

1 **Q Please state your name and title.**

2 A My name is Bruce R. DeBolt. I am Sr. Vice President and Chief Financial Officer
3 for NW Natural. I am the same Bruce DeBolt who prepared and filed direct
4 testimony, NW Natural Exhibits 1 and 2, in this docket.

5 **Q What is the purpose of your rebuttal testimony?**

6 A There are three general purposes. First, I will indicate which of the adjustments
7 proposed by Staff in their July 21, 2000, testimony are acceptable to the
8 company and show how the “settled” issues in this case affect the company’s
9 requested revenue increase. Second, I will provide a general roadmap for the
10 company’s rebuttal case in this docket. Last, I will address Staff’s case on a
11 policy level and address some specific issues raised by Staff and intervenors.

12 **Non-Contested Issues**

13 **Q Which adjustments proposed by Staff are acceptable to the company?**

14 A First, I note that Staff has adopted the company’s payroll overhead adjustment;
15 the company’s bonuses and 401(k) adjustments; and the company’s One Pacific
16 Square adjustment. In turn, the company can accept Staff’s TI-1 (Schedule 55
17 Sales) adjustment; the Vancouver Office adjustment; the uncollectible accounts
18 expense adjustment; and the Staff’s adjustment to Marketing and Advertising
19 expense. All of these Staff adjustments were sponsored by Mr. Russell in his
20 testimony (JMR-T1). Additionally, the company can accept Staff’s Working
21 Capital adjustment, sponsored by Mr. Lott in his testimony (MRL-T1), beginning

1 on p. 5; the correction to WACOG used in computing gas costs; and the generic
2 effects of all of Staff's adjustments on taxes. I consider these issues to be, for all
3 practical purposes, "settled" between company and Staff.

4 **Q Has there been an agreement reached between the company and Staff**
5 **regarding the Claims Adjustment?**

6 A. Yes. Since Staff filed their case, the company has been able to explain the
7 nature of the *Chase Gardens* judgment to Staff and has shown that at no time
8 has the judgment been reflected in rates charged to Washington customers.
9 Now that the judgment has been reversed, there is agreement that for
10 ratemaking purposes, the *Chase Gardens* judgment is a non-event and, as such,
11 the effect of the reversal of the judgment should be removed from the test period
12 results. The result is that the company's filed adjustment is proper for inclusion
13 in the determination of revenue requirement.

14 **Q. Have company and Staff settled other issues in this docket?**

15 A Yes. The company and Staff settled cost of capital issues, for an overall rate of
16 return of 8.95%. This settlement has been approved by the Commission as
17 advised by letter dated August 2, 2000.

18 **Q. How does Staff's acceptance of the referenced company adjustments, and**
19 **the company's acceptance of the referenced Staff adjustments, affect the**
20 **company's requested revenue requirement in this case?**

21 A The company's revised revenue requirement increase request previously was

1 \$5,626,590, as shown in the March 23, 2000, revised filing. The “settled” issues
2 that I have referenced, combined with the previous settlement between company
3 and Staff on cost of capital, result in a reduction of \$827,443 to the company’s
4 March 23, 2000, revised request for a revenue increase. In sum, the company’s
5 request for a revenue increase now stands at about \$4,800,000. This compares
6 to Staff’s proposed revenue increase of \$3,221,000 (JMR-T1, p. 2). As
7 discussed above, Staff is prepared to stipulate that its proposed *Chase Gardens*
8 Claims Adjustment of \$383,343 should be reversed. Once Staff makes that
9 change, I believe Staff’s overall proposed revenue increase will be about
10 \$3,604,000.

11 **NW Natural’s Rebuttal Case**

12 **Q Please describe the company’s rebuttal case.**

13 **A** Following this overview, I address Staff’s case overall.

14 Next, I address Staff’s recommendation to phase in the “state allocation”
15 portion of the company’s revenue increase. The company recognizes the
16 magnitude of the proposed rate increase and its impact on customers. However,
17 I take issue with Staff’s characterization that the state allocation issue was
18 unexpected or unanticipated, or that its effect on revenue requirement is unfair to
19 Washington.

20 Next, I address the policy issues raised by Mr. Hua regarding recovery of
21 costs relating to the company’s efforts to ensure an orderly and uneventful roll-

1 over to Year 2000. Mr. Hua claims that the company did not respond to his
2 discovery requests regarding this issue. That is not the case, as Mr. McVay
3 demonstrates in his testimony.

4 I also address testimony by Mr. Hua and by Mr. Schoenbeck for
5 Northwest Industrial Gas Users & SEH America (NWIGU/SEH) respecting the
6 company's investment in its customer information system (CIS).

7 Finally, I address the testimony of Mr. Lazar for Public Counsel regarding
8 savings that Mr. Lazar believes should be assumed in this case for meter
9 reading activities.

10 Following my testimony, Mr. Kevin McVay responds to the adjustment
11 proposed by Mr. Lott regarding Mist "owned capacity." Mr. McVay demonstrates
12 that Mr. Lott's adjustment would impose additional regulatory lag on the
13 company's ability to recover investments in Mist underground storage, without
14 compensating the company for additional costs associated with forward-looking
15 customer counts. Mr. McVay then responds to the testimony of Mr. Hua
16 regarding Staff's proposed payroll adjustment. Finally, Mr. McVay demonstrates
17 that, despite the statements of Mr. Hua to the contrary, the company fully
18 responded to Staff's requests for information about the company's 1999 Y2K
19 costs.

