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August 14, 2018

VIA ELECTRONIC FILING

Attention: Filing Center
Public Utility Commission of Oregon
201 High Street SE, Suite 100
P.O. Box 1088
Salem, Oregon 97308-1088

Re: Docket UG 344 – NW Natural Gas Company, dba NW Natural, Request for a General Rate Revision

Attention Filing Center:

Attached for filing in the above-captioned docket is an electronic copy of NW Natural's Opening Brief.

Please contact this office with any questions.

Sincerely,

Alisha Till

Alisha Till
Legal Assistant

Attachment

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	**NORTHWEST NATURAL GAS COMPANY'S OPENING BRIEF**

August 14, 2018

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Northwest Natural Gas Company d/b/a NW Natural (NW Natural or the Company) submits this Opening Brief to the Public Utility Commission of Oregon (Commission) in accordance with Administrative Law Judge Allan J. Arlow's rulings on February 2, 2018 and August 9, 2018.

I. INTRODUCTION

After settlement negotiations, NW Natural, Staff of the Public Utility Commission of Oregon (Staff), the Oregon Citizens' Utility Board (CUB), and the Alliance for Western Energy Consumers (AWEC) agreed to resolve all but three issues in this proceeding. A stipulation agreement signed by the Company, Staff, CUB, and AWEC was submitted to the Commission on August 6, 2018. As a result, the only contested issues to be addressed in this opening brief are: (1) the sharing of revenues produced by optimization of certain NW Natural assets and the Company's interstate storage operations and the proper approach to reporting the Company's optimization revenues; (2) the Company's pension balancing account, and (3) the impact of the 2017 federal Tax Cuts and Jobs Act (TCJA) on the Company's accumulated deferred income tax (ADIT) and the Company's tax expense during the time period leading up to the rate effective date.

Optimization

The Company has participated in storage services and optimization activities since the late 1990s. These endeavors, which generate revenue from both shareholder-owned and utility assets, have provided significant value for both customers and shareholders.[1] Indeed, since 2000, customers have received $133.5 million in credits, and customers have also benefited through the ability to recall expanded portions of Mist Storage to serve customers on an as-

[1] NW Natural/1300, Friedman/3.

needed basis.[2] Because the existing arrangements have proved to be tremendously successful, the Company proposes that the Commission maintain its current sharing percentages for storage services and optimization activities.[3]

Staff, CUB, and AWEC all agree that the sharing percentages for storage services should remain the same, but have each proposed significant changes to the sharing arrangements associated with the Company's optimization of utility assets, which are currently split between customers and the Company respectively on a 67/33 percent basis. Staff and CUB have proposed that the Company be directed to adopt a 90/10 sharing arrangement.[4] AWEC has proposed that the Company be directed to adopt an 85/15 sharing arrangement.[5] The parties' arguments rely in large part on the findings of Liberty Consulting Group (Liberty)—a third party consultant that evaluated the arrangements pursuant to a Commission directive, arising from the Company's last rate case and Docket No. UM 1654. In particular the parties point to Liberty's finding that the Company's share of profits is more generous than that retained by other gas utilities engaged in similar activities.[6] Staff, CUB, and AWEC have also recommended that the Commission direct the Company to report all of its optimization revenues as part of its annual results of operation (ROO) report.[7]

The adjustments proposed by the parties regarding optimization sharing percentages should be rejected for three reasons:

(1) The report issued by Liberty (Liberty Report) does not reflect the data and information that would be necessary to enable the Commission to compare the

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[2] NW Natural/1300, Friedman/3.
[3] NW Natural/1300, Friedman/33.
[4] Staff/1300, Glosser/12; CUB/200, Jenks/18.
[5] AWEC/400, Finklea/5.
[6] Staff/1600, Glosser/4; CUB/400, Jenks/4; AWEC/400, Finklea/7.
[7] Staff/1600, Glosser/10; CUB/200, Jenks/25; AWEC/400, Finklea/8.

revenues from optimization activities by NW Natural and NW Natural's peer utilities, and thus does not support the idea that significant changes should be made to the sharing arrangement.

(2) NW Natural's level of participation in optimization activities is greater than that of its peers, and NW Natural's sharing percentage should reflect the Company's greater level of effort.

(3) Any significant change to the sharing percentages could erode the Company's incentive to pursue optimization activities, potentially reducing benefits for both customers and shareholders.

The parties' proposal that optimization revenues be reported in the ROO should also be rejected. Reporting optimization revenues in the ROO inappropriately suggests that those revenues should be considered in the application of earnings reviews. The Commission should instead adopt NW Natural's proposal to report optimization revenues in the Company's annual Optimization Report.

Pension Balancing Account

In its Opening Testimony, the Company explained that it had approached the parties regarding the functioning of its pension balancing account, through which it tracks the difference between the $3.8 million collected annually in rates and its actual FAS 87 pension expenses.[8] The Company explained that the actual FAS 87 expense experienced by the Company has been significantly higher than the $3.8 million included in rates; therefore the account balance has grown to levels significantly higher than had been expected when the mechanism was agreed-to by the parties, creating a significant liability for customers—and

[8] NW Natural/200, McVay/21.

representing a cash flow issue for the Company. Because the balancing account was the result of a settlement (and the settlement prevents any party from proposing changes to the level of cost recovery in rates), the Company did not make a formal proposal for fixing the mechanism, but stated it would attempt to resolve the issue though negotiations—and present a settlement in this case.[9]

Although the parties have been unable to reach resolution, they all agree that modifications to the pension balancing account will need to be made. CUB and AWEC recommend terminating the pension balancing account and addressing recovery of pension expense in rates—but take no position as to what that amount should be.[10] CUB also recommends reducing the interest rate for the balancing account to the Company's weighted average discount rate for pensions.[11] In addition, CUB recommends opening a new proceeding to address the remaining balance.[12] Staff acknowledges that the amount of pension expense recovered in customer rates should be increased, but has concerns regarding transparency of the current mechanism with respect to interest on the account.[13]

NW Natural urges the Commission to take no action on the pension balancing account in this docket, and instead, direct the parties to continue to work toward a sustainable solution. If a solution cannot be reached, a separate docket can be opened to resolve the associated issues. The proposals made by CUB, AWEC, and Staff are general in nature and not sufficiently developed to allow for a comprehensive resolution in this proceeding. Most importantly, summarily terminating the account would not solve the ongoing issues posed by

[9] NW Natural/200, McVay/21.
[10] CUB/100, Jenks-Gehrke/41; AWEC/500, Mullins/3.
[11] CUB/300, Jenks/5.
[12] CUB/300, Jenks/5-6.
[13] Staff/1500, Fox/3.

under-recovery. And it makes no sense for the Commission to make piecemeal changes to the interest rate on the account in isolation of the other components of the mechanism. For all of these reasons, further process is required—either through settlement or a separate proceeding.

