

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON  
UM 903**

In the Matter of  
Northwest Natural  
2010 Spring Earnings Review

STAFF'S OPENING COMMENTS AND  
RECOMMENDATIONS

The Citizens' Utility Board and the Northwest Industrial Gas Users (NWIGU) have both pledged support for Staff's comments and recommendations.

**Staff's Recommendations**

Staff recommends that the Commission require NW Natural's (NWN or Company) to modify its Results of Operations report (ROO) by:

- 1) reversing the \$4.7 million adjustment to Property Tax Expense;
- 2) off-setting property tax expense by \$484,000 to reflect the balance between actual 2010 property tax liability and property tax expense included in rates;
- 3) increasing O&M expenses to correct an erroneous allocation of legal expenses to Washington ratepayers; and
- 4) increasing miscellaneous revenues by \$1.9 million to reflect interest income received in addition to a property tax refund.

Staff's changes increase proposed level of sharing from \$199,000 to \$3.6 million (see table 4 below).

**Staff's Opening Comments**

NW Natural's Earnings Review

On May 1, 2011, NWN submitted its 2010 ROO for the twelve months ending December 31, 2010. The Company states that its report was developed in a manner consistent with Commission Order No. 99-272 and reflects applicable adjustments per Commission Order No. 03-507 for its general rate filing, UG 152.

Each May NWN submits its ROO reflecting the financial results from the prior calendar year. Staff reviews the results to make sure the report is compliant with previous Commission Orders for allowable regulatory adjustments and to determine the level of earnings the utility has achieved in order to gauge whether the utility will be required to share a percentage of earnings exceeding a threshold of ROE determined in UM 903. The essence of this financial report is measured on the net operating income (NOI) of the utility which is determined by subtracting allowable expenses from gross revenues. The NOI divided by the utility's net rate base determines the overall rate of return for the test period. The Return on Equity (ROE) is a component of the overall rate of return which represents the non-leveraged or equity portion of the return.

**1). Property Tax Adjustment:**

As a Type 1 Adjustment shown in the fourth section of NWN's ROO report, Column 2(e) labeled as "property tax adjustment," the Company includes a debit<sup>1</sup> of approximately \$4.7 million for property tax expense and credit adjustments to federal and state tax expenses. The total adjustment results in a decrease to NOI. The effect of this adjustment is to lower NWN's reported earnings for 2010.

In its narrative explanation found in section four of the ROO,<sup>2</sup> NWN claims that the Normalization of Property Tax Expense "removes the expense accruals for the year and reflects the actual cash payments made during the test period."

NWN has historically adjusted its property tax expense to show actual tax expense in its ROOs since its 2003 general rate proceeding; UG 152. Table 1 below shows the adjustments NWN has made each year between 2003 and 2010 for property taxes in its ROO. In each year, NWN's adjustment has been an increase to property tax expense. In 2010, the adjustment removes the benefit of a refund from property tax expense.

Table1

NWN's Property Tax Adjustments in ROO's	
Year	Amount
2003	456,000
2004	765,000
2005	622,000
2006	389,000
2007	714,000
2008	233,000
2009	920,000
2010	4,764,000

**2). 2010 Property Tax true-up**

The Type 1 adjustment (approximately \$4.7 million) posted in the 2010 ROO is intended by NWN to reflect the actual property taxes NWN "would have paid" but for a \$5.2 million refund.

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<sup>1</sup> A debit adjustment to Property Tax Expense serves to *increase* the amount of annual expense to property taxes which lowers NOI and ultimately reduces earnings for that period.

<sup>2</sup> See Attachment A.

In response to Staff's informal inquiry regarding the adjustment, NWN stated the adjustment accounted for the receipt of a property tax refund from various counties in Oregon resulting from a favorable decision by the Oregon Supreme Court issued January 28, 2010.<sup>3</sup> The Court decision required various Oregon jurisdictions to refund property taxes related to a multi-year over-assessment of fuel inventory owned by NWN. Documentation provided in its response demonstrates that these 2010 refunds totaled \$5.2 million.

In reality, NWN paid approximately \$485,000 more in property tax liability than what is reflected in rates. This is confirmed by NWN's documentation of a property tax refund of \$5,248,470<sup>4</sup> and the corresponding adjustment in the 2010 ROO of \$4,764,000. The difference of \$484,470 represents the property tax liability paid above the amount of the amount allowed in rates ( $\$5,248,470 - \$4,764,000 = \$484,470$ ).

***Staff recommends that the Commission require NWN to reverse this adjustment.***

Doing so would allow an increase to property tax expense of \$485,000 (consistent with the adjustment made in prior periods) but would also include the impact of the \$5.2 million refund to ratepayers benefit. Staff's model demonstrates the effect of this net adjustment to the property tax liability.<sup>5</sup>

The following example and table demonstrate the effect created by NWN's adjustment in the 2010 ROO removing the property tax refund using theoretical numbers. Assume NWN's property tax liability for 2010 was \$15.5 million. The Company received the refund of \$5.2 million during the period and booked (or accrued) the refund to property tax expense.<sup>6</sup> In our example, at the end of the period the balance of property tax would be \$10.3 million (see line 3 of Table 2). *In the ROO*, NWN records an adjustment of \$5.2 million to bring property tax expense back to the balance that it "would have paid" but for the \$5.2 million (reflected on line 4 of Table 2). Ultimately, the Company nets the refund against a slightly higher tax liability (\$485,000) to end up with a final adjustment in the ROO of \$4.7 million (the last line of Table 2).

