BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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

NORTHWEST NATURAL GAS COMPANY

Direct Testimony of Zachary D. Kravitz

POLICY/MULTI-YEAR RATE PLAN

Exh. ZDK-1T

December 18, 2020

DIRECT TESTIMONY OF ZACHARY D. KRAVITZ

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I. INTRODUCTION AND SUMMARY

Q. Please state your name, address, and position.

A. My name is Zachary D. Kravitz. I work for Northwest Natural Gas Company ("NW Natural" or "Company") located at 250 SW Taylor Street in Portland, Oregon. I am the Director of Rates and Regulatory Affairs for NW Natural.

Q. Please summarize your educational background and business experience.

A. I received a Bachelor of Arts degree in English and Government from the University of Texas at Austin and a Juris Doctor degree from the University of Florida. 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. Prior to joining NW Natural, 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. Before that, I worked at the Ohio Attorney General's Office in the Labor Relations Division.

Q. What is the purpose of your testimony?

A. My testimony will describe NW Natural's proposal to utilize a multi-year rate plan and our proposals to mitigate rate impacts as a result of this rate case, including maintaining our current return on equity ("ROE") of 9.4 percent.

Q. Please summarize your testimony.

A. In this general rate case, NW Natural is requesting that the Commission approve a multi-year rate plan that allows the Company to step-up rates in year two of the plan ("Year Two") to recover the costs associated with eight long-planned, discrete projects that will be completed prior to the start of Year Two. Because these projects will be completed in advance of the date Year Two rates will become effective, the Commission can evaluate and issue a final determination of the prudently incurred costs before they are included in customer rates.

NW Natural recognizes that its proposal for a multi-year rate plan is being made against the backdrop of the profound impacts of a global pandemic. In short, we are acutely aware that many of our customers are facing hardships in their lives. For this reason, the Company has endeavored to mitigate the rate impact of this rate case, including a proposal to maintain its current ROE of 9.4 percent—despite a higher recommended ROE by our expert, Dr. Bente Villadsen (Exh. BV-1CT). In addition, the Company is making a number of proposals that will help to mitigate the proposed revenue requirement increase for year one of the plan (November 1, 2021 through October 31, 2022) ("Year One"), which includes:

- Delaying construction of Phase 2 of the Vancouver Retrofit Project so that Year One rates are not impacted;
- Delaying recovery in rates of six distribution and storage projects until Year Two that are currently scheduled to be completed prior to the Year One rate effective date;
- Suspending the amortization of a deferral balance associated with NW Natural's energy efficiency programs; and
- Offsetting the rate increase with proceeds from a recent property sale.

Finally, the Company is limiting the incremental costs it seeks to recover in Year Two to eight long-planned, discrete capital projects: the Company's Horizon 1 program, which is a major information, technology and services ("IT&S") initiative made necessary by the obsolescence of the Company's current IT&S systems; the Vancouver Yard Retrofit, which is the second phase of the larger Vancouver Retrofit Project; and, as noted above, six distribution and storage projects that are currently planned to be complete prior to the Year One rate effective date.

As discussed in detail below, approval of NW Natural's proposal will accomplish the Commission's policy goals for multi-year rate plans by minimizing regulatory lag, reducing the regulatory burden on the Commission and parties, and providing rate stability and certainty for our customers. The proposal is also consistent with the procedural and substantive requirements announced in the Commission's recent "Policy Statement on Property that Becomes Used and Useful after Rate Effective Date" ("Policy Statement").[1]

In short, NW Natural's multi-year rate plan appropriately balances the Company's need to recover crucial investments with the need to maintain the most affordable rates possible during these difficult times.

II. NW NATURAL'S APPROACH TO THIS CASE

Q. What was the Company's overall approach to this rate case?

A. In developing this case, the Company kept in mind the overall economic and social context in which these rates will take effect. As discussed in more detail in the Direct Testimony of NW Natural's Chief Executive Officer, David Anderson (Exh. DHA-1T), the Company fully recognizes that we are currently in the midst of a global

[1] *See generally In re Commission Inquiry into the Valuation of Public Service Company Property that Becomes Used and Useful after Rate Effective Date*, Docket U-190531, Policy Statement on Property that Becomes Used and Useful after Rate Effective Date (Jan. 31, 2020) [hereinafter WUTC 2020 Policy Statement].

pandemic—with significant personal and financial consequences for many of our customers. While the Company expects economic conditions to improve significantly by the time the new rates are effective, we understand that the economy may still not be where it was before the pandemic. For these reasons, the Company worked to mitigate the rate impact of the overall revenue requirement increase in this case, while still allowing the Company a reasonable opportunity to recover those costs necessary to provide safe and reliable service. Moreover, the Company's rate request for Year One includes several proposals specifically designed to mitigate the impact of its revenue requirement increase.

Q. Please describe the Company's efforts to mitigate its overall revenue requirement increase as much as possible.

A. The Company's rate request avoids proposing any new programs or rate mechanisms or any investments that are not critical to the Company's ability to carry out its mission. And importantly, the Company is proposing to maintain its ROE at the current level of 9.4 percent. Specifically, to this point, the Company's ROE expert, Dr. Bente Villadsen, has analyzed ROE for NW Natural using all the modeling frameworks typically used before this Commission—CAPM[2] and DCF[3]—and a specific analysis of the utility's business risk characteristics. Using these approaches, Dr. Villadsen recommends a 9.9 percent ROE based on a reasonable range for the Company of 9.4 to 10.25 percent.[4] However, in view of the hardships many of our customers are currently

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[2] Capital Asset Pricing Model.
[3] Discounted Cash Flow.
[4] Exh. BV-1CT 5.

enduring, the Company recommends that its currently-authorized ROE of 9.4 percent be maintained. NW Natural's current ROE was established as part of a settlement in its last Washington rate case, which was approved by the Commission in 2019.

