

Docket No. UG 435
Exhibit SBUA /100
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

OPENING TESTIMONY OF DANNY KERMODE CPA

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Danny Kermode, and my business address is 5326 75th CT SW, Olympia, Washington 98512. My business email address is 5553dkcpa@GMX.US.

Q. By whom are you employed and in what capacity?

A. I am self-employed as a Certified Public Accountant providing consulting services for organizations in utility regulatory matters.

Q. Please state your qualifications to provide testimony in this proceeding.

A. I have more than 37 years of regulatory accounting experience within both private practice and in government. A more detailed description of my qualifications is set forth in my Statement of Qualifications found at SBUA/101 Kermode. I have appeared as an expert witness in numerous contested cases presenting financial, income tax and regulatory accounting issues. I last worked as the Assistant Director for Water and Transportation at the Washington Utilities and Transportation Commission (WUTC). Prior to being appointed Assistant Director, I was the UTC's Director of Policy and Legislation. I also was the Commission's accounting advisor and a senior energy policy advisor. I am a licensed Certified Public Accountant with an undergraduate degree in accounting from Arizona State University.

I worked for the UTC for over 25 years. Prior to working at the WUTC, I accumulated over ten years of experience in private accounting practice specializing solely in public utility regulation and was certified as a Certified Financial Planner, though that certification is now inactive.

I am also a visiting faculty member and Senior Fellow at Michigan State University's Institute of Public Utilities where I continue to teach advanced regulatory studies and basic ratemaking. Previously, I was on the faculty of the Annual National Association of Regulatory Utility Commissioners' Rate School in

San Diego California. In 2014 I worked as an adjunct professor at St. Martin's University teaching business taxation.

In addition, I have written articles on public utility regulation in nationally recognized publications including the Public Utility Fortnightly and National Regulatory Research Institute Journal of Applied Regulation.

Q. Have you testified previously before a regulatory commission?

A. Yes, I have testified before the WUTC at least 13 times covering various industries including electric, natural gas, telecom, oil pipeline, and water utility. For example, I have filed testimony in two PacifiCorp dba Pacific Power general rate cases, and two Avista Utilities general rate cases. I have also testified specifically on income tax issues in a rate case involving Olympic Pipeline Company. Additionally, I have filed testimony in various water company general rate cases.

II. SCOPE AND SUMMARY OF TESTIMONY

Q. What is the purpose and scope and of your testimony?

A. The purpose is to provide testimony for the record of the impact of the current rate filing on small business within the service area of Northwest Natural Gas Company in Oregon ("NW Natural" or "Company"). It appears in the past such input for small business has been weak at best or totally lacking a worst. My testimony will address the Company's proposal to adjust rates towards parity and an analysis of the rate schedule 3's direct effect on the rates paid by small business receiving service from NW Natural. I will also provide testimony on the results of my examination *Rate Schedule 3 Basic Firm Sales Service - Non-residential (RS 3)* determining customer class structure and whether it properly reflects a homogeneous class of rate payers and if there are any interclass cross subsidy.

I'm also proposing a new approach for Employee Stock Expense that would keep the pay incentives in place but allow stock expense costs to be fairly shared

between shareholders and ratepayers. And finally, I provide testimony regarding the late payment and reconnection charges and their effect on small business.

III. INTERCLASS SUBSIDY AND USE OF PARITY FOR RATESETTING

Q. Did you read Mr. Wyman's testimony (NW Natural/1400) where he discusses the extent the current rate schedules are achieving interclass parity?

A. Yes, Mr. Wyman describes each rate class and their relationship to a parity benchmark derived from the Company's LRIC model. He specifically cites the residential schedule RS 2 and the basic commercial schedule RS 3 as "roughly" the same 95 percent of parity level. That is, according to the study, both the residential RS2 and the RS 3 commercial customers are underpaying their cost of service.¹ While many of the other classes appear to be overpaying according to the study.²

Q. Let's start the discussion by asking in your own words, what is "parity"?

A. "Parity" in utility rate-setting means that a customer class is paying no more or less than their costs of service. In other words, the cost of provision of service is equal to the amount received.

Q. The Company is recommending that all rate classes be set to parity using its LRIC model as the gauge of parity, do you agree?

A. No. In my experience as an advisor to a commission and as an accounting advisor the concept of setting rates at parity for utility rates has been debated for years. In my opinion the argument of setting rates based on parity has practical problems and policy challenges.

Q. Why in your opinion have the regulators resisted using parity as a strict method of setting rates?

A. There are two major reasons for not using parity as a strict method of setting rates. The first is cost of service studies are constructed using, to a large extent, estimates,

¹ Wyman, Exh. NW Natural/1400 at 42

² Wyman, Exh. NW Natural/1400 at 47 table 2

allocators, or educated guesses to project costs based on a multitude of interrelated factors. Many if not most of those factors require the application of judgment and a subjective assessment of the cost of providing service to each of the rate classes and the services provided. Although cost of service studies are obviously highly useful in helping guide regulators in setting rates, they are still, by their very nature, estimates. Cost of service studies, even with all their complexity, remain just a filter from which regulators can get an idea of the cost dynamics of a Company.

Cost of service studies are routinely used to support the estimated cost of service of a natural gas provider. It is not uncommon to have multiple cost of service studies filed in a rate filing by many of the various parties. In my experience, it is as rare if not unheard of, for any two filings resulting in same allocation of costs. Instead, the costs of the cost of service study normally skew away from the party filing it.

Q. What is the other reason that regulators resist using parity as a strict method of setting rates?

A. The other reason is because using parity as a method of setting rates effectually limits the ability of commissions to implement policy. It is easy to assume that obtaining parity in rates is the goal of rate making because, one would think, parity implies equity and fairness. However, it does neither. Instead, it ties the hands of policy makers when they attempt to construct rates that will be fair, just, and reasonable and in the public interest.

Rate design is the tool that provides policy makers the ability to drive policy, whether it be to change usage patterns, provide affordable rates, or to avoid economic harm to communities. Cost of service studies are important part of the rate design process. The studies provide benchmarks that regulators can use to inform their decisions and provide a better understanding of rate impacts on society.

Q. In cases where there is other cost of service studies prepared, do they all agree generally on the same proposed allocations of costs?

A. No, in my experience cost-of-service studies filed by different parties of a case inevitably result different proposed allocations of costs. As each party's cost-of-service study is developed each study applies differences in judgments, estimates, allocations, and applications of policy resulting in cost estimates which are different from one another. In other words, each study provides a slightly different view of costs.

Q. Mr. Wyman testifies that under current rates, the "Small Commercial" RS 3 rate payers are paying less than their full cost of service, do you agree?³

A. No. Mr. Wyman, relying on his LRIC study, testifies that RS 3 customers are paying 95 percent of parity. I would argue that the calculated 95 percent of parity is not absolute and must have a margin of error. For argument purposes assuming a margin of error of 5 percent, RS 3 is at parity without a parity adjustment.

Q. You testify that, in your opinion, the 95 percent parity ratio was within and assumed margin of error. Did you compute an actual margin of error?

A. No. It would be difficult to compute since the Company's LRIC uses estimates derived from sampling, for example sampling was used for the study's meter, transmission, and main sizes. It is just a statistical reality in sampling that a margin of error does exist and for rate design purposes, assuming RS 3's current parity 95 percent is within an assumed 5 percent margin is reasonable.

Q. Mr. Wyman recommends that an additional amount of revenue requirement, a parity premium, be allocated to those customers being serviced by RS 3 to reach parity, do you agree with his recommendation?

A. No, I don't agree. RS 3 consists of a large percentage of small business. Oregon's small businesses are the one of most fragile of the customer classes being served by NW Natural. Small business has been hit hard nationally by the impact of the COVID-19 pandemic and its variants with many temporarily closing or going out of

³ *ibid*

business. Even though COVID-19 related restrictions are being relaxed, small businesses continue to struggle, frankly now is not the time to increase rates beyond an equal percentage margin increase without imposing a parity premium solely for the sake of reaching a theoretical level of parity. To do so can have the potential of seriously impacting the long-term survival of many local small businesses.

