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December 12, 2018

Via Electronic Filing

OREGON PUBLIC UTILITY COMMISSION
ATTENTION: FILING CENTER
PO BOX: 1088
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**RE: Docket No. UG 344 Ph 2 – In the Matter of
NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL,
Request for a General Rate Revision.**

Staff Rebuttal Testimony, Exhibits 1700-1704 attached for filing:

> Exhibit 1700 – pages 7-9 contains confidential information
> Exhibit 1701 – 1703 (electronic)
> Exhibit 1704 – confidential

A certificate of service and service list are included with this filing. Confidential pages 7-9 and Exhibit 1704 are being mailed to parties who have signed General Protective Order no: 18-002.

/s/ Kay Barnes
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CERTIFICATE OF SERVICE

UG 344

I certify that I have, this day, served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-001-0180, to the following parties or attorneys of parties.

Dated this 12th day of December, 2018 at Salem, Oregon

Kay Barnes

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UG 344 – SERVICE LIST

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CASE: UG 344 Phase 2
WITNESS: JOHN L. FOX

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 1700

Staff Rebuttal Testimony

December 12, 2018

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

A. My name is John L. Fox. I am a Senior Financial Analyst employed in the Energy Rates, Finance and Audit Division of the Public Utility Commission of Oregon (OPUC). My business address is 201 High Street S.E., Suite 100, Salem, Oregon 97301.

Q. Have you previously provided testimony in this case?

A. Yes, I provided Opening Testimony labeled Exhibit Staff 300 and Rebuttal and Cross-Answering Testimony labeled Exhibit Staff1500.

Q. What is the purpose of your testimony?

A. I respond to the Company's testimony regarding recovery of its Pension Balancing Account and to further inform the record regarding the Tax Cuts and Jobs Act interim period excess deferred income tax issue and underfunded pension liability and pension balancing account issue as directed by Order No. 18-419.

Q. Did you prepare exhibits for this docket?

A. Yes. I prepared the following:

- Exhibit Staff/1701, FAS 87 Additions to the Pension Balancing Account in Excess of Earnings Threshold;
- Exhibit Staff/1702, Comparison of EDIT Calculations and Proposed Amortization Terms;
- Exhibit Staff/1703, Pension Plan Contributions Over (under) FAS 87 Expense; and

- Confidential Exhibit/1704, UM 1475 NW NATURAL's Redacted Direct Testimony of Stephen P. Feltz (NWN/205, Feltz/1).

Q. How is your testimony organized?

A. My testimony is organized as follows:

ISSUE 1. PRUDENCE OF AMOUNTS ACCUMULATED IN THE PENSION BALANCING ACCOUNT (PBA)

Q. What is NW Natural's Pension Balancing Account (PBA)?

A. In 2010, NW Natural filed an application to defer actual FAS 87 expense that exceeded the amount recovered in rates so that NW Natural could have full recovery of all of its FAS 87 expense. Eventually, the Commission approved a stipulation between Staff, the Citizens' Utility Board of Oregon (CUB), the Northwest Industrial Gas Users (NWIGU),[1] and NW Natural authorizing NW Natural to establish the PBA that would track the variance between actual FAS 87 pension expense and the FAS 87 expense recovered in rates.

In testimony filed in this case on November 21, 2018, NW Natural explains that at the time parties agreed to the PBA the Company believed, based on third-party actuarial forecasts of the Company's pension expense, that "the Company's FAS 87 expense would be reduced – and become negative (become income) – over a few years, and that therefore the balance in the PBA would reverse and drop to zero."[2] In other words, while NW Natural's actual FAS 87 expenses exceeded the amount included in rates for this expense at the time of the stipulation, NW Natural anticipated that in a few years, the actual expense would be less than the amount included in rates.

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[1] NWIGU is now the Associated Western Energy Customers (AWEC).
[2] NW Natural/2800, Wilson/3.

However, in the Company's words, "due to various factors outside of NW Natural's control, [the reversal] did not occur and the PBA has continued to increase."[3]

Q. Please summarize Staff's previous position regarding NW Natural's recovery of the Pension Balancing Account (PBA).

A. As noted by the Commission in Order No. 18-419, Staff had concluded its ability to challenge NW Natural's recovery of the PBA balance was limited by the terms of the 2011 stipulation between Staff, NW Natural, NWIGU and CUB regarding the method of NW Natural's recovery of FAS 87 expense. However, the Commission has rejected the idea of such a limitation:

> Although the stipulating parties assert that the prior stipulation adopted in Order No. 11-051 implies agreement to full recovery of any balance in customer rates, with no prudence review or earnings test, we discern no such an intent. The stipulation anticipated that the balance in the account would trend to zero and therefore did not address the amortization method if the anticipated zero balance did not materialize. We also highlight that AWEC, a signatory to that stipulation, also disagrees that the stipulation implied this result. Under the circumstances, we must base our decision on a more robust demonstration that the public interest supports full recovery of the balance in customer rates.[4]

Staff has not discussed prudence of the PBA specifically in opening or rebuttal testimony. However, Staff stipulated that recovery of the PBA balance was reasonable as part of a compromise addressing issues related to the PBA and NWN's sharing benefits of the TCJA with ratepayers.[5]

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[3] NW Natural/2800, Wilson/3.
[4] Order No. 18-419.
[5] NW Natural-Staff-CUB/300, Borgerson, Wilson, Gardner, and Jenks/13-15.

