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September 21, 2015

NWN OPUC Advice No. 15-03A / ADV18
REPLACEMENT FILING

VIA ELECTRONIC FILING AND US MAIL

Public Utility Commission of Oregon
Attn: Filing Center
201 High Street SE, Suite 100
Post Office Box 1088
Salem, Oregon 97308-1088

Re: REPLACEMENT Compliance Filing
UM 1635/UM 1706: Order No. 15-049

Northwest Natural Gas Company, dba NW Natural ("NW Natural" or the "Company"), files herewith a replacement to its March 31, 2015 compliance filing, which was made to comply with the Commission's Order No. 15-049 ("Order"). NW Natural requests that the March 31, 2015 filing (hereinafter, "March 31st Compliance Filing") be withdrawn.

The purpose of this replacement filing ("Revised Compliance Filing") is to make certain modifications to the Company's proposed implementation of the Order that, in part, reflect discussions with the parties to this docket that took place in compliance filing workshops held subsequent to NW Natural's March 31st Compliance Filing.

NW Natural believes that the Revised Compliance Filing implements the Order's intent. However, the Company is aware that the parties disagree with certain aspects of the filing. For that reason, the Company requests the Commission suspend the filing for further investigation, and establish a prehearing conference to develop a schedule for the resolution of any contested issues the parties raise in this docket.

Background

The Commission's Order resolved a number of outstanding issues relating to the implementation of NW Natural's Site Remediation and Recovery Mechanism (SRRM)[1], and directed NW Natural to make a compliance filing to demonstrate how "it will implement both the historic and the future decisions reached in th[e] order."[2] NW Natural made its original compliance filing on March 31, 2015.[3]

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[1] The Commission approved the SRRM in NW Natural's last general rate case, Docket No. UG 221, in Order No. 12-437.
[2] Order at 20.
[3] On March 19, 2015, NW Natural filed a petition for extension of time to make the compliance filing from March 23, 2015 to March 31, 2015, which was approved by the Commission on March 20, 2015.

Following the submission of the March 31st Compliance Filing, the parties raised several issues concerning the Company's proposed methods for complying with the Order. The parties discussed the issues over the course of several constructive workshops; this Revised Compliance Filing makes certain modifications reflecting those discussions.

NW Natural is aware of at least two points on which one or more of the parties will likely disagree with NW Natural's interpretation of the Order, as reflected in this Revised Compliance Filing. The first issue is whether the Commission's ruling on state allocation of environmental expenses intended to allow NW Natural to recover only 96.68% of its environmental remediation expenses from all remediation sites, even though some of those sites were dedicated 100% to serving Oregon customers**.** The second contested issue is whether, in addition to the $15 million disallowance, the Commission intended to disallow interest accrued on that amount of deferred expenses from the beginning of 2013 to the date of the Order. These contested issues are more fully discussed in Section IV below.

Summary of Order and NW Natural's Proposed Implementation

In the Order, the Commission addressed a number of outstanding issues relating to the implementation of the SRRM tariff. These issues include:

- The allocation of environmental costs to Oregon customers;
- The treatment of insurance proceeds received by NW Natural to cover environmental costs;
- Cost recovery for past and future environmental remediation costs and the establishment of a tariff rider;
- How an earnings test would be applied to past deferred amounts; and the appropriate earnings test to apply to deferred expenses and interest going forward.

A discussion of each action directed by the Commission in the Order, as well as a description of how NW Natural proposes to implement each action, is discussed in detail below. Where appropriate, references are made to spreadsheets, workpapers, and tariffs.

I. Allocation of Environmental Costs and Insurance Proceeds.[4]

A. Reconciliation of Amounts in the Order and Actual Amounts included in the Compliance Filing.

In the Order, the Commission referred to the amounts of environmental costs incurred, and insurance proceeds received, based on information provided to the Commission in NW Natural's filings, made earlier in this docket. In this filing, NW Natural adjusts the amounts of the environmental costs and insurance proceeds described in the

[4] In its testimony in this docket, the Company explained that in addition to insurance proceeds, the Company also expected to receive reimbursement for certain expenses from other "potentially responsible parties"—or PRPs. NWN/200, Wyatt/6. These funds will be treated identically to insurance proceeds for the purposes of the SSRM, and the "Insurance Proceeds" will refer to both insurance payments and reimbursements from PRPs.

Commission Order to reflect actual amounts on NW Natural's books, and other appropriate adjustments as follows:

First, NW Natural adjusts the Insurance Proceeds amount to recognize the receipt of an additional $1.685 million of proceeds received in December 2014 under the Company's settlement with insurers. This addition results in a total Insurance Proceeds amount of $152.2 million rather than the $150.5 million stated in the Order.

Second, NW Natural adjusts the $94.3 million pre-2013 deferral balance in order to reflect the transfer of amounts into a capital account in connection with the authorization for the Company to capitalize the Gasco Source Control facility costs.[5] This is further discussed in Section I Part (B).

Third, NW Natural allocates the environmental costs and the Insurance Proceeds based on the state allocation factors discussed in the following Section I Parts (C) and (D).

Fourth, NW Natural adjusts the Insurance Proceeds to reflect the $2.5 million applied as an offset to the Company's costs associated with the Gasco Source Control in accordance with the Commission's Order 14-077 in Docket UG 263.

Last, the Commission ordered NW Natural to hold the Insurance Proceeds attributable to the future period in a secure account, with interest accruing at the highest rate the Company is able to obtain while reasonably minimizing risk to principal. In a Stipulation filed on July 31, 2015, the parties to this docket jointly proposed that in lieu of holding the insurance proceeds in a secure account, the Company would accrue interest on the pre-tax insurance proceeds at the Prudence-Reviewed Unamortized Environmental Remediation Expense ("PURE") rate – 5 year treasury plus 100 basis points – beginning on the date the Commission issued the Order. The Commission adopted that stipulation on September 11, 2015, in Order No. 15-276.

These calculations and adjustments, among others, are detailed throughout the Revised Compliance Filing and in the attached exhibits.

