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VIA ELECTRONIC FILING

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
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Re: Docket No. UM ___

Enclosed for filing is NW Natural's Application for an Accounting Order Regarding Depreciation Rates and Flow-Through Amounts.

Very truly yours,

Sarah J. Adams

Enclosures

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BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM_____

In the Matter of the Application of NORTHWEST NATURAL for an Accounting Order regarding Depreciation Rates and Flow-Through Amounts	**NORTHWEST NATURAL'S APPLICATION FOR ACCOUNTING ORDER**

Pursuant to ORS 757.120 and 757.125, Northwest Natural Gas Company ("NW Natural" or the "Company") applies to the Public Utility Commission of Oregon (the "Commission") for an order authorizing the accounting treatment described herein to revise NW Natural's book depreciation rates and the flow-through amounts for book depreciation in excess of tax and removal costs incurred that are used in calculating NW Natural's income tax provision for rate making. In support of this Application, NW Natural provides the following information.

I. INTRODUCTION

NW Natural requests authorization to revise its accounting treatment of book depreciation rates and the flow-through amounts for book depreciation in excess of tax and removal costs incurred consistent with the results of two studies recently undertaken by the Company. The first study provided an update of book depreciation rates. That study shows that the depreciation expense shown on the Company's books, which is based on a previous study of gas plant in service as of December 31, 1993, is approximately $6.5 million higher than is appropriate based on the average service life rates of gas plant in service as of December 31, 2005. Accordingly, NW Natural requests authorization to revise its accounting treatment to reflect this $6.5 million decrease in book depreciation expense.

The second study shows that: (1) the amount of flow through in the Company's book tax provision for book depreciation in excess of tax related to the tax effects of pre-1981 plant is approximately $4.4 million lower than the amount required to ensure that NW

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Natural's regulatory tax asset is amortized over a reasonable period and (2) the amount of flow through in the Company's book tax provision related to removal costs incurred, which is approximately $2.3 million, should be reduced to zero such that all future removal costs incurred are normalized. Accordingly, NW Natural requests authorization to revise its book depreciation amount for flow-through related to the tax effects of pre-1981 plant and its removal costs incurred, which revisions would result in an increase in income tax expense (cost of service) of approximately $2.6 million. The revenue requirement change associated with this $2.6 million increase in income tax expense is approximately $4.3 million.

The net effect of these changes would be a reduction of NW Natural's system revenue requirement of approximately $2.2 million, 90% of which is applicable to Oregon. Upon approval of this application, NW Natural will seek in its 2008 Purchased Gas Adjustment filing to reduce Oregon rates consistent with this reduction in revenue requirement.

The requested accounting treatment, as well as subsequent approval of rate changes consistent with this accounting treatment, is necessary to ensure that the Company applies appropriate book depreciation rates and recovers its regulatory asset over a reasonable period on a going-forward basis.

Communications regarding this application should be addressed to:

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II. DISCUSSION

A. Depreciation Rates

The Company recently received the results of a Depreciation Study performed by a third party evaluator, Gannett Fleming, Inc. (the "Study").[1] The Study updates the Company's book depreciation accrual rates based on all gas plant in service as of December 31, 2005. The results of the Study show that the Company's current depreciation expense should be decreased by approximately $6.5 million, in order to set the depreciation accrual rates at the most appropriate level for assets in place as of December 31, 2005. This recommended change is necessary to update to current asset lives the existing depreciation accrual rates, which are based on a depreciation study performed for all gas plant in service as of December 31, 1993.[2]

The reduced depreciation expense would decrease NW Natural's system cost of service by approximately $6.5 million, with a corresponding decrease in NW Natural's revenue requirement.

B. Regulatory Tax Asset

NW Natural's Tax Manager recently conducted an extensive review of the Company's deferred income tax balances, including an analysis of NW Natural's regulatory tax asset associated with tax benefits previously flowed through to customers and attributed to its pre-1981 plant. Based upon this review, the Company determined that two accounting adjustments are needed in order to ensure that the regulatory tax asset related to the tax effects of pre-1981 plant is amortized over a reasonable period in step with the expected

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[1] A copy of the Study is available upon request.

[2] The study by Gannett Fleming included the evaluation of depreciation rates using both the average service life (ASL) procedure and the equal life group (ELG) procedure. Both methodologies have been accepted by the OPUC. The ELG procedure produced results that indicated an increase in depreciation expense of $5.9 million. This application endorses the ASL method that is consistent with the determination of the Company's existing depreciation rates.

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useful lives of these assets, to account for these assets consistent with the Company's financial accounting standards[3] and to ensure that the Company recovers on a going-forward basis the tax effects of these assets during their useful lives. The two adjustments are:

(1) Increase the federal book in excess of tax flow-through amount for depreciation of pre-1981 assets approximately $4.4 million to align recovery of these assets with their useful lives; and

(2) Treat removal costs incurred on a normalized basis, and, accordingly, decrease the federal flow-through amount of tax in excess of book from $2.3 million to zero.