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<sup>3</sup> See Attachment B.

<sup>4</sup> See Attachment C

<sup>5</sup> See Attachment D, note [5].

<sup>6</sup> A refund would be accrued as a "credit" to property tax expense which would lower the overall expense in that period.

Table 2

NWN's Reflection of Tax Adjustment in 2010 ROO	
Actual 2010 Property Tax Expense	15.5 million
<b>2010 Property Tax Refund</b>	<b>-5.2 million</b>
Balance of Property Tax Expense at end of period	10.3 million
<b>Reversal of 2010 Property Tax Refund (in ROO)</b>	<b>5.2 million</b>
Balance of Property Tax Expense after refund is removed	15.5 million
Property Tax Expense Allowed in Rates	15.0 million
Property Tax True-up for 2010	0.5 million
<b>NWN's NET ADJUSTMENTS in ROO</b>	
Property Tax True-up for 2010	0.5 million
<b>Reversal of 2010 Property Tax Refund (in ROO)</b>	<b>5.2 million</b>
Adjustment to 2010 ROO	4.7 million

At issue here is whether NWN can remove from its 2010 ROO a refund received in 2010 relating to property taxes paid in prior periods and still be consistent with its practice of adjusting property tax expense in ROOs for those prior periods so that NWN's earnings reflected NWN's actual tax expense.

Accounting rules allow prior period transactions to occur in a current period. The purpose of the Commission requiring a utility to remove expense or revenue for a prior period activity is to make certain that the cash-flow being measured appropriately matches the activity in the period.

Because NWN has reflected the *actual cash payment* of property taxes for its earnings test each year since 2003, ratepayers have borne the volatility related to any higher or lower property tax expense by virtue of these annual adjustments. Since variances related to property taxes have been borne by ratepayers, the refund relating to each of the periods since the rate case should be reflected in the cash flow during the 2010 period. In other words, on a cash-flow basis, the *actual* property tax expense during the period was lower due to the \$5.2 million refund. Requiring NWN to reverse the adjustment lowers property tax expense in the period which matches the actual cash flow.

Table 3 demonstrates Staff's recommendation of how the property tax refund should be reflected in the ROO to benefit ratepayers.

Table 3

Staff's Recommendation of Property Tax Adjustment	
End of Period Tax Expense	15.5 million
Property Tax Expense Allowed in Rates	15.0 million
Property Tax True-up for 2010	0.5 million
<b>2010 Property Tax Refund</b>	<b>-5.2 million</b>
Staff's Recommended Adjustment to 2010 ROO	-4.7 million

If, on the other hand, any variances between the *actual* property tax expense and what was included in NWN's base rates had been borne by NWN or its shareholders for purposes of the earnings test, it would be appropriate to include NWN's 2010 adjustment to property taxes as an "out-of-period," Type 1 adjustment. This could only occur, however, if NWN *had not* performed the annual adjustment in the ROO to "true-up" the property tax expense in the years for which the refund was issued. In such a case, a refund that related to that same time period would have appropriately been classified as an "out-of-period" expense.

**3). Legal Fees erroneously allocated to Washington Ratepayers:**

On page 63 of NWN's 2010 Annual Report submitted to SEC (10k), the Company states that it experienced "a \$1.0 million increase for consulting and legal fees<sup>7</sup> at the utility related to a successful property tax appeal."

On July 5, 2011, Staff issued Data Request 6<sup>8</sup> to determine whether NWN had included the \$1.0 million expense in its 2010 ROO.

The Company states that this expense was included in the ROO and that a portion of the legal expense was inappropriately allocated to Washington customers (approximately 9.9%, or 98,000).<sup>9</sup> NWN explains that the Company intends to make an adjustment to remove \$897,000 from the 2010 ROO as an off-set to the refund received for property taxes.

During informal discussions with the Company, NWN stated that it believes that it is inappropriate to include any of the expenses related to the collection of the property tax refund, therefore, in its revised filing the Company intends to remove from the ROO test period approximately \$1.0 million relating to the legal fees.

<sup>7</sup> See Attachment E, page 65

<sup>8</sup> See Attachment F.

<sup>9</sup> Based upon 3-factor formula included in 2010 ROO.

Staff believes that the legal fees are an appropriate expense as they relate to the refund that nets against the property tax liability (per Staff's recommendation). In Attachment C, note [4], Staff's model adjusts the legal expenses to correct the erroneous allocation NWN made to Washington ratepayers. The allocation represents approximately \$98,000 that should have been included in O&M expenses.

