

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: August 22, 2017

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: August 7, 2017

TO: Public Utility Commission

FROM: Lance Kaufman LK

THROUGH: Jason Eisdorfer JE and Marc Hellman MH

SUBJECT: NORTHWEST NATURAL: (Docket No. UI 385) Application for Transactions Between Affiliated Interests.

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should approve Northwest Natural's (Company) application for approval of an affiliated interest Master Services Agreement (Agreement), subject to the following conditions:

1. The Company shall provide the Commission access to all books of account, as well as all documents, data, and records that pertain to any payments to or from the affiliates.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of this arrangement in any rate proceeding or earnings review.
3. The Company shall notify the Commission of any substantive changes to the Agreement, including any material changes in price or other parameters specified in the Agreement. Any such changes shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.
4. The Company shall report to the Commission, as part of its annual affiliated interest report, all transactions entered into under the Agreement.

DISCUSSION:

Issue

Whether the Commission should approve Northwest Natural's affiliated interest Master Services Agreement.

Applicable Laws

The Company filed this application with the Commission on June 1, 2017, pursuant to ORS 757.495(1) and OAR 860-027-0040.

"Affiliated interest," as defined in ORS 757.015(3), includes every corporation five percent or more of whose voting securities are owned by any corporation or person owning five percent of the voting securities of a public utility or in any successive chain of ownership of a public utility. The affiliated interests covered by this Agreement are listed in Addendum 1 of the Agreement. Page 4 of the Company's filing identifies the affiliated interest relationships between Northwest Natural and the listed companies in the Agreement. Staff has reviewed the relationships and determined that all companies listed are affiliated interests of Northwest Natural.

The Commission reviews affiliated interest transactions to ensure they are fair and reasonable and not contrary to the public interest. ORS 757.495(3). When a transaction is entered into between affiliates in which services or supplies are sold to an energy utility by an affiliate, such transactions must be recorded at the lower of the affiliate's cost or the market rate. OAR 860-027-0048(4)(e). However, the Commission may waive this rule for good cause shown. OAR 860-027-0000(2).

Analysis

During a recent Staff audit of Northwest Natural, Staff observed that Northwest Natural may have been transacting with some affiliated interests without an associated affiliated interest agreement approved by the Commission. These transactions appeared to have been occurring under the terms of the Master Services Agreement approved by the Commission in Order No. 09-051. However, the Company had not filed an updated the list of affiliates participating under the agreement. This affiliated interest filing (UI 385) remedies Staff's concerns by updating the list of affiliates participating in the Agreement. Other than the list of affiliates, this Agreement appears identical to the agreement approved in Order No. 09-051.

Staff investigated the following issues:

1. Terms and Conditions of the Agreement;
2. Transfer Pricing;
3. Public Interest Compliance; and
4. Records Availability, Audit Provisions, and Reporting Requirements.

Terms and Conditions of the Agreement

The Agreement covers all transactions between the listed affiliates and Northwest Natural. However, Section 15 of the Agreement also provides that any of the terms and conditions may be waived at any time. Staff notes that if any terms are waived, the associated transactions will take place outside the scope of the terms of this Agreement. Staff recommends that the Company maintain procedures to separately track and record transactions that have been waived from the terms of this agreement and plans to revisit this section of the Agreement when it is re-filed in a few months, pending resolution of UM 1804 – Northwest Natural's Application for Approval of Corporate Reorganization to Create a Holding Company

Transfer Pricing

Section 3 of the Agreement specifies the transfer pricing terms of the agreement. The transfer pricing terms satisfy both OAR 860-027-0048(d) and OAR 860-027-0048(4)(e). While Staff finds that the Agreement satisfies the transfer pricing rules, Staff is concerned that Northwest Natural may not be accurately assessing the market rates or cost of service. For example, the Company considers the hourly wage, loaded for overhead, to be representative of the market cost for certain services. In Staff's view, a more appropriate approach to identifying market cost would be through identifying actual market prices for the services charged by non-affiliated entities. Staff will investigate this issue in more detail in a future Northwest Natural rate proceeding because this filing requires approval of the terms of the Agreement.

Public Interest

The Commission customarily applies a "no harm" standard in determining what is "not contrary to the public interest" in matters involving affiliated interest transactions.¹ In addition to the transfer pricing terms, customers are protected from harm by Section 3.1d, which requires that all services provided to be necessary, just, and reasonable regulated utility expenses, and that they must not duplicate functions already performed by Northwest Natural. By adhering to the terms contained in this Agreement, Staff finds that the agreement will not cause harm to customers.

¹ See, e.g., *In the Matter of a Legal Standard for Approval of Mergers*, Order No. 01-778 (Docket No. UM 1011).

Records Availability, Audit Provisions, and Reporting Requirements

Staff notes that the Commission retains the ability to review all affiliated transactions of the Company through both its annual affiliated interest report and in general rate case filings. Sections 4 through 8 of the Agreement require that all parties maintain appropriate records, provide reasonable access to records, and review the records for consistency with the Agreement. Section 11 requires that these records be made available to the Commission. Further, Staff's recommended conditions also provide for all necessary Commission examination of the Company's records concerning the Agreement.

The Company has reviewed this memo and has not communicated any objections or concerns.

Conclusion

Based on the review of this application, Staff concludes:

1. The Agreement did not appear to contain any unexpected or unusual terms or conditions;
2. The transfer pricing is fair and reasonable;
3. The transaction is in the public interest; and,
4. Necessary records are available.

PROPOSED COMMISSION MOTION:

Approve Northwest Natural's application for an affiliated interest Master Services Agreement subject to Staff's recommended conditions.