WUTC DOCKET: UG-181053
EXHIBIT: ZDK-1CT
ADMIT ☑ W/D ☐ REJECT ☐

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION Complainant, v. NORTHWEST NATURAL GAS COMPANY, Respondent.	DOCKET UG-18___

NORTHWEST NATURAL GAS COMPANY

Direct Testimony of Zachary D. Kravitz

WASHINGTON ENVIRONMENTAL COST RECOVERY MECHANISM

Exh. ZDK-1CT

SHADED INFORMATION IS DESIGNATED AS CONFIDENTIAL PER WAC 480-07-160

December 31, 2018

DIRECT TESTIMONY OF Zachary Kravitz

Table of Contents

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 Zachary D. Kravitz. My current position is Director of Rates and Regulatory Affairs for NW Natural.

Q. Please describe your education and employment background.

A. I received a Bachelor of Arts degree in English and Government from the University of Texas at Austin in 2005. I received a Juris Doctor degree from the University of Florida in 2008. From 2009 through 2011, I worked at the Ohio Attorney General's Office in the Labor Relations Division. From 2011 through 2014, I worked in the energy and utility practice at the law firms of Chester, Wilcox & Saxbe, LLC, and Taft, Stettinius & Hollister, LLP in Columbus, Ohio.

I joined NW Natural's legal department in 2014 as associate regulatory counsel. In 2018, I joined the Rates and Regulatory Affairs department in my current position.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to present NW Natural's request for past and future recovery of its environmental remediation expenses related to historic gas manufacturing plants (MGPs) that served the Company's Washington customers.

Q. Please summarize your testimony.

A. My testimony will describe and support the Company's proposed environmental remediation cost recovery mechanism for MGPs. As discussed in the Testimony of Andrew Middleton, these MGPs were operated by NW Natural and its predecessors dating back to 1913, consistent with prudent practices of the day. As explained by NW

Natural witness Robert Wyatt in Exh. RJW-1T, the environmental remediation costs associated with these MGPs were prudently incurred by the Company pursuant to applicable state and federal law, and by order of governmental agencies, under a statutory framework that governs NW Natural's responsibilities related to remediation of past gas manufacturing operations.

- My testimony will begin by quantifying the environmental remediation expenses incurred through November 30, 2018 (past environmental remediation expense), as well as the insurance proceeds and other third-party payments collected by the Company to date, that offset those costs. I then describe NW Natural's proposal for recovering both past and future environmental remediation costs. Specific to past environmental remediation expense incurred, NW Natural asks that the Commission:Find that the environmental remediation costs incurred through November 30, 2018, were prudently incurred and recoverable in rates; and
- Order that past environmental costs should be fully offset by the insurance proceeds and other third-party payments received by the Commission to date.

Specific to environmental remediation costs incurred in the future (future environmental remediation costs), NW Natural asks that the Commission adopt a recovery framework that:

- Provides for annual reporting and annual prudency review of future environmental remediation costs, beginning in March 2020;

- Allows the Company to apply all remaining insurance proceeds and third-party payments to environmental remediation expenses;
- Allows the Company to apply any insurance proceeds or third-party payments received in the future to offset then-current environmental remediation costs; and
- Allows the Company to recover prudent remediation costs, as offset by applicable insurance proceeds and third-party payments, by tracking these costs into rates through the annual PGA filing with a rate effective date of November 1 of every year.

II. PAST ENVIRONMENTAL REMEDIATION EXPENSE INCURRED

Q. Please provide a high-level description of the environmental remediation costs for which the Company is proposing recovery in this case.

A. The costs for which the Company requests recovery in this case are related to NW Natural's environmental remediation efforts at certain sites impacted by the Gasco MGP (Gasco or the Gasco Plant). NW Natural's predecessor in interest, Portland Gas & Coke Company, owned and operated the Gasco Plant from 1913 to 1956, during which time Gasco produced gas that was used to serve that Company's Oregon and Washington customers. Gasco ceased operation in 1956, and in the late 1960's most of the gasification facilities were dismantled and removed. Over the past decade, NW Natural has been required by state and federal agencies to perform environmental remediation at five sites located on and around the original Gasco plant -- Gasco, Wacker a/k/a Siltronic, Portland Harbor, Tar Deposit, and Central Gas Holdings. These sites are referred as "shared sites" given that the costs of these efforts are allocable to both Oregon and Washington customers. Since 2011, NW Natural has been deferring the Washington-allocable portion of these costs pursuant to Order No. 01 in Docket UG-110199, as well as the insurance proceeds and other third-party payments received by the Company in connection with these costs.

