

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1635

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

**OPENING TESTIMONY
OF THE
CITIZENS' UTILITY BOARD OF OREGON**

May 3, 2013



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

2 **I. I. Introduction**

3 Since 2003, NW Natural has been deferring costs associated with environmental cleanup
4 efforts related to the historic operation of manufactured gas plants (MGP) at five sites.¹ As of
5 September 30, 2011, NW Natural had deferred approximately \$64.5 million in environmental
6 costs; it now conservatively estimates its future environmental remediation liability to be an
7 additional \$58 million.² The potential costs are significantly higher. The Company estimates
8 that the costs associated with just one of the five sites could be as high as \$350 million.³

¹ UM 1635/NWN/100/Miller/7.

² OPUC Order No. 12-437 at page 1.

³ UM 1635/NWN/100/Miller/11

1 At the close of Docket UG 221, the Commission ordered, among other things, that:

- 2 • No sharing mechanism will be applied.
- 3 • An earnings test with a deadband will be applied. The parties will
- 4 have the opportunity to address the appropriate deadband and
- 5 appropriate application of the earnings test in the new proceedings.⁴

6 As stated in the Order:

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

12 Unfortunately, the PUC did not provide guidance in its Order about the desired earnings
13 test with deadbands. To CUB, this means that each party is still free to propose a mechanism
14 that results in the outcome it proposed during the UG 221 General Rate Case, so long as the
15 mechanism achieves its results through the application of an earnings test. Given the above
16 Order, NW Natural now argues for an earnings test that ignores earnings associated with gas
17 purchases, and with storage revenues associated with rate base storage. In operation, NW
18 Natural's mechanism will likely produce results which are close to or the same as the 100% pass-
19 through that the Company proposed in UG 221.

20 While CUB could, in like spirit, propose a mechanism that is built around an earnings test
21 that maximizes the amount of sharing between shareholders and customers, that does not seem
22 helpful. We brought the Commission that rock last time, and the Commission rejected it, telling
23 us to bring a different rock the next time.⁶ Rather than bring back the same rock disguised as an
24 "earning test rock," CUB instead is attempting to offer two alternative rocks which represent a
25 fair attempt at applying an earnings test.

⁴ OPUC Order No. 12-437 at page 31.

⁵ OPUC Order No. 12-437 at page 32.

⁶ This "bring me a rock" analogy has been used by Phil Carver and it is with great respect that we borrow it.

1 In this testimony, CUB will first discuss the purpose of an earnings test and how an
2 earnings test should be considered and applied. Next, CUB will evaluate NW Natural's
3 proposal. CUB will then propose what we think are two a reasonable earnings test proposals and
4 some conditions that should be placed on the mechanism.

5 **II. Purpose of an Earning Test in This Circumstance**

6 Earnings tests have a variety of uses, so it is important to first determine its purpose in a
7 specific circumstance.

8 **A. The Various Circumstances Under Which Earnings Tests Are Applied**

9 The costs here are outside of normal ratemaking. This is not a value judgment, but
10 recognition of the fact that these costs were not part of a forecasted test year. The normal
11 ratemaking process is a forecast of costs into a future test year revenue requirement that is
12 combined with a forecast of revenues (based on a forecast of load, which is based on a forecast
13 of weather and economic activity). The utility takes the risks (and reaps the rewards) that each
14 of these forecasts is correct. The regulatory process is about setting rates, not recovering specific
15 costs. It is generally the utility's job to manage its costs within the rates that are set based on
16 forecasted costs.

17 With the exception of the effects of the earnings test, costs that are recovered outside of
18 the normal ratemaking process are subject to no forecasting risks at all. The Company gets
19 dollar-for-dollar recovery whether the costs fall within the range of Company estimates or are
20 instead several multiples higher than the forecast. Neither does the Company have any risk on
21 the revenue side, as collecting this cost is not dependent on a load forecast; the Company can
22 surcharge customers until these costs are fully collected to the last dollar.

1 Sometimes costs do not fit well into a normal forecasted test year. In those cases, such
2 costs may be subject to deferral and an earnings test in order to protect consumers from being
3 charged for costs outside of a rate case that would not be allowed had they been requested within
4 a rate case. The application of an earnings test to costs that do not fit well within this pattern
5 prevents customers from being charged for additional costs when the determined utility rates
6 already allow the utility to earn a reasonable rate of return – even taking into account the
7 proposed additional costs.