Q. Why do you believe small businesses is the most fragile of the customer classes?

A. I call small businesses the most fragile because they commonly lack the working capital and financing options that large company have available to them. Without the buffer of working capital and reasonable financing options in times of low or negative cash-flow, the smallest increase in costs can lead a company to failure resulting in the small business shutting of its doors for good. Once a small business fails and goes out of business, rarely if ever do they return, affecting the community they once served and its certainly its one-time employees.⁴

Q. What is your recommendation as to Mr. Wyman' s proposal of a parity premium rate increase for RS 03?

A. I strongly recommend that the "Small Business" rate schedule RS 3 be considered within a range of reasonableness as to parity. And that the Commission support small business by spreading the final revenue requirement using an equal margin increase to all rate classes with no parity adjustment premium or discount.

IV. CROSS-SUBSIDIZATION BY SMALL BUSINESS

Q. Have you reviewed the Company's Long-Run Incremental Cost Study (LRIC) as it relates to *Rate Schedule 3C, Basic Firm Sales Service - Non-Residential*?

A. Yes. I took time to closely review the LRIC model to better understand NW Natural's development of cost allocations impacting small business and the resulting rate proposals for Rate Schedule 3 (RS 3).

⁴ Mapped: The State of Small Business Recovery in America (visualcapitalist.com), Visual Capitalist, (April 28, 2021)

Q. Did you build your own model or adopt the Company's LRIC model?

A. No, the development of a new model was not practical with the limited access to system information and time needed to produce a fully revised model. However, I feel there is no need to develop an entire model for me to make my argument. The approach taken by the Company appears well developed and the related data, appears valid the sampling and sample size. However, I have made some important observations regarding how the current rate structure is impacting Oregon's small business owners.

Q. Please describe what you looked at in your review of the Company's LRIC model.

A. I limited my review to RS 3 since that rate schedule is the focus of my involvement in this docket. Customer classifications should include customers having similar usage and demand characteristics and are developed using a customer type, service characteristics, and demand patterns. The grouping of similar characteristics allows better cost allocations since the members of that class will also have much the same cost profile. The rate schedule itself identifies the customer class it applies to, in this case, RS 3 is titled *Basic Firm Sales Service – Non-Residential*.

Q. In your review did you find that RS 03 has grouped customers of the same characteristics and demand?

A. No, it does not. Although RS 3 is commonly referred to as the "small commercial" schedule, it is not limited to just small commercial customers. Instead, customers receiving service under this rate schedule includes not just the smaller commercial users, it also includes 10.7 percent of large gas users.

Q. Please describe how you identified small commercial customers served under Rate Schedule 3?

A. There were multiple challenges in identifying small businesses serviced under RS 3. The first being just the large number of companies, almost 60,000, being served

under this rate schedule.⁵ Since there are no explicit markers indicating the business size of the natural gas customer, a surrogate was required. The most obvious surrogate is meter size. It is reasonable to assume that most small businesses demand smaller volumes of natural gas than larger commercial operations. For my analysis I have defined large commercial gas users as those commercial customers that have a maximum flow-rate capacity at or more than 1,000,000 BTU/per hour or 1,000 MBH, measured by meter size.⁶ Using the 1,000 MBH break between large and small users, I analyzed the meter-set costs developed by Mr. Wyman, and used in NW Natural's LRIC study, to understand the RS 3 tariff's cost impact on smaller companies.

Q. Please describe how you arrived at the 1,000 MBH threshold for small business.

A. The natural distribution of meters sizes within all the commercial and industrial rate schedules provides for the use of the 1,000 MBH break between large and small users. I examined the meter size distribution of the different commercial and industrial sized meters within each of their respective rate schedules 31 and 32.⁷ I found that 99% of the meters serving those customers were at or above a maximum flow-rate capacity of 1,000 MBH. Combined, only half of a percent (0.5%) were below the 1,000 MBH threshold. In contrast, small users, reflected in the residential rate schedule, essentially all meters being served were below the 1,000 MBH threshold (99.98%). My analysis supports the use of the 1,000 MBH break between large and small users.

Q. Isn't it true that a large commercial customer could be classified as a small user under your proposed threshold but not be a small business?

⁵ Wyman, Exh. NW Natural/1403 and 1404 – WP1 – Rate Spread and Rate Allocation Model, Tab Oregon Volumes & Revenues

⁶ BTU – British Thermal Unit, MBU – thousand BTU per hour

⁷ Wyman, Exh. NW Natural/1403 and 1404 – WP1 – Rate Spread and Rate Allocation Model, Tab Oregon Volumes & Revenues

A. I agree, there could be a large business that does not use large amounts of natural gas because of the nature of the business. This merely supports the ratemaking concept of fair, just, and reasonable rates. That is, any company, large or small, that have a low demand for gas should not be subsidizing those costs associated with high-demand or capacity gas service, certainly small businesses should not.

Q. Could you discuss the types of subsidies that are relevant in this case?

A. Yes. Interclass cross subsidies exist when one customer class pays more in rates than its cost of service, which effectively lowers what another customer class pays below the marginal cost of service. Mr. Wyman discusses interclass subsidies in his testimony on parity.⁸ Interclass subsidization such as what exists with the parity issue, is not necessarily bad, instead it depends on the regulatory issues and circumstances, and the needs of the community.

However, when a cross subsidy exists within a single class of customers, such as with Rate Schedule 3, it is referred to as an intraclass cross subsidy. Ratemaking acknowledges that there will be some cross subsidization within any class, but the subsidy is normally not material because the customer class is basically homogenous. It is not uncommon in the residential customer class that the intraclass subsidy is downward tilted, the larger volume users subsidize low volume users, helping address affordability issues.

Q. Did you find any intraclass cross-subsidy within RS 3?

A. Yes, there is evidence that there is a substantial upward tilted cross subsidy. That is the small users appear to be subsidizing the large users. As shown on my Exhibit SBUA/102, Kermode, I found that RS 03 is comprised of 89.3 percent of small users with the remaining 10.7 percent made up of the large users. But, although large users' makeup a little more than 10 percent of the customer base, they also account for almost half (46.5 percent) of meter costs associated with the rate schedule.

⁸ Wyman, Exh. NW Natural/1400 at 19:6-10

Q. What is the impact of this wide difference of customers type to meter costs?

A. The skewed distribution of customers and of costs results is a substantial upward tilted subsidy which provides an intraclass cross subsidization benefit to the larger users. That is, subsidization going upward from the smaller commercial customers to their larger counterparts. It indicates that the customers within this customer class are not homogenous.

Q. Describe the approach you used in analyzing meter set costs and why it's important.

A. I started my analysis by understanding the methodology used by the Company to develop its weighted-average meter cost for RS 3 customers of \$706. By using a statistical sample of its system's meters, Mr. Wyman was able to identify the number of customers and meter size. Each customer in the sample were then associated with the respective rate schedule. The Company's analysis resulted in a series of tables showing a tabulation of customers, meters, including capacity and cost of the meter set.⁹ From that data, the Company derived its weighted average cost which it used to derive the meter costs in the LRIC.

Using the same data, I was able to focus on the distribution of customers by meter size to estimate the percent of total customers were likely small businesses.¹⁰ I was able to see that under RS 3, most of the businesses demand comparatively small amounts of natural gas compared to the larger enterprises under the same tariff.

By splitting smaller capacity customers from the larger entities, I develop an intraclass-cost profile. Then by using the same approach as the Company, I was able to produce comparable cost numbers to test for the direction and the degree of subsidy.

Q. Did you prepare any exhibits showing the results of your analysis?

⁹ Wyman, Exh. NW Natural/1401 WP3

¹⁰ All small businesses are assumed to be receiving service under RS 3.

A. Yes, I have prepared two exhibits. Exhibit SBUA/102, Kermode, is a proof of the Company's calculation of its weighed average meter-set cost it proposes for RS 3. I have also prepared SBUA/103, Kermode, my analysis to verify the Intraclass Cross Subsidy for RS 3.

Q. Could you describe your Exhibit SBUA/102, Kermode, labeled "Proof of Company Calculation of Meter Set Cost for Rate Schedule 3"?

A. My exhibit calculates the weighted-average cost of meter-sets for RS 3 customers using the same approach used by Mr. Wyman. The exhibit proves the \$706 cost used in the Company's LRIC study and the validity of my worksheet.

