

Rates and Regulatory Affairs
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February 10, 2010

VIA ELECTRONIC MAIL

Public Utility Commission of Oregon
550 Capitol Street, N.E., Suite 215
P.O. Box 2148
Salem, Oregon 97308-2148

Attn: Vikie Bailey-Goggins

Re: UM 1327, NW Natural's Withdrawal of its 2010 Application for Reauthorization to Defer Costs for Smart Energy™

Northwest Natural Gas Company, dba NW Natural ("NW Natural" or "Company"), hereby withdraws its application for reauthorization to defer accounting for Smart Energy™ education costs, filed on December 30, 2009, in docket UM 1327. The Company remains committed to the success of Smart Energy™ and will continue to promote the program with existing program revenues. However, based on discussions with interested parties¹ the Company believes there is a significant risk that it would be unable to recover any deferred expenses, due to the application of an earnings test. For this reason, the Company has concluded that it would be inappropriate to defer additional costs.

BACKGROUND

In 2007, the Company launched its Smart Energy™ Pilot program that—through the sales of local, high-quality carbon offsets--encourages customers to reduce natural gas use when possible and to offset the rest. The Company believes its Smart Energy™ pilot program is a prudent, proactive approach to future carbon legislation. This program provides the Company with knowledge and experience with carbon offset markets that may reduce future compliance costs and allows the Company to search now for low-cost mitigation opportunities that may be more difficult to access in a fully developed compliance market.

In addition, through the Smart Energy™ program, NW Natural delivers customer education about the connection between climate change and the carbon emissions

¹ Parties include Oregon Public Utility Staff, Citizen's Utility Board, Renewable Northwest Project and Northwest Industrial Gas Users.

associated with natural gas use. This education provides an important context prior to potential rate increases that may accompany future climate change legislation.

In 2007, the Company paid all start-up costs associated with the program, which were approximately \$270,000. The Company also agreed it would absorb the capital expenditures associated with development of the project until the Company's next rate case. In 2008, the Company was granted authorization to defer up to \$622,000 for start-up and program education costs as forecasted in Order No. 07-383.²

In 2009, the Company was authorized to defer \$475,000 -- \$207,000 more than it projected it would need in its initial filing.³ The Company discovered this type of complex program required similar marketing investment to that of the electric renewable energy programs which during their start-up spent approximately fifty percent or more of their program budget on communications.⁴ The Company also had not realized how important it would be to provide on-going messaging to customers to maintain growth trajectories—particularly given the current economic recession.

When budgeting for 2010 education and communication expenses, the Company realized that to maintain the program's growth trajectory, it would need more funding than was being generated by program participants. The Company proposed an additional year of deferred accounting to the Portfolio Options Committee (POC), and with their support, filed a deferral application on December 30, 2009. The deferral application projected spending \$475,000 on education and communication in 2010, and provided a detailed budget.⁵

REASONS FOR WITHDRAWAL

When the Company received authorization to defer \$622,000 in 2008, and \$475,000 in 2009, it had assumed that the deferral amounts would be subject to an earnings test that mirrored the then-existing PGA earnings test-- which was the Company's authorized ROE, plus a deadband (300 basis points in 2008 and 150 basis points in 2009), an adjustment of 20% for any change in the risk-free rate and the exclusion of the shareholder's portion of WACOG savings.

The Company now understands from discussions with Staff and other interested parties that they would advocate for an earnings test capped at the Company's allowed return on equity and including any WACOG savings. Given that the Company is unable to effectively forecast the variations in WACOG savings it might experience in 2010, and given the Company's strong commitment to managing its costs, it is possible that the Company could exceed the earnings test described above. Indeed, the Company believes it is very likely it will exceed this earnings test when it is applied to the 2009 deferred balance.

² See page 3 of Appendix A of Commission Order No. 07-383

³ Ibid.

⁴ Gail Kinsey, "Green Power at a Premium," The Oregonian, January 28, 2007.

