

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

2 A. My name is Kevin S. McVay. I am a Senior Rate and Financial Analyst with Northwest Natural Gas  
3 Company (NW Natural or company), located at 220 NW Second Avenue, Portland, Oregon 97209.

4 Q. **Are you the same Kevin S. McVay who filed initial testimony in this docket, Revised Exhibits  
5 3, 4, 5, and 6?**

6 A. Yes.

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

8 A. I am sponsoring rebuttal testimony responding to Staff's case on the Payroll Adjustment, the Year-  
9 2000 Adjustment, and the Owned Capacity Adjustment.

10 **I. PAYROLL ADJUSTMENT**

11 Q. **Do you have any correction to the adjustment proposed by the Company as filed?**

12 A. Yes. The company filed its original case on January 21, 2000, using calendar year 1999 as its test  
13 period. Test year results were stated on an actual plus estimated basis, prior to completing the  
14 closing of the 1999 results. A revised case was then filed on March 24, 2000, which relied on  
15 actual test period historic results, and which recalculated the adjustments to the case using updated  
16 information through December 31, 1999. In describing the adjustments to Staff during their  
17 review of the filing, it was noted that the 12-month O&M payroll information used in forming the  
18 basis of the payroll adjustment was for 12 months ended October, 1999, rather than 12 months  
19 ended December, 1999. I have included a revised payroll adjustment as page 1 of Exhibit 26  
20 (KSM-Exhibit) that corrects for the data error and which recalculates the adjustment at \$32,966,  
21 rather than \$52,551. The resulting effect on revenue requirement in the case is to lower it by  
22 \$20,532, which reflects the application of revenue-sensitive effects.

23 Q. **Please describe Staff's treatment of the Payroll Adjustment as provided in the Company's  
24 filed case.**

25 A. Staff has asserted that there should be no adjustment for payroll expenses because of expected

1 efficiencies the company will experience in the short term.

2 Staff has referenced several elements as known and measurable considerations on whether  
3 there should be any adjustment for payroll expense. I will address each of the elements and show  
4 that while they may be valid observations, they do not represent valid reasons for eliminating the  
5 payroll adjustment.

6 Mr. Hua's first "known and measurable factor" is the Expense per Customer statistic as  
7 used in the company's Key Goal bonus program. He explains that the O&M per customer statistic  
8 can be used to show that the company has experienced efficiency gains in recent years and expects  
9 to lower that ratio still further in the current year. He states that because payroll is a significant  
10 component of O&M, and since the statistic is declining, that payroll should decline accordingly.  
11 The use of O&M per customer can be hazardous as an indicator of cost alone, however. This is  
12 because the company's efficiency gains are generated by increasing the denominator (number of  
13 customers) faster than the numerator (total expenses). In other words, costs can increase but the  
14 company can still increase its efficiency by adding customers at an even greater rate. As can be  
15 seen on page 2 of Exhibit 26 (KSM-Exhibit), expenses related to the efficiency measure referenced  
16 by Mr. Hua have actually increased from 1997 to 1998 and from 1998 to 1999. The reason the  
17 "Expense per Customer" measure has exhibited a decrease is due to the customers growing by  
18 more than the expense.

19 There is simply no basis to claim, as Staff does, that this efficiency measure is an  
20 indication that NW Natural can achieve labor or payroll savings claimed by Staff.

21 **Q. Please address the use of 2000 results by Staff.**

22 A. Mr. Hua uses the company's year 2000 "Expense per Customer" target key goal as another "known  
23 and measurable" factor supporting Staff's payroll adjustment. This argument, however, is a  
24 contradiction as it is obvious that the outcome of the targeted statistic is not known nor measurable  
25 at all even for the year 2000, much less for use in this case. What is known is that the company has

1 not had and does not expect to have any programs for year 2000 that attempt to decrease its  
2 employees or to decrease its wages per employee. The company has begun to implement a joint  
3 meter reading program as Mr. DeBolt explains in his testimony, but any reductions in numbers of  
4 meter readers are not expected in the current year. This means that reaching the targeted efficiency  
5 gain referenced by Staff is dependant on customer growth while seeking efficiencies in areas of  
6 O&M other than payroll.