8 This is a much different circumstance than the Spring Earnings Review, where the goal is
9 not to determine whether additional costs should be placed onto customers, but rather to
10 determine at what point excess earning should be shared on a limited basis with customers. This
11 is because excess earnings include some costs for which the utility took full forecasting risk.
12 Therefore, the utility should be allowed to retain some of the upside benefit, because it took
13 some of the downside risk.

14 **B. Applying an Earnings Test to the Current Environmental Remediation Circumstance**

15 In this docket, we are applying an earnings test to a circumstance where the traditional
16 forecasting risk is being shifted to customers. As we noted above, the basic purpose of an
17 earnings test is to protect customers from being subjected to surcharges for costs when current
18 rates are already adequate to cover them. The basic test that must be applied in this earnings test
19 is whether current rates are adequate to allow the utility to recover its costs, including the
20 environmental remediation costs, and earn a reasonable return without adding a surcharge to
21 customers rates to recover the full amount of the environmental remediation costs.

1 **C. NW Natural's Erroneous Interpretation of Order No. 93-257**

2 NW Natural refers to the three types of deferrals listed in Order No 93-257 to discuss the
3 application of an earnings test to the deferral. The portion of Alex Miller's testimony relating to
4 NW Natural's interpretation of Order No. 93-257 follows:

5 In Order No. 93-257, the Commission discussed three types of deferrals and
6 explained the type of earnings test that would be applicable to each as follows:

7 1. For deferrals related to an emergency increase in cost, the Commission may
8 apply an earnings test to allow the utility to amortize the deferral to the degree
9 that it raises the utility's earnings to the bottom of a reasonable range of rate of
10 return with the goal of encouraging the utility to control costs.

11 2. If the deferral created a fund for the benefit of customers, the Commission
12 could apply an earnings test that would require the utility to refund the deferral up
13 to the amount that would bring the utility's earnings to the bottom of the
14 reasonable range of rate of return.

15 3. If the deferral was of a cost that was intended to be borne by customers but
16 was delayed in order to match costs and benefits, the Commission might apply an
17 earnings test that would allow the utility to amortize the deferral up to the top of a
18 reasonable range of rate of return.

19 **Q. Which of the above descriptions of deferrals best matches the**
20 **environmental deferral at issue in this case?**

21 A. The third. In Docket UM 1078, in authorizing the Company to recover its
22 environmental remediation expenses, the Commission determined that doing so
23 was necessary in order to match costs and benefits; and in Docket UG 221, it
24 expressly found that the deferred environmental remediation costs are
25 appropriately borne by customers.⁷

26 It is important to note that the Company is reaching back 20 years to find support for the
27 idea that the amortization of a deferral should be up to the top of the reasonable earnings range.
28 There have been many deferrals over the last 20 years, and there is little precedent for allowing
29 the utility to amortize a deferral up to the top of a reasonable range. This is because this
30 promotes the use of deferrals. Allowing deferrals to be amortized when the Company is earning
31 at a level that is above allowed ROE gives the Company a better result than it would have

⁷ UM 1635/NWN/100/ Miller/14-15.

1 achieved in the rate case. If the rate case could project all costs and earnings accurately, the
2 amount above the authorized ROE would have been used to cover some or all of the deferred
3 costs.

4 In addition, it is incorrect to say that in UM 1078, “the Commission determined that
5 doing so was necessary in order to match costs and benefits.” Neither the Commission Order nor
6 the Staff public meeting memo reached that conclusion. The Commission Order that authorized
7 the deferral in that docket was limited to:

8 **IT IS ORDERED THAT:**

- 9 1) Northwest Natural’s application for reauthorization to defer costs relating to
10 unrecovered environmental costs associated with Gasco, Wacker, Portland
11 Gas, Portland Harbor and Eugene Water and Electric Board sites, for a 12-
12 month period beginning April 7, 2004, is approved.
- 13 2) Northwest Natural should file for recovery of these costs only in the context of future
14 general rate cases.⁸

15 The Staff memo from that docket did not say that it was “necessary in order to match
16 costs and benefits.” The Staff memo stated:

17 **Reason for Deferral**

18 Adoption of this deferred account is authorized by 757.259(2)(e) in order to
19 minimize the frequency of rate changes or fluctuation of rate levels. NW Natural
20 has met the requirements of OAR 860-027-0300 in its filing.⁹

21 The deferral statute being referenced by Staff (757.259(2)(e)) lists three reasons that the
22 Commission can defer costs under that section: 1) minimize the frequency of rate changes, 2) the
23 fluctuation of rate levels, or 3) to match appropriately the costs borne by and benefits received by
24 ratepayers. The Staff memo explicitly cites the first two, but not the third. Clearly, the
25 Commission did not find that this deferral was necessary to match costs and benefits.