⁵ See page 6 of NW Natural's Application for Reauthorization to Defer Accounting filed in Docket UM 1327, on December 30, 2009.

NW Natural has supported Smart Energy™ with substantial shareholder contributions, including the start-up costs incurred in 2007. NW Natural shareholders also contributed \$77,000 for Smart Energy™ offsets, which represents a total offset of the natural gas used to the Company's offices, service centers and shops for the entire five-year period of the pilot program.

In 2009, the Company used \$500,000 of shareholder funding for the development of the Threemile Canyon biodigester, which is a significant investment in the pilot's goal of bringing biogas to the region. Also, due to the application of an earnings test prior to amortization of the Company's 2009 deferral account, shareholders are likely to contribute an additional \$475,000 to the Smart Energy™ program. In total, NW Natural shareholder contributions to Smart Energy™ and the effort to bring biogas to the region are likely to exceed one million dollars.

Given the difficulty of predicting its ability to recover the deferred balance, and the already substantial shareholder contributions to the Smart Energy™ program, the Company believes it would be inappropriate to defer additional expenses in 2010. The Company is, therefore, withdrawing its deferral application and revising its plans for education and communication spending in 2010.

PLANS FOR 2010

NW Natural's goal at the inception of the Smart Energy™ program was to enroll 3% of its residential customers by the end of the pilot term (5 years) and to have the program become self-sufficient by the end of the second year. While the Company has maintained its desired growth trajectory (approximately 0.5% in 2009) even during a significant economic recession, that growth has required a sustained effort. Since the Company is in a rate case moratorium and cannot develop a secure funding mechanism for the program, it finds it necessary to reduce outreach efforts and move the program to immediate self-sufficiency.

Revenues generated by Smart Energy™ participants do allow for a small amount of funding, approximately \$150,000, to be dedicated to education and communication efforts in 2010, with the primary focus to be on direct interaction.⁶

The Company estimates that the growth rate generated by this level of funding is likely to be approximately 0.05%. NW Natural intends to move forward in the next few months with an in-depth review of the pilot program originally contemplated to take place at end of the third program year.⁷ In doing so, the Company will analyze the effectiveness of the different marketing tactics, program price and goals. At the conclusion of the review, the Company will likely propose program modifications.

The Company worked closely with the POC, the Citizen's Utility Board, and Staff to create a manageable solution to continued funding for Smart Energy.™ While the Company believes all parties strongly support the success of the program, parties could not find a sustainable way to continue funding the program outside of using existing program revenues.

⁶ See Exhibit A for a complete breakdown of projected expenses.

⁷ See NW Natural Schedule 400.

NW Natural looks forward to sharing the results of its in-depth review of Smart Energy.™

Sincerely,

/s/ Inara Scott

Inara K. Scott
Manager, Rates & Regulatory Affairs

EXHIBIT A
SMART ENERGY™ 2010 COMMUNICATIONS BUDGET

	2010
The Climate Trust	0
Costs to start up Smart Energy™ Pilot Program	
Education	\$30,000
Customer communications, advertising, media outreach	
Interaction	\$100,000
Direct mail*, email, community outreach, events, sponsorships, courtesy knock	
Professional Services	\$5,000
Creative production, fees (not included elsewhere)	
Promotional	\$2,000
give-away items, incentives, promotional activities	
Miscellaneous*	\$6,000
Postage, materials, etc.	

* as the number of participants grows, the cost for customer mailings increase	
Total	\$150,000



CERTIFICATE OF SERVICE

I certify that I have this day served the foregoing WITHDRAWAL OF APPLICATION FOR REAUTHORIZATION TO DEFER EXPENSES FOR SMART ENERGY PILOT PROGRAM COMMUNICATION COSTS upon all parties of record in this proceeding (UM 1327), by e-mailing an electronic copy of the filing to the following parties or attorneys of parties:

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DATED at Portland, Oregon, this 10th day of February 2010.

/s/ Kelley C. Miller

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