Q. How does the Company's proposed ROE compare to other gas utilities in Washington?

A. The only other gas-only utility in Washington is Cascade Natural Gas Corporation ("Cascade"). This February, the Commission approved and adopted a settlement agreement containing a 9.4 percent ROE for Cascade.[5] The Commission also set Cascade's ROE at 9.4 percent in 2018.[6] Earlier this year, the Commission set Puget Sound Energy's ROE for both its gas and electric utility at 9.4 percent.[7]

III. COMMISSION POLICY ON MULTI-YEAR RATE PLANS

Q. What is a multi-year rate plan?

A. In general, a multi-year rate plan is a series of provisionally approved annual increases in utility rates or allowed revenues intended to afford a utility the ability to avoid the need to file an annual general rate case.[8]

Q. Has the Commission ever approved multi-year rate plans?

A. Yes. Over the past decade, the Commission has evaluated and approved several multi-

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5. *Wash. Utils. & Transp. Comm'n v. Cascade Natural Gas Corp.*, Docket UG-190210, Final Order No. 05, at ¶ 10 (Wash. UTC Feb. 3, 2020).

6. *Wash. Utils. & Transp. Comm'n v. Cascade Natural Gas Corp.*, Docket UG-170929, Final Order No. 06, at ¶¶ 58-60, Settlement ¶ 8 (Wash. UTC July 20. 2018).

7 *Wash. Utils. & Transp. Comm'n v. Puget Sound Energy, Inc.*, Dockets UE-190529 & UG-190530, Final Order No. 08, at ¶ 28 and ¶ 108 (Wash. UTC July 8, 2020).

8 *See generally Att'y Gen.'s Office v. Utils. & Transp. Comm'n*, 128 Wn. App. 818, 822–23, 116 P.3d 1064, 1067 (2004) (briefly describing a five-year rate plan the Commission approved for PacifiCorp).

year rate plans proposed by utilities, either through a fully litigated case or approval of a stipulation. For example, the Commission approved multi-year rate plans in Avista's 2012 general rate case,[9] Puget Sound Energy's 2013 general rate case,[10] and PacifiCorp's 2016 general rate case.[11] The Commission also evaluated and ultimately rejected a proposed multi-year rate plan in Avista's 2018 general rate case.[12] Yet, even in that case, the Commission reaffirmed the value of such plans where appropriate.[13]

Q. Please describe the Commission's policy reasons for approving these multi-year rate plans.

A. The Commission has consistently recognized the value of multi-year rate plans in advancing three primary policy objectives:

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[9] *Avista Corp. v. Wash. Utils. & Transp. Comm'n*, Dockets UE-110876 & UG-110877, Order No. 14, at ¶¶ 1–2 (Wash. UTC Dec. 26, 2012). In this case, the Commission agreed to adopt a stipulated settlement that included a multi-year rate plan, which included rate increases in years one and two of the plan. *Id.* The Commission approved the settlement, noting that the agreed-upon rate plan allowed Avista to account for its multi-year capital expenditure program. *Id.* at ¶ 73.

[10] *In re Petition of Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, & UG-130138, Order No. 7, at ¶¶ 8–9 (Wash. UTC June 25, 2013). Under the proposed plan, Puget Sound Energy's rates would increase annually by 3 percent for electric customers and 2.2 percent for gas customers through March 2016, with an option to extend the plan through March 2017. *Id.* The Commission approved the proposed plan, emphasizing the need to "relieve all stakeholders and the Commission from the burdens of almost continuous general rate case proceedings." *Id.* at ¶ 21.

[11] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order No. 12, at ¶ 1 (Wash. UTC Sept. 1, 2016). PacifiCorp proposed a two-year rate plan that increased electric rates by 2.99 percent annually as part of its general rate case. *Id.* The Commission did approve the rate plan, although it adjusted the annual rate increases to 1.33 percent for the first year and 1.96 percent in the second year. *Id.* at 2, ¶ 329.

[12] *Wash. Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-170485 & UG-170486. Order No. 7, at ¶¶ 47–51 (Wash. UTC Apr. 26, 2018). Avista had proposed a three-year rate plan. *Id.* at ¶ 26. For the first year of the proposed rate plan, Avista requested an $81.8 million increase for electric and a $14.2 million increase for natural gas. *Id.* In year two, Avista requested a $13.5 million increase for electric and $3.7 million for natural gas. *Id.* In the final year, Avista proposed a $13.9 million increase to electric and a $3.8 million increase to natural gas. *Id.* The Commission rejected Avista's proposed rate plan because of the number of pending decisions Avista had before the Commission. *Id.* at ¶¶ 47–51. Nonetheless, the Commission did clarify that this decision "does not reflect a change in [the Commission's] recognition of the value of multi-year rate plans either to end the cycle of annual rate filings or to support the utilities' efforts at efficiency." *Id.* at ¶ 51.

[13] *Id.*

- **Reducing Regulatory Lag:** Over the past decade, the Commission has approved multi-year rate plans and other innovative rate-setting mechanisms that allow utilities to account for capital expenditures past the rate effective date of a general rate case, and thereby reduce regulatory lag.[14] In this way, the Commission can strike a balance between utility customers' needs to have safe and reliable gas service and "the financial ability of the utility to provide such services on an ongoing basis."[15]
- **Reducing Regulatory Burden:** The Commission consistently extolls the benefits of multi-year rate plans that "relieve all stakeholders and the Commission from the burdens of almost continuous general rate case proceedings that have characterized our utility regulation."[16] Even when the Commission has rejected proposed multi-year rate plans, it has continued to recognize that these plans "end the cycle of annual rate filings" and support utilities' efforts at efficiency.[17] By approving multi-year rate plans, the Commission reduces the regulatory burden on itself, Commission Staff, and all interested parties by setting reasonable and reliable rates while reducing the frequency of rate case filings.

