MRG
McDOWELL RACKNER GIBSON PC
419 SW 11th Ave, Suite 400 | Portland, OR 97205

ALISHA TILL
Direct (503) 290-3628
alisha@mrg-law.com

January 4, 2019

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:

Enclosed for filing in the above-referenced docket is an electronic copy of NW Natural's Phase II Reply Testimony and Exhibits (Brody Wilson NW Natural/3100-3109 and Sean Borgerson NW Natural 3200-3201). The confidential testimony and exhibits will be provided on Huddle per the parties' agreement to waive paper service.

Please contact this office with any questions.

Sincerely,

Alisha Till

Alisha Till
Paralegal

Attachments

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT
Exhibit 3100

January 4, 2018

EXHIBIT 3100 – UG 344 PHASE II

REPLY TESTIMONY OF BRODY WILSON

PENSION BALANCING ACCOUNT

<u>TABLE OF CONTENTS</u>

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q Please state your name and position.

A. My name is Brody Wilson. My position is Vice President, Treasurer, Chief Accounting Officer and Controller at NW Natural Gas Company (NW Natural, or Company)**.**

Q. Have you previously provided testimony in this docket?

A. Yes. I have previously filed testimony in both Phase I and Phase II of this docket. Specifically, I have filed NW Natural/2600, NW Natural-Staff-CUB/200-203 and 300, and NW Natural/2800.

Q. Please summarize your Reply Testimony?

A. In my Reply Testimony, I respond to the testimony filed by Staff of the Public Utility Commission of Oregon (Staff), Citizens' Utility Board of Oregon (CUB), and Alliance of Western Energy Users (AWEC) regarding the appropriate disposition of the amounts booked to NW Natural's pension balancing account (PBA), which was established by the Commission by an all-party stipulation (PBA Stipulation) in UM 1475.

First, I will respond to the testimony of Staff witness, John Fox, and of CUB witnesses Bob Jenks and William Gehrke, as to the reasonableness of the Second Partial Stipulation's treatment of the PBA. It is my understanding based on my review of the testimony that Staff and CUB continue to support the reasonableness of the principal concepts in the Second Partial Stipulation. Specifically, Staff and CUB continue to believe that it is in the interests of customers and the Company to offset the PBA balance with deferred tax savings achieved from the Tax Cuts and Jobs Act (TCJA), and to amortize the remaining balance over a ten-year period, at a reduced interest rate. In addition, these parties continue to agree that an earnings review should not be required prior to the amortization of the PBA balance. As described in my testimony, NW Natural also continues to believe that the principal concepts of the Second Stipulation are fair and

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

reasonable and provide an equitable and durable resolution for NW Natural and its customers.

Second, I respond to Staff's concern regarding the interest accrued on the PBA. Despite its continuing support for the terms of the Second Partial Stipulation, Staff has raised concerns about the fact that in three of the early years of the PBA, the Company made lower contributions to its funds than originally-forecast in UM 1475, due to the passage of federal pension relief legislation. Staff states, without support, that the Company's contribution pattern was a primary driver of the higher FAS 87 expense experienced by the Company, and the resulting failure of the PBA to reverse as expected. Staff relies on this erroneous conclusion to propose that the Commission disallow some portion of the interest that accrued on the PBA.

To address Staff's concerns, NW Natural retained its actuaries, Aon Hewitt (Aon), to conduct a detailed evaluation of the factors impacting the Company's FAS 87 expense over the relevant period. This evaluation shows that, contrary to Staff and AWEC's statements, there were many factors that resulted in a higher-than-expected FAS 87 expense, but the primary factor was the one identified in my Opening Testimony—the decline in discount rates over the relevant period. Other significant factors include the decline in Expected Return on Asset (EROA) during the life of the PBA, as well as the difference between expected returns and actual returns, and revised mortality tables. All of these were due to prevailing market conditions (or demographic data in the case of the mortality rates) that were entirely outside of the Company's control. By contrast, the impact of lower-than-forecast contributions was considerably less significant than assumed by Staff.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Third, I will respond to CUB's proposal that the Commission adopt most of the terms of the Second Stipulation, but with two discrete changes. Specifically, CUB requests that the interest rate during the amortization period for the PBA be lowered to the modified blended treasury rate (MBT). In response, I explain that the interest that the Company accrues on the PBA reflects the Company's actual cost of long-term financing for the PBA, and that absent an agreement to re-enter the Second Stipulation, it is appropriate to continue accruing interest at this rate. CUB also seeks to exclude all pension expense from the PBA associated with employees of NW Natural performing activities for unregulated sectors of our business. In response I explain that the Company has already removed pension expense for employees associated with unregulated activities and that no further adjustment to the PBA is needed to reflect this.

Fourth, I will respond to concerns raised by AWEC witness, Brad Mullins, regarding the impact of the Company's contributions to and management of its pension funds. Like Staff, AWEC erroneously points to the Company's lower-than-expected contributions as the major reason why FAS 87 was higher than UM 1475 projections. However, the Company's analysis performed by our actuaries demonstrates that this argument is simply not true. I also explain why Mr. Mullins' analytical framework is fundamentally flawed, and contains simple errors that when corrected would show that Mr. Mullins' analysis of NW Natural's contributions results in minimal impact to the PBA. In addition, AWEC argues that another factor increasing FAS 87 was the Company's decision to "derisk" its pension plans. This argument is pure supposition and is demonstrably incorrect. In fact, the Company did not derisk its pension plan during the relevant time periods, and in fact took prudent actions to moderately increase the risk profile of its pension plan. AWEC makes several other arguments regarding the balance of the PBA that I will address one-by-one

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

below. In short, my testimony demonstrates that the premises on which Staff and AWEC propose disallowances are incorrect and that the Company should be allowed to recover all amounts in the PBA.

Reasonableness of the Second Partial Stipulation's Treatment of the PBA

Q. Please summarize Staff's Testimony regarding the reasonableness of the Second Partial Stipulation's Treatment of the PBA.

A. Staff's testimony confirms that Staff continues to support the reasonableness of the Second Partial Stipulation. To emphasize this point, Staff has provided additional explanations as to why the Second Partial Stipulation's terms were reasonable—beyond its testimony originally filed in Phase I of this docket. In particular, Staff's Phase II testimony confirms that after reviewing NW Natural's Opening Phase I Testimony and exhibits, as well as the Company's responses to data requests, Staff has not identified any reason to disallow the FAS 87 expense portion of the PBA, and continues to believe that it would be inappropriate to apply an earnings review prior to amortization of the PBA balance. In addition, Staff reiterates the benefits of the Second Partial Stipulation as follows:

- The Second Partial Stipulation ended further additions to the PBA, and set a reasonable amortization period for the balance;
- The Second Partial Stipulation included the negotiation of a lower interest rate which would slow the growth of the account;
- The Second Partial Stipulation provided for an immediate benefit to customers of the Interim Period Tax Benefit and EDIT adjustment by using those savings to offset the PBA balance;

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

- The settlement resolves all issues surrounding the PBA and TCJA and provides stable rates for a period of five years, mitigating the potential rate instability if the issues were to be resolved in separate Commission proceedings;
- The settlement reduces regulatory risk for the Company.

Staff also emphasizes that to arrive at the Second Partial Stipulation, Staff, CUB and NW Natural all made significant concessions that balanced the interests of all parties.[1]

Q. Please summarize CUB's testimony regarding the reasonableness of the Second Partial Stipulation.

A. While CUB does not discuss the reasonableness of the Second Partial Stipulation as a whole, CUB does defend and support most aspects of that agreement. Specifically, CUB's testimony confirms the following:

- CUB continues to support reducing the balance in the PBA through the application of the deferred Interim Period Tax Deferral and EDIT adjustments.[2]
- CUB continues to believe that it was reasonable for the parties to forgo an earnings test prior to amortization of the PBA balance.
- CUB also does not propose a forward earnings review for the amortization of the balancing account. In particular, CUB notes that NW Natural's Site Remediation and Recovery Mechanism and annual purchased gas adjustment already provide for potential earnings sharing between NW Natural and its customers.[3]
- It was reasonable for the parties to forgo a prudence review of the PBA balance prior to amortization. While the Commission theoretically could judge a utility's management of its pension accounts for prudence, in general it should not—

[1] Staff/1700, Fox/31-32.
[2] CUB/500, Gehrke-Jenks/3, 15.
[3] CUB/500, Gehrke-Jenks/13.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

> because to do so would risk creating the wrong incentives. Moreover, the Commission should not find a utility's management of its pension funds imprudent absent fundamental irresponsibility—such as investing almost solely in speculative ventures, or affiliated interests—and CUB has seen no evidence of anything that rose to fundamental imprudence.[4]

Q. Does CUB propose any changes to the terms of the PBA?

A. Yes. While CUB's testimony is primarily supportive of the terms of the Second Partial Stipulation, CUB does propose that the Commission adopt two discrete changes. First, CUB asks that the interest rate on the PBA balance be revised during the amortization period from the effective rate agreed to by the parties of 4.523 percent to the MBT. Second, CUB asks that the balance in the PBA be reduced to reflect the FAS 87 expense associated with NW Natural employees engaged in unregulated activities.[5] I will respond to both of these proposals later in my testimony.

Q. You note that both CUB and Staff continue to agree that an earnings review is not required before the PBA balance can be amortized. What reasons do Staff and CUB provide for their positions.

A. Staff and CUB provide several reasons for this position. First, Staff rejects the notion that it is appropriate to apply an earnings review to the PBA balance based on the nature of FAS 87 expense and the circumstances giving rise to the balancing account. As noted by Staff, FAS 87 expense is a necessary and prudent expense, and the entire rationale for the PBA was that NW Natural should have the opportunity to recover this necessary and prudent expense in rates. Moreover, as explained by Staff:

---

[4] CUB/500, Gehrke-Jenks/7-9.
[5] CUB/500, Gehrke-Jenks/15.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

> The PBA has a complex history. Specifically that there was a [rate case] stay-out provision associated with the $3.7 million FAS 87 expense and establishing the PBA was an attempt to reconcile this restriction with the fact that actual FAS 87 expense exceeded this amount. However, it is reasonable to assume that, had the PBA not been established, the Company would not have waited until 2018 to file a general rate case and the PBA would not have grown to $80 million.
>
> . . . .
>
> Here, the actual FAS 87 expense was not included in rates because of the complex history noted above. Staff does not think an earnings review should preclude NW Natural's recovery of FAS 87 expense in these circumstances.[6]

CUB provides more specific reasons for rejecting the application of an earnings review. CUB reaffirms the fact that the original PBA Stipulation did not apply an earnings test prior to recovery of amounts in the PBA, and given that CUB was a party to that stipulation, it does not support one here.[7] In addition, CUB explains that as part of the Second Partial Stipulation, NW Natural agreed to waive the earnings test on the tax deferral, and observes that "a parallel application of an earnings test to the tax deferral would offset the benefits of an earnings test on the PBA."[8]

---

[6] Staff/1700, Fox/14-15.
[7] CUB/500, Gehrke-Jenks/13. As discussed in more detail below, the earnings review that is referenced in the PBA Stipulation relates to amounts to be amortized after the account has become negative, which has not occurred, and therefore does not apply to present circumstances.
[8] CUB/500, Gehrke-Jenks, 12-13.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. What do you conclude from Staff and CUB's view of the reasonableness of the Second Partial Stipulation?

A. NW Natural concludes that overall, after considering the additional information that NW Natural provided in its Phase II Opening Testimony, Staff continues to support the terms of the Second Partial Stipulation as reasonable, while CUB generally supports the terms of the Second Partial Stipulation, albeit with the changes noted above.

Q. Does NW Natural continue to support the Second Partial Stipulation?

A. Yes. In principle, NW Natural continues to support the terms of the Second Partial Stipulation as a fair and reasonable resolution of the issues that is in the interest of both the Company and its customers. The terms are consistent with the intent of the original PBA Stipulation and Commission precedent by allowing the Company to recover its FAS 87 expense, including the Company's costs to finance the unrecovered balance. In addition, the Second Partial Stipulation reflects a consensus of the stipulating parties, resulting in a resolution of the issues that is fair, balanced, and sustainable.

That said, if the framework of the Second Partial Stipulation were to be adopted today, two updates would need to be made. First, since November 1, 2018, the rate effective date of Phase I of the UG 344, the Company has discontinued booking excess FAS 87 expense to the PBA, but the PBA has continued to accrue interest. Therefore, the amount in the PBA to be amortized has increased. As of February 1, 2019, the PBA balance is projected to be approximately $[redacted]. In addition, we have revised estimates of the benefits associated with the TCJA to be applied to offset the PBA balance prior to amortization. Specifically, the tax benefits to be applied to the PBA would be $6.788 million for the Interim Period Tax Deferral and $6.511 million for the unprotected EDIT Non-Plant adjustment. After these updates are made, the PBA balance to be

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

amortized would be $68 million. If that amount is recovered over the same time period and at the same effective interest rate agreed to in the Second Partial Stipulation, the Company would amortize $8.47 million per year, for the next 10 years.

Q. Has the Company calculated what the impact would be on customer rates, if the Commission were to accept the framework of the Second Partial Stipulation, as applied to the updated PBA balance and TCJA benefit estimates?

A. Yes. Exhibit 3101 shows the rate impact of accepting the Second Partial Stipulation framework, as applied to the updated PBA balance and the TCJA benefit estimates. As shown in Exhibit 3101, the impact for an average residential customer would be an increase to the average monthly bill of rates of 1.11%, or $0.57.

Staff's Concerns Regarding the Prudence of PBA Accrued Interest

Q. Despite Staff's general support for the terms and concepts reflected in the Second Partial Stipulation, Staff registers concerns regarding the prudence of the interest that accrued on the PBA balance. Could you please summarize Staff's concern?

