

**BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

NORTHWEST NATURAL GAS
COMPANY, d/b/a NW NATURAL

Respondent.

DOCKET UG-18_____

NORTHWEST NATURAL GAS COMPANY

Direct Testimony of Amanda E. Faulk

**MASTER SERVICES AGREEMENT
AND
COST ALLOCATION MANUAL**

Exh. AEF-1T

December 31, 2018

DIRECT TESTIMONY OF AMANDA E. FAULK

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I. INTRODUCTION AND SUMMARY

Q. Please state your name and position with Northwest Natural Gas Company (NW Natural or the Company).

A. My name is Amanda Faulk. My business address is 220 NW Second Avenue, Portland, Oregon 97209. I am the General Accounting Manager for NW Natural, responsible for the day-to-day operations of the accounting department. I oversee the planning, recording, compliance and analysis of general and operational accounting and serve as the lead on various interdepartmental and intracompany projects including shared services management. I also oversee the Sarbanes-Oxley (SOX) compliance department.

Q. Please describe your education and employment background.

A. I graduated from Oregon State University with Bachelor's degrees in Accountancy and Business Administration-Finance, and I am a licensed Certified Public Accountant in the State of Oregon. In 2017, I received a Certificate in Utility Management from the Atkinson School of Management at Willamette University. I started at NW Natural in 2013 overseeing NW Natural's SOX Compliance Program, in 2015 I took on the additional general and operational accounting manager duties. Before joining NW Natural in 2013, I worked at PricewaterhouseCoopers, LLP, for six years, in the audit practice.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain the Company's process for allocating costs to affiliates.

1 **Q. Please summarize your testimony.**

2 A. First, I describe the Company's recent reorganization resulting in a holding company
3 structure and the formation of Northwest Natural Holding Company (NW Natural
4 Holdings). Next, I provide an overview of the Company's Cost Allocation Manual, or
5 CAM and Master Services Agreement (MSA). Finally, I explain how the CAM and
6 MSA are consistent with the Company's commitments the Company made in the
7 reorganization proceeding.

8 **II. OVERVIEW OF THE COMPANY'S RECENT REORGANIZATION**

9 **Q. Please provide a brief summary of the Company's recent reorganization to a**
10 **holding company structure.**

11 A. In Docket UG-170094, NW Natural sought—and the Washington Utilities and
12 Transportation Commission (Commission) approved— authorization to reorganize
13 into a holding company structure.¹ The holding company, NW Natural Holdings, was
14 formed on October 1, 2018. Under the holding company structure, NW Natural became
15 a wholly owned subsidiary of NW Natural Holdings, and each current subsidiary of
16 NW Natural became a wholly owned subsidiary, directly or indirectly, of NW Natural
17 Holdings.

18 **Q. Why did the Company seek to establish a holding company?**

19 A. The Company sought to establish a holding company structure to allow the Company
20 to better respond to the changing business environment of the natural gas industry and

¹ *In the Matter of NW Natural Gas Co.'s Application for Approval of Corporate Reorganization to Create a Holding Co.*, Docket UG-170094, Order 01 (Dec. 28, 2017).

1 to allow the Company to pursue new opportunities for growth, while further insulating
2 NW Natural's public utility from its other business ventures.

3 **Q. Has the Company begun implementing its strategy for growth?**

4 A. Yes. The Company is currently pursuing a strategy for growth through the acquisition
5 of water utilities through a new water subsidiary platform, Northwest Natural Water
6 Company, LLC, (NW Natural Water) under NW Natural Holdings. The Commission
7 recently approved NW Natural Water's acquisition of two water utilities, Sea View
8 Water, LLC and Lehman Enterprises, Inc. in dockets UW-180629 and UW-180630.²
9 The Company is also implementing its strategy for growth through acquisitions of
10 water utilities in Oregon and Idaho.³

11 **III. COST ALLOCATION MANUAL AND MASTER SERVICES**

12 **AGREEMENT**

13 **Q. What is the purpose of the Company's Master Services Agreement (MSA) and**
14 **Cost Allocation Manual (CAM)?**

15 A. The MSA is a contract between NW Natural and its affiliates that governs the way in
16 which costs are charged by and between the Company and its affiliates. The CAM
17 describes in detail the methodologies for allocating direct, indirect, and shared services
18 costs between NW Natural and its affiliates.