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[14] *Avista Corp. v. Wash. Utils. & Transp. Comm'n*, Dockets UE-110876 & UG-110877, Order No. 14, at ¶ 73 (Wash. UTC Dec. 26, 2012).

[15] *In re Petition of Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, & UG-130138, Order No. 7, at ¶ 20 (Wash. UTC June 25, 2013).

[16] *Id.* at ¶ 21.

[17] *Wash Utils. & Transp. Comm'n v. Avista Corp.*, Dockets UE-170485 & UG-170486, Order No. 7, at ¶ 51 (Wash. UTC Apr. 26, 2018).

- **Providing Ratepayer Stability:** The Commission believes that multi-year rate plans can benefit customers by setting low rates with stable increases throughout a rate plan.[18] Multi-year rate plans allow customers to predict any rate increases years in advance without any surprise increases brought on by continuous general rate cases.[19]

Q. In these cases, has the Commission provided any guidance to utilities as to how it intends to evaluate requests for multi-year rate cases?

A. Yes. It is true that the Commission has repeatedly emphasized its intent to evaluate requests on a case-by-case basis to maintain maximum regulatory flexibility.[20] However, the Commission has generally indicated its preference that multi-year rate plans include a stay-out or moratorium on rate case requests for the duration of the rate plan.[21] The Commission has also emphasized the need for utilities to file capital expenditure plans or progress reports to assess the provisionally approved future rate

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[18] *See Avista Corp. v. Wash. Utils. & Transp. Comm'n*, Dockets UE-110876 & UG-110877, Order No. 14, at ¶¶ 1–2 (Wash. UTC Dec. 26, 2012). ("The Settlement provides rate stability for customers for two years and represents an innovative approach that will provide incentives to Avista to cut costs in order to earn a fair rate of return.").

[19] *See In re Petition of Puget Sound Energy, Inc.*, Dockets UE-121697, UG-121705, UE-130137, & UG-130138, Order No. 7, at ¶ 150 (Wash. UTC June 25, 2013) ("The rate plan provides a degree of relative rate stability, or at least predictability, for customers for several years.").

[20] *See, e.g.*, *id.* at ¶ 23 ("It is for these reasons, among others, that this Order should not be taken as establishing hard and fast principles for general or future application."); *Avista Corp. v. Wash. Utils. & Transp. Comm'n*, Dockets UE-110876 & UG-110877, Order No. 14, at ¶ 77 (Wash. UTC Dec. 26, 2012) ("In conditionally approving the Settlement, we are not endorsing the specific attrition methodologies, assumptions, or inputs used in this case."); *see also* WUTC 2020 Policy Statement at ¶¶ 30–31 (reiterating the Commission's "flexibility" and providing guidance "without being overly prescriptive").

[21] *Wash. Utils. & Transp. Comm'n v. Pac. Power & Light Co.*, Docket UE-152253, Order No. 12, at ¶ 175 (Wash. UTC Sept. 1, 2016) ("When a utility proposes and we approve a multi-year rate plan, we do so with the understanding that the Company intends to honor a stay-out or moratorium on rate case requests for the duration of the rate plan.").

increases.[22]

Q. Since 2018, has the Commission had occasion to offer any additional policy guidance relevant to multi-year rate plans?

A. Yes. In 2018, the Washington Court of Appeals overturned a Commission order authorizing an attrition adjustment because the adjustment accounted for rate base that was not currently used and useful for Washington ratepayers.[23] After the Court of Appeals' decision, the legislature amended the used-and-useful statute to specifically allow the Commission to include in customer rates "property acquired or constructed by or during the rate effective period."[24] In so doing, the legislature not only authorized the Commission to approve attrition adjustments, but also confirmed the Commission's authority—if it was ever in doubt—to approve multi-year rate plans.[25] Importantly,

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[22] *Avista Corp. v. Wash. Utils. & Transp. Comm'n*, Dockets UE-110876 & UG-110877, Order No. 14, at ¶ 73 (Wash. UTC Dec. 26, 2012) ("Given that a detailed capital expenditure plan for 2014 may not be available . . . we require Avista to file such an updated capital expenditure plan."); *see also Wash Utils. & Transp. Comm'n v. Puget Sound Energy*, Dockets UE-170033 & UG-170034, Order No. 8, at ¶ 46 (discussing the importance of new filings to allow the Commission to evaluate the multi-year rate plans success).

[23] *Wash. Att'y Gen.'s Office v. Wash. Utils. & Transp. Comm'n*, 4 Wn. App. 2d 657, 687–89, 423 P.3d 861, 877–78 (2018).

[24] LAWS OF 2019, ch. 288, § 20(2) ("The commission has power upon complaint or upon its own motion to ascertain and determine the fair value for rate making purposes of the property of any public service company used and useful for service in this state <u>*by or during the rate effective period*</u> and shall exercise such power whenever it deems such valuation or determination necessary or proper under any of the provisions of this title. The valuation may include consideration of any property of the public service company acquired or constructed <u>*by or during the rate effective period*</u>, including the reasonable costs of construction work in progress, to the extent that the commission finds that such an inclusion is in the public interest and will yield fair, just, reasonable, and sufficient rates.") (emphasis added).