B. <u>Adjustment for Capital Costs associated with Gasco Source Control.</u>

NW Natural adjusts the pre-2013 deferral balance (identified as $94.3 million in the Order[6]) to reflect a decrease of $5.6 million of deferred expense as shown in Exhibit A. This adjustment is necessary in order to remove from the balance of capital costs associated with 2010 through 2012 Gasco Source Control spend that the Company subsequently included in the transfer to plant in 2013, in accordance with Orders No. 13-424 and 14-077. As shown in **Exhibit A**, the $5.6 million decrease to the pre-2013 deferral balance represents Gasco Source Control capital costs of $72,819 in 2010, $931,065 in 2011, and $4.4 million in 2012, and the related interest ($252,351). The Company notes that all of the environmental

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[5] *See* Commission Order Nos. 13-424 and 14-077 (authorizing NW Natural to capitalize and include in rates the costs associated with the Gasco Source Control, or "Pumping Station," upon initiation of operations at the plant).
[6] Order at 17.

remediation expenses incurred pre-2013 and in 2013 have been reviewed by the Commission for prudency.

Also shown in **Exhibit A** at page 2, the Company reduced the pre-2013 deferral balance by the disallowed expense of $33,400, related to NW Natural's inability to provide accounting information for this amount,[7] plus the related accrued interest on the disallowed amount. Based on the above adjustments, the Company reduced the pre-2013 deferral balance by a total of $5.7 million. With these adjustments, the pre-2013 deferral balance is $88.7 million.

C. State Allocation of Environmental Costs.

On page 6 of the Order, the Commission adopted the method for state allocation of environmental remediation costs agreed to in the parties' Prudence and Earnings Test Stipulation filed with the Commission on July 7, 2013 in this Docket. The Commission referenced that the parties' initially agreed-upon state allocation "relies on historic operations to determine the allocation of costs between Oregon and Washington." Because the Commission cited the use of "historic operations" as the basis for cost allocation, NW Natural believes that the Order intended to allocate to Oregon customers 96.68% of the environmental costs associated with remediation sites that historically served both Oregon and Washington customers, and 100% of the environmental costs associated with sites that historically served only Oregon customers.[8] The Company notes that this is one of the remaining contested issues related to NW Natural's proposed compliance with the Order and is further discussed below in Section IV Part A.

Applying Oregon's state allocation percentage to the April 7, 2003 through December 31, 2012 ("Past Period") environmental costs and associated interest, which have been deemed prudent, Oregon customers' allocated share is $88.7 million, as shown on page 2 of **Exhibit A**. For 2013, Oregon customers' allocated share of the total environmental expenditures is $13.1 million, as shown on page 1 of **Exhibit A**. For 2014 forward, the state allocation will be applied each year after the Commission determines whether the expenditures incurred by NW Natural are prudent.

D. Allocation of Insurance Proceeds.

The Commission ordered NW Natural to "allocate the $150.5 million in Insurance Proceeds across the entire estimated period of the remediation project."[9] Under the Order, one-third of the Insurance Proceeds are to be allocated to costs incurred in the Past Period and two-thirds are to be allocated to 2013 and forward ("Future Period").[10] The Commission found that the intergenerational allocation resulted in "approximately $50.2 million being used

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[7] On page 6 of the Order, the Commission found that all but $33,400 of NW Natural's environmental remediation costs incurred from April 7, 2003 through December 31, 2012 were prudent.
[8] The Stipulation did not detail the site-specific allocation that was described by NW Natural throughout the proceeding.
[9] Order at 6.
[10] Order at 6.

to offset the past period deferrals, and the allocation of roughly $5 million a year, plus interest earned on the balance each year, for the remaining estimated 20 years of the project."[11]

The Commission Order does not expressly prescribe a specific methodology for the state allocation of the Insurance Proceeds. In its March 31, Compliance Filing, NW Natural proposed to allocate 96.68% of the Insurance Proceeds to Oregon customers, and 3.32% to Washington customers. During the compliance filing workshops, at least one party pointed out that this allocation did not mirror NW Natural's proposed allocation of total expenses, which was based on historical operations, allocating 96.68% to Oregon for sites that historically served both Oregon and Washington and 100% to Oregon for sites that historically served only Oregon. NW Natural agrees that the allocation of Insurance Proceeds to Oregon should match the allocation of expense. NW Natural therefore proposes the following method to accomplish this result:

The Company will initially allocate Insurance Proceeds using the 96.68% allocation factor, and will update the allocation factor every 5 years over the future 20-year period, or until costs for all sites are known, based on whether the final costs are related to shared sites (96.68%) or Oregon-only sites (100%). It is important to note that the amount of the Insurance Proceeds is fixed, even though the ultimate costs of the environmental mitigation is unknown. Additionally, the minimum and maximum amounts of insurance that may be allocated to Oregon is known (96.68% of all insurance proceeds for one extreme, 100% for the other extreme). Thus, the variability around the potential outcomes for allocation of the insurance is not large. For example, if all the future spend were at sites related to Gasco, then $147.1 million of insurance would be allocable to offset Oregon allocated costs, and the remaining $5.1 million would offset Washington costs. In the other extreme, if all of the costs were related to the Oregon-only sites, the full $152.2 million would be allocated to Oregon. Because the allocation of Insurance Proceeds to Oregon customers will be accomplished over the next 20 years, through an application of $5 million per year, there is ample opportunity to adjust the initial 96.68% Oregon allocation in the future as actual costs become known. Furthermore, there will be no need to adjust past credits to Oregon customers, because the remaining balance of insurance proceeds to be credited will be large enough to cover the variability that may exist around the total amounts that will ultimately be credited.

Based on the state allocation of Insurance Proceeds described above, and the removal of the $2.5 million from the Insurance Proceeds in accordance with Commission Order 14-077 in Docket UG 263, NW Natural allocated $144.6 million of the $152.2 million of Insurance Proceeds to Oregon customers. These calculations and adjustments are detailed in **Exhibit B**. In accordance with the Order, NW Natural will allocate one-third, or $48.2 million, of the $144.6 million to the Past Period and two-thirds, or $96.4 million, to the Future Period.

Finally, the Commission ordered NW Natural to "hold the insurance proceeds [attributable to the future period] in a secure account, with interest accruing at the highest rate the company is able to obtain while reasonably minimizing risk to principal."[12] On March 31, 2015, NW Natural filed an application for reconsideration, or clarification ("Application"),

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[11] Order at 6.

requesting authorization to place the after-tax amount of its insurance receipts into the secure account ordered by the Commission. On April 15, 2015, Staff, CUB and NWIGU filed responses to NW Natural's Application, and on April 22, 2015, NW Natural filed a reply in support of its Application.

