as well as its proposal to recover all prior-  
16 incurred environmental remediation costs through insurance settlement proceeds. NW  
17 Natural's proposals do not result in fair, just and reasonable rates because they fail to  
18 strike an appropriate balance between shareholder and customer interests, and because  
19 they create intergenerational inequities between the Company's past, current, and future  
20 customers.

21 While the parties disagree on the specific earnings test and application of  
22 insurance proceeds, no parties have raised concerns regarding the rate spread that was  
23 agreed to in Phase I of this docket. Accordingly, NWIGU urges the Commission to adopt  
24 a rate spread that allocates environmental remediation costs on an equal percentage of  
25 margin basis as the parties previously agreed in Phase I of this docket.

26 ///

1 **Points and Authorities**

2 **A. Earnings Test and Insurance Proceeds**

3 This docket began following NW Natural's most recent general rate case.<sup>1</sup> As  
4 part of the final order in UG 221, the Commission approved a mechanism for NW  
5 Natural to recover environmental remediation deferrals. That mechanism is referred to as  
6 the Site Remediation Recovery Mechanism ("SRRM"). In doing so, the Commission  
7 concluded that the SRRM would include an "earnings test with a deadband,"<sup>2</sup> and then  
8 opened this docket for the parties to determine how to structure the earnings test and  
9 deadband.

10 The significance of having an earnings test with a deadband, as the Commission  
11 acknowledged, is that it might act as a *de facto* sharing mechanism in some years.<sup>3</sup> This  
12 was consistent with the positions of Staff and intervenors, all of which argued in UG 221  
13 that the Company's shareholders should be required to absorb at least some  
14 environmental remediation costs.

15 The Commission has since continued to indicate that customers should not bear  
16 the entire burden of the Company's environmental remediation costs and that there  
17 should be some "sharing" of costs even if there is not an express "sharing mechanism."  
18 In Phase I of this docket, the parties entered into a stipulation that would have required  
19 NW Natural to exclude \$7 million of prior-deferred amounts from recovery through the  
20 SRRM. In rejecting that stipulation, the Commission concluded the following:

21 we conclude that the parties' proposed stipulations do not  
22 fairly and prudently resolve whether and how NW Natural's  
23 environmental remediation costs should be shared with its  
24 customers. Based on the record, we believe that a  
disallowance of \$7 million from recovery of incurred costs  
through the proposed SRRM is too low.<sup>4</sup>

25 <sup>1</sup> *In re NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL, Request for a General Rate*  
26 *Revision*, Docket No. UG 221 (hereinafter "UG 221").

<sup>2</sup> UG 221, Order No. 12-437 (Nov. 16, 2012) at p.31.

<sup>3</sup> *Id.* at p.32.

<sup>4</sup> Order No. 13-424 (Nov. 18, 2003) at p.7.

1 In other words, the Commission rejected the stipulation in part because NW Natural had  
2 not agreed to absorb enough of the costs. It is with this guidance that NWIGU has  
3 analyzed the Company's new proposal for the earnings test and the application of  
4 insurance proceeds in Phase II of this docket, and the positions of Staff and CUB.

5 NWIGU also notes that CUB raises a compelling issue when it compares the  
6 manufactured gas plant sites to NW Natural's Mist site.<sup>5</sup> As CUB rightly points out, this  
7 docket is similar to Docket UM 1654 addressing the treatment of the Company's revenue  
8 from interstate storage and optimization activities. Both dockets involve property that  
9 once used to produce natural gas for retail customers – but one has become an asset  
10 (Mist) and one has become a liability (manufactured gas plants). NWIGU urges the  
11 Commission to keep these similarities in mind in an effort to apply fairness and equity in  
12 a consistent manner.

### 13 **1. Earnings Test**

14 The Company first asserts that the Commission should adopt an earnings test that  
15 sets the cut-off at 100 basis points above authorized return on equity ("ROE").<sup>6</sup> Using  
16 that cut-off, the Company would not have to absorb any environmental remediation costs  
17 unless it was overearning by more than 100 basis points above its authorized ROE. The  
18 Company justifies this cut-off by stating it will "prevent[] customers from absorbing  
19 expenses deferred during periods where the Company was earning above a reasonable  
20 range...."<sup>7</sup> That belief, in turn, relies on NW Natural's presumption that customers  
21 should bear all costs while the Company is earning reasonable returns, and that 100 basis  
22 points above ROE is the top of the range of "reasonable earnings."<sup>8</sup> It also relies on the  
23 Company's presumption that it must be allowed a fair opportunity to earn at or above its  
24 authorized ROE.<sup>9</sup>

25 <sup>5</sup> See CUB/200, Jenks/2 at line 26.