20 Following Mr. McVay, Dr. John Hanson addresses the testimony of Mr.
21 Mariam regarding the appropriate measurement of "normal" weather on which to

1 base rates in this case. If adopted by the Commission, Mr. Mariam's weather
2 normalization method would virtually ensure that the company cannot earn at the
3 8.95% rate of return (ROR) agreed to between company and Staff in this case.
4 Dr. Hanson also shows, contrary to the assertions of Mr. Lazar, that Washington
5 customers benefit from the company's investments in Mist underground storage.

6 **Policy Issues**

7 **Q. What are the policy issues you'd like to address?**

8 Q. There are two. The first is Staff's overall revenue requirement recommendation.
9 The second is Staff's position respecting a phase-in of revenue requirement
10 associated with implementing rates on a state-allocated basis.

11 **Q What are your concerns about Staff's overall recommendation regarding**
12 **the company's revenue requirement?**

13 A This case is a simple general rate case, even though the revenue increase
14 sought is relatively high. The need for a revenue increase arises from two
15 general sources. First, as Staff acknowledges, about \$3 million of the company's
16 total revenue increase relates to the implementation of rates on a state-allocated
17 basis. Exhibit JMR-T1, p. 4. Staff does not challenge the policy basis for, or
18 accounting results of, moving NW Natural's rates in Washington to a state-
19 allocated basis.

20 The second basis for the revenue increase is the new investments NW
21 Natural has made to serve our customers, no part of which is currently included

1 in Washington rates.

2 These investments include a new customer information system (CIS)
3 placed in service in the fall of 1997, costing approximately \$40 million. Without
4 this investment, the company could not have continued processing bills, service
5 orders and other normal business activities past the year 2000. Indeed, the old
6 1960s-vintage customer information system was very near failure even without
7 the Year 2000 issue.

8 In addition to CIS, the company made two separate investments in Mist
9 underground gas storage. The storage investments were necessary to ensure
10 service to core customers under peak seasonal conditions. The first piece, new
11 reservoir capacity (the "Al's Pool" reservoir), was placed in service in November
12 1998 at a cost of about \$29 million. The second piece was an expansion of the
13 Mist Feeder pipeline, which increased take-away delivery capacity to match the
14 reservoir capacity of the facility. The Mist Feeder expansion was an investment
15 of an additional \$35 million. These investments were demonstrated to be both
16 necessary and "least cost" in the company's 1995 Integrated Resource Plan,
17 which was accepted by the Washington Commission.

18 In sum, since the company's last general rate increase in 1997, the
19 company has invested more than \$100 million in non-revenue producing plant in
20 order to serve its customers.

21 Despite these investments, Staff's overall recommendation for a revenue

1 increase (including the change for *Chase Gardens*) is only \$3.6 million. This
2 amount includes the effects of the state allocation, which Staff does not
3 challenge and acknowledges to represent about \$3 million of annual revenue
4 requirement (JMR-T1, p. 2). Another way of viewing Staff's case is that Staff is
5 contending that Washington customers should have almost no financial
6 responsibility for the \$100 million in new investments made in customer service-
7 related facilities since NW Natural's last general rate case in Washington in 1997
8 (Docket No. UG-970932). The company's rebuttal case responds in detail to the
9 individual issues raised by Staff.

10 I think it is important for the Commission to put Staff's case in perspective:
11 Clearly, Staff's overall recommendation should be considered suspect if it means
12 that customers would not be paying to support investments that are necessary to
13 serve them. I can understand that Staff is concerned about the immediate "rate
14 shock" impact of the company's case on Washington customers, and is seeking
15 a total revenue requirement increase that would mitigate this impact. NW
16 Natural is also concerned about the incremental impact of the general rate
17 increase, especially because it will come at a time when rates have just gone up
18 due to dramatically increasing gas commodity costs. We filed the case
19 suggesting a phase-in of the final revenue number, particularly if the case could
20 be settled without hearings, so as to mitigate the impact on customers as much
21 as possible. The proposal in our transmittal letter was to implement a portion of

1 the increase on May 1, 2000, a second portion on Dec. 1, 2000, and the final
2 portion on May 1, 2001.

3 If the case is to be litigated to the end, however, I urge the Commission to
4 consider the specific issues raised by Staff individually, and on an objective
5 basis, rather than with an eye to the end result. I believe the company's rebuttal
6 case demonstrates that a \$4.8 million annual revenue increase is warranted and
7 produces fair and reasonable results. We remain interested in avoiding an
8 unnecessarily abrupt impact on customers, but short of a settlement of at least
9 the revenue requirement issue, the company is not willing to waive the end of the
10 statutory suspension period for implementing the new rates that will result from
11 decisions on these issues.

12 **Staff's Phase-In Proposal**

13 **Q Please state your understanding of Staff's proposal to phase in the cost of**
14 **service increase associated with the state allocation methodology.**

15 **A** I understand Mr. Lott's proposal to be a three-year phase-in of the effects of the
16 state allocation, in equal \$1 million increments beginning on December 1, 2000
17 and ending on December 1, 2002.

18 **Q Is NW Natural opposed to a phase-in?**

19 **A** Not necessarily. As I said, we also proposed a phase-in in our initial filing. The
20 differences between company and Staff have to do with timing and cost
21 recovery. We proposed, and still support, a shorter phase-in period.