A. Staff notes the fact that in the early years after the PBA was established, NW Natural's contributions to the pension funds were lower than originally forecast due to the pension funding relief provided to employers by MAP-21 and related legislation, which allowed employers to temporarily reduce required contributions. Specifically, as a result of this funding relief, NW Natural's actual contributions were lower than UM 1475 forecasts in 2011, 2013 and 2014. Staff recognizes that contributions in the later years were significantly higher than originally forecast[9], but claims that the balance in the PBA diverged from the original forecast primarily because of the different timing of contributions

[9] Staff/1700, Fox/7-8

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

as compared to the forecast. Staff states that the Company could have acted to address this issue by making higher cash contributions than required[10], which Staff claims would have "increased plan assets and investment returns, thereby reducing FAS 87 expense during the life of the PBA."[11] Alternatively, Staff argues, the Company could have brought the issue to the attention of the other parties.[12] In addition, Staff points out that the method used by NW Natural to calculate interest charges on the PBA is different from the one employed by the Company in making its original projections in UM 1475—which, Staff claims, magnified the impact of excess FAS 87 expense booked to the account.[13] Therefore, Staff argues that, "in the absence of the Second Partial Stipulation" the Commission should disallow the interest incurred after 2013, which it calculates as $19.8 million, as imprudently incurred.[14]

Q. What is your response to Staff's argument regarding the interest on the PBA account?

A. NW Natural disagrees with Staff's concerns and recommendations for the following reasons:

- First, Staff's proposal is based on the flawed premise that the Company's decision to make lower-than-forecast contributions for the early years of the PBA was the primary reason FAS 87 was higher than expected, and that the PBA then failed to reverse. However, this is absolutely not the case. On the contrary, an independent analysis performed by NW Natural's actuaries confirms the Company's initial conclusion expressed in Opening Testimony that the primary driver of the variance

[10] Staff/1700, Fox/10.
[11] Staff/1700, Fox/6-7.
[12] Staff/1700, Fox/10.
[13] Staff/1700, Fox/9.
[14] Staff/1700, Fox/12.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

in FAS 87 expense was the decline in discount rates during the relevant time period. In addition, the difference between the Company's EROA assumptions and actual returns had a very significant impact, as did the decline in EROA assumed on an annual basis. All of these were the result of market conditions, which were outside the Company's control. For this reason there is no basis for Staff's proposal to disallow interest after 2013.

- Second, NW Natural's actions in reducing contributions in the early years of the PBA, as a result of the MAP-21 funding relief, was prudent and in customers' interests. In UM 1475, the Company committed to and complied with paragraph 8 of the PBA Stipulation as follows:

> NW Natural has included in its testimony filed in this case the estimated amount of capital contributions it expects to make to its pension accounts over the next several years. The parties understand that these estimates are based on several assumptions—most notably expected interest rates. Should actual interest rates or other pension results vary from assumed levels, the capital contributions actually required may be higher or lower. The Parties agree that this settlement assumes and the Company expressly agrees that the Company will make whatever capital contributions required to maintain compliance with PPA requirements including avoidance of benefit restrictions. [15]

[15] Docket UM 1475, Order No. 11-051, Appendix A, at 4.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

- Third, Staff's claim that the Company did not notify stakeholders that the PBA was not functioning as expected until 2017 is misleading. In fact, in 2011 NW Natural explicitly informed the parties and the Commission of the funding relief contained in MAP-21, and the fact that it expected to make lower than originally-forecast contributions as a result. In addition, in 2014, the Company filed testimony informing the parties and the Commission as to the impact of that legislation, including its then-current forecast that the PBA would continue to increase through 2021 and would not even begin to decrease until 2022. As a result, Staff's claim that NW Natural should have notified the parties earlier that the PBA was not functioning as intended is unsupportable.
- Fourth, the interest rate booked to the PBA is precisely the rate ordered by the Commission in UM 1475, and therefore Staff's observation that it is different from the methodology used by the Company to forecast the PBA performance is not relevant or meaningful.
- And finally, the interest accrued to-date on the PBA represents the Company's very real costs required to finance this long-term and significant obligation on behalf of customers.

Given the above, Staff's recommendation for a disallowance of a portion of the interest accruing on the PBA should be rejected.

Q. Please explain your statement that the increase in FAS 87 expense and the PBA was not primarily caused by the lower-than-forecast contributions in the early years of the balancing account, but instead was primarily due to variances from expected discount rates and returns.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. In my Phase II Opening Testimony, I addressed the difference between the Company's forecast of FAS 87 expense provided in UM 1475, and the actual FAS 87 expense experienced by the Company from 2011 through 2017. Specifically, I explained that the actual FAS 87 expense experienced by the Company was higher than originally forecast primarily as a result of unexpected declines in the discount rate, as well as decreases in the Company's expected returns on the pension assets. My statements were based on my own simplified analysis using sensitivity studies provided by our actuaries, Aon.[16] Despite my testimony on this point, Staff expressed its belief in its Rebuttal Testimony that the primary driver was actually the lower-than-forecast contributions.[17] To address Staff's concerns, the Company engaged Aon to conduct a more granular analysis to identify more precisely the drivers of the variance between forecast and actual FAS 87 expense. Aon's analysis confirms my initial conclusions that the primary drivers of the variance are the decline in discount rates and returns, and similarly confirms that the Company's lower-than-forecast contributions in the early years had lesser impact overall.

Q. Why did NW Natural engage an outside consultant to perform this more detailed study?

A. As an organization we rely on experts to assist us with our pension plan, both in liability management and asset management. We also rely on expert actuaries to provide us with calculations we use to accurately record our pension obligations. It is very important to acknowledge the complexity of pension plans and the accounting for them, and where necessary, to utilize these experts to provide sound fundamental support.

Q. Please explain Aon's findings in more detail.

[16] NWN/2800, Wilson/15-17.
[17] Staff/1700, Fox/3.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. At our request, Aon performed studies that were designed to isolate the factors that impact FAS 87 expense, which allowed them to determine which factors varied from the original forecast, and to what extent the variance associated with each individual factor impacted the Company's overall FAS 87, from 2011 through 2017, Using this approach, Aon isolated and determined the impact of: (1) the decline in discount rates; (2) the difference between EROA and actual returns; (3) revised mortality tables; (4) declining EROA for the plan; and (5) the lower-than-forecast contribution levels in the early years of the PBA. This analysis generally confirmed the conclusions made in my Opening Testimony.

Q. Please discuss Aon's findings with respect to the impact of the decline in discount rates.

A. Aon confirmed that the primary driver of increased FAS 87 expense was indeed the unexpected decline in discount rates that occurred from 2012 through 2017. In our original forecasts, presented in UM 1475, we reasonably assumed a discount rate for our pension plan of 5.5 percent. However, actual discount rates declined from approximately 6 percent in 2011 to 3.9 percent in 2015. Aon's study shows, at Confidential Exhibit 3102, that this decline in the discount rate drove an increase in FAS 87 expense from 2011 to 2017 of approximately [redacted].

Q. Please describe Aon's findings with respect to the difference between expected and actual returns.

A. Aon also looked at the impact of the variance between the Company's EROA from 2011 to 2017 and the ***actual*** returns for the plans for those years. By way of context, it is important to keep in mind that EROA is an assumption about the returns expected on the plans for any particular year. At the end of the year, the difference between expected and actual returns must be amortized through the FAS 87 calculation over a determined

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

amortization period which ranging from 8.5 to 9.3 years. So over time, actual returns are then reflected in FAS 87 expense. Aon's analysis highlights the fact that in 2011 and 2015 the plan experienced losses rather than the 8.25 percent and 7.5 percent returns it assumed in the EROA. The difference in each of those years acted to increase pension expense in the years following the loss over the amortization period. The impact of these losses, together with the impact of the changes in mortality tables discussed below, which was also amortized through FAS 87, increased FAS 87 expense over the 2011 to 2017 period by [redacted]. This impact is shown in Confidential Exhibit 3103.[18]

Q. Please describe Aon's findings with respect to the impact of changes to the mortality rates.

A. One of the factors driving FAS 87 expense is the assumption made by actuaries as to how long the plan participants will live. For expense determination purposes this assumption is governed by mortality tables published periodically by the Society of Actuaries' (SOA) Retirement Plans Experience Committee. Changes in such tables change underlying assumptions about the life expectancy of participants and thus change the value of the pension's liability. The largest change of such tables during the life of the PBA was reflected in NW Natural's December 31, 2014 valuation of the pension plan in which a $29.0M actuarial loss was recognized in association with the release of Society of Actuaries mortality table RP-2014. In 2014, the SOA published RP-2014 which replaced the previously issued RP-2000 that was published in 2000. Due to the significant time passed between table releases, and the significant change in mortality assumptions over

[18] Exhibit 3103 is a spreadsheet prepared by NW Natural using AON data, and has been validated by Aon.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

those 14 years, there was a large actuarial loss resulting from the use of the new tables.[19] Consistent with the treatment of other actuarial gains and losses (for example, those recognized for the difference between expected return on plan assets and actual returns), such losses are amortized to expense over the average remaining service life of active plan participants (8.5 to 9.3 years). As shown above in Exhibit 3103, when combined with the amortization of gains and losses associated with the difference between EROA and actual returns, the total system-wide impact to FAS 87 expense was [redacted].

Q. Please describe Aon's findings regarding the impact of the decline in EROA for the plan.

A. The Company's original forecast assumed a flat EROA of 8.25 percent. However, as explained in more detail later in my testimony, market conditions were such that the Company was required to reduce this assumption twice during the 8 years, first to 8 percent in 2012 and again to 7.5 percent in 2013. EROA has remained at 7.5 percent in all subsequent years.[20] Aon's study shows that the lower EROA assumed in all plan years from 2013 on increased FAS 87 from 2011 through 2017 by [redacted]. This impact is shown in Confidential Exhibit 3104.

Q. What did Aon's report show with respect to the impact of NW Natural's contributions to the plans?

A. As discussed above, in 2011, 2013 and 2014, NW Natural's contributions to its plan were lower than forecast in UM 1475, but were above forecast for 2012, 2015 and forward. Aon's analysis looked at the overall impact of the variance on the Company's FAS 87

[19] Since 2014, the SOA has published new tables each year on an annual basis, making the impact on each subsequent year much smaller.
[20] Exhibit 3109, discussed infra contains the Company's retirement committee minutes and internal memoranda discussing the reasons for the reduction in EROA.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

expense for the 2011 through 2017 period—which in turn would be reflected in the PBA. In short, Aon found that the impact was to increase FAS 87 expense by approximately $[redacted]. See Confidential Exhibit 3105.

Q. Have you prepared a summary of Aon's analysis of the impacts of each of these factors on NW Natural's FAS 87 expense?

A. Yes. Table A summarizes the impacts of each of these factors on system wide total FAS 87 expense, and then adjusts those numbers to show the Oregon-allocated amount of the O&M portion of FAS 87 expense, which would reflect the impact on the amounts booked to the PBA.

Confidential Table A:

[redacted]

Q. What do you conclude from the Aon studies?

A. Aon's study conclusively demonstrates that contrary to Staff's supposition, the Company's lower-than-forecast contributions in the early years are not the primary driver of the PBA's failure to reverse as originally expected. On the contrary, the primary driver was unexpected declines in interest rates. In addition, decline in EROA, the difference between

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

assumed and actual yields, and revised mortality tables all had a significant impact. All of these were due to factors outside the Company's control.

Q. Have you considered how Staff's specific proposal for a disallowance would be impacted by Aon's analysis?

A. Yes. Staff has assumed that the Company's lower-than-forecast contributions made in the early years of the PBA were the main driver of the PBA's failure to reverse. Based on this erroneous assumption, Staff proposes to disallow all interest on the PBA that accrued after 2013. However, as shown by Aon, the Company's lower-than-forecast contributions were not the main driver of the increase in FAS 87 expense. Rather, of the total variance from forecast of $91.1 million, contributions were responsible for an increase in total FAS 87 by $16 million on a system-wide basis—$9.3 million of which was booked to the PBA. Therefore, assuming for the sake of argument that it were appropriate to disallow the interest accruing on the PBA resulting from NW Natural's contribution pattern, the actual amount of additional interest is $1.8 million, and not the $19.8 million proposed for disallowance by Staff. Thus, if we were to accept Staff's general logic underlying its recommendation—which we do not—the disallowance would be far lower than proposed.[21]

Q. Please explain your statement that NW Natural acted prudently to delay its pension contributions when allowed to do so under MAP-21?

A. At the outset, it is worth observing that employers do typically make the minimum required contributions to their pension accounts—generally in order to preserve liquidity and to minimize borrowing requirements. Additionally, as discussed further below, in UM 1475 the Company committed to maintain our long-standing funding policy of making at least

[21] Confidential Exhibit 3106.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

the minimum required contributions to avoid pension restrictions and this is exactly what the Company did. That said, after MAP-21 was enacted, the ability to reduce pension contributions was particularly important to NW Natural for two reasons. First, during the 2010 through 2013 period, NW Natural was in a net operating loss (NOL) position and as a result, the Company would not have received any cash tax benefit from pension contributions in those years. Second, while the Company had very strong credit ratings during the 2010 through 2017 period, for the rating we hold, certain of our cash flow metrics were close in some years to triggering reviews for downgrade or outlook changes which generally make it challenging to maintain existing credit ratings. In fact, during this period we were downgraded once by Standard and Poors, and Moody's changed their outlook on the Company three times, first in 2012 to negative, back to stable in 2014, and finally back to negative in 2018. Had we been required to make the contributions originally as forecast, we would have had to borrow money to do so, which would have increased our outstanding debt and put additional pressure on our credit metrics during this period of time. This would likely have had a cost to customers in the 2012 rate case due to higher interest rates.

