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.	)
	)

PHASE II CROSS-ANSWERING TESTIMONY OF

BRADLEY G. MULLINS

ON BEHALF OF THE ALLIANCE OF WESTERN ENERGY CONSUMERS

JANUARY 4, 2019

I. INTRODUCTION

Q. ARE YOU THE SAME WITNESS THAT PROVIDED TESTIMONY FOR AWEC IN THIS DOCKET?

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

Q. WHAT IS THE PURPOSE OF YOUR PHASE II CROSS-ANSWERING TESTIMONY?

A. I respond to the Phase II Rebuttal Testimony of Staff witness Fox. I also respond to the Phase II Rebuttal Testimony of the Citizens' Utility Board ("CUB"). In addition, I discuss two clarifications to my Phase II Rebuttal testimony.

II. RESPONSE TO STAFF

Q. WHAT IS YOUR UNDERSTANDING OF STAFF'S PHASE II REBUTTAL TESTIMONY?

A. Staff recommends some form of sharing associated with the $79,861,289 amount Northwest Natural Gas Company ("NW Natural") proposed to amortize in connection with the Pension Balancing Account ("PBA").[1] Notwithstanding, Staff supports full recovery of the balances associated with "excess pension expenses"—i.e. the difference between SFAS 87 actual expenses and the amount included in rates. Staff acknowledges that the accrued interest associated with the PBA is significant--noting that over one-quarter of the balance consists of accrued interest.[2] Staff recommends the Commission adopt an approximately 5/95 sharing on the accrued interest, i.e. customers would be responsible for about 5% of the $20,926,624 in

[1] Staff/1700, Fox/5
[2] *Id*.

accrued interest. Staff's recommendation would result in a $19,798,249 reduction to the PBA balance.[3]

Next, Staff conducted an earnings test using a design element of the Purchased Gas Adjustment ("PGA") called the "Gas Earnings Threshold."[4] Based upon Staff's earnings test, Staff believes no further adjustment to the PBA balance is necessary in connection with the earnings test requirements of ORS 757.259.[5]

Q. DO YOU AGREE WITH STAFF'S VIEW ON THE ACCRUED INTEREST ASSOCIATED WITH THE PBA?

A. With respect to accrued interest, I agree with Staff that it is unreasonable to provide NW Natural with the amount of interest it seeks. However, I have concluded that there should be no interest amortized in connection with the PBA. In my opinion, these accrued amounts represent interest on interest—since a major portion of SFAS 87 expense is interest expense. In my Phase II Rebuttal Testimony, I said that this compounding of interest expense on the PBA balance was "double counting", but I now think that language was probably too strong to describe the issue I was attempting to identify with respect to the accrued interest. If the Commission approves amortization of the PBA, there is a timing difference between when the SFAS 87 expense is accrued and when the amortization occurs. From that perspective, one might conclude that there is a "time value" associated with that timing difference. That timing difference is illusory because SFAS 87 expense represents a whole series of timing differences associated with the various cashflows involved with managing a pension. The interest component of the SFAS 87 expense is an example of a timing difference that is assigned a time

3 *Id.* at Fox/12.
4 *Id.* at Fox/13.
5 *Id.* at Fox/14.

value of money in computing pension expenses. As I view it, the interest expense is designed to capture the cost associated with the pension obligation becoming nearer in time. By compounding additional interest on the SFAS 87 expenses, NW Natural is basically recalculating the interest component in its pension expense, under the assumption that the SFAS 87 expense amount was equal to the amount included in rates. From that perspective, the incremental interest really represents an incremental pension expense that the utility never incurred. Further, NW Natural's earnings demonstrate that its capital was not impaired due to a timing difference.

Q. DO YOU AGREE WITH STAFF THAT NW NATURAL HAD A "REASONABLE BUSINESS EXPECTATION" FOR RECOVERING EXCESS PENSION EXPENSES?