Tax Cuts and Jobs Act

On December 22, 2017, United States federal income tax reform, also known as the Tax Cuts and Jobs Act (the TCJA) was enacted. The TCJA permanently lowers the U.S. federal corporate income tax rate to 21 percent from the existing maximum rate of 35 percent, effective as of January 1, 2018. Because the TCJA passed close in time to when the Company filed its case, the Company's initial filing did not address the TCJA. Instead, the Company made a supplemental filing on March 20, 2018 to address the impacts of the TCJA. Specifically, the Company's Supplemental Filing addressed the change in marginal (FIT) tax rate from 35 percent to 21 percent and the change to two deductions: the meals and entertainment deduction and transportation deduction. The Company also adjusted ADIT to reflect the elimination of the bonus depreciation deduction for energy utilities. However, the Company has proposed to resolve the remaining issues related to the TCJA through a separate deferral docket, which was opened upon petitions filed by both NW Natural and Staff.[14] Pursuant to its deferral petition, the Company is currently deferring the estimated net benefits associated with tax reform during the interim period of January 1, 2018 through October 31, 2018 (Interim Period)[15] as well as the excess deferred income tax (EDIT) benefit. Because there is substantial uncertainty regarding several issues related to the Interim Period benefit calculation and EDIT calculation

[14] NW Natural filed a TCJA-related deferral application with the Commission on December 29, 2017 in Docket No. UM 1919. Staff also filed a deferral application on December 29, 2017 with respect to the TCJA implications for NW Natural in Docket No. UM 1924.
[15] NW Natural/2500, Borgerson/5.

that are expected to be resolved in late 2018, NW Natural urges that it is necessary to address these issues in the pending deferral proceeding rather than in this case.[16]

AWEC urges that these issues should be resolved in the rate case, and the Interim Period benefit amount and EDIT should be returned to customers in the Company's base rates, which AWEC calculates to be $15.8 million and $13.5 million, respectively.[17] CUB agrees that that EDIT should be included in base rates, but suggests that the appropriate amount should be based on the Company's best estimate, which should then be used as the basis for new rates after the parties have an opportunity to review the estimate.[18] Staff proposes that the EDIT amount should be included in base rates and calculated that amount to be approximately $10 million, but agrees that the Interim Period amount and treatment should be addressed in the deferral proceeding.[19]

The parties' recommendations should be rejected for three reasons:

(1) There is a wide disagreement regarding the appropriate calculation for the Interim Period amount and EDIT amounts—which are just estimates at this point—and due to the high degree of uncertainty, the Commission should wait until the Company can provide actual amounts to be returned to customers.

(2) The appropriate treatment of the benefits of tax reform will impact other utilities as well, and it is more appropriate for the Commission to address these issues uniformly than in an individual rate case.

(3) There may be creative approaches to applying the benefits of tax reform, such as application to reduce the balance of the pension balancing account, and the

[16] NW Natural/2500, Borgerson/15.
[17] AWEC/500, Mullins/10-13.
[18] CUB/300, Jenks/10.
[19] Staff/1400, Gardner/10-11.

Commission should not adopt an approach that would preclude further consideration of such options.

For the foregoing reasons, the Company urges that the most appropriate forum for addressing the calculation and treatment of the Interim Period amount and EDIT amount is the pending deferral docket.

As detailed below, the parties' positions regarding these three issues should be rejected. The adjustments proposed by the parties to the Company's optimization revenue allocations are unsupported by the Liberty Report and should not be adopted, and the Company should not be required to report optimization revenues in the ROO, and instead should include those revenues in its annual Optimization Report. In addition, the Company has proposed the most appropriate methods for disposing of the issues regarding its pension balancing account and the remaining impacts of the TCJA.

II. ARGUMENT

A. Optimization

While the Company agrees with the Liberty Report's conclusion that the sharing percentages for storage services should remain the same, NW Natural disagrees that the Company's percentage of optimization activities revenues should be decreased. As described herein, NW Natural believes that the current sharing arrangements appropriately reward and incent the Company to expend considerable effort and resources to maximize the revenues from optimization activities, which primarily benefit the Company's customers. Customers have benefitted, and, at the same time, the sharing of revenues has provided the Company with sufficient incentive to take on the complexity and risks associated with this discretionary activity. For these reasons, the Company requests that the Commission make no changes to the existing sharing percentages. Additionally, the Company proposes that reporting of optimization revenues should be included in the Company's annual Optimization Report rather than in the Company's ROO filing.

1. Background regarding Optimization.

NW Natural commenced its storage services and optimization activities to expand and optimize utility resources beyond what would otherwise occur in the normal course of business.[20] First, the Company invested shareholder dollars to expand the then-existing gas storage operations at Mist, as a means of creating value for its investors while at the same time benefiting utility customers through revenue sharing and the ability to recall pre-built capacity on an as-needed basis and at depreciated cost.[21] The Company next developed its optimization activities[22] by contracting with third-party wholesale traders to create further value from utility resources in its gas supply portfolio.[23]

The sharing arrangements for the revenues flowing from NW Natural's storage services and optimization activities were agreed to by Staff and the Company as fairly compensating NW Natural's shareholders and customers for their respective contributions, and have been approved by the Commission under the Company's Schedules 185 and 186.[24] Schedule 185 addresses revenue sharing from storage services and applies to the Company's firm sales service customers whose rates include costs related to the Mist Storage facility.[25] Under

[20] NW Natural/1300, Friedman/2.
[21] NW Natural/1300, Friedman/2.
[22] As described in greater detail in NW Natural's supplemental direct testimony, the optimization activities include: (1) Mist Storage Optimization; (2) Liquids Extraction; (3) Commodity Contract (Portfolio) Optimization; (4) Pipeline Capacity Optimization; and (5) Off-System Storage Optimization. NW Natural/1300, Friedman/13-22.
[23] NW Natural/1300, Friedman/2.
[24] NW Natural/1300, Friedman/23.
[25] NW Natural/1300, Friedman/24.

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 to be credited to customers and 80 percent to be retained by NW Natural.[26] In addition, Schedule 185 provides that NW Natural will also share with eligible customers the net margin that is attributable to optimization of Mist Storage capacity (i.e., deliverability).[27] Net margins from Mist Storage optimization are shared: (a) 20/80 for the proportion of non-utility Mist capacity not included in the rates, and (b) 67/33 for the proportion of core Mist capacity that is included in the rates.[28] At the time when Schedule 185 was developed, the parties agreed that the 20/80 sharing allocation was reasonable to compensate customers for the use of certain assets that were in rate base in order to accomplish what was otherwise an entirely shareholder-funded endeavor.[29] The Company was pleased with the opportunity to expand its non-utility business, and Staff and stakeholders were pleased with an arrangement that allowed customers to benefit without incurring cost or risk.[30]

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.[31] Under Schedule 186, NW Natural shares with eligible customers the net margin attributable to third-party optimization for the entire portfolio of upstream capacity

[26] NW Natural/1300, Friedman/24. All references to sharing percentages will indicate the amount allocated on a customer/shareholder basis.
[27] NW Natural/1300, Friedman/24.
[28] NW Natural/1300, Friedman/24.
[29] NW Natural/1300, Friedman/24-25.
[30] NW Natural/1300, Friedman/25.
[31] NW Natural/1300, Friedman/25. Schedule 186 does not apply to optimization of those portions of Mist Storage that are included in customer rates.

contracts.[32] Specifically, under Schedule 186, the Company shares net revenues with its firm and interruptible sales customers on a 67/33 basis.[33]

Regarding the sharing arrangement for optimization activities, the parties initially agreed to the same 20/80 sharing percentages as those applicable to storage services because it was expected that any margin would be small and come primarily from Mist Storage.[34] However, the Company soon discovered that the opportunity for optimization of other resources was greater than expected, and because the majority of the Company's optimization activities rely on resources that are included in customer rates, the Company proposed to increase customers' share for optimization of resources in customer rates from 20 percent (20/80) to 67 percent (67/33).[35] This adjustment was intended to significantly increase the benefits to customers while maintaining an appropriate and necessary incentive for NW Natural to continue these optimization activities and seek new opportunities, and to fairly compensate the Company for the increased complexity, level of effort, and risks these more speculative activities impose on shareholders.[36]

In addressing the increase, the Company specifically requested that customers receive 67 percent because, at that time, that allocation matched the weighted average cost of gas (WACOG) sharing percentage adopted for the PGA for its internal normal utility optimization of gas supply resources.[37] Matching the 67 percent WACOG sharing was important because the optimization activities were in their infancy, and the Company felt that by using the PGA sharing percentage, it could eliminate any concerns of potential gamesmanship regarding