⁸ OPUC Order No. Order 03-328.

⁹ OPUC Order No. Order 03-328, Appendix A, page 2.

1 CUB suspects that the reason Staff did not cite the third reason – to match appropriately
2 the costs borne by and benefits received by ratepayers– from the statute was that this deferral
3 was not established with that purpose in mind. The utility began deferring costs in 2003, and
4 after the conclusion of a prudence review in this case, it will be amortizing these costs through
5 the SRRM mechanism. The argument that somehow 2013 or 2014 customers benefited from this
6 cost more than 2003 or 2004 customers is illogical, as is the idea that deferring the costs matched
7 costs and benefits. Commission Order No. 93-257 offers no guidance here.

8 **III. NW Natural’s Proposal**

9 There are two parts to NW Natural’s proposal in this docket. The first is how the
10 earnings test applies in the future, and the second is how the earning test applies to historic
11 deferred amounts. After analyzing both of these proposals, it is CUB’s opinion that the result
12 from each of them would combine to be the same as the Company’s proposal in UG 221: 100%
13 of the costs would be passed through to customers.

14 **A. Application of an Earnings Test to Future Environmental Remediation Costs**

15 NW Natural’s proposal to apply the earnings test to future environmental remediation
16 costs is based upon the Commission allowing NW Natural to earn up to 100 basis points above
17 its ROE before being required to absorb any of those costs. Because of the way the Company
18 defines earnings, the Company could earn above the 100 basis points of ROE from its regulated
19 utility investments and still be allowed to pass through these costs to customers.

20 ***i. The Company’s proposal suggests that a 100 basis points earning test should be applied***

21 This is the Company’s proposal:

22 Earnings Test: NW Natural proposes that the Commission adopt an earnings test
23 that would allow the Company to recover deferred environmental remediation
24 expenses, so long as the Company is earning within a reasonable range, which has

1 been defined by the Commission in other relevant contexts as not exceeding 100
2 basis points above its ROE established in its most recent rate case. For past
3 deferred amounts, the Commission should conduct the earnings test looking at the
4 average earnings of the Company for the historical period over which the costs
5 were deferred. For future deferrals, the earnings test may be conducted on an
6 annual basis, as the SRRM each year amortizes one-fifth of the balance of the
7 Company's deferred environmental costs. Strong policy considerations support
8 NW Natural's proposal, which would allow the Company to collect deferred
9 amounts only to the extent that its earnings remain within the range that has been
10 historically deemed reasonable by the Commission. The Commission should, on
11 the other hand, reject an earnings test that would cut off amortization at or below
12 the Company's authorized ROE. Such a test would be inconsistent with sound
13 regulatory policy and legal principles, forcing significant write-offs of prudent
14 expenses, and inappropriately depressing the Company's earnings. If the cut-off
15 point were set at the Company's authorized ROE, the mechanism would as a
16 practical matter make it impossible for the Company ever to earn above its
17 authorized ROE. If the cut-off point were set below the Company's authorized
18 ROE, the Company would have no opportunity to earn its authorized ROE.¹⁰

19 ***ii. The Company is proposing that most overearnings be excluded from the earnings test.***

20 In terms of looking at the historical deferred amounts and the forward-looking earnings
21 test, the Company is proposing that earnings resulting from the WACOG sharing not be
22 included:

23 Reviewing earnings after removal of the WACOG incentive demonstrates that, on
24 a period basis, NW Natural under-earned by \$12.8 million (line 28). It is
25 important for the Commission to consider how WACOG incentives contributed to
26 earnings in the historical period in designing the earnings test in this case.
27 Otherwise, the Commission could effectively order NW Natural to pay a portion
28 of its ***past and future environmental costs*** out of its WACOG incentives,
29 undermining the operation of the Company's Purchased Gas Adjustment
30 mechanism.¹¹ (emphasis added).

31 But it is not just WACOG earnings that the Company does not want included; the
32 Company also does not want to include optimization revenues as regulated earnings, even where
33 those optimization revenues grow out of use of regulated, rated-based assets:

34 We also contract with an independent energy marketing company to provide asset
35 management services using our utility and non-utility storage and transportation

¹⁰ UM 1635/NWN/100/Miller/4.

¹¹ UM 1635/NWN/100/Miller/18.