Q. Do you contest the \$706 cost used by Mr. Wyman?

A. No, I believe the approach and resulting cost used by the Company to be correct.

Q. What is presented in your Exhibit SBUA/103, Kermode, labeled "Calculation of Intraclass Cross Subsidy for Rate Schedule 3 - Commercial Sales Firm (Meters)"?

A. My exhibit details my analysis to establish whether there is a material intraclass cross subsidy within RS 3 and if so, to determine the amount of the subsidy. The exhibit uses the same approach reflected in Exhibit SBUA/102.

Q. What was your conclusion regarding the existence of a cross subsidy?

A. I confirmed that there is a substantial cross subsidy from the smaller commercial customers to the large users for meter set costs. As I mentioned above, some intraclass subsidization is expected, but in most cases, it is not material since the customer class is made up of customers that are homogeneous and receiving services that are the same or of a similar nature. Residential customers are a good example.

Typically, most residential customers have similar if not the same meter size (capacity) and use a normal amount of commodity (demand). For example, looking at the meter sizes serving NW Natural's residential customers, 98 percent of those

customers had mostly the same meter size. My review of the residential rate schedule showed an annual subsidy of the larger meter sizes by other residential customers at less than a nickel (5 cents) annually.

Q. What did you find in Rate Schedule 3?

A. I found that small users within RS 3 contribute to the large users within the class a \$42 annual subsidy: that computes into each large user receiving a \$348 annual subsidy. Recognizing that the Company's average 59,720 customers under RS 3, this subsidy results in an astounding \$2.2 million intraclass subsidy from small business to large users.¹¹ In contrast to the residential class, this intraclass cross-subsidy unfairly shifts a material portion of the rate schedule's cost burden related to meter set costs onto those businesses that are least able to bear the cost, small business.

Q. Did you do any type of "reality check" of these figures to support your result?

A. Yes, I did. I compared my results to other rate schedules that are similar to my groupings. For example, I consider small business in many ways similar, but not identical to, residential customers in both demand and capacity. I compared the computed \$423 trended cost shown on SBUA/102, Kermode, Line 42(h), associated with meter sets to the residential cost of \$301 that was derived by Mr. Wyman. Recognizing that small business is similar but not identical to residential installation, the \$423 derived cost for small commercial is reasonable. I also compared the trended cost for the large users of \$3,081 shown on SBUA/102, Kermode, L42(g), to another commercial "large customer" tariff, RS 31CSF, the trended cost computed by Mr. Wyman was \$3,831, which is, again, reasonable since they both include only large meters i.e., homogenous.

Q. In your opinion, what is the cause of such a large cross subsidy?

¹¹ 59,720 customers * 10.7% of RS 3 customers are large users = 6,365.80 large users
6,365.8 large users * \$348.42 annual subsidy = \$2,218,000

A. As mentioned above, a well-designed rate classes group homogeneous users together, homogeneous as to demand and capacity. This is not the case with Rate Schedule 3, instead the rate schedule includes customers with meter sizes that range from those that can deliver only up to 250 MBH, up to customers with meters that can deliver over 14,000 MBH. The increase capacity of the large meters carries with it a substantial increase in costs, especially when compared to the smaller meters. So, even though large users make up only 11 percent of the customers served under this tariff, they bring with them 47 percent of the total costs associated with meter sets.

Q. Did you analyze any of the other components of the company's cost study such as mains and services to check for the same type of interclass cross subsidy?

A. No, I limited my review to finding evidence of a material subsidy by the smaller commercial customers to only one major cost component, meters. There is no reason to believe that the same cost dynamics would not be encountered in the other rate base functional classifications like mains and services. However, there should be no size related costs associated with some components such as meter reading and billing.

Q. What is your solution to the problem of this cross subsidy?

A. I recommend that the Commission direct the Company to prepare a revised LRIC study that separates the Rate Schedule 3 "small commercial" tariff into two distinct rate schedules. One including only small commercial customers up to, but not including rate payers that use meters with a maximum flow-rate capacity less than 1,000 MBH. A second tariff would be created for the modified LRIC for the larger commercial basic service users with meters that have a maximum flow-rate capacity of 1,000 MBH or greater.

Q. If the rate schedule was broken up as you suggest, what would be the impact on those customers impacted by the change?

- A. Until a revised study is prepared, the impact won't be known because of the many interrelationships within the model. For example, by separating the customers into improved homogeneous groupings, the average usages will change which in turn affects allocations along with service sizes allocated to each grouping.
- However, based on the dramatic impact of separating meter set costs, I expect a new study would show a decrease in costs being allocated to the new small commercial rate schedule producing rates that would gravitate towards a rate decrease, closer to residential rates and the large users' rates would tend to move up towards the costs of the other comparable large commercial users. I would also expect that under the new modified study, the unadjusted parity discussed by Mr. Wyman for small commercial would be greater than 1.

Q. If the modified study has the results you expect, would you recommend rates to be adjusted in this docket?

- A. It would depend on the materiality of the rate change, obviously rate shock must be considered when adjusting rates to the correct levels. However, I would urge the Commission to require the Company to create a modified study in this docket and any adjustment to be considered as soon as reasonably practicable.

Q. Could you describe the impact of it on the smaller commercial customers

- A. A cost study provided by the Company will allow the structuring of a rate design that fairly allocates costs to the appropriate cost causers. For the large user basic service class there will be a loss of some intraclass cross-subsidy, but with it will be a decrease in the burden on those businesses that are least able to bear the additional cost, small business.

V. EMPLOYEE STOCK EXPENSE

Q. Have you reviewed the Company's proposed \$1.9 million Stock Expense?¹²

¹² Exh. 1200 Davilla at 18:8-10

A. Yes. I reviewed the proposed recovery of \$1.9 million for Stock Expense which is made up of NW Natural's Employee Stock Purchase Plan (ESPP) and Restricted Stock Units (RSU) compensation costs.

Q. Are you aware that the regulatory treatment of this expense has been controversial in the past?

A. Yes, I am aware of the debate which, I would suggest, is because Stock Expense is a unique equity-based expense. Because of the regulatory challenge it creates, I would like to propose a new approach for ESPP and RSU that would keep the pay incentives in place but allow stock expense costs to be fairly shared between shareholders and ratepayers based on solid regulatory and accounting principles and remove much of the subjectivity.

Q. When you say Stock Expense is unique what do you mean?

A. Stock expense is a unique type of expense because unlike other operating expenses, it does not require any cash outlay by the company, in that it uses its stock as compensation. Instead of measuring the compensation cost using an actual cash transaction, it is recorded under US GAAP at the market value of the stock promised or provided to employees. The use of company stock for compensation raises two regulatory issues. The first, since no cash transaction takes place, it becomes challenging for ratemaking purposes to accurately measure the true economic cost to the Company. Secondly, with the increase in share outstanding, whether the effect of stock dilution should be addressed in the ratemaking process.

Q. Isn't true that under US GAAP accounting rules, the recorded cost of the stock is equal to the market value?

A. For US GAAP accounting purposes that is true. That is because the Financial Accounting Standards Board (FASB) decided to use Fair Value accounting to record the value of stock compensation.¹³ For ratemaking purposes however, it is important

¹³ FASB Accounting Standards Code (see ASC 718-10)

that regulators recognize that cost and value are two different concepts and that for rate setting, cost should remain the key measure.

Q. How would you measure cost for stock compensation for ratemaking purposes?

A. For regulatory purposes I propose that stock expense be valued at the share's book value.¹⁴ That amount represents the actual sacrifice of the Company transferred to its employee. Using any amount exceeding book value incorrectly transfers the cost and risk associated with shareholder expectations from the investor to the ratepayer.

Q. What are the benefits of using Book Value to evaluate stock expense?

A. Book value per share is a non-subjective approach to value the stock expense for ratemaking that reflects exactly how much each share of stock is worth based solely on the financial statements of the company. Also, the use of Book Value removes the problem of volatility since Book Value is a stable value as compared to the volatility of the market valuation.