[32] NW Natural/1300, Friedman/25.
[33] NW Natural/1300, Friedman/25.
[34] NW Natural/1300, Friedman/26.
[35] NW Natural/1300, Friedman/26.
[36] NW Natural/1300, Friedman/26.
[37] NW Natural/1300, Friedman/26.

classification of activities as optimization activities versus normal utility gas supply WACOG savings.[38] The Company also felt that the 33 percent retention by shareholders still provided a sufficient incentive.[39] Today, it is well established which activities fall within each category (optimization activities vs. normal WACOG savings), primarily because the optimization activities are conducted under the AMA; nevertheless, the increase of the customer sharing up to 67 percent has remained in place as a significant customer benefit.[40]

The Company's customers have benefitted significantly from NW Natural's storage services and optimization activities. First, since 2000, customers have received a total of $133.5 million in credits under Schedules 185 and 186.[41] In addition, customers have received a substantial benefit provided by the ability to recall portions of the expanded Mist Storage in increments as needed, and at a depreciated book cost.[42] And importantly, customers have received all of these benefits with no additional cost and a reduction in risk.[43]

In NW Natural's 2011 general rate case, Docket No. UG 221, and again in Docket No. UM 1654, some parties argued that the sharing percentages adopted by the Commission for storage services and optimization activities should be revisited.[44] In Docket No. UM 1654, after a full contested case with two separate hearings, the Commission determined that it required additional information,[45] and issued Order No. 15-066, directing the parties to hire a third-party to perform an independent study and cost-allocation evaluation to aid a decision as

[38] NW Natural/1300, Friedman/26.
[39] NW Natural/1300, Friedman/27.
[40] NW Natural/1300, Friedman/27.
[41] NW Natural/1300, Friedman/29.
[42] NW Natural/1300, Friedman/29.
[43] NW Natural/1300, Friedman/3.
[44] NW Natural/1300, Friedman/30.
[45] NW Natural/1300, Friedman/30.

to the appropriate revenue sharing percentages.[46] That exercise has now been completed, and the Liberty Report was issued on November 27, 2017.[47]

After the issuance of the Liberty Report, the parties to this case proposed, and NW Natural agreed, to make the resolution of the revenue sharing arrangement a matter subject to this proceeding, rather than through continuing Docket No. UM 1654.

The Liberty Report, which was provided as an attachment to the Company's supplemental direct testimony as NWN/1301, concludes that the sharing percentages for storage services are supportable, but that the Company's percentage of revenues attributable to optimization activities might be appropriately decreased.[48]

2. The Current Optimization Sharing Percentages Should Be Retained.

Staff, CUB, and AWEC have each proposed significant changes to the sharing percentages associated with the Company's optimization activities for resources that are included in customer rates, which are currently subject to a 67/33 percent sharing arrangement. Staff and CUB propose modifying the sharing arrangement to 90/10 percent, and AWEC proposes an 85/15 percent split.[49] These proposals are based on these parties' claims that optimization activities are a routine component of prudent utility management and that the

[46] *In the Matter of Nw. Natural Gas Co., dba NW Natural, Investigation of Interstate Storage and Optimization Sharing*, Docket No. UM 1654, Order No. 15-066 at 5-6 (Mar. 5, 2015).
[47] NW Natural/1300, Friedman/4.
[48] NW Natural/1301, Friedman/14.
[49] Staff/1300, Glosser/12; CUB/200, Jenks/18; AWEC/400, Finklea/5.

Company's current sharing percentage is not in line with other sharing percentages in the industry.[50]

AWEC also proposes to flip the sharing arrangement for resources that are not in customer rates and which are currently subject to a 20/80 percent sharing arrangement. Staff opposes AWEC's proposal, and CUB took no position on it.[51]

The Commission should reject the parties' proposals because they are not supported by the Liberty Report, fail to recognize NW Natural's greater level of involvement in optimization activities, and could alter—to the detriment of customers—the balance of risk and reward that has incentivized the Company to pursue optimization so successfully.

a. The Liberty Report does not support the significant modification to the sharing percentages proposed by the parties.

In support of their recommendations, Staff, CUB, and AWEC rely on the Liberty Report's conclusion that there is substantial room to reduce NW Natural's share of revenues from optimization activities.[52] While the parties are correct about the Liberty Report's conclusions, the Liberty Report also has significant shortcomings that suggest it should not be relied upon on this point. Importantly, the Liberty Report fails to provide detailed information regarding the results of the peer utility companies it used for analysis as a comparison group. Thus, while the Liberty Report describes the revenue sharing arrangements for NW Natural's peer utilities, it provides no analysis of the actual results of each arrangement. It is entirely possible that while NW Natural's sharing may provide customers with a relatively smaller sharing percentage, NW Natural's customers may well be receiving significantly greater revenues than the peer utilities' customers. NW Natural believes that to fairly evaluate the

[50] Staff/1600, Glosser/4; CUB/400, Jenks/4; AWEC/400, Finklea/7.
[51] Staff/1600, Glosser/8.
[52] Staff/1300, Glosser/15; CUB/200, Jenks/18-19; AWEC/400, Finklea/5.

different sharing arrangements, it is essential to also consider and evaluate the actual revenues received by customers.[53] Given this lack of relevant information, the Commission should decline to impose a significant change to the arrangements that have provided such value to the Company's customers to date.

The Company is also concerned that AWEC has provided absolutely no support for its recommendation to flip the split between customers and the Company with respect to resources not in customer rates. The Liberty Report does not support this recommendation and AWEC has similarly provided no support in its testimony. Such a significant change is therefore unwarranted and should be rejected.

b. The Company's level of participation in optimization activities goes above and beyond that of the Company's peer utilities.

While the parties assert that participation in optimization activities is a component of prudent utility management, and thus does not merit a greater incentive, they fail to recognize that the Company's participation in optimization activities is significantly more involved than its peer utilities. The Company believes that its optimization activities go above and beyond the efforts typically expended by LDCs in the optimization of customer assets.[54] The Company has actively engaged with its third-party asset manager to ensure that it achieves the best results (*i.e.*, value) for customers. The Company's involvement in optimization activities includes daily interactions with the asset manager to ensure that long-term plans are meeting their objectives and making changes to these plans when necessary.[55] Based on the Company's experience and information, NW Natural believes that this level of involvement is unusual,

[53] NW Natural/2700, Friedman/6.
[54] NW Natural/1300, Friedman/23.
[55] NW Natural/2700, Friedman/3.

and that the 67/33 percent sharing arrangement fairly compensates the Company for this additional level of effort.[56]

c. Any significant change to the Company's sharing percentage could impact the incentives that have provided significant benefits for both customers and shareholders.

NW Natural has attained very significant value for its utility customers flowing from these optimization activities. Specifically, customers have received a cumulative $133.5 million in credits since 2000.[57] This success is proof that the current sharing percentages adequately incent the Company to engage in the active management of the optimization program that is required achieve these benefits. If 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. NW Natural believes the current arrangement has worked well, provides adequate and reasonable incentives, has produced tremendous value for customers, and should be retained.