7 **Q. Please comment on the other factors in Staff's testimony.**

8 A. Mr. Hua's second "known and measurable factor" is related to the company's new customer  
9 information system. He cites a report by an employee written in 1998 as the basis of efficiency  
10 gains. The CIS report referenced by Staff was written a year after the in-service date for CIS, and  
11 two months prior to the beginning of the test period; thus, efficiencies such as lower training times  
12 and decreased programming support have already been captured in the current case. Mr. Hua  
13 makes no case for additional gains accruing as a result of the new customer information system.

14 The third "known and measurable factor" considered by Staff is company employee  
15 counts. While it is true that employee counts have been going down over the past three years  
16 ended December 1999 as stated, it is wrong to apply a trend line to this data and infer that counts  
17 will continue to drop. In a market in which customer growth has been in the range of 5% per year,  
18 it makes no sense to assume that a company can serve more and more customers with fewer and  
19 fewer employees. As can be seen on page 3 of Exhibit 26 (KSM-Exhibit), the employee counts  
20 during the first part of 2000 have actually increased. The payroll adjustment uses end-of-period  
21 employees to construct the normalized payroll, so all of the employee losses in 1999 have been  
22 incorporated into the case, and the employee counts at year-end 1999 are low compared to the  
23 employee numbers reported in 2000. This is because the company lost many employees during  
24 1999, as the tight Portland/Vancouver labor market has enabled employees to move employment  
25 with relative ease. The company intends to replace these employees, but many of the positions

1 vacated in 1999 could not be filled until 2000.

2 The trending by staff to include savings in 2000 to support the elimination of the  
3 company's adjustment is again inconsistent with the term "known and measurable," and is  
4 unsupported by the actual employee counts that have been experienced in 2000.

5 The last known and measurable factor involves non-utility payroll. While non-utility  
6 payroll is included in total *company* payroll, it is not included in *utility* payroll. Further, it is not  
7 included in the adjustment for payroll because the O&M Payroll Factor is derived by dividing  
8 O&M payroll by total company payroll, which provides that the non-utility percentage remains as  
9 non-utility.

10 There can be no question that the company is under pressure to attract and retain quality  
11 personnel in a tight labor market which has experienced wage level increases during the past  
12 several years. Page 4 of Exhibit 26 (KSM-Exhibit) shows various price and wage indicators as  
13 reported on page 45 of the June 2000 Oregon Economic and Revenue Forecast, published by the  
14 Office of Economic Analysis in the Oregon Department of Administrative Services. This report is  
15 used for several reasons. The payroll expense related to Washington operations is incurred  
16 primarily in Clark County for direct expense and in Portland for allocated corporate expense.  
17 Labor costs in Clark County would be expected to follow the costs in the greater Portland area.  
18 The Oregon statistics for wages are dominated by Portland activity. The Washington statistics for  
19 wages are dominated by activity in the Puget Sound area, remote from Clark County. The Oregon  
20 report is thus a good indicator of the wage increases that are occurring in the labor environment in  
21 which the company operates (the Portland/Vancouver labor market), as reflected in the state  
22 allocated expenses. The report shows that in 1999, there was a 5.3 percent increase in the overall  
23 wage rate in Oregon (Oregon Average Wage Rate), and as much as a 6.0 percent increase in  
24 Manufacturing wages (Or. Manufacturing Wage Rate). There were increases in recent prior years  
25 as well.



1 **T1, pp. 5-6. Describe the nature of the information made available to Staff in support of the**  
2 **company's Y2K recovery.**

3 A. The company supported its Y2K adjustment by making personnel available, as well as  
4 Commission-filed summary reports, and by giving Staff access to the company's permanent record.

