BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

NORTHWEST NATURAL GAS COMPANY

Direct Testimony of Tobin F. Davilla

OPERATIONS & MAINTENANCE

Exh. TFD-1T

December 18, 2020

DIRECT TESTIMONY OF TOBIN F. DAVILLA

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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 Tobin Davilla. I am the Budget and Financial Analysis Manager at NW Natural. I am responsible for producing the annual operations and maintenance ("O&M") budget, the capital expenditures ("capex") budget, and the income statement budget. I also support the development of the short-term and long-term financial forecasts for senior management and support the organization with financial modeling and analysis.

Q. Please summarize your educational background and experience.

A. I hold both a Bachelor of Science degree and a Master of Business Administration degree from Oregon State University. Prior to joining NW Natural, I held a position in Finance at PacifiCorp. I joined NW Natural in 2007 as a financial analyst and have held numerous positions within the Finance department, and have been in my current position since 2018.

Q. Please provide a summary of your testimony.

A. My testimony explains how NW Natural calculated the O&M expense included in its revenue requirement in this proceeding. Specifically, I provide an overview of how the Company adjusted Test Year O&M to arrive at its rate case request and additional context on how NW Natural manages its O&M expense.

II. OPERATIONS AND MAINTENANCE EXPENSE

Q. What is the Washington-allocated O&M expense included in the Company's revenue requirement in this case?

A. The Washington-allocated expense included in the revenue requirement in the first year that rates are in effect (November 1, 2021 to October 31, 2022) ("Year One") is $19.4 million. This amount increases to $19.9 million beginning in the second year of the rate period (November 1, 2022 to October 31, 2023) ("Year Two"). As further described below and in the Direct Testimony of Jim Downing, Exh. JRD-1T, this increase in Year Two is for ongoing O&M associated with the Horizon 1 information technology and services ("IT&S") project.

Q. How did the Company calculate its Washington-allocated O&M expense?

A. The Company calculated its Washington-allocated O&M expense by:

1. Determining the Washington-allocated O&M expense that it incurred during the historical Test Year—October 1, 2019 through September 30, 2020;
2. Reducing that amount for O&M costs that the Company is not seeking cost recovery for in this case; and
3. Making certain restating and pro forma adjustments to better reflect the expense the Company will incur during the rate effective period.

Each of these steps is discussed below.

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A. Washington-Allocated O&M Expense Incurred During Test Year

Q. What was the total O&M expense that the Company incurred during the Test Year?

A. The Company incurred $185.3 million in total O&M expense during the Test Year. Since the Company serves customers in Washington and Oregon, it must allocate a certain amount of O&M expense to its Washington customers.

Q. How did the Company allocate O&M expense to its Washington customers?

A. The total O&M expense incurred during the Test Year—$185.3 million—was allocated to O&M Federal Energy Regulatory Commission ("FERC") accounts. The Company then applied Washington allocation factors to each FERC account to calculate Washington-allocated O&M.[1] This resulted in $19.4 million of Washington-allocated O&M incurred during the Test Year, which is then further adjusted as explained in sections B and C below.

B. O&M Costs for which the Company is Not Seeking Cost-Recovery

Q. Please describe the O&M costs that the Company is not seeking cost recovery of in this case.

A. The Company removed all expenses attributable to non-utility operations, the Supplemental Executive Retirement Plan ("SERP"), Executive Supplemental Retirement Income Plan ("ESRIP") and all other non-recoverable costs. In addition, the Company is not seeking recovery of COVID-19 related costs, such as personal

[1] *See* the Direct Testimony of Kyle Walker (Exh. KTW-1T) for further detail on how costs are allocated between Washington and Oregon.

protective equipment and IT&S capabilities for NW Natural's employees to work from home, that are not expected to re-occur during the period when rates are in effect, or that would otherwise already be captured in the Company's deferral for COVID-19 related costs and savings in Docket UG-200264. Furthermore, the Company is not making an upward adjustment to its O&M expense for certain items, such as travel and meals, that were not incurred during the Test Year due to COVID-19.

The cumulative effect of not seeking cost recovery of these O&M costs is a $0.6 million reduction in Washington-allocated O&M.

C. Restating and Pro Forma Adjustments to O&M Expense

Q. Please summarize the restating and pro forma adjustments to O&M expense.

A. The Company made restating and pro forma adjustments to better reflect the expense the Company will incur during the rate effective period. These adjustments use the same Washington allocation factors described above. Except for the ongoing expense related to the Horizon 1 IT&S project,[2] these adjustments are for Year One rates. The Horizon 1 adjustment will take effect during Year Two of the rate period. Each of these restating and pro forma adjustments are reflected in the table below, and in the next two subsections of my testimony.

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[2] The Horizon IT&S project is described in the Direct Testimony of Jim Downing, Exh. JRD-1T.