1 Furthermore, in order for a phased-in rate increase to be equivalent financially
2 for the company to an increase made effective all at once, any portion of the
3 annual revenue increase that was delayed beyond the first implementation date
4 would have to accumulate amounts equal to the additional margin revenues the
5 remaining increment would have generated each month, and also to accrue
6 carrying charges each month at a rate equivalent to the company's cost of
7 capital.

8 For example, the company would accept a result that collected additional
9 revenues in Washington (a) at the outset, in an amount at least equal to the
10 annual revenue decrease committed to go into effect in Oregon on December 1,
11 2000, due to implementation of the state allocation study in that state; and (b)
12 starting May 1, 2001, in an additional amount equal to the rest of the annual
13 revenue increase in Washington, plus lost revenues from the prior five months,
14 plus carrying charges. The amounts of the lost revenues and carrying charges
15 could be collected through a temporary rate surcharge to be in place for no
16 longer than a year.

17 **Q What are your issues with Mr. Lott's proposal?**

18 A Mr. Lott's proposal for a phase-in is based primarily on an argument unrelated to
19 whether the state-allocated cost of service is correct from an accounting or
20 ratemaking standpoint. Indeed, Staff does not challenge the state allocation
21 methodology or its results. Rather, Staff's recommendation rests on a claim that

1 Washington was given inadequate notice about the state allocation issue.

2 It is correct to say that the state allocation study in the company's filing
3 was initiated because of proceedings before the Oregon Public Utility
4 Commission. It is also correct that the study results in reduced rates in Oregon.
5 Where I disagree with Mr. Lott is in the implicit suggestion that the Washington
6 Staff was unaware of the timing or result of a state allocation study.

7 **Q Please elaborate.**

8 A The history of discussions between the company and WUTC Staff on the issue
9 whether the company's Washington rates should be established on a state-
10 allocated basis, as opposed to a system basis, is a long one. Staff's testimony
11 might create an impression that the issue is new and relatively unexpected in
12 terms of its results and its timing, but in fact it is neither. The issue has been at
13 or just below the surface in every Washington general rate case at least since I
14 joined Northwest Natural Gas Company and started working on regulatory
15 matters in 1980. Even then, I believe NW Natural was the only energy utility
16 providing service in both Washington and Oregon that did *not* determine rates
17 pursuant to a state allocation study that had been prepared under the auspices
18 of both regulatory jurisdictions.

19 The issue arose in the company's 1986 Washington general rate case (U-
20 86-41), as Mr. Lott testifies. Mr. Lott is correct that Staff asked the company to
21 do a study of a state allocation for Washington. However, this is only part of the

1 story. Mr. Lott may not be familiar with the rest of the story because he was not
2 closely involved in those 1986 discussions.

3 **Q Please describe the company's 1986 rate case.**

4 A The company filed the case in March 1986. In settlement discussions, Staff
5 raised the issue whether the case should be done on a state-allocated, rather
6 than a system, basis. Staff believed, due to the presence in Washington of very
7 large industrial customers such as Crown Zellerbach (later James River)
8 (Camas) and Boise Cascade (Vancouver), that rates made on a state-allocated
9 basis would reduce the revenue increase sought by the company.

10 The company undertook a thorough, although not exhaustive, look at this
11 issue while the 1986 case was under way. The company completed the study in
12 July 1986 using the same allocation methodology the WUTC had approved and
13 used for Cascade Natural Gas Company, another LDC with operations in both
14 Washington and Oregon. What we discovered was that a state allocation cost of
15 service would not have materially changed the result of the case, as Staff had
16 appeared to believe that it might. The company's study showed that the 1986
17 revenue increase would have been approximately the same size regardless of
18 whether the rates were made on a state-allocated or a system basis. A copy of
19 the internal memo presenting the study's conclusions is attached at Exhibit 24,
20 pp. 1 – 13. The full study is about one and one-half inches thick, so I have not
21 made it part of my testimony.

1 The company did not actually submit this study to the Commission. We
2 did not want to be in a position where the company was considered to be
3 committed to the expensive and politically divisive process of preparing, filing
4 and using state allocation studies in every future rate case in Washington.
5 However, I do recall talking to Staff about the study, and advising Staff about its
6 results, during our settlement discussions. Shortly thereafter, the company
7 made a comprehensive proposal to settle the issues in the U-86-41 case. The
8 settlement proposal specifically stated at page 4 that “no ‘state allocation’
9 approach to the case” was contemplated. Exhibit 24, pp. 14 – 17, at pg. 17.
10 Following the company’s proposal, in September 1986, Staff filed testimony in
11 the case incorporating a system approach to calculating revenue requirement in
12 keeping with the settlement. See, Exhibit 24, pp. 18 – 26. These documents
13 show that after giving the issue due consideration during the 1986 general rate
14 case, the company and Staff had a meeting of the minds that the state allocation
15 approach, because it did not materially change the results of the case, was not
16 worth pursuing at that time.