4). **Interest Income related to the Property Tax Refund:**

On July 19, 2011, Staff issued Data Request No. 8<sup>10</sup>. This request was made in response to a financial note in NWN's 2010 annual 10k filing<sup>11</sup>.

In addition, Staff had previously received information from NWN in response to inquiries made in March of 2010 regarding the interest associated with the refund, prior to the Company actually receiving all of the refunds. At the time of this writing, Staff has not received a formal response from NWN on Data Request no. 8, other than a verbal acknowledgment that the interest is indeed associated with the total \$5.2 million refund. The Company indicates that it received approximately \$1.9 million of interest from the various counties responsible for the over-assessments.

NWN verbally acknowledged that the refund was booked to FERC Account 419. The Code of Federal Regulations specifies that NWN should book *Interest and Dividend Income* into FERC Account 419:

Account 419, Interest and dividend income. (a) This account must include **interest** revenues on securities, loans, notes, advances, special deposits, **tax refunds** and all other interest-bearing assets, and dividends on stocks of other companies...."[emphasis added]

NWN explained that Account 419 is booked as a non-utility activity and as such, is not included in the test period for the ROO. Therefore, the \$1.9 million received by NWN in this period for interest income was not included in NWN's earnings review.

Staff acknowledges that NWN would "typically" book interest income related to a tax refund into Account 419. However, the adjustment that Staff suggests is for regulatory purposes. As noted above, NWN has been making an adjustment to its earnings results to reflect actual tax expense on an annual basis, thereby shifting to ratepayers the burden of any variance between actual tax expense and tax expense in rates. Accordingly, the Company should include the interest income in its 2010 ROO to appropriately allocate the benefit associated with the burden of the variance borne by ratepayers in previous

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<sup>10</sup> See Attachment G.

<sup>11</sup> See Attachment E, page 67.

years. Staff's model moves the benefit of the interest into miscellaneous revenues in the ROO.<sup>12</sup>

**NWN's 2010 ROO and Revisions:**

Staff's initial review of NWN's ROO began in June of 2011. Staff discovered the adjustment related to the property tax refund immediately. The Company was made aware that Staff believed the Company's adjustment was inconsistent with the treatment of property taxes in every annual earnings review since the 2003 rate case. *NWN believes the property tax refund qualifies as an out-of-period revenue and should be excluded from the ROO, therefore lowering the Company's earnings in this period.*

While preparing the Staff comments and position statement in mid-July, Staff discovered an entry in NWN's annual report submitted to the Securities and Exchange Commission (SEC) that noted the \$1.0 million expense related to the collection of the property tax refund. Staff immediately issued DR 6 and learned that this expense had been included in the ROO<sup>13</sup>. In its response, the Company acknowledged that it would be inconsistent to include the expense related to the collection of the property tax refund since the Company's intention was to remove the refund from the period. *The Company proposes in its revised 2010 ROO filing to remove the expense completely.*

Staff believes that the refund should be credited to ratepayers and therefore, the expense related to the collection of property taxes would be allowed. Staff's recommendation corrects NWN's erroneous allocation to Washington ratepayers and allows the \$1.0 million expense to flow through the ROO.

In late July (approximately July 19<sup>th</sup>), another note in the financial reports to SEC was noticed by the party representing the NWIGU and was brought forward to Staff's attention. The note indicated that NWN had received approximately \$1.9 million in interest from the various jurisdictions in addition to the \$5.2 million property tax refund. Staff immediately issued DR 7 in order to determine if this interest income was indeed related to the property tax refund that we had been discussing during this time period.

In its response, NWN indicated that the interest income was not included in the ROO as it was booked to FERC Account 419, which is not typically included as income on the ROO (see discussion in paragraph 4 above). *NWN did not include any adjustment in its Revised 2010 ROO related to the Interest Income.*

And finally, on July 17, 2010, NWN alerted Staff that it had discovered errors in its calculation of rate base in the 2010 ROO and requested the opportunity to submit a

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<sup>12</sup> See Attachment D, note [3].

<sup>13</sup> Except the portion erroneously allocated to Washington ratepayers.

revised filing that would correct the rate base balance and remove the expense associated with the collection of property taxes.

While Staff does not believe the Company has behaved nefariously in any way, Staff notes that the Commission relies upon the utilities to provide reliable and accurate information.

**Earnings Impact based upon Staff's recommendations:**

If the Commission were to adopt Staff's recommendations the result is a higher ROE and therefore, more dollars contribute to excess earning above the level of the Commission-authorized 11.02 percent ROE. NWN is required to share 33 percent of any dollars exceeding the threshold per the Earnings Performance Agreement described in Docket No. UM 903.