A. The PBA operated for many years requiring NW Natural to refund the overcollections of pension expenses, but not recover excess pension expenses. Based on the UM 1475 Stipulation, NW Natural had a reasonable business expectation of recovering excess pension expenses, if, and only if, the PBA reversed and became negative. Since it should have been evident within the first year or two of the PBA's operation that the PBA would not reverse, NW Natural should not have had a reasonable business expectation of recovering excess pension expenses.

Q. DID STAFF IDENTIFY NW NATURAL'S LOW LEVEL OF CONTRIBUTIONS RELATIVE TO THE AMOUNTS ASSUMED IN THE UM 1475 STIPULATION?

A. Yes. Staff's analysis, however, did not propose any reductions to the amount recoverable in connection with NW Natural's contribution pattern, other than its adjustment to the accrued interest discussed above. Staff did acknowledge, however, that the amount and timing of NW

Natural's contributions affected the PBA balance, and thus, contributed to the failure of the PBA.[6]

Q. WERE NW NATURAL'S EARNINGS UNREASONABLY LOW IN THE DEFERRAL PERIOD AS A RESULT OF EXCESS PENSION EXPENSES?

A. The earnings test performed by Staff confirms that NW Natural maintained a strong financial position over the term of the UM 1475 stipulation. Accordingly, the excess pension expenses—which were accrued to the PBA but not included in rates—did not impair NW Natural's financial condition, nor did excess pension expenses cause NW Natural's earnings to be unreasonably low. Table 1 details the calculation of NW Natural's actual Type II return on equity ("ROE") over the period 2011 through 2018 (the "Deferral Period"). Column [g] contains the actual Return on Equity ("ROE").

Table 1
Earnings Test - NW Natural Type II Return on Equity 2011 – 2018
Using UM 1475 Stipulation Earnings Test Methodology
In thousands

		[a]	[b]	[c]	[d]	[e]	[f]	[g]	[h]	[i]	[j]
		Type II	Rate		Cost of				Rate Case	RoE Variance	
	Desc	Oper. Inc.	Base	RoR	Debt	Debt %	Equity %	RoE	ROE	%	$
Ln	*Ref.*	*Dkt RG 40*	*Dkt RG 40*	*[a]/[b]*	*Dkt RG 40*	*Dkt RG 40*	*1-[e]*	*([c]-[d]*[e])/[f]*		*[g]-[h]*	*[b]*[f]*[i]*
1	2011	85,936	984,533	8.73%	6.56%	53.28%	46.72%	11.20%	10.20%	1.00%	4,608
2	2012	79,471	981,230	8.10%	6.30%	52.50%	47.50%	10.09%	10.20%	-0.11%	(524)
3	2013	81,709	1,067,102	7.66%	6.09%	54.04%	45.96%	9.50%	9.50%	0.00%	(2)
4	2014	88,364	1,177,346	7.51%	6.03%	52.78%	47.22%	9.15%	9.50%	-0.35%	(1,921)
5	2015	90,064	1,179,938	7.63%	6.11%	50.55%	49.45%	9.19%	9.50%	-0.31%	(1,810)
6	2016	87,717	1,166,769	7.52%	6.13%	48.89%	51.11%	8.85%	9.50%	-0.65%	(3,902)
7	2017	83,686	1,161,763	7.20%	5.41%	50.21%	49.79%	9.01%	9.50%	-0.49%	(2,824)
8	2018	*n/d*	*n/d*	*n/d*	*n/d*	*n/d*	*n/d*	*n/d*	*n/d*	*n/d*	*n/d*
9	*n/d = No data*								Average	-0.13%	(911)
10									Total		(6,375)

6 Staff/1700, Fox/11

The data in Table 1 has been obtained from the annual earnings reports filed in Docket No. RG 40. These are the same ROE values Staff relied upon in its earnings test, although the actual ROE values were not detailed separately in Staff/1701. In addition, Table 1 details the difference between NW Natural's actual ROE and the ROE that had been approved when setting rates in columns [i] and [j]. The accounting data for 2018 is not yet available. Also, there are some immaterial rounding differences between the ROE percentage calculation I have performed and the percentage NW Natural calculated.

