McDOWELL RACKNER GIBSON PC

WENDY MCINDOO
Direct (503) 290-3627
wendy@mrg-law.com

November 21, 2018

VIA ELECTRONIC AND U.S. MAIL

Attention: Filing Center
Public Utility Commission of Oregon
P.O. Box 1088
Salem, Oregon 97308-1088

Re: Docket UG 344: NW Natural's Reply Testimony

Attention Filing Center:

Enclosed for filing in the above-referenced docket is an electronic copy of NW Natural's Opening Testimony and Exhibits in Phase II of the docket. The confidential exhibit will be sent separately via U.S. Mail to the parties who have signed the Protective Order (Order No. 18-002).

Please contact this office with any questions.

Sincerely,

Wendy McIndoo
Office Manager

Enclosures

CERTIFICATE OF SERVICE

I hereby certify that on November 21, 2018 I have served by U.S. mail the foregoing NWN Opening 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: November 21, 2018

Wendy McIndoo

Wendy McIndoo
Office Manager

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Opening Testimony of Brody Wilson

PENSION BALANCING ACCOUNT

Exhibit 2800

EXHIBIT 2800 – UG 344 PHASE II

OPENING TESTIMONY OF BRODY WILSON

PENSION BALANCING ACCOUNT

TABLE OF CONTENTS

Rates & Regulatory Affairs
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I. INTRODUCTION AND SUMMARY

Q. Please state your name and position.

A. My name is Brody Wilson. I am Controller and Chief Accounting Officer 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 Phase I of this docket. Specifically, I filed: NW Natural/2600, NW Natural-Staff-CUB/200-203 and 300.

Q. What is the purpose of your testimony in Phase II?

A. The purpose of my testimony is to respond to the direction of the Public Utility Commission of Oregon (Commission) and the Administrative Law Judge that the parties provide additional testimony and briefing addressing the issues not resolved in Order No. 18-419, including rate recovery for (a) the deferred benefits flowing from the Tax Cuts and Jobs Act (TCJA) and (b) the Company's unrecovered pension asset as reflected in NW Natural's pension balancing account (PBA).[1] In Order 18-419, the Commission adopted an all-party stipulation addressing a number of revenue requirement issues raised by this case. In addition, the Commission adopted specific aspects of a partial stipulation among NW Natural, Commission Staff (Staff) and the Citizens Utility Board (CUB) (Second Partial Stipulation). Specifically, the Commission ordered the freezing of the PBA, and, on a going-forward basis, the recovery of the Company's current FAS 87 pension expense in rates. However, the Commission rejected the portions of the Second Partial Stipulation that would have allowed the Company to (a) apply the deferred TCJA benefits to the PBA;

[1] Order No. 18-419 at 14-15 and Prehearing Conference Memorandum issued on November 13, 2018, as revised by ALJ Ruling Issued November 15, 2018.

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NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

and (b) amortize the balance in the PBA over a ten-year period, with a lowered interest rate. The Commission stated that while it commended the stipulating parties' efforts, and encouraged further work to reach a practical solution, the Commission was concerned that there was not sufficient evidence in the record to support the Second Partial Stipulation's result. Therefore, the Commission ordered further proceedings in Phase II of this docket, to allow the parties to address the issues.[2] My testimony, in particular, will address the issues relevant to the Company's recovery of the PBA balance. Mr. Sean Borgerson is also filing testimony, to address the issues relevant to the TCJA.

Q. Please summarize your testimony.

A. Historically, all Oregon utilities have offered defined benefit pension plans to their employees as a component of competitive compensation. While most utilities, including NW Natural, have closed these plans to new employees, they nevertheless must maintain the plans for the life of the covered employees. Utilities fund these plans by making periodic cash contributions, which are dictated by federal laws and determined by actuaries. However, financial accounting standards—in particular, FAS 87, require that employers recognize their pension costs on an accrual basis, over the life of the retirees that will be receiving the pension payments. From the inception of FAS 87, this Commission has mandated that utilities recover their pension costs on the basis of FAS 87.

In 2010, NW Natural filed a petition to defer its excess FAS 87 expense, due to chronic under-recovery. Ultimately the parties to that docket—Staff, CUB, NW Natural and AWEC-- agreed that NW Natural should establish a pension balancing account that

[2] Order No. 18-419, at 15.

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would track its excess FAS 87 pension expense over or under the amount included in rates until, over time, the balancing account "became negative."[3] In addition, the parties agreed that the PBA would accrue interest at the Company's authorized rate of return (ROR).[4] At the time, based on third-party actuarial forecasts of the Company's pension expense, NW Natural expected 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. Due to various factors outside of NW Natural's control, that did not occur and the PBA balance has continued to increase. The Company brought this issue to the parties' attention prior to filing this case, and ultimately Staff, CUB and the Company entered into the Second Partial Stipulation, under which the Stipulating Parties agreed that the PBA would be frozen and amortized over a ten-year period, with a reduced interest rate accruing on the balance. The Stipulating Parties also agreed that prior to amortization, a portion of the Company's tax benefits resulting from the TCJA, totaling approximately $12.6 million—which had been deferred in accordance with its application in UM 1919—would be applied to the PBA, thereby reducing the balance.

The terms of the Second Partial Stipulation, which have now been rejected by the Commission, would have provided substantial benefits to NW Natural's customers. Importantly, as part of the agreement, NW Natural consented to waiving the earnings review prior to amortization of the tax benefits associated with the TCJA that have been deferred in UM 1909—that is, the benefits associated with the re-measurement of deferred taxes, which occurred in 2017, as well as the tax expense received by the Company in

[3] Order No. 11-051, Appendix A, p. 3
[4] Id.

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1-503-226-4211

2018 (the "Interim Period Deferral"). In the absence of the Second Partial Stipulation, that earnings review will reduce the net deferred benefits to customers. In addition, under the terms of the rejected stipulation, NW Natural had agreed to substantially reduce the amount of interest accruing on the amounts in the balancing account. The estimated benefit associated with the reduction, which would have been received by NW Natural's customers under the Stipulation, is approximately $11.1 million. NW Natural agreed to these concessions in order to arrive at a compromise resolution, and to secure regulatory certainty for the Company and its customers.

The Commission has asked whether it is in the public interest for the Company to recover the entire balance of the PBA, without first performing earnings and prudence reviews as requested by the AWEC. The answer to that question is yes, for the following three reasons:

- ***First***, the PBA Stipulation—which was agreed to all parties including AWEC, and approved by the Commission—allowed for dollar-for-dollar recovery by NW Natural of all amounts booked to the PBA, without a prudence review, and without an earnings review until the full amount in the account had been reduced to zero. Therefore, ordering either a prudence review or an earnings review would be inconsistent with the express terms of the PBA Stipulation—undermining the parties' efforts in arriving at the PBA Stipulation and the precedent set by the Commission in approving it.
- ***Second,*** the Commission can be assured that the FAS 87 expense included in the PBA is properly calculated and valid. Importantly, after a lengthy and comprehensive investigation, the Commission has recently affirmed its long-

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1-503-226-4211

standing practice of allowing utilities to recover their pension costs based on FAS 87. And, NW Natural's FAS 87 expense is calculated by third-party actuaries and reviewed by external auditors, and no party has ever questioned the amounts included in the PBA.

- ***And third,*** the Company has prudently exercised its fiduciary responsibilities to manage its pension accounts by making all required contributions and retaining expert pension advisors. All remaining factors that influence FAS 87 expense—such as interest rates and actuarial assumptions—are wholly outside the Company's control.

NW Natural is hopeful that through the Phase II proceedings—including additional discussions and the production of additional data—the parties will come to a reasonable resolution of the issue that can be supported and presented to the Commission for approval. However, in the absence of a full agreement, NW Natural urges the Commission to order a reasonable amortization of the PBA, with a continuation of interest at its authorized ROR—consistent with the terms of the PBA Stipulation. In addition, the Company requests that the Commission apply an earnings review prior to amortizing any portion of the deferred TCJA benefit.

II. BACKGROUND ON FAS 87 PENSION EXPENSE

Q. Please describe the pension plans giving rise to the expense tracked in the PBA.

A. NW Natural, like all Oregon jurisdictional utilities, maintains defined benefit pension plans for employees. In 2007 and 2010, NW Natural closed to new participants the qualified defined benefit pension plans for non-bargaining employees and bargaining employees respectively, in an effort to contain costs. However, the Company must continue to fund

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Portland, Oregon 97209-3991
1-503-226-4211

and manage the plans for participating employees and retirees. Accordingly, NW Natural has and will continue to have financial obligations associated with its pension plans for the lifespan of the covered employees and retirees.

Q. What is a defined benefit pension plan?

A. A defined benefit pension plan (or, simply, pension plan—for the purposes of this testimony) is an employer-sponsored retirement plan through which employees accrue benefits during their years of service to the company and receive specified payments after they retire.[5] The payments to retirees made under pension plans are guaranteed and an employer must keep the plan funded at a level such that this obligation can be met. In other words, the employer bears the responsibility of ensuring that enough funds are available to pay retirees at a specified level. This obligation is different from other types of retirement plans, such as 401(k) savings plans, where employees (and often employers) make contributions at a predefined level and employees assume the market risk of changes in the value of their investments. These latter plans are known as "defined contribution" plans.

Q. Why does NW Natural have a pension plan?

A. NW Natural's pension plan is a component of competitive compensation provided to the employees that carry out the utilities' functions. This benefit has helped companies acquire and retain qualified employees over the years. As noted, the plans were closed to new participants and today the Company offers enhanced 401(K) retirement benefits in place of the pension plan to new employees.

[5] Some pension plans allow employees to alternately take a lump-sum payout upon retirement rather than annuity payments.

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1-503-226-4211

Q. Are pension plans regulated?

A. Yes. In order to be a "qualified plan" and qualify for a tax deduction, the pension plan must meet the requirements of the Internal Revenue Code including compliance with rules set under the Employee Retirement Income Security Act of 1974 (ERISA). ERISA outlines funding requirements and charges the fiduciaries involved with:

> "…run[ning] the plan solely in the interest of participants and beneficiaries and for the exclusive purpose of providing benefits and paying plan expenses. Fiduciaries must act prudently and must diversify the plan's investments in order to minimize the risk of large losses. In addition, they must follow the terms of plan documents to the extent that the plan terms are consistent with ERISA."[6]

The ERISA rules, including the funding requirements of the Pension Protection Act of 2006 ("PPA"), are intended to provide benefits security for retirees by protecting the assets of pension funds and also guarantee payment of certain benefits in the event of plan termination through the federally chartered Pension Benefit Guaranty Corporation. The ERISA rules also establish certain minimum requirements for pension plans and require that certain information regarding plan features and funding be distributed to plan participants on a regular basis. The employers' contributions, and any returns on those contributions, cannot be remitted from the trust back to the employer unless the plan is overfunded at plan termination, at which point any reverted funds would be subject to significant excise and income taxes.

Q. Who are the fiduciaries referred to above?

A. There are multiple parties with fiduciary obligations. As an employer, NW Natural has a responsibility to contribute funds as employees accrue benefits over time. Trustees hold the pension plan assets, while administrators oversee the day-to-day operations. A

[6] U.S. Department of Labor http://www.dol.gov/ebsa/faqs/faq_compliance_pension.html

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1-503-226-4211

custodian or fund manager is tasked with managing the portfolio of investments. Actuaries, auditors and legal counsel are also employed to help ensure compliance with regulatory requirements and the terms of the pension plan.

Q. Please describe how pension plans operate.

A. At a high level, pension plans operate as follows:

- An employer (NW Natural, in this case) contributes cash or investments to a qualified pension trust;
- The funds are added to the pool of plan assets that are invested primarily in debt and/or equity securities;
- Returns on these investments increase the pool of assets; and
- Retirees are paid from the plan assets.

Q. How do the employers determine the amount to contribute?

A. Employers rely on third-party actuaries to calculate the level of funding necessary to meet specified targets. These targets are typically guided by federal minimum funding requirements based on the value of plan assets and the projected future obligation. Each year, the actuaries project the future obligation based on benefits accrued to date.

Q. How do employers recognize and account for the costs of their pension plans?

A. Since 1987, employers are required to use FAS 87 accounting standards for financial reporting of pension cost. FASB Financial Accounting Standard 87 which has been subsequently codified into FASB Accounting Standards Codification Topic 715, Compensation – Retirement Benefits (ASC Topic 715). This expense is therefore often referred to as FAS 87 expense, which is how we refer to it in this testimony. FAS 87 requires employers to recognize the cost of their pension plans on an accrual rather than a cash basis. In other words, pension cost is recognized over the period during which

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Portland, Oregon 97209-3991
1-503-226-4211

benefits are earned, or "accrued"—that is during the working years of the employees that will receive the pension benefits during retirement.[7]

The FAS 87 expense is calculated based on four components:

- Service cost—the value of the benefits earned or accrued during the current year, based on the applicable benefit formula for each participant.
- Interest cost—interest on the pension plan liability for the year. This amount increases pension cost and represents the time value of money on the benefit obligation.
- Expected return on assets—the expected return on the assets for the year, which if positive will reduce pension costs.
- Amortizations of unrecognized costs—the change in liability due to plan changes, changes in actuarial assumptions used to value plan liabilities, etc.

Importantly, FAS 87 can be positive or negative.

Q. How do Oregon jurisdictional utilities recover the costs associated with pension plans in their rate?

A. Prior to the adoption of FAS 87, recovery for pension costs was based on actual cash contributions. However, since FAS 87's inception, it has served as the basis by which Oregon utilities have recovered pension costs in rates. NW Natural was the first utility to switch to FAS 87-based rate recovery in 1986, and the other utilities followed suit. As stated by the Commission, "the use of FAS 87 . . . has been favored because it spreads

[7] In addition to FAS 87 expense, the employers account for the funded status of the pension plan and the amount of unrecognized pension expense as a liability on their financial statements. The difference between total cumulative contributions made to the pension trust and the cumulative FAS 87 expense recognized over the life of the plan equals either a prepaid pension asset (contributions in excess of FAS 87 expense) or accrued pension liability (FAS 87 expense recognized in excess of contributions).

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Portland, Oregon 97209-3991
1-503-226-4211

the cost of the plan over a reasonable period of time and is less volatile than actual cash contributions."[8]

Q. In recent years has the Commission reviewed its policy?

A. Yes. In 2012 the Commission opened a docket to investigate the ratemaking treatment of pension-related costs and to determine policy for how utilities should recover these costs on a going-forward basis.[9] Specifically, the utilities urged the Commission to continue the allowance of recovery of FAS 87 expense, but to also allow the utilities to recover the costs to finance contributions to the qualified pension trust. After a full procedural schedule, including testimony and briefs, the Commission rejected the utilities' proposal to allow the utilities the ability to recover the cost of financing cash contributions, but reaffirmed its policy of allowing utilities to recover FAS 87 expense. In making this determination, the Commission observed that "FAS 87 has been used successfully for almost 30 years as part of this Commission's overall ratemaking formula to appropriately balance the interests of the utilities and customers and establish overall rates that were just and reasonable.[10]

III. ADOPTION AND OPERATION OF THE PENSION BALANCING ACCOUNT

Q. How and why was the PBA established?

A. In 2010, in response to substantial increases in pension costs—and chronic under-recovery of those costs in rates—NW Natural filed an application to defer its excess FAS

[8] In the Matter of Pub. Util. Comm'n of Or., Investigation into Treatment of Pension Costs in Utility Rates, Docket No. UM 1633, Order No. 15-226 at 4 (Aug. 3, 2015).

[9] UM 1633 (Nov.15, 2012).

[10] Docket No. UM 1633, Order No. 15-226 at 10.

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

87 pension expenses. As the Company explained in testimony, pursuant to the Commission order in its 2003 rate case, it had been recovering its pension expense through FAS 87, set at approximately $3.796 million per year.[11] In contrast, its actual FAS 87 pension was significantly higher—at the time, almost twice that amount—and the Company was subject to a rate case moratorium, and therefore unable to request an increase in FAS 87 recoveries.[12] The parties ultimately entered into a stipulation by which they agreed that NW Natural would establish a balancing account to track the differences between actual pension expenses experienced by NW Natural, and the amount included in rates (PBA Stipulation).[13] The Commission adopted the stipulation in Order No. 11-051.

Q. Did the PBA Stipulation allow for full recovery of FAS 87 expense, including interest accrued on the balance of the PBA?

A. Yes, it did. NW Natural would not have entered into the Stipulation otherwise.

Q. How did the PBA Stipulation dictate that the balancing account would work?

A. Pursuant to the PBA Stipulation, NW Natural was to continue to collect FAS 87 expense at the same level as that set in its 2003 rate case, until that amount would be reset in the future as explained below. The PBA Stipulation prescribed that the Company would book to the balancing account on a monthly basis all FAS 87 expense incurred by the Company,

[11] NW Natural-Staff-CUB/200, Borgerson, Wilson Gardner, and Jenks (Joint Testimony in Support of Second Stipulation) at 16. The precise amount is $3.796 million.

[12] Joint Testimony in Support of Second Stipulation at 16. (The Company also requested that it be allowed to add its prepaid pension asset to rate base, but that request was not adopted in the stipulation.)

[13] Joint Testimony in Support of Second Stipulation at 16.