² *In the Matter of the Application of Sea View Water, LLC, Applicant, for the Sale and Transfer of Assets to Cascadia Water, LLC, Docket UW-180629, Order 01 (Oct. 11, 2018); In the Matter of the Application of Lehman Enterprises, Inc., Applicant, for the Sale and Transfer of Assets to Cascadia Water, LLC, Docket UW-180630, Order 01 (Oct. 11, 2018).*

³ *In the Matter of Salmon Valley Water Co., Application for Authorization of the Sale of Salmon Valley Water Co. to Nw. Natural Water Co., LLC, Pursuant to ORS 757.480 and OAR 860-036-2120, Docket No. UP 362, Order No. 18-358 (Sept. 26, 2018) (Oregon); In the Matter of the Application of Nw. Natural Water Co., LLC to Acquire Falls Water Co., Case No. FLS-W-18-01, Order No. 34103 (July 10, 2018) (Idaho).*

1 **Q. Has the Company prepared a new MSA?**

2 A. Yes. As part of the Company's Commitment No. 25E in Docket UG-170094, the
3 Company committed to filing a new MSA within 90 days of the outcome of that
4 proceeding. The holding company was formed on October 1, 2018, and accordingly
5 the Company filed the revised MSA in Docket UG-170094 on December 28, 2018.
6 The updated version of the MSA is also included as an exhibit to my testimony, Exh.
7 AEF-2C.

8 **Q. Has the Company also prepared a new CAM?**

9 A. Yes. The Company's most recent CAM was filed on April 30, 2018 in Docket UG-
10 180371 with the Company's affiliated interest report. In light of the reorganization and
11 new water utility business line, the Company has updated its CAM since the most
12 recent filing. The updated CAM is included as Exhibit A to the MSA, and accordingly
13 was also filed with the Commission on December 28, 2018 in Docket UG-170094, and
14 is included as an exhibit to my testimony, Exh. AEF-2C.

15 **Q. Please describe the Company's process for updating the CAM.**

16 A. The Company updated the CAM to reflect the addition of NW Natural Holdings and
17 NW Natural Water, and the new cost allocation structure. Additionally, the Company
18 revised the CAM to follow the National Association of Regulatory Utility
19 Commissioners (NARUC) *Guidelines for Cost Allocations and Affiliate Transactions*
20 (NARUC Guidelines). Finally, the Company also reviewed a number of cost allocation
21 manuals filed by peer utilities, and updated its CAM to conform to industry standards.

22 **Q. What are the major changes to the CAM?**

1 A. The major changes to the CAM include organizational changes, the introduction of
2 direct charges from NW Natural to NW Natural Holdings and NW Natural Water, and
3 the introduction of indirect cost allocation of common charges.

4 **Q. Please describe the organizational changes and their impact on the CAM.**

5 A. The organizational changes include the formation of the holding company and
6 execution on the Company's water utility acquisition strategy, with four closed water
7 acquisition deals completed to date. As a result of these organizational changes, the
8 Company reevaluated NW Natural's cost allocations to affiliates to consider the new
9 affiliates, and to consider charges incurred by either affiliate on behalf of others.

10 **Q. Please describe the introduction of the direct charges from NW Natural to NW**
11 **Natural Holdings and NW Natural Water.**

12 A. The introduction of direct charges from NW Natural to NW Natural Holdings and NW
13 Natural Water are a result of the organizational charges described above. Accordingly,
14 NW Natural will directly charge for time incurred on shared services to NW Natural
15 Holdings and NW Natural Water (fully loaded with payroll overhead benefits and
16 administrative overhead charge). The departments that will direct charge via shared
17 services include but are not limited to: Accounting, SOX, Tax, Treasury, Purchasing,
18 HR, Legal, Rates & Regulatory, Safety, IT, executives, and business development.