Q. Please explain your statement that NW Natural informed the parties in 2011 of the funding relief provided by MAP-21, and in 2014 provided the parties with an update as to the impact that relief had had on the PBA.

A. First, in August of 2012, NW Natural filed testimony in our general rate case, UG 221, in which we announced that President Obama has signed MAP-21 into law, which reduced the required pension contributions in the near term.[22]

[22] *In the Matter of Nw. Natural Gas Co., Application for a General Rate Revision*, Docket No. UG 221, NW Natural's Surrebuttal Testimony and Exhibits, NWN/3100, Feltz/15.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Then, in September of 2014, I filed testimony in UM 1633 that explained both the status of the PBA at that time, and that the PBA was expected to grow through 2021 due to MAP-21 and related legislation. Specifically, my testimony included the following Q and A:

> **Q. Assuming the Company continues to recover pension expense through FAS 87, and at the same level included in rates today, at what point do you expect a negative balance in the account?**
>
> A. We currently project our pension expense and contributions out 10 years (through 2023); during that project period, we do not forecast that the balance in the account will go negative. Our forecast currently shows the balancing account is expected to grow through 2021 before it begins to decrease slightly in 2022.[23]

My testimony went on to explain the reason that the PBA would not begin decreasing as originally forecast, as follows:

> This is largely the result of new legislation including MAP-21, and more recently the Highway and Transportation of Act of 2014, which extends the transition of MAP-21 for an additional 5 years. Both of these laws allow companies to delay funding of their pension plans, which acts in the short-term to keep pension expense high during the transition. After 2022, we would expect to see a similar trend of decreased expense as a result of increased contributions and thus a continued decrease in the pension balancing account.[24]

While at the time of the UM 1633 testimony, our actuarial reports were still anticipating that the PBA would eventually turn around and get to zero—that testimony establishes

[23] *In the Matter of Pub. Util. Comm'n of Or., Investigation into Treatment of Pension Costs in Util. Rates,* Docket No. UM 1633, NW Natural's Opening Testimony of Brody Wilson, NWN/200, Wilson/3.
[24] Docket No. UM 1633, NWN/200, Wilson/3-4.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

that by 2014 we had clearly informed the parties that the PBA would continue to increase for many years longer than originally anticipated.

Q. When did the Company first have reason to believe that the PBA would not go negative on a reasonable schedule?

A. Up through 2016, the Company was receiving updates from our actuaries that confirmed that FAS 87 would turn negative during the forecast period, and so the Company believed that the PBA would go negative—although on a longer timetable than originally forecast. As described in the testimony of Kevin McVay, in 2017 NW Natural informed the parties about the longer timetable and proposed to increase the level of FAS 87 expense recovered in rates and applied to the PBA to accelerate the timetable by which the PBA turned negative.[25] The resolution of this issue then was incorporated into Phase I of the rate case.

Q. Please respond to Staff's claim that the Company's calculations of interest on the PBA differed from the one presented in UM 1475.

A. This point is not well taken. Staff has pointed out that in NW Natural's original projections filed in UM 1475, the Company applied interest to after-tax cash contributions while the PBA Stipulation simply states "[t]his balancing account will accrue interest at NW Natural's currently authorized rate of return." Staff acknowledges that the parties took a different approach in the Stipulation, but claims that "the result was to magnify the effect of the FAS 87 additions to the account being higher than expected."[26] From NW Natural's point of view this observation provides no support for Staff's position. Staff acknowledges that the Company has calculated interest consistent with the terms of the PBA Stipulation; that

[25] NWN/200, Mcvay/20-21.
[26] Staff/1700, Fox/9.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

agreement was approved by the Commission and therefore NW Natural's actions have been consistent with Commission order. Staff's suggestion that somehow these facts should serve as the basis for a disallowance is without merit.

Q. Are there other reasons why it would be inequitable for the Commission to disallow the interest on the PBA?

A. Yes. Over the past eight years, since the establishment of the PBA, NW Natural has continued to recover from its customers FAS 87 expense far below the level actually experienced by the Company. To this extent, NW Natural has financed the unrecovered amounts. This is a real cost for the Company, and it was recognized as such when the parties entered into the original PBA Stipulation. If the Commission disallows the interest that has accrued on the PBA, NW Natural is deprived of the costs to finance the lack of recovery of FAS 87 expense. This result is directly contrary to the intent of the PBA Stipulation.

CUB's Recommendations to Revise Second Partial Stipulation Terms

Q. You have stated that, while generally supportive of the terms of the Second Partial Stipulation, CUB is requesting two specific changes. Please summarize the requested changes.

A. First, CUB is requesting that the interest rate on the PBA, while in amortization, be reduced to the MBT, and second, CUB advocates that the PBA be reduced by the amount of pension expense earned by NW Natural employees engaged in unregulated activities.

Q. Do you agree that the PBA must be reduced by the amount of pension expense earned by NW Natural employees engaged in unregulated activities?

A. NW Natural agrees that pension expense related to unregulated activities should be removed prior to booking to the PBA, but disagrees with the implication that this has not

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

been done. In fact, the amounts booked to the PBA reflect the Oregon utility O&M portion of pension expense, and are already net of amounts attributable to nonregulated activities and amounts allocable to Washington customers. The reports provided to the parties in response to AWEC DR 67, and an accompanying explanation on this point, are attached as Confidential Exhibit 3107.

Q. Do you agree with CUB's recommendation that the interest rate on the PBA, while in amortization, be reduced to the MBT?

A. No. NW Natural continues to believe that—in the absence of a stipulated resolution—the Company should continue earning its authorized rate of return on the PBA balance. For many years the Company has been required to finance the unrecovered portion of its FAS 87 expense, which has amounted to a very significant sum. The Company has been required to finance the unrecovered expense, like all of its long-term obligations, with a mix of debt and equity. The need to finance these unrecovered FAS 87 amounts will continue into the future, even if the Commission approves amortization in this case. For this reason, it is appropriate that the Company continue to earn its authorized rate of return on the balance. Reducing that amount to the MBT would not be appropriate, because the MBT rate does not reflect the costs of long-term debt and equity financing.

Q. CUB claims that once the PBA balance is approved for amortization, NW Natural is no longer at risk for nonrecovery of the PBA and for this reason reducing the rate to the MBT is proper. What is your response?

A. NW Natural disagrees. The Commission has generally adopted the MBT for amounts approved for amortization over a one-year period. Thus, the lower interest rate reflects the fact that the utility has received approval to recover the amounts and to do so over a relatively short time period—both of which mitigate any significant risk of non-recovery.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

However, in this case, even after the PBA amounts have been approved for amortization, the Company will be required to continue financing the balance over many years. The presence or lack of risk as to eventual recovery does not change the nature of the financing that is required. Therefore, the interest rate should be consistent with expected returns on longer term capital.

AWEC's Position Regarding the PBA

Q. Please summarize AWEC's position in this docket.

A. AWEC's general position starts with the view that neither the PBA Stipulation nor Commission policy give NW Natural the right to recover its excess pension expense in rates, and for that reason, prior to ordering amortization, the Commission needs to dig deeper into the facts surrounding the PBA and NW Natural's actions before allowing amortization. AWEC then proceeds to analyze the facts and circumstances and concludes that it would not be fair or reasonable to allow NW Natural to amortize the balance of the PBA, and that some form of sharing between customers and shareholders is required.

Q. What is AWEC's support for its view that the PBA Stipulation does not give NW Natural the right to recover its excess pension expense in rates?

A. AWEC states that the PBA Stipulation did not give NW Natural the right to amortize the balance in the account until after it had reversed to zero. In particular, AWEC points to paragraph 4 of the PBA Stipulation:

> The balancing account will terminate upon the effective date of the tariffs filed in connection with the first NW Natural general rate case submitted to the Commission after the balance of the FAS 87 pension expense balancing account becomes negative. The

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

> Commission may not request to amortize the balancing account prior to the termination date of the balancing account.[27]

Based on this language, AWEC suggests that the PBA provides no support for a request by NW Natural to amortize the balance in the account.

Q. Do you agree with this reasoning?

A. No. AWEC is taking paragraph 4 of the PBA Stipulation out of context, and attempting to apply it in an unbalanced fashion. Moreover, AWEC takes an unreasonably narrow view of the PBA Stipulation, ignoring the higher-level principles underlying that agreement.

Q. Why do you say that AWEC is taking the PBA Stipulation provision out of context and attempting to apply it in an unbalanced fashion?

A. The quoted provision was intended to govern the disposition of the PBA at the end of its life, *after the balance has gone negative*. The first sentence of the quoted provision states that the PBA will not terminate until the effective date of the tariffs filed in conjunction with NW Natural's first general rate case after the balance goes negative. The second sentence states that the Company may not submit a request to amortize the PBA prior to the termination. This provision contemplates that after the PBA has gone negative, it will have done its job and may be terminated. At that point, the amounts in the account—which may well be negative—may be amortized, and the PBA account closed out.

Here, the parties, including AWEC, explicitly requested and received an early termination of the PBA, prior to the account going negative. Therefore, it is entirely improper for AWEC to insist that amortization is allowed only after the PBA has gone negative.

[27] *In the Matter of Nw. Natural Gas Co., Application to Defer Pension Costs*, Docket No. UM 1475, Order 11-051, Appendix A, at 4.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. Why do you say that AWEC is taking an unreasonably narrow view of the PBA Stipulation as a whole?

A. As discussed in NW Natural's Opening Testimony in Phase II, the overall intent of the PBA Stipulation was to allow NW Natural to recover its FAS 87 expense over time, with interest set at its authorized rate of return. Moreover, as the Company has pointed out—and the fact that AWEC ignores—is that once FAS 87 dropped below the $3.8 million built into base rates, the PBA Stipulation intended that the Company effectively amortize the excess balance by continuing to recover $3.8 million dollars each year. AWEC's insistence that the Company was not allowed to amortize the PBA balance until after the account turned negative is a red herring, and is not helpful in finding a resolution to the situation in which the parties find themselves today.

Q. What is AWEC's support for its view that the Commission precedent does not give NW Natural the right to recover its excess pension expense in rates?

A. AWEC claims that "the general principle historically applied in Oregon is that excess pension expenses are not recoverable through deferrals." In support of this broad statement, AWEC cites Order No. 16-257, issued in UM 1623, which was a deferral application filed by PGE. But this argument is completely off base. NW Natural is not asking the Commission to approve a deferral of its FAS 87 expense, but rather is asking to amortize amounts that built up in a balancing account that was established by stipulation of all parties and approved by the Commission. The Commission's order on a deferral application by PGE is irrelevant.

Q. What are the facts and circumstances surrounding the PBA that AWEC relies on to argue that NW Natural should not be allowed to recover the full amounts in the PBA?

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. AWEC makes two primary arguments in support of its view that the Company should not be allowed to recover the full amounts in the PBA. First, AWEC argues that the Company should not be allowed to recover any portion of the PBA balance that results from the Company's decisions to delay contributions as allowed under the federal pension funding relief legislation; second, AWEC argues that the Company should not be allowed to recover any portion of the PBA balance that results from the Company's decision to "derisk" the plan. In addition, AWEC raises a variety of concerns regarding the Company's handling of the PBA

AWEC's Arguments regarding NW Natural's Contributions to the Pension Plan

Q. Please summarize AWEC's claim that the Company "promised" to make the contributions forecast in UM 1475 and your response.

A. In critiquing the contributions made by the Company after the PBA was established, AWEC refers to the contributions forecast by the Company in UM 1475 as having been "promised"—implying that the Company somehow broke a promise to the Commission when it later reduced contributions consistent with the relief offered under MAP-21. This argument is unsupported and defies the plain language of the agreement made in the PBA Stipulation. In the UM 1475 Stipulation, the parties explicitly contemplated that the forecast contributions were projections only, and that actual contributions might vary. Specifically, paragraph 8 of the PBA Stipulation provides as follows:

> NW Natural has included in its testimony filed in this case the estimated amount of capital contributions it expects to make to its pension accounts over the next several years. The parties understand that these estimates are based on several assumptions—most notably expected interest rates. Should

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

> actual interest rates or other pension results vary from assumed levels, the capital contributions actually required may be higher or lower. The Parties agree that this settlement assumes and the Company expressly agrees that the Company will make whatever capital contributions required to maintain compliance with PPA requirements including avoidance of benefit restrictions. [28]

It is true that at the time they entered the PBA Stipulation, the parties did not anticipate the funding relief contained in MAP-21; however, they did fully understand that the contributions forecast by the Company in testimony in that case reflected minimum contributions based on then-existing conditions, and that actual contributions might vary from forecast as real world conditions change. Importantly, the final sentence in paragraph 8—that the Company would "make whatever contributions required to maintain compliance"—indicates that the parties understood and intended that the Company would make ***minimum required contributions***, under all circumstances. Given this crucial context, AWEC would have clearly understood, once MAP-21 was passed, that NW Natural would accept the relief offered and make the minimum contributions required consistent with the PBA Stipulation's language.