[25] *See id.* ch. 288, § 1(5) (reiterating that the Commission's "statutory grant of authority for rate making includes consideration and implementation of . . . multiyear rate plans"). Importantly, it is quite arguable that the Commission's authority to approve multi-year rate plans was never in doubt, given that the Commission had historically required that capital investments placed in service during the rate effective period be supported by attestations or other evidence confirmed that they were used and useful prior to the associated step up in rates. *Cf. Avista Corp. v. Wash. Utils. & Transp. Comm'n*, Dockets UE-110876 & UG-110877, Order No. 14, at ¶ 73 (Wash. UTC Dec. 26, 2012) (requiring Avista to provide capital expenditure progress reports quarterly in year two of the rate plan to ensure Avista made all necessary expenditures).

after the legislature amended Washington's used-and-useful statute,[26] the Commission issued the Policy Statement to give regulated parties guidance on how to identify capital investments placed into service after the rate effective date.[27] While the Policy Statement discusses several innovative ratemaking tools that may address regulatory lag generally, it is specifically relevant to multi-year rate plans in two critical respects. First, the Policy Statement specifically encourages utilities to propose multi-year rate plans and other regulatory mechanisms that will allow them more timely recovery of investments.[28] Second, the Policy Statement establishes the evidence the Commission will require and the process it will follow to identify, review, and approve a utility's property that becomes used and useful for service in Washington after the rate effective date.[29]

Q. Does the Commission provide any general guidance as to how it thinks about the evidence required to support investments after the rate effective date?

A. Yes. In the Policy Statement, the Commission emphasizes that, as with all ratemaking processes, its overarching goal is to set just and reasonable rates by balancing the public's need for safe, reliable energy against a utility's financial ability to provide

[26] RCW § 80.04.250.

[27] *See generally* WUTC 2020 Policy Statement.

[28] *See id.* at ¶¶ 7–8 ("[B]y authorizing the Commission to provide for changes to rates up to four years after the rate effective date using 'any standard, formula, method, or theory of valuation reasonably calculated to arrive at fair, just, reasonable, and sufficient rates,' the legislature allows the Commission flexibility in establishing rate base, including for adjustments involving statistical escalations.") (quoting LAWS OF 2019, ch. 288, § 20(3)).

[29] *Id.* at ¶ 9.

service.[30] The Policy Statement confirms that WAC 480-07-510(3)(c)(ii) will still define the allowed pro forma adjustments the Commission can include in rate base.[31] The Policy Statement also reiterates that utilities must demonstrate that an investment's costs are known and measurable when the Commission includes the investment in rate base.[32] However, the amendments to the used-and-useful statute now allow the Commission to prospectively review these adjustments and confirm that the investment's costs are known and measurable once the utility places it into service.[33]

Q. Briefly describe the process the Commission outlined for identifying property that becomes used and useful past the rate effective date.

A. Very generally, the process outlined by the Commission involves two steps.[34] First, the utility must identify investments to be included in future rates and acquire provisional approval when it files its multi-year rate plan.[35] Second, the utility must include proof that the identified investments have been made and are now used and useful in its annual filings.[36] Any provisional pro forma adjustments the Commission

[30] *Id.* at ¶ 43.
[31] *Id.* at ¶ 22. Specifically, WAC provides that "Pro forma adjustments give effect for the test period to all known and measurable changes that are not offset by other factors. The company and any other party filing testimony and exhibits proposing pro forma adjustments must identify dollar values and underlying reasons for each proposed pro forma adjustment. Pro forma adjustments must be calculated based on the restated operating results. Pro forma fixed and variable power costs, net of power sales, may be calculated directly based either on test year normalized demand and energy load, or on the future rate year demand and energy load factored back to test year loads." WAC 480-07-510(3)(c)(ii).
[32] WUTC 2020 Policy Statement at ¶ 22.
[33] *Id.* at ¶ 27.
[34] *Id.* at ¶ 46.
[35] *Id.* at ¶¶ 34–38.
[36] *Id.* at ¶¶ 39–42.

approves during a general rate case are granted provisionally, subject to a final review.[37]

Q. Please further describe how a utility must identify investments it intends to include in future years of its rate plan.

A. If a utility plans to include future investments in its rate base for future years of a rate plan, the utility must identify these investments as provisional pro forma adjustments in its initial filing.[38] To identify these investments, the utility must include (1) the estimated cost of the investment, including offsetting factors and duplicative recovery considerations; (2) a description of the investment; and (3) other existing documentation that could assist the Commission in a future review of the investment.[39] The more documentation the utility can provide showing that the investment's costs are known and measurable, the higher the likelihood the Commission will provisionally approve the adjustment to future rates.[40] After identifying the investments, the utility must then delineate in what year of the plan it intends to include the investment in its rate base.[41] For example, if the investment will become used and useful in year two of the rate plan, the Commission can approve provisional rates, including this investment, starting in year two.[42]

[37] *Id.* at ¶ 44.
[38] *Id.* at ¶ 34.
[39] *Id.*
[40] *Id.* at ¶ 35.
[41] *Id.* at ¶ 36.
[42] *Id.*

Q. Assuming the Commission provisionally approves a utility's multi-year rate plan, what information must it subsequently provide before rates are stepped up in the "out" years of the rate plan?