Q. Isn't the Commission required to measure stock expense consistent with US GAAP pronouncements at fair market value?

A. No, ratemaking is not bound by US GAAP. The FERC clearly stated this principle in a landmark order when it said:

"If GAAP conflicts with the accounting and financial reporting needed by the Commission to fulfill its statutory responsibilities, then GAAP must yield... GAAP cannot control when it would prevent the Commission from carrying out its duty to provide jurisdictional companies with the opportunity to earn fair return on their investment and to protect ratepayers from excessive charges and discriminatory treatment"¹⁵

¹⁴ Book Value per Share (BVPS) equals common shareholder's equity divided by the number of shares outstanding.

¹⁵ FERC Order No. 552, 62 FERC 61,299 (March 31,1993)

Q. You mentioned as a second issue that the Commission needs to consider is the effects of stock dilution. Could you explain what stock dilution is and its impact on shareholders.

A. Stock dilution is the erosion of an existing shareholder's ownership percentage in a company's net assets as a result of the issuance of new stock. For example, the shareholder of a company that has four shareholders, each with one share, owns a quarter of the company. If the company issues one more share to a new shareholder, each shareholder now owns only one-fifth of the company. If net assets do not change, the book value of each share has decreased.

Q. Does dilution always result in a decrease in book value per share?

A. No dilution does not necessarily mean a decrease in book value per share. As shown in my Exhibit SBUA/104, the change in book value depends on the amount of the contribution paid by the new investor. In table 1 of my exhibit, book value and market value are set equal, in this example \$20. The additional shares increase the number of shares but because the sale of the stock equals book value there is no change in the existing shareholders wealth. The beginning book value per share is the same as the ending book value per share.

It is only when the proceeds from the sale is less than the book value that the existing shareholders loses value. In table 2, although book value remains at \$20, the market value is set at \$17 per share. The additional shares sold increase the number of shares but because the sale of the stock is below book value there is a decrease in existing shareholders wealth. But interestingly, even though the new shareholder book value is the same as the others (\$19.50), it is higher than what they paid (\$17.00). There was a \$2.50 transfer of wealth from the existing shareholders to the new one.

The final table is important. In Table 3, book value once again remains the same, but market value is greater than book, in this example \$30. The additional shares sold again increase the number of shares but because the sale proceeds of the

stock is greater book value there is an increase in existing shareholders wealth. Even though the new shareholder book value once again is the same as the others, the book value (\$21.67) is lower than what was paid for the share (\$30.00). There is a \$1.67 transfer of wealth from the new shareholder to each of the existing shareholders.

Q. Why is this important?

A. It is important to understand the financial dynamics of these stock issuances so the Commission can apply a supportable regulatory treatment of the stock expense for both the Restricted Stock (RSU) and the Company's Employee Stock Purchase Plan (ESPP). As Exhibit 103 shows, when the US GAAP based stock expense is recorded at fair market value and it exceeds book value, the amount in excess of book value, when included in rates, provides a transfer of wealth from ratepayers directly to existing shareholders. That amount should be disallowed for recovery from ratepayers.

Q. What is your recommendation for the recovery of the Employee Stock Purchase Plan (ESPP) costs for the test year?

A. If the Commission recognizes Book Value as the ceiling for ratepayer recovery of share expense, then the total test year ESPP expense would be disallowed.

Q. Please explain how you arrived at your recommendation.

A. Exhibit SBUA/105 Kermode, Schedule for Employee Stock Purchase Plan Proposed Disallowance, shows my analysis. In my schedule I first reconcile the company proposed test year amount to its filing. Starting on Lines 28, I compare the purchase price, the amount provided by the employee, to the share's book value. As shown on Line 30 of my exhibit, the purchase price exceeds book value by \$12.40.

The purchase of the stock has covered the actual cost of the stock, e.g., its book value, while also providing a 41% premium above book value. The employee's purchase price covers the cost to the company of the stock issued, the book value, preventing any stockholder equity dilution. Because there is no dilution, the question

as to ratepayer funding ends, the company is made whole by the employee purchase, even with the 15% discount.

Q. Why should the Commission not allow ratepayer funding for the difference between market price and the amount of the stock sale proceeds that exceeds book value?

A. Ratepayer funding is not required for amounts above book value since any excess proceeds from the sale, no matter the amount, results in direct ratepayer funding of the equity position of existing shareholders. In this case, embedding into rates the ESPP expense proposed by the company would result in a direct equity subsidy benefiting only existing shareholders.

Q. What is the impact of disallowance of ESPP stock expense?

A. Total expenses are decreased by \$187,093 with a related revenue requirement decrease of \$263,644.¹⁶

Q Did you also review the long-term incentive compensation related to restricted stock units (RSUs)?

A. Yes, RSUs are the second component of the company's Stock Expense making up over 90% of the expense.

Q Could you briefly discuss how RSUs are accounted for under United States Generally Accepted Accounting Principles (US GAAP)?

A. RSUs are stock awards that vest to an employee over time if certain retention and financial performance conditions are satisfied.¹⁷ They have similar US GAAP valuations as an ESPP relying on the Market Value of the stock at the time of award however the related expense is amortized over the period of vestment.

Q For ratemaking purposes do you agree with the US GAAP accounting?

¹⁶ Exhibit 1309 ROR and Taxes, Net-to-Gross 140.92%

¹⁷ NW Natural/800 Rogers at 11:17-19

A. No. Similar to my discussion for the company's ESPP expense recognition, the US GAAP method is not useful in a rate setting environment. As with ESPP, US GAAP recognizes market value as the amount of the expense at the time of award. For regulatory purposes, the US GAAP approach does not recognize the true cost to the company of using treasury shares to compensate its employees but instead is focused on the value of the shares. As discussed above, the only cost incurred by the company is the book value of the share at the time of award. It is this book value amount that should act as the ceiling for cost recovery. Any amount greater than book value, increasing up to market value, represents the growth and earning expectation of investors. The company has no cost basis or justification for the recovery of investor expectations. Clearly an expense greater than book value is not a cost to be borne by ratepayers

Q. Discuss your proposed treatment of RSUs for ratemaking purposes.

A. As shown in my Exhibit SBUA/106 Kermode, Lines 6-25, I first prove the data provided by the company resulting in the same amount requested by the company.¹⁸ I then recomputed the RSU stock expense using Book Value as shown in my Exhibit. The only difference between the two tables is that table 2 limits for ratemaking purposes ratepayer recovery to a Book Value ceiling. The book value approach essentially transfers cost of the stock premium above book value to existing shareholders resulting in a \$863,859 (50.4%) disallowance.

Q. Once again, the question may arise whether US GAAP pronouncements can require the Commission to measure stock expense at fair market value. Could you briefly address the issue?

A. As I discussed above, ratemaking is not bound by US GAAP. Since the Commission has the duty to protect ratepayers from excessive charges, GAAP cannot control when it would result in unjust rates.¹⁹ The use of Book Value for measuring the

¹⁸ Confidential Exhibit UG 435 OPUC DR 360 Attachment 2.xls

¹⁹ FERC Order No. 552, 62 FERC 61,299 (March 31,1993); ORS xxx

expense provides a clear demarcation between costs associated with ratepayers and those amounts that exceed the historical cost principle and should rest with shareholders.

Q What is the advantage of using Book Value instead of fair market value for ratemaking purposes?

A. As a practical matter, using fair value to value stock compensation results in an objective division of the expense between shareholders and ratepayers. This division is especially important when financial performance conditions can subjectively be seen as benefiting both groups depending on what side of the argument you are on.²⁰ Instead, using a book value to value the expense allows for a systematic division of costs that is logical and defensible while also eliminating the issues caused by price volatility.

Q. Why should ratepayers even pay for the book value of stock compensation?

A. Because the Commission also has a duty to protect not just ratepayers but also shareholders. To avoid confiscation through dilution, the Commission must provide in rates funding to counter the effects of the equity dilution. When a commission allows a company to issue shares below book value, as is the case with Restricted Stock, it must also recognize that without further action, the net worth of the existing shareholders will be reduced, a reduction that could easily be characterized as confiscation. On the other hand, any amount of ratepayer funding greater than book value results in ratepayers providing existing shareholders a direct equity subsidy, the opposite of confiscation.

Q Are you suggesting that the Book Value method you use can be a alternative for the current Staff model that reflects various disallowance percentages?

²⁰ Although clearly, a stock compensation expense that has a financial performance requirement that is purely stock price or net income driven can be allocated 100% to shareholders, but in the real world the separations are not clearly one or other but instead a subjective mix of opinion.