Q. Has the Company been engaged in similar remediation efforts for which it is not requesting recovery in this case?

A. Yes. The Company has also been performing similar remediation work at several sites impacted by an MGP plant that did not serve Washinton customers. Those sites are referred to as "non-shared" sites, and the costs of that work are not allocable to Washington customers.

Q. Please describe the insurance proceeds and third-party payments received by the Company in connection with its environmental remediation costs at both the shared and non-shared sites.

A. In 2008 the Company instituted litigation against several insurance carriers, in order to maximize its recovery and to offset as fully as possible the costs of remediation that would otherwise be borne by its customers. Ultimately the Company received approximately $152.8 million in insurance and third-party proceeds that offset the environmental remediation costs at both its shared and non-shared sites. The Company may receive additional insurance proceeds and third-party payments in the future. In addition, the Company may receive proceeds from other third-party owners and operators found responsible for contamination of the Portland Harbor Site – known as Potentially Responsible Parties (PRPs) – that would offset remediation costs.[1]

Q. What is the total amount spent by NW Natural in performing the remediation work at the shared sites?

A. As of November 30, 2018, the Company has spent $136.2 million on remediation work at the shared sites. Please see Exh. ZDK-2C.

Q. What percentage of the remediation expense incurred at the shared sites related to service to Washington customers?

A. Based on historical records, NW Natural estimates that 3.32 percent of its remediation costs assigned to the shared sites are related to Washington customers. This percentage is based on the percentage of gas from the Gasco Plant facility that was sold to Washington customers during the period it was in operation through 1956, when the plant ceased operations. Exh. ZDK-3 provides the calculations that support the 3.32 percent figure.

Q. Has the 3.32 percent sharing allocation been approved by the Washington Commission?

A. No. In a supplemental UG-110199 petition filed July 17, 2012, the Company proposed to the Washington Commission an allocation of 3.32 percent deferred costs due to historic MGP service in Washington. That petition was not acted upon, and NW Natural was informed by Staff that the Commission would not act upon this request until the Company actually sought rate recovery in Washington.

[1] Please refer to Exh. RJW-1CT, page 8, lines 7-8.

Q. Does the Company continue to propose that Washington customers bear 3.32 percent of the costs associated with the shared sites?

A. Yes. NW Natural continues to believe the 3.32 percent sharing allocation is appropriate as demonstrated in Exh. ZDK-3.

Q. Please quantify the deferred shared sites expense as of November 30, 2018.

A. As of November 30, 2018 the Company had deferred $3.0 million of expenses for remediation efforts at the five shared sites. This amount represents 3.32 percent of total remediation expenses at these sites incurred after January 26, 2011. In accordance with UG-110199 Order 01, interest has not been accrued on these balances. The table below breaks this expense down by each of the five shared sites:

Gasco (a)	$2,603,422
Portland Harbor	318,131
Tar Deposit	18,093
Siltronic (b)	54,276
Central Service Center	22,906
Total shared sites	**$3,016,828**

(a) Includes Uplands, Sediments, Source Control operating costs and insurance litigation costs.
(b) Costs incurred prior to Siltronic project being combind with Gasco Uplands according to an agreement with DEQ.

This amount represents the environmental remediation expense allocable to NW Natural's Washington customers.

Q. Has the Company incurred expenses at the shared sites that are not deferred?

A. Yes. Prior to the filing date of NW Natural's petition seeking an Accounting Order in UG-110199, NW Natural incurred remediation expenses related to efforts at the five shared sites. The portion related to service to Washington customers is $1.5 million, which represents 3.32 percent of total remediation expenses at these sites. NW Natural is not seeking to allocate to these pre-deferral expenses to Washington customers. However, these pre-deferral expenses are relevant to the Company's request in this case, because we are seeking to apply insurance proceeds and third-party payments allocable to Washington to all of the environmental expenses associated with service to Washington customers.

Q. Please quantify the insurance proceeds and third-party payments that the Company proposes to use to offset environmental expenses associated with service to Washington customers.

