

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

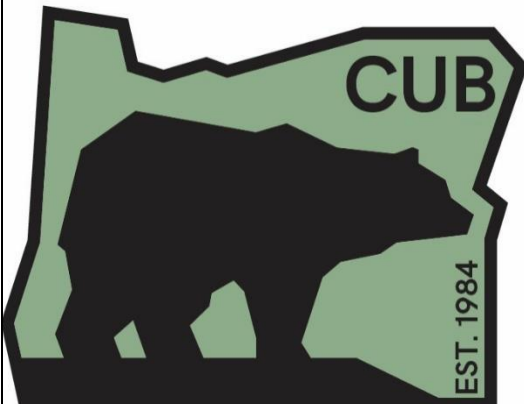
UG 344

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

**PHASE II – CROSS TESTIMONY
OF THE
OREGON CITIZENS’ UTILITY BOARD**

January 4, 2019

Redacted Version



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I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is Bob Jenks. I am the Executive Director of the Oregon Citizens’ Utility Board (CUB). My name is William Gehrke. I am an Economist employed by CUB. Our business address is 610 SW Broadway, Ste. 400 Portland, Oregon 97205.

Q. Please describe your educational background and work experience.

A. Our witness qualification statement is found in exhibit CUB/101.

Q. What is the purpose of your Phase II Cross Testimony?

A. This purpose of this testimony is to respond to Phase II Rebuttal Testimony of the Staff of the Oregon Public Utility Commission (Staff) and the Alliance of Western Energy Consumers (AWEC).

1 **II. RESPONSE TO STAFF’S TESTIMONY**

2 **Q. What is Staff’s position regarding the Pension Balancing Account (PBA)?**

3 **A.** Staff suggested that the Commission allow NWN to recover the entire FAS 87
4 expense included in the PBA account.¹ Staff does not believe that the interest
5 earned on the PBA was beyond NW Natural’s control. Beginning in 2013, the
6 PBA balance began to diverge significantly from the original expectation. Staff
7 believes that the Company must have known early on that its decision to delay the
8 timing of plan contributions would contribute to plan underfunding and
9 subsequently cause an increase in the PBA balance.

10 **Q. Prior to this proceeding, were intervenors able to identify the growth in**
11 **NW Natural’s PBA and discern that the balancing account would be**
12 **unlikely to decline to zero?**

13 **A.** Yes. The Miscellaneous Deferred Account Debits section of NW Natural FERC
14 Form 2 from 2012 to 2017 has been available to intervenors. In 2014, the
15 beginning year balance of the PBA was \$25,713,270. During this year, the
16 Company wrote in testimony “[w]e currently project our pension expense and
17 contributions out 10 years . . . we do not forecast that the balance in the account
18 will go negative. Our forecast shows the balancing account is expected to grow
19 through 2021 before it begins to decrease slightly in 2022. This is largely the result
20 of new legislation, including MAP 21, and, more recently, the Highway and
21 Transportation Act of 2014, which extends the transition of MAP 21 for an
22 additional 5 years.”²

¹ UG 334 – Staff/1700/ Fox/5/Lines 2-3.

² UM 1633 – NWN/ 200/Wilson/3.

1 **Q. Did the Company act in a reasonable manner by not notifying intervenors**
2 **about the growing balance of the PBA?**

3 **A.** No. The Company should have notified intervenors prior to October 3, 2017, as it
4 had knowledge of the problem well before that date. In the time prior to filing UG
5 344, the Company reached out to Staff, AWEC, and CUB about the growing
6 balance of PBA.³ It was during this meeting that CUB became aware of the issue.
7 For several years, the Company was aware of the growing balance of the pension
8 balancing account and that balancing account would be unlikely to reverse as
9 projected. By failing to adequately notify parties, the Company effectively enabled
10 the PBA to grow larger and larger than it otherwise would have been able to had
11 parties been notified and taken action earlier.

