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NWN Advice No. OPUC 11-19
Seventh Errata Filing

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
550 Capitol Street, NE, Suite 215
Post Office Box 2148
Salem, Oregon 97308-2148

Attention: Filing Center

Re: **UG 221 – SEVENTH ERRATA FILING**

Errata to Exhibit NWN/400 Feltz and Exhibit NWN/2000 Feltz; and
Exhibit NWN/3300 Yoshihara

Northwest Natural Gas Company, dba NW Natural ("NW Natural" or "Company"), files herewith its Errata to the above-referenced NWN Exhibits as follows:

<u>Exhibit NWN/400 Feltz.</u>

Feltz/6, Line 15	Change "Exhibit 402" to "Workpaper 400-3 Confidential"
Feltz/23, Line 22	Change the word "overfunded" to "underfunded."

<u>Exhibit NWN/2000 Feltz.</u>

Feltz/9, Lines 17-20	Revise the following sentence as shown in redline: These two rates had tracked each other ever since the <u>correlation between the rates was measured,</u> ~~Great Depression~~ and only diverged significantly from each other during the 2008-2009 financial crisis, which happened to be the period after inception of the financial swap the Company transacted.
Feltz/30, Line 20	Change $701,000 to $546,000.

<u>Exhibit NWN/3300 Yoshihara.</u>

Yoshihara/4, Line 4	Change "2019" to "2020"
Yoshihara/4, Lines 6-8	Revise the following sentence as shown in redline: The Company could have modeled a service disruption in any gas year before or after <u>2020</u> ~~2019~~, and the model would have chosen the MWVF in the year <u>prior to</u> ~~of~~ that disruption.

Please call me if you have questions.

Sincerely,

NW NATURAL

/s/ Onita King

Onita R. King
Tariffs and Regulatory Compliance

enclosures

A. We consider these investments to be temporary because we anticipate recovering these costs from customers through mechanisms adopted in this rate case, and as such, we plan to return our capital structure to the percentages it would have been absent these investments.

Q. How are you proposing to recover the costs of these temporary investments?

A. As discussed in the direct testimony of C. Alex Miller, the Company has requested the balance of deferred environmental expenditures be recovered in rates on a rolling five-year basis, reflecting expenditures and recoveries through time. I will describe later in this testimony how the Company proposes to recover the balance of unrecovered investor contributions related to the defined-benefit pension plans, which amounts to approximately $22 million for the Test Year, over eight years.

Q. Please explain the calculation of the pro forma Company capital structure, and the impact on capital structure of investments in environmental expenditures and unrecovered pension contributions.

A. Workpaper 400-3 Confidential shows the projected capital structures at year end for 2011, 2012, and 2013, plus a pro forma calculation of the capital structure for the Test Year. The pro forma capital structure for the Test Year was determined by calculating the average common equity and long-term debt for 2012 and 2013 using the beginning and end-of-year balances for each year, then pro-rating those amounts for the Test Year so that two months of 2012 and ten months of 2013 were included in the final Test Year amount. The result is a common equity ratio of 50.4 percent for the Test Year. If we had adjusted for amounts invested in as yet unrecovered environmental expenditures and pension

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A. **Is the current FAS 87 recovery methodology adequate to allow the Company to recover its prudently incurred pension related costs?**

A. No. Changes in financial markets and pension law have required the Company to make substantial contributions to the pension plans that are not recovered through the FAS 87 methodology.

Q. Please explain.

A. In 2006 Congress passed the Pension Protection Act (PPA), which established a new set of funding requirements for defined benefit pension plans. Specifically, PPA set new rules for calculating the value of plan assets and plan liabilities and for accelerating contributions of underfunded plans. In accordance with PPA, plans are now required:

- To achieve funding targets of 100 percent of projected plan liabilities;
- To reduce funding shortfalls over a shorter period (*i.e.* seven years); and
- To impose benefit restrictions and additional fees when a plan falls below certain funding levels.

As a result, the Company has been required to make large cash contributions to its plans to ensure the required levels of funding.