3. Reporting of Optimization Revenues is not Appropriate for the ROO.

CUB recommends that the Company be required to include all optimization revenues associated with rate-based, regulated activities in its Results of Operations Report (ROO), but recommends that optimization revenues associated with interstate storage should be excluded.[58] Staff and AWEC also support CUB's recommendation.[59] In support of its recommendation, CUB argues that the currently-used format for the ROO (*i.e.*, the version routinely filed by the Company) does not allow a reader to determine all of the earnings from NW Natural's regulated system, which CUB claims makes the ROO less accurate and

[56] NW Natural/2700, Friedman/4.
[57] NW Natural/1300, Friedman/3.
[58] CUB/200, Jenks/25.
[59] Staff/1600, Glosser/10; AWEC/400, Finklea/8.

transparent.[60] CUB also argues that providing this additional information would be particularly helpful if Oregon transitions to incentive regulation because incentive regulation will require the Commission to evaluate the effectiveness of such regulation and evaluation of the revenues earned by the Company related to optimization activities revenue will be part of this analysis.[61]

The Company disagrees that optimization revenues should be included in the ROO for two reasons. First, CUB's recommendation is premature because it is largely supported by an argument that the information would be needed to evaluate the impacts of incentive regulation[62]—but to date, Oregon has not adopted incentive regulation. Second, as pointed out by CUB, NW Natural is reluctant to include optimization revenues in the ROO, because doing so would incorrectly imply that these revenues should be considered in the application of earnings reviews—aside from the Company's Site Remediation and Recovery Mechanism (SRRM), where 50 percent of optimization revenues are already included, as ordered by the Commission in Order No. 15-049.[63]

While the Company disagrees with CUB's specific proposal to include the optimization revenues in the ROO, the Company *does* agree with CUB that transparency is important. To that end, the Company is willing to provide this additional data for informational purposes in the Company's annual Optimization Report. In addition to providing information about revenues, the Company could provide the impact on its earnings of its own sharing portion. Providing this information outside of the ROO would achieve CUB's goal of transparency

[60] CUB/200, Jenks/21.
[61] CUB/200, Jenks/21-22.
[62] CUB/200, Jenks/22.
[63] *In the Matters of Nw. Natural Gas Co., dba NW Natural, Mechanism for Recovery of Environmental Remediation Costs and Request for Determination of the Prudence of Environmental Remediation Costs for the Calendar Year 2013 and the First Quarter of 2014*, Docket Nos. UM 1635 and UM 1706, Order No. 15-049 at 11-12 (Feb. 20, 2015).

while eliminating any suggestion that this revenue should be considered as part of the Company's earnings for other purposes. Neither Staff nor CUB addressed the Company's alternative proposal to include optimization revenues in the Optimization Report.

B. Pension Balancing Account

All parties agree that the pension balancing account is not operating as they had expected when it was adopted by stipulation in UM 1475. However, given that the settlement, prevents parties from unilaterally recommending changes, the Company has raised concerns in this docket, but has not made a formal proposal. Instead, the Company has engaged in discussions with the parties to attempt to resolve concerns about the mechanism's functioning. CUB and AWEC have recommended terminating the account, and CUB has recommended reducing the interest rate on the balancing account. No party, however, has put forward a comprehensive proposal for changes to the pension balancing account.

The Company urges that no changes to the pension should be made in isolation, and instead the Commission must adopt a holistic approach. Toward this end, the Commission should direct the parties to engage in additional process to determine whether they can agree upon an appropriate resolution. If the parties are unable to do so through settlement, then the Commission should open a new docket to determine the appropriate method for addressing the FAS 87 pension expense under-recovery issue and next steps for the pension balancing account.

1. Background regarding the Company's Pension Balancing Account.

In Docket No. UM 1475, NW Natural filed an application for deferral of FAS 87 pension expenses required to fund the Company's pension plans.[64] At the time the Company

[64] *In the Matter of Nw. Natural Gas Co., dba NW Natural, Application to Defer Pension Costs*, Docket No. UM 1475, Application to Defer Pension Costs (Mar. 15, 2010).

filed its deferral application, it was collecting $3.8 million of FAS 87 pension expenses in rates annually, but the Company's actual pension expenses exceeded the amounts recovered in rates, and were forecasted to continue to do so for the next several years.[65] In addition, the combined effects of the market crash of 2008 and the adoption of the Pension Protection Act of 2006 required the Company to make significant cash infusions to its pension plans.[66] To resolve the problems presented by the Company's under-recovery, NW Natural, Staff, CUB, and the Northwest Industrial Gas Users entered into a stipulation regarding the Company's deferral request, which established a pension balancing account rather than a deferral.[67]

The pension balancing account was originally intended to capture the difference between the amount of FAS 87 pension expense the Company recovered in rates and the actual FAS 87 expense incurred by the company.[68] When the Company's actual FAS 87 pension expense decreased to less than $3.8 million, which was expected in future years, those amounts would reduce the balancing account.[69] Eventually, the pension balancing account was expected to become negative, and it would terminate upon the effective date of the Company's first rate case after the account becomes negative.[70] This approach was intended to allow the Company to stabilize the FAS 87 pension expense recovered in rates without having to increase customers' rates as the Company experiences volatility in the actual amount of FAS 87 pension expense each year.[71]

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[65] *In the Matter of Nw. Natural Gas Co., dba NW Natural, Application to Defer Pension Costs*, Docket No. UM 1475, Joint Brief in Support of Stipulation at 1 (Dec. 13, 2010).
[66] *Id.*
[67] *In the Matter of Nw. Natural Gas Co., dba NW Natural, Application to Defer Pension Costs*, Docket No. UM 1475, Order No. 11-051 at 2-3 (Feb. 10, 2011).
[68] *Id.* at 3.
[69] NW Natural/200, McVay/20.
[70] Order No. 11-051 at 4.
[71] NW Natural/200, McVay/20.

NW Natural still includes $3.8 million of FAS 87 pension expense in rates each year, which is subject to the pension balancing account that records the difference between the $3.8 million in rates and the Company's actual pension expense.[72] Based on the information available at the time in Docket No. UM 1475, the parties expected that NW Natural would continue to under-collect pension expenses and the balance in the account would continue to grow, but after several years the pattern would reverse itself—and eventually net to zero in about 12 to 13 years.[73] It has become clear, however, that those predictions have not borne out, in part due to lower interest rates than had been assumed at the time the pension balancing account was created, as well as changing pension funding requirements.[74] As a result, actual FAS 87 expense has not decreased as expected, and the balance in the account has grown to a level much higher than anticipated. In fact, it appears that unless FAS 87 collections are increased and/or additional amounts are applied to the balance, the Company's 2017 projections indicated that the account will not zero out until approximately 2047.[75] However, the stipulation establishing the pension balancing account provides that no party may request an increase to the FAS 87 pension expenses recovered in rates to be effective prior to the termination of the balancing account.[76]

In consideration of the terms of the stipulation in Docket No. UM 1475, NW Natural did not propose any changes to the FAS 87 pension expenses recovered in rates. However, a few months before the Company filed its rate case, the Company approached the parties to Docket No. UM 1475 to discuss the current status of pension balancing account, and advise

[72] NW Natural/200, McVay/19-20.
[73] Order No. 11-051 at 3.
[74] NW Natural/2600, Wilson/2.
[75] Staff/300, Fox/30.
[76] Order No. 11-051 at 4.

parties regarding its updated projections.[77] The Company indicated that it would be open to considering whether an increase to FAS 87 pension expense recovered in rates would be appropriate if all parties supported proposing a modification to the stipulation.[78] The meeting was informational in nature, and parties did not agree to any changes at that time.

On April 4, 2018, the parties to UM 1475 held a workshop to discuss the potential changes to the pension balancing account. While the parties are amenable to discussions regarding adjustments to the pension balancing account, to date parties have not reached an agreement regarding the appropriate approach to the pension balancing account and collection of FAS 87 pension expense.

