

ENTERED

NOV 18 2013

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON**

UM 1635

In the Matter of

NORTHWEST NATURAL GAS  
COMPANY, dba NW NATURAL,Mechanism for Recovery of  
Environmental Remediation Costs.

ORDER

DISPOSITION: STIPULATIONS REJECTED; FURTHER PROCEEDINGS  
ORDERED

**I. INTRODUCTION**

We opened this docket to address Northwest Natural Gas Company, dba NW Natural's (NW Natural) recovery of environmental remediation costs arising from the historic operation of manufactured gas plants (MGP). The parties filed two stipulations intended to resolve all disputed issues. In this order, we reject the parties' stipulations and order further proceedings.

**II. PROCEDURAL HISTORY**

In docket UG 221, NW Natural's most recent general rate case, we ordered that this docket be opened to address recovery of NW Natural's environmental remediation costs.<sup>1</sup> Procedural schedules were adopted on December 24, 2012 and February 7, 2013. NW Natural filed direct and reply testimony, and The Citizens' Utility Board of Oregon (CUB), the Northwest Industrial Gas Users (NWIGU), and Commission Staff filed rebuttal testimony. On April 10 and July 11, 2013, respectively, the parties filed two stipulations, a rate spread stipulation and a prudence and earnings test stipulation, intended to resolve all disputed issues in the docket. The parties filed testimony in support of those stipulations on August 7, 2013.

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<sup>1</sup> See *NW Natural Gas Co. Request for a General Rate Revision*, Docket UG 221, Order No. 12-437 at 31 (Nov 16, 2012).

### III. DISCUSSION

#### A. Background

The environmental conditions requiring investigation and remediation at MGP sites result from past manufacture of gas, stretching back to the mid-1800's, resulting in the presence in soil, groundwater, surface water, and river sediments of certain chemicals and materials. The Oregon Department of Environmental Quality (DEQ) first identified contamination at the Gasco Site in the late 1980s. In 2000, the Environmental Protection Agency (EPA) placed the larger Portland Harbor Superfund Site on the National Priority List, or Superfund List. Environmental impacts near the Portland Gas Manufacturing facility (PGM) were identified in 2007, during the investigation of the Portland Harbor Superfund Site. The EPA and DEQ have now required NW Natural to take a number of environmental remediation actions, most of which are ongoing. The company is managing six remediation projects at four sites: the Portland Harbor Site, the PGM Site, the Gasco Site, and the Siltronic Site. NW Natural is also pursuing recovery of the costs of its environmental investigation and remediation from insurance coverage provided by various insurers from 1930 to 1986.

After the EPA placed the Portland Harbor Site on the Superfund List, the company began incurring environmental remediation expenses – approximately \$5 million for the period up to 2003. In 2003, in docket UM 1078, NW Natural sought Commission approval under ORS 757.259(2)(e) to defer environmental remediation expenses, namely investigation, study, oversight, and likely remediation costs, associated with five MGP sites. The Commission approved the request in 2003 in Order No. 03-328, and renewed the deferred account each year since then.

#### B. Initially Contested Issues:

Prior to resolving all contested issues *via* the stipulations, the parties initially filed testimony addressing the following issues:

##### 1. *Prudence*

NW Natural: NW Natural stated it has demonstrated that its decision-making associated with its environmental remediation costs was reasonable in light of the circumstances it faced at the time: its historical MGP operations giving rise to environmental impacts were conducted prudently, and its environmental remediation costs were prudently incurred.

Staff: Staff concluded that NW Natural's environmental remediation costs through 2011 were prudently incurred, except for \$33,400 for which NW Natural did not account. Staff also concluded the insurance proceeds and third-party contributions were prudent through 2011.