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

net of amounts recovered in rates for FAS 87.[14] Also pursuant to the PBA Stipulation, the balancing account was to accrue interest at NW Natural's currently authorized rate of return.[15] Under the PBA Stipulation, NW Natural was to continue booking expenses to the PBA until the balance became a negative number, after which amounts booked to the account would be subject to an earnings test.[16] Then, after the next general rate case after the account has become negative, the PBA Stipulation called for the termination of the balancing account. At that point, the Company was to be allowed to request that the balance be amortized.[17]

Q. Please detail the earnings test required by the PBA Stipulation.

A. As noted, the earnings test was to be applied only after the balance in the account became negative—that is, after NW Natural recovered the entire balance in the PBA, by its operation. After that point, any additional amounts booked to the account were to be subject to an earnings test as follows:

> [T]o the extent that balancing account entries for the calendar year would cause the company to experience earnings in excess of its Commission-authorized return on equity, NW Natural must remove from the balancing account the amounts that would cause NW Natural to exceed it's the Commission authorized return on equity. (Example: The balance in the balancing account becomes negative in 2013. Two years later, in 2015, NW Natural undercollects $5 million from ratepayers for FAS 87 pension expense and books $5 million to the balancing account or (sic) collection $5 million balance). After NW Natural's results of operations for 2015 are available, Parties will

[14] In the Matter of Nw. Natural Gas Co., dba NW Natural, Application to Defer Pension Costs, Docket No. UM 1475, Order No. 11-051, App. A at 3 (Feb. 10, 2011). As a practical matter, after the Company received its actuarially determined FAS 87 expense, it first capitalized a percentage of the expense associated with employee payroll allocations, then the remaining amount of the Oregon-allocated expense above the amount authorized for collection in rates was booked to the balancing account.

[15] Docket No. UM 1475, Order No. 11-051, App. A at 3.

[16] Docket No. UM 1475, Order No. 11-051, App. A at 3.

[17] Docket No. UM 1475, Order No. 11-051, App. A at 4.

Rates & Regulatory Affairs
NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

> review NW Natural's earnings for 2015 to determine whether they exceed NW Natural's authorized return on equity for 2015. [18]

Q. Did the PBA Stipulation place any restrictions on any party's ability to request an increase in the amount of FAS 87 collected through the balancing account?

A. Yes. The PBA Stipulation prohibited any party from requesting that FAS 87 collected in rates be increased prior to the termination of the balancing account.[19]

Q. What was the expectation of the parties to the PBA Stipulation as to how long it would take for the balancing account to reach zero?

A. At that time, NW Natural expected that its FAS 87 pension expense would remain very high over the following three years, significantly exceeding recovered amounts and adding to the PBA balance. However, the Company also expected to make very sizeable cash contributions over the following years and therefore expected that, by 2016, FAS 87 expense would decrease below the level included in rates, thereby reducing the balance in the balancing account. Accordingly, the Company estimated that the balancing account would "go negative" by 2017.[20]

Q. Did the Company make sizeable cash contributions as expected?

A. Yes. In fact, for the period from 2010 through 2017, the Company contributed $124 million to the plan. These contributions were somewhat lower than had been predicted in the PBA Stipulation—which stated that the Company had intended to make cash contributions of approximately $128 million between 2010 and 2017[21]—because of changes in discount

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[18] Docket No. UM 1475, Order No. 11-051, App. A at 3.

[19] Docket No. UM 1475, Order No. 11-051 at 4.

[20] Docket No. UM 1475, Joint Brief in Support of Stipulation at 5. (Note that this section of the brief was filed as confidential because it included a forecast regarding future financial status of the Company. It can now be provided non-confidentially.)

[21] Docket No. UM 1475, Order No. 11-051, App. A at 2.

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

rates, and the passage in 2012 of the Moving Ahead for Progress Act for the 21st Century (MAP-21). As described in more detail below, MAP-21 allowed plans to use a higher interest rate in the short term when measuring the liability for pension funding purposes, which temporarily improves a plan's funded status and decreases the amount of contributions required.

Q. Did the amounts in the PBA decrease over time as expected?

A. No. Despite the very significant contributions made by the Company to its pension plans, other factors outside of the Company's control resulted in FAS 87 being well above collected levels over the intervening years—a condition that will only end with the new rates adopted in this case. As a result, the amounts in the account continued to increase up until the date the PBA was frozen by the Commission. Meanwhile, until a resolution is ordered, the balance in the PBA continues to accrue interest at NW Natural's authorized rate of return.

Q. What were the factors outside of the Company's control that led to the continuation of high FAS 87 expense?

A. There are many factors that impact FAS 87 expense. However, there were two factors, that resulted in the increase of the Company's FAS 87 expense-- and failure of the balance in the PBA to decrease as expected—both of which were outside the Company's control: these were the estimated discount rates and rates of return on assets. As explained in NW Natural's testimony in UM 1475, in September 2010, the Company's pension expense calculations reasonably assumed a discount rate for the plan of 5.5 percent, and that asset returns would be 8.25 percent over the forecasted period 2011 through 2023.[22] However

[22] Docket No. UM 1475, NWN/200, Feltz/8.

Rates & Regulatory Affairs
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Portland, Oregon 97209-3991
1-503-226-4211

actual discount rates steadily declined from approximately 6 percent in 2011 to 3.8 percent in 2015. Lower discount rates result in a higher benefit obligation and higher expense.

Q. Can you estimate the impact that the lower actual discount rate had on the plan assets?

A. Each year, our actuaries provide a sensitivity analysis which shows the impact of a 0.25 percent decrease in interest rates and its impact on pension expense. In 2012, the impact was estimated at $1.2 million of annual expense increase for every 0.25 percent decline in interest rates. In 2017 the same analysis showed a $1.4 million increase in annual pension expense for every 0.25 percent decline in the discount rate. With discount rates declining over 2.00 percent from 2012 through 2017, that results in an estimated $9.6 million to $11.2 million annual increase in pension expense compared to what was forecasted in 2010. Similarly, the actuaries provide sensitivities for the impact of a 0.25 decrease in the expected return on assets. In 2012, it was estimated a decrease of 0.25 in the return would result in a $0.6 million increase in expense. In 2017 the same analysis showed that a decrease of 0.25 percent in the expected return would result in a $0.7 million increase in annual expense. Since 2010 when we submitted our expectations for pension expense in UM 1475, our return on asset assumption was decreased twice, once in 2011 from 8.25 percent to 8.00 percent, and then again in 2012 from 8.00 percent to 7.5 percent. It has remained at 7.5 percent since 2012. While not as material as the change in discount rates, the lower return assumptions do impact pension expense.

Rates & Regulatory Affairs
NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

Q. Were there any other significant events that influenced the Company's FAS 87 expense?

A. Yes. As mentioned above, Congress passed MAP-21, which included pension funding stabilization provisions. Most plan sponsors calculate liabilities for pension funding purposes using three segment rates, which represent a 24-month average of interest rates. MAP-21 introduced a corridor around the 24-month average segment rates, so that each segment rate must be within a certain percentage of the 25-year average. The percentage starts at 10 percent in 2012, and gradually increases to 30 percent by 2016. This corridor was expected to increase funding interest rates for several years following the adoption of MAP-21. The actual impact of MAP-21's interest rate provisions depended on the path of future market interest rates. In a rising interest rate scenario, it would provide funding relief through 2016 and in a flat rate environment would provide relief through 2021.

Then in 2014, H.R. 5201 was passed, which extended the funding relief under MAP-21. The extension results in higher interest rates used to calculate funding requirements in the near-term (i.e., lower present value liabilities) and therefore lower contributions.

Q. Did the passage of MAP-21 and its extension result in the Company making lower-than-expected contributions to its plans?

A. Yes. While both pieces of legislation had significant impacts on contribution requirements, the Company nevertheless contributed, from 2010 to 2017, approximately $124 million compared to our projection of $128 million. This legislation really only impacted the timing of the contributions, acting to spread-out the contributions over the period, as compared

Rates & Regulatory Affairs
NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

to a more front-loaded contribution schedule that was forecasted in 2010 prior to the new legislation. While this legislation impacted timing of contributions and thus impacted pension expense, we believe that the impact of lower discount rates during the period has had the greatest impact.

Q. What is the status of the PBA today?

A. As of November 1, 2018, when the account was frozen the balance was $79.9 million, and that balance is accruing interest at the Company's authorized rate of return.

Q. How and why did NW Natural choose to raise the issue of the pension balancing account in this rate case?

A. As discussed above, NW Natural was bound to the PBA Stipulation and specifically prohibited from proposing that the FAS 87 expense recovered in rates be increased from the level agreed to in UM 1475. So, NW Natural was in no position to propose a change to the PBA unilaterally. However, the Company did want to make the Parties and the Commission aware that the PBA was a problem that would need to be solved, and so NW Natural reached out to parties before it filed its rate case to inform them of the issue.[23] Additionally, the Company described the issue for the Commission in each round of testimony in the case. The Company did state that in the event that the parties reached an agreement to modify the amount of FAS 87 recovered in rates, they could bring a proposal to the Commission in a settlement.[24]

[23] NWN/200, McVay/20-21.
[24] NWN/200, McVay/21.

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Portland, Oregon 97209-3991
1-503-226-4211

Q. Did this higher than expected balance in PBA raise issues for the parties to the PBA Stipulation?

A. Yes. All parties were concerned about the balance and level of interest accruing on the amounts in the balancing account. In addition, the continued unrecovered balance presented a cash flow issue for the Company.

Q. Did any parties make any specific proposals regarding the PBA in their testimony?

A. No, not initially. CUB recognized the limits on the parties' abilities to propose a change to the balancing account, but did suggest that the interest rate accruing on the account could be reduced, that the account should terminated, and that the amount of FAS 87 expense collected in rates might be increased.[25] Staff noted its concern about the increasing balance in the account, and stated its expectation that the parties would discuss a mutually agreeable resolution through settlement.[26]

Q. What was the Company's response?

A. The Company expressed that it would be open to changes to the balancing account.[27] For example, the Company explicitly stated that, in order to reverse the current trend of increases to the PBA, the Commission would need to approve an increase to the amount of FAS 87 expense collected in rates, and also pointed out that the parties had a unique opportunity to reduce the amount in the PBA—presented by the deferred tax benefit resulting from the TCJA, which could be applied to the PBA balance.

[25] CUB/100, Jenks-Gehrke/41-42.
[26] Staff/300, Fox/28-32.
[27] NWN/2600, Wilson/5.

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Portland, Oregon 97209-3991
1-503-226-4211

Q. Did the parties ultimately agree upon a resolution to the issues raised by the PBA?

A. Staff, CUB and the Company entered into the Second Partial Stipulation. However, AWEC declined to join.

Q. Please briefly summarize the terms of the Second Partial Stipulation.

A. The Second Partial Stipulation addressed both the impacts of tax reform, and the pension balancing account. The terms specific to the impacts of tax reform are detailed in the testimony of Sean Borgerson. The key terms specific to the PBA required NW Natural to take the following actions:

- "Freeze" the PBA as of October 31, 2018, meaning that NW Natural will no longer book FAS 87 expense into the PBA.
- Reduce the balance in the PBA by applying the deferred Interim Period Tax Deferral of $5.9 million, plus interest, and the EDIT of $6.7 million, resulting in a total reduction of the PBA by totaling $12.6 million.
- Amortize the balance of the PBA over a ten-year period by collecting $8.2 million per year from all customers through a separate tariff rider.
- Increase the amount of FAS 87 expense recovered in rates by $8.1 million to reflect the total Test Year FAS 87 pension expense.

Importantly, in agreeing to offset the total deferred tax benefit against the PBA, the Company agreed to forgo the earnings review that otherwise would have been required by statute before any portion of the deferral could be returned to customers.

Q. Why did the Stipulating Parties support the Second Partial Stipulation?

A. As discussed in the testimony filed in support of the Second Partial Stipulation, the Stipulating Parties agreed that the proposal was an appropriate result for the following reasons:

1. At the time the PBA Stipulation was entered, AWEC, Staff, CUB and NW Natural all agreed that NW Natural should fully recover its FAS 87 expense

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NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

and costs of financing that expense, and that these costs were prudently incurred.

2. The agreement to freeze the PBA would prevent the balance from increasing further and would minimize the overall amount of interest accumulating on the balance.

3. The application of $12.6 million in tax benefits to the PBA reduces the balance, and avoids the interest that would otherwise accrue on that amount.

4. The $8.2 million amortized over 10 years includes a reduction to the interest rate that would otherwise be accruing on the PBA were it to continue under the PBA Stipulation.[28]

5. Given that the PBA was frozen, NW Natural would begin recovering Test Year FAS 87 expense in rates.

All parties agreed that the Stipulation reflected a reasonable compromise and creative solution to the PBA and tax reform issues in the rate case. In addition, the parties agreed that the Stipulation was in the public interest and would result in fair and reasonable rates, consistent with the standard in ORS 756.040.[29]

Q. In support of the Second Partial Stipulation, NW Natural and the Stipulating Parties all agreed that a prudence review was not required before the balance in the PBA could be amortized. Why did the NW Natural and the Stipulating Parties take this position?

A. In their testimony in support of the Second Partial Stipulation, the parties explained that since 1986, it has been this Commission's policy to allow utilities to recover their pension expense through FAS 87 expense, and the Commission has fully investigated and

[28] Joint Testimony in Support of Second Stipulation at 18-19.

[29] Second Partial Stipulation at 5.

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NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

reaffirmed this policy as recently as 2015.[30] As explained above, this Commission is aware that FAS 87 is a complicated calculation performed by the utilities' actuaries, and has concluded that FAS 87 should be the basis of recovery in utilities' rates. Importantly, NW Natural is unaware of a case where AWEC or any other party has questioned the prudence of any utility's FAS 87 expense, and can find no instance in which the Commission disallowed any portion of any utility's FAS 87 expense.

Moreover, the Stipulating Parties explained that in adopting the PBA Stipulation NW Natural, Staff, CUB and AWEC all agreed that the Company's FAS 87 expense was prudently incurred and should be recovered by operation of the balancing account.[31] To be clear, the intent of the parties to the PBA Stipulation was that NW Natural would recover 100 percent of its FAS 87 expense over time, through the operation of the account, up until the time that the account balance was fully recovered. The fact that the amounts in the account are now being proposed to be amortized and recovered over a 10-year period does not make a prudence review any more appropriate.

Q. Similarly, NW Natural and the Stipulating Parties argued that the Commission should not perform an earnings review prior to amortizing the amounts in the PBA. Why did the NW Natural and the Stipulating Parties take this position?

A. The Stipulating Parties correctly pointed out that the PBA Stipulation did not require an earnings review[32] until the time that the amounts in the account were fully recovered, which clearly has not occurred in this case. Therefore, requiring an earnings review to be applied to the amounts booked to the account to date would be contrary to the terms of

[30] Joint Testimony in Support of Second Stipulation at 20.
[31] *Id*.
[32] Docket No. UM 1475, Order No. 11-051, App. A at 3-4.

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NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

the original PBA Stipulation. The PBA Stipulation contemplated 100 percent recovery without an earnings review and there is no reason one should be performed now.

Q. What did the Commission conclude?

A. The Commission accepted two aspects of the Stipulation, and rejected the rest. Specifically, the Commission directed NW Natural to freeze the pension balancing account, and ordered NW Natural, on a going-forward basis, to collect its Test Year FAS 87 expense, thus increasing recovery of FAS 87 expense by $8.1 million annually. However, the Commission rejected the Stipulation's agreement to apply the tax proceeds to the PBA, and to amortize the balance of the PBA over 10 years.[33]

Q. What reason did the Commission give for its actions?

A. The Commission commended the parties' efforts in attempting to forge an agreement on the PBA and related tax issues, and encouraged the parties to continue those efforts. The Commission also specifically stated that it did not oppose the concept of using tax savings to offset the rate impacts of addressing the PBA. However, the Commission found that there was simply insufficient support in the record to conclude that the Second Partial Stipulation was in the public interest. Specifically, the Commission found that it required additional evidence supporting the Stipulating Parties' view that the entirety of the PBA's significant balance is subject to recovery without a prudence review or earnings test—both of which AWEC had advocated. Therefore, the Commission ordered further proceedings to allow the parties to promptly address these issues.[34]

[33] Order No. 18-419, pp. 18-19.
[34] I*d.*

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1-503-226-4211

IV. PRUDENCE AND EARNINGS REVIEW

Q. Please explain why NW Natural believes that full recovery of the PBA is in the public interest without first performing either a prudence review or an earnings review.

A. There are three primary reasons why it is in the public interest for the Commission to allow full recovery of the PBA balance without first performing either a prudence or earnings review prior to authorizing recovery of the balance in the PBA. First, amortization of the full amount of the PBA without first requiring a prudence review is consistent with Commission precedent. Second, amortization of the full amount of the PBA without first performing a prudence or an earnings review is required to give effect to NW Natural's legitimate expectations based on the PBA Stipulation. And third, as discussed in the next section of my testimony, the overall effect of the Second Partial Stipulation—which confirms that no earnings review or prudence review are required—provides customers with very significant benefits.

Q. Why do you say that amortization of the full amount of the PBA—without first performing a prudence review—is consistent with Commission precedent?

A. As noted above, this Commission has already determined that FAS 87 expense is the preferred approach for recovery of pension costs. The Commission first adopted this position immediately after FAS 87 was adopted, and reaffirmed this position after a full investigation in 2014. Thus, since 1986, this Commission has consistently included FAS 87 expense in utility rates, and has never questioned the prudence of that expense. Similarly, the Commission has never required an earnings review.