5 **Q. What was the nature of the personal interviews with company Y2K personnel?**

6 A. Early in the review process, Mr. Hua had two meetings with Catherine Jones, the company's Y2K  
7 project manager. While it is true that Ms. Jones was not available from May 1, 2000 through July  
8 11, 2000 due to family needs, she was available the entire month of April as well as after her  
9 return, in addition to the two meetings held in March. Other company personnel were made  
10 available to Mr. Hua.

11 **Q. What was the nature of these meetings?**

12 A. During the first meeting, the project manager provided a verbal overview of the scope of the NW  
13 Natural Y2K project and how the project was administered. A draft copy of the company's final  
14 Y2K internal status report was provided for Mr. Hua's review. In the follow-up meeting of March  
15 30, Ms. Jones discussed at length the structure and composition of the company's final status  
16 report.

17 Throughout the project, this report has been a key support document and an integral piece  
18 of the company's Quarterly Report of Y2K Issues and Progress filed with the WUTC as provided  
19 for in Docket No. U-971835. The company had provided these reports since June, 1998 and, with  
20 the addition of this final report, the company has provided an extensive recap of the costs and  
21 activities involved in the Y2K effort.

22 The final program report includes detailed accounting spreadsheets itemizing cost and  
23 budget amounts both by nature of the work performed, and by sub-project code. The final report  
24 also included a copy of the original Project Plan and an Executive Overview and Assessment. In  
25 total, the document amounted to just over 250 pages.

1           The project manager compiled responses to Staff's only information request submitted  
2 prior to the month of May 1, 2000. During Ms. Jones' absence in May and June, the company  
3 continued to provide copies of the company's detailed ledger activity and adjusting journals, as  
4 well as access to the more detailed documents stored on microfilm. With this information Staff  
5 had the ability to review all the costs summarized and detailed by sub-project, by work activity,  
6 and by transaction code. Counting all the previous reports to the WUTC, Staff had access to over  
7 500 pages of information on the company's Y2K Project.

8 **Did the company not provide copies of checks and receipts as suggested?**

9 The company does not keep a file of receipts of purchase, and while copies of checks can be acquired, the  
10 process is rather involved and includes identifying the specific check and getting a disk from the bank  
11 containing a copy of that check on it.

12           As an alternative to copies of checks and receipts, the company's permanent record of  
13 paid invoices as recorded on microfilm was available to Mr. Hua. While such information is often  
14 very time-consuming, access to this information and equipment was not restricted. There is simply  
15 no basis to reject the company's prudently-incurred Y2K costs on a claim that the company did not  
16 respond to Staff's data requests. The company did reply, in full.

17 **III. OWNED CAPACITY PROPERTY ADJUSTMENT**

18 **Q. Please explain the Company's evaluation of Staff's Owned Capacity Adjustment.**

19 A. The Owned Capacity Adjustment as proposed by Staff (Exhibit MRL-T1, pp. 9-12) has not  
20 previously been used in rate proceedings involving NW Natural. The adjustment is used to capture  
21 the effect on revenue given customer growth and the recovery of a cost element of rates that does  
22 not increase with inflation as other utility costs do. The company disagrees with the application of  
23 this adjustment for the following reasons: (1) the lack of regulatory symmetry; (2) the use of  
24 forecasts projecting outside the test period; and (3) the assumption that new customers will be  
25 served by the existing owned capacity.

1 Q. What do you mean when you say Staff's Owned Capacity Adjustment lacks regulatory  
2 symmetry?

3 A. The adjustment is not symmetrical in that it attempts to eliminate a regulatory lag effect that may  
4 be present for ratepayers, but it does not eliminate the effect of regulatory lag on the company.  
5 Staff's position is that, if more customers are served by an existing asset, then per unit customer  
6 costs (and revenues) go down. However, this does not consider the regulatory lag effect that the  
7 company experiences when it invests in assets, places the assets in service, and cannot achieve  
8 revenue to support the investment until inclusion of the asset in rate base in the context of a rate  
9 case.