Q. Please summarize AWEC's position regarding the amounts of NW Natural's contributions to the pension plan.

A. AWEC points to the fact that in the first several years of the PBA's life, the Company made contributions lower than originally forecast in UM 1475. Like Staff, AWEC argues that the reduced contribution level in some of the initial years "appears to be one of the key reasons

[28] Docket UM 1475, Order No. 11-051, Appendix A, at 4.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

that the PBA did not reverse."[29] In particular, Mr. Mullins presents an analysis that purports to show that the Company's lower-than-forecast contributions are responsible for an increase to the PBA of approximately [redacted]. Based on these claims, AWEC argues that the Company should not be allowed to recover the balances that resulted from the delay in contributions.[30]

Q. Please respond to AWEC's contribution arguments.

A. My initial response is the same as I made to similar arguments made by Staff. In short, after Congress passed pension relief through MAP-21, the Company acted prudently to make minimum contributions—as it had committed to do in UM 1475 – and the level of the contributions were not the primary driver for the increased FAS 87 expense. Additionally, Mr. Mullins' analysis of the impact of NW Natural's contribution levels is fundamentally flawed. Specifically, Mr. Mullins' approach conflates the concepts of cash-basis contributions and FAS 87 expense. When calculating the time value impact of contributions on the PBA, Mr. Mullins combines the total of the variance between expected and actual cash contributions and FAS 87 expense impact. While contribution variances represent a driver of FAS 87 expense, they do not represent FAS 87 expense in of themselves and this summation is inappropriate. As a result, Mr. Mullins' calculated table overstates the impact of contribution timing.

Moreover, even accepting for the sake of argument that Mr. Mullins' approach is valid, his results are distorted by three obvious errors. When these errors are corrected, Mr. Mullins' analysis suggests that the lower contributions in 2011, 2013 and 2014 had very little impact on the PBA.

[29] AWEC/700, Mullins/23.
[30] AWEC/700, Mullins/21-23.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. Please describe the first error in Mr. Mullins' analysis.

A. In discussing NW Natural's lower-than-forecast contribution levels in the early years of the PBA, Mr. Mullins claims that in 2011, plan contributions, which were originally forecast to be [redacted], were in fact only $[redacted]. Mr. Mullins' calculation mistakenly excludes the [redacted] in contributions made during the calendar year 2011. Specifically, in Confidential Table 2, [redacted]. Confidential Exhibit 3108 confirms that the Company did make contributions totaling [redacted] in calendar year 2011.

Further, Mr. Mullins allows this error to distort the variance calculation made in Table 2. As a result, Table 2 substantially overstates the variance between forecast and actual contributions by calendar year.[31] Interestingly, Mr. Mullins' Confidential Table 3 presents forecast and actual contributions by plan year as well, and in that case, it reverses the error. However, because FAS 87 expense is accounted for on a calendar and not plan year basis, the information in Table 3 in not particularly helpful or relevant to the analysis.

Q. Does Mr. Mullins' mistake as to 2011 calendar year contributions impact his

[31] AWEC/700, Mullins/21.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

subsequent analysis?

A. In Confidential Table 4 AWEC relies on the data from Table 2 to present the variance between forecast and actual contributions for years 2011 through 2018, in order to estimate the impact that variance had on the PBA. Based on that data, Mr. Mullins estimates that the impact of the variance is approximately [redacted]. However, because Mr. Mullins' estimate erroneously assumes that the Company made only [redacted] in contributions in calendar year 2011—instead of the [redacted] actually made—his impact is significantly overstated. For ease of review, Mr. Mullins' Table 4 is reproduced below:

[redacted]

Q. Please describe Mr. Mullin's second and third errors.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. The second error relates to the estimated return on asset (EROA). The third error involves the calculation of interest.

Q. Please explain the error related to EROA.

A. Table 4 includes an assumed an estimated return on asset, or EROA, of 8.25 percent, continuously, from 2011 through 2018. (The EROA is shown in the fourth column erroneously titled "Interest Rate"). As discussed below, the actual EROA during that time frame decreased from 8.25 percent in 2011, to 8.0 percent in 2012, to 7.50 percent from 2013 through 2018. The decrease in EROA reflects broad market conditions prevailing at the time, and should be incorporated into any attempt to isolate and measure the impact of lower contributions in the early years of the PBA.

Q. Please explain the error related to the calculation of interest.

A. The calculation of interest presented in the sixth column of Table 4 (labelled Accumulated Interest) incorrectly double-counts the impact of lower contributions in earlier years. AWEC calculates interest by multiplying "Total Variance (the sum of Cumulative Variance and Accumulated Interest) by the EROA rate. However, FAS 87 expense would be impacted each year by the Cumulative Variance of Contributions. In other words, a more accurate calculation would only multiply "Cumulative Variance" by the EROA rate for the year.

Q. Have you prepared tables correcting each of Mr. Mullins' errors?

A. Yes. I have prepared three confidential tables, correcting Mr. Mullins' errors, in a cumulative fashion. The first, Table B, is identical to Mr. Mullins Table 4, except that it corrects the variance in the first year—2011—to reflect the actual contributions made by the Company. As can be seen below, that simple correction dramatically decreases the

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

impact of NW Natural's delayed contributions, from [redacted] to approximately [redacted]

Table B:

[redacted]

Q. Why does this simple correction so dramatically decrease the estimated impact of the delayed contributions?

A. Because Mr. Mullins' error was made to the first year of his analysis the impact of the error compounds over all of the years making it more significant. After substantially underestimating the actual contributions made by the Company in 2011, he compounded his error by calculating interest on the incorrect variance from 2011 to 2018. Once I corrected the contribution value for 2011, the amount of cumulative interest was reduced, substantially decreasing the total estimated impact.

Q. What was the result of correcting both the contribution variance and the EROA?

A. Table C corrects both the contribution level for 2011, and the EROA percentage. These corrections further reduce the impact of the delayed contributions from [redacted] to [redacted]

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Table C:

[redacted]

Q. What was the result of correcting all three errors?

A. Table D reflects the result of correcting all three errors—the contribution level for 2011, the EROA percentage, and the interest calculation. These corrections taken together reduce the impact of delayed contributions to approximately [redacted]

Table D:

[redacted]

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. What do you conclude from your corrections to Mr. Mullins' estimate of the impact of NW Natural's delayed contributions to the pension funds?

A. At the outset, I need to emphasize that NW Natural does not necessarily agree that Mr. Mullins' analysis is the best approach for estimating the impact on the PBA of the delay in contributions that NW Natural made consistent with MAP-21. Instead, we believe that the more granular and precise analysis prepared by Aon provides the Commission with superior information. That said, assuming for the sake of argument that Mr. Mullins' approach is valid, the specific errors he has made have caused him to vastly overestimate the impact of the delayed contributions. In fact, when all three of the errors noted above are corrected, the impact of the delayed contributions is almost completely offset by the much larger contributions made in the out years—resulting in a variance of less than [redacted].

AWEC's Arguments re Derisking Pension Plans

Q. Please summarize AWEC's argument that NW Natural made a decision to "derisk" the portfolio, which increased amounts booked to the PBA.

A. AWEC points out that in UM 1475, NW Natural assumed an investment yield for pension plans of 8.25 percent, while beginning in 2013, the investment yield that was assumed in calculating actual pension expenses was generally around 7.50 percent. Based on this change in assumed investment yields, Mr. Mullins speculates that NW Natural made a decision to "derisk" the pension plan portfolio, which Mr. Mullins claims resulted in an increase to the PBA balance of approximately [redacted]. Mr. Mullins claims that NW Natural controls the investment yield because it controls the investment portfolio[32], and

[32] AWEC/700, Mullins/26, 28.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

questions whether the Company should be allowed to recover the impact of changes to the investment yield.[33]

Q. How do you respond to this argument?

A. This argument has no merit. The reduction in the investment yield assumption from 8.25 percent to 7.50 percent was not the result of a decision by NW Natural to "derisk" the portfolio. On the contrary, the reduction in the yield assumption—which is also referred to as the expected return on asset, or EROA—was made based on a lower outlook in returns across asset classes, driven by broader market trends, including low inflation and lower treasury rates. This fact is reflected in the 2013, 2014 and 2015 memos, attached as Confidential Exhibit 3109, which explain the Company's analysis of the appropriate EROA for the Company to utilize in the upcoming years' FAS 87 expense calculation.

Q. Did the Company make any changes to the risk profile of its pension funds in this general time frame?

A. [redacted]. Plan assets can be viewed as either return-seeking (higher risk) or liability driven investing (LDI—lower risk). [redacted], [redacted] These changes are reflected in the Retirement Committee meeting minutes, attached as Exhibit 3109.

Q. Putting aside that the Company did not derisk its pension portfolios in the relevant time period, how does the Company respond to Mr. Mullins' Table 5 which estimates the impact of the lower investment yield assumption?

[33] AWEC/700, Mullin/28.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. NW Natural believes that Mr. Mullins has overestimated the impact of the change in EROA assumptions. As calculated by Aon, that number should be a total of [redacted] on a system-wide, total FAS 87 expense basis, as opposed to the $[redacted] calculated by Mr. Mullins.

AWEC's Additional Concerns

Q. What additional concerns does AWEC raise regarding the PBA?

A. In addition to the arguments noted above, AWEC raises the following concerns:

- The Company has failed to demonstrate that the failure of the PBA was due to factors outside of its control, and that the Company "destroyed" information that might have allowed it to so do[34];
- AWEC states that it has been unable to reconcile the PBA financial balance with the balances that were presented in NW Natural's Supplemental Phase II Testimony, and that NW Natural should have tested the balance in the PBA for impairment;[35]
- The Company's PBA balance reflects a double-counting of interest expenses;
- The Company should have but did not satisfy the Commission's rules for deferred accounting. In particular, AWEC claims that NW Natural failed to request annual reauthorization to defer excess FAS 87 expense, and must agree to apply an earnings test prior to amortization of the PBA, as required for deferrals.

None of these concerns are legitimate.

[34] AWEC/700, Mullins/3.
[35] AWEC/700, Mullins/7-8.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. How do you respond to AWEC's argument that the Company had an incentive to delay contributions, as allowed by MAP-21, to "avoid the cashflow implications" while at the same time increasing "revenue accruals through the PBA"?[36]

A. AWEC is correct that the Company chose to reduce planned contributions in order to ease the cashflow requirements of making very large contributions. The Company rejects the implication, however, that the Company was incented to allow the balance in the PBA to grow, in order to collect larger amounts in the future, and AWEC has provided no evidence to support the claim that NW Natural acted with this intent.

Q. Please respond to AWEC's claim that the Company has been unable to show that the failure of the PBA was due to factors outside of the Company's control.[37]

A. At the outset, NW Natural rejects the notion that it has the burden to demonstrate that the failure of the PBA was "beyond the Company's control." Rather, NW Natural's obligation is to demonstrate that it acted prudently given the relevant circumstances—which it has shown that it did. However, the analysis provided in this case demonstrates clearly that it was the lower discount rates and expected return on assets that resulted in the increased FAS 87 expense and the increase to the PBA—not the delayed contributions. Given this fact, it is clear that the failure of the PBA to turn around as initially forecast was in fact out of the control of the Company.

Q. Please respond to AWEC's claim that the documentation necessary to make a determination in this case was destroyed in connection with NW Natural's documentation policy.

[36] AWEC/700, Mullins/23.
[37] AWEC/700, Mullins/3.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. While we make every effort to retain support for all of our calculations, the forecasts provided were derived by our third-party actuaries and the amounts are hard coded in excel when sent to us. These third parties have proprietary software that they use to make these calculations and they are not provided to the Company. We typically hold meetings with the actuaries each year to understand the results, but are never provided the proprietary software that makes the calculations.

Q. Please respond to AWEC's claim that it has been unable to reconcile the PBA financial balance as of September 30, 2018 with the balances that were presented in NW Natural's Opening Testimony in Phase II.

A. In making this point, AWEC points to the regulatory asset of $72,291,000 appearing in footnote 2 of NW Natural's third quarter 10-Q filed with the Securities and Exchange Commission. As noted, this balance differs from the balance presented in NW Natural's Opening Testimony.[38] As the Company explained in detail in responses to data requests served by both Staff and AWEC, this difference arises from SEC reporting requirements which require the Company to reflect and record regulatory assets differently than required for reporting to the OPUC. However, as demonstrated in the Company's responses to data requests, when these reporting requirements are taken into account, the amounts shown in the SEC filings, and those presented in the Company's testimony in this docket, tie precisely.[39]

Q. Please summarize AWEC's claim that NW Natural's calculation method of pension expenses double-counts interest.

[38] AWEC/700, Mullins/7.
[39] *See*, NW Natural Response to Staff Data Request 421, and NW Natural Response to AWEC Data Request 67, attached as Exhibit 3108.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. Mr. Mullins claims that because FAS 87 already compensates for the time value of money through the interest on liability component, it is double-counting for the Company to earn interest on the PBA balance.[40] Mr. Mullins notes that the primary objective of the capitalization method of pension accounting is to determine the change in the present value of the pension benefit obligation, and that when moving from one period to another, a portion of the change in the present value of the pension obligation can be attributed to interest. For this reason, Mr. Mullins reasons that the interest rate component of FAS 87 expense already compensates the Company for the time value of money.[41]

Q. Is Mr. Mullins correct?

A. No. Mr. Mullins is mixing apples and oranges. The FAS 87 component labelled "Interest Costs" represents the time value of the Company's gross PBO liability as the costs (recorded at present value) move forward in time. This is not representative of a rate of return for NW Natural, but rather is a recognition of expense incurred over time as expected payouts get a year closer. On the other hand, the interest accrued on the PBA represents a granted rate of return to compensate the Company for financing the under-collection of FAS 87 in rates. Thus, the Interest Cost component of FAS 87 does nothing to compensate the Company for financing the unrecovered FAS 87 expense and is irrelevant to its right to continue to recover its legitimate costs to finance the unrecovered PBA balance.

Q. With that context in mind, how do you respond to Mr. Mullins' Table 6, which purports to represent the total amount of interest recovered through the PBA?

[40] AWEC/700, Mullins/29.
[41] AWEC/700, Mullins/30.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. As noted above this analysis is completely inappropriate and mixes two different interest calculations. The interest accruing on the balancing account is in no way related to interest recognized in FAS 87 expense representing the present value calculation of our pension liability.