26 <sup>6</sup> NWN/800, Miller/17 at line 5.

<sup>7</sup> NWN/800, Miller/17 at line 7.

<sup>8</sup> NWN/800, Miller/11 at line 13.

<sup>9</sup> NWN/800, Miller/17 at line 9.

1 As NW Natural candidly notes, the Commission has not defined what constitutes  
2 a reasonable range of earnings<sup>10</sup> and, therefore, what an appropriate cut-off should be for  
3 the earnings mechanism. Instead, the Company merely points out that 100 basis points  
4 above ROE must be near the top range of reasonableness because it is allowed to retain  
5 earnings beyond that point as part of the Spring Earnings Review.<sup>11</sup> As Staff's testimony  
6 correctly points out, NW Natural offers no evidence compelling the Commission to apply  
7 the cut-off in this docket as it has for the Spring Earnings Review.<sup>12</sup>

8 As noted above, the Commission has already indicated that customers should not  
9 bear the entire burden of the environmental remediation costs. Yet, by choosing 100  
10 basis points above ROE as the cut-off, the Company's proposal makes it more likely that  
11 customers will indeed shoulder the entire burden. As the Company's testimony  
12 acknowledges, it earned greater than its authorized ROE in four of the past ten years.<sup>13</sup>  
13 Of those four years, only once did the Company earn more than 100 basis points over its  
14 authorized ROE.<sup>14</sup> By advocating for such a high cut-off level before any sharing kicks  
15 in, the Company is severely limiting the chances that it would have to share in any  
16 environmental remediation costs.

17 In contrast, Staff and intervenors have each proposed sharing mechanisms that  
18 make it more likely shareholders will have to bear some of the burden of environmental  
19 remediation costs, but still allowing the Company an opportunity to earn its authorized  
20 ROE. Staff, for example, would set the cut-off somewhere between 50 bases points  
21 below ROE, and ROE.<sup>15</sup> CUB would similarly set the cut-off at authorized ROE.<sup>16</sup>  
22 NWIGU suggests a tiered approach that would require the Company to begin absorbing  
23 costs at its authorized ROE, but reduce the amount the Company has to absorb beyond 50

24 <sup>10</sup> NWN/800, Miller/11 at line 9.

25 <sup>11</sup> NWN/800, Miller/11 at line 20.

<sup>12</sup> Staff/200, Johnson-Bahr/10 at line 19.

26 <sup>13</sup> NWN/900, Miller/24 at line 1.

<sup>14</sup> See Staff/200, Johnson-Bahr/13 at line 1, Table 1.

<sup>15</sup> Staff/200, Johnson-Bahr/12 at line 3.

<sup>16</sup> CUB/200, Jenks/13 at line 1.

1 basis points above authorized ROE.<sup>17</sup> The rationale behind NWIGU's approach is that  
2 the more the Company earns beyond its authorized ROE, the more difficult it is to keep  
3 increasing earnings. To do so takes more innovation, or more sacrifice, on the part of the  
4 Company and, therefore, the fruit of those exceptional management efforts should be  
5 retained by the Company.

6 The proposals by Staff and intervenors all have three things in common: (1) they  
7 continue to allow the Company an opportunity to earn its authorized ROE; (2) they do  
8 not destroy the Company's incentive to earn beyond its authorized ROE (indeed,  
9 NWIGU's proposal bolsters that incentive); and (3) they make it more likely that  
10 customers will not bear the entire burden of paying for environmental remediation costs.  
11 NW Natural's proposal, in contrast, lacks that third component and, therefore, fails to  
12 strike the proper balance between shareholders and customers that the Commission  
13 should require.

14 In summary, the Company's proposal for the earnings mechanism simply is not  
15 reasonable because it fails to incorporate customer interests. The Commission should  
16 reject that proposal and instead implement one of the proposals presented by Staff or  
17 intervenors.

## 18 **2. Insurance Proceeds**

19 The most significant change in facts since this docket began is the amount of  
20 insurance proceeds the Company now has in hand. When the docket began, the  
21 Company had collected approximately \$50 million in insurance proceeds. Since that  
22 time, the Company settled with all but one insolvent insurer and will now receive a total  
23 of more than \$150 million in insurance proceeds.<sup>18</sup> These are the "last" of the  
24 Company's insurance claims (except for the insolvent company) and, therefore, define  
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<sup>17</sup> NWIGU/200, Gorman 6 at line 26.