A. A utility must provide enough information to confirm that (1) the utility has placed the investment into service on or near the projected service date and (2) the estimated costs accurately reflect the actual cost of the investment.[43] To show that its expected costs align with its actual costs, a utility can provide its actual expenditures, invoices, contracts, or other specific obligations.[44] The utility will recover the investment's actual cost at this stage of review, not the projected cost.[45] Once the Commission has completed its final review and approved the pro forma adjustment, the utility can include the investment in its rate base and apply the rates provisionally approved in its multi-year rate plan.[46]

IV. <u>NW NATURAL'S PROPOSED MULTI-YEAR RATE PLAN</u>

Q. Briefly summarize NW Natural's proposed multi-year rate plan.

A. NW Natural proposes a two-year rate plan. Year One calls for a revenue requirement increase of 8.0 percent, which will take effect on November 1, 2021. As noted above, Year One of the plan includes several proposals designed to mitigate the rate increase's impact on our customers during this difficult period. The overall rate change, inclusive of the rate mitigation proposals, results in a 5.0 percent increase.

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[43] *Id.* at ¶ 41.
[44] *Id.*
[45] *Id.*
[46] *Id.* at ¶ 46. If a utility begins to collect rates before the Commission grants final approval, the rates are subject to refund. *Id.*

Year Two calls for an incremental increase to revenue requirement of 3.7 percent, which will take effect on November 1, 2022. The rate increase proposed for Year Two is associated with just eight critical investments that will be completed prior to the rate effective date of Year Two. With adoption of this plan, the Company commits that in any subsequent rate case it might file, it will not propose an effective date for new rates prior to the end of Year Two of the plan.

A. Year One of the Rate Plan

Q. Please describe Year One of the rate plan.

A. Year One of the rate plan reflects a standard approach to cost-of-service ratemaking based on a historical test year (October 1, 2019 through September 30, 2020) ("Test Year") with restating and pro forma adjustments, more fully described in the Direct Testimony of Kyle Walker (Exh. KTW-1T).

Q. Please describe the Company's use of end-of-period ("EOP") rate base and depreciation expense in the context of its proposal for a multi-year rate plan.

A. While the Test Year actual results are shown on an average-of-monthly-averages ("AMA") basis, the Company does propose adjustments that restate those results to reflect rate base at the end of the Test Year, as well as the depreciation expense related to EOP gross plant balances. NW Natural views the EOP adjustments as a useful tool supported by the Commission to mitigate regulatory lag associated with investments and the consequent related rate recovery.

Q. Please describe the difference between using the conventional AMA basis as compared to the EOP method.

A. If incremental revenue requirement is needed due to material investments during the historical test year, under the AMA method, only a fraction of the costs of the projects completed during that period will be captured in rates. For projects added at the end of the historical Test Year, rate base determined on an AMA basis may capture as little as one twenty-fourth of the project cost. Those projects, which will have been fully vetted through the processing of the rate case, would be fully in place for the entire rate effective period, and yet rate recovery would only partially reflect the cost.

Under the EOP approach, vetted investments that are made by the end of the historical Test Year are included in rate base and the calculation of incremental rate recovery. While there will still be "regulatory lag" until rate recovery is effective on November 1, 2021, the lag, and potential need to immediately file a subsequent rate case, is substantially mitigated by the use of EOP rate base.

Q. Are normalized revenues included in the rate case reflective of the use of EOP methodology for rate base and depreciation?

A. Yes, normalized revenues were derived based on current base rates and customer charges, use per customer volumes as described in the Direct Testimony of Robert Wyman (Exh. RJW-1T), and end-of-period customer counts consistent with the end-of-period rate base adjustment.

Q. Please describe the Company's proposals to mitigate this case's rate impact in Year One.

A. As noted above, the Company understands that some of our customers may still be experiencing financial hardship resulting from the pandemic even a year after the filing of this case. Accordingly, the Company has included four proposals designed to reduce or offset the Year One rate increase, including:

- Phasing the Vancouver Retrofit Project so that the investments associated with the yard portion of the planned upgrade will not be included in rates until Year Two;
- Delaying recovery in rates of six distribution and storage projects until Year Two that are currently planned to be completed prior to the Year One rate effective date.
- Suspending the Company's amortization of its energy efficiency deferral for Year One;
- Applying revenues received from the sale of our Block 24 property[47] as a credit to customers in Year One.

Q. Please describe the Company's decision to delay the second phase of the Vancouver Retrofit Project.

A. As detailed in the Direct Testimony of Wayne K. Pipes, our Director of Facilities, NW Natural has determined that the Vancouver Resource Center requires seismic upgrading

[47] *See In the Matter of the Application of Northwest Natural Gas Company, For an Order Authorizing the Sale of the Block 24 property located in Portland, Oregon,* Docket N. UG-190457, Order 01 (Sep. 12, 2019).

and retrofitting.[48] This project will include the demolition and replacement of the on-site office building and a seismic retrofit of the existing warehouse, as well as the retrofit of the yard and outbuildings located on the property.[49] As initially planned, the entire project was to have been completed by 2020.[50] However, given the size of the total project (an estimated $15.9 million)[51] and given the Company's desire to limit the rate increase in Year One, the Company decided to complete this project in two phases by delaying the upgrade to the yard and outbuildings until 2022.[52] Specifically, the Company is now proposing two separate projects associated with the Vancouver Resource Center. The Vancouver Retrofit Project will be Phase 1 and will include the upgrades to the office building and warehouse. The cost of Phase 1 is $11.2 million, and it was completed in December 2020 and included in Year One rates.[53] Phase 2 will be referred to as the Vancouver Yard Project and will include upgrades to the yard and outbuildings. The cost of Phase 2 is $4.7 million, and it will be completed by October 2022 and included in Year Two rates.[54]

[48] Exh. WKP-1CT 46-47
[49] Exh. WKP-1CT 5, 46.
[50] Exh. WKP-1CT 50.
[51] Exh. WKP-1CT 55.
[52] Exh. WKP-1CT 5, 50-51, 55.
[53] Exh. WKP-1CT 55.
[54] *Id.*

Q. Please describe the Company's decision to delay the recovery of six distribution and storage projects for Year Two rates.

