

1 **Q. Please state your name, address, and position with Northwest**
2 **Natural Gas Company.**

3 A. My name is Kevin S. McVay. My business address is 220 N. W. Second
4 Avenue, Portland, Oregon 97209. I am a Senior Rate and Financial
5 Analyst in the Rates and Regulatory Affairs Department of Northwest
6 Natural Gas Company (NW Natural or company).

7 **Q. What are your duties and responsibilities as a Rate Analyst?**

8 A. I assist in the design and preparation of the Company's rate schedules
9 and tariffs in Washington and Oregon. I also aid in the interpretation of
10 rules and regulations governing the application of the company's tariffs.

11 **Q. What is your educational background?**

12 A. I graduated from George Mason University, Fairfax, Virginia, in 1981 with
13 a Bachelor of Science Degree in Accounting. In 1986, I received a Master
14 of Business Administration degree from George Washington University,
15 Washington, D.C..

16 **Q. Please describe your business experience.**

17 A. From 1981 to 1987, I held positions as an Accountant, Staff Auditor, and
18 Forecasting Analyst for Washington Gas Light Company in Washington,
19 D.C.. In 1987, I joined Northwest Natural Gas as a Budget Analyst and
20 was subsequently promoted to Senior Financial Analyst. As Senior
21 Financial Analyst, responsibilities included compiling capital and operating

1 budgets, budget variance analyses, earnings projections, monthly margin
2 analysis by customer class, and financial analyses of subsidiary projects.
3 I joined the rates staff of Northwest Natural Gas Company in May, 1991.

4 **Q. What is the purpose of your testimony?**

5 A. The purpose of my testimony is to establish the company's financial
6 results for its Washington operations for the test period. Part of the
7 process of establishing those results is explaining the state allocation
8 methodology that the company is proposing to use in this rate case. The
9 test period that is being evaluated by the company to determine the need
10 for a rate increase is the 12 months ended December 31, 1999. I will
11 explain the method proposed by the company to allocate amounts to each
12 state in which the company has utility operations. I will refer to Revised
13 Exhibit 4 (KSM-Exhibit) which I have prepared for the explanation of the
14 test period results.

15 **Q. Please describe Revised Exhibit 4 (KSM-Exhibit).**

16 A. Page 1 of the exhibit presents the results of operations for the entire utility
17 for the test period in column (a), and the results of operations for
18 Washington in column (b). The only other jurisdiction in which the
19 company has utility operations is Oregon.

20 The revenues on lines 1 through 4 and the gas cost on line 5 reflect
21 12 month ended results through December. The revenues for

1 Washington are almost completely direct; that is, they are the actual
2 revenues generated during the 12 months. The exceptions are the
3 allocation of utility property rental income and income for services
4 rendered to producing entities at Mist under Miscellaneous Revenues,
5 which are allocated using the 3-factor rate. The gas costs for Washington
6 are calculated to correspond precisely to the gas costs collected in billing
7 rates over the period, which parallels the deferral treatment accorded gas
8 costs in Washington.

9 Line 6 identifies uncollectible expense and line 7 represents other
10 operating & maintenance expense. Because there are substantial
11 common costs within O&M, System amounts for a large number of
12 accounts need to be allocated to Washington. Pages 2 through 22 of
13 Revised Exhibit 4 (KSM-Exhibit) show the allocation of Operations &
14 Maintenance Expense to Washington and Oregon, using the allocation
15 methodology proposed by the company. Additionally, the allocation
16 factors used are shown on page 23.

17 **Q. Please describe the allocation methodology.**

18 A. The company's proposed method to allocate common costs begins with
19 an initial attempt to determine non-common costs, and directly assign
20 those to the appropriate jurisdiction. The costs are then considered with
21 respect to specific "drivers", or elements such as volumes or customers

1 that have a causative effect on costs. If a driver is evident for a cost, it is
2 allocated on that basis. Lastly, if there is a common cost with a mix of
3 drivers or no apparent single driver, it is allocated on the basis of a multi-
4 part allocation factor, the 3-factor rate, composed of the average of 1) the
5 proportion of one jurisdiction's directly assigned gross plant to the system
6 total, 2) the proportion of one jurisdiction's number of customers to the
7 system total, and 3) the proportion of employees directly assigned to the
8 system total.