	$ millions
WA O&M Test Year Results	$18.750
Adjustments (Restating)	
Annual Incentive Adj.	$0.042
Rate Case Adj.	$0.110
Claims Adj.	$0.004
Clearing Adj.	($0.031)
Marketing & Promotional Adj.	($0.284)
Holdco Adj.	$0.014
Total Restating Adj.	($0.145)
Adjustments (Pro Forma)	
Payroll Adj.	$0.405
Payroll Overhead Adj.	$0.129
Headquarters Adj.	$0.307
Total Pro Forma Adj.	$0.841
Year 1 WA O&M Expense	$19.446
Horizon 1 Adj.	$0.460
Year 2 WA O&M Expense	$19.906

1. Restating Adjustments

Q. Please describe the annual incentive compensation adjustment.

A. The Company used a three-year historical average of annual incentive compensation paid, and made an adjustment to the Test Year to reflect this average amount. This three-year historical average excludes incentive pay compensation for Bargaining Unit ("BU") employees because these employees are no longer eligible for incentive compensation under the Collective Bargaining Agreement ("Agreement")[3] with the Office and Professional Employees International Union, Local 11, AFL-CIO ("Union") effective December 1, 2019. This adjustment increased O&M expense by $42

[3] Exh. MBR-4.

thousand. The Direct Testimony of Melinda Rogers found in Exh. MBR-1T provides more information on the incentive compensation and wages and benefit expense included in the case.

Q. Please describe the other restating adjustments that the Company has made.

A. The Company made five additional O&M restating adjustments. The first restating adjustment is outside service expense related to this rate case. The expense amount reflects one-third of the total expense expected in this case to reflect an average rate case frequency. This increased Washington-allocated O&M expense by $110 thousand.

The second restating adjustment is a claims adjustment for "ordinary" and "extraordinary" claims. An ordinary claim involves a claim for damages related to Human Resources issues, operating issues, and automobile claims. Extraordinary claims are all other claims. The adjustment for ordinary claims reflects the actual claims paid during the Test Year. In addition, we have adjusted the Test Year extraordinary claims by using a 3-year average of extraordinary claims paid versus the Test Year expense. The claims adjustment increased Washington-allocated O&M expense by $4 thousand.

The third restating adjustment is a clearing adjustment. This adjusts the difference between actual costs and what was expensed during the Test Year. The clearing restating adjustment reduced Washington-allocated O&M expense by $31 thousand.

The fourth adjustment is to remove FERC account 912 (Marketing) and FERC account 913 (Promotional advertising) expense, totaling $284 thousand, from O&M

expense. This is consistent with how the Company has treated this expense in its last Washington rate proceeding.

Finally, the Company has several departments that perform administrative and general functions for the benefit of NW Natural, Northwest Natural Holding Company, and its affiliates. These departments' labor and non-labor costs are indirectly charged via a corporate allocation to the affiliates that benefit from their service on a quarterly basis. Prior to 2020, however, the Company's affiliates were allocated these costs only at the end of the calendar year. Consequently, the Company needed to adjust these charges so that it only reflected the Test Year (October 1, 2019 to September 30, 2020), and not all of calendar 2019 and the first three quarters of 2020. The result of this adjustment is an increase to O&M of $14 thousand.

These five restating adjustments can be found in the revenue requirement model, Exh. KTW-4.

2. Pro Forma Adjustments

a. Payroll Adjustment

Q. Please explain the adjustment to BU payroll costs.

A. BU employee payroll costs were calculated using the average number of BU employees during the Test Year, and were adjusted for wage increases under the Agreement with the Union. Under the Agreement, there were several wage increases during the Test Year. First, effective December 1, 2019, all BU employees were moved to a new base rate for their job group, resulting in a 3.50 percent increase for BU employees generally. Second, the Agreement increased wages by 1.50 percent on December 1, 2019 (this is in addition to the 3.50 percent increase above), and by 2 percent on June 1, 2020. In addition to wage increases during the Test Year, the Company adjusted BU payroll costs to reflect the Agreement's 3.50 percent wage increase, effective June 1, 2021. Both 2020 and 2021 also reflect an additional 0.80 percent per year for promotions and movements from entry rate to experienced rate as described in the Agreement. *See* Exh. MBR-1T. The total adjustment to BU payroll increased O&M expense by $214 thousand.

Q. Please explain the adjustment to Non-Bargaining Unit ("NBU") payroll costs.

A. Similar to BU payroll costs above, NBU payroll costs were calculated using the average number of NBU employees during the Test Year, and were adjusted to reflect the 3 percent pay increase that will take effect on March 1, 2021. The Company also assumes an additional 0.60 percent for promotions that have historically occurred throughout the year. *See* Exh. MBR-1T. The total adjustment to NBU payroll increased O&M expense by $190 thousand.

