BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 344

In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL, Request for a General Rate Revision.	ALLIANCE OF WESTERN ENERGY CONSUMERS' RESPONSE TO NORTHWEST NATURAL GAS COMPANY'S OPENING BRIEF

Pursuant to the rulings of Administrative Law Judge Allen J. Arlow on February 2, 2018 and August 9, 2018, the Alliance of Western Energy Consumers ("AWEC") submits to the Public Utility Commission of Oregon (the "Commission") this Response to Northwest Natural Gas Company's ("NW Natural") Opening Brief.

I. INTRODUCTION

On December 29, 2017, NW Natural filed a request for a general rate increase and revised tariff sheets to become effective November 1, 2018. NW Natural requested a revision to customer rates that would increase the Company's annual Oregon jurisdictional revenues by $52.4 million.[1] On March 20, 2018, the Company filed supplemental direct testimony regarding updates to the test year and revenue requirement that accounted for, among other things, some of the impacts of the 2017 federal Tax Cuts and Jobs Act ("TCJA") to the Test Year. The impact of these revisions was to reduce NW Natural's requested revenue requirement to $37.8 million.[2]

[1] *See In the Matter of Nw. Natural Gas Co. Application for General Rate Revision*, Docket No. UG 344, NW Natural Executive Summary (Dec. 29, 2017) at 1:6-8.
[2] NW Natural/1200, McVay/5:15-17.

After several rounds of testimony and a series of settlement conferences, on August 6, 2018, NW Natural, Staff of the Public Utility Commission of Oregon ("Staff"), the Oregon Citizens' Utility Board ("CUB") and AWEC submitted a stipulation agreement (the "Stipulation") to the Commission resolving all but three issues in this proceeding.[3] AWEC urges the Commission to adopt the Stipulation.

The three unresolved issues in this docket are: (1) the sharing of revenues produced from the optimization of certain NW Natural assets and storage operations and the proper approach to reporting NW Natural's optimization revenues; (2) the treatment of NW Natural's pension balancing account and how to address pension costs going forward; and (3) the impact of the TCJA on NW Natural's interim deferred tax benefits from January 1, 2018 through October 31, 2018 ("Interim Period deferral") and excess deferred federal income tax ("EDFIT").

On August 14, 2018, NW Natural submitted an Opening Brief addressing these three contested issues. In this Response Brief, AWEC responds to NW Natural's arguments and presents its own arguments with respect to each of the three contested issues.

CONTESTED SETTLEMENT OF PENSION BALANCING ACCOUNT AND REMAINING TAX ISSUES

On August 28, 2018, NW Natural, Staff and CUB agreed in principle to settle the pension and the remaining tax issues in this docket. <u>AWEC is not a party to that settlement</u>. Once AWEC has had the opportunity to review the stipulation, in addition to this brief addressing the pension and remaining tax issues, AWEC reserves the right under OAR 860-001-0350 to file objections or request a hearing on the stipulation.

[3] *In the Matter of Nw. Natural Gas Co. Application for General Rate Revision*, Docket No. UG 344, Stipulation (Aug. 6, 2018).

SUMMARY OF AWEC'S POSITIONS AND ARGUMENTS

Mist Optimization

NW Natural generates revenue through participation in interstate storage services and optimization activities. Those activities, and the revenue NW Natural shares with customers, provides a significant value for both customers and shareholders. Currently, revenues from storage services are split 20/80 between customers and NW Natural, and revenues from optimization are split 67/33 between customers and NW Natural.[4] An independent third-party consultant hired by the parties, Liberty Consulting Group ("Liberty"), conducted a comprehensive investigation into storage services and optimization activities at the direction of the Commission. Liberty's investigation and analysis is reflected in a report (the "Liberty Report"), which is part of the record in this proceeding.[5] Liberty concluded that customers' respective share of revenues for storage services should remain the same, but that revenues from optimization revenues could be substantially increased to be more in line with other jurisdictions.[6] AWEC, Staff and CUB agree with the Liberty Report that the sharing percentages for storage services should remain the same and also agree that customers' share of optimization revenues should be significantly increased. Although NW Natural argues that the Commission should adhere to the findings of the Liberty Report with respect to revenue sharing for storage activities, it makes the self-serving argument that the Commission should reject the findings of the Liberty Report with respect to optimization activities. Consistent with the Liberty Report, optimization sharing percentages should be revised to reflect the low cost, low risk nature of NW Natural's optimization activities. While AWEC proposed in testimony that NW Natural be directed to adopt an 85/15 sharing arrangement between customers and NW Natural, AWEC

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[4] AWEC/400, Finklea/4:12-18.
[5] NW Natural/1301, Liberty Report.
[6] NW Natural/1301, Liberty Report/10.

agrees that the 90/10 sharing arrangement proposed by Staff and CUB is reasonable and supported by the findings of the Liberty Report.

Pension Balancing Account

In Docket UM 1475, NW Natural established a Pension Balancing Account to address a deficiency in recovery of pension expenses that it was collecting. At that time, NW Natural forecast that pension expenses and revenues would eventually balance out, and that further contributions from ratepayers would be unnecessary.[7] This trend, however, never materialized and all parties agree that the Pension Balancing Account is not sustainable.[8] NW Natural recommends leaving the Pension Balancing Account in place with the hope that the parties can eventually reach a settlement addressing the problem—with interest accruing at its authorized rate of return on the balances in the account. AWEC, however, urges the Commission to terminate the Pension Balancing Account and adopt a ratemaking methodology based on SFAS 87 for future pension costs. AWEC further recommends that the Commission open an investigation into the proper treatment and ratepayer/shareholder responsibilities for the balances in the account. In that investigation, the parties would consider the responsibly for these balances by reviewing the prudence of historical pension contribution levels, interest rate assumptions, and other actuarial assumptions, which give rise to the year-to-year balances. Additionally, AWEC opposes NW Natural's proposal to amortize excess EDFIT to pay down the pension balancing account. Amortization of EDFIT and treatment of the Pension Balancing Account are distinct issues that should be addressed separately on their own merits.

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[7] NW Natural's Opening Brief at 18:13-15.
[8] NW Natural's Opening Brief at 19:7-13.