The following table illustrates Staff's recommendation for the amount that NWN should be required to share as a result of its 2010 ROO Earnings Performance:

Table 4

SHARING CALCULATION	NWN's Original Filing	NWN's Revised Filing	Staff's Recommendation
Threshold ROE (See Staff Letter Dated April 2011)	11.02%	11.02%	11.02%
Actual Equity as a % of Total Capital - 12/31/2010	47.86%	47.86%	47.86%
Actual Weighted Average Cost of Long Term Debt	3.46%	3.47%	3.47%
Return on Rate Base needed for threshold ROE	8.73%	8.73%	8.73%
Rate Base	\$954,051	\$967,308	\$967,308
Operating Income needed for authorized ROE	\$83,327	\$84,484	\$84,484
2010 Actual Operating Income after Type I Adjustments	\$84,123	\$84,845	\$91,063
Operating Revenue <i>exceeding</i> authorized ROE (after tax)	\$796	\$361	\$6,579
Operating Revenue <i>exceeding</i> authorized ROE (before tax)	\$1,329	\$602	\$10,988
Sharing Percentage per Performance Agreement	33%	33%	33%
Amount Shared to Customers	<b>\$439</b>	<b>\$199</b>	<b>\$3,626</b>



This concludes Staff's opening comments.

Dated at Salem, Oregon, this 27th day of July, 2011.



**Carla Bird**  
Senior Revenue Requirements Analyst  
Electric Rates & Planning

NW Natural  
 Test year Normalizing Adjustments: TYPE I ADJUSTMENTS  
 2010 Oregon Earnings Review  
 (\$000)

Line No.	Column A from Page 1	Weather Normalization & Gas Costs Adjustment (2a)	Miscellaneous Revenue Adjustment (2b)	Advertising & Promotional Adjustment (2c)	Memberships and Dues Adjustment (2d)	Property Taxes Adjustment (2e)	Uncollectible Accounts Adjustment (2f)	Stock Issuance Adjustment (2g)	Bonus Adjustment (2h)	Total Type I Adjustments	Column C from Page 1
1	Operating Revenues										
2	Sale of Gas	\$662,188	\$72,587							\$72,587	\$734,775
3	WARM Revenue	14,190	(14,082)							(14,190)	(1,307)
4	Revenue & Technical Adjustments	13,642	(14,949)	(108)						(14,949)	13,033
5	Transportation	13,033								0	4,851
6	Miscellaneous Revenues	4,304	547							547	
7	SB408 Deferrals	7,721	(7,721)							(7,721)	0
7	Total Operating Revenues	715,078	58,505	(22,231)	0	0	0	0	0	36,274	751,352
8	Operating Revenue Deductions										
9	Gas Purchased	384,591	46,300							46,300	430,892
10	Uncollectible Accrual	1,547	242				773		0	1,015	2,562
10	Other Operating & Maintenance Expenses	102,060		(549)	(201)	0		17	(4,355)	(5,088)	96,972
11	Total Operating & Maintenance Exp.	488,198	46,542	(549)	(201)	0	773	17	(4,355)	42,227	530,426
12	Federal Income Tax	33,066	3,295	177	65	(1,536)	(249)	0	1,421	(3,997)	29,069
13	State Excise	8,219	807	43	16	(376)	(61)	0	348	(980)	7,239
14	Property Taxes	13,928				4,764		0	0	4,764	18,692
15	Other Taxes	24,020	1,742	0	0	0	0	0	0	1,755	25,775
16	Depreciation & Amortization	56,029				0	0	0	0	0	56,029
17	Total Operating Revenue Deductions	623,460	52,386	(329)	(120)	2,852	463	17	(2,586)	43,770	667,230
18	Net Operating Revenues	91,618	6,119	(329)	120	(2,852)	(463)	(17)	2,586	(7,496)	84,123
19	Average Rate Base	1,973,029									1,971,534
20	Utility Plant in Service	(867,949)								(1,495)	(867,949)
21	Accumulated Depreciation									0	
21	Net Utility Plant	1,105,080	0	0	0	0	0	0	(1,495)	(1,495)	1,103,585
22	Aid in Advance of Construction	(1,959)								0	(1,959)
23	Materials & Supplies	80,833								0	80,833
24	Water Heater Program	0								0	0
25	Leasehold Improvements	1,716								0	1,716
26	Accumulated Deferred Income Taxes	(230,124)								0	(230,124)
27	Total Rate Base	\$955,546	\$0	\$0	\$0	\$0	\$0	\$0	(\$1,495)	(\$1,495)	\$954,051
28	Interest Coordination		0	0	0	0	0	0	(52)	(52)	(52)

Attachment A

WILLAMETTE LAW ONLINE  
Supreme Court of Oregon

2010 - 3

Decisions issued January 28, 2010

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On January 28, 2010, the Oregon Supreme Court issued the following opinion summarized below:

(1) TAX: The business inventory exemption of ORS 307.400 applies to the inventory of taxpayers whose property is subject to central assessment.

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(1) Northwest Natural Gas Co. v. Dept. of Revenue  
Case No. S056384

AREA OF LAW: TAX

**HOLDING:** (Opinion by LINDER, J.) The business inventory exemption of ORS 307.400 applies to the inventory of taxpayers whose property is subject to central assessment.