19 **Q. Please describe the introduction of indirect cost allocation of common charges.**

20 A. In light of the reorganization into a holding company structure, the Company
21 reevaluated common costs that are or will be incurred by NW Natural or NW Natural
22 Holdings that may indirectly benefit the entire organizational group and that do not
23 lend themselves to be tracked directly by affiliate.

1 **Q. What are the key principles in the CAM?**

2 A. Consistent with the NARUC Guidelines, the Company's approach to allocating costs
3 is to directly assign costs whenever possible. For costs that cannot be directly assigned,
4 the Company also allocates costs based on the function or driver of the cost and to
5 ensure that unauthorized subsidization of unregulated activities by regulated activities,
6 and vice versa, does not occur. For the remaining general indirect costs that cannot be
7 direct charged or allocated based on underlying cost drivers, the CAM applies an
8 indirect general allocator. The general allocator, which is based on the Massachusetts
9 Formula, uses an average of plant, revenues, and employee headcount for the preceding
10 year ended December 31st. Costs incurred by the Company or NW Natural Holdings
11 that directly relate to an affiliate will be directly assigned to that affiliate and only the
12 remaining unassigned expenses will be allocated to the affiliates using the general
13 corporate allocation methodology.

14 **Q. What types of costs are allocated through the CAM?**

15 A. The types of costs allocated through the CAM can take the form of direct labor, direct
16 purchased goods or services, and indirect charges, and are charged by the providing
17 party to the receiving party at fully loaded costs.

18 **Q. What types of costs are allocated directly?**

19 A. The Company directly allocates labor costs whenever possible for time that the
20 Company's employees spend on affiliate or holding company matters. Additionally,
21 certain types of expenses such as legal or consulting expenses will continue to be
22 directly allocated to affiliates or the holding company to the extent the expenses are
23 incurred for the benefit of entity being charged. Affiliates are charged directly for any

1 materials or supplies purchased by NW Natural on behalf of an affiliate, used by an
2 affiliate, or used by an employee for the benefit of the entity being charged.
3 Additionally, the Company directly allocates a monthly demand charge to Kelso-
4 Beaver Pipeline under its Gas Transportation Agreement.

5 **Q. What types of costs are allocated by cost driver or function?**

6 A. The insurance policies procured by NW Natural for the entire organization will
7 continue to be allocated to the affiliates covered by the insurance based on the
8 underwriting principles of each policy, including revenues, assets, payroll, and
9 Directors and Officers, as the cost drivers of the insurance policies. The policies will
10 now cover and be allocated to NW Natural Holdings and NW Natural Water and any
11 additional affiliates. Additionally, income tax benefit or expense will continue to be
12 allocated based on the adjusted pre-tax income or loss of the affiliate or activity.

13 **Q. What types of common costs are allocated indirectly using the Massachusetts**
14 **Formula?**

15 A. NW Natural's common costs incurred that are allocated indirectly using the
16 Massachusetts Formula include both the payroll and non-payroll costs, and additional
17 administrative overhead of the following departments: Corporate Governance &
18 Compliance, Corporate Secretary, Financial Planning & Budgeting, Financial
19 Reporting, Internal Audit, Investor Relations, and Shareholders Services.

20 **Q. Are certain costs from NW Natural Holding allocated to affiliates?**

21 A. Yes. NW Natural Holdings' structure as a publicly traded holding company provides
22 substantial benefits to its regulated utilities and other affiliates through access to capital
23 markets. For these costs that benefit various functional areas and affiliates, it is not

1 practical to charge the costs directly. Costs incurred by NW Natural Holdings directly
2 related to the publicly traded company structure will be allocated to the affiliates using
3 the general corporate allocator.

