

BEFORE THE PUBLIC UTILITY COMMISSION

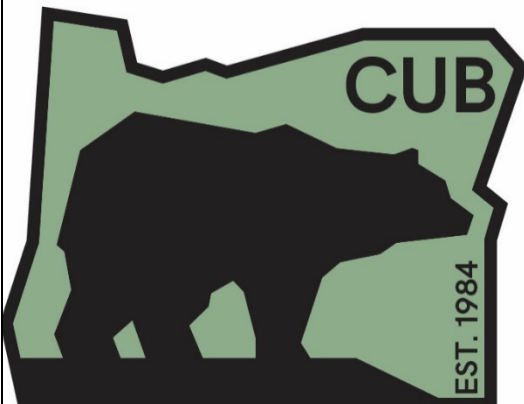
OF OREGON

UG 344

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

**REBUTTAL TESTIMONY
OF THE
OREGON CITIZENS' UTILITY BOARD**

June 20, 2018



**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UG 344

In the Matter of)	
)	
NORTHWEST NATURAL GAS COMPANY,)	REBUTTAL TESTIMONY OF THE
dba, NW NATURAL,)	OREGON CITIZENS' UTILITY
)	BOARD
Request for General Rate Revision)	
)	
)	

I. INTRODUCTION

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

2 A. My name is Bob Jenks. I am the Executive Director of the Oregon Citizens' Utility
3 Board (CUB). My business address is 610 SW Broadway, Ste. 400 Portland,
4 Oregon 97205.

5 **Q. Please describe your educational background and work experience.**

6 A. My witness qualification statement can be found in exhibit CUB/101.

7 **Q. What is the purpose of your testimony?**

8 A. In this testimony, I respond to issues raised by NW Natural (NWN or the
9 Company) in its Reply Testimony filed May 23, 2018, as well as issues raised
10 throughout the proceeding. Specifically, my testimony makes a practical
11 recommendation regarding treatment of the Company's pension balancing account,
12 and it discusses implications on deferred income taxes resulting from the federal
13 Tax Cuts and Jobs Act (TCJA or federal tax reform). CUB's Rebuttal Testimony is
14 organized in the following manner:

- 1 I. Introduction
- 2 II. Pension Balancing Account
- 3 III. Deferred Income Taxes.

II. PENSION BALANCING ACCOUNT

4 **Q. Can you summarize your issue with the Company's pension balancing**
5 **account?**

6 **A.** First and foremost, it is imperative for parties to reach a creative solution leading to
7 the termination of the pension balancing account. CUB's concerns about the
8 account's inability to show any signs of moving toward zero, as well as concerns
9 about future intergenerational equity, have not been alleviated and in fact are
10 shared by the Company.¹ Without the termination of the balancing account, parties
11 are unable to address the underlying issue: the under recovery of FAS 87 costs.
12 Since the inception of the pension balancing account, NWN's FAS 87 expense has
13 consistently remained above the amount in rates every year.² Under the terms of
14 the stipulation reached in the pension balancing account docket (UM 1475), the
15 Company and parties³ are prohibited from increasing the pension expense included
16 in rates in order to reduce growth in the balancing account.⁴

17 However, there is no limitation on increasing FAS 87 expense, once the pension
18 balancing account is terminated. Once the pension balancing account is terminated,
19 FAS 87 expense in rates should be reset to match actual forecasted FAS 87 from

¹ UG 344 – NW Natural/1500/McVay/37.

² UG 344 – CUB/100/Jenks – Gehrke/35.

³ The pension balancing account arose out of a negotiated stipulation between CUB, Commission Staff, and NWIGU in docket UM 1475.

⁴ *In re Northwest Natural Gas Company's Application to Defer Pension Costs*, OPUC Docket No. UM 1475, Joint Brief in Support of Stipulation at 7 (Dec. 13, 2010).

1 that year. The Company most recent actuarial projection of its FAS 87 expense in
2 2019 is \$11.937 million.