A. There is a total of six long-planned, discrete capital projects (four distribution and two storage projects) that are currently planned and scheduled to be complete in October 2021 but for which we are nevertheless requesting recovery in Year 2 of the rate plan. The distribution projects include a system reinforcement in White Salmon, Washington, the second phase of a public-works relocation on SE 1st St in Vancouver, Washington, and rebuilding the Battle Ground and Ridgefield gate stations to meet customer demand. The storage projects include the annual Mist Well Rework Program in compliance with the Pipeline and Hazardous Materials Safety Administration requirements, and phases three and four of the Mist Corrosion Abatement Project, which allows for in-line inspection of pipelines at the Mist underground storage facility. The Company is proposing to include these projects in Year Two to further mitigate the rate impact of the rate change in Year One. Each of these projects is described in more detail in the Direct Testimony of Joe Karney (Exh. JSK-1T).

Q. How does this proposal impact the Company's requested revenue requirement in Year One?

A. By not seeking recovery of these projects in Year One, the Year One revenue requirement is reduced by $755 thousand.

Q. Briefly describe the Company's proposal to suspend amortization of its energy efficiency deferral.

A. NW Natural is currently amortizing approximately $1.4 million annually from a regulatory asset associated with its energy efficiency programs, as approved in the

Company's last general rate case,[55] which results in a monthly surcharge on customer bills of approximately 2 percent. The Company proposes to suspend amortization of the regulatory asset during Year One, which will mitigate the requested increase. The Company proposes to continue amortizations beginning in Year Two.

Q. Please describe the Company's proposal to return to customers in Year One the revenues associated with a property sale.

A. By its Order 01 in UG-190457, the Commission authorized the Company's request to record the Washington-allocated net gain from the sale of Block 24, or $839,327, in FERC Account 254 (Other Regulatory Liabilities) for the ultimate benefit of Washington customers. NW Natural is crediting the full amount of these revenues to customers in Year One to immediately offset the rate increase associated with this general rate case, as shown in the Direct Testimony of Robert Wyman (Exh. RJW-1T).

B. Year Two of the Rate Plan

Q. Please summarize NW Natural's proposed rate increase for Year Two.

A. As mentioned above, the Company proposes a 3.7 percent revenue requirement increase to take effect on November 1, 2022, coincident with NW Natural's Purchase Gas Adjustment rate change. The rate change in Year Two is driven by the Company's Horizon 1 program; the Vancouver Yard Retrofit, which is the second phase of the larger Vancouver Retrofit Project; and the six distribution and storage projects described above.

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[55] *Wash. Utils. & Transp. Comm'n v. NW Nat. Gas*, Docket UG-181053, Order No. 6 at ¶ 78 (Wash. UTC Oct. 21, 2019).

Additionally, the Company proposes to credit customers with the revenues associated with the sale of its Astoria Resource Center[56] in Year Two. The Commission's Order 01 in UG-200120 will enable the Company to record the Washington-allocated net gain from the sale of its Astoria Resource Center, expected to be $42,692, in FERC Account 254 (Other Regulatory Liabilities) for the ultimate benefit of Washington customers.

1. The Horizon 1 Project

Q. Briefly describe Horizon 1.

A. The Direct Testimony of Jim Downing (Exh. JRD-1T), the Company's Vice President and Chief Information Officer, provides a comprehensive explanation of the Horizon program, including the justification for and costs of Horizon 1. However, for the purposes of my testimony, a short explanation is helpful. In brief, Horizon is a long-term, planned upgrade to the Company's technology architecture.[57] This first phase of the program, known as Horizon 1, upgrades NW Natural's existing enterprise resource planning ("ERP") software.[58] The ERP platform functions as the Company's backbone software—managing and integrating all of NW Natural's essential business functions.[59] NW Natural recently completed Horizon 1's pre-planning phase in

[56] *See In the Matter of the Application of Northwest Natural Gas Company, For an Order determining that Certain Property Located in Astoria, Oregon is No Longer Necessary or Useful,* Docket No. UG-200120, Order 01 (Jun. 25, 2020).

[57] Exh. JRD-1T 40.

[58] Exh. JRD-1T 41.

[59] *Id.*

September 2020,[60] and plans on completing the entirety of Horizon 1 by October 2022.[61]

Q. Why is NW Natural undertaking Horizon 1 now?

A. As explained in more detail in Mr. Downing's testimony, NW Natural has been planning these systematic, foundational upgrades to its IT&S system for many years, and the upgrades are urgently needed to support the Company's basic operations. Importantly, the new ERP platform is necessary to support the Company's next phase of the Horizon program, which involves the Company's Customer Information System ("CIS"). The current CIS platform is over two decades old, relies on an outdated programming language, and lacks modern-day connectivity, archiving, and disaster-recovery capabilities. Upgrading the CIS is urgent, and depends on the ERP replacement. Moreover, NW Natural's current ERP platform is nearing the end of its useful life,[62] and the developer intends to discontinue support for the software by 2027.[63] If NW Natural were to wait to implement these upgrades, it would need to undertake approximately $13.4 million in investments to continue using the current ERP platform. Finally, the cost to upgrade the Company's current platform would likely increase substantially as the developer's service cutoff approaches, as many companies—including many utilities—will be relying on a limited set of third-party

[60] Exh. JRD-1T 55.
[61] Exh. JRD-1T 44, 55.
[62] Exh. JRD-1T 47.
[63] *Id.*

consultants to oversee and implement the software transition.[64] In short, the Company simply could not put off Horizon 1 past its currently planned completion date.