2. The Commission Should Not Terminate the Pension Balancing Account.

Both CUB and AWEC recommend terminating the balancing account on a going-forward basis, because it is not currently functioning as anticipated.[79] The Commission should reject this approach. Abruptly terminating the balancing account will not resolve the problem, and could limit the Company's ability to develop creative solutions to address this issue.[80] If the mechanism is terminated, in the absence of a more comprehensive solution, the Company will continue to significantly under-recover this expense—which gave rise to the pension balancing account in the first place. Because terminating the balancing account will not solve the problem—and will likely make the problem worse—the Commission should allow the mechanism to remain in place until the parties can present a comprehensive proposal to address the under-recovery of FAS 87 pension expense.

[77] NW Natural/200, McVay/20.
[78] NW Natural/200, McVay/20.
[79] CUB/100, Jenks-Gehrke/41; AWEC/500, Mullins/3.
[80] NW Natural/2600, Wilson/6.

AWEC, however, goes one step further than CUB, suggesting that once the mechanism is terminated, NW Natural may not necessarily recover the balance already accumulated in the account.[81] The Company believes that AWEC's assertion is fundamentally contrary to the stipulation giving rise to the balancing account, which was designed to allow *full* recovery over time.[82]

Staff does not explicitly recommend terminating the balancing account, but expresses some concern that leaving the balancing account in place and increasing recovery "masks the portion of the increase that would be applied to interest."[83] While the Company disagrees that there is a lack of transparency, the Company would be happy to provide Staff and the parties with any additional information they wish to review regarding the principal and interest accumulating in the account.[84]

3. The Commission Should Not Make Any Changes to the Interest Rate for the Pension Balancing Account at this Time.

CUB also recommends decreasing the interest rate for the balancing account to the Company's weighted average discount rate for pensions.[85] Staff does not support CUB's recommendation, and the Company urges the Commission to reject it.[86] First, the parties agreed that amounts in the balancing account should accrue interest in recognition of the fact that there were amounts not being timely recovered and that then required financing.[87] This approach is typical of any mechanism that addresses the under-recovery of amounts from ratepayers—an interest element must be included to recognize the financing implication of

[81] AWEC/500, Mullins/3-4.
[82] NW Natural/2600, Wilson/9.
[83] Staff/1500, Fox/3.
[84] NW Natural/2600, Wilson/5.
[85] CUB/100, Jenks-Gehrke/41.
[86] Staff/1500, Fox/4.
[87] NW Natural/1500, McVay/38.

amounts not recovered.[88] The interest rate was set at the Company's overall rate of return, which reflects that long-term capital is required to finance the long-term account balance.[89] CUB has offered no evidence that the current interest rate does not reflect the Company's actual financing costs, and the Commission should therefore retain the existing interest rate until such time that the parties present a new proposal regarding the pension balancing account for the Commission's consideration.

4. The Commission Should Allow Parties to Continue to Work Together to Find an Appropriate Solution.

CUB has indicated that it believes it is "imperative for parties to reach a creative solution leading to the termination of the pension balancing account."[90] While the Company does not agree that terminating the balancing account immediately is the correct approach, the Company *does* agree that it is in all parties' interest to develop an approach that will reduce the balance over a reasonable amount of time, and address future FAS 87 recovery in a sustainable fashion. Toward this end, the parties have—at a very high level—considered several components to a solution. In particular, the parties have considered potentially applying a portion of the excess deferred federal income taxes arising from the TCJA to reduce the principal in the balancing account. Staff and CUB have indicated they are open to discussions regarding whether the benefits of tax reform could be used to offset the balancing account increase, though AWEC does not support this approach.[91] That said, none of the parties have proposed a resolution that is either detailed or comprehensive. For that reason, NW

[88] NW Natural/1500, McVay/38.
[89] NW Natural/1500, McVay/38. Additionally, this interest is not grossed up for taxes that the Company ultimately has to pay.
[90] CUB/300, Jenks/3.
[91] Staff/1500, Fox/4; CUB/300, Jenks/5.

Natural believes that the parties should engage in additional discussions to explore the various tools available to address this issue.

To facilitate additional discussion regarding the proper approach to the pension balancing account issue, CUB recommends opening a new proceeding.[92] NW Natural supports this request, and believes it would be constructive to allow for additional time and process to explore the various options and reach a solution that it is workable for all parties.

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

On December 22, 2017, United States federal income tax reform, also known as the Tax Cuts and Jobs Act (the TCJA) was enacted. The TCJA permanently lowers the U.S. federal corporate income tax rate to 21 percent from the existing maximum rate of 35%, effective as of January 1, 2018. The reduction in federal corporate income tax results in three matters for regulatory consideration: 1) whether the income tax expense in NW Natural's rate case filing, for utility rates effective November 1, 2018, reflects the lower federal income tax rate; 2) whether NW Natural should defer any estimated net benefit from the lower income tax rate, for the period January 1, 2018 through October 31 2018 (the Interim Period Deferral), and if so, what is an appropriate treatment for this deferral; and 3) whether NW Natural deferred any benefit from the net decrease in its cumulative utility deferred income tax liability balances, recorded upon enactment in 2017 ("Excess Deferred Income Taxes" or "EDIT Deferral"), and if so, what is an appropriate treatment for this deferral.[93]

NW Natural and the parties to this docket have come to a resolution regarding the application of the TCJA's lower federal income tax rate in base rates. This reduction to the test year revenue requirement was incorporated into the Stipulation filed with the Commission

[92] CUB/300, Jenks/5-6.
[93] NW Natural/2500, Borgerson/2-3.

on August 6, 2018. However, the treatment of the Interim Period Deferral and the EDIT Deferral have not been resolved and are the subject of this briefing. For the reasons that follow, NW Natural urges the Commission to decide these remaining issues in the deferral dockets where they were originally presented to the Commission as an appropriate precursor to determining the ratemaking treatment of the deferrals.

1. The Interim Period Deferral.

Beginning on January 1, 2018, NW Natural's regulated utility income tax expense is lower as a result of the decrease in the federal income tax rate. However, the current rates established in NW Natural's last rate case continue to reflect the higher tax rate that was in effect until the TCJA was enacted. As a result, there will be mismatch between the tax expense in rates and NW Natural's current income tax obligation until the time that NW Natural's rates are reset in this proceeding on November 1, 2018 (the "rate effective date"). This period beginning January 1, 2018, when the TCJA took effect, and the date when NW Natural's rates will be reset from this proceeding is referred to as the "Interim Period."

To address the change in the federal income tax rate, NW Natural filed a TCJA-related deferral application with the Commission on December 29, 2017. Staff also filed a deferral application on December 29, 2017. As a result, NW Natural is utilizing regulatory deferral accounting to defer the estimated net benefits associated with tax reform during the Interim Period. This deferral was intended to capture both the Interim Period Deferral discussed here, and the EDIT Deferral which is discussed below. The deferral began on January 1, 2018, the effective date of the TCJA, and is expected to continue through October 31, 2018, the day prior to the expected rate effective date. After the rate effective date, there will be no need for further deferral of the lower federal income tax rate because that reduction will be captured in base rates going forward.[94]

a. Issues in this Case related to the Interim Period Deferral.

NW Natural did not address ratemaking treatment for the Interim Period Deferral in this rate case because this issue is currently being addressed in NW Natural's deferral docket. However, AWEC has argued that NW Natural should amortize the Interim Period Deferral as part of this rate case and has proposed calculations for the Interim Period Deferral and a methodology for amortizing the Interim Period Deferral to customers. NW Natural disagrees with AWEC's proposals and as a result, there are three open issues regarding the Interim Period Deferral in this case.

b. The Commission Should 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.