Tax Cuts and Jobs Act

On December 22, 2017, the United States Congress enacted a federal income tax reform, known as the Tax Cuts and Jobs Act. Among other things, the TCJA lowers the U.S. federal corporate income tax rate from 35 percent to 21 percent, effective January 1, 2018.[9] In general, the remaining tax reform issues in the case are not overly complicated, and the points of disagreements between AWEC and NW Natural are relatively narrow. NW Natural's lengthy narrative on this topic is simply incorrect, unsupported, and irrelevant. The only relevant fact at issue with respect to tax reform is the fact that NW Natural wants to keep, or delay giving back, valid items of ratepayer savings that it has recognized with respect to tax reform.[10] NW Natural's position is neither defeasible nor appropriate, particularly when one considers the ways that tax reform has been implemented for NW Natural's peers.[11]

AWEC respectfully requests that the Commission consider all known effects of tax reform, or the best available estimate of those effects, in the rates that go into effect on November 1, 2018. NW Natural's failure to properly calculate and document the refunds due to customers should not impair customers' ability to begin recognizing the benefits of tax reform in a timely manner.

After consideration of the tax issues addressed in the Stipulation, the only two issues that remain with respect to tax reform are the Interim Period deferral and EDFIT. AWEC recommends that the best estimate of both of these amounts be considered in the rates established through this proceeding. With respect to the Interim Period deferral, AWEC recommends the Commission establish a deferral equal to $19,719,000, amortized over two years at a rate of $10,982,000 per year. Further, AWEC recommends the Commission consider

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[9] AWEC/200, Mullins/6:3-5.
[10] NW Natural's Opening Brief/29:13-15, 33:20-23.
[11] AWEC/200, Mullins/12:10-11.

$7,435,414 of EDFIT amortization in the test period—a revenue requirement reduction of approximately $11,971,308 after considering the effects of the conversion factor and rate base impacts of accumulated EDFIT amortization prior to the test period. NW Natural on the other hand wants to keep, or unnecessarily delay giving back, the monies owed to ratepayers. The issue is as simple as that and does not require a dissertation on deferred taxes for the Commission to resolve it.

II. ARGUMENT

A. Optimization--The Commission should adopt the findings detailed in the Liberty Report

The Liberty Report contains the findings of the comprehensive investigation into NW Natural's interstate storage services and optimization activities by an independent third party. With nothing more than conclusory arguments, NW Natural asks the Commission to follow the Liberty Report with respect to findings that favor NW Natural and disregard the Liberty Report with regard to findings that favor customers.[12] NW Natural's arguments should be rejected.

AWEC agrees with all parties in this docket, including NW Natural, that the sharing percentages for revenue from interstate storage services should remain the same.[13] AWEC disagrees with NW Natural's argument that the sharing percentage for optimization activities should also remain the same.

AWEC supports the thorough analysis contained in the Liberty Report which details the justification for increasing the sharing percentage for optimization activities in favor of customers. While AWEC recommended that the sharing percentage be changed to 85 percent to

[12] NW Natural's Opening Brief/7:15-17.
[13] NW Natural Opening Brief/7:15-17.

customers and 15 percent to NW Natural, AWEC supports the proposals of Staff and CUB which recommend 90 percent going to customers and 10 percent for NW Natural.[14]

The current sharing arrangements were developed without analysis and before the full value and extent of NW Natural's services were known. Considering the amount of time that has passed since the Commission first established these sharing ratios, and the level of information and analysis now available, it would be imprudent to continue the current sharing mechanisms for optimization services when the evidence shows that customers are entitled to a greater percentage of the revenues. As the Liberty Report concluded, optimization activities are not a risky enterprise for NW Natural, these activities are not particularly complex for NW Natural and NW Natural's efforts are in line with normal utility practices. For these reasons, AWEC requests that the Commission adopt a sharing arrangement for optimization services that is in line with the recommendations of Staff and intervenors.

1. Background regarding Optimization

NW Natural began providing storage and optimization activities to expand and optimize its utility resources.[15] NW Natural first expanded the then-existing gas storage operations at Mist to benefit shareholders while at the same time benefiting utility customers through revenue sharing and the ability to recall capacity on an as-needed basis.[16] NW Natural then developed its optimization activities by contracting with third-party wholesale traders to create further value from utility resources in its gas supply portfolio.[17]

[14] Staff/1600, Glosser/5:5-9; CUB/400, Jenks/3:22-23.
[15] NW Natural Opening Brief/8:5-7.
[16] NW Natural Opening Brief/8:7-10.
[17] NW Natural Opening Brief/8:10-12.

NW Natural's Schedules 185 and 186 establish the sharing arrangements for revenues derived from NW Natural's storage and optimization activities.[18] Under Schedule 185, NW Natural shares with eligible customers the net margin received from non-utility interstate and intrastate storage services on a 20/80 basis, with 20 percent going to customers and 80 percent going to NW Natural.[19] Further, net margins from Mist Storage optimization are shared: (a) 20/80 for the portion of non-utility Mist capacity not included in the rates, and (b) 67/33 for the portion of core Mist capacity that is included in the rates.[20]

Schedule 186 addresses revenue sharing from the optimization activities and applies to firm and interruptible sales service customers whose rates include costs related to upstream pipeline capacity.[21] Under Schedule 186, the Company shares net revenues with its firm and interruptible sales customers on a 67/33 basis.[22]

In NW Natural's last general rate case, UG 221, NW Natural, Staff, CUB and AWEC (formerly Northwest Industrial Gas Users, or "NWIGU"), agreed to open a separate proceeding to investigate the sharing arrangements described in NW Natural's Schedules 185 and 186.[23] Based on that agreement, the Commission initiated Docket UM 1654, opening an investigation to assess whether the revenue sharing percentages should be revised.[24]

In UM 1654, based on a review of the history of the sharing mechanisms, AWEC determined that there was no technical support for those mechanisms, which were developed before the full value of NW Natural's Services were known. Considering the amount of time that had passed since the sharing started and the level of available information, AWEC believed

[18] NW Natural Opening Brief/8:13-16.
[19] NW Natural Opening Brief/9:1-3.
[20] NW Natural Opening Brief/9:3-7.
[21] NW Natural Opening Brief/9:14-16.
[22] NW Natural Opening Brief/10:1-2.
[23] UG 221/Joint Explanatory Brief/12:18-13:3.
[24] UG 221/Joint Explanatory Brief/13:1-3.