Q. What is Staff's position now regarding the PBA?

A. Staff believes it is appropriate for the Company to recover all the FAS 87 expense included in the PBA balance, but believes that the interest earned on the PBA balance is a different matter. Staff believes that the accumulation of a large amount of interest in the account was not necessarily beyond the Company's control and that sharing of that interest between ratepayers and the Company may be appropriate.

Q. What is the PBA balance as of October 31, 2018, and what is the proportion of accumulated FAS 87 expense to interest?

A. The balance of the account at that date is $80 million and includes $59 million FAS 87 expense and $21 million interest, 74 percent and 26 percent, respectively.

Q. Please explain Staff's position regarding the FAS 87 portion of the account balance.

A. As discussed in the Company's testimony, FAS 87 expenses measures the annual cost of providing the retirement benefit on an accrual basis.[6] Although Staff has concerns regarding the accrual of interest on the excess FAS 87 expense included in the PBA, Staff believes full recovery of the FAS 87 portion of the PBA is consistent with Commission policy.

Q. Why does Staff distinguish between the recovery of the FAS 87 expense and the interest?

[6] NW Natural/2800, Wilson/8-9.

It is important to recognize the relationship between FAS 87 expense and required minimum contributions, which was discussed at length in Order No. 15-226.[7] This order affirmed the use of FAS 87 to determine rates and rejected the joint utilities request to include the difference between FAS 87 and cash contributions (prepaid pension assets and liabilities) in rate base. In other words, these timing differences are an item of regulatory lag that is ignored for ratemaking purposes.

Q. Please explain Staff's position regarding the interest portion of the account balance?

A. The Company's opening testimony summarizes the history of the pension investigation, Order No. 15-226, and the PBA, Order No. 11-051.[8] Note that the PBA order preceded the pension investigation order by several years. The PBA is a remedy for a different type of regulatory lag, the difference between the actual FAS 87 cost and the $3.7 million amount of FAS 87 cost included in rates. However, both dockets involve compensating the Company for timing differences resulting from how pension costs are included in rates either through inclusion in rate base (Order No. 15-226) or adding interest to the PBA (Order No. 11-051). Cash contributions to the plan are relevant for determining the prudence of interest added to the PBA account as higher cash contributions, all other things being equal, would have increased plan assets

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[7] See *In the Matter of PUBLIC UTILITY COMMISSION OF OREGON Investigation into Treatment of Pension Costs in Utility Rates,* Docket No. UM-1633, Order No. 15-226 (Aug 03, 2015).
[8] See *In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL Application to Defer Pension Costs,* Docket No. UM-1475, Order No. 11-051 (Feb 10, 2011).

and investment returns, thereby reducing FAS 87 expense during the life of the PBA.

Q. Were the Company's contributions to the PBA reasonable in each year the PBA was in effect?

A. Not in every year. The following chart compares the actual and projected PBA balances:

[Begin Confidential]

[redacted]

[End Confidential]

The chart shows that in 2011 and 2012 there was no reason to think that the PBA mechanism was not functioning as intended. **[Begin Confidential** [redacted] **[End Confidential]**

Furthermore, Exhibit 1703 shows Company contributions to the pension trust substantially exceeded FAS 87 expense in 2011 and 2012 then turned substantially negative beginning in 2013, which corresponds to the divergence of the PBA from the original projections. Company financial personnel should have been aware that the PBA balance was increasing at the same time contributions began to decline relative to FAS 87 expense.

Q. Why did the PBA diverge from original projections?

A. The original projections underlying Order No. 11-051 are presented in Confidential Exhibit 1704.

[Begin Confidential] [redacted]

[redacted]

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[9] Phase II - NW NATURAL's Supplemental Testimony and Exhibits of Brody Wilson, (NW Natural/3000-3002, Wilson).

[10] NW Natural/2800, Wilson/14-15.

[redacted] **[End Confidential]**

Q. What did the Company do when the actual PBA began to diverge from the original projections?

A. The Company continued to contribute the minimum required and took no action to address the divergence. The Company explained its funding policy in response to Staff DR No. 228.

> The Company's funding policy is to contribute at least the minimum required under the Employee Retirement Income Security Act of 1974 (ERISA). It is the intent of the Company to contribute to the Plan such amounts as are calculated to be sufficient on a sound actuarial basis to provide for the payment of benefits under the Plan, and to make annual contributions to the Plan in an amount,

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[11] Staff/300, Fox/30.

[12] Exhibit 1704, Table B, WACC on Cash Contributions in Excess of Rate Recovery to Balancing Account.

[13] See *In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL Application to Defer Pension Costs,* Docket No. UM-1475, Order No. 11-051 (Feb 10, 2011), p. 4.

> certified by an enrolled actuary, to be not less than the amount necessary to maintain the minimum funding requirements under the applicable funding requirements of ERISA.

Q. Does Staff believe the Company acted reasonably when it continued to make only minimum contributions?

A. No. The Company could have taken action to address the increasing balance. The Company could have increased its contributions or brought the issue of the increasing balance to the stipulating parties. Although the Company asserts that the FAS 87 balance increased due to "factors outside of the Company's control,"[14] the Company still had control over what actions it took.