## 2. *Earnings Test*

NW Natural: NW Natural proposed that the Commission adopt an earnings test that would allow the company to recover deferred environmental remediation expenses, so long as the company's earnings are within a reasonable range, *i.e.* not exceeding 100 basis points above its return on equity (ROE) established in its most recent rate case. For past deferred amounts, NW Natural argued an earnings test should look at the average earnings of the company for the historical period over which the costs were deferred. For future deferrals, the earnings test may be conducted on an annual basis, as the Site Remediation Recovery Mechanism (SRRM) each year amortizes one-fifth of the balance of the company's deferred environmental costs.

NWIGU: NWIGU argued the earnings test should be capped at authorized ROE in each year and consider all earnings, including the weighted average cost of gas (WACOG) incentives, with insurance or other third-party proceeds flowing through directly to customers outside the earnings test. NWIGU argued the earnings test going forward should function on an annual basis and serve to cap amortization of remediation costs at the level of the company's authorized ROE, and should include all sources of company earnings.

Staff: Staff recommended that the Commission apply the earnings test that is typically applied when deferred amounts are requested to be amortized. Under this approach, Staff reviews the utility's results of operations and makes Type 1 adjustments, and then compares these results to the utility's authorized ROE for the period of the deferrals. Staff then determines how much, if any, of the deferred costs could have been appropriately absorbed by the utility in the deferral period.

For the historic period, Staff recommended the Commission adopt reasonable earnings as between 9.2 percent (100 basis points below authorized ROE) and 10.2 percent (authorized ROE during the deferral period). Going forward, Staff recommended the following earnings test with sharing:

- 50/50 sharing in a band for results both up to 50 basis points higher than authorized ROE, and results down to 50 basis points lower than authorized ROE.
- For results lower than 50 basis points of ROE, ratepayers pay 95 percent of costs and shareholders should pay 5 percent of costs.
- For results above more than 50 basis points of authorized ROE, customers pay 5 percent of costs and shareholders pay 95 percent of costs.

CUB: CUB proposed an earnings test that would allow NW Natural to recover costs as necessary to bring earnings up to the authorized ROE. According to CUB, this ensures that customers are not required to pay additional amounts when the company's rates are already adequate to absorb the additional environmental remediation costs and maintain authorized earnings. For future periods, CUB also endorsed an earnings test with sharing bands. CUB argued the bands, or sharing percentages, should be asymmetrical, to

recognize that the mechanism shifts significant risk to customers not found in traditional regulation. CUB proposed the following earnings test:

- a. Customers pay 100 percent of costs up to 100 basis points below ROE
- b. Customers pay 80 percent of costs from 100 basis points below ROE to ROE
- c. Customers pay 10 percent of costs up to 100 basis points above ROE
- d. Customers pay no costs above 100 basis points above ROE

### 3. ***Gasco***

NW Natural: NW Natural stated that it is required by DEQ to construct a hydraulic containment system for groundwater source control at the Gasco Site, to prevent the further movement of contaminated groundwater into the Willamette River. The station is expected to cost between \$11 million and \$30 million to construct, and should be operational in 2014. NW Natural recommended that, after the station is complete and its costs known, and after the Commission has conducted a prudence review of the station's costs through the SRRM process, they should be added to rate base, rather than being amortized through the SRRM. This will lessen the near-term impact on customers and better match amortization of these costs with the expected life of the facility.

Staff: Staff argued that a decision on Gasco is not ripe in this proceeding, because the station is not yet online.

### 4. ***Jurisdictional Allocation***

NW Natural: NW Natural proposed to allocate costs 96.68 percent to Oregon and 3.32 percent to Washington, to reflect that during the period of time when the plant was operational, Oregon received 96.68 percent of the benefits, and therefore should be allocated 96.68 percent of the costs.

CUB: CUB argued that the Commission should not look at historic operations to determine the allocation between states. If remediation costs are supposed to represent a current cost associated with current decisions of environmental regulators, the costs should be assigned to states based on the current allocation: 90.07 to Oregon, and 9.93 to Washington.