A. Yes. Book Value valuation is not a perfect substitute, but it does provide a rational and supportable approach to allocate the costs of shareholders and ratepayers resulting in a fair, just, and reasonable, end result.

Q. What is the impact of partial disallowance of RSU stock expense?

A. Total expenses are decreased by \$863,859 with a related revenue requirement decrease of \$1,217,350.²¹

Q Is there an income tax impact to this adjustment?

A. Yes. Because there is a timing difference between when the financial books and records recognizes the RSUs stock expense, and when it is recognized for income tax purposes a deferred tax asset is created. A deferred tax asset is created when an expense is recognized first in the financial statements and then later for income taxes. Because I am reducing the stock expense the adjustment, a \$233,242 reduction to deferred tax asset is also required.²²

Q Please summarize your adjustments to Stock Expense.

A. Employee Stock Purchase Plan - Because the employee's purchase price is greater than book value, there is no dilution of stockholder capital and therefore ratepayers are not required to make the shareholders whole. On the other hand, the amount received over book value clearly provides an equity premium to existing shareholders and does not require ratepayers to provide any equity contributions above book value. Recommend a 100% disallowance.

Restricted Stock Units – RSUs are awarded without any contributions by the employee resulting in an underfunded book value. Without correction, the issuance would dilute the ownership capital of existing shareholders. The Commission is under a duty to protect shareholders and to do so here requires rates to be provided to make existing shareholders once again whole. But as with the Employee Stock Purchase Plan, there is a ceiling. Any recognized value over book value, e.g., Fair

²¹ Exhibit NW Natural/1309 ROR and Taxes, Net-to-Gross 140.92%

²² Exhibit SBUA/106 Kermode at 1:55-58

Market Value, clearly provides an equity premium to existing shareholders and should not be funded by ratepayers.

VI. LATE PAYMENT & RECONNECTION CHARGES

Q. Has NW Natural requested a change in its Schedule C – Miscellaneous Charges and Credits?

A. No it has not, however I would like to propose the elimination of two of its Schedule C charges: Late Payment and Reconnection Charges.

Q. Please explain what makes these two charges unique.

A. Tariffs can be classified into two broad categories: rates and charges. Rates normally apply to commodity sales such as the sale of natural gas. Charges normally apply to special services provided by the company, for example non-AMR meter read charge recovers the cost of a meter reader going to the meter location to do a monthly read.²³ I call those kinds of charges, quid pro quo charges, that is, something given, and something received.

Late payment charges are designed to affect customer behavior and can be seen as punitive in nature. Similarly, reconnection charges are commonly seen as punitive even though they originally were designed to recover costs.

Q. Please explain what a late payment charge is and how it impacts customers.

A. Late-payment charges are commonly thought to provide a disincentive for paying a bill late or put another way, to motivate (or nudge) prompt payment. The obvious weakness of this view is that it assumes that all customers have the wherewithal to pay when the bill comes due and it's simply a matter of financial incentives that determines when a customer decides to pay. In my opinion, that is a false assumption. Instead, I have found through my experience working with customers and companies, that most customers charged a late payment charge paid late because they simply did not have the money. The late payment charge had no impact on their decision to pay late.

²³ AMR - Automated Meter Reading

Q. Please explain the impact late-payment charges have on small business customers.

A. Cash flow is essential to small business, when cash flow decreases the impact of a late payment can be material, especially when the charge is a percentage-based late payment charge. In late-payment scenarios that lead to disconnection can also result in the pancaking of additional charges on customers including not just the late payment charge but add in reconnection charges and possibly a charge from both the utility and the bank for Nonsufficient Funds (NSF).

Q. Please explain why you are recommending the Commission consider the elimination of Late Payment charges.

A. Although the general business community has traditionally used late fees, it is not appropriate in a public utility setting. Not only because of the impact late-payment charges have on small business customers, but because the charge does not equate to its cost, the revenue received is effectively subsidizing other customers.²⁴

In fact, the Kentucky Public Service Commission (Kentucky PSC) questioned the use of late payment charges because of their regressive nature. In its recent decision the Kentucky PSC found that late fees are not calculated based on actual costs but instead are a source of revenue. Plus, the Kentucky PSC found that late fees do not have the intended impact on customer behavior as I discussed above.²⁵

Q. What else did the Kentucky commission find?

A. In addition to finding the charge did not recover actual expenses it found:

“...the collection of late fees...[are] purely a punitive exercise that disproportionately affects those customers already unable to pay for service

²⁴ Exh SBUA/107 - ABC News, Jasen Lo Associate Press, “Food or power: Energy bill late fees force tough choices” (March 7, 2022)

²⁵ KY PSC 2020-00085 (Sept 9, 2020) at p.22 available at: <https://psc.ky.gov/Case/ViewCaseFilings/2020-00085> (Last accessed 4/19/22).

rendered, and the evidence in this matter indicates it has little-to-no effect on a customer's timeliness of payment."²⁶

Q Could you describe the NW Natural's Late Payment Charge?

A. NW Natural's Schedule C provides for a charge equal to 2% of the unpaid balance or \$3.00, whichever is greater. Although the charge is applicable to all its customers regardless of customer class it does distinguish between residential and non-residential. Residential customers are assessed the charge when the company prepares the subsequent month's bill whereas for non-residential customer's the charge is assessed the day following the due date.

Q. What is your recommendation for late-payment charges?

A. I recommend late-payment charges be eliminated, and any allocated costs be socialized and collected through general rates. It is my opinion that the focus of a public utility company should be to strengthen the ability of its customers to remain on the system, or be reconnected to the system, as economically and fairly as possible without the burden of a late-payment charge.

Q. What is the impact of your recommendation on Revenue Requirement?

A. There is no impact on the final revenue requirement of the company. The revenue normally received through the late-payment charge will be collected through general rates. If the test year late payment revenues were collected through the sale of gas rather than as a separate charge, the commodity rate would increase by \$0.00196 per therm.²⁷

Q Have you also looked at the Company's Service Reconnection Charge?

A. Yes, I also reviewed the company's Service Reconnection Charge also described in its tariff's Schedule C.

Q Could you describe NW Natural's tariffed Service Reconnection Charge?

²⁶ *ibid*

²⁷ Exhibit SBUA/108 Kermode

- A. NW Natural's tariff provides for varying Service Reconnection Charges depending on whether the reconnection is during normal business hours, after 5:00 p.m. or same day reconnection. A reconnection during normal business hours costs the natural gas customer \$30. The charge increases to \$80 for a scheduled after-hours reconnection following the day of disconnection, then stepping up to \$100 for same-day reconnection outside normal business hours or on weekends or holidays.

Q. What is your opinion of the reconnection charge?

- A. The reconnection charge is similar to the late payment charge. It places another burden on those customers shown to be already struggling to pay for service. As an alternative, I encourage the Commission to allow reconnection to the system as economically and fairly as possible by removing the additional financial burden of a reconnection charge. As with the current late payment charge, the cost of disconnection does not equal the charge. It is my understanding of the capacity of AMR meters that NW Natural's Itron smart meters provides the Company with the ability to remotely shutoff service greatly reducing costs from the days with someone would have to go out and shut off a meter and then again to reconnect.

Q. What is your recommendation for reconnect charges?

- A. I recommend the reconnection charges also be eliminated, and any allocated costs be socialized and collected through an increase of the volumetric rates. If the test year reconnection revenues were collected through an increased volumetric rate rather than as a separate reconnection charge, the commodity rate would increase by \$0.00051 per therm.²⁸

²⁸ Exhibit SBUA/108 Kermode

Q. If the Commission finds that the elimination of the Late Payment Charge and the Reconnection Charge is something for later discussion, do you have an alternative proposal?

A. Yes, in the alternative I would propose that in the company's *Rule 11 Disconnection and reconnection of service – By Company*, the section titled "Notice of Disconnection of Service," citing residential customers be expanded to include small businesses. The change would provide additional time for a small business to seek funding, work with the company on a payment plan and all while continuing to operate their business.²⁹

The section titled "Reconnection of Service, Residential Requirements – Reconnect within 20 days of Disconnection," should be expanded to allow small business to reconnect by paying at least one-half of all past due amounts. Again, allowing the small business to continue operations while seeking funding and or working with the company on a payment plan.