Q. Why does NW Natural need to include the Horizon 1 project in Year Two?

A. Unlike other forms of capital investments, IT&S projects depreciate rapidly. Simultaneously with the filing of this rate case, NW Natural filed a Petition for an Accounting Order seeking approval to depreciate the life of the cloud-based assets associated with Horizon 1 over 10 years. Without this approval, Horizon 1 would depreciate over approximately five years, which does not represent the Company's expected useful life of the investment and would result in higher rates for our customers. Specifically, by extending the life of the cloud-based assets to ten years, the Year Two revenue requirement is reduced by $375 thousand. Assuming the Accounting Petition is granted, if the Company were to delay adding Horizon 1 to rates for even one year past its in-service date, the Company would fail to recover a full ten percent of its investment. Additionally, by including the project in Year Two, the Company can avoid filing an additional rate case at the end of 2021 to minimize the regulatory lag of Horizon 1.

Q. In addition to the capital investment, does the Company propose to recover any other costs associated with Horizon 1 in Year Two?

A. Yes. NW Natural's Year Two rate increase also includes the increased ongoing O&M expenses associated with Horizon 1.

[64] Exh. JRD-1T 48.

Q. Please describe the increases to ongoing O&M costs associated with Horizon 1.

A. As detailed in Mr. Downing's testimony, Horizon 1 is a cloud-based IT&S solution, which NW Natural has determined represents the most economically and technically efficient approach to serving the Company's IT&S needs. However, the costs of cloud-based IT&S systems are structured differently from on-premises approaches, such as NW Natural's current system. Historically, NW Natural's software costs were accounted for as capital and that software would be depreciated over the life of the asset when it is placed in service. Under that framework, software costs would be part of the overall capital expenditure for the project. As the Company transitions to cloud computing, the accounting guidelines for software licensing do not permit the Company to capitalize the annual software licensing costs. Instead, the cloud-based software licensing fees must be treated as an expense for accounting purposes. Because NW Natural will be significantly adding to its cloud-based software portfolio with the completion of Horizon 1 by October 2022, NW Natural is requesting to include those new cloud-based software licenses in rates in the Year 2 rate change. The O&M costs associated with Horizon 1 is $6.2 million on a system-wide basis, or $0.7 million on a Washington-allocated basis.

Q. Has the Company included any savings or other offsetting amounts associated with Horizon 1?

A. Yes, the Company is including the savings and other offsetting amounts in its Year Two rate change. As discussed more in the testimony of Mr. Downing, the Company expects to achieve operational efficiencies in several departments throughout NW Natural when it implements Horizon 1. While we expect that it will take time, possibly over a year, to fully harness the identified savings, we are committed to including the full amount of the savings in our Year Two rate change. We believe there are $1.5 million of annual system savings that directly reduce the Company's costs on a system-wide basis. There are also $0.7 million in annual costs associated with sunsetting applications that the Company will no longer incur after it implements Horizon 1. On a Washington allocated basis, these savings and offsets reduce the O&M expense in Year Two by $254 thousand. Thus, the Company's net ongoing incremental O&M is $3.989 million, or $460 thousand on Washington-allocated basis.

Additionally, we have removed the depreciation expense associated with our current SAP system that will cease when the Horizon project is used and useful. The Washington allocated amount of $159 thousand per year of depreciation expense is offsetting the depreciation expense in Year Two. The Direct Testimony of Kyle Walker (Exh. KTW-1T), and specifically, Exh. KTW-8, detail these adjustments.

Q. Does NW Natural plan on recovering any other costs associated with Horizon 1?

A. Yes, NW Natural also filed an Accounting Petition seeking authorization to defer one-time O&M implementation costs associated with Horizon 1. We expect these one-time costs to total approximately $8.4 million on a system-wide basis, or $0.8 million on a Washington-allocated basis. As described in the Accounting Petition, we are unable to capitalize the costs identified in the Accounting Petition because they are classified as O&M expenses. Generally, O&M expense is recovered in a rate case as a component of revenue requirement. However, generally utilities will include in revenue requirement only those O&M expenses that it expects to incur on a recurring basis. Given that the implementation costs for Horizon 1 is a one-time expense, we have not included this amount in revenue requirement. Instead, we have proposed to defer these costs in a regulatory asset, and to amortize these costs over 10 years—which aligns with the Company's request to depreciate the cloud-based assets in Horizon 1 over 10 years. Recovery for these costs would begin in Year Two of the rate plan.

2. The Vancouver Yard Retrofit

Q. Briefly explain the Vancouver Yard Retrofit project.

A. As discussed above, the Vancouver Yard Retrofit is Phase 2 of the Company's construction at its Vancouver Resource Center. Initially, this project was planned to be completed in one phase. In early 2020, the Company made the decision to split out the project into two phases. As a result, the Company will finish construction of the office building in 2020 and the Yard Retrofit in 2022. The Company phased this project over multiple years in order to mitigate the customer rate impact by smoothing the increase in rates associated with this project over two different rate changes.

Q. What are the total costs associated with the Vancouver Yard Retrofit that the Company proposes to include in Year Two?

A. As detailed further in Mr. Pipes' testimony, the Vancouver Yard Retrofit's projected costs are $4.7 million.[65]

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[65] Exh. WKP-1CT 55.

Q. Has the Company determined whether there are any savings or offsetting revenues associated with the Vancouver Yard Retrofit?