The policy of making minimum contributions was clearly conflicting with the need to make contributions sufficient to pay down the balance in the PBA. On November 29 the Company filed supplemental testimony in this case that included the actuarial reports of the ASC 715 Pension Cost for 2011 through the end of calendar year 2018. The sum of FAS 87 expense and expected contributions are shown in Exhibit 1703. Actuarially determined FAS 87 contributions total $148 million and expected contributions are $128 million. This confirms the Company was making only minimum contributions to the pension trust.

Q. Could Staff, NWIGU, and CUB have known about the growth of the PBA sooner than 2017?

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[14] NW Natural/2800, Wilson/14-17.

A. Yes, the amount of FAS 87 expense being added to the PBA each year and the accumulating balance in the PBA account were disclosed in the footnotes to the Company's financial statements each year and the financial statements were filed each year as part Company's annual regulatory filings.[15]

Q. Does the fact Staff and stakeholders could have known about the growing balance mean they are precluded from challenging NWN's recovery in this case?

A. No. The question presented to the Commission is whether NWN acted in an objectively reasonable manner. The fact Staff and stakeholders could have known, or did know, about the Company's actions at the time they were taken does not change how the Commission determines prudence.

Q. Were the Company's actions in connection with the PBA prudent?

A. Not entirely. The Company decided in each year what amount, if any, to contribute to the pension trust in excess of the required minimum contribution and also reviewing the actuarial assumptions underlying the FAS 87 calculations each year. As discussed above, the amount and timing of the Company's contributions significantly affected the balance of the PBA. And, the Company should have known earlier than 2017, which is when the Company approached parties to the 2011 Stipulation regarding the PBA balance, that contributions to the plan were not adequate to reverse the PBA. Also, if the Company felt it was unable to increase contributions due to various constraints

[15] See *In the Matter of NW NATURAL GAS COMPANY dba NW NATURAL 2011 FERC FORM 2 with Oregon Supplement.,* Docket No. RG 37, filed annually no later than May 1.

it would be a reasonable expectation that they would inform the parties that the PBA was no longer viable before they actually did in fall of 2017.

Q. Please summarize Staff's position regarding the prudence of the $80 million PBA balance.

A. The use of FAS 87 expense in ratemaking is a long standing Commission policy and Staff agrees that the Company has a reasonable business expectation to recover this amount and should be entitled to recover the FAS 87 portion (74 percent) of the account balance in full.

The magnitude of the interest portion of the outstanding balance (26 percent) is a direct result of amounts in the PBA exceeding the original projection and although all parties to the order establishing the PBA bear some responsibility for monitoring the account, for the reasons discussed above the Company should bear the vast majority of responsibility. Therefore, it is appropriate for the Commission to disallow some or all of the accumulated interest in the PBA as being imprudently incurred.

Staff also notes that concerns regarding recovery of the interest portion of the account was one of the variables underlying Staff's decision to enter into the Second Partial Stipulation in this case as discussed further below.

Q. What is Staff's recommendation to the Commission regarding the prudence of the interest portion of the Pension balancing account?

A. In the absence of the Second Partial Stipulation, Staff recommends that Commission consider interest on the PBA incurred after 2013 ($19.8 million) as imprudently incurred.

ISSUE 2. APPLICATION OF AN EARNINGS TEST

Q. Please summarize Staff's previous testimony in this case regarding the application of an earnings test to the PBA.

A. Staff has not discussed application of an earnings test to the PBA specifically in opening or rebuttal testimony. However, a potential earnings test is discussed in Joint Reply Testimony in Support of the Second Stipulation.[16]

Q. Has Staff prepared additional calculations regarding earnings during the 2011-2017 timeframe?

A. Yes, we have prepared Exhibit 1701 showing the Company's earnings during the years the PBA was in effect. [17]

Each year the Company makes an earnings sharing election[18] followed by Staff calculation of the Gas Earnings Threshold (GET),[19] which is a hurdle rate that is compared to the final Results of Operations[20] for a particular year.

Exhibit 1701 shows the amount of additional earnings (earnings variance) that would have been necessary to generate a return on equity (ROE) equivalent to the GET. Exhibit 1701 also shows the annual FAS 87 and interest additions underlying the accumulated $79.9 million PBA balance. FAS 87 contributions did exceed the calculated earnings variance in the early years of the PBA by $14.9 million dollars (or $13.4 million assuming 90/10 earnings sharing).

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[16] NW Natural-Staff-CUB/300, Borgerson, Wilson, Gardner, and Jenks/13-15.
[17] Staff Exhibit 1701uses the same methodology as Staff's response to AWEC's data request regarding 2017 earnings which is also reproduced as an exhibit in the Company's opening testimony. NW Natural/2909.
[18] Filed annually in Docket No. UM 1286.
[19] Determined annually in Docket No. UM 903.
[20] Filed annually in Docket No. RG 40.

Q. Does the application of an earnings test affect how much of the PBA balance NW Natural should be allowed to recover?

A. Not in Staff's opinion.

The entire rationale for the PBA is that NW Natural's actual FAS 87 expense exceeded the $3.7 million of FAS 87 expense included in rates. As noted above, FAS 87 is a necessary and prudent expense. Therefore, if the PBA did not exist, the entire amount of FAS 87 expense would appropriately be included in both expense and the revenue requirement.

The PBA has a complex history. Specifically that there was a 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 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.

The Commission applies an earnings test because deferred accounting is essentially single-issue ratemaking allowing a utility to track one component of expense or revenue without considering whether changes to other expenses or revenues might have offset the deferred amount. Because the Commission does not undertake a holistic examination of a utility's operations during the deferred accounting process, the Commission uses an earnings test to determine whether the amortization of deferred amounts is reasonable.[21]

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.