12 **Q. What would have intervenors done if notified early about the growing**
13 **balance of the PBA?**

14 **A.** If NW Natural informed UM 1475 parties that the PBA was no longer viable prior
15 to 2017, CUB would have been supportive of ending the balancing account and
16 increasing the amount of FAS 87 expense collected in rates. With early action, the
17 balance of the PBA would not have become out of hand.

18
19 This PBA was a long-term forecast. In UM 1633, CUB learned that actuarial
20 projections are long-term forecasts, not short-term forecasts. As with any forecast,
21 there is a wide range of uncertainty. In prior actuarial pension reports, NW Natural

³ UG 344 – CUB/60X/Gehrke-Jenks.

1 was presented with charts indicating that there is a significant range of uncertainty
2 with future FAS 87 expense.⁴

3 **Q. What is Staff's position regarding the prudence of the PBA balance?**

4 **A.** Staff does not dispute the recovery of FAS 87 expense. Staff does believe that is
5 appropriate for the Commission to disallow some or all of the accumulated interest
6 in the PBA as it is incurred.

7 **Q. What is CUB's position regarding the prudence of the PBA balance?**

8 **A.** CUB believes that Staff's position is reasonable. CUB believes that it is
9 appropriate to consider disallowing some or all of the accumulated interest in the
10 PBA. NW Natural could have avoided substantial growth of the PBA by notifying
11 intervenors sooner. CUB believes it is appropriate for some or all of the
12 accumulated interest in the PBA to be disallowed because the Company could have
13 acted sooner. NWN should not be rewarded for its inaction to the detriment of
14 customers.

15 **III. RESPONSE TO AWEC'S TESTIMONY**

16 **Q. Please summarize AWEC's position on NW Natural's pension**
17 **contributions.**

18 **A.** In UM 1475, the Company stated that it intended on making contributions "█

19 █

20 █

21 █

22 █⁵ AWEC is critical of the Company █

⁴ UG 344 – CUB/502/Gehrke-Jenks.

⁵ UM 1475 – NW Natural/200/Feltz/11/Lines 3-4.

1 [REDACTED] [REDACTED]⁶ AWEC asserts that reduced
2 contribution levels were one of the key reasons that PBA did not reverse, as was
3 initially contemplated.⁷ [REDACTED]

4 [REDACTED]

5 **Q. Is there a relationship between plan contributions and future FAS 87**
6 **expense?**

7 **A.** Yes. There is a relationship between plan contributions and future periodic
8 pension expenses. Lower company contributions to the plan, all things equal,
9 should produce higher future periodic pension expense. Plan contributions are also
10 a tradeoff between present earnings and future earnings. A company can overfund a
11 pension at the expense of present earnings, which has the potential to reduce the
12 need for future pension earnings.

13 **Q. What does AWEC recommend to the Commission regarding underfunding**
14 **of the Company's pension?**

15 **A.** AWEC has recommended that the Commission consider making adjustments to the
16 pension balancing account based on underfunding pension contributions.⁸ AWEC
17 estimates [REDACTED] After applying

18 total interest and foregone returns, AWEC [REDACTED]

19 [REDACTED]

20 **Q. What issues does CUB have with AWEC's adjustment regarding reduced**
21 **contribution levels?**

⁶ UG 344 – AWEC/700/Mullins/20/Lines 9-11.

⁷ UG 344 – AWEC/700/ Mullins/23/Lines 8-9.

⁸ UG 344 – AWEC/ 700/ Mullins/23/Lines 23-24.

1 **A.** CUB believes that it is generally a bad policy for the Commission to rule on the
2 cash contributions to the pension plan. Pensions are an agreement between the
3 employees of the Company and NW Natural. The Commission should not make a
4 prudence determination over the amount of corporate contributions to pensions.
5 Utility contributions are not recognized for ratemaking. Rather, FAS 87 is the
6 standard ratemaking metric used. If the Commission found that the utility
7 underfunded its pension in this case, it is important to think through the
8 consequences.