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Portland, Oregon 97209-3991
1-503-226-4211

Q. Why do you say that recovery of the PBA without a prudence or earnings review is required to give effect to NW Natural's legitimate expectations based on the PBA Stipulation?

A. The PBA Stipulation did not contemplate disallowances of any portion of the Company's FAS 87 expense, either by operation of a prudence review, or an earnings review prior to the full recovery of the PBA balance. On the contrary, the PBA Stipulation allowed the Company to book 100 percent of its unrecovered FAS 87 to the PBA, with the full expectation that the balance would be recovered by the Company over time, with interest. This stipulation represented a compromise of the parties' positions and was signed by all parties—Staff, AWEC and CUB—and approved by the Commission. Thus, this Commission's adoption of the PBA Stipulation created in NW Natural the reasonable business expectation that the Company would be allowed to recover the full amount in the account. It would be poor public policy for the Commission to "undo" the PBA Stipulation and frustrate the Company's reasonable expectations.

Q. AWEC argued that an earnings review should be required prior to amortizing amounts in the PBA, pointing to the earnings review that was in included in the PBA Stipulation. What is your response?

A. NW Natural was surprised that AWEC would make this request—given the terms of the PBA Stipulation. As explained above, the earnings review in the PBA Stipulation very clearly and expressly was to be applied only after NW Natural fully recovered the entire balance of the PBA.[35] However, NW Natural has never recovered any portion of the balance of the PBA, so the earnings review in the PBA Stipulation is not relevant to the

[35] Docket No. UM 1475, Order No. 11-051, App. A at 3-4.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
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1-503-226-4211

situation the parties are addressing. To be clear, the earnings review AWEC is now proposing does not advance but rather undermines the parties' intent as reflected in the PBA Stipulation, which was to allow the Company the ability to recover 100 percent of its FAS 87 expense up until the time PBA became negative. And importantly, both Staff and CUB agree with NW Natural on this point.[36]

Q. How can the Commission be assured that all amounts contained in the PBA were prudently incurred?

A. For two reasons. First, all amounts booked to the PBA are FAS 87 expense which the Commission has found to be the appropriate basis for the recovery of pension costs. The Company's FAS 87 expense has been accurately calculated and therefore appropriately booked to the PBA. Second, the Company prudently exercised its fiduciary responsibility to manage its pension accounts, and all actions that it took that impacted the amounts in the PBA were prudent.

Q. Please explain in more detail how can the Commission be assured that the FAS 87 that was included in the PBA was accurately calculated?

A. The Company's FAS 87 expense is calculated by a reputable third-party actuary. From 2011 to 2017, this was Aon Hewitt. The Company's FAS 87 expense is also subject to audit review annually by the Company's external auditors, PriceWaterhouseCoopers (PwC). PwC's audit of the Company's financial statements for the period 2011-2017 resulted in unqualified opinions for each year, which confirms that there were no material misstatements in the Company's financial statements, including the calculation of FAS 87 expense. The Company is currently preparing a summary of the amounts recorded to the

[36] Joint Testimony in Support of Second Stipulation at 15.

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

pension balancing account over the life of the account tied back to the Company's third-party actuarial statements, and will make these available as a supplement to this testimony as soon as practicable.

Q. Please explain how can the Commission be assured that all actions the Company took that impacted FAS 87 were prudent?

A. As mentioned above, there are major factors influencing FAS 87 expense over which an employer has no control at all: discount rates and mortality and demographic factors. However, there are two factors that impact FAS 87 expense—over which an employer does have control: (1) contributions to the pension plans, and (2) the Company's exercise of its fiduciary responsibilities for the plan, which can impact asset returns. Because the Company made prudent contributions to the plan, and hired expert advisors to assist in managing the plan, the Commission can be assured that the FAS 87 expense was prudently incurred.

Q. Please comment on the prudence of NW Natural's contributions to the plans.

A. Contributions act to reduce FAS 87 and while employers have limited discretion as to the level of contributions required, the Company exercised that discretion prudently. As explained above, the Commission has recognized that employers use actuaries to determine the amounts to contribute to the plans, and that contribution levels are guided by federal minimum funding requirements. The Commission has noted that employers may make discretionary contributions above the minimum funding obligations; however, the Internal Revenue Code contains provisions limiting the maximum tax deduction for

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

pension fund contributions.[37] In NW Natural's case, the Company prudently made minimum contributions in each of the years since the PBA was instituted. This was entirely consistent with the expectation of the parties to the PBA Stipulation, which provided that the Company would "make whatever capital contributions are required to maintain compliance with PPA requirements, including the avoidance of benefit restrictions." The Company has complied with PPA requirements and avoided benefit restrictions since entering into the PBA Stipulation. And importantly, as explained above, while there were a number of legislative changes that provided funding relief, the amount of contributions made by the Company from 2010 to 2017 was extremely close to the amount expected at the time the PBA Stipulation was approved.

Q. Please comment on the prudence of NW Natural's exercise of its fiduciary responsibilities for its pension plan assets.

A. Expected returns on pension funds influence the level of FAS 87 determined by the actuaries, and employers retain experts to manage their funds. During the period 2011 through 2017 the Company utilized the experts from Willis Towers Watson to assist in its investment plan review. Willis Towers Watson is a leading global advisory, brokering and solutions company. They specialize in retirement consulting and actuarial services and currently serve 75 percent of the Fortune 500 companies. Their capabilities include retirement plan strategy, design, actuarial services and support, retirement plan financial management, governance and compliance strategies, risk management, and defined benefit pension administration and outsourcing. Every year, our pension committee would

[37] In the Matter of Pub. Util. Comm'n of Or., Investigation into Treatment of Pension Costs in Utility Rates, Docket No. UM 1633, Order No 15-226 at 3 (Aug. 3, 2015).

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

meet quarterly with Willis to review asset returns by asset class and would take appropriate actions to maximize performance of the plan. Beginning in 2018, as part of the Company's selection of a total retirement outsource provider, the Company hired Fidelity, who became the Company's actuary as well as investment advisor for the plan.

Overall, while the Company can have some influence on contributions and pension asset performance, these are areas where the Company relies heavily on experts to assist in ensuring we are complying with all laws and maximizing asset returns for the participants in the plan.

V. CUSTOMER BENEFITS OF THE SECOND PARTIAL STIPULATION

Q. Can you summarize why you continue to believe that the Second Partial Stipulation provides significant benefits to customers?

A. There are two major benefits provided to customers under the Second Partial Stipulation that they would not otherwise receive. First, under the stipulation, the Company voluntarily agreed to significantly reduce the interest rate accruing on the PBA. Pursuant to the PBA Stipulation, the PBA accrued interest at the Company's rate of return, which is currently 7.317 percent. And while the parties did not specify the effective interest rate to be paid by customers under the Second Partial Stipulation, as shown in NWN/2801, that interest can be estimated at 4.523 percent, which would result in a customer benefit of $11.1 million.

Second, under the Second Partial Stipulation, NW Natural agreed to apply the full amount of deferred tax benefits to the PBA, to offset that balance and pay it down. However, by law, had the parties not entered into that Stipulation, the Commission would have been required to perform an earnings review on the balance in the deferral account, prior to amortization of the benefit. As described in the testimony of Sean Borgerson, an earnings

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NW NATURAL
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Portland, Oregon 97209-3991
1-503-226-4211

review would apply in 2017 for the re-measurement of accumulated deferred income taxes, and in 2018 for the Interim Period Deferral. With respect to the 2017 earnings review, we would point to Staff's response to AWEC's DR 01, which estimated that an application of an earnings review would result in the Company retaining $9.5 million.[38] With respect to the 2018 earnings review, at this time, we cannot perform an earnings review on the entire amounts because we do not have year-end financials for 2018. To the extent the Company performs at similar levels as 2017, the interim period deferral would be subject to sharing as well.

Q. Did the Second Partial Stipulation provide customers and the parties with any other benefits?

A. Yes. In addition to the financial benefits noted above, the Second Partial Stipulation would have provided all parties with regulatory certainty regarding the disposition of the PBA going forward. And importantly, the Second Partial Stipulation preserved—to the extent possible—the expectations of the parties to the PBA Stipulation, by allowing recovery of FAS 87 expense, while at the same time allowing for the recovery of amounts in the balancing account over time, thereby avoiding a sudden rate increase.

Q. Now that the CUB and Staff have withdrawn from the Second Partial Stipulation, does NW Natural continue to voluntarily agree to reduce the interest rate on the PBA balance, or to waive the earnings review on the tax deferral?

A. No. NW Natural agreed to give up the earnings review on the tax deferral, and to reduce the interest rate on the PBA, as a compromise with CUB and Staff, in order to come to a

[38] AWEC/600, Mullins/601. NW Natural recognizes that the details of the earnings review would need to be determined by the Commission.

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Portland, Oregon 97209-3991
1-503-226-4211

mutually-agreeable resolution of the PBA, and to gain regulatory certainty regarding the recovery of its balance. However, these concessions were very significant ones, from both legal and financial standpoints, and the Company would not make them unless they were part of another comprehensive settlement.

Q. Does this conclude your testimony?

A. Yes.

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Portland, Oregon 97209-3991
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BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Opening Testimony of Brody Wilson

PENSION BALANCING ACCOUNT
Exhibit 2801

November 21, 2018

EXHIBITS 2801 – PENSION BALANCING ACCOUNT

Table of Contents

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

NW Natural
Rates & Regulatory Affairs
2017 Oregon GRC - Phase II

$	93,063,736	Amortization at ROR
$	82,000,000	Amortization at Implied Interest Rate
$	11,063,736	Customer Benefit

		Amort with full cost of capital				Amort assuming $8.2 mil annual			
			7.317%				4.523%		
		Balance	Interest	Payment		Balance	Interest	Payment	
Year	Month	$ 65,863,167				$ 65,863,167			
2018	November	65,489,237	401,601	775,531		65,428,096	248,262	683,333	
2018	December	65,113,026	399,321	775,531		64,991,385	246,622	683,333	
2019	January	64,734,522	397,027	775,531		64,553,028	244,976	683,333	
2019	February	64,353,709	394,719	775,531		64,113,018	243,324	683,333	
2019	March	63,970,575	392,397	775,531		63,671,350	241,665	683,333	
2019	April	63,585,104	390,061	775,531		63,228,017	240,000	683,333	
2019	May	63,197,283	387,710	775,531		62,783,013	238,329	683,333	
2019	June	62,807,098	385,345	775,531		62,336,332	236,652	683,333	
2019	July	62,414,533	382,966	775,531		61,887,967	234,968	683,333	
2019	August	62,019,574	380,573	775,531		61,437,912	233,278	683,333	
2019	September	61,622,207	378,164	775,531		60,986,160	231,582	683,333	
2019	October	61,222,418	375,741	775,531	$ 9,306,374	60,532,706	229,879	683,333	$ 8,200,000
2019	November	60,820,190	373,304	775,531		60,077,542	228,170	683,333	
2019	December	60,415,510	370,851	775,531		59,620,663	226,454	683,333	
2020	January	60,008,363	368,384	775,531		59,162,061	224,732	683,333	
2020	February	59,598,733	365,901	775,531		58,701,731	223,003	683,333	
2020	March	59,186,605	363,403	775,531		58,239,666	221,268	683,333	
2020	April	58,771,964	360,890	775,531		57,775,859	219,526	683,333	
2020	May	58,354,795	358,362	775,531		57,310,304	217,778	683,333	
2020	June	57,935,082	355,818	775,531		56,842,994	216,023	683,333	
2020	July	57,512,810	353,259	775,531		56,373,923	214,262	683,333	
2020	August	57,087,963	350,684	775,531		55,903,083	212,494	683,333	
2020	September	56,660,526	348,094	775,531		55,430,469	210,719	683,333	
2020	October	56,230,482	345,488	775,531		54,956,073	208,938	683,333	
2020	November	55,797,817	342,865	775,531		54,479,889	207,149	683,333	

2020	December	55,362,513	340,227	775,531		54,001,910	205,354	683,333
2021	January	54,924,555	337,573	775,531		53,522,130	203,553	683,333
2021	February	54,483,926	334,902	775,531		53,040,541	201,744	683,333
2021	March	54,040,611	332,216	775,531		52,557,137	199,929	683,333
2021	April	53,594,592	329,513	775,531		52,071,910	198,107	683,333
2021	May	53,145,854	326,793	775,531		51,584,855	196,278	683,333
2021	June	52,694,380	324,057	775,531		51,095,963	194,442	683,333
2021	July	52,240,152	321,304	775,531		50,605,229	192,599	683,333
2021	August	51,783,156	318,534	775,531		50,112,646	190,749	683,333
2021	September	51,323,372	315,748	775,531		49,618,205	188,893	683,333
2021	October	50,860,785	312,944	775,531		49,121,901	187,029	683,333
2021	November	50,395,378	310,124	775,531		48,623,726	185,158	683,333
2021	December	49,927,133	307,286	775,531		48,123,673	183,280	683,333
2022	January	49,456,032	304,431	775,531		47,621,735	181,396	683,333
2022	February	48,982,059	301,558	775,531		47,117,905	179,504	683,333
2022	March	48,505,196	298,668	775,531		46,612,176	177,604	683,333
2022	April	48,025,426	295,760	775,531		46,104,541	175,698	683,333
2022	May	47,542,729	292,835	775,531		45,594,993	173,785	683,333
2022	June	47,057,090	289,892	775,531		45,083,524	171,864	683,333
2022	July	46,568,490	286,931	775,531		44,570,126	169,936	683,333
2022	August	46,076,910	283,951	775,531		44,054,794	168,001	683,333
2022	September	45,582,333	280,954	775,531		43,537,519	166,059	683,333
2022	October	45,084,740	277,938	775,531		43,018,295	164,109	683,333
2022	November	44,584,113	274,904	775,531		42,497,113	162,152	683,333
2022	December	44,080,433	271,852	775,531		41,973,967	160,187	683,333
2023	January	43,573,683	268,780	775,531		41,448,848	158,215	683,333
2023	February	43,063,842	265,691	775,531		40,921,751	156,236	683,333
2023	March	42,550,893	262,582	775,531		40,392,666	154,249	683,333
2023	April	42,034,816	259,454	775,531		39,861,588	152,255	683,333
2023	May	41,515,592	256,307	775,531		39,328,507	150,253	683,333
2023	June	40,993,202	253,141	775,531		38,793,417	148,243	683,333
2023	July	40,467,627	249,956	775,531		38,256,310	146,226	683,333
2023	August	39,938,847	246,751	775,531		37,717,179	144,202	683,333
2023	September	39,406,843	243,527	775,531		37,176,015	142,170	683,333
2023	October	38,871,595	240,283	775,531		36,632,812	140,130	683,333
2023	November	38,333,084	237,020	775,531		36,087,561	138,082	683,333
2023	December	37,791,288	233,736	775,531		35,540,255	136,027	683,333
2024	January	37,246,190	230,432	775,531		34,990,886	133,964	683,333
2024	February	36,697,767	227,109	775,531		34,439,446	131,893	683,333
2024	March	36,146,001	223,765	775,531		33,885,927	129,815	683,333
2024	April	35,590,870	220,400	775,531		33,330,322	127,728	683,333
2024	May	35,032,354	217,015	775,531		32,772,623	125,634	683,333

2024	June	34,470,433	213,610	775,531		32,212,821	123,532	683,333
2024	July	33,905,085	210,183	775,531		31,650,910	121,422	683,333
2024	August	33,336,290	206,736	775,531		31,086,880	119,304	683,333
2024	September	32,764,027	203,268	775,531		30,520,725	117,178	683,333
2024	October	32,188,275	199,779	775,531		29,952,435	115,044	683,333
2024	November	31,609,011	196,268	775,531		29,382,003	112,902	683,333
2024	December	31,026,216	192,736	775,531		28,809,421	110,751	683,333
2025	January	30,439,868	189,182	775,531		28,234,681	108,593	683,333
2025	February	29,849,943	185,607	775,531		27,657,775	106,427	683,333
2025	March	29,256,422	182,010	775,531		27,078,694	104,252	683,333
2025	April	28,659,282	178,391	775,531		26,497,430	102,069	683,333
2025	May	28,058,501	174,750	775,531		25,913,975	99,878	683,333
2025	June	27,454,057	171,087	775,531		25,328,321	97,679	683,333
2025	July	26,845,927	167,401	775,531		24,740,459	95,472	683,333
2025	August	26,234,089	163,693	775,531		24,150,381	93,256	683,333
2025	September	25,618,520	159,962	775,531		23,558,080	91,032	683,333
2025	October	24,999,198	156,209	775,531		22,963,545	88,799	683,333
2025	November	24,376,099	152,433	775,531		22,366,770	86,558	683,333
2025	December	23,749,201	148,633	775,531		21,767,745	84,308	683,333
2026	January	23,118,481	144,811	775,531		21,166,462	82,051	683,333
2026	February	22,483,915	140,965	775,531		20,562,913	79,784	683,333
2026	March	21,845,479	137,096	775,531		19,957,089	77,509	683,333
2026	April	21,203,151	133,203	775,531		19,348,981	75,226	683,333
2026	May	20,556,906	129,286	775,531		18,738,581	72,933	683,333
2026	June	19,906,721	125,346	775,531		18,125,880	70,633	683,333
2026	July	19,252,571	121,381	775,531		17,510,870	68,323	683,333
2026	August	18,594,432	117,393	775,531		16,893,541	66,005	683,333
2026	September	17,932,280	113,380	775,531		16,273,886	63,678	683,333
2026	October	17,266,091	109,342	775,531		15,651,895	61,342	683,333
2026	November	16,595,840	105,280	775,531		15,027,559	58,998	683,333
2026	December	15,921,502	101,193	775,531		14,400,870	56,644	683,333
2027	January	15,243,053	97,081	775,531		13,771,819	54,282	683,333
2027	February	14,560,466	92,945	775,531		13,140,396	51,911	683,333
2027	March	13,873,717	88,782	775,531		12,506,594	49,531	683,333
2027	April	13,182,781	84,595	775,531		11,870,403	47,142	683,333
2027	May	12,487,632	80,382	775,531		11,231,813	44,744	683,333
2027	June	11,788,244	76,143	775,531		10,590,817	42,337	683,333
2027	July	11,084,592	71,879	775,531		9,947,404	39,921	683,333
2027	August	10,376,649	67,588	775,531		9,301,566	37,495	683,333
2027	September	9,664,390	63,272	775,531		8,653,294	35,061	683,333
2027	October	8,947,787	58,929	775,531		8,002,578	32,617	683,333
2027	November	8,226,815	54,559	775,531		7,349,409	30,165	683,333