In addition to PPA, financial market factors beyond the Company's control materially affected the Plans' contributions. In 2008 and 2009, the equity and bond markets collapsed, which led to a significant decline in the value of the Plans' assets. The recession that followed also caused a significant reduction in interest rates to historic lows, which dramatically increased Plan liabilities. As a result, the Company went from being underfunded by several million dollars at the end of 2007 to being underfunded by $98 million at the end of 2008, despite the Company having contributed

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the correlation between changes in the “swap rate” and changes in the expected interest rate on the underlying future bond issuance. The correlation between the AA swap rate and an AA utility bond rate (which would be similar to a NW Natural first mortgage bond rate) had historically been very close, and in fact has reverted to the historical relationship. However, after the Company entered into the financial swap, there was a significant, unexpected, and apparently unprecedented departure of these rates from each other. My Exhibit NWN/2002 demonstrates this departure, which is the fundamental reason the swap did not have the effect intended. Not only did the change in rates not correlate, they became inversely correlated, which is to say they moved in the opposite direction.

Q. Why didn’t the Company know that the hedge would have the result it did?

A. In order for the Company to have known that such a result would occur, it would have needed to have information that no other party had at that time either. Specifically, it would have to been able to predict the financial crisis that occurred during 2008 and 2009, which caused an unexpected variance between the 10-year swap rate and the debt costs of AA utilities, and it would have to have foreseen that this would be the result of the financial crisis. These two rates had tracked each other ever since the correlation between the rates was measured, and only diverged significantly from each other during the 2008-2009 financial crisis, which happened to be the period after inception of the financial swap the Company transacted.

Q. Is the fact that the Company paid UBS money under the swap also because the Company did not anticipate the results under the swap?

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up on the income statement. Moreover, Staff's argument erroneously suggests that it is appropriate to apply an earnings test before prudently made shareholder investments are added to rate base—a suggestion that is inconsistent with Commission policy.

Q. What arguments does NWIGU-CUB make against the Company's pension proposal?

A. NWIGU-CUB makes three arguments. These parties make the same retroactive ratemaking argument as Staff. They also argue that ratepayers should not be responsible for cash contributions made when pension accounts are underfunded, because they do not receive the benefit when pension accounts are overfunded. Finally, NWIGU-CUB suggest that there is no reason to alter the current recovery mechanism because "as the market recovers, the value of the assets will rise and the additional contributions will no longer be required."

Q. You have already responded to the retroactive ratemaking argument. Please respond to NWIGU-CUB's argument that ratepayers do not receive the benefit when pension funds are overfunded.

A. NWIGU-CUB is completely wrong on that point. When pension accounts are overfunded, FAS 87 expense usually drops to a negative expense, which means that customers not only aren't paying any FAS 87 expense but instead they are getting a rate reduction. This occurred with NW Natural's pension account when in the 1998 Oregon rate case customers were credited with a negative $546,000 revenue requirement.

Q. And do shareholders also benefit when pension accounts are overfunded.

A. No. This is definitely a one-way street.

Q. Please explain.

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A. No, it does not. As I explained in my reply testimony, the Company modeled five supply service disruptions staggered at two-year increments. Two of these scenarios included disruptions on the Grants Pass Lateral, both of which were arbitrarily modeled as occurring in the 2020 gas year. For both scenarios, the model results show that the MWVF needs to be in service prior to the modeled disruption if the Company is going to continue to serve customers' demand during a disruption. The Company could have modeled a service disruption in any gas year before or after 2020, and the model would have chosen the MWVF in the year prior to that disruption. Rather than undermining the Company's evidence that the MWVF is needed for reliability purposes, it actually supports the Company's position, because a service disruption on the Grants Pass Lateral could occur at any time. The results demonstrate the MWVF's ability to enhance reliability by providing an alternate supply route that utilizes existing on-system storage assets.

Q. In addition to ensuring system reliability in the event of a disruption on the Grants Pass Lateral, does the MWVF provide any other distribution reliability benefits?

A. Yes. Northwest Pipeline is located east of most of the Company's load centers in this area. The MWVF provides a way to deliver storage gas from the west side of these load centers, therefore increasing reliability and reducing the need to build reinforcements across highly populated areas to meet long-term future growth. It also improves reliability in the instance of a service disruption on one of the major distribution feeders to these areas that could occur downstream of the Northwest Pipeline gate stations.

Q. Did Staff address the reasons you put forward for needing the MWVF at this time?

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