A. As of November 30, 2018, the Company had recieved a total of $152.8 million in insurance proceeds and third-party payments related to its remediation expenses at the shared and non-shared sites. NW Natural proposes to use 3.32 percent of these insurance and third-party proceeds to offset the total environmental remediation expense attributable to the shared sites. Using this approach, the Company proposes that $5.1 million of the total insurance and third party payments received be applied to the the $4.5 million in environmental remediation expense related to service to Washington customers, as of November 30, 2018.

III. PRUDENCE REVIEW AND TREATMENT OF EXPENSES INCURRED AND INSURANCE PROCEEDS

Q. What treatment does the Company propose for its past environmental expense related to the shared sites?

A. NW Natural proposes that all pastenvironmental remediation costs related to the shared sites as of November 30, 2018 be reviewed and found to be prudently incurred. The

Company believes the Semi-Annual Report on Environmental Costs[2] filed with the Commission, and the testimonies of Messrs. Middleton and Wyatt provide substantial record for a determination of prudency of environmental remediation expenses. The Company also requests that the Commission approve NW Natural's allocation to Washington customers of 3.32 percent associated with the shared sites costs.

Q. What treatment does the Company propose for insurance proceeds received as of the end of November 30, 2018?

A. NW Natural proposes that the Commission find that 3.32 percent of these insurance proceeds – totaling $5.1 million – should be used to offset the Company's expense related to service to Washington customers, leaving an insurance balance of $0.6 million.

Q. What treatment does the Company propose for the remaining insurance proceeds?

A. NW Natural proposes that the remaining insurance proceeds be applied against shared sites expenses incurred after November 30, 2018, until they are exhausted. Accordingly, all insurance proceeds would be exhausted before the Company would seek to recover any remediation expenses from customers.

IV. WASHINGTON ENVIRONMENTAL COST RECOVERY MECHANISM (ECRM) PROPOSAL

Q. Please summarize your Washington Environmental Cost Recovery Mechanism (ECRM) proposal.

[2] Per UG-110199 Order 02, this report will be filed annually beginning March 2019.

A. NW Natural proposes an annual review of the prudency of its future environmental remediation costs allocable to Washington customers. This review would be a part of, and coincide with, a Washington Environmental Cost Recovery Mechanism (ECRM) Regulatory Report filed annually in March.[3] Prudent costs would be amortized annually, via a simple cost recovery mechanism, and tracked into the annual PGA filing with a rate effective date of November 1 of that year.

Q. Please summarize NW Natural's Washington environmental remediation cost reporting to date.

A. Beginning March 26, 2012 and through March 15, 2018, NW Natural has filed with the Commission semi-annual reports on its deferred environmental expenses and balances.

Q. Please describe NW Natural's reporting requirement beginning March 2019.

A. UG-110199 Order 02 establishes, beginning March 1, 2019, that NW Natural will file with the Commission an annual report on its deferred environmental expenses and balances, "as well as provide a narrative summary along with a timeline summarizing the status of each environmental remediation project."[4] Per Order 02, the goal of the new reporting requirements is to "assist Commission Staff in monitoring the Company's compliance with its remediation obligations."[5]

Q. What modifications does NW Natural propose for this annual reporting requirement?

[3] The report the Company currently files is referred to as the "Semi-Annual Report on Environmental Costs."
[4] See UG-110199 Order 02, paragraph 4.
[5] *Ibid*, paragraph 5.

A. The annual report process does not specify that the Commission will make a prudency determination based on the report. NW Natural proposes that the annual report process provide that each year, based on the information included in the report, or such additional information that may be requested by the Commission or its Staff, the Commission will determine the prudency of the costs incurred for all Washington allocable shared sites costs over the prior calendar year. The first annual report to include a test of prudency would be the first report to be filed after the rate effective date of this rate case, on March 1, 2020.

Q. What timeline does the Company propose for the prudency review?

A. Beginning March 1, 2020 the Company would submit its first annual report for prudency review, and on March 1 of every year thereafter. The annual report would detail the Company's recorded expenditures for environmental remediation activities at the shared sites since the last month prudently incurred expenses were placed into an account (the "ECRM Account") for deferral, up through the end of the prior calendar year. The recorded expenditures included in the annual report would equate to one year's worth of Washington allocable remediation expenses.[6] The Company would also report the receipt of any insurance or other third-party proceeds related to its remediation activities during that same time period. Between March 1 and the Company's PGA filing date of each year (usually September 15), the parties,

[6] For example, the March 2022 report would seek prudency review of remediation expenses incurred from January 2021 through December 2021 for recovery in the 2022-2023 PGA effective November 1, 2022.