2027	December	7,501,447	50,163	775,531	6,693,778	27,703	683,333
2028	January	6,771,656	45,740	775,531	6,035,676	25,231	683,333
2028	February	6,037,415	41,290	775,531	5,375,093	22,751	683,333
2028	March	5,298,697	36,813	775,531	4,712,021	20,261	683,333
2028	April	4,555,475	32,309	775,531	4,046,449	17,761	683,333
2028	May	3,807,720	27,777	775,531	3,378,368	15,253	683,333
2028	June	3,055,407	23,218	775,531	2,707,769	12,734	683,333
2028	July	2,298,506	18,630	775,531	2,034,642	10,207	683,333
2028	August	1,536,990	14,015	775,531	1,358,978	7,669	683,333
2028	September	770,831	9,372	775,531	680,767	5,122	683,333
2028	October	(0)	4,700	775,531	0	2,566	683,333

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

UG 344 – Phase II

NW Natural

Opening Testimony of Sean Borgerson

FEDERAL INCOME TAX REFORM

Exhibit 2900

November 21, 2018

EXHIBIT 2900 – UG 344 PHASE II

OPENING 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 have previously filed testimony in Phase I of this docket. Specifically, I filed: NW Natural/2500, NW Natural-Staff-CUB/200-203 and 300.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to respond to the direction of the Public Utility Commission of Oregon (Commission) and the Administrative Law Judge that the parties provide additional testimony and briefing addressing the issues not resolved in Order No. 18-419, including rate recovery for (a) the deferred benefits flowing from the Tax Cuts and Jobs Act (TCJA), and (b) the Company's unrecovered pension asset as reflected in NW Natural's pension balancing account (PBA).[1] In Order No. 18-419, the Commission adopted an all-party stipulation addressing a number of revenue requirement issues raised by this case. In addition, the Commission adopted specific aspects of a partial stipulation among NW Natural, Commission Staff (Staff) and the Citizens' Utility Board of Oregon (CUB) (Second Partial Stipulation). Specifically, the Commission ordered the freezing of the PBA, and, on a going-forward basis, the recovery of the Company's current FAS 87 pension expense in rates. However, the Commission rejected the remainder of the Second Partial Stipulation, including the parties' agreements regarding the calculation and treatment of tax benefits associated with the TCJA, stating that there was not sufficient

[1] Order No. 18-419 at 14-15 and Prehearing Conference Memorandum issued on November 13, 2018, as revised by ALJ Ruling Issued November 15, 2018.

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

evidence in the record to support the Second Partial Stipulation's result. Therefore, the Commission ordered further proceedings in Phase II of this docket, to allow the parties to address the issues.[2] My testimony addresses the issues related to federal income tax reform.

Q. Please summarize your testimony.

A. I will first provide background and context regarding the impacts of federal income tax reform, and then describe: (1) the Company's updated calculation of the benefit from the lower income tax rate for the period January 1, 2018 through October 31, 2018 (the Interim Period), which now reflects the Company's actual results during the Interim Period, as well as the proposed ratemaking treatment for the Interim Period benefit; and (2) the Company's updated calculation for the remeasurement of the benefit from the net decrease in NW Natural's cumulative utility deferred income tax liability balances, recorded upon enactment in 2017 (Excess Deferred Income Taxes or EDIT), and the proposed regulatory treatment for the EDIT balances. Finally, I conclude my testimony by addressing the tax-related concerns raised by Alliance of Western Energy Consumers (AWEC) during Phase I of this proceeding that were noted by the Commission in Order No. 18-419 in Phase I of this proceeding.

II. OVERVIEW OF THE TAX CUTS AND JOBS ACT

Q. Please provide an overview of the TCJA and how it impacts NW Natural's federal income taxes.

A. On December 22, 2017, Congress enacted comprehensive income tax reform, known as the Tax Cuts and Jobs Act (the TCJA or alternatively referred to as tax reform). The TCJA

[2] Order No. 18-419 at 15.

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

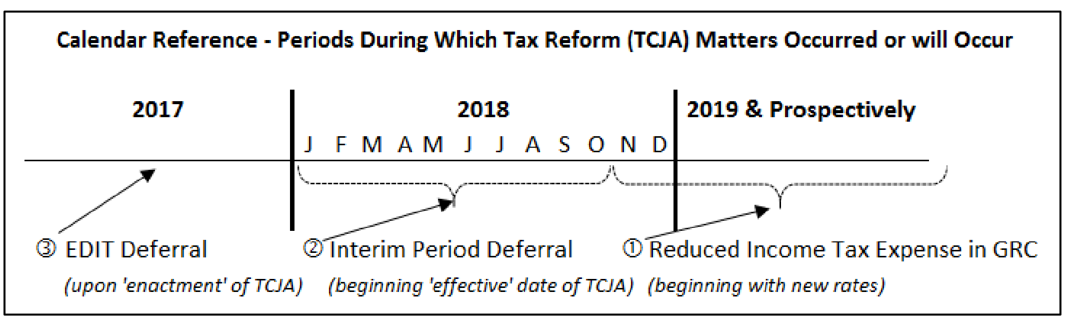
permanently lowered the federal corporate income tax rate from 35 percent to 21 percent, effective as of January 1, 2018.

The reduction in the federal corporate income tax rate raises three different matters for regulatory consideration:

1. The need to reflect the lower federal income tax rate in NW Natural's utility rates effective November 1, 2018;
2. The calculation and appropriate regulatory treatment of the Interim Period benefit, which NW Natural deferred (Interim Period Deferral); and
3. The remeasurement and appropriate regulatory treatment for the benefit from the net decrease in NW Natural's cumulative utility deferred income tax liability balances, recorded upon enactment in 2017, which NW Natural is currently deferring (EDIT Deferral).

These three regulatory matters are all a result of the TCJA, but they are separate and distinct issues occurring during different calendar periods. Please see the timeline included as Figure 1 below for reference.

Figure 1.



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

Q. Were any of the three tax reform regulatory matters resolved during Phase I of this proceeding?

A. Yes. During Phase I of this proceeding, NW Natural made a supplemental filing, dated March 20, 2018, which updated the general rate case revenue requirement to reflect the reduction in the tax rate from 35 percent to 21 percent.[3] No further adjustments were proposed by Staff,[4] CUB,[5] or AWEC,[6] and the revenue requirement amount agreed upon in the first partial stipulation filed on August 6, 2018 (First Partial Stipulation) reflected the lower federal tax rate resulting from the TCJA. The Commission approved the First Partial Stipulation in its entirety in Order No. 18-419.[7] As a result, the lower income tax rate is reflected in NW Natural's rates going forward, and this matter has been resolved.

Q. Were the other two tax reform regulatory matters resolved during Phase I of this proceeding?

A. No. The calculation and proposed regulatory treatment of the Interim Period Deferral as well as the remeasurement and proposed regulatory treatment of the EDIT Deferral were addressed in the Second Partial Stipulation, and in its Order No. 18-419, the Commission approved only certain elements of the Second Partial Stipulation—which did not include these income tax matters.

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[3] NW Natural/1200, McVay/1-2.
[4] Staff/100, Gardner/46; Staff/1400, Gardner/3.
[5] CUB/300, Jenks/6-7.
[6] AWEC/500, Mullins/1-2
[7] Order No. 18-419 at 13.

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

Q. Please describe the Commission's ruling in Order No. 18-419 on these aspects of the Second Partial Stipulation.

A. The Commission rejected the components of the Second Partial Stipulation relevant to the tax issues, and made no findings on these matters. The Commission directed the parties to resolve all of the remaining issues in the Second Partial Stipulation by February 1, 2019.

III. INTERIM PERIOD DEFERRAL

Background and Context Regarding Interim Period Deferral

Q. Please describe the Interim Period and the Company's Interim Period Deferral.

A. For the period January 1, 2018 through October 31, 2018, NW Natural's regulated utility income tax expense was reduced as a result of the decrease in the federal income tax rate. NW Natural anticipated that the lower income tax rate would result in a benefit during the Interim Period and filed a TCJA-related deferral application with the Commission on December 29, 2017, which was docketed as UM 1919.[8] The purpose of the deferral application was to permit the Company to "defer all amounts that are recovered through rates, but which are determined to be appropriately adjusted in light of the tax reform" — which would allow the Company to return the appropriate portion of benefit to customers, subject to an earnings review.[9]

The Interim Period Deferral began on January 1, 2018, the effective date of the TCJA tax rate reduction, and continued through October 31, 2018. Each month during

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[8] *In the Matter of Nw. Natural Gas Co., dba NW Natural, Application for Authorization to Defer Certain Expenses Associated with the 2018 US Tax Cuts and Jobs Act*, Docket No. UM 1919, Application (Dec. 29, 2017).

[9] Staff also filed a deferral application for NW Natural's Interim Tax Benefit on December 29, 2017, which was docketed as UM 1924.

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

the Interim Period, NW Natural recorded a reduction to revenue for the estimated net benefit, which included a gross up for income taxes, and recorded the offsetting balance to a regulatory liability account. This regulatory liability balance also accrues interest to the benefit of customers.

Calculation of the Interim Period Deferral

Q. Now that the Interim Period has concluded, has NW Natural prepared a calculation of the Interim Period benefit amount based on actual results?

A. Yes. Because the Interim Period concluded on October 31, 2018, NW Natural has prepared a calculation of the Interim Period benefit amount based on actual results. As shown in Exhibit NW Natural/2901, the actual amount of benefit accruing during the Interim Period as a result of the reduction in the tax rate is $6.8 million.

Q. How did the Company calculate the Interim Period Deferral amount?

A. To calculate the net reduction to income tax expense from the TCJA, NW Natural is utilizing a 2018 Oregon results of operations report format to perform a "with" and "without" TCJA calculation. This methodology is consistent with the approach outlined by NW Natural at the tax workshop held on February 28, 2018, the follow up direction provided via email by Staff's counsel at the Oregon Department of Justice, and the updates filed by NW Natural to the original deferral application on April 16, 2018[10] and again on July 16, 2018,[11] which provided the Company's best estimates of the full ten-month Interim Period benefit using a combination of actual results and forecasts. Using 2018 actual results is

[10] NW Natural/2902.
[11] NW Natural/2903.

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

also consistent with Commission policy.[12] It is necessary to consider tax expense in the Interim Period, in the context of other revenue and expenses in the same period.

Q. What is a "with" and "without" calculation?

A. The "with" and "without" TCJA calculation prepared by NW Natural is calculating the Oregon regulated gas utility after tax earnings, for the 2018 ten-month deferral period, using a 21 percent federal income tax rate (i.e., "with" TCJA) and comparing that to the after tax earnings that would have occurred using a 35 percent federal income tax rate (i.e., "without" TCJA). This comparison is a straight-forward and reliable way to identify the additional earnings that occurred as a result of the lower federal tax rate in the period in which the lower rate was in effect.

Q. Did the Company prepare an exhibit supporting the Interim Period Deferral amount?

A. Yes. The Company's Exhibit NW Natural/2901 presents the details of the Interim Period Deferral approach used by NW Natural. Now that the Interim Period from January 1, 2018 through October 31, 2018 has passed, this exhibit shows the final ten-month Interim Period revenue deferral for Oregon is $6.788 million based on the Company's actual results during the Interim Period. The exhibit also shows the history of forecasting this amount – the forecast from January 2018 disclosed in the tax workshop with all parties in February 2018,[13] and the March and June forecasts used to prepare the update filings in UM 1919.[14] NW Natural's calculation has been consistent and transparent since it was

[12] *In the Matter of Nw. Natural Request for a General Rate Revision,* Docket No. UG 221, Order No. 12-437 at 26 (Nov. 16, 2012) (addressing a change to NW Natural's Oregon State income tax rate, the Commission stated that "it is improper to consider changes to components of the revenue requirement in isolation. As Staff notes, a change to one item of the revenue requirement is often offset by a corresponding change in another item.").

[13] NW Natural/2904.

[14] Exhibits NW Natural/2902 and NW Natural/2903.

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

first discussed with all of the parties to this proceeding at the tax workshop in February of 2018.

Q. How does the final Interim Period Deferral of $6.788 million compare to the Interim Period Deferral estimate of $5.89 million included in the Second Partial Stipulation?

A. The increase in the Interim Period Deferral benefit resulted from a combination of an increase in revenues and a decrease in depreciation expense compared to our prior forecast. As a result, the actual benefits for the Interim Period were slightly higher than the forecast in NW Natural's second quarter update filing.

Proposed Calculation and Treatment of Interim Period Deferral in Second Partial Stipulation

Q. What did the parties to the Second Partial Stipulation (Stipulating Parties) propose regarding the calculation of the Interim Period Deferral amount?

A. The Stipulating Parties agreed to use the Company's "with" and "without" TCJA approach, which I described earlier in my testimony.[15] At the time that the Stipulating Parties entered the Second Partial Stipulation, the Interim Period benefit amount was calculated to be $5.9 million.[16]

Q. How did the Stipulating Parties propose to address ratemaking treatment for the Interim Period Deferral?

A. The Stipulating Parties agreed that it is important to pay down the balance in the PBA as quickly as possible to minimize additional interest accruing on the account, and determined that it would be prudent to reduce the balance of the PBA by applying certain

[15] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/14-15.
[16] Second Partial Stipulation at 5.

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

benefits of tax reform to the account.[17] Specifically, the Stipulating Parties agreed to apply the Interim Period Deferral amount (plus interest) to the PBA balance.[18]

Q. As a part of that stipulation, NW Natural waived the earnings review to which it otherwise would have been entitled prior to applying the Interim Period Deferral to the PBA for customer benefit. Why did the Company agree to waive the earnings review?

A. NW Natural agreed to waive the earnings review because it saw great benefit to resolving the issue of the PBA in a fashion that benefitted customers and the Company. Mr. Brody Wilson's testimony addresses this issue in more detail.

Potential Treatment of Interim Period Deferral Absent Second Partial Stipulation

Q. Prior to filing the Second Partial Stipulation, did the Company make a specific proposal regarding the treatment of the Interim Period Deferral?

A. No. While the Company indicated that it would be open to applying the benefit from the Interim Period to reduce the PBA balance, the Company did not make any specific proposals prior to filing the Second Partial Stipulation. Instead, the Company recommended that the treatment of the Interim Period Deferral should be addressed in Dockets UM 1919 and 1924 (the "TCJA Deferral Dockets"). However, as NW Natural explained in its opening brief, Oregon law requires that an earnings review be performed to determine whether or what portion of the deferred amounts should be returned to customers in rates.[19]

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[17] NW Natural-Staff-CUB/200, Borgerson, Wilson, Gardner, and Jenks/20.

[18] The parties also agreed to apply another $6.7 million of EDIT (Other Non-Plant) to the PBA balance, which will be discussed later in this testimony. Second Partial Stipulation at 5.

[19] NW Natural's Opening Brief at 37-38.

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

Q. Would an earnings review apply to the Interim Period Deferral of $6.788 million?

A. Yes. NW Natural understands the application of an earnings test to be appropriate in this circumstance.[20] As discussed in greater detail later in my testimony, NW Natural had agreed to waive the application of an earnings test which otherwise would have applied to the Interim Period Deferral as part of the Second Partial Stipulation.

Q. Can the earnings review be performed now for the Interim Period Deferral?

A. Typically, the Commission reviews the Company's earnings for the twelve month calendar year in which amounts were being deferred as outlined in OAR 860-027-0300(9). In this case, the Company's earnings report for calendar year 2018 will not be available until 2019.

Q. What options are available to return the benefit of the Interim Period Deferral to customers?

A. There are a number of ways that customers could receive the benefit of the Interim Period Deferral. These options are not mutually exclusive and they could be used in combination.

The methods include: customer billing credits, application to an outstanding regulatory asset, or application to new or existing capital projects. As noted in the Commission's Order No. 18-419,[21] the Commission is not opposed to applying Interim Period tax savings to address the PBA regulatory asset. Applying the Interim Period Deferral benefit to the PBA balance also helps to address operating cash flow concerns that could otherwise contribute to a credit rating downgrade for NW Natural.[22].

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[20] ORS 757.259(5); OAR 860-027-0300(9); *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).

[21] Order No. 18-419 at 18.

[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

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

Q. In the absence of the Second Partial Stipulation, does the Company have a proposal to address the Interim Period Deferral?

