BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344

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In the Matter of	)
	)
NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL,	)
	)
Request for a General Rate Revision.	)
	)

TESTIMONY SUPPORTING THE THIRD STIPULATION OF

BRADLEY G. MULLINS

ON BEHALF OF THE ALLIANCE OF WESTERN ENERGY CONSUMERS

February 14, 2019

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS?

A. My name is Bradley Mullins. My business address is 1475 SW Harbor Way, Ste 450, Portland, Oregon 97201.

Q. ARE YOU THE SAME WITNESS THAT HAS FILED TESTIMONY IN THIS MATTER?

A. Yes. I have previously filed multiple rounds of testimony in this docket on behalf of the Alliance of Western Energy Consumers ("AWEC").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. On February 4, 2018, NW Natural, AWEC, Staff of the Public Utility Commission of Oregon, and the Citizens' Utility Board ("CUB") (collectively, the "Stipulating Parties") entered into the Third Stipulation resolving all remaining issues in Phase II of this docket. In this testimony, I provide AWEC's statement in support of the Third Stipulation and discuss the reasons AWEC found the Third Stipulation to be reasonable and in the public interest.

Q. DOES AWEC RECOMMEND THE COMMISSION APPROVE THE THIRD STIPULATION?

A. Yes.

Q. WHAT ISSUES DOES THE THIRD STIPULATION RESOLVE?

A. In Order No. 18-419, the Commission initiated Phase II of this docket to address three principal outstanding issues in this docket: 1) treatment of the Pension Balancing Account ("PBA") balances; 2) treatment of "Protected" and "Unprotected" Excess Deferred Federal Income Taxes ("EDFIT"); and, 3) the treatment of the tax reform savings recognized by NW Natural in the Interim Period from January 1, 2018 through October 1, 2018. The Third Stipulation resolves all of these issues.

Q. HOW DOES THE STIPULATION RESOLVE THE ISSUES SURROUNDING THE PBA?

A. The Stipulating Parties have stipulated that, notwithstanding the termination of the PBA, NW Natural will be allowed to amortize balances it accrued to the PBA. The amortized balance will be based on the amount NW Natural had calculated as of October 31, 2018 or $79,861,289. Under the terms of the Third Stipulation, the balance will be reduced by a $10,500,000 adjustment, and further reduced by certain tax reform items. After considering these further tax related reductions, a PBA balance of $56,850,237 will be amortized over a ten-year period using the sinking fund method. The amortization will be a fixed amount of $7,131,059 per year calculated using an interest rate of 4.3%. This amount will be amortized in base rates and not subject to future adjustments.

Q. WHY DOES AWEC SUPPORT AMORTIZING THE PBA BALANCE?

A. AWEC identified several significant issues associated with the PBA and was critical of NW Natural's actions and inactions with respect to the PBA. Notwithstanding, NW Natural agreed to reduce the balance, which was necessary for AWEC to support the Third Stipulation. As described above, the Third Stipulation applies a $10,500,000 adjustment to the PBA regulatory asset balance, which is a significant benefit to customers.

Q. WHAT DOES THE $10,500,000 ADJUSTMENT TO THE PBA REPRESENT?

A. There was not necessarily agreement on what this adjustment represented. To put the amount into context, however, the adjustment amount is equal to approximately half of the $20,936,625 of interest that NW Natural had accrued in its calculation of the October 31, 2018 balance. NW Natural's agreement to reduce the balance in the PBA by $10.5 million is a significant reason AWEC is a signatory to the Third Stipulation.

Q. WAS IT ALSO IMPORTANT TO AWEC TO USE THE BALANCE CALCULATED AS OF OCTOBER 31, 2018?

A. Yes. The basis for the amortization is the PBA balance as of October 31, 2018, which excludes the incremental interest accrual NW Natural had recorded following the Commission Order No. 18-419, which "froze" the PBA. As noted in previous rounds of testimony, NW Natural was continuing to accrue interest at its weighted cost of capital after Order 18-419. While AWEC, NW Natural, and other parties may not have agreed on what the Commission meant by freezing the PBA, by using the October 31, 2018 balance, the subsequent incremental interest accruals have been removed from the PBA balance, which benefits all customers.