## C. **Stipulations**

The parties' stipulations proposed to resolve all contested issues, as follows:

### 1. ***Rate Spread***

The parties agreed that the rate allocation of the SRRM will be based on an equal percentage of margin basis, reflecting the final rate allocation in docket UG 221.

The parties agreed that the rate spread will not change from an equal percent of margin basis during the period over which costs are collected through the SRRM, although the actual percentages billed may vary. If amounts are refunded to customers based on the receipt of insurance proceeds or other third party recoveries, the same basis will be used in allocating such refunds. To the extent insurance proceeds or other recoveries reduce the amounts charged to customers through the SRRM, those receipts will reduce costs to each customer class based on the same equal percentage of margin basis.

## 2. *Prudence*

The parties agreed that the total net environmental remediation expenses incurred by NW Natural through December 31, 2012 in the amount of \$97,624,243 (including interest) were prudently incurred, with the exception of \$33,400 in expenses. The \$97,624,243 deferred does not reflect expenses paid for fines or penalties. The \$33,400 will not be included in the SRRM. The parties stipulated that the insurance settlements finalized through December 31, 2012 were prudently executed.

## 3. *Earnings Test*

ORS 757.259(5) requires the application of an earnings test at the time of amortization. In their stipulation, the parties propose differing treatment for the historic and future deferral periods.

*Amounts deferred prior to January 1, 2013:* For amounts deferred prior to January 1, 2013, the parties agreed that \$7 million dollars of the \$97,624,243 deferred through December 31, 2012 should be disallowed from recovery through the SRRM. The remaining amounts will begin to be amortized through the SRRM on November 1, 2013. The amount to be amortized through the SRRM is \$49,886,779: the total environmental spent, with interest (\$97,624,243), less insurance receipts (\$40,704,064), the reduction per prudence review (\$33,400), and the reduction per settlement (\$7 million).

*Amounts deferred on or after January 1, 2013:* For amounts deferred on or after January 1, 2013, parties agree to the following earnings test for remediation expenses on an annual basis:

- If results of operations (ROO) for a given year show earnings less than 75 basis points below authorized ROE for that year, company is allowed to collect all prudently incurred environmental remediation expenses deferred that year.
- If ROO for a given year show earnings between 75 basis points below authorized ROE and authorized ROE, company credits the balance of the SRRM, up to amount deferred for that year net of insurance proceeds or recoveries allocated to that year, 10 percent of earnings between 75 basis points below authorized ROE and actual ROE.

- If ROO for a given year show earnings up to 50 basis points above authorized ROE, company will credit to the balance of the SRRM, up the net amount deferred,
  - (1) 80 percent of earnings between authorized ROE and 50 basis points above ROE, (2) 10 percent of earnings between 75 basis points below authorized ROE and authorized ROE.
- If ROO shows earnings more than 50 basis points above authorized ROE, company will credit to the balance of the SRRM, up to the net amount deferred:
  - (1) 95 percent of its earnings above 50 basis points above authorized ROE,
  - (2) 80 percent of earnings between authorized ROE and 50 basis points above authorized ROE, and
  - (3) 10 percent of earnings between 75 basis points below authorized ROE and authorized ROE.

During a prudence review, parties reserved the right to inquire about the timing of deferred expenses, and argued that a different timing should be imputed if the parties believe the timing was influenced by the company's anticipated or calculated earnings in any particular year.

#### ***4. Application of Insurance Proceeds and Third-Party Recoveries***

The parties agreed that insurance proceeds and third-party recoveries will be credited to the SRRM as follows:

- Insurance proceeds or third-party recoveries receives as of the close of business December 31, 2012 will be credited against expenses deferred prior to that period for purposes of rate recovery and the earnings test.
- Any insurance proceeds or third-party recoveries received after close of business Decemer 31, 2012 will be credited against amounts approved for amortization in the SRRM in equal amounts per year over the 10 year period following NW Natural's receipt of the funds, for purposes of rate recovery and the earnings test.
- Once insurance proceeds or third-party recoveries are received by the company, those amounts will incur interest, until credited to customers, at a rate calculated as the weighted average of the 5-year treasury bill rate plus 100 basis points, at a 4/5<sup>th</sup> weighting and the modified blended treasury rate, at a 1/5<sup>th</sup> weighting.