Q. DID NW NATURAL EARN A REASONABLE RETURN ON EQUITY IN THE DEFERRAL PERIOD?

A. As demonstrated in Table 1, NW Natural's actual ROE was very near to the ROE value that was used to establish NW Natural's rates. In no year did NW Natural's Type II ROE produce returns that were less than 100 basis points of the ROE approved when setting rates. Further, I note that the ROE used to set rates is not a guarantee of that return; it merely gives NW Natural the "opportunity" to earn that return. Accordingly, I have concluded that NW Natural's earnings were well within a range of reasonableness of the ROE that was approved when setting rates, without the need for any incremental revenues associated with excess pension expenses.

Q. HOW DID NW NATURAL'S ROE COMPARE TO THE ROE APPROVED FOR THE PURPOSE OF SETTING RATES?

A. On average, NW Natural underearned slightly, relative to the ROE used in setting rates. As noted at the bottom of column [i], this underearning equated to just 13 basis points using an arithmetic average. In terms of dollars, the underearning relative to the rate case ROE equated to $911,000 per year, or $6,375,000 over the seven years of data available, both stated on a post-tax basis. Thus, if the earnings test were applied using a threshold based on the ROE used to set rates, only $6,375,000 of the PBA balance would be recoverable from ratepayers.

Q. WHY HAS STAFF REACHED A DIFFERENT CONCLUSION WHILE USING THE SAME EARNINGS DATA?

A. Staff's earnings test can be found in Exhibit Staff/1700. Staff concluded that it is not necessary to make any adjustment to the PBA balance in connection with the earnings test. In reaching this conclusion, Staff relied on the Gas Earnings Threshold as the basis for determining whether NW Natural's earnings were sufficient in the deferral period. The Gas Earnings Threshold is a design element of gas utilities' Purchase Gas Adjustment ("PGA") regulatory mechanisms. The Gas Earnings Threshold requires gas utilities to refund excessive earnings and is set at a level that is materially higher than the ROE that forms the basis for establishing rates in a rate case.

Q. DID THE UM 1475 STIPULATION REQUIRE THE GAS EARNINGS THRESHOLD TO BE USED FOR THE PBA EARNINGS TEST?

A. No. Paragraph 3 of the UM 1475 Stipulation identified the earnings test that was to apply upon amortization of the PBA. The UM 1475 stipulation stated: "NW Natural must remove from the balancing account the amounts that would cause NW Natural to exceed its Commission-authorized return on equity."[7] Thus, the UM 1475 Stipulation required the "authorized return on equity" be used in applying the earnings test. I have found no reference to the higher Gas Earnings Threshold in the record in UM 1475. In contrast, the UM 1475 stipulation went into detail describing how the earnings test would be performed over the multi year deferral period.

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[7] UM 1475 Stipulation ¶ 3

Table 1, above, represents my understanding of that calculation which would only support amortization of $6,375,000.

Q. WHY IS IT NOT APPROPRIATE TO USE THE GAS EARNINGS THRESHOLD IN APPLYING THE EARNINGS TEST TO THE PBA?

A. I reviewed Order 99-272 that established the use of a Gas Earnings Threshold. Based on that order, I see no valid reason for using the Gas Earnings Threshold for the PBA in the same way that it is applied to the context of gas utilities' PGA filings. The Gas Earnings Threshold was an issue to which parties stipulated in UM 903, a docket containing numerous other issues unrelated to the PGA. The Gas Earnings Threshold was just one component of the PGA mechanism, which has numerous design elements. The purpose of the Gas Earnings Threshold was to align the risks and incentives associated with the PGA mechanism. The Gas Earnings Threshold was designed as an incentive for gas utilities to prudently manage their gas costs in years when they are overearning. If the PGA had used an earnings test based on gas utilities' authorized ROE, gas utilities would have no incentive to manage gas costs in years when earnings exceeded the authorized level because any incremental gas cost savings would go directly back to customers. Further, the Gas Earnings Threshold was not designed to determine whether the PGA could be amortized in rates but was rather designed to refund excessive earnings that might be recognized in conjunction with the PGA. The Gas Earnings Threshold was not implemented to deal with the unique circumstances that are present in this case, nor was it designed to supplement the earnings test that must be conducted under ORS 757.259 in the case of amortizing a deferral. Accordingly, I do not believe it is appropriate to use the Gas Earnings Threshold when applying the earnings test to the PBA.