Q. Should the Commission reject the Company's unrelated proposal to apply the 2017 earnings variance of $9.555 million as a reduction of excess deferred income taxes (EDIT)?

A. Yes, this is an improper application of the earnings test. The EDIT revaluation is a refund of tax included in prior year revenue requirement that became instantly due and payable when President Trump signed the bill into law on December 22, 2018. These excess deferred amounts have nothing to do with 2017 results of operations and should be refunded to customers in full using appropriate amortization principles.

Furthermore, amortization of EDIT amounts will be part of ongoing annual ratemaking expense and therefore reflected in the ongoing annual earnings tests based on the Company's filed results of operations. The Company's proposal would effectively subject the same amounts to an earnings test twice. Once when the Accumulated Deferred Income Tax (ADIT) revaluation occurred

[21] *In the Matters of Northwest Natural Gas Company, dba NW Natural, Mechanism for Recovery of Environmental Remediation Costs (UM 1635) and Request for Determination of Prudence of Environmental Remediation Costs for the Calendar Year 2013 and the First Quarter of 2014* (Docket No. UM 1706), Order No. 15-049, p. 11.

in 2017 and again when the resulting EDIT amounts are amortized into ratemaking tax expense.

The Commission must reject the proposed $9.555 million reduction.

ISSUE 3. TAX CUT AND JOBS ACT (TCJA)

Q. Please summarize Staff's previous testimony in this case regarding TCJA benefits.

A. The impact of the TCJA was discussed specifically in the rebuttal and cross-answering testimony of Marianne Gardner.[22] Staff recommended annual EDIT amortization of $10 million including a revenue gross up of 36 percent. Staff also discussed the final TCJA settlement amounts in Joint Reply Testimony in Support of the Second Stipulation.[23]

Q. Do you believe there is sufficient information in the record supporting the nature and amount of TCJA benefits at issue?

A. Yes, the Company has provided robust information regarding the TCJA tax benefit calculations in reply testimony, surrebuttal testimony, and opening testimony in phase 2.[24] In particular NW Natural Exhibits 2500, 2901, 2906-8, and 2910-12, provide detailed information.

Q. Has the Company changed any of its positions regarding TCJA benefits subsequent to rejection of the Second Partial Stipulation in this case?

A. Yes, the Company has proposed several changes,

- An increase in Oregon allocated EDIT of $1.7 million due to a revaluation based on the Company's final 2018 tax returns.

[22] Staff/100, Gardner/46-49 and Staff/1400, Gardner/3-11.
[23] NW Natural-Staff-CUB/300, Borgerson, Wilson, Gardner, and Jenks/13-15.
[24] NW Natural/1500, NW Natural/2500, and NW Natural/2900.

- Changes in the Oregon allocation percentage for EDIT (Plant) and EDIT (Other).
- Reduction in Oregon allocated EDIT of $9.555 million based on Staff's response to AWEC DR 01.
- Decrease EDIT (Plant) amortization from $3.263 million per year to $3.0 million per year as a result of the changes in EDIT calculation.
- Decrease EDIT (Gas Reserves) amortization from $2.929 million per year over five years to $684 thousand per year over 20 years.
- Two options for EDIT (other); Option 1 would offset $6.5 million against the accumulated PBA balance, Option 2 would amortize provide amortization of $651 thousand per year over 10 years with no PBA offset.
- Proposing a lower rate base increase compared to the $22.1 million amount in the Second Partial Stipulation.
    - Option 1: $15.7 million rate base increase.
    - Option 2: $10.8 million rate base increase.

Q. Have you prepared an exhibit related to these changes?

A. Yes, the proposed changes are all interrelated and the data is presented in a number of separate Company exhibits. I have prepared Exhibit 1702, which compiles the various Company exhibits along with the analogous figures from the Second Partial Stipulation.

Q. Does Staff oppose application of the 2017 earnings sharing to offset the EDIT revaluation?

A. Yes, for the reasons discussed under Issue 2 above.

Q. Is there an additional adjustment Staff is recommending to the Company's calculation of EDIT benefits?

A. Yes, Staff recommends using a gross up or net to gross factor of 1.40917214 rather than the 1.36 factor showing in Exhibit 1702 to value the EDIT benefits. This reflects 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. The net to gross factor of 1.41(rounded) includes revenue sensitive costs that are variable and included in the revenue requirement in the rate case.[25] As the EDIT benefits will offset rate making tax expense dollar for dollar 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.

Q. Did the Company use a 1.36 factor to record the regulatory liability for financial reporting?

A. Yes, but that is irrelevant. The tax benefit returned to customers should be based on the change in rate making tax expense not financial statement estimates.

Q. Why didn't Staff raise this consideration earlier?

A. EDIT and gross up calculations for the investor owned utilities are generally being handled in the tax deferral dockets.[26] Because the Second Partial Stipulation was an attempt to resolve all outstanding issues related to tax

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[25] Uncollectable accounts, other taxes, OPUC fees, and actual state taxes.
[26] Docket Nos. UM 1919 and UM 1924 for NW Natural.

reform, this variance in the gross up rate was a concession within the overall settlement. Now that the Second Partial Stipulation has been rejected Staff must bring this issue into the record to protect the interests of ratepayers.