Q. Please respond to AWEC's claim that the Company did not satisfy the rules for deferred accounting.

A. This argument is a red herring. As AWEC is well aware, the PBA was agreed to by the parties, and approved by the Commission, not as a deferral, but a balancing account. As such, the PBA was ordered under the Commission's general jurisdiction, and not pursuant to ORS 757.259. For this reason, ORS requirements, both for annual reauthorization and earnings reviews, are not required or relevant to the Commission's inquiry in this case.

Q. Does this conclude your testimony?

A. Yes.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

Exhibit 3101

January 4, 2019

NW Natural **NW Natural Gas Company**
Rates & Regulatory Affa **UG 344 - Phase I I Proposal**
UG 344: Phase I I
Effects on Average Bill by Rate Schedule [1]
ALL VOLUMES IN THERMS

1			PROPOSED Rates								BILL IMPACTS							
2			11/1/2018	UG 344	UG 344	UG 344	UG 344	Total			Rate Case	Rate Case	Average	Average	Average	Change in	Change in	
3			Billing	Base Rate	PBA Amort.	Gas Reserves EDIT	Protected EDIT	Billing	Customer		Annual	End of Period	Monthly	Monthly Bill at	Monthly Bill at	Average	Average	Therms in
4			Rates	Adjustment	Adjustment	Adjustment	Adjustment	Rates [1]	Charge		Volumes (therms)	Customers	Use Per Customer	Current Rates [1]	Proposed Rates [1]	Monthly Bill $'s	Monthly Bill %	Block
5								**F = A+B+C+D+E**										
6	Schedule	Block	**A**	**B**	**C**	**D**	**E**	**F**	**E**		**G**	**H**	**I**	**J**	**K**	**L**	**M**	**N**
7	2R		$0.81780	$0.00175	$0.01529	-$0.00100	-$0.00541	$0.82843	$8.00		385,050,429	606,831	53	$51.34	$51.91	$0.57	1.11%	N/A
8	3C Firm Sales		$0.77606	$0.00124	$0.01072	-$0.00100	-$0.00380	$0.78322	$15.00		166,461,516	58,617	237	$198.93	$200.62	$1.69	0.85%	N/A
9	3I Firm Sales		$0.75175	$0.00106	$0.00914	-$0.00100	-$0.00324	$0.75771	$15.00		4,874,416	355	1,144	$875.00	$881.82	$6.82	0.78%	N/A
10	27 Dry Out		$0.70565	$0.00135	$0.01171	-$0.00100	-$0.00415	$0.71356	$6.00		1,197,618	1,962	51	$41.99	$42.39	$0.40	0.95%	N/A
11	31C Firm Sales	Block 1	$0.51544	$0.00099	$0.00854	-$0.00100	-$0.00302	$0.52095	$325.00		12,784,484	740	2,859	$1,780.75	$1,796.02	$15.27	0.86%	Block 1
12		Block 2	$0.49461	$0.00091	$0.00780	-$0.00100	-$0.00276	$0.49956			12,605,537							Block 2
13	31C Firm Trans	Block 1	$0.20915	$0.00097	$0.00858	$0.00000	-$0.00304	$0.21566	$575.00		1,523,968	74	3,938	$1,363.96	$1,388.51	$24.55	1.80%	Block 1
14		Block 2	$0.19126	$0.00089	$0.00784	$0.00000	-$0.00278	$0.19721			1,972,618							Block 2
15	31I Firm Sales	Block 1	$0.45816	$0.00071	$0.00600	-$0.00100	-$0.00213	$0.46174	$325.00		4,299,679	217	5,380	$2,728.35	$2,746.12	$17.77	0.65%	Block 1
16		Block 2	$0.43995	$0.00064	$0.00542	-$0.00100	-$0.00192	$0.44309			9,710,862							Block 2
17	31I Firm Trans	Block 1	$0.18617	$0.00077	$0.00682	$0.00000	-$0.00242	$0.19134	$575.00		91,578	5	6,059	$1,630.43	$1,659.81	$29.38	1.80%	Block 1
18		Block 2	$0.16829	$0.00070	$0.00617	$0.00000	-$0.00218	$0.17298			271,990							Block 2
19	32C Firm Sales	Block 1	$0.38728	$0.00070	$0.00503	-$0.00100	-$0.00178	$0.39023	$675.00		28,058,173	433	7,524	$3,588.89	$3,611.09	$22.20	0.62%	Block 1
20		Block 2	$0.36951	$0.00059	$0.00428	-$0.00100	-$0.00152	$0.37186			9,518,066							Block 2
21		Block 3	$0.33997	$0.00042	$0.00302	-$0.00100	-$0.00107	$0.34134			1,350,403							Block 3
22		Block 4	$0.31037	$0.00024	$0.00176	-$0.00100	-$0.00062	$0.31075			166,168							Block 4
23		Block 5	$0.28916	$0.00000	$0.00087	-$0.00100	-$0.00031	$0.28872			0							Block 5
24		Block 6	$0.27893	$0.00000	$0.00043	-$0.00100	-$0.00015	$0.27821			0							Block 6
25	32I Firm Sales	Block 1	$0.38086	$0.00051	$0.00365	-$0.00100	-$0.00129	$0.38273	$675.00		5,409,612	62	18,579	$7,607.21	$7,638.18	$30.97	0.41%	Block 1
26		Block 2	$0.36410	$0.00043	$0.00310	-$0.00100	-$0.00110	$0.36553			5,816,515							Block 2
27		Block 3	$0.33615	$0.00030	$0.00219	-$0.00100	-$0.00078	$0.33686			2,020,748							Block 3
28		Block 4	$0.30825	$0.00018	$0.00128	-$0.00100	-$0.00045	$0.30826			576,257							Block 4
29		Block 5	$0.28911	$0.00000	$0.00065	-$0.00100	-$0.00023	$0.28853			0							Block 5
30		Block 6	$0.27897	$0.00000	$0.00033	-$0.00100	-$0.00012	$0.27818			0							Block 6
31	32 Firm Trans	Block 1	$0.10999	$0.00046	$0.00358	$0.00000	-$0.00127	$0.11276	$925.00		14,881,729	178	43,409	$4,781.50	$4,878.66	$97.16	2.03%	Block 1
32		Block 2	$0.09350	$0.00039	$0.00305	$0.00000	-$0.00108	$0.09586			16,126,373							Block 2
33		Block 3	$0.06612	$0.00027	$0.00215	$0.00000	-$0.00076	$0.06778			10,000,748							Block 3
34		Block 4	$0.03868	$0.00016	$0.00125	$0.00000	-$0.00044	$0.03965			20,036,765							Block 4
35		Block 5	$0.02220	$0.00009	$0.00072	$0.00000	-$0.00025	$0.02276			25,892,025							Block 5
36		Block 6	$0.01127	$0.00005	$0.00036	$0.00000	-$0.00013	$0.01155			5,784,825							Block 6
37	32C Interr Sales	Block 1	$0.38637	$0.00042	$0.00339	-$0.00100	-$0.00120	$0.38798	$675.00		5,114,441	58	33,806	$13,229.13	$13,271.57	$42.44	0.32%	Block 1
38		Block 2	$0.36954	$0.00035	$0.00288	-$0.00100	-$0.00102	$0.37075			6,268,233							Block 2
39		Block 3	$0.34147	$0.00025	$0.00203	-$0.00100	-$0.00072	$0.34203			3,312,192							Block 3
40		Block 4	$0.31341	$0.00015	$0.00119	-$0.00100	-$0.00042	$0.31333			6,448,719							Block 4
41		Block 5	$0.29656	$0.00008	$0.00068	-$0.00100	-$0.00024	$0.29608			2,385,488							Block 5
42		Block 6	$0.28423	$0.00000	$0.00031	-$0.00100	-$0.00011	$0.28343			0							Block 6
43	32I Interr Sales	Block 1	$0.38620	$0.00041	$0.00338	-$0.00100	-$0.00120	$0.38779	$675.00		6,003,909	68	33,849	$13,240.04	$13,282.10	$42.06	0.32%	Block 1
44		Block 2	$0.36944	$0.00035	$0.00287	-$0.00100	-$0.00102	$0.37064			7,358,360							Block 2
45		Block 3	$0.34145	$0.00025	$0.00203	-$0.00100	-$0.00072	$0.34201			3,888,225							Block 3
46		Block 4	$0.31348	$0.00014	$0.00118	-$0.00100	-$0.00042	$0.31338			7,570,236							Block 4
47		Block 5	$0.29668	$0.00008	$0.00068	-$0.00100	-$0.00024	$0.29620			2,800,356							Block 5
48		Block 6	$0.28441	$0.00000	$0.00031	-$0.00100	-$0.00011	$0.28361			0							Block 6
49	32 Interr Trans	Block 1	$0.10798	$0.00034	$0.00297	$0.00000	-$0.00105	$0.11024	$925.00		7,385,146	85	193,105	$9,873.89	$10,060.29	$186.40	1.89%	Block 1
50		Block 2	$0.09182	$0.00029	$0.00252	$0.00000	-$0.00089	$0.09374			12,638,632							Block 2
51		Block 3	$0.06490	$0.00020	$0.00178	$0.00000	-$0.00063	$0.06625			9,591,680							Block 3
52		Block 4	$0.03795	$0.00012	$0.00104	$0.00000	-$0.00037	$0.03874			30,167,941							Block 4
53		Block 5	$0.02180	$0.00007	$0.00059	$0.00000	-$0.00021	$0.02225			53,015,711							Block 5
54		Block 6	$0.01103	$0.00003	$0.00030	$0.00000	-$0.00011	$0.01125			84,168,292							Block 6
55	33		$0.00578	$0.00000	$0.00018	$0.00000	-$0.00006	$0.00590	$38,000		994,600,661	669,684						N/A
56																		
57	**Totals**																	

[1] Due to demand optionality for large customers, demand is not included in the billing rates and average bill for Schedules 31 and 32.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3102

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES' AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3103

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES' AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3104

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES' AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3105

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES’ AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3106

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES' AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3107

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES' AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3108

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES’ AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

CONFIDENTIAL
Exhibit 3109

January 4, 2019

THIS EXHIBIT IS CONFIDENTIAL AND WILL BE PROVIDED SEPARATELY PURSUANT TO MODIFIED PROTECTIVE ORDER NO. 18-002. THE DOCUMENT WILL BE PROVIDED ON HUDDLE PER THE PARTIES’ AGREEMENT TO WAIVE PAPER SERVICE.

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Sean Borgerson

FEDERAL INCOME TAX REFORM

Exhibit 3200

January 4, 2019

EXHIBIT 3200 – UG 344 PHASE II

REPLY TESTIMONY OF SEAN BORGERSON

FEDERAL INCOME TAX REFORM

TABLE OF CONTENTS

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

I. INTRODUCTION AND SUMMARY

Q. Please state your name and position with Northwest Natural Gas Company (NW Natural or Company).

A. My name is Sean Borgerson. I am currently the Tax Director for NW Natural.

Q. Have you previously provided testimony in this docket?

A. Yes. I previously provided testimony in Phase I of this docket, which included NW Natural/2500, NW Natural-Staff-CUB/200-203 and 300. I also provided testimony in Phase II of this proceeding, NW Natural/2900-2913.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the testimony filed by Staff of the Public Utility Commission of Oregon (Staff), the Oregon Citizens' Utility Board (CUB) and the Alliance of Western Energy Consumers (AWEC) regarding the appropriate treatment of the benefits resulting from the Tax Cuts and Jobs Act (TCJA), and to explain and support the Company's proposed treatment of those benefits.

Q. Please summarize your testimony.

A. In my testimony, I first review the regulatory framework through which the benefits from the TCJA should be evaluated and discuss the deferral accounting protocols that apply based on Oregon law and the policy of the Public Utility Commission of Oregon (Commission). Next, I contend that all parties are generally in agreement regarding the calculation of the benefit amounts resulting from the TCJA. I then review and respond to the parties' proposals regarding regulatory treatment of the TCJA benefit amounts. Specifically, I respond to Staff's claim that an earnings review should not apply to the remeasurement of the excess deferred income tax resulting from the TCJA. As dictated by Oregon law and Oregon Commission policy, an earnings review is required prior to

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

amortization of a deferral. I will also explain why the Commission should reject AWEC's recommendation that all benefits associated with the TCJA should be returned to customers through a rate credit, and explain why the Commission should instead adopt CUB's proposal that certain benefits of the TCJA should be applied to reduce the pension balancing account (PBA) balance. Using the benefits of tax reform to pay down the PBA will balance customers' interest in seeing an immediate benefit from tax reform with the Company's interest in managing its cash flow and credit ratings. Finally, I summarize and support the Company's proposed regulatory treatment of the TCJA benefit amounts.

II. REGULATORY EVALUATION OF TCJA BENEFITS

Q. What is the appropriate regulatory framework for evaluation of the Company's deferral of TCJA benefits?

A. At its very core, the appropriate treatment of the TCJA benefits requires the Commission to evaluate and apply the statutes and administrative rules governing deferrals under ORS 757.259.

Q. What were the TCJA benefits that the Company deferred in calendar year 2017?

A. In calendar year 2017, NW Natural deferred $144.3 million to reflect the remeasurement of the Company's existing deferred income tax balances using the new corporate income tax rate of 21 percent as provided for by the TCJA. The remeasurement of deferred income taxes was a 2017 event, and was not a retroactive change to prior years. We refer to these balances as Excess Deferred Income Taxes or EDIT benefit. This benefit is comprised of the following balances:

- $128.407 million – The "Plant" deferred tax remeasurement benefit experienced by NW Natural in December of 2017 upon enactment of the TCJA;[1]

[1] NW Natural/2907 Borgerson/1; Staff/1702, Fox/1, Line 5, Column J (pre-gross up).