<sup>18</sup> NWN/800, Miller 7 at line 2; *See* Staff/200, Johnson-Bahr/1.

1 the full amount of insurance proceeds the Company will receive.<sup>19</sup> According to NW  
2 Natural's response to Staff Data Request No. 17, the company is investigating whether it  
3 can acquire any additional funds from the insolvent insurance company.

4 There is no dispute that the insurance proceeds are a customer asset. The question  
5 remains, however, how the Commission should apply the insurance proceeds in light of  
6 the fact that the Company will recover environmental remediation costs from several  
7 generations of customers.

8 Although the Company has been incurring environmental remediation costs for  
9 more than a decade, it now proposes to apply the insurance proceeds it has received so  
10 that it fully recovers the costs it has already incurred.<sup>20</sup> There are several aspects of this  
11 proposal that are unreasonable.

12 First, through this proposal, the Company is ignoring the previous order from the  
13 Commission, which concluded that the \$7 million of past costs the Company was willing  
14 to write off through the stipulation was "too low." With little explanation, the Company  
15 has not only failed to propose an increase in the amount that shareholders would absorb,  
16 but has reduced that amount to zero. NW Natural's proposal should be rejected.

17 NW Natural's rationale for fully recovering past costs is its assertion that the  
18 Commission ordered it to do so in UG 221. In support of that assertion, NW Natural  
19 relies on language in Order No. 12-408 that states "deferral of environmental remediation  
20 expenses should continue as they are now, with appropriate offsets when insurance  
21 proceeds are recovered."<sup>21</sup> NW Natural asserts that this quoted language indicates the  
22 Commission's intent that all insurance proceeds should be used to offset deferred  
23 amounts. What NW Natural conveniently ignores, however, is the fact that Order 12-408  
24 states that NW Natural should make "appropriate" offsets. It is the purpose of this docket  
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26 <sup>19</sup> *Id.*

<sup>20</sup> NWN/800, Miller/23 at line 3.

<sup>21</sup> NWN/800 Miller/23 at line 20.

1 to determine what amount of insurance proceeds is appropriate to offset deferred costs  
2 and the Commission should dismiss the Company's attempt to short circuit that process.

3       Second, as noted in Staff's testimony,<sup>22</sup> NW Natural's approach continues to  
4 place the entire burden of the environmental remediation costs on current and future  
5 customers. Not only would shareholders not be required to absorb any of the Company's  
6 historic remediation costs, applying insurance proceeds to fully recover past costs leaves  
7 fewer dollars to apply to future costs and, therefore, increases the burden on current and  
8 future customers.

9       A key factor in determining how insurance proceeds should be applied is the fact  
10 that these proceeds stem from litigation settlements. The settlement payments are  
11 designed to cover the insurance company's liability to NW Natural for the costs the  
12 Company has already incurred, as well as for the costs the Company is likely to incur for  
13 environmental remediation in the future. In other words, the insurance settlement  
14 payments are related to *all* of the Company's environmental remediation costs, whether  
15 or not they have yet been incurred. The Commission should therefore ensure that those  
16 proceeds are shared by *all* customers – past, present and future. NW Natural's proposal  
17 simply fails to advocate for any intergenerational equity with respect to those proceeds  
18 and is therefore unreasonable.

19       In contrast, Staff and intervenors have each offered a proposal that will dampen  
20 the intergenerational inequities that inherently exist when asking current and future  
21 customers to pay for utility costs that are unrelated to the provision of current service.  
22 Staff, for example, has proposed to allocate the insurance proceeds roughly  
23 proportionally to the time periods in which the costs occurred, or about one-third to past  
24 expenses and two thirds to future expenses.<sup>23</sup> NWIGU independently came up with the  
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<sup>22</sup> See Staff/200, Johnson-Bahr/3, at line 5.

<sup>23</sup> Staff/200, Johnson-Bahr/4 at line 15.



1 same recommendation,<sup>24</sup> which is based on the rationale that the Company has incurred  
2 about one-third of the costs it expects to incur, and that it has been engaged in  
3 environmental remediation for about one-third of the amount of time it expect to have to  
4 do so. Although CUB has a slightly different approach that would reduce each year's  
5 deferral by one-third,<sup>25</sup> that recommendation is similarly based on the fact that the  
6 insurance proceeds are approximately one-third of what the Company anticipates it will  
7 spend on environmental remediation.<sup>26</sup>

8 In summary, the Company's insurance proceeds are a customer asset that should  
9 be used to offset costs that would otherwise be borne by past, present and future  
10 customers. Those proceeds should therefore be allocated in an equitable manner between  
11 those generations. NW Naturals' proposal fails to do that and, therefore, is not  
12 reasonable. The Commission should instead implement one of the proposal presented by  
13 Staff and intervenors, each of which strike a better balance between generations of NW  
14 Natural's customers. The Commission should also reject NW Natural's proposal because  
15 it allows the Company to avoid absorbing any costs of past environmental remediation  
16 costs.