Following settlement conferences held on May 19, 2015 and May 22, 2015, NW Natural and the parties agreed that NW Natural would withdraw its Application, and NW Natural and the parties would enter a stipulation requesting that the Commission amend its Order pursuant to its authority under ORS 756.568. On July 31, 2015, NW Natural filed the Stipulation with the Commission. The Stipulation provides that the value of the pre-tax insurance proceeds will be used as an offset against prudently incurred environmental remediation. The parties further requested that the Commission amend the Order "to eliminate the directive to NW Natural to hold insurance proceeds for future environmental remediation costs in a secure account." Additionally, the parties agreed the interest on the pre-tax insurance proceeds will accrue at the PURE rate beginning on the date the Commission issued the Order. Additional provisions are detailed in the stipulation, which was adopted by the Commission on September 11, 2015 in Order No. 15-276.

II. Recovery of Past Environmental Remediation Costs (4/7/2003 - 12/31/2012).

A. Application of the Earnings Test to the Past Period.

On page 18 of the Order, the Commission stated:

> Exercising our discretion in a manner consistent with our regulatory duties, and in consideration of all of the issues discussed above, we reduce NW Natural's share of past costs to $15 million. NW Natural will amortize the remaining $29.2 million through its SRRM.

Based on the Commission's application of the earnings test for this period, NW Natural has reduced the deferred amounts for the Past Period by $15 million.

III. Recovery of Future Environmental Remediation Costs: 2013 Forward.

A. Tariff Riders

On page 6 of the Order, the Commission adopted Staff's recommendation to divide remediation expenses into two time periods, using a cut-off date of December 31, 2012 to demark the two periods.[13] Environmental costs incurred before December 31, 2012 are to be considered as past costs; environmental costs incurred after December 31, 2012 are to be treated as future costs.[14] With respect to the future time period, the Commission Order also directed NW Natural to collect $5 million per year in base rates through a tariff rider and directed "NW Natural to file a compliance tariff to add this rider using sales estimates and allocation factors from docket UG 221, its last general rate case."[15]

[13] Order at 6.
[14] Order at 6.
[15] Order at 11.

In its March 31 Compliance Filing, NW Natural proposed two tariff riders, Schedule 181 and Schedule 182, to implement the Commission's directive to collect $5 million in base rates for the future period. Schedule 181 proposed to collect $5 million related to 2013, $5 million related to 2014, and the prorated portion of $5 million for 2015. Schedule 182 proposed to collect $5 million in base rates prospectively.

In the March 31 Compliance Filing, Schedule 181 proposed a two-part process. The first part applied a one-time bill surcharge on June 2015 sales service customer bills, which would be offset by the June interstate storage credits provided to the same sales service customers. The second part of Schedule 181 proposed to amortize the allocated share of the $5 million for the five months ending May 31, 2015 and the transportation customers' share of the $5 million each year for 2013 and 2014, through a 12-month amortization over the 2015-2016 PGA year to commence November 1, 2015. NW Natural's proposal was intended to allow for a timely recovery of the Schedule 181 tariff rider amount while mitigating the increase to rates. Certain parties objected to the collection methods proposed under Schedule 181, and given the passage of time, the originally-suggested schedule for the one-time surcharge is now moot. As a result, NW Natural withdraws the proposed Schedule 181 tariff with this Revised Compliance Filing.

In place of Schedule 181, the Company proposes to implement the Commission's directive relating to the 2013, 2014 and partial 2015 future period by capturing these amounts in the Schedule 183 SRRM account for recovery using the same method as the deferred expenses. This results in $13.8[16] million being place into the SRRM Amortization Account.

The collection of these amounts is not additive to the environmental deferrals. Rather, the amounts that are collected pursuant to the rider for 2013, 2014, and 2015 will be applied against, and reduce environmental deferrals for those years. For 2013, the reduction to environmental deferrals is simultaneous with the collection of the rider for that year, since both the expenses from that year and the rider for that year areincluded in the SRRM beginning November 1, 2015. For 2014 and 2015, the tariff rider amounts are included in the SRRM balance beginning November 1, 2015, and the offset of deferred expense will occur following the Commission's prudence review of those costs, and before they are included in the SRRM Amortization Account.

Under the March 31st Compliance Filing, NW Natural would have recovered the $13.8 million associated with the tariff rider for 2013, 2014, and the first ten months of 2015 through a combination of a one-time surcharge and a one-year amortization. Under the approach described above in this Revised Compliance Filing, the recovery of that $13.8 million will be on the same basis as the deferred amounts under the SRRM—through the amortization of only one-fifth of the amount for each year over the next five years.

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[16] The difference between $12.4 million requested in the original compliance filing and $13.8 million in the Revised Compliance Filing reflects the addition of five months of recovery in 2015 that have not been collected. Because the tariff rider is effective November 1, 2015, the first 10 months of the 2015 remain unrecovered, or approximately $3.8 million.

The rate effect of this proposal has been filed, for parties' review and the Commission's approval, as NWN OPUC Advice No. 15-11 dated July 31, 2015 with a requested effective date of November 1, 2015, which is coincident with the Company's annual PGA and other rate change filings.

The Schedule 182 tariff, also filed in NWN OPUC Advice 15-11, proposes to collect \$5 million in base rates using sales estimates and allocation factors from Docket UG 221, the Company's last general rate case, as directed by the Commission. The rate effects of the collection of \$5 million in base rates under the proposed Schedule 182 tariff rider has also been filed for parties' review and the Commission's approval as part of NWN OPUC Advice 15-11 filing with a requested effective date of November 1, 2015.

Also during the compliance filing workshops, the parties suggested NW Natural should accrue interest in customers' favor on the \$5 million collected under the Schedule 182 tariff rider for year 2016 forward, until those amounts are used to offset environmental remediation expenses. NW Natural is generally agreeable to the parties' suggestion because the funds, as they are collected, are available capital to the Company until such time as they are used to offset environmental expenses, which would occur after those expenses are deemed prudent by the Commission and deemed recoverable under the earnings test.