#### ***5. Reexamination of SRRM and Earnings Test***

The parties agreed that after the sooner of (1) the date on which the amount collected from customers through the SRRM reached \$250 million or (2) 10 years from the SRRM's adoption, any party may petition the Commission to change or eliminate the SRRM.

**6. *Gasco***

The stipulation provides that the capital costs associated with the Gasco Pumping Station will be evaluated for prudence following its completion, expected by the end of the third quarter of 2013. If the Commission finds the costs associated with the station to be prudent, those costs will be included in base rates in the company's next PGA. The parties will work to determine the extent to which any insurance amounts received should be applied against rate base included in base rates for Gasco.

**7. *State Allocation Factor***

The parties agree that 96.68 percent of the deferred costs amortized through the SRRM will be allocated to Oregon customers.

**D. Resolution**

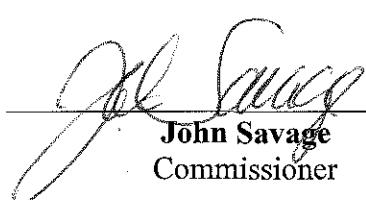
We resolved the issue of the capital costs associated with constructing a water treatment plant at NW Natural's Gasco Site by permitting the capital costs at issue to be placed into rates by November 1, 2013, subject to refund after a review of the prudence of the costs in docket, UG 263. A schedule has been adopted for that docket, and we will address any issues regarding the prudence of the Gasco capital costs in that docket.

With regard to all remaining issues, we conclude that the parties' proposed stipulations do not fairly and prudently resolve whether and how NW Natural's environmental remediation costs should be shared with its customers. Based on the record, we believe that a disallowance of \$7 million from recovery of incurred costs through the proposed SRRM is too low. Further, the environmental remediation costs at issue raise significant public policy considerations about how the Commission should address the sharing of costs, earnings reviews, deadbands, and other proposals made by the parties to apportion costs fairly. We believe that these issues should not be resolved through a stipulation, but rather through a more thorough examination of the facts and policy standpoints.

**III. ORDER**

IT IS ORDERED that the stipulations filed by the parties are rejected. The Commission will schedule a prehearing conference to adopt a schedule for further proceedings in this docket.

Made, entered, and effective NOV 18 2013



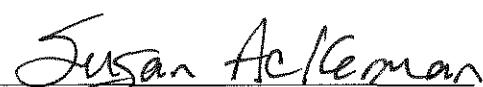
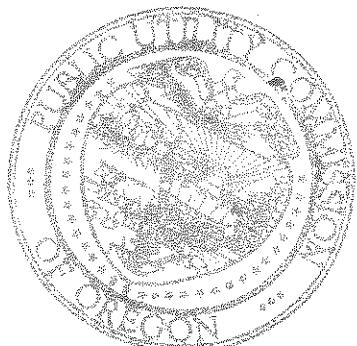
John Savage  
Commissioner



Stephen M. Bloom  
Commissioner

Chair Ackerman, dissenting:

I would accept the stipulations, and so dissent from my colleagues' conclusions. The settlement requirement that the company absorb \$7 million of the historical period's deferrals seems insufficient to my colleagues. This number, however, is within a range of acceptable resolutions that are available to the Commission based on the evidence and reasonable interpretations of applicable law. The going forward settlement appears fairly restrictive to the company based on Commission precedent governing gas utility earnings reviews, but it, too, is within a range of acceptable resolutions. Therefore, it appears that the parties balanced these two periods in reaching their overall stipulation. The overall balance struck seems reasonable given the facts of this case, and I would therefore accept the stipulations.



Susan K. Ackerman  
Chair

A party may request rehearing or reconsideration of this order under ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480 through 183.484.