9
10 To do so, let's walk through an illustrative example. A utility was penalized for
11 making minimum pension contributions. In response, the Company contributes
12 additional funding to its pension. Two years after increasing pension contributions,
13 the pension plan incurs a large market loss. The utility could then complain to its
14 regulators that is not being compensated for actions by the regulator. The utility
15 should be allowed to make its own management decisions with regards to pension
16 contributions. It is impossible for the regulator to accurately predict the returns of
17 pension investments and the impact of pension contributions. Investments are
18 subject to risk, including loss of principal. Therefore, the level of investment in the
19 pension should be a utility management decision. CUB believes that ruling on the
20 prudence of the Company's cash contributions has the potential to harm customers.

21
22 If the Commission is inclined to adopt AWEC's suggestion, CUB recommends that
23 it find that the act of imprudence rated to the PBA, not the management of the

1 pension. Making a minimum contribution should not be viewed as an imprudent
2 action within NWN's role of a pension manager. However, making a minimum
3 contribution could be considered imprudent within NWN's role as a manager of the
4 PBA.

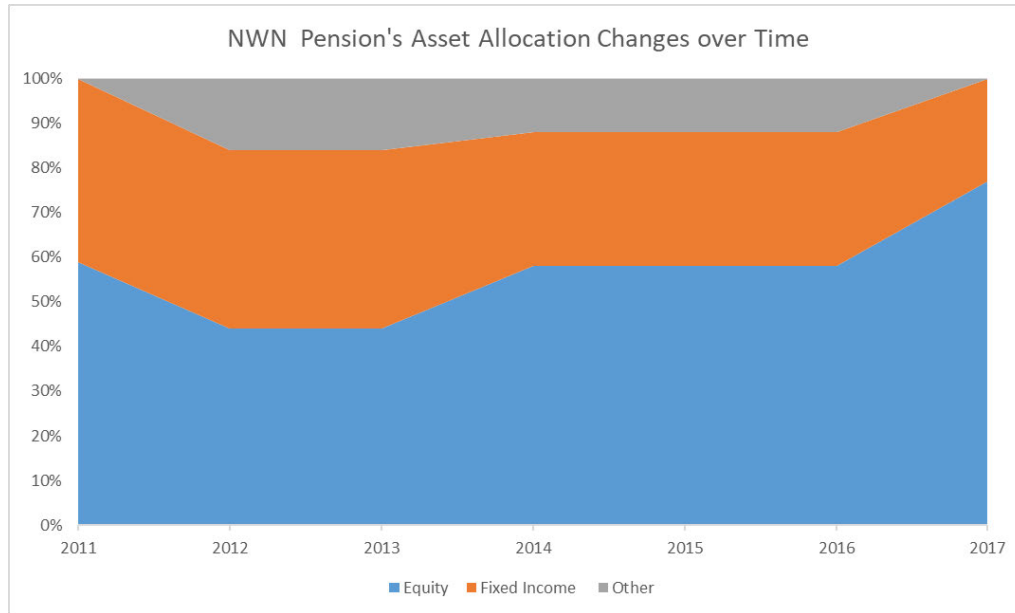
5 **Q. Please summarize AWEC's position on de-risking the pension plan.**

6 **A.** AWEC asserts NW Natural has control over the investment decisions of the
7 pension plan. AWEC believes that NW Natural de-risked the asset allocation over
8 time. Therefore, it should not be allowed to recover any fund accrued due to
9 derisking its pension plan. AWEC provides an estimate of \$12,628,085 as an
10 estimate of the impact of de-risking.⁹

11 **Q. How has NW Natural's Pension asset allocation changed over time?**

12 **A.** The pension's target asset allocation has varied over the past six years. Over the
13 past six years, the Company pension's asset allocation has varied year over year.
14 The stack area chart below visualizes the Company's changes in asset allocation
15 from 2011 to 2017. It appears that NW Natural has actually increased the risk of its
16 pension asset allocation since 2011. Historically, equity assets have a higher
17 returns and risk than fixed income assets such as government or corporate bonds.