17 **Q What else do you remember from those 1986 discussions with Staff?**

18 A 1986 was an important year in the natural gas industry. Just a few months
19 before the company filed its 1986 case, in October 1985, the Federal Energy
20 Regulatory Commission (FERC) issued its landmark Order No. 436 (50 Fed.
21 Reg. 42408). Order No. 436 was the beginning of the FERC’s program to

1 unbundle natural gas commodity from interstate transportation service. It was
2 also the beginning of the FERC's policy that *encouraged* large industrial gas
3 users to physically bypass local gas distributors in favor of direct service from the
4 interstate pipelines. Today, industrial bypass is a fact of life for LDCs. In 1986,
5 however, it was a relatively new threat. The company and the WUTC Staff knew
6 that bypass was a serious threat, but we didn't know when or where it might
7 happen first. I recall having discussions with WUTC Staff about these issues
8 while we were trying to settle the company's 1986 Washington case.

9 **Q Why is the industrial bypass issue relevant to a discussion of state-**
10 **allocated rates?**

11 A It is relevant because Staff's belief in 1986 that Washington would be
12 advantaged by a state-allocated approach to cost of service rates was due to the
13 historical presence on NW Natural's Washington system of large industrial gas
14 loads. Our operations in Washington had had a much larger margin contribution
15 from the industrial market, relatively speaking, than our operations in Oregon.
16 The margin revenues these customers contributed to NW Natural's cost of
17 service greatly benefited the company's other customers. If that load left the
18 company's system, as it by then had the potential to do, then the state-allocated
19 approach would definitely *not* benefit Washington. The company had
20 discussions with WUTC Staff about the potential for bypass and its effect on a
21 volume-driven state allocation. I believed at that time that Staff understood the

1 implications of bypass on small customers in Washington: The bypass threat
2 meant that a state allocation strategy would shift system revenue responsibility
3 from Oregon customers to Washington customers once the industrial load
4 (particularly the large Washington customers) had left the system.

5 As it turned out, the first industrial bypass of NW Natural's system in
6 Washington did not occur until somewhat later, in 1993. Northwest Pipeline
7 Corporation did not finally accept FERC's Order No. 436 blanket certificate for
8 transportation services until June 1988. By then, the company had succeeded in
9 negotiating long-term special contracts with its largest customers which kept
10 these customers on the system — contributing margin revenues — for longer
11 than we would have guessed possible in 1986. For example, James River
12 (Camas), NW Natural's single largest customer at the time, finally completed its
13 bypass and left the system in October 1993. Washington customers actually did
14 not feel the impact of these bypasses for several more years because the
15 company did not file a general rate case between 1986 and 1997. It wasn't until
16 the 1997 general rate case, in UG-979032, that Washington customers first
17 experienced the system's losses to bypass.

18 **Q Why is this history important?**

19 **A** It is important because it explains why neither the company nor Staff came
20 forward with a proposal to base rates in Washington on a state-allocated basis
21 following the 1986 rate case. Another way the Commission can look at this

1 history is as follows. The rates that were in effect in Washington for NW Natural
2 from 1986 through 1997 were the rates that were approved in 1986 rate case.
3 At the time the rates were approved, they neither advantaged nor disadvantaged
4 Washington customers vis-à-vis Oregon customers. The same conclusion was
5 also true for Oregon. NW Natural's Oregon rates, until 1999, were those that
6 were approved by the Oregon Commission in the company's 1989 general rate
7 case. NW Natural's rates in effect in both states during most of the 1990s were
8 approved at a time when there was relative parity between the states, and that
9 parity probably would have existed regardless of whether rates were based on a
10 system or a state allocation approach. There has been no long-standing subsidy
11 going from Washington to Oregon.

12 **Q When might the parity have begun to change?**

13 **A** Probably in the mid-1990s, as the large Washington industrial customers left the
14 system and as small customer growth in Washington accelerated. Of course, we
15 can't know precisely when the tilt occurred, because NW Natural was able to
16 avoid the need for general rate cases during most of the decade. It only became
17 clear during the company's 1997 general rate case in Washington that the
18 circumstances had shifted. Prior to that filing, the WUTC Staff began an
19 investigation of whether a state allocation cost of service should be required in
20 the case. The results of Staff's preliminary investigation strongly suggested that
21 a state allocation could shift revenue responsibility from Oregon to Washington,

1 so the Staff terminated its review. Exhibit 24, pp.27 – 30 (Staff response to data
2 request). Staff did not require the company to pursue a state-allocated cost of
3 service in the 1997 case.

4 **Q Staff also testified that Staff reserved the right, in 1999, to challenge the**
5 **state allocation study in this rate case. Do you agree?**

6 A I agree that Staff reserved the right to challenge *the methodology* of the state
7 allocation cost of service, meaning the development of allocation factors for the
8 individual elements of cost of service. To my knowledge no one from Staff ever
9 said, however, that they were reserving an option to recommend a rejection of
10 the state allocation approach altogether in favor of retaining the system
11 approach.