Commission Staff, and ultimately the Commissioners would have an opportunity to review these costs and receipts to determine that they were prudently incurred.[7]

Q. Will the first annual report following this rate case include environmental remediation expenses incurred prior to the preceding 12 months?

A. Yes. Since we propose recovery of costs up through November 30, 2018 in this proceeding, the first annual report with prudency review obligation would include deferred shared sites expenses for December of 2018 in addition to the calendar year 2019 expenses. All annual reports thereafter would be based on calendar year expenses.

Q. What cost recovery mechanism does NW Natural propose for costs that are deemed prudent after the review period?

A. Once the expenses are determined to be appropriately recoverable in rates through the annual reporting process, we propose that the remediation expenses – net of all available Washington allocable insurance proceeds – be transferred to the ECRM Account. The ECRM Account will be amortized into rates over a one-year period via the proceeding PGA, effective November 1 of that year.

Q. How do you propose to spread the amoritized expense across rate schedules?

A. The annual environmental remediation deferral amount placed in the ECRM Account would be collected from all customers by applying a percentage of the costs to each class that is equal to the percentage of margin that is paid by that class as of that PGA year.

[7] The Company proposes a prudency review cut-off date about two weeks prior to the PGA filing date, or September 1 annually.

Q. How will the Company treat negative deferral balances?

A. It is possible that in some future year, recoveries from insurance providers or other third-party payments allocable to Washington will more than fully offset shared sites expenses. NW Natural proposes amortizing the amount over one year and returning the deferral balance in the ECRM Account to customers through the PGA filing effective November 1 of the year immediately following the negative balance year. A credit balance may be carried, however, to the next PGA filing if it is determined by the Commission that the credit balance is best used to offset future expected environmental site remediation costs not yet recorded in the deferral account, or for such other reasons as the Commission may approve.

Q. Please explain why you believe that the proposed ECRM will benefit customers?

A. The proposed ECRM will allow for the environmental remediation expenses to be recovered over time, as they are incurred, instead of allowing large deferral balances to accrue between the Company's rate cases. This approach will better match costs and benefits and will improve generational equity.

The mechanism would also accommodate uncertainty regarding future recoveries and costs by adjusting the amount of recoveries in the future to reflect costs as they are incurred, net of any available insurance recoveries or other third-party payments. The mechanism also allows for recovery to be based on actual costs, avoiding the over- or under-recovery that would result from basing collections strictly on a forecast of costs or receipts.

V. <u>IMPACTS OF THE ECRM PROPOSAL ON CUSTOMER RATES</u>

Q. What will be the impact of the ECRM proposal on customer rates at the effective

date of this rate case?

A. There will be no impact on customer rates due to this proposal at the time new rates go into effect with this rate case. There will be no impact because the deferred remediation expenses will be offset by Washington allocated insurance proceeds. The net balance of insurance proceeds would be $0.6 million.

Q. When will the ECRM proposal, if approved, begin to affect customer rates?

A. This proposal would not impact customer rates until the first PGA filing after the effective date of this rate case. This would be the filing for the 2020-2021 PGA year. The Company expects that shared sites remediation expenses allocated to Washington will achieve a net positive balance for the first time in the latter half of 2019.

Q. Please summarize the estimated impact of the ECRM proposal on customer rates beyond the rate case effective date.

A. During the first year this mechanism is in effect beyond the effective date of this rate case, the impact to rates beginning the 2020-2021 PGA year will be minimal due to the availablility of insurance proceeds to off-set much of the remediation costs in 2019. We anticipate that residential and small commercial rates would rise by 0.4 percent in that PGA year relative to current rates. Anticipating the rate impact in future years can be difficult because the annual remediation costs and third-party recoveries are not generally smooth year-to-year, but we expect beginning the 2021-2022 PGA year and through at least the 2024-2025 PGA year the rate impact to residential and small commercial customers will be between 0.6 percent and 0.7 percent in each year relative to current rates.

Q. Does this conclude your testimony?

A. Yes, it does.

VI. LIST OF EXHIBITS