3 **Q. Why should the Commission terminate the balancing account?**

4 **A.** As mentioned, the Company's pension balancing account has shown no signs of
5 moving towards zero, and its existence creates an improper incentive for the
6 Company. The Company is incentivized to contribute the minimum cash
7 contributions allowable to the pension fund, in order to maintain a balance in the
8 account. If the Company contributes minimal cash contributions to the retirement
9 plan, then FAS 87 expense increases, which increases the size of the balancing
10 account. The balancing account is considered an asset on NWN's books; the
11 interest on the balancing account is booked as earnings for NW Natural. Since the
12 interest accrues at the Company's regulated rate of return, a balance in the account
13 is akin to the Company earning a return on a ratebased asset.

14 It is patently unfair for customers to continue to pay interest on this account for the
15 benefit of Company shareholders, when the customers themselves do not realize a
16 benefit. It is in the interest of customers, NWN, and its retirees to have a well-
17 funded and healthy pension fund. The pension balancing fund incentivizes NW
18 Natural to minimize cash contributions to its pension. An underfunded pension
19 presents risk to NW Natural and its customers. Removing the pension balancing
20 account will decrease the incentive for the company to provide only minimal cash
21 contributions.

1 **Q. What should be done with the remaining balance in the pension balancing**
2 **account?**

3 A. First, prior to setting rates at the end of this proceeding, CUB recommends
4 applying the deferred tax savings associated with the federal tax reform for the
5 2018 tax period to the balancing account. Since the annual interest on the
6 balancing account is presently \$5 million per year, there is an immediate need to
7 reduce the balance remaining in the balancing account.

8 CUB recommends changing the interest rate to the Company's weighted average
9 discount rate for pensions. Currently, the balancing account accrues interest at
10 NWN's authorized rate of return. The pension balancing account is not a capital
11 investment, and the Company should not benefit from it being treated as such.
12 FAS 87 expense is an expense under an accrual account; it is a future obligation,
13 not an actual cash outlay by the Company. The Company should be compensated
14 for the time value of money, rather than obtaining a return on its investment.
15 Therefore, CUB recommends the Commission adopt the weighted average discount
16 rate for pensions on the remaining balance of the pension balancing account.

17 After applying the deferred taxes to the balancing account, approximately 67
18 million will remain the pension balancing account. CUB does not have a proposal
19 on how to reduce the remaining 67 million. Instead, CUB recommends once the
20 balancing account is terminated, the interest reset, and the deferred taxes applied to
21 the balancing amount, a new proceeding should begin. A new proceeding would

1 allow parties to address what should happen to the amount remaining in the
2 balancing account. While the Company has not provided adequate alternatives in
3 this proceeding to ensure the balancing account be terminated, a solution must be
4 reached. The parties to this proceeding need sufficient time to explore various
5 options, in order to reach an agreement benefiting all.

III. TCJA

6 **Q. What are base rates?**

7 **A.** Base rates are tariffed charges, which are calculated to recover a utility's
8 expenses and rate of return. Base rates are calculated to cover the customer
9 allocated revenue requirement. Base rates are updated in each rate case, to
10 account for increased or decreased expenses incurred since the last rate case.

11 **Q. What is the revenue requirement?**

12 **A.** The revenue requirement represents the total amount of money a utility must
13 collect from ratepayers to cover expenses and provide a reasonable return on
14 investment. On a high level, the revenue requirement model is revenue
15 requirement = operating expenses + (rate base * rate of return).

16 **Q. Why are taxes an issue in this rate case?**

17 **A.** The Tax and Jobs Act of 2017 reduced the corporate income tax rate from
18 35% to 22%. In the revenue requirement model, corporate income tax is tied to
19 two elements of the model: operating expenses and rate base. A reduction in
20 corporate income tax results in a reduction in the expenses needed to operate a
21 utility. The base rates prior to the rate case were set with a tax rate of 35%.

1 Therefore, this rate case must incorporate the lower tax rate, and tax expenses
2 should be reduced. However, adjusting for a lower tax rate is not that simple,
3 because customers prepaid the utility's taxes, in order to provide tax advantages
4 of accelerated depreciation. Tax law allows the utility to depreciate its capital
5 investments very quickly for tax purposes.