Q. Does Staff question any other aspect of the Company's revised EDIT calculations?

A. Yes, the reduction in annual ARAM amortization presented in the Company's exhibit NW Natural/2910 appear to be based on a flat 6.79 percent reduction across all five years. The ARAM methodology is based on EDIT being returned at the point where straight line depreciation exceed accelerated depreciation for individual assets or groups of assets. 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.

Q. Otherwise, is Staff providing a comprehensive counter proposal at this time addressing the Company's proposals above?

A. No, Staff feels that a specific counter proposal at this time would only add additional complexity in this case and would be counterproductive to the Commission's direction in Order 18-419 to further inform the record.

Q. Does Staff believe there is a key question the Commission ought to consider to further inform the record?

A. Yes, Staff believes it would be more productive for the Commission to consider the overall range of possibilities for returning each element the TCJA benefits to customers. This will assist the Commission in considering whether the rejected portions of the Second Partial Stipulation would have contributed to a fair, just, and reasonable resolution of the PBA and TCJA issues and also provide context for evaluating the positions of the various parties.

Staff's analysis and discussion of the range of settlement possibilities follows:

Return of 2018 Interim Tax Benefits

Options discussed for returning the $6.8 million to customers are a base rate reduction, separate tariff rider, or offset against the outstanding PBA balance. Regardless of the mode of return, and recognizing that the Commission has wide discretion, application of an earnings test to the deferred tax benefits could result in this benefit being reduced to zero with no refund to rate payers.

Also, it is important to note that the reduction in statutory rate from 35 percent to 21 percent is only part of the tax benefit payable to customers during the 10 month interim period. A proportion of the EDIT benefits and related rate base adjustment would be allocable also. The Second Partial Stipulation ignored all EDIT that would have been allocable to the interim period in favor of establishing a flat five year amortization of EDIT (Plant) to promote rate stability. This was acknowledged and discussed in the testimony regarding the ARAM "speed limit"[27] as the delay in return of the 10 month EDIT is what allows the flat rate amount of $3.263 million in year one of the amortization rather than the lower actual ARAM amount of $2.461 million.[28] Unbundling of the Second Partial Stipulation means the interim tax benefits

[27] NW Natural/2500, Borgerson/21-22 and NW Natural/2900, Borgerson/17-19.
[28] ARAM amounts per NW Natural/2910.

could be revised to include EDIT and may be $10 million for the 10 month period before any earnings test.

Return of EDIT (Plant) Benefits

These amounts would be returned at a flat rate of $3.263 million per year under the provisions of the Second Partial Stipulation or $3.0 million per year under the Company's new revised proposal. Changing the gross up factor to 1.41 as advocated by Staff would increase these amounts to $3.382 million and $3.153 million, respectively.

The Company is still advocating for a five-year averaging methodology. The Commission could reject this and adopt the actual annual amounts which would start approximately 25 percent less in year one escalating to 26 percent more in year five.[29] If the averaging method is discontinued, the timing of return could be shifted to allocate 10 months of year one to the 2018 interim tax benefit as discussed above.

Return of EDIT (Gas Reserves) Benefits

These amounts are valued at $14.643 million and returned to customers over five years under the provisions of the Second Partial Stipulation, or $13.674 million per year over 20 years under the Company's new revised proposal. Changing the gross up factor to 1.41 as advocated by Staff would increase these amounts to $15.181 million and $14.176 million, respectively. The timing of return of EDIT benefits is only restricted for assets subject to IRS normalization rules (ARAM method) also commonly referred to as "protected"

[29] See NW Natural/2501, Borgerson/1 for annual amounts.

assets. EDIT (Gas Reserves) is not subject to normalization rules, commonly referred to as “unprotected”. This means the Commission could choose to return the entire amount to customers immediately or over time using any reasonable amortization method. The EDIT (Gas Reserves) was earmarked for return to sales customers in the Second Partial Stipulation and also the Company’s revised proposal. The Commission could choose to offset the EDIT (Gas Reserves) against the outstanding PBA balance or return them to a different class of customers although this would likely generate objections as the return to sales customers is supported by all parties.

Return of EDIT (Other) Benefits

These amounts are valued at $6.671 million and immediately offset against the outstanding PBA balance under the provisions of the Second Partial Stipulation. Under the Company’s new revised proposal, the amounts are valued at $6.511 million and immediately offset against the outstanding PBA balance as well. Changing the gross up factor to 1.41 as advocated by Staff would increase these amounts to $6.671 million and $6.750 million, respectively.

As it is for EDIT (Gas Reserves), EDIT (Other) is “unprotected” or not subject to IRS normalization rules. This means the Commission could choose to return the entire amount to customers immediately or over time using any reasonable amortization method.

The decision to offset EDIT (Other) against the outstanding PBA balance in the Second Partial Stipulation remains controversial with AWEC. AWEC advocates returning these amounts to a specific class "transportation" customers[30] rather than using them to offset against the outstanding PBA balance to the benefit of all customer classes.

Rate Base Adjustment for EDIT Return

The Second Partial Stipulation and the Company's new revised proposal both follow the same general pattern of adding back one half of the EDIT amortized over five years and the entire amount of EDIT immediately offset against the PBA.

Rate base in Order 18-419 continues to be reduced by both the ADIT and the EDIT balances. The Commission can provide a rate base adjustment for EDIT return using any method or none at all. In other words, the Commission could eschew the rate base adjustment until the next general rate case. Rate base adjustments can only occur in general rate cases.