However, NW Natural notes that because it will accrue interest on its total deferred expenses under the Schedule 183 SRRM, the two sets of interest will essentially offset each other, leading to the same basic result as if NW Natural did not accrue interest on the first \$5 million of its environmental remediation expenses in each year. For this reason, and for the sake of simplicity, rather than accruing interest on the \$5 million collection from customers, NW Natural proposes to forego the accrual of interest on the first \$5 million of expenses deferred each year, beginning January 1, 2016, in recognition that these amounts are recoverable through rates under the tariff rider.

B. <u>Timing of Prudence Reviews.</u>

In order to synchronize the annual prudence review of environmental remediation costs ("Prudence Review"), which covers 12-months, with the annual earnings review, which covers 12-months, NW Natural proposes to change the timing of the annual Prudence Review filing from May 15 to March 15, and to report environmental expenditures on a calendar year basis. NW Natural's SRRM tariff currently provides that NW Natural must file its annual report of environmental costs by May 15 each year. Under the existing tariff, NW Natural reports on four quarters of expenses, ending the first quarter of a year, or March 31st. Pursuant to OAR 860-022-0070(6), NW Natural must file test year results of operations for purposes of conducting an earnings review by May 1. This is done on a 12-month calendar year basis. This change will allow more time for the parties' review and will synchronize the prudence review period with the earnings test period so that the earnings test can apply to the same 12 months.

For 2015, however, because March 15 had already passed when the initial compliance filing was made, the Company proposed to file its Prudence Review for the period April 1, 2014 through December 31, 2014, on May 15, 2015, and subsequently submitted that filing on May 15, 2015. For expenses incurred in 2015 and subsequent years, NW Natural will file the annual Prudence Review for the entire calendar year on or before March 15 of the following year. The proposed changes to the SRRM tariff for the timing of prudence reviews has been included in the Company's filing, NWN OPUC Advice 15-11, with a requested effective date of November 1, 2015.

C. **Earnings Test.**

On page 12 of the Order, the Commission adopted an earnings test set at NW Natural's Return on Equity ("ROE"). For purposes of the annual earnings review, the Order states that NW Natural is to include 100% of the WACOG sharing mechanism revenues and losses and 50% of shareholder AMA Optimization revenues derived from ratepayer-supported assets.[17] The Order discusses implementation of the earnings test as follows:

> NW Natural will continue to defer its remediation expenses. Each year, [the Commission] will examine the prudence of those expenditures. [The Commission] will offset prudently incurred amounts first by applying the amounts collected under the tariff rider. If amounts collected under the tariff rider in any year exceed remediation costs for that year, NW Natural will credit the excess amounts against the SRRM balance. [The Commission] will then offset any remaining expenditures by applying that year's insurance proceeds and interest accrued on insurance proceeds. If the remaining expenditures in any year are less than the amount of $5 million in rates and $5 million, plus interest, in insurance proceeds, then the balance of the insurance proceeds will roll forward to offset the next year's costs.
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> [The Commission] will then apply an annual earnings test on the remaining deferred expenses incurred in that previous 12-month period. NW Natural will be allowed to amortize deferred amounts as necessary to bring its earnings up to its authorized ROE. The company will be required to offset each year's environmental expenses with any earnings above its ROE for that year.[18]

Following several discussions with the parties regarding the proper application of an earnings test for 2013 forward, NW Natural proposes to apply an earnings test as follows:

Each year, the amount (if any) by which NW Natural earns more than its authorized ROE will be calculated. To the extent NW Natural is earning over its authorized ROE (inclusive of WACOG sharing mechanism revenues and losses and 50% of shareholder AMA Optimization revenues derived from ratepayer-supported assets), NW Natural will offset any remaining deferred environmental remediation expense with that amount (to the extent NW Natural's deferred environmental expenses are greater than the $5 million tariff rider and application of the $5 million of insurance proceeds plus interest in that year and any carryover insurance proceeds from prior years).

NW Natural will recover interest, accrued at its cost of capital, on only the recoverable deferred amount, until the deferred amount is collected. The "recoverable

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[17] Order at 12.
[18] Order at 13.

deferred amount" refers to total deferred expense in a year, minus any over-earnings in that year.

D. Implementation of 2013 Earnings Test.

On page 6 of the Order, the Commission found that NW Natural's environmental remediation costs from January 1, 2013 through March 31, 2014 were prudently incurred. In 2013, NW Natural recorded $13.1 million of deferred environmental spend. NW Natural will offset the $13.1 million first by the $5 million base rate adjustment, and then by the annual $5 million of insurance proceeds, and interest accrued on insurance proceeds in 2013 ($3.7 million). In total, the Company has $13.7 million to offset expenditures in 2013, which fully offsets the $13.1 million deferral balance in 2013. As there is no further 2013 environmental spend to subject to an earnings test, the Earnings Test for this specific year is not applicable.[19] Consequently, NW Natural will recover accrued interest on the entire deferred expense from 2013, which totals $0.45 million. The $0.45 million in interest is then offset by the remaining $0.6 million of insurance in 2013, leaving $0.15 million of unused insurance in 2013. This unused insurance will be carried forward to apply to 2014 spend. See **Exhibit A**, page 1 of this Revised Compliance Filing for a demonstration of these steps for the 2013 environmental costs.

E. Implementation of 2014 Earnings Test.

The Commission found that the Company's environmental remediation costs for the period from January 1, 2014 through March 31, 2014 were prudently incurred.[20] These amounts and the associated interest have been transferred to the SRRM Post-Prudence Account, and are earning interest at the lower PURE rate. On May 31, 2015, NW Natural filed its annual Prudence Review for the period April 1, 2014 through December 31, 2014. As of the date of this filing, the parties are continuing to review the costs from April 1, 2014 through December 31, 2014 for prudency, and a Commission decision is not expected by the date of NW Natural's annual rate change, effective November 1, 2015. For this reason, NW Natural has not yet sought inclusion of 2014 costs (or the application of insurance proceeds or interest on insurance) in the SRRM.