A. The Company has considered this question, but as a retrofit of existing buildings and other structures, the Vancouver Yard Retrofit does not result in any savings or offsetting revenues.

Q. With respect to the six distribution and storage projects in Year Two, is the Company proposing any savings or offsetting revenues with these projects?

A. Yes, the rate base associated with these projects that are currently scheduled to go in-service in October 2021 will be net of accumulated depreciation between the time the projects are placed in-service and when the projects are moved into rates on November 1, 2022. This results in a reduction of $157 thousand to depreciation expense in Year Two. The testimony of Kyle Walker, and specifically, Exh. KTW-8, captures this adjustment.

V. COMPLIANCE WITH COMMISSION POLICIES FOR MULTI-YEAR RATE PLANS

Q. Does NW Natural's proposal for a multi-year rate plan comply with Commission policy?

A. Yes, it does. NW Natural's proposal complies with the broad principles that the Commission has adopted for multi-year rate plans, as articulated in the Commission's orders and the Policy Statement. Specifically, the plan will reduce regulatory lag for the Company, reduce regulatory burden for the Commission and parties, and will result in stable rates for customers. Moreover, the Company's proposal also complies with the required process to identify and support investments that NW Natural completed during the rate effective period, as detailed in the Policy Statement. And finally, the proposal includes a rate case "stay-out" provision, which would preclude NW Natural from proposing, in a subsequent rate case, new rates that would take effect prior to the end of Year Two (October 31, 2023).

Q. How does NW Natural's proposed multi-year rate plan reduce regulatory lag on the Company?

A. Both the Horizon 1 and Vancouver Yard Retrofit represent significant capital investments that will be completed after the rate effective date in this case. Without the ability to capture these important projects in rates to recover these investments in the second year of a multi-year rate plan (or another rate case filed immediately after completing this one), the Company would experience significant regulatory lag on its recovery of these investments. And this lag would be especially acute for the Horizon 1 project given its proposed 10-year depreciation life. The Commission can alleviate this regulatory burden by allowing NW Natural to account for the Horizon 1 and Vancouver Yard Retrofit in Year Two.

Q. How does NW Natural's proposed multi-year rate plan reduce the regulatory burden of the Commission and interested parties?

A. As noted above, without a multi-year rate case, NW Natural would likely need to file another general rate case immediately after the conclusion of this case to allow it to begin to recover its investment in the Horizon 1 and Vancouver Yard Retrofit. By allowing the Company to include these investments as part of a two-year plan, the Commission will alleviate itself, Commission Staff, the Company, and all other interested parties of the burden imposed by "the cycle of continuous rate cases."

Q. How does NW Natural's proposed multi-year rate plan provide predictable rates to its customers?

A. Like all multi-year rate plans, NW Natural's proposal will provide customers more certainty about the rates they will pay in the upcoming years. Importantly, NW Natural designed this multi-year rate plan with three key goals in mind. First, the Company set out to present a case that would minimize the overall increase to customer rates over the plan's life. Second, the Company identified approaches that would offset the rate increase in Year One when the economic downturn's effects are expected to be felt most acutely. And third, the Company limited its Year Two increase to recover the costs of limited, long-planned, and discrete capital projects. As a result, the plan not only provides rate predictability, it is designed with particular attention to the current economic environment by spreading rates over two years, thereby smoothing out the rate increases in this case.

Q. How does NW Natural's proposal comply with the process for multi-year rate plans laid out in the Commission's Policy Statement?

A. As noted above, under the process laid out in the Policy Statement, NW Natural must (a) identify the capital investments it intends to include in subsequent years of its rate plan separately from other pro forma rate adjustments;[66] (b) state whether it is seeking recovery through base rates or a separate tariff schedule;[67] (c) include the estimated or projected costs of the capital investments, a description of the investment, and other

[66] WUTC Policy Statement. at ¶ 34.
[67] *Id.*

relevant documentation to assist the Commission in its review of the investments;[68] and (d) provide the expected in-service date of the investment and its relation to the date it plans to include the investment in its rates.[69] NW Natural has provided all of the required information through Mr. Downing's testimony regarding the Horizon 1 project, Mr. Pipes' testimony regarding the Vancouver Yard Retrofit, and Mr. Karney's testimony regarding the six distribution and storage projects. Based on the detailed information provided by these witnesses, the Commission can be assured that costs associated with the projects are prudently-incurred, that the projects will be used and useful in advance of the date that Year Two rates will be effective, and that the Company's cost estimates are accurate.

Q. In the Policy Statement, the Commission suggests that rates adopted for the "out" years of a multi-year rate plan will be subject to refund. Does that requirement apply in this case?

A. No. According to the Policy Statement, rate increases for out years are only subject to refund if the rate increases come into effect before the utility provides a final accounting of the capital investment projects.[70] NW Natural plans to give a final accounting of the Horizon 1 and Vancouver Yard Retrofit projects before the Year Two rates come into effect. Thus, the Commission does not need to make Year Two rates subject to refund.

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[68] *Id.*
[69] *Id.*
[70] *Id.* at ¶ 41.

Q. Please describe your proposed process for the final accounting of the Year 2 projects.

A. NW Natural proposes to file in this docket on or before July 15, 2022 an updated accounting of the costs of the two projects in advance of the Year Two rate change on November 1, 2022. In the event that the costs of the project are below what we have included in rates in this rate case, the Company will adjust the Year Two rate request to reflect the lower costs of the projects. In the event that the costs are higher than those included in rates in this rate case, the Company proposes to include an explanation for why the costs of the projects were higher than currently anticipated, why those costs were prudently incurred, and an update to the Year Two rates.

Q. Does this conclude your testimony?

A. Yes.