Q. How do you respond to the argument that the utility should not be a source of financing for the small business.

A. It is important to recognize that many small businesses simply do not have the possibilities of financing that large businesses have. In many cases, the owners self-finance through home mortgage or other non-conventional means. When a company has reached the point where they are being disconnected, it really is a question allowing the company to continue to operate while seeking help rather than a question of different financing options.

Q. Does this conclude your testimony?

A. Yes, it does.

²⁹ Proposal does not include expanding the provision regarding medical conditions to small business.

Docket No. UG 435
Exhibit SBUA /101
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

STATEMENT OF QUALIFICATIONS - DANNY KERMODE CPA

Statement of Qualifications

Danny Kermode - Certified Public Accountant
5326 75th Ct SW | Olympia, WA 98512
5553dkcpa@gmx.us

Assistant Director for Water and Transportation

April 2015 – December 2020

Washington Utilities and Transportation Commission

Managed and directed the economic regulation of Washington investor-owned water companies and certain regulated transportation companies such as the state's investor-owned solid waste and residential recycle haulers, oil pipeline, harbor pilots, passenger ferries, low level radioactive waste and bio-waste transporters. Developed and directed transportation policy regarding rule enforcement and rate setting. Oversaw the use of rate base and operating ratio approaches to ratemaking. Provided expert recommendations include acting as expert witnesses in judicial proceedings.

Acting Director of Policy and Legislation January 2015 – March 2015

Senior Policy Advisor May 2010 – December 2014

Washington Utilities and Transportation Commission

Provided direct policy and decision-making support to the commissioners and executive director while serving as an expert in policy, economic or technical issues related to regulated electric and gas industries, specifically in the areas renewable technology, power system reliability and cyber security. Projects, assignments, and continuing work included formulating, developing, analyzing, communicating, and implementing state, regional or national regulatory and ratemaking policies. Assigned more than 80 electric and over 100 natural gas filings ranging for PGAs to full rate cases.

Regulatory Analyst

October 1996 – April 2010

Washington Utilities and Transportation Commission

Constructed complex computer models to analyze electric, natural gas, and water company financial and accounting data. Reviewed cost data and prepared cost of service models, assigned over 45 electric cases and more 46 natural gas filings. Audited and analyzed financial data filed in support of tariff revisions. Conducted studies as a team lead and as a team member. Prepare written testimony and exhibits and appear as an expert accounting witness, regarding financial, income tax and accounting issues. Presented recommendations to the commission in public open meetings.

Controller

June 1994 - October 1996

Rocky Mountain Institute

Responsible for all financial and accounting aspects including budgeting for the institute's seven research areas with consolidated revenues of over \$5 million. Developed new budgeting approaches and management reports. Managed the financial accounting and budgeting of its wholly-owned subsidiary E-Source.

Partner

February 1986 - September 1993

Kozoman & Kermode CPAs - Phoenix, AZ

Prepared testimony and exhibits supporting rate applications and financing requests. Appeared as an expert accounting witness concerning public utility financial and accounting issues. Prepared corporate, partnership, and not-for-profit tax returns. Provided financial analysis, accounting reviews, systems design and developed positions on tax issues. Development of projections and forecasts, including pro forma financial statements, rate base, and cost of capital analysis used in rate proceedings.

Staff Accountant

July 1983 - January 1986

Troupe, Kehoe, Whiteaker & Kent CPAs - Phoenix, AZ

Prepared testimony and exhibits supporting rate applications and financing requests. Appeared as an expert accounting witness concerning public utility financial and accounting issues. Provided management consulting functions which included performing financial analysis of accounting records. Preparation of complex public utility year-end statements and corporate tax returns. Prepared schedules and exhibits used in regulatory proceedings.

Education

San Carlos University - Cebu City, Philippines

Postgraduate - Management Accounting, Economic Analysis and
Quantitative Business Analysis

Arizona State University - Tempe, Arizona

Bachelor of Science in Business Administration, Major in Accounting

College of Financial Planning - Denver, Colorado

Professional Education Program - CFP certification

Publications

FERC reporting through the XBRL looking glass (2019)

Public Utility Fortnightly, Oct 2019

The Philippines: An update on the Country's New Feed-In Tariff (2014)

Update for: A Handbook for International Energy Regulators (2011) USAID NARUC

Transforming Regulated Industries

iBR Magazine, Vol 3 Issue 2 (2013)

Regulatory Provision of Income Taxes for S Corporations

The NRRI Journal of Applied Regulation, Vol 2 (2004)

Contributions in Aid of Construction: IRS Final Regulations

Journal AWWA, Vol. 94, No. 3 (2002)

Faculty Member

IPU Annual Ratemaking Course	Institute of Public Utilities Michigan State University, 2019 - 2022
Advanced Regulatory Studies Program	Institute of Public Utilities Michigan State University, 2019 - 2021, 2009 - 2012
USAID NARUC Regulatory Programs	Africa, Philippines, and Ukraine
The NARUC Utility Rate School	1992, 1993, 2008 - 2013
Saint Martin's University	Adjunct Professor – Business Income-Taxes 2014

Other Notables

Certified Public Accountant

Senior Fellow at the Institute of Public Utilities, Michigan State University

NARUC Innovator in Regulatory Policy Award 2017

United States Air Force Veteran

Docket No. UG 435
Exhibit SBUA /102
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

PROOF OF COMPANY CALCULATION OF METER SET COST FOR RATE SCHEDULE 3

Line No.

Proof of Company Calculation
of Meter-Set Cost for Rate Schedule 3

Table 1

(a)	(b)	(c)	(d)
Meter Model / Customer Count			
Model / Capacity	OSC	OSC	Total
			(b) x (c)
250	15	5,077	3,002
275	-	204	204
630	13	1,126	1,139
800	2	156	158
1000	3	142	145
2M175	-	34	34
3M175	2	160	162
5M175	4	107	111
7M175	1	59	60
8C175	-	1	1
11M175	1	21	22
15C175	-	12	12
16M175	-	1	1
23M232	-	-	-
23M125	-	-	-
38M125	-	-	-
Total Customers	41	5,100	5,141

Note (1)

Table 2

(e)	(f)	(g)	(h)
Average cost by Meter Model			
Model	OSC	Total	
			(g) / (h)
250	268	\$ 829,658	
275	268	54,738	
630	677	771,262	
800	886	140,037	
1000	1,136	164,717	
2M175	2,355	80,078	
3M175	2,799	453,433	
5M175	4,142	459,779	
7M175	4,320	259,209	
8C175	4,543	4,543	
11M175	4,594	101,062	
15C175	2,287	27,448	
16M175	10,750	10,750	
23M232	15,861	-	
23M125	21,847	-	
38M125	25,155	-	
Total Cost		\$ 3,356,714	
Average cost		\$ 652.93	(g) / (d)

Note (1)

Table 3

(a)	(b)
Cost trend adjustment (Meters)	
Average Cost	\$ 652.93
2019 Index	296.52
2023 Index	428.91
FWN Proposed Trended Cost	\$ 706.27
Investment Carrying Charge	14.67%
Annual Revenue Requirement	\$ 1,103.61

Note (1) Sources: UG 435 - Enh. 1401 - WP3 - Meter Sets Cost Development

Docket No. UG 435
Exhibit SBUA /103
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

**CALCULATION OF INTRACLASS CROSS SUBSIDY FOR RATE SCHEDULE 3 -
COMMERCIAL SALES FIRM (METERS)**

Line No.