A. Yes. After performing an earnings review, NW Natural proposes that the Commission approve the application of Interim Period Deferral balance as a reduction of the PBA regulatory asset since it would decrease the balance of the PBA, and therefore, accelerate the reduction of interest that accrues on the outstanding balance.

If Commission instead determines that the Interim Period Deferral balance should be amortized as a reduction in rate revenue, then NW Natural proposes that the $6.788 million Interim Period Deferral be subject to an earnings test, with the amount to be returned to customers amortized over two years through a separate tariff rider.

IV. EXCESS DEFERRED INCOME TAXES DEFERRAL

Background and Context for EDIT

Q. Please describe what deferred taxes are, and how they come about.

A. Accumulated deferred income tax assets and liabilities (ADIT) generally represent the cumulative difference between total income tax expense included in utility ratemaking vs. income taxes actually paid to the government by the utility (total income tax expense = current income taxes + deferred income taxes). ADIT primarily arises when accelerated and/or bonus tax depreciation on utility plant provides for a temporary delay of a portion of income taxes payable until later in a new asset's operating life.

ADIT directly benefits ratepayers and is akin to a utility rate subsidy provided by the government. For example, if NW Natural was able to claim an additional income tax

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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.

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

deduction for plant depreciation (in excess of book depreciation on utility plant) of $100 the federal benefit of that accelerated deduction was recorded in the books and records as a deferred tax liability of $35 (a result of a pre-TCJA 35% federal income tax rate). This represents $35 of interest free financing and as a result the rate base on which customer rates are determined was also reduced by $35. The reduction to rate base passes the full benefit of the deferred tax liability to customers. Thus, to the extent that the payment of income taxes by the utility is deferred until a later period, the full benefit of that deferral—the ADIT—is subtracted from rate base on which customer rates are based.

NW Natural avails itself of available methods to accelerate tax recovery of plant assets as part of normal income tax planning and managing for lower customer rates. The benefits of ADIT are passed on to customers through a recognition that they provide the utility with interest-free financing for a time, and therefore they warrant an offset to the utility's rate base. For these reasons, Staff and other interested parties require utilities to take advantage of these opportunities. For example, Staff recently argued that, in the case of a different utility, failing to claim bonus depreciation "is unreasonable, imprudent, and harms [the utility's] customers."[23]

Remeasurement of EDIT

Q. Please explain the remeasurement of deferred taxes that was required as a result of the TCJA.

A. Accounting Standards Codification (ASC) 740, issued by the Financial Accounting Standards Board (FASB), requires remeasurement of deferred tax liabilities and deferred tax assets for the effects of a change in tax laws or rates in the period that includes the

[23] *In the Matter of Cascade Natural Gas Corp., Request for a General Rate Revision*, Docket No. UG 305, Staff/100, Gardner/17 (Aug. 11, 2016).

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

enactment date (December 22, 2017) of the TCJA. An entity with a calendar fiscal year-end, like NW Natural, was required to recognize the effects of the federal legislation in December 2017.

Q. Did NW Natural remeasure its deferred tax liabilities and assets to take into account the TCJA?

A. Yes. Federal ADIT was remeasured in December of 2017, the enactment period of the TCJA, using the newly lowered income tax rate. The change in ADIT was determined by measuring the federal temporary differences using a 21 percent federal statutory income tax rate and comparing this result to the federal ADIT balance existing immediately prior to the remeasurement. The change in ADIT, or excess deferred income tax (EDIT) amount, was recorded as a net reduction in ADIT with an offsetting entry to a new regulatory liability account.

The remeasurement of taxes can be illustrated continuing the example from above regarding the benefits of ADIT. The TCJA lowered the federal income tax rate to 21 percent when it was enacted into law in December of 2017. As a result of the reduced tax rate, the $100 accelerated tax depreciation deduction taken in a pre-TCJA year, originally resulting in a $35 deferred tax liability will only require a federal tax payment of $21 when it reverses in a post-TCJA enactment year. To reflect this reduced liability, the Company 'remeasured' its regulatory federal accumulated deferred tax liabilities in December of 2017. Without regulatory deferral accounting, the reduced deferred tax liability as a result of remeasurement would have resulted in an income tax benefit being recorded in 2017 equal to the full amount of the deferred tax liability reduction.

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

Q. Has NW Natural requested deferred accounting treatment for the benefit resulting from the remeasurement of deferred taxes?

A. Yes. The TCJA-related deferral applications[24] filed by NW Natural and Staff in December 2017 addressed the deferral of the excess deferred income taxes benefit, in addition to the Interim Period Deferral of reduced tax expense. The deferral application updates, filed by NW Natural in April and July 2018, also note that the EDIT benefit recorded at the end of 2017 is being deferred.[25]

NW Natural's books clearly reflect the EDIT Deferral to be used to benefit customers. ASC 980, also issued by the FASB, indicates that if the Company determines that, as a result of a regulatory action, it is probable that the reduction in income tax expense recorded in 2017 as a result of the deferred tax remeasurement will accrue to the benefit of customers, then the income tax benefit should be reversed and a regulatory liability should be recorded. This occurred in December 2017. The regulatory liability for the EDIT was recorded in 2017 as a result of the Company's view of the probable regulatory outcome, which is that customers will receive the benefits of EDIT related to the utility. Federal Energy Regulatory Commission (FERC) guidance in AI93-5-000 mirrors the guidance in ASC 980 on this topic. NW Natural's books reflect adherence to both of these guidelines.

[24] Docket Nos. UM 1919 and UM 1924.
[25] NW Natural/2902 and 2903.

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

Q. Is there any uncertainty with respect to the amounts deferred for excess deferred income tax remeasurement?

A. In the tax workshop held in February of 2018[26] and in earlier testimony in this proceeding[27] it was noted that additional TCJA guidance from the U.S. Treasury and final figures from the 2017 federal corporate income tax return may result in changes to the EDIT balances as recorded. Treasury guidance regarding the TCJA bonus depreciation rule changes was issued in August of 2018 and the 2017 corporate income tax return was completed and filed in October of 2018. As a result, there are relatively small changes to the EDIT balances. NW Natural is not aware of any ongoing uncertainty regarding EDIT balances as determined by the Company.

Q. Please describe the changes to the EDIT balances.

A. At the time the Stipulating Parties entered into the Second Partial Stipulation, the system-wide estimated EDIT balance recorded for financial statement purposes was $156.8 million, as of December 31, 2017.[28] After resolution of TCJA uncertainties, the system-wide EDIT balance is now $158.6 million, with additional liability of $57.1 million to reflect a gross up for income taxes.[29] These balances do not reflect a reduction that would occur after application of a 2017 earnings review which applies to deferrals.

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[26] NW Natural/2904.

[27] NW Natural/2500, Borgerson/15:3-18.

[28] NW Natural-Staff-CUB/200, Borgerson, Wilson, Gardner, and Jenks/6-7. An additional estimated liability of $56.5 million, to reflect a gross up for income taxes at a 1.36 tax gross up rate was also recorded. NW Natural/2905 (tax gross up proof).

[29] NW Natural/2906.

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

The Company has prepared new exhibits regarding the Company's remeasurement of EDIT:

- Exhibit NW Natural/2906 – Summary of 2017 Oregon Regulatory Liability;
- Exhibit NW Natural/2907 – Deferred Tax Remeasurement Plant; and
- Confidential Exhibit NW Natural/2908 – Deferred Tax Remeasurement Non-Plant Other and Non-Plant Gas Reserves.

Together, these documents support the regulatory liability balances for consideration in Phase II of this proceeding: Plant $163.1 million, Non-Plant Other $6.5 million, and Non-Plant Gas Reserves $13.7 million.[30]

Additional Context Regarding Different Categories of EDIT

Q. Are there different categories of EDIT?

A. Yes. As explained above, the Company's EDIT is comprised of the total EDIT for Plant, Other Non-Plant, and Non-Plant Gas Reserves.

Q. Could you please describe the different types of EDIT in greater detail?

A. All deferred tax balances included in ratemaking were remeasured and deferred in a regulatory liability account that includes an income tax gross up. Plant-related remeasurement balances are generally subject to normalization considerations and non-plant balances are not subject to these considerations. As a result, we have grouped the effects of remeasurement into two primary categories, plant and non-plant. In addition, one of the non-plant remeasurement balances, the Gas Reserves investment, relates to an Oregon only investment. For clarity during regulatory proceedings, we further broke out the Gas Reserves related remeasurement balance from other non-plant balances.

[30] As discussed in greater detail later in my testimony, the EDIT balances described above reflect application of a 2017 earnings review.

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

Q. Are there any special considerations for the EDIT associated with Non-Plant Gas Reserves?

A. Around $10.8 million of the Company's EDIT related to tax reform comes about as a result of the Company's investment in gas reserves. 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.

Q. Are there any special considerations for the EDIT associated with the general Non-Plant Other category?

A. The deferred tax remeasurement deferral for general Non-Plant Other relates to all customer classes. As a result, there are no relevant rate design considerations for returning this benefit to customers.

Q. Are there limits on how quickly certain types of EDIT should be returned?

A. Yes. The amortization of EDIT (Plant) is subject to normalization requirements, which set a limit on how quickly EDIT should be returned to customers. In its testimony in Phase I of this proceeding, NW Natural referred to this as a "speed limit" for return of EDIT.[31] If the Company returns EDIT (Plant) faster than is allowed by the "speed limit," the Company could be subject to a normalization violation, which would result in a dollar-for-dollar additional income tax liability of the amounts returned too quickly.

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

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Portland, Oregon 97209-3991
1-503-226-4211

Q. Please explain further.

A. The normalization language in the TCJA indicates that a taxpayer, in this case NW Natural, would commit a normalization violation, "if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method." The language can be broken down into several pieces to be better appreciated:

- "in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account": This indicates that normalization only applies if the benefit of excess deferred taxes is shared with customers. In NW Natural's case, this applies, because the benefit will be shared with customers. The TCJA does not, in and of itself, however, require this result.
- "reduces the excess reserve more rapidly or to a greater extent": This is simply the setting of an upper "speed limit." It is not setting a specific speed requirement. In other words, the language says that to the extent the benefit is shared with customers, it cannot be done faster than the limit provided for in the law, without other tax consequences (i.e., the additional tax liability)
- "would be reduced under the average rate assumption method": The average rate assumption method (ARAM) is a specific formulaic method for creating an amortization schedule. So the ARAM amortization schedule is to be used as a benchmark for the speed limit but it is in no way required to be used as the regulatory prescribed result.

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

In AWEC's rebuttal testimony in Phase I of this proceeding, AWEC included an IRS publication as an exhibit[32] which states that normalization,

> limits the rate at which the excess tax reserve may be reduced and flowed through to the utility's customers in setting rates. It does not require the utility to flow through the excess tax reserve to its customers, but permits the utility to do so provided the reduction to cost of service is not more rapidly than would be under the ARAM.

This statement by the IRS is consistent with NW Natural's explanation and interpretation of normalization.

In summary, the normalization rule for excess deferred income taxes comes into play when the excess tax reserves are used to benefit customers and the excess tax reserve is reduced more rapidly (or to a greater extent) than the reserve would be reduced under a model amortization schedule, the Average Rate Assumption Method (ARAM). There is nothing in the normalization rule that dictates a specific accounting treatment, a time limit for settlement of the excess tax reserves, or requires that the Commission address excess tax reserves in a particular way.

Q. Please describe further the impacts that the normalization requirements may have on potential amortization of the EDIT Deferral.

A. The federal normalization rules indicate that the ARAM amortization method is the primary method to be used to develop the annual "speed limit" test. However, the TCJA goes on to provide that if the data to prepare the ARAM schedule is not available, then the Reverse South Georgia Method (RSGM) can be used. A more thorough reading of the legislation and history clarifies that the data availability test for ARAM vs. RSGM is a vintage-by-vintage one. In other words, if the data exists to prepare an ARAM schedule for every

[32] AWEC/503, Mullins/5.

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Portland, Oregon 97209-3991
1-503-226-4211

vintage except one, then RSGM can only be used for the one vintage in which the required data to calculate ARAM is not available.

Q. Please describe the amortization schedules that result from the ARAM method and the RSGM method.

A. The ARAM method results in an amortization schedule that mimics the timing of when the deferred tax reversal would have been payable to the taxing authorities in the absence of a tax rate reduction. The RSGM method results in an amortization schedule that is straight-line over the remaining regulatory life of the property.

Q. Can NW Natural simply elect to use RSGM despite the fact that it has the data available to use ARAM?

A. No. Using RSGM when the data is available to use ARAM would result in the use of an incorrect speed limit to measure against the annual customer benefit from excess deferred income taxes and could result in a normalization violation.

Proposed Treatment of EDIT Deferral in Second Partial Stipulation

Q. Please describe the Stipulating Parties' agreements regarding the remeasurement and ratemaking treatment of EDIT.

A. At a high level, the Second Partial Stipulation included the following elements regarding the remeasurement and treatment of EDIT:

- The Stipulating Parties agreed that NW Natural properly recorded the remeasurement of regulated utility EDIT as a result of the TCJA.[33]
- NW Natural will return to customers EDIT (Plant), subject to ARAM, in the amount of $3.26 million per year in base rates beginning on the rate effective date.[34]

[33] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/6.
[34] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/7.

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

- NW Natural will return to sales customers $14.64 million of EDIT (Non-Plant Gas Reserves), inclusive of a gross up for income taxes, over five years through a separate tariff rider.[35]
- NW Natural will credit to customers' benefit $6.67 million of EDIT (Other Non-Plant) reflected as a one-time reduction to the PBA.[36]
- Effective on the rate effective date, rate base will be increased by $22.15 million to reflect the EDIT being provided to customers as part of the Second Partial Stipulation. This increase to rate base results in a $2.06 million increase to revenue requirement.[37]
- In the Company's next general rate case, or five years from the date of the rate effective date, whichever is sooner, the amount of plant-related EDIT being amortized subject to ARAM will be reviewed and adjusted as appropriate based on the remaining balance of the EDIT and normalization requirements under ARAM. In the event that an adjustment to the amortization of EDIT occurs outside of a general rate case, the adjustment would be made through a separate tariff rider, and rate base would not be adjusted until the Company's next general rate case.[38]
- NW Natural agrees to forego any sharing of deferred amounts that it would otherwise be allowed to recover under any earnings review the Commission applies before amortization of EDIT in the TCJA Deferral Dockets.[39]

[35] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/7.
[36] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/7.
[37] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/7.
[38] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/7.
[39] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/8.

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

Q. Why did the Stipulating Parties agree to return $3.26 million of EDIT (Plant) to customers?

A. The amount of $3.26 million was the average of the first five years of grossed up ARAM amortization.[40] The Stipulating parties agreed this was a reasonable result because it would result in a fixed amount being returned to customers and would avoid additional rate fluctuations and provide a timely return of the benefits of tax reform. Additionally, the Stipulating Parties anticipated that returning $3.26 million per year would not result in a normalization violation.[41]

Q. Why did the Stipulating Parties agree that in the Company's next general rate case, or five years from the date of the rate effective date, whichever is sooner, the amount of EDIT subject to ARAM being amortized will be reviewed and adjusted as appropriate based on the remaining balance.

A. It is necessary to periodically revisit the amortization of the EDIT (Plant) because, over time, the amount of annual ARAM fluctuates. In order to balance the competing needs of avoiding a normalization violation, yet returning TCJA benefits to customers on a timely basis, the EDIT amortization inclusion in base rates should be reviewed on a periodic basis. The Stipulating Parties agreed that five years from the rate effective date or the Company's next general rate case, whichever is sooner, would be a reasonable time frame for revising the amortization of plant-related EDIT.[42]

[40] NW Natural/2501, Borgerson/1, line F.
[41] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/11-12.
[42] NW Natural-Staff-CUB/200 Borgerson, Wilson, Gardner, and Jenks/12.

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

Q. Why did the Stipulating Parties agree to return $14.64 million of EDIT (Non-Plant Gas Reserves) to sales customers over five years through a separate tariff rider?

A. The Stipulating Parties determined that EDIT (Non-Plant Gas Reserves) would be returned to sales customers through a separate tariff rider because the costs and benefits of the gas reserves investment, and its related deferred taxes, only affect sales customers. As a result, a separate tariff rider was proposed to return EDIT benefits related to gas reserves to the same customer group.

Q. What amount did the Stipulating Parties agree should be credited to the benefit of customers as a reduction to the PBA for EDIT (Other Non-Plant)?

A. The Stipulating Parties determined that $6.67 million of EDIT (Other Non-Plant) would be applied to reduce the balance of the PBA. The EDIT (Other Non-Plant) amount is $5,450,377 system wide and $6.67 million is the grossed up amount of the Oregon portion.[43] This amount represents 100 percent of the Oregon jurisdiction allocation of EDIT (Other Non-Plant).

Q. Why did the Stipulating Parties agree to increase rate base by $22.15 million?

A. Rate base must be adjusted when EDIT is amortized, because rate base includes deferred taxes, and changes to deferred taxes from amortization result in a change to rate base. The Stipulating Parties calculated the adjustment to rate base to be $22.15 million,[44] which includes all of the non-ARAM EDIT amount of $6.671, and half of the five-year amortizations of EDIT subject to ARAM ($8.156 million) and non-plant gas reserves

[43] NW Natural-Staff-CUB/201, Borgerson, Wilson, Gardner, and Jenks/1 and NW Natural/2501, Borgerson/1.

[44] NW Natural-Staff-CUB/201, Borgerson, Wilson, Gardner, and Jenks/1.