For illustrative purposes, however, **Exhibit A**, page 1 shows the application of the 2014 earnings test, assuming the Commission finds the April 1, 2014 through December 31, 2014 environmental spend prudent. In 2014, NW Natural recorded $14.2 million of environmental spend. NW Natural will first offset the $14.2 million by the $5 million base rate adjustment, and then the 2013 insurance carryover of $0.15 million, the annual $5 million of insurance proceeds, and interest accrued on insurance proceeds in 2014 ($10.6 million). In total, the Company has $20.7 million to offset expenditures in 2014, which fully offsets the $14.2 million deferral balance in 2014. As there is no further 2014 environmental spend to subject to an earnings test, the Earnings Test for 2014 is not applicable. NW Natural therefore will recover accrued interest on the entire deferred expense from 2014, which totals $0.7 million. The $0.7 million interest is then offset by the remaining $6.6 million of insurance

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[19] For presentation purposes, NW Natural has provided **Exhibit C**, which is confidential and subject to the protective order in this docket, to show the results of the Earnings Test after adding in 50% of AMA Optimization revenues derived from ratepayer-supported assets.
[20] Order at 6.

in 2014, leaving $5.9 million of unused insurance in 2014. This unused insurance will be carried forward to apply to 2015 spend. Upon a Commission determination that the environmental expenses associated with April 1, 2014 through December 31, 2014 time period are prudent, NW Natural will implement the calculations described above, and include the appropriate amount in the SRRM balance.

F. <u>Implementation of 2015 (and Future Years) Earnings Test.</u>

In accordance with the Order and Schedule 183, NW Natural will continue to defer environmental remediation expenses in its deferral account, accruing interest at the Company's authorized rate of return. NW Natural will file its Prudence Review for 2015 expenditures and subsequent years' environmental remediation expenses by March 15 each year. Upon Commission determination that the environmental expenses are prudent, NW Natural will transfer these amounts, offset first by the $5 million in base rates and the $5 million of insurance proceeds, plus interest accrued on the insurance proceeds and any applicable carry-over insurance, to the SRRM Post-Prudence Account. The balance of each year's expenses will be subject to the applicable year's earnings test if the Company earns over its authorized ROE after adding in 50% of AMA Optimization revenues derived from ratepayer-supported assets. Effective November 1 of each year, NW Natural will move one-fifth of the SRRM Post-Prudence Account into the SRRM Amortization Account coincident with the Company's annual PGA filings. NW Natural will account for the interest associated with the deferral and SRRM Post-Prudence Account and the SRRM Amortization Account in accordance with Schedule 183.

For illustrative purposes, page 1 of **Exhibit A** details the above described process for a hypothetical year "20XX" where the hypothetical assumption is that NW Natural defers $17 million of environmental expense, and over-earns by $4 million. As shown in the example, $4 million of the environmental expense would be disallowed, and NW Natural would collect interest accrued on the recoverable amount only.

H. <u>Proposed Treatment of the SRRM.</u>

Exhibit A at page 2, shows that the Company would transfer $54.1 million into the SRRM Post-Prudence Account for calculation of rates effective November 1, 2015. One-fifth of the SRRM Post Prudence Account balance, or $10.8 million, would be transferred into the SRRM Account. The amount transferred to the SRRM Post-Prudence Account is derived from the environmental expenses through 2013 and related interest, which have been deemed prudent. The amount is calculated as follows, as shown on **Exhibit A** page 2:

NW Natural allocated approximately $48.2 million of insurance proceeds to offset the $88.7 million deferral balance. This represents one-third of the Oregon-allocated share of the Insurance Proceeds and the deduction of that amount of insurance proceeds applied against the costs of the Gasco Source Control ($2.5 million).

This amount is further reduced in the customers' favor by the Commission's past period disallowance of $15 million. NW Natural is also offsetting the pre-2013 deferral balance with $3.3 million of interest accrued on the insurance proceeds in 2012, to customers' benefit, at NW Natural's cost of capital. NW Natural applies this interest in customers' favor because it is appropriate to net against the interest that was accrued on the spend in 2012, so that customers bear only the net financing costs incurred by the Company.

The amount in the SRRM is not increased with respect to the $13.5 million of 2013 environmental expenses and related interest, because the Company fully offset the expenses and interest by the base rate adjustment, Insurance Proceeds, and interest on the Insurance Proceeds applicable to that year.

The Company added to the SRRM Post-Prudence Account $16.2 million of interest accumulated on the pre-2013 deferral balance in 2013, 2014, and the first two months of 2015 because those amounts were deemed recoverable after the application of the earnings test. The Company also added $1.3 million of interest accumulated on the 2013 deferred expense in 2014 and the first two months of 2015 to the SRRM Post-Prudence Account.

As described above, in lieu of a tariff rider covering the period 2013 through October 31, 2015 (initially proposed under Schedule 181), $13.8 million has been added to the SRRM Post-Prudence Account in order to collect $5 million for 2013, $5 million for 2014, and $3.8 million for 2015 (the pro-rated amount of the tariff rider applicable to the first 10 months of 2015). The tariff rider amounts associated with 2014 and 2015 will be applied to costs at the time of implementation of the applicable year's earnings test, and when those expenses would otherwise be allocated to the SRRM. The final adjustment to the SRRM Post-Prudence Account is the addition of the interest accrued at the PURE rate on post-prudence costs ($0.7 million). This final adjustment represents the interest that accrued on the amount of recoverable deferred amounts through 2013, from the time the Commission's Order was issued through the effective date of NW Natural's upcoming PGA (during which time the lower PURE rate applied to the deferrals).

I. <u>Adjustment of SRRM Amortization Account.</u>

As discussed above, in order to include some of the environmental costs in rates concurrently with the PGA adjustment on November 1, 2015, and with the agreement of the parties to this docket, NW Natural filed Advice No. OPUC 15-11 on July 31, 2015, which transferred $41.8 million into the SRRM Post-Prudence Account. In the Advice Filing, the Company moved one-fifth of the $48.1 million, or $8.4 million, of the balance in the SRRM Post-Prudence Account into the SRRM Amortization Account for amortization beginning November 1, 2015. Exhibit A at page 5, of NWN Advice OPUC 15-11 details the amounts currently in the SRRM Post-Prudence Account and the amounts to be amortized in the SRRM Amortization Account. The Company recognizes that the SRRM Post-Prudence Account balance in **Exhibit A at page 2**, of this filing differs from the SRRM-Post Prudence Account balance in the Advice Filing. **The Company does not propose to revise the Advice Filing, but rather, proposes to adjust the SRRM Amortization Account in future years consistent with the Commission's decision in this docket.** In other words, once any disputed issues associated with this filing are resolved, we will be able to determine the appropriate balance of the SRRM. NW Natural will update the SRRM balance to reflect the reduction of the amounts already collected from customers, and the addition or subtraction of any necessary amounts determined in the Commission's order in this docket, after concluding a review of this filing. NW Natural would then use the corrected balance going forward, allocating 1/5th of the balance to rates next year, per the normal operation of the SRRM.