that it would be imprudent to continue the sharing mechanisms without a more formal analysis.[25] Therefore, AWEC urged the Commission to require analysis by a third-party "to identify the various components of NW Natural's system that drive the costs and revenues associated with Interstate Storage Services, and to definitively identify all shared facilities and resources" that "would in turn inform whether the split in revenue between ratepayers and shareholders is equitable."[26]

In Order 15-066, the Commission ordered NW Natural and the other parties to form a steering committee to interview and hire an independent consultant to perform a cost study for the storage services and optimization activities.[27] After issuing a request for proposal and interviewing interested firms, the steering committee selected Liberty to perform the investigation. Liberty allowed the stakeholders to participate in the process, provide comments on the scope of review and review and provide comments on the final report and analysis.[28] The Liberty Report was issued on November 27, 2017 and concludes that the sharing percentages for storage services are supportable, but NW Natural's percentage of revenues attributable to optimization activities should be more favorable to customers.[29]

2. The Current Optimization Sharing Percentages Should be More Favorable to Customers

AWEC, CUB and Staff all agree with the findings in the Liberty Report, which concludes that the percentage of revenues attributable to optimization activities should be increased in favor of customers. Accordingly, Staff and Intervenors have proposed significant changes to the sharing percentages associated with NW Natural's optimization activities, which are currently

[25] UM 1654/NWIGU Post Hearing Brief/4:7-21.
[26] UM 1654/NWIGU Post Hearing Brief/5:1-5.
[27] *In the Matter of NW. Natural Gas Co. Investigation of Interstate Storage and Optimization Sharing*, Docket No. UM 1654, Order 1654 (Mar. 5, 2015).
[28] AWEC/400, Finklea/3:21-22.
[29] NW Natural/1301, Liberty Report/10; AWEC/400, Finklea/4:3-5.

subject to a 67/33 percent sharing arrangement. Staff and CUB propose modifying the sharing arrangement to 90/10, and AWEC proposed an 85/15 split, but also finds the recommendations of Staff and CUB reasonable and supported by the record.[30] NW Natural, on the other hand, argues that the Commission should not alter the sharing percentage for optimization activities as recommended by the Liberty Report because the Liberty Report "fails to provide detailed information regarding the results of the peer utility companies it used for analysis as a comparison group."[31] NW Natural's argument should be rejected.

a. The Liberty Report supports Staff, CUB, and AWEC's proposal for modifying sharing percentages

In opposition to Staff, CUB and AWEC's proposals to increase the customer percentage share of optimization revenues, NW Natural asserts that the Liberty Report "has significant shortcomings" and "fails to provide detailed information regarding the results of the peer utility companies."[32] NW Natural argues that in order to "fairly evaluate the different sharing arrangements, it is essential to also consider and evaluate actual revenues received by customers."[33] NW Natural points out that customers have received a cumulative $133.5 million in credits from optimization activities since 2000.[34]

But the cumulative benefit to customers is irrelevant to the question of whether the split in revenue between ratepayers and shareholders is equitable. Optimization activities capture extra value from the Mist storage facilities without putting NW Natural at risk.[35] The sharing percentage that NW Natural ownership receives stands as a clear outlier among peer local

[30] Staff/1600, Glosser/5:5-9; CUB/400, Jenks/3-22-23; AWEC/400, Finklea/5:13-18.
[31] NW Natural Opening Brief/13:16-17.
[32] NW Natural Opening Brief/13:14-16.
[33] NW Natural Opening Brief/13:22-14:2.
[34] NW Natural Opening Brief/15:7-8.
[35] NW Natural/1301, Liberty Report/60.

distribution companies.[36] The Liberty Report found no exceptional risk exposure, operational responsibilities or costs that "would justify an unusually large share of optimization margins to NW Natural."[37] NW Natural further minimizes risk through its use of a third-party asset manager, Tenaska Marketing ("TMV"). TMV has deep expertise and a good track record in this area and, therefore, NW Natural's role is limited.[38] FERC has also standardized asset management to a considerable degree.[39] As a result, TMV's asset management activities are standard utility practice and do not present much risk to NW Natural.

Furthermore, NW Natural's assertion that the Liberty Report "has significant shortcomings" is unconvincing and unsupported.[40] NW Natural participated in the docket to revisit revenue sharing percentages under Schedules 185 and 186. In that docket, the Commission ordered the parties to engage a third-party consultant to perform a cost study for the storage services and optimization activities.[41] NW Natural vetted and approved Liberty in advance of the Liberty Report. Liberty allowed the stakeholders to participate in the process, provide comments on the scope of review, and review and provide comments on the final report and analysis.[42] NW Natural participated and provided comments throughout the proceeding. Now, NW Natural asks the Commission to adopt the Liberty Report with respect to findings that favor NW Natural and disregard the Liberty Report with regard to findings that favor customers. AWEC urges the Commission to follow the Liberty Report with regard to storage practices *and* optimization activities because the report is thorough and unbiased.

[36] NW Natural/1301, Liberty Report/33
[37] NW Natural/1301, Liberty Report, p. 50.
[38] AWEC/400, Finklea/6:15-16.
[39] AWEC/400, Finklea/6:16-19.
[40] NW Natural Opening Brief/13:14-16.
[41] *In the Matter of NW. Natural Gas Co. Investigation of Interstate Storage and Optimization Sharing*, Docket No. UM 1654, Order 15-066 (Mar. 5, 2015) at 5-6.
[42] AWEC/400, Finklea/3:21-22.

b. NW Natural's level of participation in optimization activities is consistent with other similarly situated utilities

NW Natural argues that its "participation in optimization activities is significantly more involved than its peer utilities" and "its optimization activities go above and beyond the efforts typically expended by LDCs in the optimization of customer assets."[43] NW Natural's assertions lack any evidentiary support. Further, the Liberty Report directly refutes NW Natural's vague assertions regarding the extraordinary nature of its optimization activities.