[30] AWEC/600, Mullins/7.

ISSUE 4. THE COMPANY'S CURRENT POSITION AFTER REJECTION OF THE SECOND PARTIAL STIPULATION

Q. Did Staff withdraw from the Second Partial Stipulation and why?

A. Yes. Staff believes it can more effectively investigate the issues in Phase 2 of this proceeding without agreeing in advance to a particular outcome.

Q. Did CUB also withdraw from the Second Partial Stipulation?

A. Yes.

Q. Has the Company filed a notice of withdrawal from the Second Partial Stipulation?

A. No.

Q. Does the Company still support the Second Partial Stipulation?

A. Yes, the Company continues to believe the Second Partial Stipulation provides significant benefits to customers.[31]

Q. Please summarize changes the Company's current position regarding the Pension Balancing Account (PBA) and Tax Cut and Jobs Act (TCJA) benefits due to Staff and CUB withdrawing their support of the Second Partial Stipulation.

A. Absent approval of the Second Partial Stipulation, the Company rescinds the following concessions:[32]

- Waiver of an earnings test on the 2018 interim tax deferral.

[31] NW Natural/2800, Wilson/28.
[32] NW Natural/2800, Wilson/29-30 and NW Natural/2900, Borgerson/26-27.

- Application of the 2018 interim tax deferral as a reduction to the outstanding PBA account balance.
- Reduction of the interest rate on the PBA and the resulting 10-year amortization of $8.2 million per year.
- Changes in how EDIT benefits are calculated and amortized. And changes in the related rate base adjustment (see Exhibit 1702 and the TCJA discussion above under Issue 3).

Q. Is the 2018 interim tax benefit $5.9 or $6.8 million and is there complexity in how this amount has been presented?

A. The various estimates of interim tax benefits are presented in the Company's Exhibit 2901.

The estimate underlying the Second Partial Stipulation was $5.9 million and was applied as a reduction of the outstanding estimated projected PBA balance of $78.7 million[33] prior to calculation of the $8.2 million annual amortization. At the time, the full interim period of 10 months had not yet elapsed and the $5.9 million estimate was based on June 2018 results. Exhibit 2901 shows the interim tax benefit is now $6.8 million based on final 10 month results. The Company also reports the final October 31, 2018 PBA balance is $79.9 million.[34]

This is important because the $8.2 million annual amortization amount in the Second Partial Stipulation was based on a $66.2 million starting point

[33] NW Natural-Staff-CUB/201.
[34] NW Natural/3001.

having been reduced by the $5.9 million interim tax benefit and also the then estimate of $6.7 million for EDIT (other).

ISSUE 5. WHY STAFF SUPPORTED THE SECOND PARTIAL STIPULATION

Q. Please summarize Staff's previous testimony in this case regarding why Staff supported the Second Partial Stipulation.

A. This is discussed in Joint Reply Testimony in Support of the Second Stipulation.[35]

Q. Does Staff believe there is additional information regarding the Second Partial Stipulation the Commission ought to consider beyond what is already in the record?

A. Yes. It would be beneficial to elaborate on Staff's thinking during settlement negotiations and ultimately why Staff believed the Second Partial Stipulation (settlement) provided a resolution would have been a fair, just, and reasonable outcome for all parties.

Q. Why is it important to consider the provisions of the Second Partial Stipulation holistically?

A. Because the various concessions made by the parties, when taken as a whole, represented a fair, just, and reasonable outcome.

Q. Please discuss the provisions of the settlement regarding the Pension Balancing Account (PBA).

A. As noted above, there is some question regarding the Company's actions and their effect on the amount of interest that accrued on the PBA. If these questions regarding prudence led to a disallowance, such disallowance should be limited to the $21 million portion of the PBA attributable to interest. Staff

[35] NW Natural-Staff-CUB/300, Borgerson, Wilson, Gardner, and Jenks/13-15.

has not identified any reason to disallow the FAS 87 expense portion of the PBA, which is $59 million. Staff concluded that settling issues related to the PBA created significant value and avoided the potential downside associated with litigation.

Settlement ended further additions of pension cost to the PBA by including all FAS 87 cost in current rates beginning October 1, 2018. Resolution of the accumulated balance requires amortization over a reasonable period of time and negotiation of an interest rate adjustment to slow growth of the account. The account has been earning interest at NW Natural's ROR. Financing the FAS 87 additions to the PBA presumably has created an arbitrage opportunity for the Company if they can borrow money at a rate lower than the ROR. Typical practice would be for the account to earn interest at the Modified Blended Treasure rate after the Commission approves amortization (currently 2.92 percent)[36] which is, presumably, below the Company's cost to finance the PBA account. As noted in the Company's testimony,[37] the settlement of $8.2 million over 10 years reduces the interest rate on the account from 7.317 percent to 4.523 percent. This is a midpoint value that is likely closer to the Company's actual cost of financing the account. Staff agreed to the settlement at the reduced interest rate because it represents a reasonable

[36] Available on the PUC website at thttps://www.puc.state.or.us/electric_gas/UM%201147%20MBT%20MBE%20UG%20221%20PURE%20Rates.pdf accessed 12.7.18.
[37] NW Natural/2800, Wilson/28.

compromise that is responsive to the business needs of the Company while limiting ratepayer liability during the amortization term.