IV. <u>Contested Issues.</u>

Following NW Natural's March 31 Compliance Filing, a number of issues were raised by the parties concerning the Company's interpretation of the Order and proposed methods of complying with the Order. While the parties were able to resolve a number of the issues, NW Natural understands there are at least two aspects of the Revised Compliance Filing that one or more of the parties will likely contest. The first issue is whether the Commission's ruling on state allocation of environmental expenses intended to allow NW Natural to recover only 96.68% of its environmental remediation expenses from all remediation sites, even though some of those sites were dedicated 100% to serving Oregon customers**.** The second contested issue is whether, in addition to the $15 million disallowance, the Commission intended to disallow interest that accrued on that amount of deferred expenses from 2013 to the date of the Order. A discussion of these contested issues is offered below, which is intended to assist the expeditious resolution of these issues by the Commission, and explain the Company's decisions to not adjust its position on these items in this revised filing.

A. Whether the Commission's ruling on state allocation of environmental expenses intended to allow NW Natural to recover only 96.68% of its environmental remediation expenses from all remediation sites, even though some of those sites were dedicated 100% to serving Oregon customers.

In the Order, the Commission stated it was adopting the parties' initially agreed-upon state allocation of environmental remediation costs (referring to the stipulation rejected by the Commission in Order No. 13-424) "which relies on historic operations to determine the allocation of costs between Oregon and Washington."[21] That stipulation specifies 96.68% of the costs will be allocated to Oregon customers—using, but not referring to by name, the historical allocation factor.

The parties now argue that in referring to the historic operations approach employed in the stipulation, the Commission intended that ***all*** environmental remediation costs should be allocated 96.68% to Oregon and 3.32% to Washington—***regardless of whether the sites remediated were used to serve Washington customers***. This interpretation should be rejected.

A review of the evidence and advocacy in the record is critical to understanding this issue:

Throughout this case, NW Natural has advocated for a state allocation of environmental remediation costs based on the service customers received from the manufactured gas plants at the time of their operation. The parties referred to this approach as the "historic operations" or "historic allocation" approach. Consistent with this approach, NW Natural has argued that the sites related to the Gasco plant, which served both Oregon and Washington customers, costs should be split in accordance with an allocation factor applicable during the time period the manufactured gas plants were operational—96.68% to Oregon, and 3.32% to Washington. Because certain sites, such as the Portland Gas Manufacturing ("PGM") site, served only Oregon customers, NW Natural argued the costs to remediate those sites should be allocable 100% to Oregon.[22] We believe the Commission's use of the term "historic operations" in the Order suggests that the Commission agrees with NW Natural that to the extent historic operations served Oregon customers, then costs to clean up those sites should be allocated to Oregon customers, and to the extent a site is

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[21] Order at p. 6.
[22] See NWN/100, Miller/26-27 (Phase I Testimony); and NWN/900, Miller/42 (Phase II Testimony).

associated with service to Washington, the costs associated with those sites should not be allocable to Oregon.

CUB has consistently opposed the historic operations approach, arguing the remediation expenses are current costs due to current environmental regulations and the current Washington/Oregon allocation factor (roughly 90% Oregon, 10% Washington) should be used for all costs[23] Importantly, Staff has supported the Company's use of the historical allocation approach—although it has not commented on NW Natural's differentiation between the sites related to the Gasco plant and other sites. [24]

Thus, the result advocated by the parties is unsupported by any testimony or argument submitted in the docket. It is true the rejected stipulation does not on its face differentiate between sites that served Washington and Oregon customers and sites that solely served Oregon. However, that stipulation was the result of a compromise. It is notable that no party has ever explicitly argued – either in Phase I or Phase II of this case – that it was fair or appropriate for the Commission to apply the historic allocation factor to sites that did not serve Washington customers. NW Natural thus interprets the Commission's order as providing for an allocation of costs based on historic usage of the sites, and not ordering an allocation of only 96.68% of costs to Oregon for even sites that are related wholly to Oregon service.

B. Whether, in addition to the $15 million disallowance, the Commission intended to disallow interest that accrued on that amount of deferred expenses from 2013 to the date of the Order.

In the Order, the Commission adjusted the disallowance of the earnings test for the past period downward from the calculated amount of $30.4 million to $15 million.[25] The parties are now seeking to increase the $15 million disallowance, by asking the Commission to disallow an additional $2.8 million they claim represents interest on the $15 million, accrued from January 1, 2013 to the time the Order was issued. NW Natural believes that when the Commission ordered a $15 million disallowance it intended a $15 million disallowance, and the additional disallowance proposed by the parties is contrary to the Order.

In determining the application of the earnings test for the past period, the Commission evaluated the reasonableness of the earnings test by "appropriately balanc[ing] the circumstances of the deferral, the utility's earnings, and the benefits and costs to customers."[26] In evaluating these criteria the Commission considered several discrete factors. *First,* the Commission considered the unique circumstances of the Company's deferral and found NW Natural was required to incur these costs, the costs were deferred over a 10 year period, and during much of that period NW Natural was not permitted to bring a rate case.[27] *Second*, the Commission considered the utility's earnings and found an

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[23] . CUB/100, Jenks/21 (Phase I Testimony); CUB/200, Jenks/29-20 (Phase II Testimony).
[24] Staff/100, Johnson/16 (Phase I Testimony); Staff/200, Johnson-Bahr/4 (Phase II Testimony).
[25] Order at p. 18.
[26] *Id.*
[27] *Id*.

adjustment to the earnings test was "necessary to protect NW Natural's long-term financial health."[28] *Third*, the Commission determined the financial hardship of a $30.4 million write-off in one year would "likely increase [the Company's] financing costs, which would ultimately be borne by ratepayers."[29] The Commission balanced these varied considerations and decided to impose a one-time disallowance in 2015 of $15 million – which it presented as a total sum. Importantly, the Commission did not specify – or give any indication – that the disallowance represented only the principal, and that a further disallowance of interest would be required. The parties' attempt to "re-balance" the Commission's analysis to place a higher financial burden on the Company does not comply with the Order and should be rejected.