6 However, this accelerated depreciation does not affect rates, so customers have
7 been paying taxes that exclude accelerated depreciation. The result is customers
8 prepay taxes associated with capital investments, and the problem in this case is
9 customers prepaid the taxes at a rate of 35%, rather than the actual tax rate of
10 22%. For the test year, this means that in addition to resetting the tax rate from
11 35% to 22%, we must also refund to customers the amount of overpayment of
12 taxes relating to 2018. CUB agrees with AWEC's proposal that credit should be
13 forecasted in base rates, rather than tracked in a deferral.

14 **Q. Why do you prefer a base rate adjustment to a deferral?**

15 **A.** There are two reasons. First, the purpose of ratemaking is to set accurate rates
16 on a going-forward basis. Setting rates at a level that is too high, and relying on a
17 deferral to refund money to customers, should be avoided whenever possible.
18 Second, the Legislature and the Commission have a policy to set taxes in rates
19 based on a forecast, and NWN has not made a compelling case to abandon this
20 policy.

1 **Q. Can you explain the ratemaking issue?**

2 **A.** Yes. The core function of the regulatory process is to set fair and reasonable
3 rates. It uses a forecasted test year in the rate case context as a tool to do this.
4 Once rates are established, the utility is expected to operate its business with these
5 rates. When the utility can no longer earn a reasonable rate of return with the
6 rates set in the last rate case, it can request a new rate case. In this case,
7 customers have already overpaid the taxes associated with the test year. If no
8 adjustment is made, rates will be established at a level greater than justified. This
9 would run counter to the Commission's mandate to establish just and reasonable
10 rates. Because the overpayment of taxes will continue for many years, rates will
11 be higher than necessary for many years.

12 NWN claims customers will be made whole, because the overpayment will be
13 tracked through a deferral and used to benefit customers in the future. Charging
14 customers rates that do not meet a just and reasonable test, and then using an
15 annual deferral process to get back to just and reasonable rates, is an inefficient
16 way to conduct ratemaking. CUB prefers and recommends establishing base rates
17 at the most accurate level possible.

18 **Q. Please describe the current Commission policy with regards to taxes?**

19 **A.** Ratemaking associated with taxes has been controversial in Oregon. When
20 Enron owned PGE, there was a concern PGE customers were paying millions of
21 dollars in forecasted taxes. Parties were concerned Enron was able to avoid nearly

1 all taxes, so little of the tax money charged to PGE customers was finding its way
2 to government entities. In 2005, this led to the legislation of SB 408, which
3 required the Commission to establish annual adjustment clauses, providing an
4 annual credit or surcharge on customers' bills. The adjustment clauses were
5 created to true up the difference between taxes paid to the government and the
6 taxes customers were charged.

7 The utilities generally opposed SB 408, and they did not like the tax true-ups.
8 Having annual tax true-up proceedings for every regulated utility was a burden for
9 the regulatory system. In addition, the true-up created a problem for the utility
10 companies. When a utility had an unprofitable year and earnings were down, its
11 tax payments were also down. Therefore, it would have to refund the
12 overpayment of taxes and thereby exacerbate its under-earning. When utility
13 earnings were above normal, the utility would pay additional taxes, so customers
14 would be surcharged to pay for those additional taxes, thus increasing the utility's
15 over-earning.

16 This led to negotiations over a new tax bill in 2011, SB 967. This law
17 established the policy of taxes being set on a forecasted basis. SB 967 made clear
18 the Commission could consider Enron-like tax loopholes when forecasting rates.
19 In addition, that law requires "fair, just and reasonable" rates to incorporate
20 "expected current and deferred tax balances," "accumulated deferred income
21 taxes", and they must reflect "all known changes to tax and accounting laws."⁵

⁵ ORS 757.269

1 SB 967 reflects the current tax setting policy of the Commission. CUB believes it
2 requires the Commission to use the most accurate forecast of taxes, based on the
3 new tax law and accounting for deferred taxes.

4 **Q. How should the Commission Resolve this issue?**

5 **A.** NWN should be ordered to provide the best estimate it can of the expected
6 actual tax liability for the test year, including the changes in tax law, as well as all
7 elements required under SB 967. Intervenors and Staff should be given a period
8 to review this forecast, and the forecast should be used as the basis for taxes
9 charged to customers.

10 **Q. Does this conclude your testimony?**

11 **A.** Yes.