10 The incremental addition of Mist assets in 1999 is the first in which the company has  
11 proposed rate treatment concurrent with the in-service date. In fact, given that rate recovery will  
12 likely not be established until a full year after the in-service date of December 1, 1999, the  
13 company will have been subjected to a full year's regulatory lag on this investment. In earlier Mist  
14 increments, the lag has been greater. In November, 1989, the company placed into service the first  
15 level of investment in Mist. The rate case that reflected that investment was based on the 12  
16 months ended June, 1996, and in October, 1997, the company attained rate recovery related to that  
17 investment. A second phase of Mist investment, expanded reservoir capacity, went into service on  
18 November 1, 1998. A third phase of Mist expansion, expansion of the South Mist Feeder, went  
19 into service on November 1, 1999. This rate case represents the company's effort to gain rate  
20 recovery on the 1998 and 1999 investments, with rates likely in place in December, 2000, more  
21 than two years after the in-service date of the first (1998) expansion.

22 NW Natural does not have a history of filing a rate case at the very moment its rate of  
23 return drops below its expected allowable. This ensures a period of sub-allowable returns. When  
24 the company does file, it is required to make its case on an historic test period in a process which  
25 takes almost a full year to complete. That is regulatory lag to the company. To have an



1 adjustment that neutralizes the ratepayer side of regulatory lag based on customer growth but then  
2 ignores the company's regulatory lag is one-sided ratemaking.

3 **Q. What is your issue with Staff's use of forecasts in its Owned Capacity Adjustment?**

4 A. Staff has used a forecast for customer growth in determining the Owned Capacity Adjustment.  
5 While the company does not dispute the methodology used to derive the forecast (NW Natural's  
6 2000 Integrated Resource Plan), its use is problematic for several reasons. The use of known and  
7 measurable test period data for rate case purposes is not just a convenience but is necessary if  
8 clarity is a goal in determining a company's normalized revenue requirement. If projections of  
9 costs or revenues that extend beyond the end of the test period are allowed to substantiate  
10 adjustments, then projections are appropriate for all of the company's revenues or costs. The  
11 company has not filed its case on that basis, but has relied on actual results and known and  
12 measurable revenues and costs in a historic test year. To single out one cost element of all the  
13 costs that are included in determining revenue requirement, and to use a forecast to capture the  
14 projected revenue recovery due to projected additional customers, ignores the fact that other costs  
15 of serving customers will also increase. Staff has not considered the effect of these other, future  
16 costs, and hence its adjustment is one-sided and unfair.

17 **Q. Why shouldn't Staff assume that new customers can be served with existing capacity?**

18 A. It is wrong to assume that new customers will be served with existing capacity. The results of the  
19 company's 2000 Integrated Resource Plan reveal that the company is in balance with respect to  
20 peak requirements and capacity holdings, such that, serving new customers will come at the  
21 expense of acquiring new capacity, either as storage or pipeline contract. One of the benefits of  
22 storage is the ability to add increments as the load increases, while avoiding the "lumpiness" of  
23 pipeline expansions. Staff has incorrectly assumed that the company's owned capacity is in excess  
24 of the capacity the company needs to serve its current customers.

25 **Q. Please summarize your testimony on the Owned Capacity Adjustment.**

1 A. The Owned Capacity Adjustment proposed by Staff should be rejected. It is an unbalanced  
2 adjustment that is biased against the company. Staff's adjustment is based on capturing the growth  
3 related to a single element of the company's overall costs using a forecast of customer additions  
4 clearly outside the test period, while not recognizing that other costs will increase. Finally, its  
5 fundamental premise is flawed in that it assumes the company can serve new loads without adding  
6 incremental capacity.

7 **Q. Does this conclude your rebuttal testimony?**

8 A. Yes, it does.