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

($7.322 million). The increase in rate base resulted in a $2.06 million increase to revenue requirement.

Q. NW Natural agreed to forego the earnings review to which it otherwise would have been entitled prior to amortization of the EDIT Deferral amounts for customer benefit. Why did the Company agree to waive the earnings review?

A. NW Natural agreed to waive the earnings review as part of an overall compromise in the Second Partial Stipulation and because it saw great benefit to resolving the issue of the PBA in a fashion that was fair to customers and the Company.

Q. What was the amount of the benefit to customers as a result of NW Natural's agreement to forego earnings sharing for the EDIT Deferral?

A. With respect to the 2017 earnings review, Staff estimated that NW Natural's agreement to forego earnings sharing resulted in a benefit to customers of approximately $9.5 million.[45]

Potential Treatment of EDIT Deferral Absent Second Partial Stipulation

Q. What options are available to benefit customers with the EDIT Deferral?

A. There are a number of ways that NW Natural could return the benefits of the EDIT Deferral to customers. These options are not mutually exclusive and they could be used in combination. One area of concern is the varying degrees of impact on operating cash flows from the available options.[46] The methods include: customer billing credits,

[45] NW Natural/2909.

[46] 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.

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

application to an outstanding regulatory asset, or application to new or existing capital projects.

Q. Does a 2017 earnings review apply to the deferral for the EDIT?

A. Yes. NW Natural understands the application of an earnings test to be appropriate in this circumstance. As shown in Figure 1 of my testimony, the EDIT remeasurement and deferral was recorded at the end of December 2017, and accordingly a 2017 earnings review would apply.

Q. Will customers continue to receive a benefit associated with the EDIT Deferral until the appropriate ratemaking treatment for EDIT is determined and implemented?

A. Yes. Customers will continue to receive a benefit because the calculation of rate base, as included in the rate case revenue requirement model and approved in the First Stipulation through Order No. 18-419, continues to include a reduction to rate base for the full amount of the EDIT recorded upon enactment of the TCJA at the end of 2017. As a result, customers will continue to benefit from the EDIT in the revenue requirement determination at the authorized rate of return until the deferral process is concluded.

Q. What recommendation did the Company make regarding potential ratemaking treatment for the EDIT Deferral in its previous testimony in Phase I of this proceeding?

A. The Company originally proposed to address all of the tax reform elements in the TCJA Deferral Dockets. However, all other parties to this proceeding, Staff, CUB, and AWEC, urged that tax reform could be and should be addressed in this general rate case. In response to the desires of the other parties, while the Company did not advance a specific proposal related to EDIT, the Company recommended that any approach agreed to in this proceeding should include consideration of the ARAM amortization speed limit, the

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

regulatory life of the underlying non-plant assets, an application of an earnings test, and the increase to test period rate base that results from inclusion of this benefit in the rate case.

Q. In the absence of the Second Partial Stipulation, does the Company have a proposal to address the EDIT Deferral?

A. Yes. As I explained earlier regarding the return of the Interim Period Deferral benefit, there are operating cash flow considerations and their associated credit rating risks that are important to consider in conjunction with the TCJA deferrals. Accordingly, NW Natural proposes that the EDIT (Other Non-Plant) balance of $6.5 million should be applied as a reduction to the PBA regulatory asset, with a corresponding increase to rate base of $6.5 million. NW Natural proposes that for the next five years, the EDIT (Plant) be returned to customers in the amount of $3.0 million per year, which reflects an ARAM amortization schedule.[47] For the EDIT (Non-Plant Gas Reserves), NW Natural proposes to return to sales customers $0.68 million per year over 20 years to reflect the underlying life of the asset. The Company also proposes making corresponding adjustments to rate base in the amount of $9.2 million to reflect the return of EDIT to customers. A summary of this proposal is included as Exhibit NW Natural/2911.

If the Commission instead determines that the EDIT (Other Non-Plant) balance should be amortized as a reduction in rate revenue (i.e., cash flow reduction), then NW Natural proposes to return that balance 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. Taken together with the Company's proposals for EDIT (Plant) and EDIT (Non-Plant

[47] For additional detail regarding the ARAM amortization schedule, see NW Natural/2910.

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

Gas Reserves) described above, over the next five years, the annual total amortization would be $4.3 million, and NW Natural also proposes a corresponding increase in authorized rate base of $10.8 million. A summary of this proposal is included as Exhibit NW Natural/2912.

V. AWEC'S POLICY CONCERNS REGARDING TAX ISSUES

Interim Period Deferral

Q. Did AWEC express concerns regarding NW Natural's calculation of the Interim Period Deferral?

A. Yes. In the Commission's Order No. 18-419, rejecting in part the Second Partial Stipulation, the Commission noted that, "AWEC argues that NW Natural's calculation of the tax savings during the interim period from January 1 to October 31, 2018 is materially flawed . . . ."[48] However, at no time during Phase I of this proceeding did AWEC identify or document a flaw of any kind in NW Natural's calculation.

Q. Did AWEC provide any alternative proposals for calculating the Interim Period Deferral amount?

A. Yes. In its testimony in response to the Second Partial Stipulation, AWEC identified two alternative methodologies to calculate the Interim Period Deferral. One method uses calendar year 2017 results of operations as a proxy, which AWEC asserts was the method used by the Idaho Public Utilities Commission (IPUC) to determine the Interim Period Deferral amount.[49] The other method proposed by AWEC uses data from NW Natural's last rate case in 2012, which AWEC describes as the same approach used by the

[48] Order No. 18-419 at 17.
[49] AWEC/600, Mullins/16.

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

Washington Utilities and Transportation Commission (WUTC) for Avista Utilities (Avista) and Cascade Natural Gas Corporation (Cascade).

Q. AWEC implied that these methods are the adopted approaches for the Interim Period Deferral of the WUTC and IPUC. Is this correct?

A. No. In the Cascade case—in which AWEC participated—the WUTC clarified that use of the last rate case method was only to arrive at an estimate so that Cascade could begin amortizing the benefit to customers.[50] The WUTC directed that Cascade could true up any differences between the estimate and actual amount once the actual 2018 interim period benefit was known. Use of a proxy year to arrive at an initial estimate in Cascade's proceeding may have been a reasonable approach since it was so early in 2018 that the actual interim period benefit could not be known. However, the clarifying Order 07 clearly indicates the WUTC's intention that the Interim Period deferral benefit would ultimately be determined by actual 2018 results.

The IPUC issued Order No. 33965 (Case No. GNR-U-19-01) in January of 2018 (one month after the TCJA was enacted) to direct all utilities to file a report by March of 2018 which reported how much the Interim Period benefit would have been if it had applied to 2017. This report was used by the IPUC to determine which utilities would benefit from the TCJA and should come in to address appropriate ratemaking. A number of utilities were excused from further IPUC tax reform proceedings based on this report. However, use of the 2017 year was not the required approach by the IPUC for actual ratemaking proceedings. In fact, Avista's stipulation and settlement with the IPUC in Case No. GNR-U-18-01 for Interim Period deferral did not use 2017 as a proxy but instead used 2018.

[50] NW Natural/2913.

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

Idaho Power did use 2017 as a proxy in their Idaho settlement for their interim period deferral, but it was not the required method of the IPUC—instead, it was an approach developed through negotiations with interested parties and agreed to in a stipulation.

Q. Even if these two Interim Period Deferral calculation methods were not the ordered methods of the WUTC and IPUC as AWEC suggested, are they still reasonable methods for consideration?

A. No. AWEC actually attempted to calculate an Interim Period Deferral amount for NW Natural using both of these methods – see AWEC's 'Idaho Method' at AWEC/602, Mullins/1, and AWEC's Last Rate Case 'Washington' method at AWEC/602, Mullins/4.

AWEC's approaches have three major flaws, which I will discuss in turn. First, AWEC's approach is problematic because it improperly considers changes to NW Natural's revenue requirement from its 2012 general rate case, UG 221, to calculate the amount of the deferral. The Commission has found that, "[e]xcept in limited circumstances, it is improper to consider changes to components of the revenue requirement in isolation."[51] NW Natural's actual revenues and costs have changed significantly from those used to set its revenue requirement in its last rate case. Consequently, calculating an income tax expense deferral for 10 months of 2018 based on revenues and costs that are no longer relevant estimates of the Company's actual results will not provide a calculation that is dependable or reasonable. In contrast, the Company is utilizing a 2018 results of operations report format that performs a "with" TCJA and "without" TCJA calculation. By using the 2018 results of operations, the Company has captured the actual tax benefit amount (*i.e.* the income tax benefit from the difference

[51] *In the Matter of Nw. Natural Request for a General Rate Revision,* Docket No. UG 221, Order No. 12-437 at 26 (Nov. 16, 2012).

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

between the prior 35 percent federal income tax rate and the new 21 percent income tax rate) based on the Company's 2018 revenues and costs.

Second, AWEC's approach of applying 10/12ths to its estimate for the annual amount to calculate the Interim Period amount may be appropriate for a utility that has relatively consistent earnings throughout the year, but is inappropriate for a gas utility that earns the bulk of its revenues during the winter months. As such, AWEC's approach unjustifiably assumes evenly distributed revenues for the entire year. Because gas utility revenues are significantly higher during the colder months and much lower during the warmer summer months, it is essential to consider actual or forecast revenues during the months that are included during the Interim Period (January through October) rather than applying a mathematical formula that does not consider how the Company's revenues vary throughout the year. AWECs use of the 10/12ths method ignores that NW Natural's rates have been reset as of November 1, 2018 to reflect the lower federal tax rate, and that November and December generate a significant portion the Company's annual revenue.

Third, AWEC's calculation of the Interim Period Deferral is also misguided because it includes an additional $3 million representing the amortization of EDIT prior to November 1, 2018.[52] As explained in NW Natural's testimony and the Opening Brief in Phase I of this proceeding, NW Natural deferred the full remeasurement of deferred taxes resulting from federal income tax reform as of December of 2017, consistent with the deferral filing in Docket No. UM 1919. The Commission's Order No. 18-419 did not authorize amortization of this balance—nor has any other Commission order. As a result, AWEC's

[52] AWEC/200, Mullins/13; AWEC/500, Mullins/8; AWEC's Response Brief at 23, AWEC/602 - Mullins/1, and AWEC/602 - Mullins/4

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

calculation is premature because there has been no amortization of EDIT occurring during the Interim Period. In addition, AWEC adds an interest accrual on top of the premature EDIT amortization even though it is clear in regulatory ratemaking that until such time that the EDIT amortizes, customers are still receiving a full benefit of reduced rate base for the EDIT balance – which is the equivalent of customers earning the full authorized rate of return on that amount. Including additional interest amounts on this balance has the effect of double-counting the impacts of interest on the balance.

Q. As another alternative, AWEC recommends the Commission adopt the Interim Period Deferral resolution from Portland General Electric Company's (PGE) stipulation in their current rate case, Docket UE 335. Is this reasonable?

A. No. In the Commission's Order No. 18-419, rejecting in part the Second Partial Stipulation, the Commission noted that, "AWEC recommends that we adopt the same approach that has recently been used in [PGE's] ongoing general rate case. [AWEC recommends that] NW Natural should begin refunding its estimate of the interim period tax savings over a two year period, subject to a true up in the second year based on further proceeding in the tax deferral docket."[53] PGE's Interim Period is not over until December 31, 2018 and therefore using an estimate on a temporary basis may be a reasonable method in their case. NW Natural is positioned differently than PGE in that NW Natural's Interim Period is now over and the actual amount of the benefit can be known.

[53] Order No. 18-419 at 17.

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

EDIT Deferral

Q. Did AWEC express concerns regarding NW Natural's use of the ARAM normalization method?

A. Yes. In the Commission's Order No. 18-419, rejecting in part the Second Partial Stipulation, the Commission noted that, "although AWEC generally agrees with the EDIT balances and amortization amounts identified in the second stipulation, AWEC has concerns with the ARAM methodology used to calculate those values."[54] It is true that AWEC has repeatedly argued that NW Natural lacks the data to use ARAM, and instead proposes to use a variant of the RSGM method, for all vintages. However, AWEC's concern regarding the use of ARAM is completely unfounded. As I explained earlier in this testimony (and during Phase I of this proceeding), ARAM is the appropriate method for determining the proposed amortization schedule for plant-related EDIT, and if adequate data is available to use ARAM, ARAM must be used.

Q. Why does AWEC claim that NW Natural cannot use ARAM to determine the amortization schedule for EDIT (Plant?)

A. AWEC's primary arguments are that: (1) NW Natural does not have the data necessary to perform the ARAM calculation; (2) NW Natural uses PowerTax software, which includes certain assumptions that AWEC believes are inappropriate for determining ARAM;[55] and (3) in order to use ARAM, the ARAM amortization schedule must be calculated at both the FERC asset account and vintage level.[56]

[54] Order No. 18-419 at 17.
[55] AWEC/600, Mullins/21.
[56] AWEC/600, Mullins/21.

Rates & Regulatory Affairs
NW NATURAL
220 N.W. Second Avenue
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First, NW Natural has provided the data necessary to support the calculation of ARAM. NW Natural previously provided AWEC with accumulated book and income tax depreciation by vintage, for the calendar years ending 2017, 2018, and 2019, and noted that this was the same information used by NW Natural to determine the ARAM amortization.[57]

Second, NW Natural does not use PowerTax software, thus any algorithm assumptions that might be included in this software module, and which may be of concern to AWEC, would not impact NW Natural's calculation of ARAM.

Third, the ARAM calculation is actually defined as being calculated on a vintage by vintage basis. There is no guidance that performing the calculation at a more detailed level (i.e., by FERC account balance within each vintage) is preferred or required. A related IRS Private Letter Ruling 200743030 was included as Exhibit AWEC/503, Mullins/5, which clarifies that ARAM is a vintage approach: "…under ARAM, excess tax reserves pertaining to a particular <u>vintage</u> or <u>vintage</u> account are not flowed through to ratepayers until such time as the timing differences in the particular <u>vintage</u> account reverse." Beyond the fact that there is no requirement or preference for performing the ARAM calculation at a level of detail greater than by vintage, doing so would not result in a different outcome.

Q. Did AWEC recommend any specific treatment regarding the EDIT (Other Non-Plant) balance?

A. Yes. In the Commission's Order No. 18-419, rejecting in part the Second Partial Stipulation, the Commission noted that, "AWEC also objects to the second stipulation's

[57] AWEC/601, Mullins/10. In addition, NW Natural provided AWEC with an electronic version of the ARAM schedule in response to UG 344 - AWEC DR 57.

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220 N.W. Second Avenue
Portland, Oregon 97209-3991
1-503-226-4211

proposed treatment of the $6.7 million of EDIT (Other Non-Plant). AWEC contends that those funds that are earmarked for the pension balancing account balance should be refunded to transportation customers."[58] As previously discussed in this testimony, the Non-Plant Other EDIT remeasurement balance relates to ratemaking involving all customer groups, and has no special rate design implications. AWEC provides no reasoning or support regarding the special allocation they had proposed.

Q. Did AWEC provide any objections regarding the application of tax reform benefits to the PBA regulatory asset?

A. Yes. In the Commission's Order No. 18-419, rejecting in part the Second Partial Stipulation, it was noted that, "AWEC recommends all EDIT amounts be returned to ratepayers and not used to offset the pension balancing account balances."[59] AWEC's concern—that it is inappropriate to consider application of the benefits from the TCJA to reducing the balance of the PBA—is entirely unfounded, and has no support as a matter of law or policy. AWEC has not cited any relevant precedent to support its claim, and in fact, the Commission recently approved a stipulation achieving a similar result for Idaho Power Company's customers.[60] There simply is no barrier to the application of the benefits of tax reform to reduce the PBA balance. This issue is discussed further in Mr. Wilson's testimony.

[58] Order No. 18-419 at 17.

[59] Order No. 18-419 at 17.

[60] *In the Matter of Idaho Power Co., Requests Approval of Changes to Rates Related to the Accelerated Depreciation of Valmy and Approval to Defer and Amortize the 2018 Ratepayer Benefits Associated with the Income Tax Provisions of the U.S. Tax Cuts and Jobs Act*, Docket Nos. UM 1928 and UE 345, Order No. 18-199 (May 30, 2018) (applying certain benefits of tax reform to reduce the customer impact of accelerating depreciation for Idaho Power's Valmy Unit 1).