1 capacity, the results of which are included in the *gas storage business segment*.
2 Pre-tax income from gas storage at Mist and third-party management services
3 using our utility's storage or transportation capacity is subject to revenue sharing
4 with core utility customers. Under this regulatory incentive sharing mechanism in
5 Oregon, we retain 80% of pre-tax income from Mist gas storage services and from
6 asset management services when the underlying costs of the capacity being used
7 are not included in our utility rates, and 33% of pre-tax income from such storage
8 and asset management services when the capacity being used is included in utility
9 rates.¹² (emphasis added).

10 Mist contains both regulated and unregulated gas storage. For the regulated storage, the
11 cost of the investment is in rate base and customers pay the O&M costs associated with
12 maintaining the facility. While customers receive 2/3 of the net income from this 3rd party
13 optimization of the asset, NW Natural does not book the 1/3 that it retains as utility income, even
14 though this is income produced with rate-based assets.

15 Excluding both of these from an earnings test is unusual. Other utilities update forecasted
16 commodity costs and other revenues from utility assets when reporting results of operations,
17 which is the basis for the earnings test. These are earnings from the utility system. In the case of
18 the PGA, they are caused by the fact that the actual cost of gas is less than what was forecasted
19 into rates. The Company has a sharing mechanism that allows it to retain 10% to 20% of this
20 difference. In the case of storage gas, NW Natural is allowed to keep 33% of the net revenues
21 associated with rate-based Mist storage, even though utilities are required to manage rate-based
22 assets for the well-being of customers.¹³ Other utilities also generate third-party revenues with
23 rate-based assets such as pole attachments and sales for resale, but 100% of those earnings pass
24 through to customers (in some cases, 100% of forecasted revenues flow to customers, and the
25 utility retains the difference between actual and forecasted).

¹² NW Natural 2012 10K, page 34.

¹³ The stipulation in UG 221 requires that NW Natural begin a docket this year to examine storage activities and sharing percentages. Both CUB and Staff proposed changes to these sharing arrangements in UG 221.

1 By proposing to exclude WACOG sharing amounts, the Company is attempting to
2 exclude most of its overearnings from the earnings test. The Company admits that “when the
3 Company has over-earned historically, it has been on account of WACOG savings.” By
4 excluding earnings from rated-based assets at Mist, the Company excludes more overearnings
5 from the earnings test.

6 *iii. Would including all earnings of utility assets fundamentally change the Company’s*
7 *incentive?*

8 The Company’s argument against fully including the earnings from other mechanisms
9 claim that such inclusion will undermine the incentive associated with these mechanisms.

10 CUB disagrees. These mechanisms were not attempting to create a stream of income that
11 the Company was entitled to. Instead, these mechanisms were trying to incent the Company to
12 control its costs and to increase its revenues, which is something most utilities are expected to do
13 without incentive mechanisms.

14 Furthermore, even if these incentive mechanisms are included in the earnings test, they
15 will themselves continue to provide incentives. First, it should be recognized that the
16 environmental remediation amounts that have been deferred since 2005 vary between \$5.3
17 million and \$9.2 million.¹⁴ PGA sharing retained by the Company can approach this number.
18 Last year, the Company was under a 90/10 sharing mechanism. The Company refunded
19 approximately \$44 million,¹⁵ which means that it retained \$4.4 million.

20 For gas storage optimization revenues, the Company has credited Oregon customers with
21 \$9.2 million, \$12.5 million, and \$11 million in each of the last three years.¹⁶ This represents
22 both the rate-based portion, which customers retain 67% of, and the non-rate-based portion, of

¹⁴UM 1635/NWN/101.

¹⁵ NWN Docket No. UG 239/Advice No. 12-14, October 26, 2012, page 3.

¹⁶ NWN 2012 10-K, page 30.

1 which customers retain 20%. While CUB is unable to identify the Company retained earnings
2 associated with just the rate-based portion, these numbers suggest that it is likely in the millions
3 of dollars.

4 The end result is that the annual environmental remediation costs may well be below the
5 total amount of these retained earnings. Therefore, these incentive mechanisms will still have
6 the potential to increase earnings even after an earnings test application. In addition, there will
7 be circumstances where these PGA and storage earnings drive the utility's earnings up to and
8 over the earnings test threshold. In this case, while the PGA and storage earnings that are above
9 the earnings test threshold would be used to pay for environmental remediation costs, the amount
10 of PGA and storage earnings below the earnings threshold would still be retained by the
11 Company. Finally, there may be cases where, even with the addition of the PGA and storage
12 earnings, the Company's earnings are below the earnings test threshold. In this case, the
13 Company would fully retain any benefits associated with PGA and storage earnings.