Q. WHAT WOULD NW NATURAL'S EARNINGS HAVE BEEN IF IT IS PROVIDED AMORTIZATION OF EXCESS PENSION EXPENSES?

A. In Table 2, below, I have detailed NW Natural's earnings calculated on a retrospective basis assuming the full amount of recovery NW Natural seeks. Amortizing $79,861,289 now will result in retrospective earnings that are in well in excess of the ROE that was found to be reasonable when setting NW Natural's rates.

Table 2
Calculation of Retrospective Earnings, Including PBA Amortization Revenue

		[a1]	[a2]	[a3]	[a]	[b]	[c]	[d]	[e]	[f]	[g]	[h]	[i]	[j]
		Type II	NWN PBA	Tax On	Retro.	Rate		Cost of				Rate Case	RoE Variance	
	Desc	Oper. Inc.	Amort.	Amort.	Oper. Inc.	Base	RoR	Debt	Debt %	Equity %	RoE	ROE	%	$
Ln	Ref:	Dkt RG 40	NWN/3001 [,z]	[a2]*0.27	[a1]+[a2]+[a3]	Dkt RG 40	[a]/[b]	Dkt RG 40	Dkt RG 40	1-[e]	[c]-[d]*[e])/[f]		[g]-[h]	[b]*[f]*[i]
1	2011	85,936	6,242	(1,685)	90,493	984,533	9.19%	6.56%	53.28%	46.72%	12.19%	10.20%	1.99%	9,164
2	2012	79,471	6,912	(1,866)	84,517	981,230	8.61%	6.30%	52.50%	47.50%	11.17%	10.20%	0.97%	4,522
3	2013	81,709	7,585	(2,048)	87,246	1,067,102	8.18%	6.09%	54.04%	45.96%	10.63%	9.50%	1.13%	5,535
4	2014	88,364	8,258	(2,230)	94,392	1,177,346	8.02%	6.03%	52.78%	47.22%	10.24%	9.50%	0.74%	4,107
5	2015	90,064	8,974	(2,423)	96,615	1,179,938	8.19%	6.11%	50.55%	49.45%	10.31%	9.50%	0.81%	4,741
6	2016	87,717	9,789	(2,643)	94,863	1,166,769	8.13%	6.13%	48.89%	51.11%	10.04%	9.50%	0.54%	3,243
7	2017	83,686	10,587	(2,859)	91,415	1,161,763	7.87%	5.41%	50.21%	49.79%	10.35%	9.50%	0.85%	4,905
9	n/d = No data											Average	1.00%	5,174
10	[z] = Excess pension exp. plus accrued interest											Total		36,218

In Table 2, I added the excess pension expenses and accrued interest, as detailed in NWN/3001, to NW Natural's operating results. I also deducted the incremental taxes that NW Natural would pay if its requested PBA amortization were approved. As shown above, NW Natural's proposed level of PBA amortization result in overearning by 100 basis points on average over the seven-year period. Annually, that overearning equates to $5,174,000 or $36,218,000 on a post-tax basis. On a pre-tax basis (i.e. a revenue requirement basis), that overearning represents $49,613,700 over the seven-year period. It may not be reasonable to retrospectively put NW Natural in a position of overearning now that the PBA has failed, particularly when the failure was due in part to actions undertaken by NW Natural.