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220 N.W. Second Avenue
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1-503-226-4211

Q. Does this conclude your testimony?

A. Yes it does.

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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

Opening Testimony of **Sean Borgerson**

FEDERAL INCOME TAX REFORM
Exhibit 2901-2913

November 21, 2018

EXHIBITS 2901-2913 – INCOME TAX REFORM

Table of Contents

Rates & Regulatory Affairs
NW Natural
220 N.W. Second Avenue
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NW Natural
2018 Oregon Interim Period Deferral - TCJA Income Tax Benefit
Interim Benefit from January 1, 2018 through October 31, 2018
Forecasted - As of Each Date Noted - For 10 Month Period

		As of January 2018			As of March 2018			As of June 2018			Final Ten Month Interim Period As of October 2018		
No.		**w/o TCJA**	**w/ TCJA**	**Change**	**w/o TCJA**	**w/ TCJA**	**Change**	**w/o TCJA**	**w/ TCJA**	**Change**	**w/o TCJA**	**w/ TCJA**	**Change**
	Operating Revenues												
1	**Sale of Gas**	$ 441,939	$ 441,939	$ -	$ 443,369	$ 443,369	$ -	$ 444,422	$ 444,422	$ -	$ 424,015	$ 424,015	$ -
	Less: SRRM	8,325	8,325	-	8,325	8,325	-	8,345	8,345	-	8,251	8,251	-
2	**WARM Revenues (Actuals Only)**	-	-	-	-	-	-	(3,989)	(3,989)	-	7,137	7,137	-
3	**Revenue & Technical Adjustments (Actuals Only)**	-	-	-	-	-	-	1,398	1,398	-	(1,967)	(1,967)	-
4	**Decoupling Adjustments (Actuals Only)**	-	-	-	-	-	-	3,567	3,567	-	8,602	8,602	-
5	**Transportation (Actuals Only)**	-	-	-	4,666	4,666	-	8,890	8,890	-	15,260	15,260	-
6	**Miscellaneous Revenues**	3,075	3,075	-	3,071	3,071	-	3,059	3,059	-	4,511	4,511	-
7	**Total Operating Revenues**	436,688	436,688	-	442,782	442,782	-	449,002	449,002	-	449,307	449,307	-
	Operating Revenue Deductions												
8	**Gas Purchased**	165,520	165,520	-	165,825	165,825	-	178,765	178,765	-	174,845	174,845	-
9	**Uncollectible Accrual for Gas Sales**	609	609	-	609	609	-	609	609	-	236	236	-
10	**Other Operating & Maintenance Expenses**	121,851	121,851	-	121,851	121,851	-	122,727	122,727	-	125,202	125,202	-
	Less: SRRM	8,325	8,325	-	8,325	8,325	-	8,345	8,345	-	8,251	8,251	-
11	**Total Operating & Maintenance Exp.**	279,655	279,655	-	279,960	279,960	-	293,756	293,756	-	292,032	292,032	-
12	**Federal Income Tax**	11,274	6,764	4,510 *-A*	13,518	8,086	5,432 *-A*	10,751	6,420	4,331 *-A*	12,402	7,411	4,991 *-A*
13	**State Excise**	2,649	2,649	-	3,243	3,243	-	2,594	2,594	-	2,983	2,983	-
14	**Property Taxes**	16,942	16,942	-	17,775	17,775	-	17,798	17,798	-	17,293	17,293	-
15	**Other Taxes**	18,945	18,945	-	18,569	18,569	-	18,843	18,843	-	18,323	18,323	-
16	**Depreciation & Amortization**	64,162	64,162	-	63,878	63,878	-	63,878	63,878	-	61,883	61,883	-
17	**Total Operating Revenue Deductions**	393,627	389,117	4,510	396,943	391,511	5,432	407,620	403,289	4,331	404,916	399,925	4,991
18	**Net Operating Revenues**	$43,062	$47,572	($4,510)	$45,838	$51,270	($5,432)	$41,382	$45,713	($4,331)	$44,391	$49,382	($4,991)
			Income Tax Gross Up:	1.36 *-B*		*Income Tax Gross Up:*	1.36 *-B*		*Income Tax Gross Up:*	1.36 *-B*		*Income Tax Gross Up:*	1.36 *-B*
				$ (6,134)			$ (7,388)			$ (5,890)			$ (6,788)
19	**Interim Period Benefit Deferral (Grossed Up)**		**Rounded:**	$6.1 Million		**Rounded:**	$7.4 Million		**Rounded:**	$5.9 Million		**Rounded:**	$6.8 Million

A U.S. Federal corporate income tax rate decreased from 35% to 21%, which is a 40% decrease. The 'change' in federal income tax expense above, or interim period benefit, is consistent with this expected decrease (e.g., reduction in January estimate on row 12 of $4,510 is 40% of w/o TCJA federal tax expense of $11,274)

B Income tax gross up rate derived by dividing one by one minus the applicable blended statutory income tax rate [1.36 = (1 / (1-.264737)]

To estimate the net reduction to income tax expense from the TCJA, NW Natural is utilizing a 2018 results of operations report format to perform a “with” and “without” TCJA calculation. This methodology is consistent with the approach outlined by NW Natural at the tax workshop held on February 28, 2018, and the follow up direction provided via email by Staff’s counsel at the Oregon Department of Justice. It is necessary to determine the 2018 interim period benefit using 2018 results in the context of other revenue and expenses in the same period. As noted by the Oregon PUC Commission in Order No. 12-437 (at 26), "It is improper to consider changes to components of the revenue requirement in isolation."

	Final Ten Month Federal Tax Exp. As of October 2018		
	w/o TCJA	**w/ TCJA**	**Change**
Operating Revenues	$ 449,307	$ 449,307	$ -
Operating Deductions	(292,032)	(292,032)	-
Property & Other Taxes	(35,616)	(35,616)	-
Book Depreciation	(61,883)	(61,883)	-
Interest (Rate Base * Cost of Debt)	(26,186)	(26,186)	-
State Tax Deduction	(2,983)	(2,983)	-
PreTax Regulatory Earnings Subtotal	30,607	30,607	-
Permanent Tax Differences	5,046	5,046	-
PreTax Subtotal Plus Perm. Tax Differences	35,653	35,653	-
Federal Income Tax Rate	**35%**	**21%**	
Federal Income Tax Before Credits	12,478	7,487	4,991
Research Credit	(76)	(76)	-
Federal Income Tax Expense	**$ 12,402**	**$ 7,411**	**4,991**

Mark R. Thompson
Director of Regulatory Affairs
Tel: 503.721.2476
Fax: 503.721.2516
email: mark.thompson@nwnatural.com

NW Natural
220 NW 2ND AVENUE
PORTLAND, OR 97209
TEL 503.226.4211
www.nwnatural.com

April 16, 2018

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
Attention: Filing Center
201 High Street SE Suite 100
Post Office Box 1088
Salem, Oregon 97308-1088

Re: UM 1919: Update to NW Natural's Deferral Application

As requested by the Staff of the Public Utility Commission of Oregon in its March 23, 2018 email to all energy utilities that filed deferral applications in response to the Federal Tax Cuts and Jobs Act ("TCJA"), Northwest Natural Gas Company ("NW Natural" or "Company") provides the following update to its deferral application filed on December 29, 2017 (the "Application").

NW Natural is currently recording a deferral of estimated excess revenue in 2018, based on the forecasted benefit of the lower federal corporate income tax rate provided in the TCJA, for the period from January 1 through October 31, 2018. To determine the net reduction to income tax expense from the TCJA, NW Natural is utilizing a results of operations report format to perform a "with" and "without" TCJA calculation. Based on our current projections, including some actual results, we estimate that the amount of the deferral for the period January 1, 2018 through October 31, 2018 is $7.4 million. NW Natural's current request for a general rate revision will capture the effects of the TCJA in its new rates beginning on November 1, 2018.

We are also deferring the net benefits associated with the excess deferred tax balances recorded at the end of 2017. NW Natural looks forward to working with the parties in this docket, or potentially NW Natural's rate case, to determine the best course for customers to receive the benefit of the excess deferred taxes. Until such time that customers receive that benefit, they would continue to benefit from the lower rate base balance resulting from the excess deferred taxes.

If you have any questions about this update to the Application, please do not hesitate to contact me.

Sincerely,

NW NATURAL GAS COMPANY

/s/ Mark R. Thompson

Mark R. Thompson
Director of Regulatory Affairs

Mark R. Thompson
Director of Regulatory Affairs
Tel: 503.721.2476
Fax: 503.721.2516
email: mark.thompson@nwnatural.com

NW Natural

220 NW 2ND AVENUE
PORTLAND, OR 97209
TEL 503.226.4211
www.nwnatural.com

July 16, 2018

VIA ELECTRONIC FILING

Public Utility Commission of Oregon
Attention: Filing Center
201 High Street SE Suite 100
Post Office Box 1088
Salem, Oregon 97308-1088

Re: UM 1919: Update to NW Natural's Deferral Application

As requested by the Staff of the Public Utility Commission of Oregon in its March 23, 2018 email to all energy utilities that filed deferral applications in response to the Federal Tax Cuts and Jobs Act ("TCJA"), Northwest Natural Gas Company ("NW Natural" or "Company") provides the following update to its deferral application filed on December 29, 2017 (the "Application").

NW Natural is currently recording a deferral of estimated excess revenue in 2018, based on the forecasted benefit of the lower federal corporate income tax rate provided in the TCJA, for the period from January 1 through October 31, 2018. To determine the net reduction to income tax expense from the TCJA, NW Natural is utilizing a results of operations report format to perform a "with" and "without" TCJA calculation. Based on our current projections, including some actual results, we estimate that the amount of the deferral for the period January 1, 2018 through October 31, 2018 is $5.9 million. NW Natural's current request for a general rate revision will capture the effects of the TCJA in its new rates beginning on November 1, 2018.

We are also deferring the net benefits associated with the excess deferred tax balances recorded at the end of 2017. NW Natural looks forward to working with the parties in this docket, or potentially NW Natural's rate case, to determine the best course for customers to receive the benefit of the excess deferred taxes. Until such time that customers receive that benefit, they would continue to benefit from the lower rate base balance resulting from the excess deferred taxes.

If you have any questions about this update to the Application, please do not hesitate to contact me.

Sincerely,

NW NATURAL GAS COMPANY

/s/ Mark R. Thompson

Mark R. Thompson
Director of Regulatory Affairs

Tax Cut and Jobs Act (TCJA)

On December 22, 2017, H.R.1 – An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018, also known as the Tax Cuts and Jobs Act, (the “TCJA”) was enacted. The TCJA permanently lowers the U.S. federal corporate income tax rate to 21 percent from the existing maximum rate of 35 percent, effective as of January 1, 2018. The TCJA includes specific provisions related to regulated public utilities that provide for the continued deductibility of interest expense, and the elimination of bonus depreciation after September 27, 2017. Certain rate normalization requirements for accelerated cost recovery benefits related to regulated plant balances also continue.

The TCJA also included changes to the treatment of the §199 production deduction, contributions in aid of construction, net operating losses, meals and entertainment expenditures, investigatory expenditures, transportation fringe benefits, bicycle commuting reimbursements, the alternative minimum tax, officer’s compensation limits, and other items.

Excess Deferred Income Taxes (EDIT)

- Accumulated deferred tax assets and liabilities (ADIT) generally represent the cumulative difference between total income tax expense and income taxes paid (*total income tax expense = current income taxes + deferred income taxes*). Utility rates are initially designed to allow for a recovery of total utility income tax expense, both current and deferred (ORS 757.269)
- ADIT primarily arises when accelerated and/or bonus depreciation provides for a temporary deferral of a portion of income taxes payable until later in a new asset's operating life. However, ADIT can also arise from differences related to non-plant activity (e.g., pension, employee benefits, etc.)
- During the income tax payable deferral period, customers receive a return on ADIT when it is applied as a reduction to rate base which results in lower customer rates
- Federal ADIT was remeasured in December of 2017 using the newly enacted tax rate. The change in ADIT was determined by measuring the federal temporary differences using a 21% federal statutory income tax rate and comparing this result to the federal ADIT balance existing immediately prior to the remeasurement. The change, or excess deferred income tax (EDIT), was recorded as reduction or increase in ADIT with an offsetting entry to:
    - A new regulatory liability or asset (for deferred tax items included in ratemaking; generally a net liability)
    - An existing regulatory liability or asset (for existing regulatory tax balances or flow-through items)
    - Income tax expense or benefit (for deferred tax items not included in ratemaking)
- The new regulatory liability balances, which include a gross up for income taxes at the newly enacted tax rate, represent the EDIT anticipated to accrue to the future benefit of customers. The balances are comprised of both *plant* and *non-plant* related EDIT

Excess Deferred Income Taxes (EDIT) – cont'd

- Timing of EDIT benefit
  - Plant EDIT:
    The plant related EDIT balances will generally be subject to amortization over the remaining life of the underlying assets using the average rate assumption method (ARAM) which is applied on a vintage by vintage basis. ARAM results in an amortization method that mimics the timing of when the deferred tax reversal would have been payable to the taxing authorities in the absence of a tax rate reduction. If insufficient data exists for a particular vintage to determine ARAM, then the reverse south Georgia method (RSGM) applies to that vintage. RSGM results in straight-line amortization.
    ARAM and RSGM are 'normalization' methods. Amortization, as determined by regulatory action, can be slower than that required by normalization without penalty. However, amortization that occurs more quickly than normalization requires is subject to an equivalent dollar for dollar addition to income taxes payable.
  - Non-Plant EDIT:
    The non-plant EDIT balances are not subject to normalization and may be amortized over any reasonable period.
- Method of benefit – Bill credit, offset to existing regulatory assets, allocate to capital projects, etc.
- Other Considerations
  - Uncertainties – EDIT balances recorded as of December 2017 are estimates. These balances may change as a result of refinements made during preparation of the income tax return for this period, Treasury guidance related to various elements of the TCJA, tax authority examinations, or by regulatory action of utility commissions
  - Cash Flow – Additional debt and/or equity financing may be necessary to support billing credits
  - Credit Ratings – Utility rating agencies have issued warnings of credit rating downgrades for utilities, related to cash flow metrics, as a result of the TCJA and regulatory outcome risk
  - Tax Recovery – Has the EDIT balance been fully recovered in rates (e.g., earning below authorized, etc.)

Excess Revenue for Income Tax Recovery

- In determining a utility's revenue requirement, the Oregon PUC establishes rates that provide a utility an opportunity, though not a guarantee, to recover the reasonable costs of providing utility service and earn an authorized rate of return on prudent investments. These rates are initially designed to allow for a recovery of total estimated utility income tax expense, both current and deferred (ORS 757.269)
- The TCJA reduces the corporate federal income tax rate from 35 percent to 21 percent. The new tax rate is effective as of January 1, 2018 on a prospective basis.
- The recovery allowance for income taxes determined in a general rate case, before the TCJA, included a 35 percent federal income tax rate. The income tax calculation may have also included flow-through tax items, production tax credits for wind, a domestic production deduction, certain tax disallowances (e.g., meals), or other items, the impact of which may change as a result of the TCJA.
- A utility's actual revenues and costs in any particular year may be different from the future test year estimates used to set rates for a number of reasons (e.g., weather, customer growth, inflation, fuel prices, etc.). If a utility's actual revenue or costs are higher or lower than the test year estimate, then net income, and related income taxes, may be higher or lower as a result. Income taxes are related to actual revenues and costs incurred.

Excess Revenue for Income Tax Recovery – cont'd

- Beginning in January of 2018, the reduced tax amount, grossed up for income taxes, will be recorded as a reduction to current revenue, with an equal offset to a new regulatory liability account which is anticipated to accrue to the future benefit of customers.
- To determine the net reduction to income tax expense from the TCJA, utilities are utilizing an annual results of operations report (or earnings test report) to perform a with and without TCJA calculation. Due to different facts and / or circumstances (e.g., primary operating jurisdiction, anticipated rate case timing, etc.), some utilities may use current year operating results, and others may select a proxy year.
- The excess revenue deferral balance, recorded in a new regulatory liability account, is not subject to normalization and may be amortized over any reasonable period.
- Other Considerations
  - Uncertainties – These balances may change as a result of refinements made during preparation of the income tax return for this period, Treasury guidance related to various elements of tax reform, tax authority examinations, or by regulatory action of utility commissions. In addition, US states may enact legislation in response to the TCJA that may change these results.
  - Tax Recovery – Application of earnings test, consider whether income tax expense has been fully recovered in rates (e.g., earning below authorized, etc.)

Calculation of Utility Regulatory Liability for Excess Deferred Income Taxes
Simplified Example for Reference Purposes
Applicable Income Tax Rate Decreasing from 39.5% to 26.5% (Combined Federal and State Rate)

Proof that NW Natural's Accounting Methodology for EDIT is Complete and Accurate

Assumptions:
~ Applicable income tax rate decreases from 39.5% to 26.5%
~ Entity has history of only one operating year at a 39.5% tax rate; All deferred taxes created in this year one
~ Entity paid zero taxes in year one so that all tax expense for year one is 'deferred' tax expense (avoids incorporating taxes paid into the example)
~ Deferred income taxes are remeasured using new 26.5% rate (39.5% - 26.5% = 13% delta)
~ The decrease in deferred income taxes from remeasurement is grossed up (@ 1.36) by new tax rate and recorded as regulatory liability

Outcome:
Ratepayers / customers receive 100% of the benefit / revenue reduction when the following occurs -
Remeasure existing deferred taxes using the new tax rate, identify the change as excess deferred income taxes, gross up the excess deferred income taxes using the new/prospective tax rate (1.36), record the grossed up EDIT as a regulatory liability, benefit customers with the regulatory liability balance.

