ITEM NO. CA12

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: April 14, 2015

REGULAR ____ **CONSENT** _X_ **EFFECTIVE DATE** **August 7, 2014**

DATE: March 31, 2015

TO: Public Utility Commission

FROM: Judy Johnson JJ

THROUGH: Jason Eisdorfer and Marc Hellman

SUBJECT: NORTHWEST NATURAL: (Docket No. UM 1703) Requests Deferral of Net Revenues or Net Costs Related to Post-Carry Wells in Jonah Field.

STAFF RECOMMENDATION:

Staff recommends that the Commission approve Northwest Natural Gas Company's (NW Natural or Company) request to defer net revenues or net costs associated with post-carry wells in Jonah Field for the twelve-month period beginning August 7, 2014, for accounting purposes only.

DISCUSSION:

NW Natural makes this filing in accordance with ORS 757.210, 757.259 and OAR 860-027-0300. NW Natural seeks authorization to defer net revenues or net costs associated with post-carry wells in Jonah Field pursuant to the amended agreements that govern NW Natural's joint venture in gas reserves in the field.

When NW Natural made this filing, it believed that its annual deferral for gas commodity costs, filed as part of the Purchase Gas Adjustment (PGA) mechanism, would be sufficient to authorize it to defer these revenues and expenses. However, the Company, Staff, and the customer representatives have been unable to agree on a precise process for cost recovery and have discussed flowing revenues or costs through the Company's PGA mechanism.

Background:
In UM 1520, the Commission reviewed NW Natural's application for authorization to enter into a Carry and Earnings Agreement and joint venture with Encana. Under the agreement, NW Natural funded certain drilling activities in the Jonah Field, and in

exchange received an interest in the production of gas from the field. The Commission found that it was prudent for NW Natural to enter into the Carry and Earning Agreement in Order No. 11-176.

Early in 2014, NW Natural and Encana entered into an amendment to the Carry and Earning Agreement to terminate the obligation to fund and drill "carry wells."[1] This was done in order to facilitate Encana's sale of the Jonah Field to a Texas Pacific Group (TPG) company (Jonah Energy). As part of the negotiations with Encana, NW Natural states it was able to obtain a favorable upward adjustment to the volumes that it would have otherwise received under the performance of the Carry and Earning Agreement. According to the Company, this upward change in volumes helped restore the volumes that NW Natural and Encana had expected at the time they entered into the agreement, making up for differences that were due to lower production than anticipated.

The original agreement was amended after drilling 72 of the 102 wells, so 30 of the original 102 wells were left undeveloped. There were an additional eight wells that would have been left undeveloped even if the drilling program had been completed. Under the amended agreement, NW Natural has an opportunity to participate in the drilling of these undeveloped wells (post-carry wells) when Jonah Energy proposes to drill each of them.[2]

In May 2014, NW Natural received notice from Jonah Energy that it wished to drill several wells in sections where NW Natural had a working interest. NW Natural conducted an analysis to determine the expected gas costs that would be associated with the wells, as well as the ultimate prices that would be expected to be paid by customers if NW Natural were to seek to add the gas from the wells to its gas portfolio. NW Natural determined that, for most of the wells up to August of 2014, the gas was favorably priced, largely due to the terms of the amended agreement. Consequently, NW Natural has elected to participate in the drilling of certain wells, and to not participate in the drilling of certain other wells proposed by Jonah Energy.

On February 26, 2015, NW Natural filed an application for a prudence review of the costs of post-carry wells. This matter has been docketed as Docket No. UM 1717 and is currently in progress.

<u>Description</u>:
NW Natural seeks authorization to use deferred accounting for all associated expenses and revenues related to gas reserves capital costs (including drilling and completion

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[1] The wells were referred to as "carry wells" because NW Natural had agreed to "carry" a portion of Encana's pro rata share of the drilling costs in three separate sections of Jonah Field.
[2] For post-carry wells, NW Natural is required to fund only its own pro rata share of the drilling costs.

costs, tie-in costs, cathodic protection costs, and transactions costs) that occur during the time period of the deferral, August 7, 2014, through August 6, 2015. The Commission may authorize deferred accounting treatment pursuant to ORS 757.259(2)(e).

Proposed Accounting:
NW Natural states that the charges for gas costs, absent the requested deferral, would be recorded as increases/decreases in the appropriate 80X gas expense subaccounts. The Company intends to include the activity for the post-carry wells in the monthly accounting calculations, consistent with the inclusion of the carry and earnings activity. NW Natural further states that the tracking of the investment and related expenses will be accomplished so that the activity can be reported, and reviewed, on a stand-alone basis.

Estimated Deferrals in Authorization Period:
At the time NW Natural submitted this deferral application, the Company estimated that it would defer a net credit of between $1 million and $4 million for the revenue and expenses for the wells during the deferral period.

The Company subsequently updated its estimates on March 25, 2015, and now believes the deferral will result in a net collection of between $0 and $1 million for the wells during the deferral period.

Staff notes that recommending approval of this deferral in no way pre-judges whether the amortization of this deferral should also be approved. There is currently a Docket No. UM 1717 which has been opened to determine if the deferred amounts should be considered prudent and can be amortized.

Interest Rates:
The interest rate for the deferral accounts is 7.78 percent as directed in the Commission Order Nos. 12-408 and 12-437.

Information Related to Future Amortization

- Earnings review – Amortization of this deferral will not require an earnings review because it will be collected through an automatic adjustment clause, through the PGA.

- Prudence Review – A review to determine that costs were prudently incurred must be done prior to amortization. This review is currently being performed in Docket UM 1717, filed by NW Natural on February 26, 2015.

- Sharing – Sharing has not been decided. It will be proposed as part of the prudence review.

- Rate Spread/Design – Rate Spread/Design will be spread on an equal cents per therm basis consistent with rate design for all other commodity costs of gas.

- Three Percent Test (ORS 757.259(6)) – The three percent test measures the annual overall average effect on customer rates resulting from deferral amortizations. The three percent test limits (exceptions at ORS 757.259(7) and (8)) the aggregated deferral amortizations during a 12-month period to no more than three percent of the utility's gross revenues for the preceding year. The limit for these deferrals will be determined at the time of amortization.

Staff Analysis
As NW Natural's application to defer is appropriately made under the statutes, and the application meets the requirements of OAR 860-027-0300, Staff recommends its approval.

PROPOSED COMMISSION MOTION:

Northwest Natural's request to defer net revenues or net costs associated with post-carry wells in Jonah Field for the twelve-month period beginning August 7, 2014, be approved.