9 The total number of allocation factors used in assigning O&M is 21,
10 as shown on page 23. Even though the number is somewhat high when
11 considering the desired simplicity of a method, a review of the nature of
12 the factors shows that most are just refinements of the drivers typically
13 relied on, namely volumes and customers. The derivation of the
14 allocation factors are shown on pages 24 and 25. The total amount of
15 O&M cost allocated directly is about \$23.2 million, or 31.8% of the total,
16 the amount allocated on the basis of the 3-factor rate is \$20.9 million, or
17 28.6%, the amount allocated on customers is \$16.7 million or 22.9%, and
18 the amount allocated on volumes is \$4.9 million or 6.7%. The remaining
19 10.0% of O&M cost was allocated based on several other factors.

20 Page 22 shows the total amounts of O&M allocated to each state,
21 and the overall % of O&M allocated to Washington of about 7.4%. These

1 total O&M amounts include uncollectible expense, so when returning to
2 the results of operations on page 1, lines 6 and 7 represent a breakout of
3 the total O&M.

4 **Q. Please continue your explanation of page 1.**

5 A. Lines 9 and 10 of page 1 represent the Federal income taxes and Oregon
6 excise taxes reported for 1999 for the system basis and the Federal taxes
7 for Washington using the tax provision model for year-end 1999. To
8 calculate the Washington historic tax provision, interest was taken as the
9 cost of long- and short-term debt multiplied by the proportion of rate base
10 supported by those debt components. Calculated in this way, taxes for
11 Washington operations need not be recalculated as an adjustment to
12 account for the exclusion of typically included interest income as well as
13 the revision of the interest expense level to reflect capital structure and
14 rate base.

15 Line 11 details the System and Washington expenses for property
16 taxes during the test period. The Washington amount reflects the direct
17 assignment of property taxes incurred.

18 Other Taxes on line 12 include franchise taxes which are assigned
19 directly to each jurisdiction. Payroll Taxes are allocated using a payroll
20 factor generated in the O&M allocation model that reflects the weighted
21 average of all other cost allocations as they were used for accounts

1 containing payroll expense. Miscellaneous other taxes are almost all
2 directly assigned.

3 Because of their interdependence, Depreciation and Amortization
4 on line 13 can be explained in conjunction with the determination of
5 System and Washington Total Rate Base on line 16, which are detailed
6 on pages 26 and 27. The following explanation of the allocation of gross
7 plant in rate base should be considered as consistent with the allocation
8 of depreciation and amortization expense and accumulated depreciation
9 in rate base. As with O&M, the use of direct assignment is the default
10 approach, and is available for the allocation of production, transmission,
11 and distribution plant in beginning rate base as well as plant additions
12 during the test period. Intangible plant concerning computer software,
13 which is primarily Customer Information System software, is allocated
14 using all customers due to its service to customers generally. Storage
15 and storage transmission plant is allocated on the basis of firm volumes,
16 insofar as it is considered a substitute to pipeline capacity. CNG and LNG
17 facilities and general plant are allocated using the 3-factor approach, due
18 to their contribution to various company activities.

19 The other elements of rate base are 1) cushion gas in storage
20 which, following the storage plant, is allocated on firm volumes, 2)
21 customer advances which are allocated directly, 3) the unamortized

1 balance related to the company's now terminated high efficiency water
2 heater incentive program in Washington which is directly assigned to
3 Washington, 4) unamortized leasehold improvements which are directly
4 assigned to Washington for those related to the Vancouver district office
5 and allocated on a 3-factor approach for improvements in One Pacific
6 Square and the district office in The Dalles, and 5) deferred taxes which
7 are directly assigned in the case of state deferred taxes and allocated on
8 the basis of percentage of total gross plant for federal deferred taxes,
9 after grossing up for the effect of state deferred taxes on the federal
10 amount. End of period amounts are included in both the System and
11 Washington rate base, consistent with the treatment for deferred taxes in
12 the company's latest rate case.

13 **Q. Please explain lines 17 and 18 on page 1.**

14 A. For System results in column a and Washington specific results in column
15 b, line 17 represents the overall return on rate base using the Net
16 Operating Revenue on line 15 divided by the Total Rate Base on line 16.
17 Line 18 is the resulting return on equity when the debt and preferred cost
18 components of the capital structure are removed from the overall return.

19 **Q. Does this complete your testimony?**

20 A. Yes, it does.