The net revenues at issue are those from enhanced optimization activities conducted by a third-party asset manager, TMV, hired by NW Natural.[44] Use of asset managers for optimization activities is common industry practice.[45] Additionally, based on a survey of other utilities and jurisdictions, the Liberty Report concluded that NW Natural's optimization efforts have "paralleled that of the industry generally" and are "commonly performed among the range of gas industry participants whose operation [Liberty] has examined."[46]

c. Modifying sharing percentages would not diminish NW Natural's incentive to engage in optimization activities

NW Natural also asserts that "[i]f NW Natural's sharing percentage is substantially eroded – as advocated by the parties – the Company's incentive to achieve the consistently favorable results enjoyed under the current framework would also be substantially altered."[47] The Liberty Report directly addressed this issue and concluded that bringing NW Natural's share of optimization benefits into alignment with other jurisdictions would not diminish the incentive to maximize optimization benefits.

[43] NW Natural Opening Brief/14:14-15.
[44] NW Natural/1301, Liberty Report/9.
[45] NW Natural/1301, Liberty Report/32.
[46] NW Natural/1301/Liberty Report/37-38.
[47] NW Natural/ Opening Brief/15:10-13.

Optimization activities are conducted by TMV. TMV retains an incentive to maximize revenues regardless of the portion of revenues flowing to customers because it receives compensation commensurate with the margins its optimization activities have produced for NW Natural and its customers.[48] TMV's services are deducted from the net revenues and accordingly, shared between ratepayers and the Company.[49] Furthermore, as discussed in detail above, the optimization activities are a low risk endeavor for NW Natural. As the Liberty Report concluded, there are no exceptional risks that would justify an unusually large share of optimization margins.[50]

d. Optimization Conclusion

AWEC recommends that the Commission adopt Staff and CUB's recommendation for an 90/10 split for optimization activities because it tracks the conclusions in the Liberty Report, but in no event less than AWEC's recommendation of 85/15. Staff, CUB and AWEC's proposals are designed to acknowledge (1) that these types of activities have become standardized, (2) that they involve very little risk to NW Natural's investors, and (3) that the level of sharing is outside the norm compared to other jurisdictions. Finally, revenue derived from Optimization Activities should be reported on NW Natural's annual results of operations (ROO) because the income derived from Schedules 185 and 186 is derived or made possible from customer-funded assets.

B. Pension Balancing Account

It is undisputed that the pension balancing account has failed to operate as expected when the Commission approved the stipulation in UM 1475.[51] AWEC recommends that the Commission eliminate the pension balancing account, transition going forward to a ratemaking

[48] NW Natural/1301, Liberty Report/41.
[49] NW Natural/1301, Liberty Report/9.
[50] NW Natural/1301, Liberty Report/50.
[51] *In the Matter of Nw. Natural Gas Co. Application to Defer Pension Costs*, Docket No. UM 1475, Order No. 11-051 (Feb. 10, 2011).

methodology based on SFAS 87 pension expense and open an investigation to determine how to deal with the balances in the balancing account. Rather than eliminate the balancing account, NW Natural recommends leaving the mechanism in place until it can be modified by agreement amongst the settling parties—presumably so that it can continue to earn its rate of return on the balances until the issue is resolved.[52] Further, NW Natural indicated that it will recommend using amortization of EDFIT to pay down the pension balancing account balance.[53]

1. Background Regarding the Company's Pension Balancing Account

In Docket UM 1475, NW Natural filed an application for deferral of FAS 87 pension expense to fund NW Natural's pension plans.[54] At the time, NW Natural was concerned that its FAS 87 expense was greater than the $3.8 million it was collecting in rates.[55] NW Natural forecasted that this deficiency would continue for three more years, followed by a period of four years in which expenses and revenues would balance out, and then a period where expenses would be less than $3.8 million.[56] After settlement discussions, NW Natural entered into a stipulation with NWIGU, CUB and Staff establishing a pension balancing account rather than a deferral.[57] NW Natural agreed to establish this balancing account, with the expectation the balancing account would net to zero in approximately twelve to thirteen years.[58]

Rather than leveling off after three years as predicted, the balancing account has continued to grow. When NW Natural requested the balancing account, it was facing a pension

[52] NW Natural/ Opening Brief/20:18-20.
[53] NW Natural/ Opening Brief/22:17-19.
[54] *In the Matter of NW. Natural Gas Co. Application to Defer Pension Costs*, Docket No. UM 1475, Application to Defer Pension Costs (Mar. 15, 2010).
[55] *In the Matter of NW. Natural Gas Co. Application to Defer Pension Costs*, Docket No. UM 1475, Joint Brief in Support of Stipulation (Dec. 13, 2010) at 1.
[56] CUB/100, Jenks-Gehrke/34:13-18.
[57] *In the Matter of NW. Natural Gas Co. Application to Defer Pension Costs*, Docket No. UM 1475, Order No. 11-051 (Feb. 10, 2011) at 2-3.
[58] *Id.* at 3.

expense three to four million dollars greater than was accounted for in its rates.[59] In contrast to the stipulated $3.8 million of pension expense expected in the long-run, actual SFAS 87 pension expenses are forecast to be $11,937,012 in 2019.[60] Additionally, the annual interest added to the account alone is $4.5 million.[61] This means that even if the SFAS 87 Pension Expense reduces to zero, the balancing account will continue to grow, because the interest will be greater than the $3.8 million collected in rates. Thus, the negative balance is unlikely to reverse as intended.

2. The Commission Should Terminate the Pension Balancing Account

NW Natural argues that the pension balancing account should not be terminated because "the Company will continue to significantly under-recover this expense" and rather than solving the problem, "it will likely make the problem worse."[62] This argument, however, incorrectly presumes that NW Natural is entitled to recover all the pension balancing account balances from ratepayers, when the mechanism was intended to naturally reverse over time. At a minimum, there should be a new proceeding to address how to deal with the pension account balances and what amount, if any, should be recovered from customers and what amount should be recovered from shareholders.