Northwest Natural Gas (NW) is a utility company that is subject to central assessment under ORS 308.515(1). The Department of Revenue (Department) determined that because NW is subject to central assessment, its inventory was not exempt under the business inventory exemption of ORS 307.400. The Department's proposed assessments included gas reserves and retail appliances held by NW. NW petitioned for reduction in the assessments, and argued that the business inventory exemption applied. The Department denied these petitions and reasoned that because the central assessment provisions expressly include inventory, the gas reserves and retail appliances were assessable. The tax court held that the business inventory exemption under ORS 307.400 applied to centrally assessed property and therefore NW's gas reserves and retail appliances were not assessable. The Supreme Court held that the gas reserves and retail appliances were tangible personal property that was stock in trade, held for sale in the ordinary course of business, and was therefore subject to the business inventory exemption of ORS 307.400. Affirmed.

[Summarized by Terisa Page]

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*Return to Oregon Supreme Court 2009*  
OREGON COURTS NEWS  
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Attachment B

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**BIRD Carla**

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**From:** Siores, Natasha [ncs@nwnatural.com]  
**Sent:** Tuesday, May 24, 2011 4:01 PM  
**To:** BIRD Carla  
**Cc:** ROSSOW Paul  
**Subject:** RE: Membership and Dues  
**Attachments:** 2010 property tax refund from DWA 5-24-11.xlsx; 2010 membership & dues FINAL.xlsx; 2010 O&M 2966 and 2666 detail.xlsx

Thanks Carla,

- Attached is the property tax information and it comes from Dave Aimone, our Treasury Manager. This workpaper shows the \$5.2 million that was received for the property tax refund and was credited to Property Tax Expense during 2010.
- I've also attached just a little more detail on the Membership & Dues – I say just a little because it's just the drilldown detail from the ledgers. I can get the electronic scans of some of the invoices, but it will take me a little time to find, print and scan those. It's not a problem, just not something I can produce for you today. The Gas Tech Institute is a non-profit R&D group – we participate in funding various of their programs. I can pull some invoices for you and send them along.
- The amount shown for Northwest Biogas is for the Threemile Canyon Farm biodigester project in Boardman. This expense is seen as an R&D expense, like many of our memberships to organizations like Gas Research Institute, etc. Last year we had a payment to them for \$100K which I think was labeled Threemile Canyon, but it was the same project. I do have the invoice for this expense and will scan and send along with everything else here.
- Corp Exec Board is an organization for senior executives. I pulled the invoice for this and it is for a membership to the Finance Leadership Exchange, which is a service offered by Corporate Executive Board.
- The \$88K for promotional and other expense is not a membership/dues item. We included the adjustment here because it made the most sense. These costs are charges to O&M that were coded to a category we've set aside called "non-recoverable" expenses. Managers are instructed to code items here that we would not ask for or request recovery for in rates. Stuff like a Christmas party or t-shirts, should be coded here. Then when I pick up all the O&M for the ROO, I query for this account category and make an adjustment to remove them entirely. Attached is the detail for these expenses, which are in account category 2966 and 2666. I guess we could have set this out as its own adjustment and I do recall at some point talking to a Bonnie or Ed about where to adjust it and this seemed to make the most sense. But now that it's up to you and I, if you want to move that adjustment, we can do that, no problem.

I hope that's everything – I will get printing and scanning on some of these invoices that I mentioned above.

Let me know what else I might owe you. Thanks Carla for the quick turn on this ROO – hopefully I can help you get your stuff tied up quickly.

Natasha

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**From:** BIRD Carla [mailto:carla.bird@state.or.us]  
**Sent:** Tuesday, May 24, 2011 2:06 PM  
**To:** Siores, Natasha  
**Cc:** ROSSOW Paul  
**Subject:** Membership and Dues

Hi again Natasha!  
Thanks for getting me so much information so quickly!