At the time NW Natural filed its rate case in December of 2017, the TJCA had not yet passed. As soon as it did, NW Natural recognized that there would be savings associated with the TJCA, and that those should be preserved for the benefit of the Company's customers. For this reason, NW Natural filed a deferral, which is being processed in Docket No. UM 1919. Other regulated utilities in Oregon made similar filings, and Staff also filed its own deferral application. Subsequent to these filings, a workshop with Staff and interested parties was held, where all of the relevant impacts of the TJCA were discussed. NW Natural expects that through continued engagement with Staff, interested parties, and the other utilities, the many detailed questions regarding the impacts of the TJCA that are raised in those dockets will be addressed and resolved in the deferral proceedings. Staff has also noted that it may be

[94] NW Natural/1500, McVay/25; NW Natural/2500, Borgerson/5-6.

appropriate to address the Interim Period Deferral as part of the deferral dockets.[95] NW Natural urges the Commission to address the Interim Period Deferral issue in the pending deferral dockets.[96]

It is true that the Commission could decide to address the Interim Period deferral in this docket. However, NW Natural believes that the deferral docket provides a better forum for three distinct reasons. First, that docket will allow for a process that is better tailored to a detailed review of the calculations of Interim Period Deferral than NW Natural's general rate case. The Commission has not approved the proper methodology to calculate the Interim Period Deferral, and because the Interim Period Deferral includes tax expense amounts up and until October 31, 2018, the total amount will not be known until after the rate effective date. These factors could be considered more carefully in a separate proceeding that is on a different schedule from this rate proceeding.

Second, because all of the major regulated utilities are subject to the same law, and have similar adjustments to their taxes, it would make sense to use a separate forum to ensure uniformity and consistency among the utilities. Questions that would be common to all utilities include the methodology used to calculate the Interim Period Deferral, and what type of earnings test to apply under ORS 757.259(5). Deciding these issues in NW Natural's rate case would require the Commission to address these important issues for a single utility prior to

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[95] Staff/1400, Gardner/10-11.

[96] The TCJA is an exceptional event that can be appropriately considered in a deferral docket. The Commission has previously found that "deferred accounting allows rates to be adjusted outside of a general rate case when certain expenses or revenues arise that are deemed exceptional." *In the Matter of Utility Reform Project and Ken Lewis Application for Deferred Accounting*, Docket No. UM 1224, Order No. 09-316 at 14 (Aug. 18, 2009). Further, the Commission states that "a cost or revenue change that is imposed on a utility by the legislature due to statutory modification is typically considered exceptional, because the change cannot be predicted and may have significant financial impact on the utility." *Id.* As such, NW Natural believes that the Commission should continue to utilize UM 1919 to consider NW Natural's TCJA-related questions.

hearing all parties' evidence and arguments. This approach would not only be an inefficient use of the Commission's resources, it would risk inconsistent decisions, and could unfairly prejudice the rights of other parties that could be affected by the precedent that is established, but who are not party to this proceeding.

Third, a separate docket is better suited to considering TCJA-related issues than this rate proceeding because that separate docket would allow for a more reasoned determination about the methods through which the benefits to customers should be provided. For example, in NW Natural's case, it may well be that the return of the Interim Period Deferral to customers could play an important role in developing a method for addressing some of the concerns raised by parties with respect to NW Natural's pension balancing account.[97] That issue has not been fully developed in this record because of the limits on the parties' ability to make proposals for how that balancing account could be changed.[98]

It is also important to note that utilizing a separate docket to decide these important issues does not harm customers, or benefit the utility. The Interim Period Deferral is currently accruing interest to customers' benefit. For this reason, customers are not disadvantaged by a reasonable delay, and at the same time, the utility is not advantaged during the time in which the separate docket is processed.

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[97] CUB/300, Jenks/5; NW Natural/2500, Borgerson/11-12.

[98] The stipulation establishing the pension balancing account provides that no party may unilaterally request an increase to the FAS 87 pension expenses recovered in rates to be effective prior to the termination of the balancing account. Order No. 11-051 at 4. Accordingly, the Company has worked to address proposed changes to the pension balancing account through settlement negotiations with parties rather than by proposing a new approach in this case.

c. The Commission Should Reject AWEC's Incorrect Calculation of the Interim Period Deferral.

NW Natural urges the Commission to decline AWEC's recommendation that the Commission determine the amount of the Interim Period Deferral in this rate case. However, if the Commission determines that this rate case is the appropriate forum to review this issue, AWEC's incorrect calculation of $15.8 million[99] for the Interim Period Deferral should be rejected. By AWEC's own admission, its calculation of the proposed Interim Period Deferral amount is not based on actual results of the Company.[100] Instead, it is, a "higher-level approach" using a "simplified formula."[101]

In contrast, NW Natural's approach to the Interim Period Deferral is based on actual results. Each month during the Interim Period Deferral, NW Natural records a reduction to revenue for the estimated net benefit of the Interim Period Deferral, which includes a gross up for income taxes, which is recorded to a regulatory liability account that accrues interest in the customers' favor.[102] To estimate the net reduction to income tax expense during the Interim Period, NW Natural is utilizing a 2018 results of operations report format to perform a "with" and "without" TCJA calculation.[103] Although NW Natural will not know the total amount of the Interim Period Deferral until sometime after October 31, 2018, NW Natural has provided quarterly updates of the forecasted Interim Period Deferral in UM 1919. The latest forecast of the Interim Period Deferral filed on July 16, 2018 is $5.9 million, before interest begins to accrue. All of this evidence suggests that AWEC's projection is wildly overstated, and should be rejected.

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[99] AWEC/500, Mullins/2 (two-year amortization returning $7.9 million each year).
[100] AWEC/200, Mullins/12.
[101] AWEC/200, Mullins/12-13.
[102] NW Natural/2500, Borgerson/6.
[103] NW Natural/2500, Borgerson/6.

d. The Commission Should Reject AWEC's Proposal to Amortize the Interim Period Deferral.

AWEC initially proposes to amortize the Interim Period Deferral in base rates. As an alternative, AWEC suggests that it would not object to amortizing the Interim Period Deferral as part of a separate schedule. Both recommendations should be rejected by the Commission.

First, AWEC's recommendation to amortize the Interim Period Deferral in base rates is not a reasonable proposal for ratemaking. As explained in the Surrebuttal Testimony of Sean Borgerson, the Interim Period Deferral is capturing a one-time event for the reduction in income tax expense for a defined period.[104] At the end of the Interim Period, NW Natural will know exactly what the deferred amounts are, and at that time, NW Natural will stop deferring those amounts. AWEC's proposal to amortize this one-time event in base rates would result in an ongoing annual reduction to base rates, even after the full amount of the Interim Period Deferral had been amortized.[105] NW Natural believes a reasonable approach would be to amortize the Interim Period Deferral on a separate schedule that captures the one-time event only and looks forward to discussing this approach in UM 1919.

As an alternative, AWEC suggests that it would not object to amortizing the Interim Period Deferral in a separate schedule. AWEC argues that is "imperative that the amounts begin to be returned to ratepayers as soon as possible, corresponding with the final rate change in this docket."[106] While NW Natural also does not want to delay the amortization of the Interim Period Deferral to ratepayers, AWEC's dire sense of urgency is misplaced. As previously stated, the Interim Period Deferral cannot be known until after the rate effective date, and therefore, it is premature to amortize the deferral. Furthermore, customers will not

[104] NW Natural/2500, Borgerson/9.
[105] NW Natural/2500, Borgerson/10.
[106] AWEC/500, Mullins/12.

be harmed if the Interim Period Deferral is not amortized in this rate case because the deferral is currently accruing interest in customers' favor. After the treatment of the deferral is carefully reviewed in the deferral dockets, the Interim Period Deferral could be amortized at later date corresponding with the Company's annual Purchased Gas Adjustment, or used as an offset to the pension balancing account if the parties found this approach acceptable. As such, NW Natural urges the Commission to reject AWEC's needlessly rushed approach.