14 Incentive sharing mechanisms and earnings test mechanisms serve different purposes but
15 do interact. NW Natural would have the Commission protect the incentive mechanisms, even if
16 it means that the earnings test mechanism no longer serves the purpose of protecting customers
17 from paying for additional costs when a utility is already overearning. However, this is
18 unnecessary. Even where they interact, the incentive mechanisms still provide incentives.

19 ***iv. Allowing 100 basis points above ROE is not reasonable.***

20 As discussed earlier in this Opening Testimony, because the environmental remediation
21 costs are being handled outside of a traditional rate case, the earnings test can be seen as a
22 requirement that we pause to examine the question of whether the utility's current rates are

1 adequate to allow it to recover its costs, including some or all of the environmental remediation
2 costs at issue here, and still earn a reasonable return.

3 If we apply an earnings test and find NW Natural's earnings are sufficient to absorb the
4 environmental remediation costs at issue here and still receive an ROE of 10.0 – 50 basis points
5 above what the PUC used to set rates last December – CUB does not believe there is any
6 justification for raising rates. The Company's investors are earning more than the authorized
7 rate of return.

8 **B. Application of an Earnings Test to Historic Environmental Remediation Costs**

9 Next we address NW Natural's proposal for applying an earnings test to the historic
10 deferred amounts. Essentially, NW Natural's proposal is to avoid any write-off due to excess
11 earnings in the deferral period by averaging their ROE during the time period and exclude a large
12 portion of the earnings. CUB would like to point out again that the principal purpose of an
13 earnings test is to protect customers from having to pay for additional costs when the utilities'
14 rates are already sufficient to cover costs (including the additional cost) and maintain reasonable
15 earnings.

16 *i. NW Natural Was Overearning.*

17 There was extensive discussion by CUB (UG 221/CUB/200) and Staff
18 (UG221/Staff/200/Johnson) in UG 221 of the fact that NW Natural was overearning during this
19 period. CUB does not want to keep rehashing this evidence.

20 NW Natural attempts to hide its overearnings by averaging years and by removing
21 earnings associated with the gas commodity and the PGA. The Company's Exhibit 101 shows
22 that the Company's practice was to remove the PGA sharing before 2008, but does not offer a
23 reason as to why. Before the UM 1286 review of the PGA mechanism, there was no sharing for

1 NW Natural unless earnings were greater than 300 basis points above ROE. This huge earnings
2 band made it largely irrelevant whether earnings from the gas commodity were included.
3 However, in 2008, when the earnings band was lowered to a reasonable level (100 or 150 basis
4 points) in the PGA review (UM 1286), it became apparent that including the gas earnings had an
5 impact. CUB is not aware of Staff or CUB challenging the Company's removal of the gas
6 commodity earnings before 2008, when the deadband was 300 basis points. In CUB's case, this
7 was not because we agreed that PGA earning should not count as earning, but was simply an
8 acknowledgement that with a 300 basis earnings band, there was no real point to the Spring
9 Earning Review process because sharing of excess earnings was unlikely no matter how earnings
10 were defined.

11 CUB believes that gas commodity earnings should be included and should be included all
12 the way back to 2004. If this issue had been put to the Commission in 2004, CUB feels that the
13 Commission would have agreed that gas commodity earnings are utility earnings and properly
14 belong in the Results of Operation and the Earning Test. The same logic that has led the
15 Commission to support including gas commodity costs in the earnings review today were present
16 at that time.

17 In addition, CUB strongly disagrees with the Company's attempt to average the years.
18 Deferrals are authorized on an annual basis. As previously discussed, the principle behind the
19 earnings test is to protect customers from being charged for additional costs when the Company
20 is already earning a rate of return that is adequate to cover some or all of the additional costs. In
21 other words, when a utility is overearning, the overearning should be used to absorb some or all
22 of the deferral. This is exactly the case in many of these historic deferral years.

1 **IV. CUB's Proposals**

2 In Order 12-437, the Commission asked for proposals built around an earnings test with a
3 deadband. From CUB's perspective, because the underlying asset that is being cleaned up is a
4 manufactured gas plant unrelated to current service, and the utility is seeking recovery of costs
5 without any traditional forecasting risk, it is important that such an earnings test and deadband be
6 primarily developed as a consumer protection mechanism.

7 **A. Deadbands**

8 CUB is struggling with the Commission's desire for an earnings test with deadbands.
9 Because this is an additional cost being added on top of base rates, and not the variation from a
10 forecasted cost (such as the electric Power Cost Adjustments), it is hard to see how a deadband
11 would work.

