

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 3, 2018

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: June 4, 2018

TO: Public Utility Commission

FROM: Brian Fjeldheim *BF*

THROUGH: *E* Jason Eisdorfer and *JE* John Crider

SUBJECT: NORTHWEST NATURAL: (Docket No. UM 903) 2018 Spring Earnings Review.

STAFF RECOMMENDATION:

Staff recommends the Commission accept Staff's finding that Northwest Natural Gas Company's (NW Natural or Company) earnings for the 12 months ended December 31, 2017, are below the earnings threshold established in UM 903, and that no Earnings Sharing applies to the 2017 Fiscal Year.

DISCUSSION:

Issue

Whether the Commission should approve Staff's finding that NW Natural's earnings for the 12 months ended December 31, 2017, are below the earnings threshold established in UM 903, and that no Earnings Sharing applies to the 2017 Fiscal Year.

Applicable Law

NW Natural makes this filing in accordance with OAR 860-022-0070. Each Oregon regulated natural gas distribution company recovers gas costs under an automatic adjustment clause known as the Purchased Gas Adjustment (PGA). The Commission adopted the PGA in 1998 and the implementing rules in 1999.¹ The Commission has modified the PGAs and rules through the years.² The purpose of the PGA is to permit

¹ Order Nos. 98-503 and 99-272 (Dockets UM 903 and AR 357).

² See e.g., Order Nos. 07-019, 08-504 (Docket Nos. AR 512 and UM 1286).

each natural gas utility to adjust revenue annually to reflect actual increases or decreases in gas costs.

The PGA has two components.³ The first component is prospective and resets base gas costs each year to reflect changes in the utility's cost of purchased gas.⁴ The second component is retroactive and allows the utility to defer for later inclusion in rates differences between actual fixed costs and the base level in rates as well as a portion of the differences between actual commodity-related costs and the base level in rates.⁵

To ensure that earnings of a natural gas utility are not excessive prior to passing through prudently incurred base gas costs, the Commission, by rule (OAR 860-022-0070) requires that an earnings review be conducted on an annual basis.⁶

Components of the Spring Earnings Review are as follows:

Annual Election

Not later than September 15 of each year, each Local Distribution Company (LDC) must make an annual sharing election for the applicable gas year, which begins November 1.⁷ The LDC must choose either 90/10 Weighted Average Cost of Gas (WACOG) sharing or 80/20 WACOG sharing with a corresponding earnings review threshold.⁸

Spring Earnings Review

An earnings review shall be performed each spring (pursuant to OAR 860-022-0070) based on the most recent fiscal year's results of operations. The earnings review will apply to the WACOG sharing election previously made by the Company (e.g., the 2016 election will apply to the 2017 Fiscal Year results of operations that are the subject of the 2018 Spring Earnings Review). If earnings are found to be above a specified return on equity (ROE) level (Earnings Threshold), a portion of those revenues will be booked to a deferred account.

The Earnings Threshold

A LDC that elects 90/10 WACOG sharing will be subject to an Earnings Threshold of 100 basis points above its ROE, adjusted to reflect changes in conditions in capital

³ See e.g., Order No. 03-198 at 1 (Docket No. AR 449).

⁴ Order No. 03-198 at 1.

⁵ Order No. 03-198 at 1.

⁶ Order No. 03-198 at 1.

⁷ Order No. 08-504 at 17; Order No. 11-196, Appendix at 4; Order No. 14-238, Appendix A at 8.

⁸ 90/10 or 80/20 WACOG Sharing means that 90 or 80 percent of the variance will be deferred for subsequent charge or credit to customers, and 10 or 20 percent will be absorbed or retained by the LDC.

markets.⁹ An LDC that elects 80/20 WACOG sharing is subject to an Earnings Threshold of 150 basis points above its ROE, adjusted in the same manner.¹⁰

Structure of Earnings Reviews

By May 1 of each year, the LDC will file results of operations for the 12 months ended the prior December 31. Staff will complete its review and distribute summary conclusions by June 10 to all parties. At the first regular public meeting in July, Staff will present the results of the earnings review. If there are unresolved issues, a settlement conference will be held. If there are still outstanding issues, parties will file position statements by August 1 and the Commission would issue its decision on unresolved issues by August 15. These rate changes will include amortization of credit amounts in the deferred account, if any, resulting from the spring earnings review.¹¹

Earnings Adjustments

Recorded results of operations will include retained WACOG variance earnings and will be adjusted for Type 1 adjustments as set forth in Order No. 99-272, Appendix B. NW Natural made a one-time election not to include a weather normalization adjustment in its spring 1999 earnings review filing and each subsequent annual filing.