Year One Operations, 39.5% Income Tax Rate				
Revenue Requirement		$	665	~ In this year one, authorized revenue requirement was determined / calculated to allow for a 39.5% income tax rate and provide for net regulatory operating income of $100.
O&M / Depreciation / Other			(500)	
Income before Tax			165	
Income Tax Expense	39.5%		(65)	~ No income taxes are paid in this year - so all of the income tax expense is 'deferred' income tax expense
Net Operating Income		$	100	

Remeasure of Deferred Income Taxes at New 26.5% Income Tax Rate			
Gross Deferred Tax	100.0%	(165)	
Deferred Tax Liability at Old Rate	39.5%	(65)	< Original deferred tax liability balance at year end
Deferred Tax Liability at New Rate	26.5%	(44)	< New deferred tax liability balance at year end (remeasured)
Excess Deferred Tax Liability		(21)	< Excess deferred income taxes
Gross Up Factor - New Tax Rate		1.36	< Gross up factor using new 26.5% income tax rate [1/(1-26.5%)]
Regulatory Liability		(29)	< Regulatory Liability including gross up at 1.36

Proof - Recalculated Year One Revenue Requirement at New Rate of 26.5%		**Yr. 1 Recalculated**			**Yr. 1 Original**		**Change in Rev. Requirement**	
Revenue Requirement		$	636		$	665	$ (29)	Revenue Requirement would have been $636, which is $29 less that originally authorized in year one. The regulatory liability calculated above using the 1.36 gross up factor based on the new tax rate results in a regulatory liability of $29.
O&M / Depreciation / Other			(500)			(500)	-	
Income before Tax			136			165	(29)	
Income Tax Expense	26.5%		(36)	39.5%		(65)	29	
Net Operating Income		$	100		$	100	$ -	

As can be seen in the 'Proof' above, a customer benefit of $29 (calculated using a 1.36 gross up rate) results in a full 100% benefit to customers and no harm to the utility.

Due to the simplicity of this example, the timing of cash flows and financing are not considered. As previously noted, 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.

NW Natural - Deferred Tax Remeasurement and Regulatory Liability
Summary of 2017 Oregon Regulatory Liability

	a	b		c		d	e	f	g
		Original System Wide Deferred Tax Remeasurement		**Adjustment - Resolved Uncertainties**		**Final System Wide Deferred Tax Remeasurement**	**Final Oregon Allocated EDIT**	**Original Oregon Allocation**	**Oregon Increase (Decrease)**
1	Plant	$ 140,618.8	+	$ 2,426.1	=	$ 143,044.9	$ 128,406.8	$ 126,556.9	$ 1,849.9
2	Non-Plant - Other	5,450.3	+	(639.1)	=	4,811.2	5,126.8	4,905.3	221.5
3	Non - Plant - Gas Reserves	10,766.8	+	-	=	10,766.8	10,766.8	10,766.8	-
4		$ 156,835.9		$ 1,787.0		$ 158,622.9	$ 144,300.4	$ 142,229.0	$ 2,071.4
							91%	91%	

		Oregon Allocated EDIT	**Relative Percent of Total**	**Application of 2017 Earnings Sharing**	**Oregon Allocated EDIT Post 2017 Earnings**		**Gross up For Income Taxes**		**Oregon Regulatory Liability, w/ Gross Up**
5	Plant	$ 128,452.7	89%	$ (8,502.9)	$ 119,949.8	x	1.36	=	$ 163,131.7
6	Non-Plant - Other	5,127.0	4%	(339.4)	4,787.6	x	1.36	=	6,511.2
7	Non - Plant - Gas Reserves	10,766.8	7%	(712.7)	10,054.1	x	1.36	=	13,673.6
8		$ 144,346.5		$ (9,555.0)	$ 134,791.5		1.36		$ 183,316.5

a1,2,3: The three EDIT categories. Primarily 'plant' and non-plant, however, Gas Reserves is broken out from non-plant as Gas Reserves is an Oregon only activity
b4: The original system wide remeasurement balance, prior to resolution of TCJA regulatory uncertainties
c4: Adjustments to reflect to the reslution of TCJA regulatory uncertainties, primarily reflects additional accelerated tax depreciation for 2017
e1,2,3: See NW Natural/2907 and 2908 for detail of these balances
e4: Deferred tax remeasurement balances for Oregon - allocated based on historical inclusion of deferred taxes included in Oregon ratemaking
f4: The original Oregon allocated remeasurement balance before resolution of TCJA regulatory uncertainties
g4: The increase in the remeasurement balance allocated to Oregon after resolution of TCJA regulatory uncertainties
e5,6,7: The relative percent of the total remeasurement balance of the three EDIT categories
d8: The 2017 application of earnings sharing review as estimated by OPUC Staff See NW Natural/2909
e8: The Oregon allocated remeasurement balance after application of a 2017 earnings review
f8: The income tax gross up factor to determine full regulatory liability balance for customers in Oregon See NW Natural/2905
g8: The full Oregon regulatory balance deferred for the future benefit of Oregon customers

NW Natural - Excess Deferred Tax Remeasurement - 2017
Plant Deferred Taxes

Plant:	Gross Balance before Remeasurement	Original Asset (Liability)	Remeasured Asset / (Liability)	Change	Federal Deferred Change	Federal Detriment of State Change	Oregon Regulatory Deferral - New	
				Oregon:	90.60%	100.00%		
Fixed Assets - Plant	(1,093,864,276)	(357,005,157)	(214,203,094)	(142,802,063)	(153,140,999)	10,338,936	(128,406,809)	
Willamette Valley Feeder	(18,513,543)	(6,030,772)	(3,618,463)	(2,412,309)	(2,591,896)	179,587	-	**B**
Total	(1,112,377,819)	(363,035,929)	(217,821,557)	(145,214,372)			(128,406,809)	**A**
				Plant, Oregon Allocation of Remeasurement:			**$ 128,406.8**	

State Plant DTL: *(Not remeasured)*	(73,849,542)
Willamette Valley Feeder	(1,282,765)
Total	(75,132,307)

A - The relative proportions of the federal and federal detriment of state changes as noted in percentages above

B - Willamette Valley Feeder asset previously excluded from ratemaking and rate recovery in Oregon

REDACTED

NW Natural - Excess Deferred Tax Remeasurement - 2017
Non-Plant Other and Non-Plant Gas Reserves

				Oregon:	90.60%	100.00%	Oregon
Non-Plant Other:	**Gross Balance before Remeasurement**	**Original Asset (Liability)**	**Remeasured Asset / (Liability)**	**Net Change**	**Federal Deferred Change**	**Federal Detriment of State Change**	**Regulatory Deferral - New**
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Total	(43,766,254)	(14,256,823)	(8,554,094)	(5,702,729)			(5,126,765)

Non-Plant Other, Oregon Allocation of Remeasurement: $ 5,126.8

				Oregon:	100.00%	100.00%	Oregon
Non-Plant Gas Reserves:	**Gross Balance before Remeasurement**	**Original Asset (Liability)**	**Remeasured Asset / (Liability)**	**Net Change**	**Federal Deferred Change**	**Federal Detriment of State Change**	**Regulatory Deferral - New**
Gas Reserves	(82,265,394)	(26,797,888)	(16,078,733)	(10,719,155)	(11,517,155)	798,000	(10,719,155)
Gas Reserves	(3,730,092)	(1,215,075)	(729,045)	(486,030)	(522,213)	36,183	(486,030)
			Less Gas Reserves Part II Excluded from Regulatory Tax Recovery:				438,339
							(10,766,846) **A**

Non-Plant Gas Reserves, Oregon Allocation of Remeasurement: $ 10,766.8

A - The relative proportions of the federal and state changes as noted in percentages above

Date: September 17, 2018

TO:
CHAD STOKES
ALLIANCE OF WESTERN ENERGY CONSUMERS
CABLE HUSTON LLP
1001 SW FIFRTH VE SUITE 2000
cstokes@cablehuston.com

FROM: John Fox
Senior Financial Analyst
Energy Rates, Finance and Audit Division

OREGON PUBLIC UTILITY COMMISSION
Docket No. UG 344 – AWEC's Data Request filed September 13, 2018

AWEC's Data Request DR 01:
Reference the Multi-Party Second Partial Stipulation, Paragraph 10: Did Staff perform an earnings test period to prior to determining the reasonableness of the amounts identified for amortization against the Pension Balancing Account balance? If yes, please provide a copy of such analyses.

Staff Response to AWEC's DR 01:
Yes. Referencing the most recent results of operations filed by the Company, the threshold for earnings sharing is 10.66%.[1]
Staff identified the change in federal tax expense that would have been necessary to trigger earnings sharing for 2017 using the goal seek function in the underlying excel model. The required decrease in tax would be $22,100 – 31,655 = ($9.555) million.

The results of this analysis are presented on the following page.

The sum of the Company's reported interim tax savings, protected EDIT Plant Amortization, and unprotected EDIT Non-Plant Amortization for 2018 is $9.761 million (including gross up).[2] Accordingly 98% these savings, had they been realized in 2017, would have been below the earnings threshold.

[1] *See In the Matter of Northwest Natural Gas Company, dba NW Natural, 2018 Spring Earnings Review,* Docket No. UM 903, Order No. 18-254, Appendix A, page 4 of 5 (Jul. 03, 2018).
[2] *See In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL, Application for Authorization to Defer Certain Expenses Associated with the 2018 US Tax Cuts and Jobs Act.,* Supplemental Application filed 7/16/2018 and NW Natural/2501, Borgerson/1.

2017 Reported Results Order 18-254 (UM 903)	2017 Reported Results Proforma at 10.66% ROE
Results after Type II	**Results after Type II**
(g) = (c) + (f)	**(g) = (c) + (f)**
$652,927	$652,927
0	0
(6,188)	(6,188)
0	0
17,987	17,987
3,609	3,609
668,336	668,336
287,282	287,282
752	752
142,291	142,291
430,325	430,325
31,655	22,100
7,511	7,511
20,118	20,118
23,978	23,978
71,062	71,062
584,650	575,095
$83,686	$93,241
$2,765,246	$2,765,246
(1,227,221)	(1,227,221)
1,538,025	1,538,025
(2,852)	(2,852)
(4,446)	(4,446)
61,966	61,966
336	336
(431,266)	(431,266)
0	0
0	0
$1,161,763	$1,161,763
7.20%	8.03%
8.998%	10.665%

NW Natural - Average Rate Assumption (ARAM) Amortization

	ARAM Amortization *WITHOUT* 2017 Earnings Sharing						
	2018	**2019**	**2020**	**2021**	**2022**		
ARAM	2,011,335	2,324,564	2,622,580	3,007,454	3,361,668		
Oregon Allocation Factor	90.00%	90.00%	90.00%	90.00%	90.00%		
Gross Up Factor	1.36	1.36	1.36	1.36	1.36		
Grossed Up Amortization	**2,461,875**	**2,845,267**	**3,210,038**	**3,681,124**	**4,114,682**	16,312,986	Total
						Divided by 5	
						3,262,597	Average
						$3.263 Million	

	ARAM Amortization *WITH* 2017 Earnings Sharing						
ARAM	1,874,666	2,166,611	2,444,377	2,803,099	3,133,244		
Oregon Allocation Factor	90.00%	90.00%	90.00%	90.00%	90.00%		
Gross Up Factor	1.36	1.36	1.36	1.36	1.36		
Grossed Up Amortization	**2,294,591**	**2,651,932**	**2,991,917**	**3,430,993**	**3,835,091**	15,204,524	Total
						Divided by 5	
						3,040,905	Average
						$3 Million	

<u>ARAM Consideration for Plant Related EDIT Amortization:</u>
The normalization language in the TCJA indicates that a taxpayer, in this case NW Natural, would commit a normalization violation, “if the taxpayer, in computing its cost of service for ratemaking purposes and reflecting operating results in its regulated books of account, reduces the excess tax reserve more rapidly or to a greater extent than such reserve would be reduced under the average rate assumption method.”

NW Natural - Deferred Tax Remeasurement and Regulatory Liability
Summary of Oregon Regulatory Liability Amortization - Proposal Non-Plant Applied to PBA and Remainder Amortized to Rates

		a	b	c	d	e	f	g	
				Applied to Ratemaking Years as Follows:					
		Oregon Regulatory Liability, w/ Gross Up	**PBA Now**	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	
1	Plant	$ 163,131.7		$ 3,000	$ 3,000	$ 3,000	$ 3,000	$ 3,000	**A**
2	Non-Plant - Other	$ 6,511.2	$ 6,511.2			-	-	-	**B**
3	Non - Plant - Gas Reserves	$ 13,673.6		684	684	684	684	684	**C**
4		$ 183,316.5		$ 3,684	$ 3,684	$ 3,684	$ 3,684	$ 3,684	**D**
5	Rate Base Increase	>>>	$ 6,511.2			$ 9,210			**E**

A Reflects the first five years of Plant EDIT amortization at a rate intended not to exceed a normalization speed limit
B Reflects immediate application of the full Non-Plant Other balance to the Pension Balancing Regulatory Asset
C Reflects straight-line amortization over twenty years to reflect the underlying life of the non-plant gas reserves asset the EDIT relates to

D Total proposed annual amounts that can be used to provide bill credits, apply to reduce the regulatory pension balancing asset, or apply as a reduction to other capital projects. One or a combination of these applications are appropriate.
E Increase to rate base in this general rate case proceeding - Increase of $6.511.2 for the immediate application of Non-Plant Other to the PBA, and increase of $9,210 to reflect half of the first five years of total amortization.

NW Natural - Deferred Tax Remeasurement and Regulatory Liability
Summary of Oregon Regulatory Liability Amortization - Proposal if Amortized as a Reduction to Rates

	a	b	c	d	e	f	g	
		Oregon Regulatory Liability, w/ Gross Up	**Applied to Ratemaking Years as Follows:**					
			Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**	
1	Plant	$ 163,131.7	$ 3,000	$ 3,000	$ 3,000	$ 3,000	$ 3,000	**A**
2	Non-Plant - Other	$ 6,511.2	651	651	651	651	651	**B**
3	Non - Plant - Gas Reserves	$ 13,673.6	684	684	684	684	684	**C**
4		$ 183,316.5	$ 4,335	$ 4,335	$ 4,335	$ 4,335	$ 4,335	**D**
5	Rate Base Increase	>>>			$ 10,838			**E**

A Reflects the first five years of Plant EDIT amortization at a rate intended not to exceed a normalization speed limit
B Reflects straight-line amortization over ten years to reflect the underlying life of the non-plant assets and liabilities the EDIT relates to
C Reflects straight-line amortization over twenty years to reflect the underlying life of the non-plant gas reserves asset the EDIT relates to

D Total proposed annual amounts that can be used to provide bill credits, apply to reduce the regulatory pension balancing asset, or apply as a reduction to other capital projects. One or a combination of these applications are appropriate.
E Increase to rate base in this general rate case proceeding - Equal to half of the first five years of total amortization.

**BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. CASCADE NATURAL GAS CORPORATION, Respondent.	DOCKET UG-170929 ORDER 07 GRANTING CASCADE'S MOTION FOR CLARIFICATION OF ORDER 06

BACKGROUND

1 On August 31, 2017, Cascade Natural Gas Corporation (Cascade or Company) filed with the Washington Utilities and Transportation Commission (Commission) revisions to its Tariff WN U-3 for natural gas service provided in Washington. Following an evidentiary hearing on June 20, 2018, the Commission entered its Final Order, Order 06, on July 23, 2018.

2 On July 30, 2018, Cascade filed a Motion for Clarification of Order 06 (Motion). In its Motion, Cascade requests that the Commission clarify the meaning of the following statement in paragraph 44 of Order 06: "To address any discrepancy, Cascade may file a true up, effective November 1, 2019, once its actual 2018 tax liabilities are known." Cascade believes that the Commission "clearly intended that the ordered tax refund amount, $1.6 million, would be trued up to the actual benefit received by the Company based on its 2018 tax filing."[1] Cascade further explains that Commission staff (Staff) believes that the Commission intends for the true up to reflect any difference between the $1.6 million refund ordered and the credit actually paid to customers as of November 2019.

DISCUSSION

3 We grant Cascade's Motion and clarify the Commission's statement in paragraph 44 of Order 06. Paragraph 44 states:

> For the reasons discussed above, we find that Cascade failed to carry its burden to prove that allowing the Company to retain the Interim Period EDIT would benefit

[1] Cascade's Motion ¶1.

> customers or result in rates that are fair, just, reasonable, and sufficient. We decline to allow Cascade to treat TCJA benefits as period costs and direct Cascade to amortize the Interim Period EDIT through a separate schedule over a 15-month period consistent with the first year amortization schedules for the Company's Protected and Unprotected EDIT amounts. As we have repeatedly expressed, the excess deferred taxes should inure to the benefit of ratepayers as soon as reasonably practicable. To address any discrepancy, Cascade may file a true up, effective November 1, 2019, once its actual 2018 tax liabilities are known.

In its entirety, paragraph 44 reflects the Commission's determination that Cascade may not retain any portion of the Interim Period EDIT benefit owed to its customers. The Commission acknowledged, however, that the Interim Period EDIT amount was estimated, and that the Company's "liability" for actual benefits due back to customers remained unknown. The purpose of the true up, therefore, is to ensure that the Interim Period EDIT benefit is neither over- nor under-refunded to customers.

4 In hindsight, we recognize that the term "tax liabilities" is subject to more than one interpretation. To remove any perceived ambiguity, we amend paragraph 44 by replacing the phrase "once its actual 2018 tax liabilities are known" with the phrase "once the actual Interim Period EDIT benefit owed to customers is known." We modify the last sentence of paragraph 44 of Order 06, by this reference, as follows: "To address any discrepancy, Cascade may file a true up, effective November 1, 2019, once the actual Interim Period EDIT benefit owed to customers is known."

ORDER

THE COMMISSION ORDERS:

5 (1) Cascade Natural Gas Corporation's Motion for Clarification is GRANTED.

6 (2) Order 06 is modified as set out in paragraph 4, above.

DATED at Olympia, Washington, and effective July 31, 2018.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

DAVID W. DANNER, Chairman

ANN E. RENDAHL, Commissioner

JAY M. BALASBAS, Commissioner