12 The company had advised Staff of the fact that Oregon wanted a state
13 allocation as early as the summer of 1999, while we were in negotiations in NW
14 Natural's Oregon general rate case. We asked the staffs of both state
15 commissions to participate in a collaborative effort to develop a mutually-
16 acceptable state allocation study for NW Natural that could be used to apply
17 concurrent rate changes in both states. The Oregon PUC Staff agreed to
18 postpone the effect of rates to implement such a study in Oregon from
19 December 1, 1999, until December 1, 2000. Both staffs participated actively and
20 constructively in the development of the study, a process that took several
21 months. The WUTC Staff did not indicate at any time that they would object to a

1 December 1, 2000, implementation date.

2 **Q What should the Commission conclude from these background facts?**

3 A If the system approach ever resulted in Washington customers' subsidizing
4 Oregon customers, then such a situation must have pre-dated the company's
5 1986 rate case. Based on our discussions with Staff about industrial bypass
6 potential, however, I believe the WUTC Staff knew in 1986 that industrial bypass
7 would shift the balance between the states. Staff was aware of the implications
8 of bypass when it actually began occurring in the late 1980s and early 1990s.
9 And by the time of the company's 1997 rate case, WUTC Staff certainly knew
10 that the state allocation approach would probably shift revenue responsibility
11 from Oregon to Washington. I believe Staff has been aware since 1997 that
12 Washington customers were benefiting on an ongoing basis from further delay in
13 conducting and implementing a state allocation study. There is no case to be
14 made that the state allocation study or its results were unforeseen or
15 unforeseeable by the Washington Staff.

16 **Q Staff also states that the company did not provide a state allocation study**
17 **to Staff as Staff requested following the company's 1986 case. Could you**
18 **respond?**

19 A I do not challenge the statement that Staff asked for a state allocation study at
20 that time. I do not recall the specific circumstances of the request, but I do
21 remember concluding that the request had been honored by the company's

1 performing its internal study of a state allocation approach and sharing the
2 results (if not the actual study) with Staff in the context of settling the case. I do
3 not remember subsequent requests from Staff regarding a further state
4 allocation, rather I think that both company and Staff dropped the issue following
5 the 1986 rate case discussions.

6 **Q What does NW Natural consider to be the key problem with Staff's phase-in
7 proposal?**

8 A Aside from legal or constitutional problems that the attorneys will debate, the
9 Staff's proposed phase-in would cause a significant financial problem for the
10 company. NW Natural will implement a revenue reduction in Oregon worth
11 about \$3 million per year on December 1, 2000, based on the cost of service
12 results allocated to Oregon from the very same state allocation methodology filed
13 in this case. The company participated in good faith in a collaborative
14 development of the state allocation methodology and this specific study's results.
15 We have relied on what we believed were the two states' commitments to
16 making the change in ratemaking policy, and the application of the study to rates
17 in both states, *concurrently*. We are counting on the additional revenues
18 required from Washington under the study to compensate for the revenues lost
19 from Oregon under the same study. Implementation of the study should be a
20 zero-sum exercise for the company as a whole.

21 If, however, the WUTC Staff's phase-in proposal were adopted by the

1 Commission, then as of the effective date of new rates in this case, the company
2 would not and could not earn the rate of return (8.95%) stipulated and approved
3 by the Commission. Nor could the company earn the return on equity assumed
4 by company and Staff in the calculation of the stipulated rate of return. Since
5 the company must pay debt holders according to the terms of the company's
6 notes, the revenue shortfalls would be incurred by shareholders.

7 By agreement between the company and Staff, the rate of return
8 settlement filed in this docket did not specify the number for return on equity that
9 was used in the derivation of the overall rate of return of 8.95%. We have
10 calculated, however, that Staff's phase-in proposal would mean that, as of
11 December 1, 2000, the company's shareholders would be short by 530 basis
12 points in equity return by virtue of the shortfall in revenues resulting from a delay
13 in full implementation of the state allocation. And as of the December 1, 2001,
14 effective date proposed by Staff for the second \$1 million increment,
15 shareholders still would be short by an ongoing 260 basis points on equity. Only
16 as of the December 1, 2002, effective date, would the company's shareholders
17 be brought to the point where rates were collecting enough revenue from
18 customers in Washington to recover the cost of service allocated to Washington
19 under an allocation study that both the company and Staff agreed was fair and
20 reasonable two years earlier.

21 Absent a provision allowing for recovery of lost revenues during the

1 phase-in period, as well as carrying charges representing lost use of cash, I
2 believe the Staff's proposal would be confiscatory as it would apply to
3 shareholders. I am not aware that the Commission has ever phased in an
4 otherwise just and reasonable increase in a utility's revenue requirement without
5 allowing the utility carrying costs on the balances. Staff may not contest this key
6 policy point, but Mr. Lott does not touch on the need for recovery of lost
7 revenues and carrying charges in his testimony.

8 **Q Please respond to Staff's statements that NW Natural's rates are "fair and**
9 **reasonable" whether they are based on a system approach or a state**
10 **allocated approach.**

11 A In NW Natural's case, I think it could be concluded that rates based on a system
12 ratemaking methodology would be fair and reasonable as long as that approach
13 was applied in like fashion by both states. Similarly, rates based on a state-
14 allocated methodology would be fair and reasonable as long as that approach
15 was applied in like fashion by both states. It's when one state seeks to use one
16 methodology, and the other state seeks to use the other, that the result could be
17 unfair and unreasonable for the company.

18 That is why we devoted a year to developing a state allocation study on a
19 collaborative basis, with a presumption of concurrent application. Both states
20 participated. We believed in and relied on their respective commitments to the
21 process. The WUTC Staff has accepted the results of the state allocation cost of

1 service that assigns Washington's share of company plant to Washington. Staff
2 and the Commission have accepted that the company's investors should be
3 allowed a rate of return (ROR) of 8.95%. And, once the case is completed, the
4 Commission will have examined and approved reasonable expense levels for the
5 company's Washington operations. Having completed this review and balanced
6 the interests of customers and shareholders respecting these issues, the
7 Commission should not delay the required rate increase based on an assertion
8 that the Commission should reject the bargain and go back to the old
9 methodology after all.