Transitioning to a SFAS expense methodology will represent a significant increase for ratepayers compared to the amounts the parties stipulated to in Docket UM 1475.[63] The primary question associated with changing methodologies is how the balances should be treated. Had the pension balancing account not been in place and rates originally set based on SFAS pension expenses, NW Natural would not have been provided with recovery equal to the amounts that

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[59] UM 1475 NW Natural/200, Feltz/15.
[60] Exhibit AWEC/501, NW Natural's Supplemental Response to CUB Data Request 47.
[61] CUB/100, Jenks-Gehrke/35.
[62] NW Natural Opening Brief/20:15-18.
[63] AWEC/500, Mullins/4:6-7.

have accrued to the pension balancing account.[64] If SFAS 87 had been used from the beginning, pension recovery would have been set at a static level in the rate case and would not have been tracked on a year-to-year basis.[65]

Further, SFAS 87 pension expenses are based on historical contributions, interest rates and other actuarial assumptions.[66] Therefore, to consider the responsibly for these balances, it is necessary to perform an analysis for each year to analyze the prudence of historical pension contribution levels, interest rate assumptions, and other actuarial assumptions, which give rise to the year-to-year balances.[67] If, for example, the higher than expected expenses were caused by an imprudent pattern of contributions, then it would not be appropriate for NW Natural to recover those amounts. Further, if the interest rate assumptions have declined based on actions taken by NW Natural to reduce the risk of its pension portfolio, that may be an indication of imprudence.[68]

Finally, the stipulation in UM 1475 provides that if NW Natural's earnings exceed the company's authorized rate of return on equity, NW Natural must remove that amount from the pension expense booked to the SFAS 87 pension expense balancing account.[69] To effectuate this provision, the stipulation requires that NW Natural present an earnings test. To date, NW Natural has not presented an earnings test in this docket, further complicating the treatment of the account balances.[70]

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[64] AWEC/500, Mullins/4:10-12.
[65] AWEC/500, Mullins/4:12-14.
[66] AWEC/500, Mullins/4:15-16.
[67] AWEC/500, Mullins/4:16-19; *See* ORS 757.259(5) (providing that "the Commission's determination on the amount of deferrals allowable in the rates of the utility is subject to a finding by the Commission that the amount was prudently incurred by the utility").
[68] AWEC/500, Mullins/5:3-5.
[69] *In the Matter of NW. Natural Gas Co. Application to Defer Pension Costs*, Docket No. UM 1475, Stipulation (Nov. 4, 2010).
[70] AWEC/500, Mullins/5:6-8.

If the Commission agrees that the balancing account has not functioned as intended and should be terminated, AWEC recommends that the Commission open an investigation regarding the ratemaking treatment of the remaining balance in the pension balancing account. There is insufficient information to properly assess the extent to which ratepayers should be responsible for the remaining balances in this docket. Therefore, a new investigation regarding the ratemaking treatment of the remaining balances in the pension balancing account is the appropriate forum.

3. AWEC opposes NW Natural's Proposal to apply EDFIT to the pension balancing account

NW Natural recommends that the Commission authorize the amortization of excess EDFIT to pay down the pension balancing account.[71] AWEC disagrees with this approach. Amortization of EDFIT and treatment of the pension balancing account are distinct issues that must be addressed on their own merits. The pension balancing account mechanism failed mid-way through its intended life and the recovery of pension costs should be transitioned going forward to a ratemaking method based on SFAS 87. As noted above, it is premature to assume that all the balances in the pension balancing account are recoverable from ratepayers. Accordingly, it would be improper to apply EDFIT amortization to the account balance before the Commission determines, in a separate proceeding, how much of the pension balancing account balance should be recovered from ratepayers—including application of an earnings test and consideration of actuarial assumptions.[72]

Further, the amortization parameters associated with EDFIT are a separate point of controversy in this Docket. The amount of EDFIT and the period over which that amount must be amortized must be considered on its own merits. The fact that the two adjustments might

[71] NW Natural Opening Brief/22:15-17.
[72] AWEC/500, Mullins/6:16-19.

offset each other should have no bearing on the amount of EDFIT that ultimately gets returned to ratepayers.[73]

C. Federal Tax Cuts and Jobs Act

1. Impacts of the 2017 Federal Tax Cuts and Jobs Act

On December 22, 2017, the United States Congress enacted a major federal income tax reform, also known as the Tax Cuts and Jobs Act. Among other things, the TCJA lowers the U.S. federal corporate income tax rate from 35 percent to 21 percent, effective as of January 1, 2018.[74] AWEC and the parties to this docket have come to a resolution regarding application of the TJCA's lower federal income tax rate to NW Natural's income tax expense. The Stipulation filed with the Commission on August 6, 2018 included a reduction to the test year revenue requirement to reflect the lower income tax expenses in operating results.[75]

The two remaining contested issues are: (1) whether NW Natural should defer any estimated net benefit from the lower income tax rate associated with the Interim Period Deferral, for the period January 1, 2018 through October 31 2018, and if so, what is an appropriate treatment for this deferral; and (2) whether NW Natural's operating results should be adjusted for the net decrease in its EDFIT liability balances, recorded upon enactment in 2017, and if so, what is an appropriate treatment for this deferral.

NW Natural argues that the Commission should decide these remaining issues in the deferral dockets where they were originally presented as a precursor to determining the ratemaking treatment of the deferrals.[76] AWEC urges the Commission to address amortization of the Interim Period Deferral in this docket. Similarly, AWEC urges the Commission to return

[73] AWEC/500, Mullins/6:20-7:4.
[74] AWEC/200, Mullins/6:3-5.
[75] *In the Matter of Nw. Natural Gas Co. Application for General Rate Revision*, Docket No. UG 344, Stipulation (Aug. 6, 2018).
[76] NW Natural, Opening Brief/24.

the EDFIT amounts to ratepayers through base rates in this docket based on calculations identified by AWEC.