Calculation of Intraclass Cross Subsidy for
Rate Schedule 03 - Commercial Sales Firm (Meters)

Table 1

(a)	(b)	(c)	(d)
Meter Model / Customer Count			
Model / Capacity	OSC Large	OSC Small	Total
	(b) * (d) / (c)	(c) * (d) / (c)	(d) * (c)
250		3,092	3,092
275		204	204
630		1,139	1,139
800		158	158
1000	145		145
2M175	34		34
3M175	162		162
5M175	111		111
7M175	60		60
8C175	1		1
11M175	22		22
15C175	12		12
16M175	1		1
23M125	-		-
23M125	-		-
38M125	-		-
Total Customers*	548	4,593	5,141

Table 2

(e)	(f)	(g)	(h)	(i)
Weighted Average cost by Meter Model				
Model	OSC	OSC Large	OSC Small	OSC Total
	(e) * (f)	(g) * (f)	(h) * (f)	(i) * (f)
250	see Note (1)			
275	268			829,658
630	268			54,738
800	677			771,262
1000	886			140,037
1000	1,136	164,717		164,717
2M175	2,355	80,078		80,078
3M175	2,799	453,433		453,433
5M175	4,142	459,779		459,779
7M175	4,330	259,309		259,309
8C175	4,543	4,543		4,543
11M175	4,594	101,062		101,062
15C175	2,287	27,448		27,448
16M175	10,750	10,750		10,750
23M125	15,861	-		-
23M125	21,847	-		-
38M125	25,155	-		-
Total Cost *		\$ 1,561,019	\$ 1,795,699	\$ 3,356,714
Average cost		\$ 2,849	\$ 391	\$ 653
% of Total Costs		41.5%	53.5%	100%
% of Total Customers		10.7%	89.3%	100%

Table 3

(a)	(b)	(c)
Annual Subsidy Received / Large Meter		
Proposed Trended Cost	\$ 706	(b) * (c)
Large Metered Trended Cost	3,081	(c) * (c)
Difference in Cost	\$ 2,375	(c) * (c) - (b) * (c)
Carrying Cost	14.67%	(see Note (2))
Annual Subsidy (Received)	\$ 348,422	(c) * (c) - (b) * (c)

Table 4

	(f)	(g)	(h)	(i)
	Cost trend adjustment (Meters)			
source		OSC Large	OSC Small	OSC Total
L 30	Average Cost	\$ 2,849	\$ 391	\$ 653
Note (1)	2019 Index	397	397	397
Note (2)	2023 Index	429	429	429
L 30 * (4) / (3)	Trended Cost	\$ 3,081	\$ 423	\$ 706
Investment Carrying Charge		14.67%	14.67%	14.67%
Annual Revenue Requirement		\$ 452.03	\$ 62.04	\$ 103.61
Annual Subsidy - profit		\$ 348.42	\$ (41.57)	

Table 5

(a)	(b)	(c)
Annual Subsidy Paid / Small Meter		
Proposed Trended Cost	\$ 706	(b) * (c)
Small Metered Trended Cost	423	(c) * (c)
Difference in Cost	\$ (283)	(c) * (c) - (b) * (c)
Carrying Cost	14.67%	(see Note (2))
Annual Subsidy (Paid)	\$ (41,571)	(c) * (c) - (b) * (c)

Note (1) Source: UG 4.35 - Exh. 1402 - WP3 - Meter Sets Cost Development

Note (2) Source: UG 4.35 - Exh. 1402 - WP6 - Long-run Incremental Cost Study (LRIC) Model - Tab Inc. Investment

59720
636579.7%
2,217,948

Docket No. UG 435
Exhibit SBUA /104
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

IMPACT OF BOOK VALUE IN THE DILUTION FROM STOCK SALES

Line No.

Table 1

Company sells stock with market (\$20) equal to book (\$20)

Result: No change in original shareholders wealth

	Total Company		Value / Share	
	Book value	Shares	Book Value	Market Value
Before	2,000,000	100,000	20.00	20.00
Stock Sale	400,000	20,000		
After	2,400,000	120,000	20.00	20.00
	Change		-	
	% Change		0.0%	

Assumptions:

Market Price	\$	20.00
Sale price	\$	20.00
Starting BV		20.00

Table 2

Company sells stock with market (\$18) less than book (\$20)

Result: Decrease in original shareholders wealth by 2.5%

	Total Company		Value / Share	
	Book value	Shares	Book Value	Market Value
Before	2,000,000	100,000	20.00	17.00
Stock Sale	340,000	20,000		
After	2,340,000	120,000	19.50	17.00
	Change		(0.50)	(b)
	% Change		-2.5%	

Assumptions:

Market Price		17.00
Sale price		17.00
Starting BV		20.00

(b) Reconciliation of Change

Total Proceeds	\$	340,000
Proceeds at Book		400,000
Original Shareholders Dilution	\$	(60,000)
Total Shares after sale		120,000
Dilution per share	\$	(0.50)

Table 3

Company sells stock with market (\$30) greater than book (\$20)

Result: Increased original shareholders wealth by 8.3%

	Total Company		Value / Share	
	Book value	Shares	Book Value	Market Value
Before	2,000,000	100,000	20.00	30.00
Stock Sale	600,000	20,000		
After	2,600,000	120,000	21.67	30.00
	Change		1.67	(a)
	% Change		8.3%	

Assumptions:

Market Price		30.00
Sale price		30.00
Starting BV		20.00

(a) Reconciliation of Change

Total Proceeds	\$	600,000
Proceeds at Book		400,000
Bonus to Original Shareholders	\$	200,000
Total Shares after sale		120,000
Bonus per share	\$	1.67

Docket No. UG 435
Exhibit SBUA /105
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

**SCHEDULE FOR EMPLOYEE STOCK PURCHASE PLAN AND PROPOSED
DISALLOWANCE**

Schedule for Employee Stock Purchase Plan
Proposed Disallowance

		Projected		
		2022	2023	
Employee Stock Purchase Plan				
Shares		23,210	25,020	DR 360 attachment 2, Tab: ESPP
Market Price	\$	50.46	\$ 50.46	DR 360 attachment 2, Tab: ESPP
Purchase Price (15% of Mkt)		42.89	42.89	DR 360 attachment 2, Tab: ESPP
Difference	\$	7.57	\$ 7.57	L11 - L12
		2022	2023	
Projected Stock Expense		175,674	189,376	L9 * L13
Stock Expense AMA		29,279	157,814	L16 /12 *2 ; L16/12*10
Projected Stock Expense AMA		187,093		(a) Sum L17 / Also foots to DR 360

(a) UG 435 AWEC DR 45 Attachment 1, Tab: Budget - E52

SBUA Proposed Adjustment

Purchase Price	\$	42.89	L12
Book Value		30.49	Zacks.com (last accessed April 4, 2022) (b)
Purchase Price Greater than Book	\$	12.40	L28 - L29 Premium- 41%
Disallowance	\$	187,093	L19
Sale proceeds	\$	1,073,133	L9 * L28
Book Value		762,860	L9 * L29
Premium above BV	\$	310,273	L36 - L37

(b) NWN Book Value - Zacks.com

Docket No. UG 435
Exhibit SBUA /107
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

**ABC NEWS ARTICLE - FOOD OR POWER: ENERGY BILL LATE FEES FORCE TOUGH
CHOICES (MARCH 7, 2022)**

Food or power: Energy bill late fees force tough choices

Americans paid a combined \$561 million in late payment fees to electrical utilities in 2019

By JASEN LO Associated Press

March 7, 2022, 3:25 PM • 8 min read



The Associated Press

Mary C. Williams sits in her home in New Orleans on Friday, Feb. 4, 2022. Williams, who... [Read More](#)

NEW ORLEANS -- Chris Kinney, a resident of Rapides Parish in central Louisiana, has seen his electricity disconnected eight times in the past two years for falling behind on his energy bills to Cleco Power.

His family did everything they could think of to catch up: pawning possessions, accumulating vast bank overdraft fees, borrowing money and applying for energy assistance.

Somehow, Kinney's outstanding balance kept growing.

While his electrical charges added up to about \$6,400 for the past two years, Cleco Power also billed him over \$1,250 for being late on paying his bills, including late fees, reconnection charges and deposits.

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"These charges keep piling up and there is no way to catch up. The financial strain was just insane," Kinney said.

Exhibit SBUA/107
Kermode / 2

Americans paid a combined \$561 million in late payment fees to electrical utilities in 2019.

But how much you pay depends on where you live.

An AP analysis of federal regulatory data found that several major utility companies in states like Louisiana, Mississippi, Kentucky, Florida and Maryland are charging customers late fees that are much higher than the national average.

Five power companies — Cleco Power, Kentucky Power Co. and three subsidiaries of Entergy Corp. — averaged more than \$17.50 per customer in annual late fee revenues between 2011 and 2020. That's three times the national average of \$5.83 per customer in the same time period.