10 **Year 2000 Costs**

11 **Q What is your understanding of Staff's position on the company's Y2K
12 costs?**

13 A Staff argues that the expenses incurred by NW Natural to ensure continued
14 service and business operations after the changeover to year 2000 were "non-
15 recurring" and therefore should not be permitted (KH-T1, p. 5-6). Staff also
16 asserts that the company did not respond to Staff's discovery requests, and the
17 person responsible for the company's Y2K program was not available to Staff. I
18 will respond to Staff's adjustment; Mr. McVay will respond to Mr. Hua's
19 assertions that information was not made available to him for a review of the
20 company's expense levels.

21 **Q What was the Year 2000 problem?**

1 A As everyone knows by now, the year 2000, or Y2K, computer problem was
2 caused by the efforts of early computer programmers to save computer storage
3 space. Programmers developed systems that read only the last two digits of any
4 given year. Data storage was costly when most computer systems were first
5 developed in the 1960s and '70s, and this programming tool was a universal cost
6 saving measure.

7 However, as the 1900s neared completion, it became a concern to
8 businesses, government, and other organizations that the inability to read a full
9 four-digit year could cause computers and delivery systems to fail when the
10 calendar rolled over from 1999 to 2000. Beginning well before 2000, all
11 responsible businesses in the United States and in the rest of the developed
12 world were attentive to finding and fixing any computer systems that could fail
13 due to the Y2K issue. Public policy makers nation-wide were particularly
14 interested in the ability of utilities to continue functioning after the calendar
15 change-over, since utility service is necessary to the health of citizens and the
16 economy.

17 **Q Was the State of Washington interested in ensuring that its utilities**
18 **identified and fixed Y2K issues so as to be able to continue service?**

19 A Yes. As early as 1997, the WUTC initiated an investigation docket, Docket No.
20 U-971835, to assure that gas and electric utilities in particular were assessing
21 equipment and systems for Y2K compliance, converting or replacing non-

1 compliant systems, testing the new systems, and otherwise ensuring that
2 customers would be protected from service disruptions. NW Natural participated
3 in this docket, and fully complied with all of Staff's and the Commission's
4 recommendations and requests.

5 **Q Did NW Natural have a successful changeover to year 2000?**

6 A Yes, NW Natural's systems were all replaced or fixed, and tested, prior to the
7 calendar changeover. We experienced no service disruptions. I can report this
8 success in two short sentences, but they represent an enormous amount of
9 planning and hard work by a large team of skilled, dedicated employees and
10 contractors.

11 **Q What is your reaction to Staff's proposal that no costs associated with the**
12 **company's Y2K efforts should be included in rates for Washington**
13 **customers because they are non-recurring?**

14 A I can understand why Staff occasionally recommends disallowances in rate
15 cases based on the "non-recurring" nature of some utility expenses. With
16 respect to this particular cost, however, I think Staff's recommendation is
17 regrettable, and its acceptance by the Commission would be poor policy.

18 NW Natural's efforts to assess, convert, and test its systems so that the
19 company could ensure uninterrupted customer service after December 31, 1999,
20 were lengthy and thorough, and ultimately very successful. We did not just
21 examine all of the company's systems; we engaged in discussions with our

1 suppliers on which we are dependent to ensure *their* readiness, and provided
2 assistance as necessary to customers to help them ensure that their own
3 systems would operate correctly. These efforts meant that service could be
4 continued to customers; that customers and the public generally would be
5 confident their infrastructure systems would continue working in face of Y2K
6 uncertainties (and, from some quarters, doomsaying); and that the company's
7 computer-aided delivery systems (now fixed) will be in service for many years to
8 come. We believe that result was what the Commission expected of us when it
9 undertook its investigation into the utilities' preparedness for the calendar year
10 changeover. It never occurred to the company that these costs would not be
11 considered "prudent" given the Commission's obvious and expressed interest in
12 continued service after year 2000.

13 It is true that the company will not again experience a changeover of its
14 systems to year 2000, so the expenses devoted just to that fix are definitionally
15 "non-recurring," as Staff suggests. But this is not an issue where semantics
16 should prevail over good judgment, sound policy, and fair play. The company's
17 test year expenses (not all year Y2K expenses were incurred in the test year)
18 should be allowed as requested in the company's filing because they were
19 reasonable, prudent business expenses directly related to ongoing customer
20 service.

21 Alternatively, it could reasonably be concluded that the costs incurred in

1 NW Natural's Y2K program were an investment in the company's ability to
2 provide both continuing and improved service in the future. Accordingly, it would
3 be fair and reasonable to recognize a portion of the Y2K costs allocated to
4 Washington from the total cost of the three-year program as an amortization
5 expense, and to recognize the unamortized balance in rate base.

6 **Q How do you respond to Staff's assertion that the company did not seek**
7 **deferred accounting for its Y2K expense (KH-T1, p. 6)?**

8 A Deferred accounting does not assure recovery of costs in rates, since utilities
9 seeking deferred accounting must nevertheless demonstrate the prudence of the
10 costs at the time recovery is requested. The company is making that
11 demonstration now. The lack of a deferred accounting application is irrelevant
12 for purposes of this general rate filing because it is irrelevant to the issue of
13 whether the company's Y2K expenses were reasonable and prudent.