\*\*PRINCIPLE ONLY\*\*

Property Tax Principle Refund Estimate 02/24/2010

Tax County	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	2008-2009	2009-2010	Projected Total
02 Total Benton County	\$ -	\$ 3,574	\$ 5,402	\$ 7,403	\$ 8,587	\$ 8,897	\$ 21,822	\$ 10,927	\$ 66,612
03 Total Clackamas County	\$ -	\$ 18,867	\$ 29,808	\$ 44,299	\$ 52,330	\$ 51,652	\$ 138,995	\$ 74,255	\$ 410,206
04 Total Clatsop County	\$ -	\$ 1,345	\$ 1,977	\$ 2,677	\$ 3,270	\$ 3,189	\$ 8,368	\$ 4,167	\$ 24,993
5 Total Clatsop County	\$ -	\$ 1,597	\$ 2,342	\$ 3,176	\$ 3,688	\$ 3,565	\$ 9,731	\$ 4,863	\$ 28,962
05 Total Columbia County	\$ 314,725	\$ 268,571	\$ 219,527	\$ 290,769	\$ 353,125	\$ 318,529	\$ 80,241	\$ 105,125	\$ 1,950,612
6 Total Columbia County	\$ 28,503	\$ 24,323	\$ 19,882	\$ 26,334	\$ 31,981	\$ 28,848	\$ 7,267	\$ 9,521	\$ 176,660
06 Total Coos County	\$ -	\$ 161	\$ 1,107	\$ 641	\$ 20,708	\$ 3,092	\$ 9,240	\$ 4,888	\$ 39,837
10 Total Douglas County	\$ -	\$ -	\$ -	\$ -	\$ 1,599	\$ -	\$ -	\$ -	\$ 1,599
14 Total Hood River County	\$ -	\$ 864	\$ 1,418	\$ 2,063	\$ 2,338	\$ 2,217	\$ 6,187	\$ 3,005	\$ 18,092
20 Total Lane County	\$ -	\$ 10,530	\$ 16,421	\$ 22,915	\$ -	\$ -	\$ 26,938	\$ -	\$ 76,804
20 Total Lane County	\$ -	\$ -	\$ -	\$ -	\$ 26,630	\$ 25,094	\$ 39,710	\$ 34,464	\$ 125,898
21 Total Lincoln County	\$ 66,589	\$ 46,388	\$ 48,534	\$ -	\$ -	\$ -	\$ -	\$ -	\$ 161,510
22 Total Lincoln County	\$ -	\$ -	\$ -	\$ 54,749	\$ 53,716	\$ 77,165	\$ 28,929	\$ 63,530	\$ 278,089
22 Total Linn County	\$ -	\$ 4,878	\$ 7,986	\$ 10,081	\$ 9,436	\$ 13,490	\$ 36,857	\$ 18,946	\$ 101,674
24 Total Marion County	\$ -	\$ 15,417	\$ 22,739	\$ 32,184	\$ 37,643	\$ 36,365	\$ 97,606	\$ 49,392	\$ 291,347
26 Total Multnomah County	\$ 39,145	\$ 53,665	\$ 64,230	\$ 78,157	\$ 81,641	\$ 90,577	\$ 131,875	\$ 107,842	\$ 647,131
27 Total Polk County	\$ -	\$ 3,913	\$ 6,729	\$ 9,770	\$ 11,384	\$ 11,343	\$ 29,409	\$ 15,285	\$ 87,831
29 Total Tillamook County	\$ -	\$ 23	\$ 33	\$ 44	\$ 90	\$ 46	\$ 117	\$ 56	\$ 409
33 Total Wasco County	\$ -	\$ 1,108	\$ 1,980	\$ 2,633	\$ 3,038	\$ 2,762	\$ 6,955	\$ 3,385	\$ 21,860
34 Total Washington County	\$ -	\$ 32,511	\$ 48,799	\$ 71,862	\$ 83,801	\$ 87,936	\$ 226,585	\$ 113,935	\$ 665,429
36 Total Yamhill County	\$ -	\$ 3,664	\$ 6,125	\$ 8,887	\$ 10,548	\$ 10,383	\$ 18,470	\$ 14,840	\$ 72,916
<b>Total</b>	<b>\$ 448,963</b>	<b>\$ 491,396</b>	<b>\$ 505,039</b>	<b>\$ 668,643</b>	<b>\$ 795,552</b>	<b>\$ 775,150</b>	<b>\$ 925,303</b>	<b>\$ 638,425</b>	<b>\$ 5,248,470</b>

NW Natural  
 2010 Oregon Earnings Review  
 12 Months Ended December 31, 2010  
 (\$000)

Condensed Earnings Test Presentation to Illustrate Potential Corrections

Line No.		NWN's CORRECTED Test Year Results	ORIGINAL FILING Test Year Results	CHANGE in Test Year Results	STAFF'S RECOMMENDED Test Year Results	STAFF'S CHANGE in Test Year Results
1	Operating Revenues	751,352	751,352	0	753,252	1,900 [3]
2	O&M Expenses	529,529 [1]	530,426	(897)	530,524	(98) [4]
3	Taxes and Depreciation	136,979	136,804	175	131,655	(5,149) [5]
4	Net Operating Revenues	84,844	84,122	722	91,073	6,951
5	Rate Base:					
6	Utility Plant in Service	1,971,533	1,971,533	0	1,971,533	0
7	Accumulated Depreciation	(854,691) [2]	(867,949)	13,258	(854,691)	13,258
8	Other Rate Base Items	(149,534)	(149,534)	0	(149,534)	0
9	Net Rate Base	967,308	954,050	13,258	967,308	13,258
10	Rate of Return	8.77%	8.82%	-0.05%	9.42%	0.64%
11	Return on Common Equity	11.10%	11.20%	-0.10%	12.43%	1.33%
12	Threshold ROE	11.02%	11.02%	0.00%	11.02%	0.00%
13	Amount Shared to Customers [3]	199	439	(240)	3,626	3,427

- 14 Notes:
- 15 [1] Change reflects a correction to remove from O&M expenses Oregon's share of a \$996k legal fee relating to the property tax refund;
- 16 the tax impact of this reduced O&M is reflected on line 5
- 17 [2] Accumulated Depreciation reserve adjusted to reflect the correct reserve balance as reported in the Company's annual report and Form-2.
- 18 An erroneous accounting report led to the wrong number being used in the original 2010 ROO filing.
- 19 [3] Adds \$1.9 million of miscellaneous revenues to reflect interest accrual related to property tax refund originally booked to Account 419
- 20 which is not included in Results of Operations Report. This adjustment adds the interest into the earnings review.
- 21 [4] NWN erroneously allocated a portion of the legal expenses to its Washington jurisdiction. The \$98,206 correction serves to
- 22 include 100% of legal expenses in the ROO.
- 23 [5] Reverses Original Adjustment made by NWN - Adds \$4.7 million to expenses to neutralize the receipt of a property tax refund of
- 24 \$5.2 million and removes \$4.7 million from current property tax expense to reflect the refund plus \$485,000 of additional property tax
- 25 expense without consideration of the refund. Total adjustment also includes effects of taxes on the reduced expense.