Q. WHAT IS THE SINKING FUND METHOD AND WHY IS IT APPROPRIATELY USED FOR THE PBA?

A. The sinking fund method is sometimes referred to as mortgage-style amortization.[1] Basically, the sinking fund method takes an interest accruing balance and converts the balance into a single levelized payment. The single levelized payment is calculated to compensate for all of the principal and interest accruals over the repayment period.

The sinking fund method is in contrast to a straight-line method of amortization, where the principal portion of the payment remains fixed, but the associated interest accrual declines over time as the obligation is repaid. The straight-line method is usually the method used for depreciation accounting and results in a declining payment schedule after considering interest. With the straight-line method, the total payment is initially very high but declines over time, due to reductions in the principal balance and associated reduction to the interest accrual.

1 See e.g. Marston, Winfrey and Hempstead, *Engineering Valuation and Depreciation,* page 195, (Chapter 9, Section 11) (1953).

It is worth noting the sinking fund method here, because from AWEC's perspective, using the sinking fund method is the preferred way for dealing with long-term amortization of regulatory assets. The reason the method is preferred is it results in a single levelized payment for each year the amortization takes place. Thus, the method provides ratepayers with the benefit of the declining principal balance, without having NW Natural file a rate case every year. If the goal was to align consumption and use, as is the case in a depreciation study, a straight-line approach might be appropriate. When dealing with regulatory assets such as the PBA, however, a sinking fund approach should be considered.

Q. WHY IS THE 4.3% INTEREST RATE REASONABLE?

A. There was no specific agreement on how the 4.3% interest rate was calculated. Notwithstanding, AWEC supports an approach of using an interest rate equal to 100 basis points above the risk-free rate in the amortization period. Over the period in which this settlement has been negotiated, ten-year treasury yields have been fluctuating between 2.9% to 3.3%, and thus, AWEC found the 4.3% rate to be reasonable. Further, it is important to note that the interest rate is fixed so ratepayers are not subject to the risk of interest rate fluctuations impacting the PBA amortization.

Q. PLEASE DESCRIBE THE TREATMENT OF PROTECTED EDFIT.

A. With respect to protected EDFIT, the Parties stipulated to a $3,262,600 amount of protected EDFIT amortization which will flow through base rates. Protected EDFIT are the plant related reserve balances that must be refunded to customers using the Average Rate Assumption Method ("ARAM"), or Alternative Method, as outlined in the Tax Cuts and Jobs Act. AWEC did not necessarily agree with the specific amortization amounts NW Natural had calculated, although the amounts AWEC had calculated were in a general range of reasonableness with the amounts that NW Natural calculated using NW Natural's implementation of the ARAM. Further, AWEC was concerned that the protected EDFIT accrued in the Interim Period was not properly considered in NW Natural's amortization proposal. Notwithstanding, AWEC was willing to accept the $3,262,600 annual amount, specifically because the Third Stipulation would allow NW Natural to "catch-up" the amortization schedule in its next general rate case. Thus, to the extent that the ARAM reversals are being returned to ratepayers more slowly than NW Natural's actual ARAM schedule, due to, for example, the omission of amortization in the Interim Period, an adjustment may be made in the next rate case to "catch up" the funds being returned to ratepayers.

Q. HOW DOES THE STIPULATION RESOLVE ISSUES SURROUNDING UNPROTECTED EDFIT?

A. The Parties agreed to Unprotected EDFIT amortization of $5,437,344, which is to be applied to reduce the balance of the PBA.

Q. WAS A SIMILAR APPROACH USED FOR THE INTERIM PERIOD TAX SAVINGS?

A. Yes. Parties agreed to an Interim Period tax savings amount of $7,073,708, which will also reduce the balance of the PBA.