14 **Customer Information System (CIS)**

15 **Q What is your understanding of Staff's and NWIGU/SEH's objections to**
16 **allowing NW Natural \$37.1 million in CIS plant?**

17 A Staff and NWIGU/SEH raise similar arguments, and I will respond generally to
18 both where I can. First, NWIGU/SEH claims that based on its review of the
19 company's CIS documents, about one-half of the company's investment in the
20 new Customer Information System should have been disallowed by the Oregon
21 Commission, and therefore by the Washington Commission. Second,

1 NWIGU/SEH urges a plant allowance based on average, or “per customer” CIS
2 costs for other utilities, relying on a study OPUC Staff produced in the company’s
3 Oregon rate case, UG 132. Staff makes a similar argument, but bases its plant
4 allowance on the company’s original CIS budget, stated on a per customer basis
5 and updated for current customer counts. Both NWIGU/SEH and Staff object to
6 the fact that the company did not account for CIS costs as they would have
7 desired. Both NWIGU/SEH and Staff indicate that the Oregon Commission’s
8 approved CIS plant amount may be reasonable for Washington, too.

9 **Q How do you respond to NWIGU/SEH’s suggestion that half of the total CIS**
10 **plant amount should be disallowed?**

11 A NWIGU/SEH’s testimony on this point is based on its assertion that no part of
12 the company’s early CIS efforts were transferred to and used and useful in the
13 final CIS.

14 This issue has already been discussed at length in my opening testimony
15 in this docket (NW Natural Exhibit 1 (BRD), p. 20, line 15 through p. 22, line 20),
16 and in the testimony of Charles Beyer (NW Natural Exhibit 17 and 18). In brief
17 summary, however, the company began its CIS efforts by attempting to build a
18 custom computer system. When it became clear that the company’s contractor
19 could not complete such an effort within budget or on time, the company
20 switched directions and completed an off-the-shelf project that was modified to
21 be useable for NW Natural.

1 NWIGU/SEH believes that all of the early work on the custom project
2 should have been “written off.” However, as Mr. Beyer testifies at length, the
3 vast majority of the work performed prior to the change in direction was effort
4 that would have been required in the second phase as well. It was incorporated
5 in the final, completed CIS and is used and useful today. NWIGU/SEH’s
6 argument that no part of the investment in the first phase of CIS could be used
7 and useful in the final, completed phase is like arguing that all of the soil and
8 field preparation a farmer does prior to planting is somehow not used or useful if
9 the farmer later decides to plant wheat instead of oats.

10 This issue is also discussed in the OPUC Order on CIS, attached to the
11 testimony of Mr. Hua, Exhibit KH-6. I refer the Commission to this previously
12 filed testimony for a discussion responding to NWIGU/SEH’s claims that half of
13 CIS plant could be disallowed.

14 **Q Please respond to NWIGU/SEH’s second argument, that NW Natural’s CIS**
15 **costs on a per customer basis were too high, and that a reasonable plant**
16 **allowance could be found by comparing NW Natural’s costs to those of**
17 **other utilities.**

18 **A** NWIGU/SEH’s second argument appears to rest on two different assertions.
19 First, NWIGU/SEH (as well as Staff) claims that the company did not keep
20 detailed accounting records itemizing the costs of all of the various items of CIS
21 investment; thus casting the impression that a traditional regulatory review would

1 not be possible. The company did not keep its accounting records in the formats
2 preferred by NWIGU/SEH and Staff because the company utilized a fixed price
3 contract with IBM covering a final delivered project. The company did keep
4 itemized records of the company's expenses, but did not receive itemized
5 records of IBM's expenses. The accounting records are detailed in the testimony
6 of Mr. Steve Feltz, NW Natural Exhibits 19 and 20.

7 Second, NWIGU discusses an OPUC Staff analysis that compared NW
8 Natural's CIS costs, on a per customer basis, to the average per customer costs
9 of 17 other utilities. During the Oregon case, the company checked with the
10 utilities used in the OPUC Staff's testimony to ensure that Staff had accurately
11 captured the same types of plant costs, and to update the costs. OPUC Staff's
12 analysis had been based on a proprietary review of utility CIS projects, and the
13 proprietary study was old. The company learned that OPUC Staff's study did not
14 accurately compare "apples-to-apples" CIS projects, since the utilities often were
15 not reporting all of their investments as "CIS" related. Also, these utilities, like
16 NW Natural, had experienced higher costs since the time their projects were
17 discussed in the study. Using updated numbers, the OPUC Staff's analysis
18 showed that NW Natural's CIS costs were about average on a per customer
19 basis, at about \$82 per customer, compared to NW Natural's number of \$86 per
20 customer.

21 In any event, I believe that assessing the reasonableness of the

1 company's investment on the basis of what other utilities had spent is an
2 insufficient basis for review because it does not explain what NW Natural had to
3 do to develop a useful computer information system in its own circumstances, as
4 contrasted to those of the other utilities. Prior to the CIS investment, NW Natural
5 had been using a 1960s vintage computer system based on an old programming
6 language that had been replaced by most utilities in the 1970s or 1980s. Also,
7 the company's project involved not just software development, but hardware,
8 networking and desktop applications. The prudence of the company's CIS
9 investments when compared to the investments by other utilities of similar size
10 cannot be determined without knowing the starting point of these other utilities'
11 systems. NWIGU/SEH provides no such information, and consequently their
12 purported comparison of NW Natural to other utilities' computer systems does
13 not tell the Commission anything about the prudence of NW Natural's
14 investment.