V. <u>Request for Approval</u>

The Company respectfully requests that the Commission:

- Allow NW Natural to withdraw its March 31, 2015 compliance filing and replace it with this Revised Compliance Filing;
- Schedule a prehearing conference to establish a schedule for the resolution of any contested issues that the parties raise in this docket;

Copies of this letter and the filing made herewith are available in the Company's main office in Portland, Oregon, and on the Company's website at www.nwnatural.com.

The Company waives paper service in this proceeding.

Please address correspondence on this matter to me with copies to the following:

eFiling
Rates & Regulatory Affairs
220 NW Second Avenue
Portland, Oregon 97209
Telephone: (503) 226-4211 x 3589
Telecopier: (503) 721-2516
E-mail: eFiling@nwnatural.com

Sincerely,

/s/ Mark R. Thompson

Mark R. Thompson
Rates & Regulatory Affairs

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[28] *Id*.
[29] *Id.*

EXHIBIT A

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

NW NATURAL SUPPORTING MATERIALS

UM 1635 Replacement Compliance Filing

NWN OPUC Advice No. 15-03A/ADV 18

September 21, 2015

NW NATURAL

EXHIBIT A

Supporting Material

UM 1635 – Replacement Compliance Filing

NWN OPUC Advice No. 15-03A/ADV 18

September 21, 2015

Description	Page
Applications of Earnings Test	1
Determination of Initial SRRM and Amortization Amounts	2

NW Natural
Application of Earnings Test
Exhibit A
Page 1

CONFIDENTIAL SUBJECT TO PROTECTIVE ORDER 13-030

		2013 (A)	2014 (B)	20XX [1] (C)
1	Deferred Expense	$ 13,060,619	$ 14,185,900	$ 17,000,000
2	Application of base rate adjustment	$ (5,000,000)	$ (5,000,000)	$ (5,000,000)
3	Application of previous year's insurance carryforward	$ -	$ (147,884)	$ -
4	Application of insurance	$ (5,000,000)	$ (5,000,000)	$ (5,000,000)
5	Application of interest on insurance	$ (3,657,302)	$ (10,597,129)	$ (2,088,000)
6	Total amount available to be applied	$ (13,657,302)	$ (20,745,013)	$ (12,088,000)
7	Application of offsets to deferred expense (lesser of line 1 or line 6)	$ (13,060,619)	$ (14,185,900)	$ (12,088,000)
8	Remaining offset to be applied to accrued interest (line 6 minus line 7)	$ (596,683)	$ (6,559,113)	$ -
9	Deferred expense subject to Earnings Test (line 1 plus line 7)	$ -	$ -	$ 4,912,000
10	Over-Earnings by Year		$ -	$ 4,000,000
11	Disallowance (lesser of line 9 or line 10)	$ -	$ -	$ 4,000,000
12	To SRRM Post Prudence	$ -	$ -	$ 912,000
13	Accrued Interest During the Calendar Year	$ 448,799	$ 674,956	$ 661,300
14	Interest on disallowed deferred expense	$ -	$ -	$ 155,600
15	Interest subject to rider and insurance application	$ 448,799	$ 674,956	$ 505,700
16	Application of remaining offset to interest (lesser of line 8 or line 15)	$ (448,799)	$ (674,956)	$ -
17	To SRRM Post Prudence (line 15 plus line 16)	$ -	$ -	$ 505,700
18	Total to SRRM Post Prudence (line 12 plus line 17)	$ -	$ -	$ 1,417,700
19	Total Carry-Over of Insurance to Next Year (line 8 minus line 16)	$ (147,884)	$ (5,884,157)	$ -

Notes:
[1] Sample year 20XX assumes $80 million proceed balance @ 2.61%.

NW Natural
Determination of Initial SRRM and Amortization Amounts
Exhibit A page 2

			Amount	
1	**Pre-2013 deferral balance**			
2	Pre-2013 spend and interest @ 12/31/12	$	88,661,268	[a]
3	Interest in 2013 related to pre-2013 deferred expenses	$	7,155,057	
4	Interest in 2014 related to pre-2013 deferred expenses	$	7,732,006	
5	Jan-Feb 2015 interest related to pre-2013 deferred expenses	$	1,347,973	
6	Disallowance per Order	$	(15,000,000)	
7	Application of 1/3 of insurance proceeds	$	(48,216,213)	
8	Interest in 2012 related to insurance proceeds	$	(3,319,623)	
9	Pre-2013 deferral balance to SRRM Post Prudence	$	38,360,468	
	2013 Deferrals			
10	2013 spend and interest as of 12/31/13	$	13,509,418	
11	Application of tariff rider, insurance proceeds, and interest on insurance			
12	(sum of Exhibit A, lines 2, 4, 5, and 13)	$	(13,509,418)	
13	Interest in 2014 related to 2013 deferred expenses	$	1,089,333	
14	Jan-Feb 2015 interest related to 2013 deferred expenses	$	189,911	
15	Life-to-date 2013 deferrals to Post Prudence	$	1,279,244	
16	**Total to SRRM Post Prudence**	$	39,639,712	
17	**Interest accrued on post prudence costs through 10/31/15**	$	695,004	[b]
18	**Payments towards 2013 deferred costs (2013 tariff rider)**	$	5,000,000	
19	**Payments towards 2014 deferred costs (2014 tariff rider)**	$	5,000,000	
20	**Payments towards 2015 deferred costs (pro-rated 2015 tariff rider)**	$	3,776,931	
21	**SRRM Post-Prudence (for calculation of rates effective 11/1/15)**	$	54,111,648	
22	**1/5 of balance for rates effective 11/1/15**	$	10,822,330	

Notes:

[a] *Pre-2013 balance is reduced by the amount of Gasco Source Control capitalized in 2010, 2011, and 2012.*

12/31/12 balance per March 2015 compliance filing	$	94,370,821
Excluding Source Control Spend for 2010, 2011, and 2012 (OR Allocated):		
2010 Source Control Spend	$	(72,819)
2011 Source Control Spend	$	(931,065)
2012 Source Control Spend	$	(4,380,752)
Total Source Control Spend adjustment	$	(5,384,636)
Source Control Interest on pre 2013 spend	$	(252,351)
Total Source Control adjustments	$	(5,636,987)
Disallowance of $33,400 plus interest	$	(72,566)
Total adjustment	$	(5,709,553)
Adjusted Amount (line 2)	$	88,661,268

[b] *Calculation of interest on Post Prudent account*

		Interest @ 2.61% (2015 PURE Rate)		Balance
Int accrued on the balance placed into the SRRM (line 17) for Mar-Oct 2015			$	39,639,712
Mar-15	$	86,216	$	39,725,929
Apr-15	$	86,404	$	39,812,333
May-15	$	86,592	$	39,898,924
Jun-15	$	86,780	$	39,985,705
Jul-15	$	86,969	$	40,072,674
Aug-15	$	87,158	$	40,159,832
Sep-15	$	87,348	$	40,247,179
Oct-15	$	87,538	$	40,334,717
	$	695,004		

EXHIBIT B

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

NW NATURAL SUPPORTING MATERIALS

UM 1635 Replacement Compliance Filing

NWN OPUC Advice No. 15-03A/ADV 18

September 21, 2015

NW NATURAL

EXHIBIT B

Supporting Material

UM 1635 – Replacement Compliance Filing

NWN OPUC Advice No. 15-03A/ADV 18

September 21, 2015

Description	Page
Insurance and Third Party Recoveries – Oregon Allocation	1

Exhibit B
NW Natural
Order 15-049 Compliance Filing
Insurance and Third Party Recoveries - Oregon Allocation

Total proceeds received as of 12/31/2014	152,201,738	**[a]**
Oregon portion of proceeds (96.68%)	147,148,640	
Less: insurance applied to Source Control **[b]**	(2,500,000)	
Total remaining Oregon proceeds	144,648,640	
1/3 of proceeds applied to life-to-date 2012 balances	48,216,213	
2/3 of proceeds applied to future periods	96,432,427	
Insurance proceeds applied to 2013 expenditures	(5,000,000)	
Remaining insurance to be applied to future periods	91,432,427	

Notes:

[a] This amount does not include accrued interest on insurance proceeds.

[b] Per Order 14-077, $2.5 million of insurance was applied to the Source Control investment included in rate base.

EXHIBIT C

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

NW NATURAL SUPPORTING MATERIALS

UM 1635 Replacement Compliance Filing

NWN OPUC Advice No. 15-03A/ADV 18

September 21, 2015

NW NATURAL

EXHIBIT C

Supporting Material

UM 1635 – Replacement Compliance Filing

NWN OPUC Advice No. 15-03A/ADV 18

September 21, 2015

Description	Page
2013 Oregon Earnings Review – Pro Forma with 50% AMA Revenues	1

Exhibit C - REDACTED
NW Natural
Order 15-049 Compliance Filing
2013 Oregon Earnings Review - Pro Forma with 50% AMA Revenues
($000's)

Line No.		OREGON EARNINGS TEST REVIEW				
		Test Year Results AS FILED	50% of NWN's Share of AMA Revenues	Test Year Results ADJUSTED	TYPE I Adjustments	Results after Type I
		(a)	(a1)	(a2)	(b)	(c)
	Operating Revenues					
1	**Sale of Gas**	$667,918			($10,670)	
2	**WARM Revenues**	(13,240)			13,240	
3	**Revenue & Technical Adjustments**	(9,004)			0	
4	**Decoupling Adjustments**	8,411			(8,411)	
5	**Transportation**	14,083			0	
	Miscellaneous Revenues	4,027			(1)	
6	**50% of NWN's Share of AMA Revenues**	0			0	
7	**Total Operating Revenues**	672,195			(5,843)	
	Operating Revenue Deductions					
8	**Gas Purchased**	338,979			(5,559)	
9	**Uncollectible Accrual for Gas Sales**	175			1,115	
10	**Other Operating & Maintenance Expenses**	116,051			(3,465)	
11	**Total Operating & Maintenance Exp.**	455,205			(7,909)	
12	**Federal Income Tax**	26,743			606	
13	**State Excise**	6,252			140	
14	**Property Taxes**	18,364			169	
15	**Other Taxes**	22,675			69	
16	**Depreciation & Amortization**	62,329			0	
17	**Total Operating Revenue Deductions**	591,569			(6,925)	
18	**Net Operating Revenues**	$80,626			$1,083	
	Average Rate Base					
19	**Utility Plant in Service**	$2,349,248		$2,349,248	($1,306)	$2,347,942
20	**Accumulated Depreciation**	(1,005,403)		(1,005,403)	0	(1,005,403)
21	**Net Utility Plant**	1,343,845		1,343,845	(1,306)	1,342,539
22	**Aid in Advance of Construction**	(3,214)		(3,214)	0	(3,214)
23	**Customer Deposits**	(5,027)		(5,027)	0	(5,027)
24	**Materials & Supplies**	68,440		68,440	0	68,440
25	**Leasehold Improvements**	1,120		1,120	0	1,120
26	**Accumulated Deferred Income Taxes**	(336,756)		(336,756)	0	(336,756)
27	**Total Rate Base**	$1,068,408		$1,068,408	($1,306)	$1,067,102
28	**Rate of Return**	7.55%				
29	**Return on Common Equity**	9.27%				
30	**SHARING THRESHOLD**	9.50%				9.50%
31	**Over Threshold - ROE**					
32	**Over Threshold - After Tax Operating Rev**					
33	**Over Threshold - Before Tax Operating Rev**					
34	**2013 Deferred Environmental Spend**					
35	**Base Rate Adjustment**					
36	**Insurance Applied**					
37	**Deferred Environmental Spend Subject to Earnings Test**					
38	**Overearnings Applied to Environmental Spend (Lesser of Lines 37 and 33)**					