#### 17 **B. Rate Spread**

18 As part of the stipulation in Phase I of this docket, the parties agreed on a rate  
19 spread that allocated costs on an equal percent of margin. Although the Commission  
20 rejected the stipulation, it later indicated that it had no problem with the rate spread  
21 component of the stipulation and invited the parties to settle again on that issue.<sup>27</sup>

22 NWIGU raised the rate spread issue again in its response testimony.<sup>28</sup> Staff  
23 similarly recommended that the Commission allocate rates in this docket on an equal  
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25 <sup>24</sup> NWIGU/200, Gorman/13 at line 20.

26 <sup>25</sup> CUB/200, Jenks/16 at line 21.

<sup>26</sup> CUB/200, Jenks/16 at line 11.

<sup>27</sup> UM 1635, Memorandum (Dec. 5, 2013).

<sup>28</sup> NWIGU/200, Gorman/3 at line 5.

1 percent of margin basis.<sup>29</sup> No other party objected to NWIGU's or Staff's  
2 recommendation. NWIGU urges the Commission to adopt the rate spread proposal  
3 originally presented in the parties' stipulation.

#### 4 **C. Express Sharing Mechanism**

5 As part of UG 221, a majority of the Commission concluded that it would  
6 approve NW Natural's SRRM without an express sharing mechanism. The landscape has  
7 changed in the intervening time since the Commission issued its order in UG 221, and to  
8 the extent the Commission is inclined to reconsider its order in that docket, NWIGU has  
9 suggested an approach where the environmental remediation costs are first allocated  
10 between regulated and non-regulated companies of NW Natural, before applying an  
11 earnings test.<sup>30</sup> The reasonableness of this approach is grounded in the fact that the  
12 liability associated with the environmental remediation costs is a corporate liability that  
13 predates NW Natural. The environmental damage necessitating remediation dates back  
14 to the activities of Pacific Gas and Coke and eventually passed to NW Natural.

15 Based on the Company's 2013 Annual Report, total company assets are listed at  
16 \$2.97 billion.<sup>31</sup> Of this amount, \$2.64 billion are related to regulated utility operations.<sup>32</sup>  
17 As such, NWIGU's expert suggested that 11 percent of the environmental costs be  
18 allocated to non-regulated companies, and 89 percent should be allocated to regulated  
19 operations.<sup>33</sup> After this allocation, the earnings test would be applied. This approach is  
20 warranted because these are unique costs that are unrelated to providing service to current  
21 customers and reflect the corporate liability nature of the costs.

#### 22 **D. Staff and CUB Proposals**

23 NWIGU believes that the positions of Staff and CUB regarding the allocation of  
24 insurance proceeds, the treatment of costs between 2003 and 2012, and the treatment of

25 <sup>29</sup> Staff/200, Johnson-Bahr/4 at line 9.

26 <sup>30</sup> NWIGU/200, Gorman/4-6.

<sup>31</sup> Id.

<sup>32</sup> Id.

<sup>33</sup> Id.

1 future environmental costs are well reasoned and provide reasonable alternatives to those  
2 suggested by NWIGU. NWIGU would support the adoption of the alternatives suggested  
3 by either CUB or Staff.

4 **Conclusion**

5 Based on the foregoing, the Commission should reject NW Natural's proposal for  
6 an earning test and its proposed application of insurance proceeds to fully recover prior  
7 deferred amounts. Instead, the Commission should establish an earnings test and  
8 application of insurance proceeds consistent with the proposals presented by NWIGU,  
9 Staff or CUB.

10  
11 Dated this 2nd day of July 2014.

12 Respectfully submitted,

13  
14 /s/ Tommy A. Brooks

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24 Of Attorneys for the

25 Northwest Industrial Gas Users

**CERTIFICATE OF SERVICE**

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I CERTIFY that I have on this day served the foregoing document upon all parties of record in this proceeding via electronic mail and/or by mailing a copy properly addressed with first class postage prepaid.

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**Public Utility Commission**

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Dated in Portland, Oregon, this 2nd day of July 2014.

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