15 **Q How do you respond to Staff's proposal to base a plant allowance on the**
16 **company's original CIS budget, stated on a per customer basis and then**
17 **updated for current customer counts?**

18 A Staff's proposal suffers from many of the same types of flaws as NWIGU/SEH's
19 testimony. The company's original budget does not say anything about whether
20 the final CIS is used and useful, or whether final project costs were prudent.
21 Few large utility projects are completed exactly on budget, because

1 unanticipated difficulties will cause the utility to correct course. Events can add
2 to plant costs without making those costs imprudent. For example, if an electric
3 utility carefully chose a site to construct a generating facility, and during
4 construction uncovered cultural artifacts that caused construction delays, this
5 event would add to budgeted costs, but the costs would not be imprudent.
6 Staff's analysis suggests, I believe incorrectly, that a budget is the only way of
7 measuring prudence.

8 **Q Finally, please respond to the testimony of Mr. Lazar for Public Counsel**
9 **that NW Natural has not demonstrated that its CIS is "cost-effective"**
10 **(Lazar, pp. 6-7).**

11 A This argument, too, was raised in the Oregon case regarding CIS. The
12 company's old computer system was so dated, relying on 1960s technology, that
13 we knew it would certainly fail at the year 2000 roll-over, and that it might fail
14 even before then due to the inability of the system to support new customers.
15 The system had to be replaced, and soon, in order for the company to continue
16 its business operations. Under those circumstances, the CIS replacement was
17 certainly "cost-effective" compared to business failure.

18 The company undertook an exhaustive search of CIS options both at the
19 start of the project, and then again in 1995 when the company changed
20 directions. Included in this search was the possibility of purchasing CIS services,
21 as Avista had done. However, available purchase options did not serve our

1 customers' needs and were not, therefore, a reasonable choice.

2 **Q NWIGU/SEH indicates that it could accept the Oregon Commission's**
3 **allowed CIS plant amount of \$32 million (T1, p. 6-7), and Staff suggests that**
4 **it generally agrees with the Oregon result (KH-T1, p. 7). Could the**
5 **company also accept the Oregon CIS plant allowance of \$32 million?**

6 A Yes. The CIS project was intensively litigated in Oregon, and the discussion the
7 Commission has seen in this docket merely scratches the surface of the Oregon
8 discussion. For example, this issue alone produced about three large three-ring
9 binders of testimony and exhibits on the correct level of CIS plant. While I
10 continue to believe that \$37.1 million is a correct, prudent plant investment for a
11 used and useful computer system, the company could also accept the Oregon
12 result (\$32 million of plant associated with the residential & commercial CIS) in
13 Washington.

14 **Joint Meter Reading/Bimonthly Billing**

15 **Q Please state your understanding of Public Counsel's testimony on meter**
16 **reading and billing.**

17 A Public Counsel references a joint meter reading program undertaken by NW
18 Natural and Portland General Electric Company (PGE) in the Portland area, and
19 suggests that the Commission should reduce the company's meter reading costs
20 because the company could conceivably jointly read meters with Clark Public
21 Utilities in Vancouver, as well. Lazar, pp. 4-5.

1 I agree that joint meter reading may reduce costs, but the Commission
2 should be aware that the joint NWN-PGE project is still only a pilot project. It
3 took our two companies almost two years of coordination to get to the point of
4 rolling out the pilot project; we have not yet determined to go forward with a full
5 program. PGE has had to invest substantially to make its computer systems
6 compatible with NW Natural's, and if the pilot goes forward, NW Natural may
7 have to make similar investments as well. We do expect savings from these
8 programs, but we have not realized them in either the test year (1999) or the
9 current year (2000), and may not for some time. The costs for meter reading
10 allocated to Washington under the state allocation study represent fairly what it
11 actually cost NW Natural to read its Washington customers' meters during the
12 test year; and those circumstances have not changed since the end of the test
13 year.

14 There have been no serious discussions with Clark PUD about joint meter
15 reading. Nor has there been an examination of what investments might be
16 required to make their systems compatible with ours. The Commission could
17 expect a similar time frame for discussions with Clark County, but it is not at all
18 certain that a similar approach would work in that service area, or that the
19 savings would be similar to those we expect from the PGE program.
20 Consequently, Mr. Lazar's suggestions are speculative and an insufficient basis
21 on which to adjust the company's meter reading expenses in this case.

1 **Q How do you respond to Public Counsel's suggestion that the company**
2 **read and bill bi-monthly, rather than monthly (Lazar, pp. 4-5)?**

3 A Mr. Lazar does not recommend or support an expense disallowance based on
4 hypothetical savings from such an approach, but simply mentions his analysis in
5 the Avista case. For the Commission's information, however, NW Natural's
6 experience has been that most customers simply do not like the idea of multi-
7 month bills. It is more difficult to budget for bi-monthly bills, and customers like
8 to know what their usage is each month so they can better manage their
9 consumptions. Bills for two months during the winter can be high, and therefore
10 more difficult for customers to manage.

11 **Q Does this conclude your rebuttal testimony?**

12 A Yes, it does.