Q. DO YOU AGREE WITH STAFF'S POSITION REGARDING THE TERMS OF THE SECOND PARTIAL STIPULATION?

A. Staff's position, with respect to the second partial stipulation, is somewhat unclear. For example, Staff proposes a disallowance on accrued interest and proposes a new adjustment to the gross-up factor that would increase EDFIT amortization. Notwithstanding, Staff provides several pages of testimony where it appears to justify its decision to support the Second Partial Multi-Party Stipulation. While I can not speak for Staff, AWEC certainly did not view the Second Partial Multi-Party Stipulation to be a very reasonable compromise.

Q. DO YOU AGREE WITH STAFF'S PROPOSAL TO APPLY A DIFFERENT GROSS-UP FACTOR TO THE EDFIT AMORTIZATION?

A. No. While I understand the rationale for using a higher gross-up factor, based on previously existing tax rates, I recommend using the gross-up factor NW Natural calculated. The gross-up factor is necessary because NW Natural avoids incremental taxes when it amortizes the excess tax reserves and refunds those amounts to customers.

It is true that if NW Natural had known that the tax rate would decline in 2018 and had never booked the excess reserves to begin with, customer savings associated with the reduced deferred taxes would have been recognized based upon the higher gross-up factor that was in effect prior to the passage of the TCJA.

The refund of excess tax reserves, however, are occurring now and therefore the gross-up factor should be based on the tax rates that are now in effect.

Q. DO YOU AGREE WITH STAFF'S POSITION REGARDING THE RETURN OF $6,700,000 OF EDFIT?

A. No. Staff continues to recommend that the portion of EDFIT, unrelated to gas reserves, be applied as an offset against the PBA. CUB makes a similar recommendation. I disagree. In my Phase II Rebuttal Testimony, I recommended that unprotected EDFIT be handled in a manner that is consistent with the treatment used for Portland General Electric Company. Specifically, I recommended that the outstanding unprotected EDFIT amortization of approximately $6,700,000 due to all customers be included in the Interim Period deferral calculation and spread on an equal percent of margin basis. I also recommended amortizing this amount over two years as a component of the Interim Period deferral, consistent with the treatment for Portland General Electric Company.

To be clear, the unprotected EDFIT amortization that I recommend be spread to all customers on an equal percent of margin basis is the portion of unprotected EDFIT that is not related to gas reserves. I acknowledge that the portion of unprotected EDFIT associated with gas reserves, approximately $14,640,000, is due solely to sales customer and should not be shared with transportation customers.

Also, I recognize it may be reasonable to think about the items of EDFIT separately from the Interim Period deferral. AWEC has proposed to include both the Interim Period ARAM amortization and the entirety of unprotected (other) EDFIT in the Interim Period deferral. One might argue that these items should be viewed separately. It would not necessarily be unreasonable to apply the customer credits associated with EDFIT separately through a series of separate riders. AWEC would not necessarily oppose treating these items separately, although handling EDFIT in conjunction with the Interim Period makes administrative sense, and certainly did so in the case of Portland General Electric Company.

The PBA is unrelated to the impacts of the tax reform, and assigning tax reform dollars to offset the PBA balances presumes ratepayer responsibility for those balances. AWEC has been clear on this point for the entirety of this proceeding. Further, the practical effect of offsetting the balances is that the tax reform balances effectively get the same amortization treatment as the PBA and would be subject to whatever amortization conditions are assigned to the PBA, which are not yet known. For example, if the Commission were to amortize some amount of the PBA balance over a 10-year period, without interest, Staff's proposal to use EDFIT to offset the PBA balance would have the effect of amortizing the EDFIT over a 10-year period, subject to no incremental interest accruals.

I continue to recommend that the Commission evaluate the issues associated with tax reform and the PBA separately.

Q. DOES THIS CONCLUDE YOUR PHASE II CROSS-ANSWERING TESTIMONY?

A. Yes.