Q. Please discuss the provisions of the settlement regarding the Tax Cut and Jobs Act (TCJA).

A. The settlement provided for an immediate return of the 2018 interim tax benefit and EDIT (Other) by offsetting the accumulated PBA account balance. This provided a ratepayer benefit over the next 10 years by reducing the amount ratepayers will be charged for amortization of the PBA balance. In other words, the agreed upon $8.2 million figure is less than it otherwise would have been using the same implicit interest rate.

In addition, the Company agreed to forgo any earnings test for the 2018 interim tax benefits, return the EDIT (Gas Reserves) benefit over five years instead of 20 years, and agreed to average and return the Edit (Plant) benefit in an equal amount each year over five years.

Q. Please discuss how the settlement would have provided regulatory certainly for the Company and rate stability for customers.

A. The settlement resolves all issues surrounding the PBA and TCJA issues and provides stable rates for a period of five years thereby eliminating a substantial amount of regulatory risk for the Company. This, in turn, reduces business risk for the Company as they will have a more stable and predictable cash flow. The rate stability benefit for customers is twofold. First, by combining and offsetting the PBA and TCJA issues, the various rate increases associated with resolving the PBA are offset by the available TCJA benefits with a stable net increase over a five year period thereby mitigating the potential rate instability if the issues were to be resolved in separate Commission proceedings. Second, given the Company's history of long intervals between rate cases, it is advantageous to resolve the PBA and TCJA issues now and spread the resulting net increase over a longer period of time.

Q. Please discuss how the provisions of the settlement, taken as a whole, represented a reasonable compromise and would have resulted in just, fair, and reasonable rates.

A. The Company made significant concessions to arrive at a negotiated settlement, in particular,

- Mid-point interest rate on the PBA.
- Recovery of the PBA in rates over a relatively long 10 year timeframe.
- Waiver of any earnings test on the 2018 interim tax benefits.
- Return of EDIT (Gas Reserves) over five years instead of 20 years.
- Return of EDIT (Other) immediately rather than arguing for separate return over a number of years.
- Return of EDIT (Plant) using an averaging method that results in returning more sooner than otherwise would have occurred using the individual ARAM method for each year. The Company also assumed the burden of defending this method before the IRS with a significant downside risk if the method is deemed to be a normalization violation.

Staff and CUB also made significant concessions, in particular,

- Amortization of the accumulated PBA balance into rates, including both FAS 87 and interest, without further investigation.
- Mid-point interest rate on the PBA during the amortization term rather than the lower Modified Blended Treasury rate.
- Immediate increase in FAS 87 expense from $3.8 million to $11.9 million.
- Return of EDIT (Gas Reserves) over five years rather than pursuing an immediate return of the full amount.
- Offsetting EDIT (Other) against the accumulated PBA balance, effectively agreeing to recover EDIT (Other) over 10 years, instead of seeking an immediate reduction in rates.
- Delaying return of EDIT (Plant) benefits that would otherwise have been allocable to the 10-month interim period.
- Offsetting the 10-month interim tax benefits against the accumulated PBA balance, effectively agreeing to recover the interim tax benefits over 10 years, instead of seeking an immediate reduction in rates.

In summation, both parties made significant concessions that balanced the interests of all parties. Resolution of these issues also benefits all parties by eliminating the cost and uncertainties inherent in further litigation. Accordingly, Staff believes the settlement represents a fair, just, and reasonable outcome.

Q. Does this conclude your testimony?

A. Yes.

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FAS 87 Additions to the Pension Balancing Account in Excess of Earnings Threshold

Calculation of Earnings Variance:

	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)	(n)	(o)	(p)	(q)
									Results after Type 2 Adjustments								
		Rate Case		UM 1286 Sharing Election			UM 903 Gas Earnings Threshold (GET)		ROO (RG 40) (000's)		Approximate Earnings to match ROE and GET						GET Earnings
Line	Year	Order	ROE	Date	Sharing %	BP [1]	Order	GET	Rate Base	Earnings	Recalc	ROR	LT Debt	Pref Stock	Stock %	ROE	Variance
1	2011	03-507	10.20%	10/14/2011	90/10	100	12-278	10.920%	$ 984,533	$ 85,936	$ 84,700	8.60%	3.50%	0.00%	46.72%	10.92%	1,236
2	2012	03-507	10.20%	10/9/2012	90/10	100	13-255	10.952%	981,230	79,471	83,500	8.51%	3.31%	0.00%	47.50%	10.95%	(4,029)
3	2013	12-437	9.50%	10/15/2013	90/10	100	14-248	10.580%	1,067,102	81,709	87,000	8.15%	3.29%	0.00%	45.96%	10.57%	(5,291)
4	2014	12-437	9.50%	9/19/2014	90/10	100	15-212	10.580%	1,177,346	88,364	96,200	8.17%	3.18%	0.00%	47.22%	10.57%	(7,836)
5	2015	12-437	9.50%	9/11/2015	90/10	100	16-240	10.600%	1,179,938	90,064	98,300	8.33%	3.09%	0.00%	49.45%	10.60%	(8,236)
6	2016	12-437	9.50%	9/15/2016	90/10	100	17-240 [2]	11.060%	1,166,769	87,717	100,900	8.65%	3.00%	0.00%	51.11%	11.05%	(13,183)
7	2017	12-437	9.50%	9/8/2017	90/10	100	18-254	10.660%	1,161,763	83,686	93,241	8.03%	2.72%	0.00%	49.79%	10.66%	(9,555)
8	2018	12-437	9.50%	9/14/2018	90/10	100											

9 [1] per Order No. 08-504 earnings threshold also includes change in risk free rate as calculated in annual UM 903 compliance filings.