The fees account for a small part of major energy companies' overall revenue — less than one-quarter of a percent on average — but for the people who must pay them, they can be crushing.

Late fees typically punish customers who are least able to afford their utility bill to begin with. Poorly insulated homes and damage from natural disasters all contribute to poor residents spending larger portions of their paychecks on their energy bills. And Black and Hispanic households are more likely to experience energy insecurity and face utility disconnections.

For those who fall behind, it often means choosing between paying for power and affording other necessities.

Mary Boyd, who is 83 and lives in New Orleans, said her expensive energy utility bills from Entergy — a major utility provider in Louisiana and three other Southern states — were causing her to choose between medication, and other expenses such as repairing the damage to her fence caused by Hurricane Ida.

"I am sick. I have high blood pressure, asthma and arthritis," Boyd said. "Now just imagine this, this three hundred and some dollars energy bill takes away from food and other things."

Power companies, including Entergy and Cleco Power, say late fees are an important tool to encourage customers to pay their bills.

"Ultimately, late payment policies are put in place to help protect all customers from potential rate increases caused by uncollected payments," Entergy spokesperson Jerry Nappi said in an email. The company doesn't profit from late fees, he said.

But for some major utility providers, including Entergy, late payment fees make up far more of the companies' revenues than average.

Nine companies, including Baltimore Gas and Electric, Central Hudson Gas and Electric, and Cleveland Electric Illuminating Co., derive more than 0.5% of their total revenue from late payment fee collection from 2011 to 2020 — double and even triple the national average of about 0.24%.

Exhibit SBUA/107
Kermode / 3

Late fees are meant to cover the cost of collecting a bill, or the cost of disconnecting or reconnecting power to a residence.

They're not meant to be punitive, said Odogwu Obi Linton, who sits on the board of directors of the National Association of Regulatory Utility Commissioners.

If a customer pays the bill quickly, the utility doesn't have to carry or pursue collection of the debt, Linton said. This saves the utility company money on things like turnoff notices and making phone calls to collect late payments.

But advocates say the amount being charged doesn't reflect expenses to power companies.

"Historically few, if any, of the late fees our utilities charge are cost-based," said Kent Chandler, chairman of the Kentucky Public Service Commission.

Dan Kermode, a former policy advisor at the Washington Utilities and Transportation Commission, said that rules on late fee penalties in many states were decided long before the advent of new technologies and computer systems. Billing software and automated meters have made the cost of collecting late payments virtually zero for utilities.

In Louisiana, state regulations allow for up to a 5% penalty on late payments for all electric utilities. When asked for the rationale for why the late fees penalty was set at 5%, Public Service Commission press secretary Colby Cook said he could not comment because the rules on late fees, which were adopted in 1976, did not articulate the reasoning behind its adoption.

"This is what's unique about late fees — these are charges which are not to collect costs, but to act as a disincentive for late payment," Kermode said.

Some regulators and consumer advocates question whether late fees even work.

In Kentucky, the pandemic led to a moratorium on late fees for residential customers until the end of 2020. When looking back at the effects of that moratorium, the commission said, "late fees have little discernible effect on the timeliness of residential customer payments for utility service."

Energy insecurity has affected Black and Hispanic households disproportionately, and the ongoing pandemic has made things even worse, according to Indiana University researchers in a paper they published in the science journal Nature Energy.

In New Orleans, an organization called Total Community Action helps disburse federal energy assistance, based on need. Nearly all of the group's 7,000 clients who receive energy assistance are Black, even though only approximately 60% of New Orleans residents are Black.

In 2017, Black households spent 43% more of their incomes on energy costs than white households did, according to the American Council for an Energy-Efficient Economy. The council's analysis, published in 2020, also found Native American households' and Hispanic households' energy costs accounted for much larger portions of their incomes than those of white households.

Older homes, including in low-income communities, generally are less energy-efficient in the first place — and floods or other disasters can damage those buildings to the point that they no longer qualify for government weatherization assistance.

"Homes in Louisiana have been impacted by hurricanes and by floods. It makes it so that we can't come in and weatherize them because it needs a whole new roof," said Lauren Holmes, who oversees energy assistance programs for the Louisiana Housing Corp. "That's outside the scope of weatherization. We can't go in and insulate an attic if you've got a four foot gaping hole in the attic."

In neighboring Kentucky, most homes that apply for such assistance aren't able to get it, either.

Kent Chandler, a member of the state's Public Service Commission, said for every home the Kentucky Housing Corp. is able to weatherize using federal funds, roughly two homes cannot be retrofitted due to underlying health and safety problems that disqualify them from receiving that aid.

And weatherization isn't the only thing affecting energy efficiency; how people heat their homes also plays a major role. In rural areas of Kentucky, many homes are heated with inefficient electric heating, which causes extraordinarily expensive bills in winter months, Chandler said.

Getting financial assistance to pay those bills, though, can be easier said than done for people who are unemployed or self-employed.

"When residents receive a disconnection notice, they only have a few days to get help and all the supporting documentation that is required before they are disconnected," said Selton Jones, Total Community Action's community service specialist for energy services. "If I play at a jazz bar and I'm just on the saxophone, I ain't got no tax stubs."

Those who get pensions, Social Security or other retirement income do have that documentation and are more able to get help paying their bills, but that still doesn't always mean they won't fall behind.

Carolyn Peters lives in New Orleans on a fixed retirement income and has received aid from the federal Low Income Home Energy Assistance

Program. Her bill in February from Entergy New Orleans was almost \$500, including late fees that had been charged in previous months.

When asked about how she was planning to pay her outstanding bill, Peters said she would have to give up another necessity like medication. "It's a strain," she said.

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Docket No. UG 435
Exhibit SBUA /108
Witness: Danny Kermode

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON
UG 435

SMALL BUSINESS UTILITY ADVOCATES

COMPUTATION OF RATE IMPACT OF ELIMINATION OF LATE PAYMENT CHARGE

Line No.

Computation of rate impact of elimination of Late Payment Charge

	12 Months Ended February 2018	12 Months Ended February 2019	12 Months Ended February 2020	Test Year ⁽¹⁾
Test Year Revenue - Reconnection Charge				
FORFEITED DISCOUNTS-LATE PAYMENT CHARGE	2,056,283	1,914,477	2,024,242	<u>1,998,334</u>
Oregon Test Year Sold Volumes ⁽¹⁾				1,022,080,218.0
Reconnection Charge Test Year Revenue				<u>\$ 1,998,334</u>
Proposed Increase				<u>\$ 0.001955</u> L14 / L13

Computation of rate impact of elimination of Reconnection Charge

	12 Months Ended February 2018	12 Months Ended February 2019	12 Months Ended February 2020	Test Year ⁽¹⁾
Test Year Revenue - Reconnection Charge				
	(a)	(b)	(c)	(d)
MISC SERVICE REVENUES-RECONN CHG-CR-AFTE	\$ 3,080	\$ 2,150	\$ 2,020	\$ 2,020
MISC SERVICE REVENUES-RECONN CHG-CR-DURI	257,500	238,700	217,209	217,209
MISC SERVICE REVENUES-RECONN CHG-SEAS-AF	160	80	80	80
MISC SERVICE REVENUES-RECONN CHG-SEAS-DU	9,510	8,910	8,310	8,310
MISC SERVICE REVENUES-DELINQ RECONN FEE	286,940	263,910	280,498	277,116
MISC SERVICE REVENUES-SEAS RECONN FEE	15,200	13,900	12,600	12,600
Total Reconnection Charge	<u>\$ 572,390</u>	<u>\$ 527,650</u>	<u>\$ 520,717</u>	<u>\$ 517,335</u>
Source: Exhibit 1305 - Misc Revenues				
Oregon Test Year Volumes ⁽¹⁾				1,022,080,218
Reconnection Charge Test Year Revenue				<u>\$ 517,335</u>
Proposed Increase				<u>\$ 0.000506</u> L39 / L38
Combined Total Increase				<u>\$ 0.002461</u> L15 + L40

⁽¹⁾ Source: Exhibit 1305 - Misc Revenues

⁽²⁾ Source: UG 435 - Exh 1403 and 1404 - WP1 - Rate Spread and Rate Allocation Model