Q. WHY DID AWEC ACCEPT OFFSETTING THE PBA WITH THE UNPROTECTED EDFIT AND THE INTERIM PERIOD TAX SAVINGS?

A. Considering other terms of the Third Stipulation, AWEC was willing to accept a longer-term, 10-year amortization period for Unprotected EDFIT and Interim Period savings. Accordingly, AWEC was also willing to offset the balances of the PBA because the only practical difference between a ten-year amortization and offsetting the PBA was the financing charges that might be applied to the various balances.

AWEC initially thought that offsetting the balance would provide a slight financing benefit to ratepayers, compared to a scenario where EDFIT and the Interim Period savings were amortized separately over a ten-year period. Notwithstanding, based on further review, I now believe the action of offsetting the PBA will probably represent a slight financing cost to ratepayers, albeit small. In the revenue requirement calculation, the Unprotected EDFIT liability is completely removed from rate base, where it would otherwise accrue a carrying charge benefit at NW Natural's cost of capital of approximately 7.3%. By offsetting the PBA balance, the assumption is that a 4.3% carrying charge is applied to Unprotected EDFIT and the Interim Period tax savings balances. Given the other beneficial terms of the Third Stipulation, AWEC did not view the difference to be material enough to alter its support of the Third Stipulation.

Q. WHY WAS THE STIPULATION AMENDED WITH RESPECT TO GAS RESERVES EDFIT?

A. In the Third Stipulation, Gas Reserves EDFIT of $14,643,000 million will be returned to customers over a five-year period. The Gas Reserves EDFIT amounts represent the tax reform savings associated with NW Natural's fixed investment in gas producing reserves. In the Third Stipulation, the benefit of these EDFIT amounts were credited only to sales customers through a separate tariff rider. Such an approach is appropriate because the gas reserves in question are included in the cost of natural gas, which is not applicable to transportation customers, and AWEC was supportive of this approach because it aligns the tax benefits in a manner that is consistent with the way the underlying gas reserve costs get allocated.

Q. WHY WAS THE STIPULATION AMENDED WITH RESPECT TO GAS RESERVES EDFIT?

A. Shortly after filing the Third Stipulation, AWEC recognized that the rate base impacts associated with Gas Reserves EDFIT were being applied to general revenue requirement and not to sales customers through the supplemental schedule. In Paragraph 6 of the Third Stipulation, parties agreed to increase rate base by $15.38 million to reflect the EDFIT being provided to customers as part of the Third Stipulation. This increase to rate base results in a $1.43 million increase to revenue requirement. Notwithstanding, approximately $501,465 of this revenue requirement increase was due to EDFIT associated with gas reserves, which only benefits sales customers through a separate tariff rider. After filing the Third Stipulation, AWEC noted this issue to the Parties and there was agreement that this was not the intended result of the Third Stipulation. The allocation impacts are relatively small, so AWEC appreciates the parties' willingness to resolve the issue on principle after having already agreed to the language in the Third Stipulation.

In the amendment, Parties agreed that the revenue requirement associated with the rate base impacts of Gas Reserves EDFIT will apply only to sales customers. The remaining $931,088 revenue requirement increase associated with the rate base impact of unprotected and protected EDFIT will apply to all customers in base rates.

Q. PLEASE SUMMARIZE YOUR RECOMMENDATION.

A. It was important to AWEC that NW Natural accept some responsibility for the failure of the PBA, since AWEC believed NW Natural's actions or inactions contributed to the failure of the PBA. As a result of the parties' testimony and settlement discussions, in AWEC's opinion, NW Natural accepted some responsibility over the PBA balances, and therefore, AWEC found it reasonable to resolve the remaining issues in this docket in the manner outlined in the Third Stipulation. AWEC recommends the Commission accept and approve the Third Stipulation.

Q. DOES THIS CONCLUDE YOUR TESTIMONY SUPPORTING THE THIRD STIPULATION?

A. Yes.