12 If the earnings test established a deadband of 50 or 100 basis points around the authorized
13 ROE, it seems to CUB to be the same thing as setting an earnings test at 50 to 100 basis points
14 below ROE. It is not clear what the upper end of the band would do because money would be
15 flowing only from customers to the Company. It would, however, be possible to separate
16 insurance receipts from costs so that there would be a financial flow in each direction. Costs
17 would flow to customers up to the bottom of the deadband and insurance receipts would be
18 shared with customers down to the top of the deadband. This makes little sense. Because
19 insurance settlements are likely to be more sporadic than cleanup costs, this would set up a
20 situation where costs and insurance would be allocated differently to customers. Customers
21 could end up with 95% of the costs, but 85% of the insurance. In addition, the UG 221 order
22 seems, and the historic deferral orders seem, to endorse netting insurance against the cost. This is
23 why CUB struggles with the idea of a deadband.

1 As an alternative to a deadband, it would be possible to create sharing bands. For
2 example, it could be that customers pay 100% of the cost up to 100 basis points below authorized
3 ROE, 75% between 100 basis points below and the authorized level, and 25% between the
4 authorized level and 100 basis points above ROE. This should resolve the concern expressed by
5 NW Natural over having a hard cap on earnings. While a sharing band does not alleviate CUB's
6 concern that the Company may charge customers for costs when the utility is actually
7 overearning (earning above its authorized rate of return), this mechanism would at least be
8 defensible because the utility would be taking some for the risk by sharing some of the cost from
9 100 basis points below authorized ROE. Again, this mechanism would be an earnings test with
10 sharing, not an earnings test with a deadband.

11 Based upon the above analysis, CUB now offers two alternatives, neither of which
12 contains a deadband.

13 **B. Necessary conditions**

14 CUB believes that any mechanism selected in this docket must be bounded by certain
15 conditions.

16 *i. All earnings from utility assets must be included.*

17 The basic test for fair rates is whether the rates allow the utility to recover its costs and
18 earn a fair return. This cannot be determined if a significant share of earnings is not included in
19 the mechanism or even reported in the Results of Operation Report. CUB proposes that all
20 earnings that are gained from utility assets – this means earnings growing out of the PGA and
21 earnings that are derived from optimizing rate-based storage – should be included in the
22 mechanism.

1 **ii. The mechanism should be limited to environmental remediation costs associated with the**
2 **five historic manufactured gas properties.**

3 A mechanism that allows for full cost recovery, subject to an earnings band, is
4 significantly different than the mechanism proposed by CUB in UG 221. The sharing
5 mechanism CUB proposed in UG 221 was not an attractive mechanism for the Company, which
6 CUB thought was appropriate given that the environmental remediation costs were unrelated to
7 current utility service. The mechanisms CUB is proposing in this testimony should be much
8 more attractive to the Company. This is because the risk reductions associated with the earnings
9 test mechanisms could be attractive as a means to affect cost recovery for the company,
10 particularly between rate cases. This attractiveness raises the concern that this mechanism could
11 grow to include a great deal of unrelated, additional environmental remediation costs. All
12 utilities currently have, and will continue to have, costs associated with environmental
13 remediation. But CUB believes that the mechanisms discussed in this docket should be limited
14 to environmental remediation costs associated with the five historic manufactured gas properties
15 described NW Natural's testimony. Costs associated with environmental remediation as a
16 general program area or associated with environmental damage outside of the historic properties
17 discussed in this docket should be excluded from these mechanisms.

18 **iii. Cap on costs associated with this**

19 CUB is concerned about the unknowns of the potential costs of environmental
20 remediation at these five sites.

21 Q. Does the Company's estimate of future environmental costs remain consistent
22 with the information you provided in Docket UG 221?

23 A. Yes. In Docket UG 221, NW Natural estimated \$58 million in future
24 remediation costs—which, ***in accordance with standard accounting practices, is***
25 ***a low-end estimate***. That low-end estimate has now been revised to \$70 million.
26 Moreover, as described in Docket UG 221, the actual expenses could be much

1 greater than this, and estimates have been adjusted upward over time. For
2 example, the upper end of the range for the Gasco/Siltronic site alone (which
3 includes the Portland Harbor Superfund site) as described in the Company's most
4 recent 10-K is \$350 million. Additionally, certain expenses are not estimable at
5 this time, as described in the 10-K. (emphasis added)¹⁷