Table of Contents**Consolidated Operations***Operations and Maintenance*

Operations and maintenance expense was \$121 million in 2010, compared to \$127.1 million in 2009, a decrease of \$6.1 million or 5 percent. The following summarizes the major factors that contributed to changes in operations and maintenance expense:

*2010 compared to 2009:*

- a \$5.6 million decrease in utility payroll expense related to a reduced number of employees. There was a reduction of 105 employees or 9 percent over the two year period beginning January 2009;
- a \$2.4 million decrease in utility bad debt expense (see below for further discussion);
- a \$1.9 million decrease in pension expense, due to the increase in market value of plan investments from contributions in 2009 and 2010;
- a \$1.5 million decrease in health care and other employee benefit expense due to reduced employee count;
- a \$0.2 million decrease in damage claims in 2010.

Partially offsetting the above factors were:

- a \$4.9 million increase in gas storage expenses, primarily related to start-up costs including salaries and benefits, power costs, legal fees and investment bank consulting costs; and
- a \$1.0 million increase for consulting and legal fees at the utility related to a successful property tax appeal.

Legal  
Fees

*2009 compared to 2008:*

- an \$8.0 million increase in pension expense primarily due to lower assumed discount rates and a decrease in our plans' funded status, which resulted from a significant decline in the market value of assets during 2008;
- a \$5.3 million increase in employee labor and benefit expense due to higher health care premiums and higher bonuses related to above-target operating results, which affect annual incentive payments and compensation;
- a \$1.1 million charge related to our voluntary severance program involving workforce reductions during the third and fourth quarters of 2009;
- a \$1.1 million increase in strategic initiatives including performance improvement and corporate tax projects; and
- a \$1.0 million increase in utility bad debt expense (see discussion below).

Partially offsetting the above increases were:

- a \$2.1 million decrease in employee compensation expense related to reduced employee count; and
- a \$0.6 million decrease in claims in 2009.

Our bad debt expense as a percent of revenues was 0.21 percent for the year ended December 31, 2010, compared to 0.42 percent for the same period last year. The 2010 lower bad debt expense ratio was partly due to improved collections and increased recoveries from delinquent account balances. Credit risks are still somewhat high due to the weak economy and high unemployment rates, but our credit exposure has improved as evidenced by a decrease in delinquent account balances over last year. Lower customer usage from warmer than normal weather this past winter coupled with customer conservation, lower gas prices and low income energy assistance funds have contributed to our reduced credit exposure.

Health care costs have been trending higher, and it was recently reported that local and national health care cost increases were expected to be between 10 and 12 percent in 2011. Based on recent premium notices, we estimate that our employee health and welfare benefit costs for 2011 will increase by approximately 5 percent, including potential changes imposed by health care reform.



Table of Contents

In addition, our pension costs are expected to increase in 2011. However, effective January 1, 2011 the OPUC approved the deferral of utility pension expense above the amount recovered in rates, which was set in our last general rate case. The pension expense deferral will be recorded to a regulatory balancing account, and we expect it will result in a \$4 to \$5 million decrease in operations and maintenance expense for 2011. For further explanation of the pension balancing account, see “Regulatory Matters—Rate Mechanisms—Pension Deferral,” above.

General Taxes

General taxes, which are principally comprised of property and payroll taxes and regulatory fees, decreased \$4.4 million, or 16 percent, in 2010 compared to 2009, and increased \$1.6 million, or 6 percent, in 2009 compared to 2008. The major factors that contributed to changes in general taxes are:

Property Tax Refund

*2010 compared to 2009:*

- a \$5.2 million refund of property taxes received in 2010 pursuant to a favorable ruling from the Oregon Supreme Court regarding taxation of utility gas inventory held for sale (see below for further discussion), partially offset by an increase in property taxes related to a 2 percent increase in net utility plant balances.

*2009 compared to 2008:*

- a \$1.0 million or 5 percent increase in property taxes related to a 3 percent increase in net utility plant balances; and
- a \$0.5 million increase in payroll taxes due to higher incentive compensation and employee severance compensation in 2009.

Over the past several years, we had been involved in litigation with the Oregon Department of Revenue over whether inventories held for sale were required to be taxed as personal property. In January 2010, the Oregon Supreme Court unanimously ruled in our favor, stating that these inventories were exempt from property tax. As a result of this ruling, we were entitled to a refund of approximately \$5.2 million, plus accrued interest, for property taxes paid on inventories beginning with the 2002-03 tax year. We recognized a net \$6.1 million increase in pre-tax income in the first quarter of 2010, which consisted of \$5.2 million for the refund of property taxes, \$1.9 million for accrued interest income, and \$1.0 million of increased operations and maintenance expense for legal and consulting services. We received all of the property tax refunds.