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

- $5.127 million – The "Non-Plant" deferred tax remeasurement benefit experienced by NW Natural in December of 2017 upon enactment of the TCJA;[2]
- $10.767 million - The "Non-Plant Gas Reserves" deferred tax remeasurement benefit experienced by NW Natural in December of 2017 upon enactment of the TCJA.[3]

Q. What were the TCJA benefits that the Company deferred in calendar year 2018?

A. As a result of the lower federal corporate income tax rate of 21 percent provided for by the TCJA, NW Natural's income tax expense was lower beginning January 1, 2018 than it otherwise would have been. In calendar year 2018, NW Natural deferred $4.991 million to reflect a reduction in the Company's regulatory income tax expense for Oregon during the period January 1, 2018 through October 31, 2018.[4] We refer to the 10-month time period between January 1, 2018 through October 31, 2018 as the Interim Period, and the benefit deferred during this period as the Interim Period Deferral. Beginning November 1, 2018, NW Natural's Oregon rates were reset in this proceeding to reflect the lower 21 percent tax rate, thereby eliminating any ongoing benefit.

Q. Has NW Natural amortized any of the deferral balances from 2017 or 2018?

A. No. Amortization of the amounts the Company has deferred is only allowed as authorized by the Commission. The 2017 EDIT benefit of $144.3 million and the 2018 Interim Period Deferral of $4.911 million continue to be deferred.

Q. What would be the normal course of action for these regulatory deferrals?

A. Under Oregon law and Commission policy, the Commission evaluates deferred amounts for prudency and then performs an earnings review for the period(s) during which the

[2] NW Natural/2908, Borgerson/1; Staff/1702, Fox/1, Line 5, Column K (pre-gross up).
[3] NW Natural/2908, Borgerson/1; Staff/1702, Fox/1, Line 5, Column L (pre-gross up).
[4] NW Natural/2901, Borgerson/1, Line 18; AWEC/700, Mullins/32, Line 21.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

deferrals took place.[5] As Staff has previously explained, "the results of an earnings review determines the utility's "ability to absorb a deferred cost or its need to retain deferred revenues."[6] After performing the prudency and earnings reviews, the Commission may then evaluate any excess or remaining balances for amortization.

Q. What are the deferral periods in this case for which earnings reviews should take place?

A. The Commission performs an earnings review for the period in which the deferral occurred.[7] In this case, the appropriate time period for earnings review is calendar year 2017 for the EDIT deferral and calendar year 2018 for the Interim Period Deferral.

Q. What would be the results of an earnings review for the EDIT deferral period (calendar year 2017) and the Interim Period Deferral (calendar year 2018)?

A. With respect to the 2017 earnings review of the EDIT deferral, Staff previously indicated in response to an AWEC data request that NW Natural earned $9.555 million below its Oregon earnings threshold in 2017.[8] This earnings review would result in a $9.555 million reduction of the 2017 EDIT deferral of $144.3 million, leaving approximately $134.8 million available for future amortization.[9]

---

[5] ORS 757.259(5); OAR 860-027-0300(9); *In the Matter of the Util. Reform Project and Ken Lewis, Application for Deferred Accounting*, Docket No. UM 1224, Order No. 09-316 at 7 (Aug. 8, 2009) ("ORS 757.259 requires the Commission to consider the Company's earnings when determining whether a deferred account should be amortized into rates."), *aff'd Util. Reform Project v. PUC of Or.,* 261 Or App 388 (Sept. 12, 2012); *In the Matter of Idaho Power Co., Request for General Rate Revision*, Docket No. UE 233, Order No. 13-416 (Nov. 12, 2013) (the Commission determined that Idaho Power's income tax refund benefit deferral was subject to an earnings test).
[6] Order No. 09-316 at 8, *citing* Letter from T. Ray Lambeth to Anne Eakin, Pacific Power & Light Co., et al., pp. 1-2 (Mar. 25, 1992).
[7] Order No. 09-316 at 14-15; OAR 860-027-0300(9) (directing that the utility will provide the Commission with its financial results for a 12-month period or for multiple 12-month periods to allow the Commission to perform an earnings review, and that the period selected for the earnings review will encompass all or part of the period during which the deferral took place).
[8] NW Natural/2909.
[9] NW Natural/2906, Line 8.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

With respect to a 2018 earnings review of the Interim Period Deferral, NW Natural's calendar year 2018 regulatory Oregon earnings results are not yet available. These results would normally be filed with the Commission on or about May 1, 2019. If we assume that the 2018 regulatory earnings results will be similar to 2017, this would result in a reduction of the Interim Period Deferral of $4.911 million to zero, leaving no balance available for future amortization.

Q. Are there any additional factors the Commission should consider before ordering the amortization of the remaining EDIT deferral balances after application of the earnings review?

A. Yes. The Commission should take into account the following factors when ordering the amortization of the EDIT deferral balances:

- The amortization of EDIT (Plant) is subject to normalization requirements, which set a limit on how quickly EDIT should be returned to customers. In my testimony in Phase I of this proceeding, I described this as a "speed limit" for return of plant-related EDIT.[10]
- There are no normalization restrictions on the timing of amortization of Non-Plant related EDIT balances.
- The deferral for general EDIT (Non-Plant Other) relates to all customer classes. As a result, the only rate design consideration would be returning this benefit in a way that would benefit all customers.
- There are rate design considerations that should be considered before the provision of benefits associated with EDIT (Non-Plant Gas Reserves) to customers is determined. Specifically, these benefits should be provided to the customers that have paid for gas reserves in their rates, namely sales customers.
- All of these EDIT deferral balances are currently reducing rate base in this proceeding. Any amortization of these EDIT balances should consider the corresponding increase in rate base and related revenue requirement.

[10] NW Natural/2500, Borgerson/21-22.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. What are the Commission's options for returning the EDIT benefits to customers?

A. There are a number of ways that NW Natural could return the benefits of the EDIT to customers. The methods—which are not mutually exclusive and could be used in combination—include: customer billing credits, application to an outstanding regulatory asset, or application to new or existing capital projects. In evaluating these options, the Company asks that the Commission give due consideration to the impact on NW Natural's operating cash flows. [11] The remeasurement of existing deferred income tax balances that created the EDIT deferral in 2017 did not generate cash. As a result, any amortization of EDIT in the form of customer billing credits will need to be funded from either current operating cash flows or will need to be financed.

III. CALCULATION OF TCJA BENEFITS

Q. Please summarize the TJCA benefit amounts using the Company's calculations from your Phase II Opening Testimony.

A. The TCJA benefit deferral amounts, ***before*** any gross up or application of an earnings review, are as follows:

- Interim Period Deferral amount - $4.991 million;[12]
- Remeasured EDIT amounts:
    - EDIT (Plant) - $128.407 million;[13]

[11] NW Natural/2900, Borgerson/10-11, n.22 ("Moody's Investors Service, in January of 2018, issued a credit rating downgrade warning with respect to NW Natural and twenty three other rate regulated utilities. The credit downgrade watch is a direct outcome of federal income tax reform and includes forecasts of more challenging cash flows. Using a combination of options to benefit customers, which considers the relative cash flow impacts of each, would be appropriate in an effort to help reduce downgrade risk and the resulting potential for higher financing costs.")

[12] NW Natural/2901; AWEC/700, Mullins/32, Line 21.

[13] NW Natural/2907, Borgerson/1; Staff/1702, Fox/1, Line 5, Column J.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

- EDIT (Non-Plant Other) - $5.127 million;[14] and
- EDIT (Non-Plant Gas Reserves) – $10.767 million.[15]

Q. At this point in the proceeding, is there any significant disagreement among the parties regarding the calculation of TCJA benefit amounts?

A. No, there is no significant disagreement regarding the calculation of the actual amounts of the TCJA benefits. AWEC notes that it remains concerned with the method used by NW Natural to calculate the Interim Period amount—the “with and without” method, but indicates that it recently signed on to a stipulation in the Portland General Electric rate case, Docket UE 335, which used the “with and without” method, and would agree to use that method in this case provided that additional amounts of EDIT (both Plant and Non-Plant Other) are also returned to customers through a rate credit (not PBA application) on an accelerated basis.[16] Additionally, Staff had a few minor adjustments or clarifications regarding the appropriate gross-up factor and regarding the amortization schedule for plant-related EDIT. In sum, while there are a few points that require clarification or a slight adjustment, fundamentally there is no significant disagreement among the parties regarding the Company’s calculation of the TCJA benefits amounts.

Q. Do all parties agree on the precise amount of the TCJA benefits?

A. No. While all parties are in agreement regarding the methods for calculating the TCJA benefits, AWEC and Staff have presented different proposals for the benefit amount because these parties have taken different approaches as to how the TCJA benefits from 2017 and 2018 should be grouped and amortized, and whether an earnings review applies

[14] NW Natural/2908, Borgerson/1; Staff/1702, Fox/1, Line 5, Column K.
[15] NW Natural/2900, Borgerson/17; *see also* NW Natural/2906; Confidential NW Natural/2908; Staff/1702, Fox/1, Line 5, Column L.
[16] AWEC/700, Mullins/33-34.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

to those amounts. I will address these issues later in my testimony in the discussion regarding the parties' proposals for regulatory treatment of the TCJA benefits. In this section of my testimony, I will address Staff's proposed adjustment to the gross up factor for revenue sensitive taxes and Staff's comments regarding the amortization schedule for plant-related EDIT.

Q. What issues did Staff raise regarding the calculation of EDIT?

A. Staff recommended adjusting the gross up factor applied to the value of EDIT benefits from 1.36 to 1.41 (rounded), and Staff also indicated that it was uncertain about the ARAM amortization presented in my Phase II Opening Testimony.

Q. Please explain Staff's proposed adjustment regarding the gross up factor.

A. Staff recommends using a gross up or net to gross factor of 1.41 rather than the 1.36 gross up factor NW Natural used for determining the value the EDIT benefits.[17] Staff proposed this adjustment to reflect the net to gross factor used for the tax calculations underlying the tariffs placed into effect November 1, 2018, in compliance with Commission Order No. 18-419 in this case.[18] The net to gross factor of 1.41 includes revenue sensitive costs that are variable and included in the revenue requirement in the rate case.[19] Staff notes that because the EDIT benefits will provide a dollar for dollar offset to rate making tax expense before gross up, using a gross up factor of 1.36 to value the EDIT benefits instead of the actual 1.41 "will cause an additional benefit for the Company to the detriment of customers."[20]

[17] Staff/1700, Fox/19.
[18] Staff/1700, Fox/19.
[19] Staff/1700, Fox/19.
[20] Staff/1700, Fox/19.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. Do you agree with Staff's recommendation regarding the gross up factor?

A. Partly. If an amount is amortized as a customer billing credit, the gross up would include an amount for income taxes and revenue sensitive taxes. The easiest way to determine the applicable gross up is to apply the standard revenue requirement model. Staff's Reply testimony correctly indicated that the combined gross up factor for income taxes and revenue sensitive taxes is 1.41.[21]

However, if an amount is applied to recovery of a regulatory asset, such as the Pension Balancing Account (PBA), it would include a gross up only for income taxes and not revenue sensitive taxes. The gross up including revenue sensitive taxes applies only when amortization occurs through revenues in the form of a rate credit. Applying the TCJA deferrals to recovery of the PBA saves customers the revenue sensitive taxes they would incur if the PBA was recovered through rates, so ultimately the difference in gross up is a net neutral to customers. As indicated in my Opening Testimony in Phase II of this docket, the gross up factor for this regulatory treatment is 1.36.[22]

Q. Please summarize Staff's description of its uncertainty regarding the ARAM amortization amount.

A. Staff noted that "the reduction in annual ARAM amortization presented in the Company's exhibit NW Natural/2910 appears to be based on a flat 6.79 percent reduction across all five years," and that "Staff is unsure if the flat 6.79 percent reduction is an appropriate approximation for how these separate calculations would aggregate for a reduced EDIT amount."[23]

[21] Staff/1700, Fox/19, Line 7.
[22] NW Natural/2905.
[23] Staff/1700, Fox/20.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. Please explain the reduction to the annual ARAM amortization

A. The difference in the annual ARAM amortization between the Second Partial Stipulation and the currently proposed ARAM amortization by NW Natural—the 6.79 percent reduction about which Staff expressed uncertainty—is only a reflection of the application of the 2017 earnings review, reducing the total EDIT benefit deferral to be amortized by $9.555 million (or approximately 6.79%). Exhibit NW Natural/2910, Borgerson/1 presents the annual ARAM amortization both before and after the application of the 2017 earnings review.