The higher book in excess of tax flow-through amount required by the first adjustment and the lower tax in excess of book flow-through amount required by the second adjustment increase NW Natural's cost of service by increasing income taxes by approximately $2.6 million (based on a combined effective tax rate of 39.29%), on a system basis.[4] The effect on NW Natural's system revenue requirement associated with this increase in income taxes is approximately $4.3 million.

1. Depreciation of Pre-1981 Assets

The Company's review of deferred income tax balances shows that NW Natural should increase the federal flow-through (book in excess of tax) amount for depreciation of pre-1981 assets from the current amount of $635,000 to $5,021,000, on a system basis. The increased revenue requirement associated with this change is $2.8 million, on a system basis. This adjustment is necessary to ensure that NW Natural's regulatory tax asset is

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[3] The Company adopted Statement of Financial Accounting Standards No. 109 (SFAS No. 109), "Accounting for Income Taxes," effective January 1, 1993.

[4] The higher book in excess of tax flow-through amount required by the first adjustment increases the Company's income taxes approximately $1.7 million and the lower tax in excess of book flow-through amount required by the second adjustment increases the Company's income taxes approximately $0.9 million.

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amortized over a reasonable period (20 years rather than 100 years given the current flow-through amount) and to conform to the Company's financial accounting standards.

Under the flow-through method of accounting, which is required for pre-1981 assets, in the early years of the lives of the assets the benefits of tax depreciation rates that are higher than book depreciation rates are included in revenue requirements in the form of lower tax provisions. As these assets age and reach the end of their tax depreciation lives, there is no longer any tax benefit related to depreciation on the assets, and the tax provision for revenue requirement must be higher than it otherwise would be based on book depreciation. SFAS No. 109 requires a regulatory asset account be established on the Company's balance sheet that represents these accumulated tax effects of book versus tax methods on pre-1981 plant. Consistent with this requirement, as the flow-through amount changes (due, *e.g.*, to the mix of new plant, different year tax depreciation rates, and the aging of assets) the flow-through amount as applied to the regulatory asset account changes.

The Company's review of deferred income tax balances shows, however, that the flow-through amount recorded in the regulatory asset account for pre-1981 assets and included in rates since 1997 was approximately $4.4 million lower (on a system basis) than the amount necessary to align recovery of the tax effects of these assets with their useful lives. NW Natural therefore requests the proposed revision to its accounting treatment of these assets, which would increase the amount recorded on NW Natural's books for federal flow-through for depreciation of pre-1981 assets $4.4 million, consistent with the requirements of SFAS No. 109 and the flow-through method of accounting, and which would, upon incorporation of this expense in rates, ensure that this regulatory tax asset is amortized over a reasonable period of 20 years.

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2. Removal Costs Incurred for Pre-1981 Assets

The Company's review of deferred income tax balances also shows that the Company's practice of flowing through the tax benefit of removal costs incurred is no longer appropriate. Instead, on a going-forward basis, the Company proposes to normalize removal costs incurred consistent with book-tax differences attributed to post-1980 assets. Accordingly, NW Natural proposes to reduce the current federal flow through of tax in excess of book of $2.3 million to $0, with a corresponding increase in income tax liability of $0.9 million and revenue requirement of $1.5 million.

This change recognizes that removal costs incurred, which are currently treated as pre-1981 and therefore flowed through, should be normalized on a going-forward basis. This is the appropriate treatment for these costs, the large majority of which are now associated with post-1980 assets.

III. ACCOUNTING ORDER REQUEST

Pursuant to ORS 757.120 and 757.125, NW Natural requests that the Commission issue an accounting order that authorizes the Company to revise its accounting treatment of book depreciation expense and the flow-through amounts for book depreciation in excess of tax and removal costs incurred as follows:

(1) Decrease the Company's depreciation expense by $6.5 million;

(2) Increase the federal book in excess of tax flow-through amount for depreciation of pre-1981 assets $4.4 million; and

(3) Treat removal costs incurred on a normalized basis, and, accordingly, decrease the federal flow-through amount of tax in excess of book from $2.3 million to zero for removal costs incurred.

Upon approval of this application, NW Natural will seek in its 2008 Purchased Gas Adjustment filing to pass on to ratepayers the reduction in revenue requirement resulting from this change in the Company's book depreciation rates and flow-through amounts for book depreciation in excess of tax and removal costs incurred.

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IV. CONCLUSION

For the reasons set forth above, NW Natural respectfully requests that the Commission issue an order granting the proposed accounting changes.

DATED: August 3, 2007.

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Of Attorneys for NW Natural

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