6 Thus, the low end of the projected costs has risen from \$58 million to \$70 million. CUB takes
7 no comfort in these projections because there is no reason to believe that the costs will actually
8 be in the low end of the range. In its most recent 10K filing, NW Natural states that:

9 Unless there is an estimate within a range of possible losses that is more likely than
10 other cost estimates with that range, we record the liability at the low end of tis
11 range. It is likely that changes in these estimates and ranges will occur throughout
12 the remediation process for each of these sites due to our continued evaluation and
13 clarification concerning our responsibility, the complexity of environmental laws and
14 regulations and the determination by regulators of remediation alternatives.¹⁸

15 At this time, neither NW Natural nor anyone else really knows what these environmental
16 remediation costs will ultimately turn out to be. The mechanisms have no upper limits, and the
17 forecasts of costs are extremely squishy. The proposal is to add the environmental remediation
18 costs onto the actual cost of serving customers. As proposed by NW Natural, there is no upper
19 limit to this mechanism and customers could end up paying more than \$1 billion.

20 CUB believes there needs to be an upper limit to every mechanism. When that limit is
21 reached, recovery of the environmental remediation costs should be reevaluated, including a
22 reevaluation of whether sharing should be included.

23 CUB suggests that the mechanism cap be set at 10 years or \$250 million of
24 environmental remediation costs, net of insurance proceeds being allocated to customers.

25 **C. CUB's Alternative Proposals**

26 With the above conditions in place, CUB offers two proposals that in CUB's opinion
27 represent reasonable applications of earnings test to these environmental remediation costs.

¹⁷ UM 1635/NWN/100/Miller/11.

¹⁸NW Natural 2012 10-K.

1 ***i. Earnings test at allowed ROE***

2 CUB's first proposed mechanism is to have an earnings test which allows recovery up to
3 allowable ROE. While CUB believes that the reasonable earnings band begins below allowable
4 ROE, and Oregon would be fully justified in allowing recovery only up to 50 or 100 basis points
5 below ROE, CUB is not proposing such a mechanism. In doing so, CUB is giving some weight
6 to the Company's argument that these costs will be with us for a number of years and that
7 establishing a recovery cap below authorized ROE will make it more difficult for the Company
8 to earn its authorized rate of return over an extended period of time. At the same time, CUB also
9 recognizes that with the inclusion of the PGA earnings and rate-based storage earnings, the
10 Company will have a greater opportunity to reach its authorized ROE than it claims.

11 The reason to set the earnings threshold at allowable ROE would be to alleviate CUB's
12 primary concern of ensuring that customers are not having additional charges placed upon them
13 when the Company's rates are already adequate to absorb these additional environmental
14 remediation costs while still earning its authorized ROE.

15 ***ii. Earnings Test With Sharing Bands***

16 CUB's alternate mechanism proposal would be the establishment of an earnings test with
17 sharing bands. CUB believes that the bands, or the sharing percentages, should be asymmetrical
18 so as to recognize that this mechanism shifts significant risk to customers not found in traditional
19 regulation. The use of asymmetry in a mechanism to offset the asymmetry of risk has been well
20 established in Power Cost Adjustment mechanisms. CUB proposes the following:

- 21 • Customers would pay 100% of the costs up to 100 basis points below ROE.
- 22 • Customers would pay 80% of the costs from 100 basis points below ROE to ROE.
- 23 • Customers would pay 10% of costs up to 100 basis points above the authorized ROE.

- Customers would pay no costs above 100 basis points above ROE.

This mechanism would address NW Natural's complaint that an earnings band at ROE acts as a cap on earnings. If the earnings associated with the PGA mechanism and the rate-based storage are greater than the 20% of costs in the second band allocated to the Company, the Company can easily move into the third band and have earnings that are greater than authorized.

V. Deferred Costs

The deferred costs should be subject to an earnings test at the ROE that was established at the time the cost was incurred. This should be done on a year-by-year basis and should include all earnings associated with utility investments. This is not unusual for deferrals. NW Natural's complaints about having to absorb a write-off are misplaced. The deferral statute requires an earning test. Using authorized ROE is well established. The Company has known or should have known that this was not only a possible outcome, but a very likely one.

VI. Insurance Receipts

In UG 221, CUB proposed that the environmental remediation costs should be shared between shareholders and customers. That proposal has been rejected in favor of an earning test. Because an earnings test ensures that shareholders are being treated fairly and have an opportunity to earn a reasonable return, CUB proposes the earnings test be applied before the application of insurance. This means that in exchange for shareholders receiving fair treatment through the earnings test, customers would get first crack at the insurance receipts. Insurance receipts should be used to offset the customer share of the environmental remediation costs, including the costs of rate-basing associated with the Gasco site. However, if insurance receipts are greater than the environmental remediation costs that are being placed on customers, CUB

1 has no objection to the Company retaining any excess to compensate for overearnings given up
2 under this mechanism.