2. Excess Deferred Income Taxes

a. Deferred Taxes Generally

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.[107] As a result of a utility's significant plant investments, utility deferred income taxes primarily arise when depreciation expense is accelerated for income tax purposes into earlier periods.[108] The result being that taxable income for a particular period may be less than financial statement operating income ("book income") for that same period.[109] This provides for a temporary delay of a portion of income taxes payable until a later period.[110] In other words, a utility records deferred income tax liabilities when it has financial statement income, but that income is not taxable until a future period.[111]

In the context of regulation, deferred taxes have specific ratemaking impacts. First, under Oregon law and Commission precedent, Oregon utilities collect from customers, through rates, both "current and deferred income taxes" of the utility.[112] This means that customers'

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[107] NW Natural/2500, Borgerson 12.
[108] NW Natural/2500, Borgerson 12.
[109] NW Natural/2500, Borgerson 12.
[110] NW Natural/2500, Borgerson 12.
[111] NW Natural/2500, Borgerson/12.
[112] ORS 757.269(1).

rates are set to recover the income taxes associated with the test year forecasted income of the utility, without regard to whether those income taxes are deferred (and thus paid later) or current (and thus paid in the year used to determine the rates). Therefore, when income tax is deferred, the utility recovers from customers more, for income taxes, than is actually paid in that same year. The amount deferred will be paid in a later year. This has a significant consequence—this money is available to reduce financing costs that the utility otherwise would incur in order to operate the business. Regulation reflects this financing benefit to the utility through lowering rate base by an amount equal to the accumulated deferred tax liability of the utility. This result ensures that customers pay an appropriate amount for the utility's financing, because this financing is reduced by any accumulated deferred taxes on the utility's books.

b. Impact of Tax Reform on Utilities' Accumulated Deferred Taxes

The TJCA not only changes the prospective income tax rate imposed on utilities, including NW Natural, but it also requires utilities to "re-value," or "re-measure" their accumulated deferred tax liabilities.[113] This requirement makes sense because, as described above, a utility's accumulated deferred tax liability represents, in some sense, amounts that it has collected from customers, but which will be paid for income taxes in future years under tax rates in effect at that time. Because the corporate income tax rate has now decreased, the utility must now remeasure the amount due for those taxes that were deferred.

The effect of all of these adjustments is that the remeasurement determines the amount of income taxes the utility is expected to pay in the future related to deferred taxes, and also the benefit the utility can provide to customers related to the lowering of that amount.

[113] NW Natural/2500, Borgerson/13.

c. Remeasurement of NW Natural's Taxes

In accordance with the TJCA, NW Natural remeasured its deferred taxes, and recorded this amount in December of 2017. In NW Natural's case, this resulted in a $156.8 million reduction in the Company's deferred tax liabilities associated with providing utility service. These remeasured deferred taxes that are available to benefit customers are called "Excess Deferred Income Taxes," or EDIT.

These EDIT-related benefits are then further grossed-up, to reflect the fact that a future credit of these benefits is a tax-deductible event, at the new corporate tax rates.[114] This gross-up increases the estimated benefit to customers to $213.3 million.

d. Issues in this Case Related to Excess Deferred Income Taxes

In this case, there are three open issues regarding these remeasured deferred taxes, or EDIT. They include: 1) the amount of benefit available for customers from the remeasurement, 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 by the Commission.

NW Natural addresses the third issue (the most appropriate forum) first, because if the Commission determines that the separate deferral docket (UM 1919) is the correct forum for determining the amounts to provide to customers, and the methodology for providing benefits to customers, then the first two issues need not be addressed by the Commission in its order in this proceeding.

[114] NW Natural/2500, Borgerson/14-15.

e. The Commission Should Utilize the TJCA Deferral Dockets to Determine the Amount of EDIT, and the Methodology for Providing EDIT-Related Benefits to Customers.

In its deferral application, NW Natural expressly recognized that one of the benefits to customers as a result of the TCJA would most likely be to reduce the Company's tax liability for accumulated deferred income taxes. NW Natural stated:

> The tax reform represents a major change to corporate tax policy, and given this extensive legislation, NW Natural is continuing to evaluate its full impact on the Company. The most significant provision is the lowering of the federal corporate income tax rate from 35% to 21% beginning January 1, 2018. **Other effects include, but may not be limited to, changes to deferred taxes**, and impacts to state and local taxes to the extent those are tied to or affected by the federal taxing system. These changes will cause certain of NW Natural's expenses or net investment amounts to go up, and others to go down. Overall, on a net basis, we expect that the tax reform will allow NW Natural to reduce expense to customers. **This request seeks to defer all costs and benefits resulting from tax reform, so that an appropriate net adjustment can be made to customers' rates in the manner approved by the Commission in the future.**[115]

For the same reasons that a separate deferral docket is more appropriate to address the issues regarding the Interim Period Deferral, the EDIT-related benefits should be carefully considered in the deferral docket. Additionally, a separate docket is appropriate because NW Natural's EDIT calculations are not yet final, due to outside factors that could influence them. These include the normal examination by the Internal Revenue Service of NW Natural's relevant tax returns, and the Treasury's intention to issue clarifying guidance on certain elements of the TJCA.[116]

Moreover, the complexity associated with deferred taxes is evident from the record before the Commission in this proceeding, and NW Natural believes that utilizing a separate

[115] *NW Natural's Application for Deferred Accounting Order*, Docket No. UM 1919, Application at 2-3 (Dec. 29, 2017) (emphasis added).
[116] NW Natural/2500, Borgerson/15.

proceeding is warranted, because additional workshops and face-to-face discussions could be had on the topic that would likely be more efficient at developing a common understanding.

Importantly, the Commission's decision to address the EDIT-related benefits in the deferral docket will not harm customers. As described in the testimonies of Kevin McVay, and Sean Borgerson, until EDIT-related benefits directly benefit customers, they continue to be reflected as a reduction to NW Natural's rate base, providing a significant indirect benefit to customers. This approach prevents customers from foregoing benefits, and also means that the utility is not advantaged while the separate docket is processed.

Utilizing the separate deferral process to resolve these issues is in no way contrary to normalization requirements under the TJCA or existing tax law. In testimony, AWEC's Bradley Mullins testified that the Commission must use the rate case forum to pass EDIT-related benefits on to customers or else it would be committing a normalization violation.[117] NW Natural's Director of Tax responded, explaining that normalization requirements place a limit on how quickly EDIT benefits can be passed back, but do not in any way dictate that this must be implemented through rate cases, or that the benefits must be passed back at this time.[118]

This testimony is supported by the text of the TCJA, which provides that a normalization violation occurs if:

> the taxpayer, 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.[119]

[117] AWEC/500, Mullins/7-8.
[118] NW Natural/2500, Borgerson/21-23.
[119] Tax Reform and Jobs Act of 2017, Pub. L. No. 115–97, 131 Stat. 2099 (Dec. 22, 2017) (emphasis added).

f. The Commission Should Reject AWEC's and Staff's Incorrect Calculations of NW Natural's EDIT, and their Proposed Rate Credit.

Despite NW Natural's testimony explaining why it makes more sense to calculate NW Natural's EDIT, and determine how it should be passed back to customers in UM 1919, the witnesses for Staff, AWEC, and CUB argued that the Commission should determine a specific amount in this case by which to reduce NW Natural's revenue requirement to reflect an amortization of NW Natural's EDIT. AWEC calculates that $13.5 million should be returned to customers in this rate case on an annual basis.[120] Staff sets that number at $10.009 million[121] while CUB does not provide a specific amount.