⁹ UG 344- AWEC/Mullins/28/Table 5.



1 **Q. How have the expected returns on pensions assets varied for other utilities?**

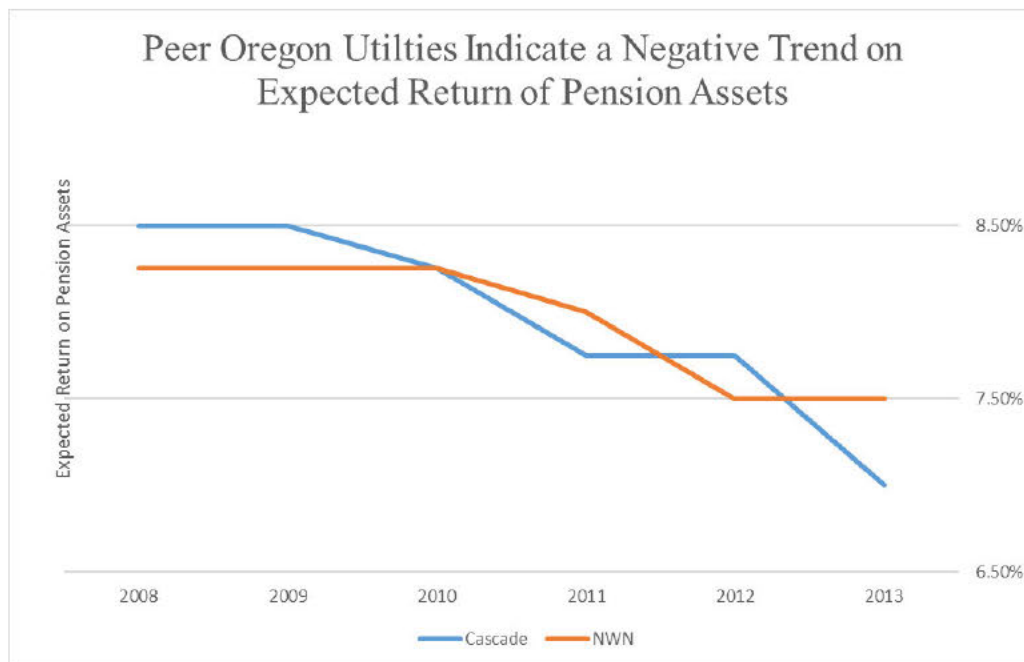
2 **A.** Pension data from UM 1633 show a negative trend on the expected returns on
3 pension assets. Cascade's¹⁰ and NW Natural's¹¹ expected returns on pension data is
4 publically available.¹² The "de-risking" of expected returns of pension assets is not
5 unique to NW Natural. A decline in the expected returns on pensions has been
6 observed in other industries.¹³

¹⁰ UM 1633 – CUB Exhibit 103.

¹¹ UM 1633 – CUB Exhibit 105.

¹² Additional information on other utilities is available at Confidential UM 1633 CUB Exhibits 102,104-108.

¹³ <https://www.newconstructs.com/danger-zone-pension-accounting-expected-returns-on-plan-assets/>.



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2 **Q. What criticism has AWEC levied against NW Natural's handling of the**
3 **balance of the PBA?**

4 **A.** AWEC stated that it was obvious in 2011 that the PBA was not operating as
5 anticipated.¹⁴ [REDACTED]

6 [REDACTED]¹⁵ AWEC has stated that it believes NW Natural
7 was not being reasonable assuming that the account would reverse in rates.

8 **Q. Does CUB agree with AWEC's criticism of NW Natural's handling of the**
9 **PBA?**

10 **A.** Yes. NW Natural should have notified parties prior to 2017 about the growing
11 balance of the PBA. In 2014, the Company stated in testimony that the PBA was
12 unlikely to reverse as expected. From 2014-2017, the Company was aware that
13 the PBA would be unlikely to reverse, but did not notify parties.