IV. PARTIES' PROPOSED REGULATORY TREATMENT OF TCJA BENEFITS

Overview of Parties' Positions

Q. Please summarize the other parties' positions regarding regulatory treatment for the TCJA benefits.

A. I will summarize each party's recommendations regarding regulatory treatment for the benefits of the TCJA:

- ***Staff.*** Staff does not make a comprehensive proposal with respect to application of TCJA benefits, and instead presents a range of potential options.[24] Additionally, Staff stated that it opposes application of an earnings review to the remeasured EDIT.[25]
  - *Interim Period.* Staff noted that the Commission has wide discretion, and potential options include a base rate reduction, separate tariff rider, or offset against the outstanding PBA balance.[26] Staff also suggested that a certain amount of the other EDIT (Plant) could also be allocable to the Interim Period, and, without making a specific proposal, indicated there could be a total of $10 million of benefits for the Interim Period [27]
  - *Return of EDIT (Plant).* Staff stated that the EDIT (Plant) could be returned at a flat rate over five years, or the Commission could reject this approach and

[24] Staff/1700, Fox/20.
[25] Staff/1700, Fox/15-16.
[26] Staff/1700, Fox/21.
[27] Staff/1700, Fox/21-22.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

adopt the actual annual ARAM amounts which would start approximately 25 percent less in year one escalating to 26 percent more in year five.[28]

- *Return of EDIT (Non-Plant Other).* Staff stated that the Commission could use the EDIT (Non-Plant Other) as an offset against PBA balance, or return it to customers immediately or over some other time frame.[29]

- *Return of EDIT (Non-Plant Gas Reserves).* Staff noted that although the EDIT (Non-Plant Gas Reserves) amount was originally earmarked for return to sales customers in the Second Partial Stipulation and Company's Phase II testimony, the Commission could instead return this amount to all customers or use it as an offset to the PBA balance.[30]

- *Rate Base Adjustment for EDIT Return.* Staff suggested that the Commission could include a rate base adjustment for the return of EDIT or could wait to adjust rate base until the Company's next rate case.[31]

- ***CUB.*** CUB noted that as part of the Second Stipulation, the Company agreed to forgo application of an earnings review for the TCJA deferrals[32] but acknowledged that an earnings review applies. CUB recommends that the Interim Period amount and EDIT amounts should be applied to offset the PBA balance.[33]

- ***AWEC.*** AWEC's proposal for the Interim Period (AWEC's Interim Amount) groups together the $6.788 million Interim Period Deferral amount with proposed amortization of 10 months of EDIT (Plant) in the amount of $2.7 million, as well as amortization of unprotected EDIT (Non-Plant Other) in the amount of $6.7 million, for a total of $16.2 million. AWEC's Interim Amount does not reflect application of an earnings review. AWEC recommends amortization of this amount over two years on an equal percentage of margin basis.[34] AWEC does not oppose the Company's proposal to return the EDIT Non-Plant Gas Reserves amount to sales customers.[35]

I will address each of the issues raised by the parties in turn.

Earnings Review for Remeasured EDIT and Interim Period EDIT

Q. Do you agree with Staff that an earnings review should not be applied to the remeasured EDIT?

[28] Staff/1700, Fox/22.
[29] Staff/1700, Fox/23-24.
[30] Staff/1700, Fox/23.
[31] Staff/1700, Fox/24.
[32] CUB/500, Gehrke-Jenks/12-13.
[33] CUB/500, Gehrke-Jenks/3, 15.
[34] AWEC/700, Mullins/4, 34-35.
[35] AWEC/700, Mullins/35.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

A. No. As I explained in my Phase II Opening Testimony, the Company agreed to forgo an earnings review for the remeasured EDIT as a part of an overall compromise in the Second Partial Stipulation. In the absence of the Second Partial Stipulation or some other agreement in which the Company would voluntarily waive an earnings review, an earnings review is not only appropriate, it is required by Oregon law and Commission policy.

Q. Did Staff explain why they believe an earnings review should not be applied?

A. Staff stated that the Company's proposed application of a 2017 earnings review to the remeasured EDIT is improper because the EDIT revaluation is akin to a tax refund instantly due and payable when the TCJA was signed into law, and these amounts have nothing to do with the Company's 2017 results of operations.[36] Additionally, Staff stated that the Company's proposal would effectively subject the return of EDIT to an earnings review twice: once when the remeasured accumulated deferred income tax (ADIT) revaluation occurred, and again when the resulting EDIT amounts are amortized into ratemaking tax expense.[37]

Q. Do you agree with Staff's reasoning for not applying an earnings review?

A. No. As a matter of law, NW Natural believes that an earnings review is required before amortization of the tax benefits is determined, and the Company will address this issue in briefing. However, as a practical matter, we reject Staff's arguments that the TCJA benefits are akin to a tax refund. As previously discussed in this testimony, the EDIT benefit did not generate any immediate cash. The EDIT benefit recorded is a financial recognition that the Company's deferred tax obligation to the U.S. government has been permanently reduced as of the enactment of the TCJA in December of 2017.[38]

[36] Staff/1700, Fox/15.
[37] Staff/1700, Fox/15-16.
[38] NW Natural/2900, Borgerson/11-14.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Second, Staff's argument that the 2017 EDIT benefit deferred had nothing to do with the Company's 2017 results of operations is simply incorrect. The Oregon deferral rule provides that that "Deferred Accounting" may be used by gas utilities for "a current expense or revenue associated with current service, as allowed by ORS 757.259."[39] The change in EDIT reflected a change in the Company's expense, which occurred in 2017, and accordingly, the Company's 2017 results of operations are relevant to consideration of the 2017 EDIT benefits. Moreover, if Staff is correct that the EDIT benefit is not associated with the Company's 2017 results of operations, then arguably the EDIT benefit would not qualify for deferral and NW Natural should have retained the benefit in 2017.

Third, Staff's assertion that the EDIT benefit deferral could be subject to an earnings review twice – once in 2017, and then again in the future when it is amortized – is plainly mistaken. An earnings review applies to the "period during which the deferral took place" and it occurs before amortization is authorized.[40] An earnings review does not apply again in subsequent periods after amortization of the deferred amount has been authorized.

Q. Did NW Natural previously agree to waive the application of an earnings review to the TCJA benefits?

A. Yes—but only in the context of the Second Partial Stipulation, and waiver of the earnings review in that context was a material concession by the Company. CUB noted in their reply testimony that the Stipulating Parties had agreed to waive application of an earnings review to both the PBA and the tax deferrals as part of a comprehensive settlement agreement.[41] In the event that parties are able to reach a global resolution of the PBA

[39] OAR 860-027-0300(1)(b)(A).
[40] ORS 757.259(5); OAR 860-027-0300(9); Order No. 09-316.
[41] CUB/500, Gehrke-Jenks/12.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

and tax issues through settlement in Phase II of this proceeding, the Company may be willing to waive earnings review for the tax deferrals. However, in the absence of a comprehensive settlement, NW Natural does not agree to voluntarily waive the earnings review on the tax deferrals.

Q. Did parties address the Company's proposal to perform an earnings review for the Interim Period Deferral?

A. Not specifically. However, consistent with my Opening Testimony in Phase II, and as previously discussed in this Reply Testimony, Oregon law and Commission policy require that an earnings review should be applied to the Interim Period Deferral amount.[42]

Grouping TCJA Benefits from Different Periods

Q. Please explain AWEC's proposal for the Interim Period Deferral (AWEC's Interim Amount).

A. AWEC's Interim Period Amount includes all of the various TCJA benefits (ignoring earnings review) that could be amortized to proportionally benefit industrial customers as billing credits right now. AWEC's Interim Amount includes—in addition to the $6.788 million Interim Period Deferral calculated by NW Natural with income tax gross up of 1.36—a proposal to amortize 10 months of EDIT (Plant) in the amount of $2.7 million, as well as unprotected EDIT (Non-Plant Other) in the amount of $6.7 million, both of which also reflect an income tax gross up of 1.36. By including these amounts, AWEC asserts that the total Interim Period amount should be $16,207,166.[43]

[42] NW Natural/2900, Borgerson/10-11.
[43] AWEC/700, Mullins/4.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

Q. Does NW Natural agree with AWEC's approach regarding of each of these discrete benefits?

A. No. NW Natural finds this presentation to be confusing and counterproductive. Grouping amounts from different periods—2017 and 2018—does not allow for consideration of the applicable period for earnings review. The EDIT benefits occurred in 2017 and the actual Interim Period Deferral occurred in 2018. As a result, these items have different deferral periods and are subject to separate earnings reviews before determination of their amortization.

Q. Did Staff also propose grouping together benefits from different periods for the Interim Period Deferral?

A. Yes, and while Staff did not propose a specific amount for the Interim Period, Staff noted that a certain amount of the other EDIT (Plant) could also be allocable to the ten months for the Interim Period, suggesting there could be a total of $10 million of benefits for the Interim Period.[44] Staff's proposal suffers from the same problems as AWEC's Interim Period Amount, because it inappropriately combines TCJA benefits from two distinct periods—2018 Interim Period Deferral and 2017 EDIT (Plant)—even though a separate earnings review would need to performed for each type of benefit.

Adjustment to AWEC's Interim Period Amount

Q. AWEC's Interim Amount does not reflect application of an earnings review. Have you made adjustments to AWEC's Interim Amount to reflect application of an earnings review?

A. Yes, and this adjustment is shown in my exhibit NW Natural/3201. As previously noted in this testimony, it is likely that the application of a 2018 calendar year earnings review

[44] Staff/1700, Fox/21-22.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

would eliminate the entire 2018 Interim Period Deferral of $4.991 million (before gross up). As presented in NW Natural/2906, the application of 2017 earnings review to the EDIT deferral would result in $6.511 million of EDIT Non-Plant Other after gross up.[45] As presented in NW Natural/2910, the EDIT Plant ARAM amortization, after application of 2017 earnings review, would reduce the 2018 annual Oregon ARAM amortization to $2,294,591[46] with gross up, of which 10/12ths would be $1.912 million. As a result, using AWEC's proposal which combines all of these items, but also including the anticipated outcome from an earnings review, the total would be $8.423 million rather than $16.2 million.[47] The $8.423 million figure includes zero Interim Period Deferral after earnings review, $6.511 million EDIT Non-Plant Other after earnings review, and $1.912 million available EDIT Plant amortization after earnings review and ARAM normalization consideration.[48] This comparison is identical to AWEC's proposal but simply includes the consideration of an earnings review and normalization requirements.

Regulatory Treatment for Interim Period Amount

Q. Please summarize the parties' positions regarding ratemaking treatment for the Interim Period amount.

A. Staff did not offer a specific proposal for return of the Interim Period Deferral amount, but noted that the Commission has wide discretion, and potential options include a base rate reduction, separate tariff rider, or offset against the outstanding PBA balance.[49] CUB recommends that the Interim Period amount should be applied to offset the PBA

[45] NW Natural/2906, Borgerson/1, Line 6, Column G.
[46] NW Natural/2910 Borgerson/1.
[47] NW Natural/3201.
[48] NW Natural/3201.
[49] Staff/1700, Fox/21.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

balance.[50] AWEC recommends that the Interim Period amount should be returned to customers over two years as a rate credit.[51]

Q. How do you respond to the parties' proposals regarding ratemaking treatment for the Interim Period amount?

A. I agree with Staff that the Commission has a variety of options at its disposal, but believe that CUB's proposal to apply the Interim Period amount to the PBA balance is the best approach. As I mentioned in my Opening Testimony, this approach will provide an immediate benefit to customers by reducing the PBA balance and will also address operating cash flow concerns that could otherwise contribute to a credit rating downgrade for NW Natural.[52]

Regulatory Treatment for EDIT (Plant)

Q. Please summarize the parties' positions regarding ratemaking treatment for the EDIT (Plant).

A. Staff stated that the EDIT (Plant) could be returned at a flat rate over five years, or the Commission could reject this approach and instead adopt the actual annual amounts which would start approximately 25 percent less in year one escalating to 26 percent more in year five.[53] CUB did not make a specific recommendation regarding the return of EDIT (Plant), and AWEC did not address EDIT (Plant) in its Phase II Rebuttal Testimony, other

[50] CUB/500, Gehrke-Jenks/3, 15.
[51] AWEC/700, Mullins/4, 34-35.
[52] NW Natural/2900, Borgerson/10-11, n.22 ("Moody's Investors Service, in January of 2018, issued a credit rating downgrade warning with respect to NW Natural and twenty three other rate regulated utilities. The credit downgrade watch is a direct outcome of federal income tax reform and includes forecasts of more challenging cash flows. Using a combination of options to benefit customers, which considers the relative cash flow impacts of each, would be appropriate in an effort to help reduce downgrade risk and the resulting potential for higher financing costs.").
[53] Staff/1700, Fox/22.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

than suggesting that 10 months of EDIT (Plant) should be included with the Interim Period amount.

Q. What is your response to Staff's discussion regarding EDIT (Plant)?

A. Staff does not offer a specific proposal, but instead describes options available to the Commission. NW Natural believes that a flat amortization over a five year period is the best approach because it will require less frequent rate changes, promoting rate stability, and is intended to avoid violation of applicable normalization requirements.

Regulatory Treatment for EDIT (Non-Plant Other)

Q. Please summarize the parties' positions regarding ratemaking treatment for the EDIT (Non-Plant Other).

A. Staff did not take a particular position, and instead stated that Commission could use the EDIT (Non-Plant Other) as an offset against the PBA balance, or return it to customers immediately or over some other time frame.[54] CUB recommended that the EDIT amounts should be applied to offset the PBA balance.[55] AWEC recommended amortization of EDIT (Non-Plant Other) over two years (along with amortization of the Interim Period amount).[56]

Q. How do you respond to the parties' positions regarding regulatory treatment for EDIT (Non-Plant Other)?

A. NW Natural agrees with CUB that the EDIT (Non-Plant Other) should be applied to the PBA balance. AWEC's proposal for amortization of the EDIT (Non-Plant Other) would present similar cash flow concerns as discussed above regarding the amortization of the Interim Period amount, and accordingly NW Natural recommends that the Commission reject AWEC's proposal.

[54] Staff/1700, Fox/23-24.
[55] CUB/500, Gehrke-Jenks/3, 15.
[56] AWEC/700, Mullins/4, 34-35.