2. The Interim Period Deferral

Beginning on January 1, 2018, NW Natural's regulated utility income tax expense reflects the lower deferral income tax rate instituted by the TJCA.[77] NW Natural's current rates established in its last rate case reflect the higher pre-TJCA federal income tax rate amount and will remain in effect until NW Natural's rates are reset in this proceeding on November 1, 2018. As a result, NW Natural will collect from customers income tax expenses in excess of its actual tax liability from January 1, 2018 to November 1, 2018.[78]

To address the change in federal income tax rate, NW Natural filed a TJCA-related deferral application with the Commission on December 29, 2017.[79] As a result, NW Natural is using regulatory deferred accounting to defer the estimated net benefits associated with tax reform during the Interim Period. The deferral began on January 1, 2018, the effective date of the TJCA, and will continue through October 31, 2018, the day prior to the expected rate effective date.[80]

a. The Commission should not utilize the TJCA deferral dockets to determine the amount of the Interim Period deferral and the methodology for providing Interim Period deferral benefits to customers

NW Natural argues that the Commission should address the Interim Period deferral issue in the pending deferral dockets. NW Natural argues that the deferral docket provides a better forum because: (1) the total amount of the Interim Period deferral will not be known until after

[77] *In the Matter of Nw. Natural Gas Co. Application for General Rate Revision*, Docket No. UG 344, Stipulation (Aug. 6, 2018) at 1.
[78] AWEC/200, Mullins/12:19-21.
[79] NW Natural, Opening Brief/24:15-16.
[80] NW Natural, Opening Brief/24:20-22.

the rate effective date;[81] (2) the issue should be resolved in a separate forum to endure uniformity and consistency among the utilities;[82] and (3) NW Natural wants to offset the pension balancing account with the Interim Period deferral and/or EDFIT amounts, which can only be done after issues related to the pension balancing account have been decided in this docket.[83] AWEC urges the Commission to address the Interim Period deferral in this docket for the reasons set forth herein.

While the Commission may appropriately decide whether to approve a deferral in a deferral docket, the amount of the deferral and amortization schedule is a matter that is commonly reserved for a rate case. For example, when PacifiCorp requested to defer costs associated with closure of the Deer Creek Mine, the Commission approved the deferral but required that the amount and amortization of the major portion of the deferral be established in PacifiCorp's next general rate case.[84] A general rate case is a venue in which all issues are subject to review. Therefore, it is unnecessary for NW Natural to delay returning the Interim Period tax savings amounts to ratepayers by seeking to consider those amounts outside of the general rate case. Even if the delay in returning the Interim Period tax savings to ratepayers is only a month or two, it will result in instability since the ratepayers might see a rate increase in one month, followed by a rate reduction in the subsequent month.[85]

b. Amortization of the Interim Period Deferral Should Commence on November 1, 2018

AWEC recommends that the Commission begin amortization of the Interim Period deferral on Nov. 1, 2018. Mr. Mullins testimony recommended the establishment of a deferral

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[81] NW Natural, Opening Brief/26:8-12.
[82] NW Natural, Opening Brief/26:13-15.
[83] NW Natural, Opening Brief/27:5-12.
[84] *In the Matter of PacifiCorp Application for Approval of Deer Creek Mine Transaction*, Docket No. UM 1712, Order No. 15-161 (May 27, 2015).
[85] AWEC/500, Mullins/12:5-9.

equal to $19,718,520, amortized over two years.[86] AWEC has identified an error in its original calculation of $7,696,140 in amortization expense, which should have been $10,982,000. If the proper amount is amortized over two years using the levelized, sinking fund method Mr. Mullins recommended,[87] the $19,719,000 deferral balance would yield annual amortization of approximately $10,982,000 for two years.

Oregon is already lagging behind other states in incorporating the impacts of tax reform.[88] Further delay in returning these funds is unnecessary and unacceptable, and beginning amortization of the Interim Period deferral avoids the undesirable a situation where rates increase, only to decline in a subsequent period.

AWEC recognizes that NW Natural would like to keep the Interim Period tax savings, through the application of an earnings test. AWEC opposes application of an earnings test because this is customer money, which is being over-collected to pay a specific federal tax liability that no longer exists.[89] Allowing NW Natural to use an earnings test would create a windfall for NW Natural, and guarantee its ability to earn its authorized rate of return even if, for example, the company acts imprudently. Such a result is undesirable.

Finally, since the deferral represents deferred revenues, there is no need to wait until the end of the year to figure out the effects of the Interim Period deferral. The deferral is calculated by taking the level of rates that will result in the utility achieving the same return on equity as if tax reform had not been passed.[90] This can be done in a relatively straightforward manner by considering the overall rate base of the utility in conjunction with its capital structure.[91]

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[86] AWEC 204, Mullins/1.
[87] AWEC/200, Mullins/14:11-12.
[88] For example, Idaho incorporated tax reform into base rates for all utilities by Jun 1, 2018. *See Investigation into the Impact of Federal Tax Code Revisions on Utility Costs and Ratemaking*, Idaho GNR-U-18-01 (2018).
[89] AWEC/200, Mullins/14:25-26.
[90] AWEC/200, Mullins/13:3-6.
[91] AWEC/200, Mullins/13:9-19.

Alternatively, one can consider the utility's results, and recompute the tax provision included in those results using the new rate and determine the amount of revenues necessary to give the utility the same return on equity as it achieved before tax reform.

NW Natural criticized Mr. Mullins approach as being the simplified approach, but never actually identified anything wrong with using Mr. Mullins' valid methodology.[92] As Mr. Mullins stated, "NW Natural was requested to provide its best estimate of the impacts of the TCJA on the revenue requirement approved in the 2012 general rate case[, but] NW Natural objected to the request and responded that it does not have an estimate."[93] Mr. Mullins was forced to use the simplified approach because NW Natural was uncooperative in providing the calculations based its most recent general rate case.[94]

Waiting until the end of the year does not provide any additional data necessary to determine the revenue effects of the Interim Period deferral and has not stopped other states from incorporating the impacts of the interim period in rates.[95] The revenue impacts of the tax reform are calculated by determining the price change that would have been necessary for NW Natural to earn the same return on equity that it would have earned if the tax reform had not occurred. Since rates are based on normalized assumptions, one can apply the revenue requirement formula to determine the revenue impacts of tax reform without having to consider operating results in the test period, as Mr. Mullins has done.