For the reasons described in the testimony of Sean Borgerson, the Commission should reject these proposals. Staff's and AWEC's calculations rely, erroneously, on a depreciation methodology that is not appropriate for NW Natural's circumstances, rather than the "Average Rate Assumption Method" (ARAM) that is required.[122] AWEC's calculation includes inappropriate rate base adjustments (which go the wrong way), and includes ineligible balances of deferred taxes that were previously benefited directly to customers in periods before 1981.[123] And, both proposals use depreciation lives that are too short, and amortization amounts that are so high that their proposed credits would result in normalization violations.[124]

For these reasons, if the Commission were to determine that an EDIT-related rate benefit should be provided to customers in this case, it should reject the calculations offered by Staff and AWEC, and instead look to the calculations provided by NW Natural. NW

[120] AWEC/500, Mullins/11.
[121] Staff/1400, Gardner/10.
[122] NW Natural/2500, Borgerson/23-29.
[123] NW Natural/2500, Borgerson/27.
[124] NW Natural/2500, Borgerson/27.

Natural's calculations, which were provided to parties in this case through discovery and presented in testimony, show that the correct total EDIT-related benefit is $156.8 million, on a system-wide basis.[125] This ties directly to NW Natural's financial statements that are audited and publicly available.[126] It is appropriate, also, to gross up this number for taxes, at the current tax rate, in order to determine the overall benefit that should be provided to customers. This gross up increases the amount to $213.3 million.[127]

NW Natural set forth in testimony, what amount of annual credit to customers would be appropriate in order to address the $213.3 million balance, on a schedule that would be consistent with normalization limits, and with a recognition that the benefits were recorded in 2017. That proposal is set forth in NW Natural/2501, Borgerson/1, and results in an annual rate credit of $4.5 million, as described in the following section. In addition, a base rate increase of $419 thousand would be necessary to reflect the additional revenue requirement of the rate base increase as a result of crediting customers $4.5 million of deferred taxes.[128]

g. If the Commission Were to Determine That It Should Reduce NW Natural's Revenue Requirement to Reflect the Return of EDIT-Related Benefits to Customers in This Case, It Should Order a $4.5 Million Reduction.

For the reasons described above, the Commission should utilize Docket No. UM 1919 to resolve the implementation of NW Natural's EDIT-related benefits, as well as the other items that require resolution under the TJCA. If, however, the Commission were to determine that it should reduce NW Natural's revenue requirement in this proceeding to reflect amortization of a portion of the EDIT-related benefits to customers, then the Commission

[125] NW Natural/2500, Borgerson/29-30.
[126] NW Natural/2500, Borgerson/1; NW Natural/2501, Borgerson/1.
[127] NW Natural/2501, Borgerson/1.
[128] Natural/2500, Borgerson/29-30

should order a rate reduction of $4.5 million, and a rate increase of $419 thousand, be reflected in rates (a net rate decrease of $4.081 million).

As described above, the annual amortization figure is reflected in NW Natural/2501, Borgerson/1, which details the calculation of that annual amount, and the additional revenue requirement from the associated rate base increase is discussed at NW Natural/2500, Borgerson/29-30. This annual amortization amount is calculated to consider the ARAM amortization "speed limit" imposed by the IRS's normalization requirements,[129] and it reflects the regulatory life of the underlying non-plant assets that gave rise to the deferred taxes. It also takes into consideration that a significant amount of EDIT came about because of the Company's investment in gas reserves, and that these should benefit the appropriate group of customers that pay the costs of that investment, and on an appropriate timeframe. It also reflects the application of an earnings test to the deferral amount that was recorded in 2017, by reducing the balance due to customers by $3.9 million. This $3.9 million is the grossed up amount by which NW Natural earned below its authorized Return on Equity in 2017, and which was approved by the Commission in Order No. 18-254.[130]

NW Natural understands the application of an earnings test to be appropriate in this circumstance, based on Commission's Order No. 13-416.[131] In that Order, the Commission determined that Idaho Power's income tax refund benefit was subject to an earnings test, and would not be refunded to customers because Idaho Power was under-earning during the time

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[129] NW Natural/2500, Borgerson/29.

[130] *In the Matter of Nw. Natural Gas Co. dba NW Natural, 2018 Spring Earnings Review*, Docket No. UM 903, Order No. 18-254 (July 3, 2018).

[131] *In the Matter of Idaho Power Co., Request for General Rate Revision*, Docket No. UE 233, Order No. 13-416 (Nov. 12, 2013).

period.[132] In NW Natural's case, the Company was under-earning during 2017, the time period in which the EDIT was booked as income (subject largely to regulatory deferral).

The net rate credit of $4.081 million reflects an appropriate state allocation to Oregon, and an adjustment to NW Natural's rate base, to increase it by the amount of the credit provided. This rate base adjustment is appropriate because the Company's accumulated deferred tax liability is decreased when a credit is provided to customers, and thus the financing benefit to the Company is removed, and rate base (i.e. the net financing done by the company in providing utility service) is increased.[133]

h. The Commission Should Consider Other Alternative Methods for Providing a Benefit to Customers Related to EDIT.

If the Commission were inclined to provide a benefit to customers in this case related to EDIT, then it should consider other tools available for providing that credit, which NW Natural believes may represent a better approach than the rate credit proposal offered by the parties. First, the Commission should consider that a more precise tracking of the amortization could be accomplished through utilizing an annual adjustment process, concurrent with the Company's Purchased Gas Adjustment.[134] This would give the Commission an opportunity each year to determine an appropriate annual amortization of EDIT-related benefits, and consider rate base changes that go along with the provision of these benefits as well.

Additionally, the Commission should consider that EDIT-related benefits represent a large sum of dollars. Because there are other regulatory mechanisms that the Commission will likely be considering, which have impacts on customer bills (e.g. the pension balancing

[132] *Id.*
[133] NW Natural/2500, Borgerson/29-30.
[134] This potential approach was discussed in NW Natural/1500, McVay/20-21 and NW Natural/2500, Borgerson/30-31.

account, which was discussed in this proceeding), it may make sense to use some of these EDIT-related benefits to mitigate impacts to customers of any modifications to those mechanisms.[135]

i. Conclusions Regarding Excess Deferred Income Taxes

For the reasons described above, NW Natural respectfully requests that the Commission find that UM 1919 is the more appropriate forum in which to resolve the calculation of, and application of benefits from NW Natural's excess deferred income taxes. If the Commission is inclined, however, to apply a benefit in this case, it should order a rate reduction of $4.5 million, and a rate increase of $419 thousand (a net rate decrease of $4.081 million), be reflected in NW Natural's revenue requirement. The Commission should consider utilizing the Company's annual Purchased Gas Adjustment process to effect an appropriate adjustment to this amount each year, and it should also consider whether it would be in customers' interest to apply some amount of the EDIT-related benefit to offset other cost increases that could come about for customers related to resolution of the pension balancing account matter raised in this proceeding, which could be resolved in a future proceeding.

III. CONCLUSION

For the reasons set forth above, NW Natural respectfully requests that the Commission: (1) reject the significant modifications proposed for the optimization revenue sharing and instead retain the existing sharing arrangements, and confirm that it is not necessary for the Company to report the revenues from its optimization in the ROO but instead to report them through its annual Optimization Report; (2) open a new docket to allow the parties to Docket

[135] *See* NW Natural/2500, Borgerson/31 (discussing the potential connection with the pension balancing account).

No. UM 1475 to continue discussions regarding the under-recovery of FAS 87 pension expense and the pension balancing account; and (3) defer any determinations regarding the calculation and treatment of the Interim Period TCJA benefit amount and the calculation and treatment of the EDIT for consideration in the pending deferral proceedings.

Respectfully submitted this 14th day of August, 2018.

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