4 **Q. Which departments have common charges that will be allocated indirectly?**

5 A. All costs related to the following departments will be allocated indirectly: Corporate
6 Governance & Compliance, Corporate Secretary, Financial Planning & Budgeting,
7 Financial Reporting, Internal Audit, Investor Relations, and Shareholders Services.

8 **Q. Are there common costs associated with the public company structure?**

9 A. Yes. The common charges also include public company-related costs related to the
10 public company structure that will now be incurred by NW Natural Holdings that were
11 previously incurred by NW Natural. These costs include certain fees such as the Public
12 Company Accounting Oversight Board fee, New York Stock Exchange fee, Securities
13 and Exchange Commission registration fees, etc. that are included in the common cost
14 allocation pool, which will result in allocations to the Company and its affiliates.

15 **Q. Please summarize the major changes to the MSA.**

16 A. The MSA has been revised to reflect the reorganization to a holding company structure
17 and the addition of the new water business. Additionally, the Company revised the
18 MSA to reflect the changes to the CAM, which are described above.

19 **IV. COMPLIANCE WITH UG-170094 COMMITMENTS**

20 **Q. What commitments did NW Natural make in Docket UG-170094 relevant to the**
21 **allocation of shared costs and the prevention of cross-subsidization?**

22 A. The Company made the following commitments in Docket UG-170094:

- 1 • Condition No. 21 requires NW Natural Holdings and NW Natural to accurately
2 track employee, officer, director, agent, and attorney time (inclusive of loading
3 percentages), identifying to within an hour time not spent for NW Natural utility
4 purposes. The cost of such time may not be allocated to NW Natural ratepayers.
- 5 • Condition No. 22 explicitly assigns to NW Natural the burden of proving that any
6 particular NW Natural Holdings or affiliate expense should be allocated to the
7 utility.
- 8 • Condition No. 24 prohibits cross-subsidization between NW Natural and other
9 businesses.
- 10 • Condition No. 25: specifies accounting protocols for inter-company transactions as
11 follows:
- 12 ○ Subject to any cost allocation methodology subsequently approved by the
13 Commission, any allocation of costs, corporate and affiliate investments,
14 expenses, or overheads between NW Natural and NW Natural Holdings or an
15 affiliate will comply with the following principles:
- 16 ▪ Cost allocations to NW Natural will be directly charged whenever
17 possible, and shared or indirect costs will be allocated based upon
18 primary, demonstrable, and transparent cost-driving factors.
- 19 ▪ The holding company and all subsidiaries and affiliates will maintain
20 accounting systems adequate to support the allocation and assignment
21 of costs of executives and other relevant personnel to or from NW
22 Natural.

- 1 ▪ All costs subject to allocation will be auditable and their origin among
2 the companies must be demonstrable, so as to be specifically identified,
3 tracked, and trended. Failure to adequately support any allocated cost
4 may result in denial of its recovery in rates.
- 5 ▪ Any corporate cost allocation methodology used for rate setting, and
6 subsequent changes thereto, will be submitted to the Commission for
7 approval.

8 **Q. Please explain how the CAM and MSA comply with Condition No. 21, which**
9 **requires the Company to track time spent on non-utility activities.**

10 A. As explained in the CAM, NW Natural direct charges its time on non-utility activities
11 to the extent possible in the SAP time tracking system. The departments that direct
12 charge time include but are not limited to: Accounting, including Shared Services
13 Management, Accounts Payable, Clerical Administrative Services, Corporate
14 Communications, Engineering and Operations, Environmental, Executives –
15 Management Oversight, Facilities and Security, Gas Accounting, HR and Payroll,
16 Information Services, Legal, Marketing, Public Policy and Government Affairs,
17 Purchasing and Stores, Rates and Regulatory, Risk and Land, Safety, Strategic
18 planning, business development, Tax, and Treasury. As provided in the CAM and
19 MSA, the time spent on non-utility activities is direct charged to the applicable entity
20 whenever possible, and is not allocated to NW Natural or paid for by NW Natural’s
21 customers.