Earnings Performance

If adjusted earnings (including any retained WACOG variance) are below the Earnings Threshold, there will be no rate adjustment.¹² If adjusted earnings are above the Earnings Threshold, the amount of revenue in the test year representing 33 percent of the earnings (including WACOG earnings) exceeding the threshold will be shared with customers (Earnings Sharing).¹³

Effective Date of Rate Adjustment and Applicable Interest

Upon completion of the earnings review, any amount of earnings over the sharing dead band determined to be returned to customers will be booked to a deferred account. Interest shall apply beginning the previous January 1. The rate adjustment and amortization will be effective with the date of the subsequent base gas cost change.¹⁴

⁹ The Earnings Threshold is adjusted each year by 20 percent of any change in the risk free rate for the twelve-month calendar year preceding the annual earnings review (See Order No. 04-203 at 3-4 and OAR 860-022-0070(5)(c)).

¹⁰ *Id.*

¹¹ OAR 860-022-0070(6).

¹² OAR 860-022-0070(5)(c).

¹³ Order No. 98-543.

¹⁴ OAR 860-022-0070(5)(e).

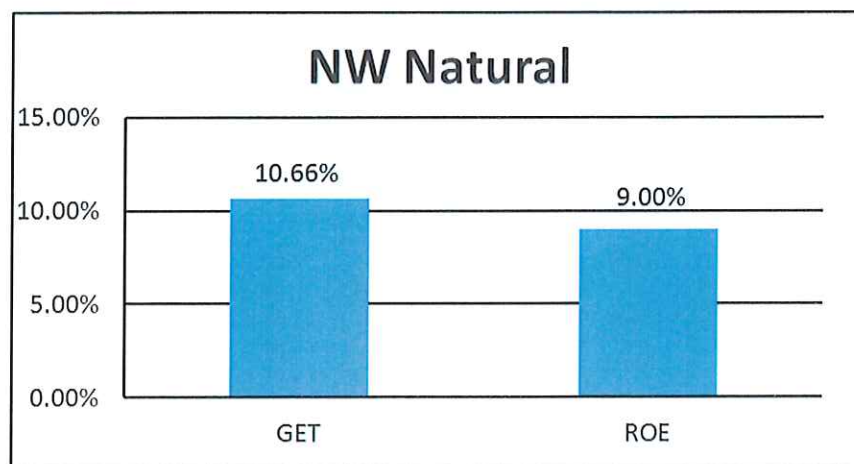
Analysis

NW Natural's Earnings

The Gas Earnings Threshold (GET) for the Company for this 2018 Spring Earnings review (review of the 2017 results of operations) is 10.66 percent.¹⁵ NW Natural elected a 90/10 WACOG sharing for the 2017 Fiscal Year in Docket UM 1286.¹⁶ Accordingly, calculation of NW Natural's Earnings Threshold began with the Company's authorized ROE for 2017.¹⁷ Then 100 basis points (based on a 90/10 WACOG Sharing election) were added to NW Natural's ROE. Finally, an adjustment of 20 percent of the change in United States Treasury Risk Free Rate between the immediately prior year and the year the LDC's most recent general rate case order was applied. For the 2017 Fiscal Year, there was a 0.16 percent change in the risk free rate.

Pursuant to OAR 860-022-0070, NW Natural submitted its 2017 Results of Operations (ROO) report for the 12 months ended December 31, 2017.¹⁸ NW Natural calculates its ROE as 9.00 percent after the application of its Type I adjustments, excluding weather normalization.

Staff reviewed the Company's ROO report and the supporting workpapers, and concludes that NW Natural's reported ROE has been calculated correctly. Because NW Natural's adjusted ROE is below the GET of 10.66 percent, no Earnings Sharing is required.



¹⁵ Gas Earning Thresholds and supporting calculations are posted on the Commission's website at the following address: http://www.puc.state.or.us/Pages/electric_gas/Natural_Gas.aspx.

¹⁶ NW Natural's Annual PGA Sharing Election (2016-2017), Docket UM 1286 filed September 15, 2016.

¹⁷ NW Natural's authorized ROE is 9.5 percent. Docket UG 221, Order 12-437 at 6.

¹⁸ *In the Matter of Northwest Natural Gas Company dba NW Natural, Annual Earnings Review Report - Results of Operations*, Docket RG 40, submitted May 1, 2018.

Consistent with OAR 860-022-0070(6), Staff submitted its conclusions to the parties in Docket No. UM 903 before June 10, 2017. Staff is unaware of any unresolved issues following its presentation of this review to the parties.

Conclusion

Staff reports above its calculations of: (1) the Company's adjusted return on equity ("Earnings Threshold"), and (2) adjusted revenues for the 2017 fiscal year, both of which are used to determine whether NW Natural must share a portion of its 2017 fiscal year earnings with customers under NW Natural's Purchased Gas Adjustment mechanism. Based on these calculations, Staff concludes that NW Natural should not be required to share its 2017 earnings with customers in connection with its PGA.

PROPOSED COMMISSION MOTION:

Accept Staff's finding that NW Natural's 2017 earnings are below the Earnings Threshold designated in UM 903, and that no Earnings Sharing applies to the 2017 Fiscal Year.