3 **VII. Washington Allocation**

4 CUB rejects the Company's proposal to look at historic operations to determine the
5 allocation between states. If these costs are directly related to historic operations, these costs are
6 unrelated to current service and should not be placed on customers at all, at least without
7 significant sharing. CUB made that argument in UG 221, and it was rejected, so it should not be
8 used as the basis for interstate allocation. If these environmental remediation costs are supposed
9 to represent a current cost associated with current decisions of environmental regulators, then
10 these costs should be assigned to states based on the current allocation.

11 In addition, it should be recognized that if the desire continues to be to look back at
12 historic usage of manufactured gas many decades ago, then residential customers will complain
13 loudly as they would have to take a significantly lower share than anticipated by the rate spread
14 stipulation. CUB's research suggests that historically, street lighting, commercial service, and
15 industrial service made up a much more significant share of NW Natural's load than they do
16 today. If historic allocations are to be used, those historic allocations must be used consistently.

17 CUB did not insist on this strict allocation using historic customer loads when we
18 negotiated the stipulation on rate spread for these costs. There, CUB agreed to spread the costs
19 on equal percent of margin, recognizing that this is how current costs are generally allocated.
20 CUB proposes the same for interstate allocation: use the methodology that is current used for
21 most costs.

1 Using the work papers from NW Natural's UG 221, the allocations should be 90.07 to
2 Oregon and 9.93 to Washington.¹⁹

3 **VIII. Conclusion**

4 CUB recommends that the PUC reject NW Natural's proposed mechanism for applying
5 an earnings test to the currently deferred amounts and the future additional costs associated with
6 the environmental remediation at these five sites. Instead, CUB recommends the following:

- 7 • The earning test should include all earnings that use utility assets including PGA
8 earnings and earnings associated with the optimization of rate-based storage.
- 9 • The mechanism should be limited to the costs associated with environmental
10 remediation of historic manufactured gas facilities at the five sites described in this
11 docket.
- 12 • The mechanism should be limited to 10 years, or \$250 million of costs, net of
13 insurance benefits, being placed on customers.
- 14 • The mechanism should be one of the two option proposed by CUB in this testimony.
- 15 • The amounts currently deferred should be subject to a year-by-year application of an
16 earnings test at the then allowable ROE and include all earnings associated with
17 utility property.
- 18 • Insurance receipts should be applied after the application of the earning test.
- 19 • The current allocation of costs between Oregon and Washington should be used to
20 allocate the costs between the states: Oregon 90.07%; Washington 9.93%.

¹⁹ UG 221, Workpapers NWN 300-312, McVay-Siores Revenue Requirement, TME 201109 master state IS allocation (2).xlsx.

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EXPERIENCE: Provided testimony or comments in a variety of OPUC dockets, including UE 88, UE 92, UE 102, UE 115, UE 116, UE 137, UE 139, UE 161, UE 165, UE 167, UE 170, UE 172, UE 173, UE 207, UE 208, UE 210, UE 213, UE 215, UE 217, UE 220, UE 227, UE 228, UE 233, UE 246, UG 152, UG 221, UP 168, UT 125, UT 141, UM 903, UM 918, UM 995, UM 1050, UM 1071, UM 1121, UM 1147, UM 1206, UM 1209, UM 1355, UM 1415, and UM 1461. Participated in the development of a variety of Least Cost Plans and PUC Settlement Conferences. Provided testimony to Oregon Legislative Committees on consumer issues relating to energy and telecommunications. Lobbied the Oregon Congressional delegation on behalf of CUB and the National Association of State Utility Consumer Advocates.

Between 1982 and 1991, worked for the Oregon State Public Interest Research Group, the Massachusetts Public Interest Research Group, and the Fund for Public Interest Research on a variety of public policy issues.

MEMBERSHIP: National Association of State Utility Consumer Advocates
Board of Directors, OSPIRG Citizen Lobby
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Electricity Policy Committee, Consumer Federation of America

UM 1635 – CERTIFICATE OF SERVICE

I hereby certify that, on this 6th day of May, 2013, I served the foregoing **OPENING TESTIMONY 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.

(W denotes waiver of paper service)

(C denotes service of Confidential material authorized)

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