Regulatory Treatment for EDIT (Non-Plant Gas Reserves)

Q. Please summarize the parties' positions regarding ratemaking treatment for the EDIT (Non-Plant Gas Reserves).

A. Staff again did not take a position, but noted that the EDIT (Non-Plant Gas Reserves) could be returned to sales customers as proposed in the Second Partial Stipulation, or the Commission could instead return this amount to all customers or use it as an offset to the PBA balance.[57] CUB did not state its position regarding EDIT (Non-Plant Gas Reserves), and AWEC noted that it does not oppose the Company's proposal to return the EDIT Non-Plant Gas Reserves amount to sales customers.[58]

Q. How do you respond to the parties' proposals regarding EDIT (Non-Plant Gas Reserves)?

A. As I explained in my Opening Testimony and earlier in this Reply Testimony, there are rate design considerations that should be considered before the provision of benefits associated with EDIT (Non-Plant Gas Reserves) is determined, and the Company believes these benefits should be provided to the customers that pay for gas reserves in their rates, which are sales customers. We have not proposed applying this benefit to the PBA since it reflects a benefit allocable to a single class of customers. As described in my Phase II Opening Testimony, the Company proposes to return these amounts to sales customers over 20 years.[59]

Rate Base Adjustment for Return of EDIT

Q. Do you agree with Staff that the Commission could either include a rate base adjustment for the return of EDIT now or wait until the Company's next rate case?

[57] Staff/1700, Fox/23.
[58] AWEC/700, Mullins/35.
[59] NW Natural/2900, Borgerson/26.

A. No. The Company has reflected the entire EDIT benefit deferral as a reduction to rate base in this proceeding pending resolution of the regulatory treatment for the EDIT benefits. This reduction to rate base provides a benefit to customers, and it would be inappropriate to continue to reflect reduced rate base once the EDIT benefits are used for the benefit of customers through reduction of the PBA balance or rate amortization.

V. NW NATURAL'S PROPOSED REGULATORY TREATMENT OF TCJA BENEFITS

Q. Has the Company changed its proposed regulatory treatment of the TCJA benefits since the Company filed its Opening Testimony in Phase II of this proceeding?

A. No. The Company's position regarding the proposed treatment of the benefits of the TCJA has not changed since the Company filed its Opening Testimony.

Q. Please summarize the Company's proposed regulatory treatment for the TCJA benefits.

A. The Company's proposed treatment for the TCJA benefits are as follows:

- Earnings review would apply to both Interim Period Deferral (2018) and remeasured EDIT (2017) before gross up and application;
- Interim Period Deferral – Apply $6.788 million to PBA balance (or amount that remains post 2018 earnings review and after applicable gross up);
- EDIT (Plant) – Return $3.0 million annually to customers over five years (considering revenue sensitive tax gross up as applicable), and this amount will be reviewed and adjusted in the Company's next general rate case, or five years from the date of the Commission's order in this case, and in the event that an adjustment occurs outside of a general rate case, the adjustment would be made through a separate tariff rider and rate base would not be further adjusted until the Company's next general rate case;
- EDIT (Non-Plant Other) – Apply $6.5 million to the PBA balance immediately (including income tax gross up);
- EDIT (Non-Plant Gas Reserves) – Return to sales customers $0.68 million per year over 20 years (considering revenue sensitive tax gross up as applicable);

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

- Rate Base Adjustment – Increase rate base by $15.721 million to reflect the return of EDIT benefit to customers[60] and increase the associated revenue requirement by $1.464 million.

Q. Why do you believe the Company's proposed regulatory treatment is appropriate?

A. The Company's proposal reflects the basic principles I described earlier in my testimony regarding the regulatory evaluation of the TCJA benefits. Specifically, the Company's proposal appropriately includes an earnings review and properly balances customers' interests in seeing an immediate benefit from the TCJA, through reduction to the PBA balance, with the Company's cash flow and credit ratings concerns. Additionally, the Company's proposal regarding EDIT (Plant) will avoid concerns regarding a potential normalization violation, and the return of EDIT (Non-Plant Gas Reserves) appropriately reflects applicable rate design considerations. Finally, the rate base adjustment properly reflects the fact that the TCJA benefits are being returned to customers. With the exception of the earnings review, this proposal is very similar to that included in the rejected Second Partial Stipulation. Notwithstanding the fact that Staff and CUB withdrew from the Second Partial Stipulation, both Staff and CUB were supportive of this proposal as explained in the Joint Testimony in Support of the Second Partial Stipulation and in Phase II Rebuttal Testimony of both CUB and Staff.

Q. Does the Company have an alternative proposal?

A. Yes. In the event that the Commission does not adopt the Company's proposed regulatory treatment described above that applies some of the TCJA benefit to the PBA, and instead decides that TCJA benefit amounts should be returned to customers through a rate credit, the Company recommends the following alternative treatment:

[60] NW Natural/2911, Borgerson/1, Line 5, Columns B and E.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

- Earnings review would apply to both Interim Period Deferral (2018) and remeasured EDIT (2017) before application;
- Interim Period Deferral – Amortize $6.788 million over two years through a separate tariff rider (or amount that remains post 2018 earnings review);
- EDIT (Non-Plant Other) – Return $6.5 million to customers over ten years to reflect an average of the underlying lives of the non-plant assets, in the amount of $0.65 million per year;
- EDIT (Plant) and EDIT (Non-Plant Gas Reserves) – Same as original proposal described above;
- Rate Base Adjustment – Increase rate base by $10.838 million to reflect the return of EDIT to customers[61] and increase the associated revenue requirement by $1.009 million.

Q. Is the Company's alternative proposal consistent with the principles described above?

A. Yes. The Company's alternative proposal appropriately includes an earnings review and will provide an immediate benefit to customers through amortization of the Interim Period amount, but will still take into account the Company's cash flow considerations by returning the other types of EDIT to customers more gradually. Additionally, the alternative amortization schedule described above reflects the underlying useful life of the assets and ARAM normalization considerations. However, the second proposal does not take advantage of the opportunity to accelerate a reduction in the PBA balance to the benefit of customers, and accordingly, it is not NW Natural's preferred approach.

Q. Does this conclude your testimony?

A. Yes.

[61] NW Natural/2912, Borgerson/1, Line 5, Column E.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Reply Testimony of Sean Borgerson

FEDERAL INCOME TAX REFORM

Exhibit 3201

January 4, 2019

NW Natural - Analysis of AWEC's Interim Proposal
Comparison and Correction of AWEC's Interim Period Tax Savings Proposal - To Include Earnings Review

AWEC'S Interim Period Tax Savings Calculation

	a	b	c	d	e = b + d		f		g = e x f	h	
	2018 TCJA Benefit	**2018 Oregon Interim Benefit**	**Relative Percent of 2018 Total**	**Application of 2018 Earnings Review**	**Interim Benefit Post 2018 Earnings Review** (not below zero)		**Gross up For Income Taxes**		**Oregon Interim Benefit, w/ Gross Up**	**TCJA Benefit Available @ 11/1/2018 - AWEC Comparison**	
1	Interim Benefit	$ 4,991	100%	$ -	$ 4,991	x	1.36	=	$ 6,788	$ 6,788	
	2017 TCJA Benefit	**2017 Oregon EDIT Benefit**	**Relative Percent of 2017 Total**	**Application of 2017 Earnings Review**	**EDIT Benefit Post 2017 Earnings Review**		**Gross up For Income Taxes**		**Oregon EDIT Benefit, w/ Gross Up**		**$ 16,207** **AWEC's Figure**
2	Plant	$ 128,406.8	89%	$ -	$ 128,406.8	x	1.36	=	$ 174,633.2	$ 2,719.2	
3	Non-Plant - Other	4,905.3	4%	-	4,905.3	x	1.36	=	6,671.2	6,700.0	<< rounded
4	Non - Plant - Gas Reserves	10,766.8	7%	-	10,766.8	x	1.36	=	14,642.8	*see Note A*	
5		$ 144,078.9		$ -	$ 144,078.9		1.36		$ 195,947.2		

NW Natural's Correction of AWEC's Calculation to Include Required Earnings Review

	a	b	c	d	e = b + d		f		g = e x f	h	
	2018 TCJA Benefit	**2018 Oregon Interim Benefit**	**Relative Percent of 2018 Total**	**Application of 2018 Earnings Review**	**Interim Benefit Post 2018 Earnings Review** (not below zero)		**Gross up For Income Taxes**		**Oregon Interim Benefit, w/ Gross Up**	**TCJA Benefit Available @ 11/1/2018 - AWEC Comparison**	
6	Interim Benefit	$ 4,991	100%	$ (9,555.0)	$ -	x	1.36	=	$ -	$ -	
	2017 TCJA Benefit	**2017 Oregon EDIT Benefit**	**Relative Percent of 2017 Total**	**Application of 2017 Earnings Review**	**EDIT Benefit Post 2017 Earnings Review**		**Gross up For Income Taxes**		**Oregon EDIT Benefit, w/ Gross Up**		**$ 8,423** **Corrected Figure**
7	Plant	$ 128,406.8	89%	$ (8,502.6)	$ 119,904.2	x	1.36	=	$ 163,069.7	$ 1,912.2	
8	Non-Plant - Other	5,126.8	4%	$ (339.5)	4,787.3	x	1.36	=	6,510.8	6,510.8	
9	Non - Plant - Gas Reserves	10,766.8	7%	$ (712.9)	10,053.9	x	1.36	=	13,673.3	*see Note A*	
10		$ 144,300.4		$ (9,555.0)	$ 134,745.4		1.36		$ 183,253.8		

<u>2018 Interim Benefit</u> - Reference figure of $4.991 million from NW Natural/2901 Row 12
<u>2017 EDIT Benefit</u> - Reference figures of $128,406.8, $5,126.8, and $10,766.8 (000's) from NW Natural/2906 column e, rows 1, 2, and 3

d6: The NW Natural correction assumes the 2018 earnings review will be equivalent to the 2017 earnings review adjustment of $9.555 million

Note A: AWEC includes only figures that will proportionally benefit industrial customers; EDIT Non-Plant Gas Reserves is a 'sales customers' only benefit

<u>The primary difference between AWEC's proposal and the corrected figure is the consideration of the required earnings reviews for the 2017 and 2018 TCJA Benefits</u>

Differences that required correction are highlighted in grey above and referenced below:

b3: AWEC's EDIT Non-Plant Other figure was not updated to reflect the higher figure as reported by NW Natural at NW Natural/2906

d1-4: AWEC is not applying an earnings review to the 2017 and 2018 TCJA deferrals prior to consideration of deferral amortization

h2: AWEC's intent appears to be utilization of 10 months of the 2018 ARAM amortization before earnings review - that figure would actually be $2,051.5 [(10/12 = 83.33 x 2,461,875 = 2,051,563) See NW Natural/2910 for ARAM Amortization]; Using the five year (2018-2022) average ARAM amortization of $3.263 million just for 2018 would be a normalization violation.

h7: This figure was corrected to $1,912.2 [(10/12 = 83.33 x 2,294,591 = 1,912,159) See NW Natural/2910 for 2018 ARAM Amortization WITH 2017 Earnings Review]

CERTIFICATE OF SERVICE

I hereby certify that on January 4, 2019 I have served via Huddle the foregoing Confidential Reply Testimony and by electronic mail the redacted NWN Reply Testimony upon all parties of record in docket UG 344.

UG 344

FILING CENTER **(C) (HC)** PUBLIC UTILITY COMMISSION OF OREGON PO Box 1088 Salem, OR 97308-1088 <puc.filingcenter@state.or.us>	BRYAN CONWAY **(C) (HC)** PUBLIC UTILITY COMMISSION PO Box 1088 Salem, OR 97308-1088 <bryan.conway@state.or.us>
ALLIANCE OF WESTERN ENERGY CONSUMERS	
BRADLEY MULLINS **(C)** MOUNTAIN WEST ANALYTICS 1750 SW Harbor Way STE 450 Portland, OR 97201 <brmullins@mwanalytics.com>	CHAD M. STOKES **(C) (HC)** CABLE HUSTON BENEDICT HAAGENSEN & LLOYD 1001 SW 5th – STE 2000 Portland, OR 97201 <cstokes@cablehuston.com>
EDWARD FINKLEA ALLIANCE OF WESTERN ENERGY CONSUMERS 545 Grandview Dr. Ashland, OR 97250 <efinklea@awec.solutions>	
NW NATURAL	
NORTHWEST NATURAL 220 NW 2nd Ave. Portland, OR 97209 <efiling@nwnatural.com>	ZACHARY KRAVITZ **(C)** NORTHWEST NATURAL 220 NW 2nd Ave. Portland, OR 97209 <zdk@nwnatural.com>
LISA F. RACKNER **(C) (HC)** MCDOWELL RACKNER GIBSON PC 419 SW 11th Ave. Suite 400 Portland, OR 97205 <dockets@mrg-law.com>	
OREGON CITIZENS UTILITY BOARD	
MICHAEL GOETZ **(C) (HC)** OREGON CITIZENS UTILITY BOARD 610 SW Broadway, STE 400 Portland, OR 97205 <mike@oregoncub.org>	ROBERT JENKS **(C) (HC)** OREGON CITIZENS UTILITY BOARD 610 SW Broadway, STE 400 Portland, OR 97205 <bob@oregoncub.org>

OREGON CITIZENS' UTILITY BOARD 610 SW Broadway, STE 400 Portland, OR 97205 <dockets@oregoncub.com>	
STAFF	
MARIANNE GARDNER **(C) (HC)** PUBLIC UTILITY COMMISSION PO Box 1088 Salem, OR 97308-1088 <marianne.gardner@state.or.us>	STEPHANIE ANDRUS **(C) (HC)** PUBLIC UTILITY COMMISSION Business Activities Section 1162 Court St. NE Salem, OR 97301-4096 <stephanie.andrus@state.or.us>

DATED: January 4, 2019

Alisha Till

Alisha Till
Paralegal