10 [2] Election shows 90/10, GET calculated based on 80/20.

Calculation of FAS 87 Additions to Pension Balancing Account (PBA):

		Account Additions			**Excess**	**After**
		FAS 87		PBA	**FAS 87**	**90/10**
Line	Year	Deferral	Interest	Balance	**Deferral**	**Sharing**
11	2011	$ 6,008	$ 234	$ 6,242	**$ 7,244**	**$ 6,520**
12	2012	7,876	904	15,022	**3,847**	**$ 3,462**
13	2013	9,115	1,577	25,713	**3,824**	**$ 3,441**
14	2014	4,578	2,250	32,541	**-**	**$ -**
15	2015	8,241	2,966	43,748	**5**	**$ 5**
16	2016	6,252	3,781	53,780	**-**	**$ -**
17	2017	6,542	4,579	64,902	**-**	**$ -**
18	Oct 18	10,314	4,645	79,861		
19	**Total**	**$ 58,925**	**$ 20,937**	**$ 79,861**	**$ 14,919**	**$ 13,427**
20		74%	26%	100%		

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Comparison of EDIT Calculations and Proposed Amortization Terms

Line	(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)	(i)	(j)	(k)	(l)	(m)
		EDIT valuation in Second Partial Stipulaton Exhibit NW Natural-Staff-CUB/201				**EDIT valuation in Phase 2 Opening Testimony Exhibit NW Natural/2906 and 2911**				**EDIT valuation in Phase 2 Opening Testimony Exhibit NW Natural/2906 and 2912**			
Line		(Plant)	(Other)	(Gas Reserves)	Total	(Plant)	(Other)	(Gas Reserves)	Total	(Plant)	(Other)	(Gas Reserves)	Total
1	System Wide Deferred Tax Remeasurement	$ 140,619	$ 5,450	$ 10,767	$ 156,836	$ 140,619	$ 5,450	$ 10,767	$ 156,836	$ 140,619	$ 5,450	$ 10,767	$ 156,836
2	Adjustment - Resolved Uncertainties					2,426	(639)		1,787	2,426	(639)		1,787
3		140,619	5,450	10,767	156,836	143,045	4,811	10,767	158,623	143,045	4,811	10,767	158,623
4	Oregon %	90.00%	90.00%	100.00%		89.77%	106.57%	100.00%		89.77%	106.57%	100.00%	
5		126,557	4,905	10,767	142,229	128,407	5,127	10,767	144,300	128,407	5,127	10,767	144,300
6	Unknown adjustment				-	46			46	46			46
7	Application of 2017 Earnings Sharing				-	(8,503)	(339)	(713)	(9,555)	(8,503)	(339)	(713)	(9,555)
8		126,557	4,905	10,767	142,229	119,950	4,787	10,054	134,791	119,950	4,787	10,054	134,791
9	Gross Up Factor	1.36	1.36	1.36		1.36	1.36	1.36		1.36	1.36	1.36	
10		$ 172,118	$ 6,671	$ 14,643	$ 193,432	$ 163,132	$ 6,511	$ 13,674	$ 183,316	$ 163,132	$ 6,511	$ 13,674	$ 183,316
		Amortization Proposal				**Amortization Proposal**				**Amortization Proposal**			
11	Immediate		$ 6,671		$ 6,671		$ 6,511		$ 6,511				$ -
12	Year 1	3,263		2,929	6,192	3,000		684	3,684	3,000	651	684	4,335
13	Year 2	3,263		2,929	6,192	3,000		684	3,684	3,000	651	684	4,335
14	Year 3	3,263		2,929	6,192	3,000		684	3,684	3,000	651	684	4,335
15	Year 4	3,263		2,929	6,192	3,000		684	3,684	3,000	651	684	4,335
16	Year 5	3,263		2,929	6,192	3,000		684	3,684	3,000	651	684	4,335
17		$ 16,315	$ 6,671	$ 14,645	$ 37,631	$ 15,000	$ 6,511	$ 3,420	$ 24,931	$ 15,000	$ 3,255	$ 3,420	$ 21,675
18	Rate Base Adjustment	$ 8,156	$ 6,671	$ 7,322	$ 22,149	$ 7,500	$ 6,511	$ 1,710	$ 15,721	$ 7,500	$ 1,628	$ 1,710	$ 10,838

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Pension Plan Contributions Over (under) FAS 87 Expense

Excerpt from NW Natural Supplemental Testimony November 29, 2018

Line		(a) FAS 87 Cost	(b) Expected Contributions	(c) Contributions Over (under) FAS 87
1	2011	$ 16,295,255	$ 22,021,803	$ 5,726,548
2	2012	19,143,533	23,500,000	4,356,467
3	2013	21,514,241	11,700,000	(9,814,241)
4	2014	14,187,012	10,500,000	(3,687,012)
5	2015	20,772,490	14,108,111	(6,664,379)
6	2016	17,271,567	14,470,000	(2,801,567)
7	2017	18,126,300	19,430,000	1,303,700
8	2018	20,788,764	12,470,000	(8,318,764)
9		$ 148,099,162	$ 128,199,914	$ (19,899,248)

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