Further, NW Natural's forecast of $5.9 million for the Interim Period deferral amount is on its face unreasonable and off by an order of magnitude.[96] NW Natural offers no support in

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[92] NW Natural Opening Brief/28:8-10. Note that the error with respect to the amortization discussed above did not impact the deferral balance and was in NW Natural's favor.
[93] AWEC/200 Mullins/14:16-18.
[94] AWEC/200, Mullins/13:9-11.
[95] *See eg. Wash. Utils. & Transp. Comm'n, v. Cascade Natural Gas Co*., WaUTC Docket No. UG-170929, Order No. 06 (Jul. 20, 2018).
[96] NW Natural Opening Brief/28:19-21.

the record for that value. Parties came to an agreement regarding impact on tax expense of going from a 35 percent to 21 percent tax rate in the Stipulation.[97] In Mr. Mullins model, the revenue requirement impact on tax expense was $13,265,953.[98] Applying 10/12ths of that amount yields $11,052,460, which is nearly two times the amount that NW Natural expects to benefit in the ten-month period. Using the simplified approach, Mr. Mullins calculated $11,875,000 of tax expense savings,[99] which is relatively consistent with the test period tax expense savings. Further, the effects of EDFIT in the Interim Period also need to be considered, which is discussed below. Mr. Mullins' Interim Period deferral calculation considered an additional $7,843,000 of EDFIT reversal (before gross-up).[100] Collectively, AWEC calculated that the tax reform savings amounts to be approximately $19,719,000 in the deferral period.[101] Thus, the $5,900,000 represented by NW Natural is only about a quarter of the funds that are due back from NW Natural for the Interim Period deferral.

While AWEC continues to support annual amortization of $10,982,000 over two years, AWEC would not object to a resolution of the Interim Period deferral in this docket that establishes an initial amount of amortization of $5,900,000, which is equal to NW Natural's forecast. Under this approach, the second-year amortization would be adjusted to refund whatever remaining amounts are found to be due to customers in the deferral docket. AWEC believes the amount due back to customers is significantly higher than this value. Notwithstanding, setting a provisional amount of amortization, appropriately returns the Interim

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[97] *See In the Matter of Nw. Natural Gas Co. Application for General Rate Revision*, Docket No. UG 344, Stipulation (Aug. 6, 2018).
[98] AWEC/202, Mullins/1:5.
[99] AWEC/204, Mullins/1:15.
[100] AWEC/204, Mullins/1:17.
[101] AWEC/204, Mullins/1:18.

Period benefits in a timely manner, while allowing NW Natural to preserve its objections for the deferral docket.

AWEC continues to support a two-year amortization for these balances and recommends that the Commission order a two-year amortization in this case. Further, AWEC is neutral as to whether these funds are returned through base rates or a separate schedule. Even though AWEC was willing to accommodate NW Natural's initial request to consider the interim tax savings in a separate schedule, it appears that NW Natural would object under either approach, without providing any suitable alternative for returning the funds.[102] This sort of categorical objection towards resolving any objection related to related tax reform is inappropriate and should be rejected.

3. Impact of Tax Reform on Excess Deferred Income Taxes

Deferred income tax liabilities are amounts recorded on a utility's balance sheet that represent cash income taxes that will be paid by the utility in the future. Utility deferred income taxes usually arise when depreciation expense for plant investments are accelerated for income tax purposes into earlier periods.[103] Oregon utilities collect from customers both "current and deferred income taxes" of the utility.[104] Therefore, rates recover income taxes associated with the test year forecasted income of the utility, without regard to whether those income taxes are deferred or current.[105] Because the corporate income tax rate decreased, NW Natural will pay the decreased income tax rate on income taxes associated with test years for which customers paid the pre-TJCA rate.

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[102] *See* NW Natural, Opening Brief/25-30.
[103] NW Natural, Opening Brief/30:10-12.
[104] ORS 757.269(1).
[105] NW Natural, Opening Brief/31:1-3.

In addition to decreasing the corporate income tax rate, the TJCA contains new normalization provisions surrounding EDFIT which simplify the treatment of the balance sheet impacts of the new tax law.[106] For business enterprises other than a public utility, the change in tax rate will result in material balance sheet impacts and deferred tax liabilities. Funds that the entity is effectively holding in reserve to pay for future taxes must be revalued at the new tax rate. For non-utilities, this results in the recognition of a gain or loss, which flows through the income statement in the current period in one lump sum.[107]

For public utilities, however, the treatment is different. Under the normalization requirements of IRC § 168(i)(9), the balance sheet gains associated with the change in tax rate must remain on the public utility's balance sheet, and instead of recognizing the gains in one lump sum, the gains are amortized over an extended period of time.[108] A few methods are available to amortize the gains, but the amortization period is generally intended to correspond to the period over which the underlying book-tax differences are expected to reverse.[109]

NW Natural presents three contested issues related to EDFIT: (1) the amount of benefit available for customers from the remeasurement of NW Natural's deferred taxes; (2) the methods through which the benefits should be provided to customers; and (3) the appropriate forum through which the first two determinations should be made.[110]

a. This general rate case is the appropriate venue to consider EDFIT reversals

NW Natural argues that utilizing the TJCA Deferral Dockets would "likely be more efficient at developing a common understanding" on the topic of EDFIT.[111] AWEC rejects this

[106] AWEC/200, Mullins/8:16-17.
[107] AWEC/200, Mullins/9:5-11
[108] AWEC/200, Mullins/9:12-15.
[109] AWEC/200, Mullins/9:15-17.
[110] NW Natural, Opening Brief/31:11-15.
[111] NW Natural, Opening Brief/33:27-34:2.

contention because a general rate case is the only appropriate forum to consider the ongoing impact of EDFIT on base rates.

Dockets UM 1919 and UM 1924 were established only to deal with the Interim Period tax savings that NW Natural will recognize prior to the establishment of new rates on November 1, 2018.[112] The ongoing effect of EDFIT amortization after October 31, 2018, however, falls outside the scope of the Interim Period deferral considered in those dockets.

b. Excess Deferred Federal Income Tax Must be Considered in Revenue Requirement

It is somewhat difficult to parse-out NW Natural's actual recommendation with respect to EDFIT in its Opening Brief. It appears that NW Natural's primary recommendation is that the Commission ignore the effects of EDFIT when establishing cost of service rates in this docket. While NW Natural appears to acknowledge that EDFIT represents valid funds due to ratepayers, NW Natural has taken the position that it is preferable to continue deferring those funds and address them in Docket UM 1919.[113]

Continuing to defer those funds, however, is not a workable solution. The longer that customers are required to wait to incorporate the impacts of tax reform the more volatile the impact of the Interim Period deferral becomes.[114] Further, it would place NW Natural in position of deferring some, but not all of the effects of tax reform, since the effects of tax reform on tax expense will be incorporated into base rates on November 1, 2018 per the stipulation. As Mr. Mullins noted on behalf of AWEC Dockets UM 1919 and UM 1924 were established only to deal with the Interim Period tax savings that NW Natural will recognize prior to the