¹⁴ UG 344 – AWEC/700/Mullins/18/Lines 3-5.

¹⁵ UG 344 – AWEC/700/Mullins/18/Confidential Table 1

1 **IV. Response to AWEC Tax Issues**

2 **Q. What has AWEC recommended with regards to amortization of the total**
3 **Interim Period deferral calculation?**

4 **A.** In testimony, AWEC recommended that the Commission amortize the Interim
5 Period deferral calculations over a two-year period.

6 **Q. Does CUB agree with AWEC recommendation?**

7 **A.** No. AWEC's recommendation fails to account for rate base associated with NW
8 Natural's gas reserves.

9 **Q. What are NW Natural's gas reserves?**

10 **A.** In 2011, NW Natural entered into a joint venture to acquire gas reserves with
11 Encana Oil & Gas.¹⁶ NW Natural helped to fund the drilling of natural gas fields in
12 Wyoming, in exchange for obtaining a working interest in the reserve in the field.
13 These natural gas reserves only serve NW Natural's core customers. Transport
14 customers do not obtain their gas supply from NW Natural.

15 **Q. What should be done with regards to tax savings items relating to gas**
16 **reserves?**

17 **A.** The tax benefits associated with gas reserves rate base should be returned to the
18 core customers through a separate schedule. At the end of AWEC's Rebuttal
19 Testimony, AWEC appears to not oppose this treatment.¹⁷

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¹⁶ UG 204 – NWN/100/Miller.

¹⁷ UG 344 – AWEC/700/Mullins/35/Lines 14-15.

V. Conclusion

Q. What does CUB recommend regarding the remaining issues in this docket?

A.

- CUB supports NW Natural recovering all of the FAS 87 expense in the PBA. CUB asks the Commission to not make an adjustment for NW Natural's de-risking of the pension assets and on the prudence of NW Natural's cash contributions to the pension.
- CUB supports a Commission decision to remove some or all of the interest accrued in the PBA. CUB believes that the Company did not take adequate action to provide notice to parties about the growing balance of the PBA. With notice to parties, the broken PBA could have been frozen, and customers could have been insulated by the harm incurred through a ballooning PBA and interest accrued.
- CUB believes that using the modified blended treasury rate for 2019 is appropriate for the amortization of the remaining balance of the pension balancing account.
- CUB is supportive of returning the interim tax benefits to customers, with the exception of gas reserves. Gas Reserves were funded solely by Core Customers.

Q. Does this conclude your testimony?

A. Yes.



Mike Goetz <mike@oregoncub.org>

NWN Workshop/Meeting

Walker, Kyle T. <Kyle.Walker@nwnatural.com>

Tue, Oct 3, 2017 at 8:53 AM

To: GORSUCH Lisa <lgorsuc@puc.state.or.us>, "bob@oregoncub.org" <bob@oregoncub.org>, Mike Goetz <mike@oregoncub.org>, Ed Finklea <efinklea@nwigu.org>, tbrooks <tbrooks@cablehuston.com>, "john.crider@state.or.us" <john.crider@state.or.us>

Cc: "Thompson, Mark R." <Mark.Thompson@nwnatural.com>, "Kravitz, Zachary D" <Zachary.Kravitz@nwnatural.com>

All,

NW Natural would like to sit down with you and discuss the current status of our pension balancing account and review possible modifications that may make the mechanism better. In addition, we would like to discuss the change in pension accounting and the approach NW Natural is taking. Ideally, we would like to meet at the end of this month or early November, because some of the options for modification would need to be incorporated into our next rate case, which may be filed late this year. How does the mornings of either Friday October 27th, Wednesday November 1st, or Monday November 6th work? We anticipate needing two hours and can meet in Salem.

Thanks,

Kyle Walker, CPA

Rates/Regulatory Analyst

NW Natural | 503-226-4211 ext. 5858

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