Q. Does the O&M payroll expense include any non-regulated full-time equivalents (FTEs)?

A. No. The O&M payroll expense excludes any and all payroll related to non-regulated activity. This non-regulated activity includes any time spent by employees on affiliate activities.

b. Payroll Overhead Adjustment (Benefits)

Q. Please describe the payroll overhead adjustments.

A. The Company adjusted for medical benefits and pension expense. For medical benefits, the Company used 2021 medical benefit costs, as well as employee service elections completed in November 2020. This adjustment also reflected that NBU employees will pay for a greater share of Medical PPO and Medical HMO Plans. Currently the Company pays 80 percent of the premium under these plans and NBU employees pay 20 percent. In 2021, the Company's share will drop to 78 percent and the employees' share will increase to 22 percent. The medical benefits adjustment increased O&M expense by $72 thousand.

The Company has adjusted pension expense to reflect calendar year 2021. This reflects the amount provided by the Company's actuary, and better reflects what the Company will incur during the period when rates are in effect. This increases O&M expense by $58 thousand.

c. Headquarters Expense

Q. What is the Company's total adjusted headquarters expense?

A. NW Natural's headquarters total annual adjusted headquarters expense is $10.9 million. This is composed of $8.2 million in lease expense and common area maintenance ("CAM") costs, $1.5 million in tenant improvement amortization, $1.1 million operating expenses, and $0.2 million in company vehicle parking as shown in column A of Exh. TFD-2. The Company had to adjust its headquarters expense because it moved to a new headquarters, 250 Taylor, during the Test Year. These total adjusted amounts annualize NW Natural's headquarters expense at 250 Taylor, and do not include any expense related to NW Natural's previous headquarters, One Pacific Square. The Direct Testimony of Wayne Pipes, Exh. WKP-1CT, further describes NW Natural's decision to move to 250 Taylor.

Q. How was the Company's headquarters expense allocated between the utility and the Company's other affiliates?

A. The operating, lease, and CAM expenses, excluding the storage component, were allocated 95.1 percent to the utility as shown in column B of Exh. TFD-2. This allocation reflected the amount of square footage used for utility activities in comparison to the total square footage of the building, removing the square footage of sublease spaces and space utilized by affiliate employees. Since tenant improvement amortization already excluded sublease space (i.e., the Company did not improve sublease space), the tenant improvement amortization was allocated at a higher percentage—99.9 percent to the utility. This allocation removed the square footage of space utilized by affiliate employees. *See* column B of Exh. TFD-2.

Q. Please explain any other reductions to headquarters expense.

A. After the allocation to the utility, total utility expense is $10.5 million for the system or $1.1 million on a Washington-allocated basis as shown in columns D and E of Exh. TFD-2. The lease expense, tenant improvement amortization, operating expenses and company vehicle parking are subject to a capital administrative transfer, where 35 percent of these costs are transferred to Capital. *See* columns F and G of Exh. TFD-2. This reduced the O&M expense $0.4 million and brought the total Washington-allocated headquarters expense to $0.7 million. The $0.7 million was further reduced by $0.4 million to remove headquarters expense incurred during the Test Year, including all headquarters expenses incurred at NW Natural's previous headquarters, One Pacific Square, as shown in columns H and P of Exh. TFD-2. This resulted in an adjustment that increases O&M expense $307 thousand.

d. Horizon 1 Adjustment, effective November 1, 2022

Q. Please describe the Horizon 1 adjustment.

A. After Horizon 1 is placed in service in October 2022, it will entail annual net ongoing O&M costs of $4.0 million on a system-wide basis—or $460 thousand on a Washington-allocated basis. These costs are associated with the cloud-based subscription service of the new ERP platform. This adjustment takes effect at the beginning of Year Two. Horizon 1 is further described in the Direct Testimony of Jim Downing in Exh. JRD-1T.

D. O&M Cost Management

Q. Please describe the protocols the Company has in place to manage its O&M budget.

A. Under the direction of the CFO and CEO, my department engages in an annual budgeting and financial planning process, through which we determine and manage to a Company-wide budget. This budget is informed by individual departmental needs, customer and operational requirements, and an ongoing focus on managing costs. Throughout the year, we review and provide actuals-to-budget reports to each department, and engage with departments on their spending levels. We also require that each department justify their budget and explain any significant departures from budgeted amounts.

Q. Please provide your view of NW Natural's O&M levels, including the adjustments made above.

A. NW Natural's O&M levels have grown at a reasonable rate, reflecting good cost management practices within the Company. As is true with most companies, much of the pressure on our O&M expense levels comes from inflation. In addition, as described above, the Company's O&M adjustments are, in part, based on contracted increases that represent "lumpier" increases to O&M, such as the 250 Taylor lease.

Q. Does this conclude your testimony?

A. Yes, it does.

III. LIST OF EXHIBITS

Exh. TFD-2 .... Headquarters Adjustment