[112] *In the Matter of Nw. Natural Gas Co. for Authorization to Defer Certain Expenses or Revenues Associated with the 2018 U.S. Tax Cuts and Jobs Act*, Docket No. UM 1919, Application (Dec. 29, 2017); *In the Matter of Staff of the Pub. Util. Comm'n of Oregon Application to Defer Changes in Nw. Natural Gas Co.'s Federal Tax Obligations Resulting from H.R. 1 – Tax Cuts and Jobs Act*, Docket No. UM 1924, Application to Defer Changes in Northwest Natural Gas Company's Federal Tax Obligations Resulting from H.R. 1 – Tax Cuts and Jobs Act (Dec. 29, 2017).
[113] NW Natural, Opening Brief/33:20-26.
[114] AWEC/500, Mullins/12:6-8.

establishment of new rates on November 1, 2018. Those dockets are not the appropriate venue to consider the ongoing impact of EDFIT on base rates following establishment of new rates in this docket.[115]

Further, ignoring the requirement to pass back EDFIT in newly established base rates violates normalization requirements. These requirements can be found in § 13001(d) of the TCJA. This federal law states that NW Natural is in violation of the normalization requirements if it, "in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method."[116] The statute then goes on to describe the average rate assumption method ("ARAM") methodology, as well as the Alternative Method available for utilities that rely on group depreciation accounting.[117]

NW Natural seems to suggest that passing back none of the excess tax reserve is consistent with federal statutes because it would return those balances no more rapidly, or to no greater extent, than would be calculated under the ARAM. Zero, of course, is by definition less than any positive number. That argument should be rejected, however, because the statute presumes that some rational method of normalization is being used in place of the ARAM.[118] If NW Natural has not adopted any reasonable system for amortizing the excess tax reserves for customer benefit, then it has not recognized the excess tax reserves as required by the statute. TCJA § 13001(d)(3)(A) requires NW Natural to carry an Excess Tax Reserve for public utility property. That requirement is not optional, and thus if NW Natural does not account for the

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[115] AWEC/500, Mullins/8:5-8.
[116] TCJA § 13001(d)(1).
[117] TCJA § 1651(d)(3).
[118] AWEC/200, Mullins/8:16-24.

excess tax reserves, and the corresponding effects of amortizing those balances, it would not be using a system of normalization.

With respect to EDFIT, AWEC expressed its concern that NW Natural has not provided support of its calculation of the EDFIT amortization.[119] AWEC continues to disagree with the validity of NW Natural's calculations and requests that the Commission use its amortization calculation, based on the use of the Alternative Method. Further, NW Natural does not possess prerequisite data necessary to use the ARAM methodology, since NW Natural does not calculate its depreciation reserves with the level of granularity necessary to support using the ARAM.[120]

Further, NW Natural's unsupported criticism of Mr. Mullins calculation should be rejected. Mr. Mullins' calculation is not wrong, and NW Natural points to nothing in the record that would indicate that his calculation is wrong. The fact that NW Natural is making unsupported statements regarding accuracy of Mr. Mullins' calculations speak to the fact that NW Natural has been unable to provide any of the data necessary to support its own calculations.

The normalization rules clearly recognize that utilities that rely on depreciation studies to calculate book reserve balances do not possess data that is granular enough to calculate the ARAM. TCJA § 13001(d)(2) states:

> ALTERNATIVE METHOD. —The ''alternative method'' is the method in which the taxpayer—
>
> (i) computes the excess tax reserve on all public utility property included in the plant account on the basis of the weighted average life or composite rate used to compute depreciation for regulatory purposes, and

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[119] AWEC/500, Mullins/8:21-22.
[120] AWEC/500, Mullins/9:5-10:13.

(ii) reduces the excess tax reserve ratably over the remaining regulatory life of the property.

For Mr. Mullins calculation, he took the excess tax reserve amount and multiplied it by the composite depreciation rate of 2.71 percent, which came directly from NW Natural's depreciation study.[121] Mr. Mullins calculation accurately complies with the Alternative Method and is appropriately used to establish rates, given that NW Natural has failed to demonstrate that it possesses the requisite data to use the ARAM method.

With respect to NW Natural's new calculation, it provides no evidentiary support surrounding the reasonableness of $4.5 million of EDFIT amortization that it has identified in its brief, and therefore it would be inappropriate for the commission to use that value.[122]

AWEC continues to support including $7,435,414 of EDFIT amortization in the test period, and after considering the effects of the conversion factor, this level of amortization results in a revenue requirement reduction of $11,971,308.[123] Notwithstanding, AWEC does not object to NW Natural truing up these calculations in a later docket, after it has filed its tax return. Allowing for some kind of true up has been common place as utilities in the region have been implementing the effects of tax reform in rates.

III. Conclusion

For the reasons set forth above, AWEC respectfully requests that the Commission: (1) increase the revenue sharing percentage for optimization activities to 90 percent to customers and 10 percent to NW Natural as recommended by Staff and CUB, but no less that 85 percent to customers and 15 percent to NW Natural as recommended by AWEC; (2) terminate the pension

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[121] AWEC/203, Mullins/2.
[122] NW Natural Opening Brief/36:14-38:8.
[123] See AWEC/203, Mullins/2. AWEC agrees with NW Natural that the sign was reversed on the rate base adjustment originally presented in AWEC 202, Mullins/1:6. This figure corrects that error.

balancing account, open a new docket to address how to deal with the balances and transition to ratemaking method based on SFAS 87 for future pension costs; and (3) decline to defer determinations regarding the calculation and treatment of the Interim Period TJCA benefit amount and the calculation and treatment of EDFIT and, in this general rate case, adopt the amortization methodologies proposed by AWEC.

Finally, as noted above, Staff, NW Natural, and CUB will be filing a new stipulation addressing the pension and tax issues in this docket. AWEC reserves the right, under OAR 860-001-0350 to file written objections or to request a hearing on the yet to be filed stipulation.

Dated this 29th day of August 2018.

Respectfully submitted,

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