1 **Q. Please explain how the CAM and MSA comply with Condition No. 22, which**
2 **requires that NW Natural bear the burden of proving that any particular NW**
3 **Natural Holdings or affiliate expense should be allocated to the utility.**

4 A. As provided in the CAM, NW Natural Holdings or affiliate expense which is direct
5 charged on the basis of time or cost driver/function is not allocated to NW Natural.
6 Only certain common or shared services related to NW Natural Holdings are allocated
7 indirectly to NW Natural as described above.

8 **Q. Please explain how the CAM and MSA comply with Condition No. 24, which**
9 **prohibits cross-subsidization between NW Natural and other businesses.**

10 A. The provisions in the CAM and MSA regarding direct allocation of costs by time or
11 cost driver/function, as well as the provisions regarding indirect allocation for common
12 or shared services will prevent cross-subsidization among NW Natural and its affiliates.
13 For both direct charged and indirect affiliate labor charges an additional administrative
14 overhead load of 27.5 percent of labor cost is added to cover the cost of rented space,
15 office supplies, IT costs, furniture and equipment and other administrative costs, as
16 well as the payroll overheads to prevent cross-subsidization.

17 **Q. Condition No. 25 includes several subparts. Please explain how the CAM and**
18 **MSA comply with the subpart of Condition No. 25 which requires that the**
19 **allocation of costs between NW Natural and NW Natural Holdings or an affiliate**
20 **will be directly charged whenever possible.**

1 A. Both the CAM and MSA provide that the allocation of costs will be directly charged
2 whenever possible.⁴

3 **Q. Please explain how the CAM and MSA comply with the subpart of Condition No.**
4 **25 which requires that the allocation of costs between NW Natural and NW**
5 **Natural Holdings or an affiliate will be tracked in appropriate accounting systems.**

6 A. SAP is the Company's accounting system of record. Direct labor and overhead will be
7 recorded directly to affiliates by the employees (or employees' assistants) in the SAP
8 time reporting system and transferred to that affiliate. All NW Natural employees and
9 executive assistants are to record all time spent on non-Company matters in the SAP
10 time reporting system semi-monthly for time incurred in aggregate of 30 minutes per
11 day directly to the respective affiliate, or non-utility activity in which the time relates
12 to. The administrative overhead is recorded manually via a journal entry in SAP and
13 tracked in the respective intercompany accounts. All other charges and allocations are
14 also recorded in SAP via manual journal entry and tracked in the respective
15 intercompany accounts.

16 **Q. Please explain how the CAM and MSA comply with the subpart of Condition No.**
17 **25 which requires that the allocation of costs between NW Natural and NW**
18 **Natural Holdings or an affiliate will be auditable and traceable to their origin.**

19 A. Because costs that direct-billed will be tracked and direct-assigned based on time or
20 cost driver of function, all costs subject to that are direct-billed will be auditable and
21 traceable to their origin. Additionally, the Company will track common or shared costs

⁴ See MSA, Section 4 and CAM at page 2-3 (Exh. AEF-2C).

1 that are allocated indirectly among NW Natural and its affiliates so that those costs will
2 be traceable to their origin as well. As noted above, all charges other than direct labor
3 are recorded via manual journal entry in SAP and the Company maintains all evidence
4 and support for each journal entry, which ensures all entries are auditable and traceable
5 to their origin.

6 **Q. Please explain how the CAM and MSA comply with the subpart of Condition No.**
7 **25 which requires that that any cost allocation methodology will be submitted to**
8 **the Commission for approval.**

9 A. As explained above, the Company filed the revised CAM and revised MSA to the
10 Commission in Docket UG-170094 on December 28, 2018.

11 **V. CONCLUSION**

12 **Q. Does this conclude your testimony?**

13 A. Yes.

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VI. LIST OF EXHIBITS

Exh. AEF-2C.....NW Natural’s Master Services Agreement (Redacted
and Confidential)