Depreciation and Amortization

Total depreciation and amortization expense in 2010 increased by \$2.3 million, or 4 percent, as compared to a \$9.3 million or 13 percent decrease in 2009 over 2008. The increased expense in 2010 was primarily related to Gill Ranch going into service in the fourth quarter of 2010 plus the additional investments in utility plant for customer growth and system improvements. The decreased expense in 2009 was primarily related to the adoption of the new depreciation rates, which were approved by the OPUC, WUTC and FERC effective January 1, 2009 (see “Regulatory Matters—Rate Mechanisms,” above).

Table of ContentsOther Income and Expense – Net

The following table provides details on other income and expense – net for the last three years:

Thousands	2010	2009	2008
Gains from company-owned life insurance	\$ 2,042	\$ 3,416	\$ 2,190
Interest income	2,024	211	250
Income from equity investments	588	1,329	667
Net interest on deferred regulatory accounts	4,692	2,051	552
Gain on sale of investments	223	45	1,737
Other non-operating	(2,467)	(3,338)	(1,650)
Total other income and expense - net	<u>\$ 7,102</u>	<u>\$ 3,714</u>	<u>\$ 3,746</u>

*2010 compared to 2009:*

Other income and expense – net increased \$3.4 million, primarily due to \$1.9 million of interest income related to property tax refund plus a \$2.6 million increase in interest from regulatory account balances largely due to smaller balances in gas costs between 2010 and 2009, partially offset by a \$1.4 million decrease in income from life insurance due to higher policy gains realized in 2009.

**Interest Income***2009 compared to 2008:*

Other income and expense - net decreased by less than \$0.1 million in 2009 over 2008. The decrease was primarily due to a net increase in other non-operating expense for higher business development costs and other strategic planning expense in 2009, and from a gain on sale of an aircraft realized in 2008. These were partially offset by increases in income from life insurance, income from our equity investment in Palomar and interest income from deferred regulatory account balances.

Interest Expense – Net

Interest expense—net of amounts capitalized in 2009 increased by \$1.9 million, or 5 percent, compared to 2009, and increased in 2009 by \$3.1 million, or 8 percent, compared to 2008. Increases in interest expense over the last two years reflect the issuance of long-term debt during 2009, which included \$75 million of 5.37 percent medium term notes (MTN's) issued in March and \$50 million of 3.95 percent MTN's issued in July, and higher short-term debt balances in 2010. Higher interest expense also reflects a lower average interest rate used in calculating the allowance for funds used during construction, which is referred to as AFUDC. AFUDC rates, comprised of short-term and long-term capital costs as appropriate, were 0.6 percent in 2010, 1.0 percent in 2009 and 3.6 percent in 2008.

Income Tax Expense

The increase in income tax expense of \$2.8 million or 6 percent, compared to 2009 was primarily due to higher pre-tax consolidated earnings and an increase in our effective tax rate of 40.5 percent in 2010 compared to 38.3 percent in 2009. Income tax expense increased \$6.0 million, or 15 percent, for the year ended December 31, 2009 compared to 2008, primarily due to higher pre-tax consolidated earnings and a slightly higher effective tax rate of 38.3 percent in 2009 compared to 36.9 percent in 2008.

For the 2010 tax year, the higher effective tax rate was primarily the result of increased amortization of our regulatory tax account on pre-1981 utility plant assets (see "Regulatory Matters—Rate Mechanisms," above) and a lower non-taxable gain on company-owned life insurance. For the 2009 tax year, the higher effective tax rate was primarily the result of an increase in the Oregon corporate income tax rate (see below for further discussion), an increased amortization of our regulatory tax asset account on pre-1981 plant assets, and an adjustment to deferred income taxes attributed to our non-regulated business segments. For more information on our income taxes, including a reconciliation between the statutory federal and state income tax rates and the effective rate, see Note 2 and Note 10.

**NATASHA SIORES**  
Senior Rates Analyst  
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email: ncs@nwnatural.com



July 13, 2011

Public Utility Commission of Oregon  
550 Capitol Street, NE, Suite 215  
Post Office Box 2148  
Salem, Oregon 97308-2148

ATTN: Vikie Bailey-Goggins  
Administrator, Regulatory Operations Division

RE: **2010 Results of Operations Report: Staff Data Request Nos. 6**

NW Natural submits the following responses to Staff's request for information in the above-referenced matter.

- On page 63 of NWN's 2010 Annual Report submitted to SEC (10k), the Company states that it experienced "a[n] \$1.0 million increase for consulting and legal fees at the utility related to a successful property tax appeal". Please explain whether this expense is included in the 2010 Results of Operations report. If so, please explain provide the FERC account number(s) and an explanation of the categories of costs that were impacted by this expense.

**Response**

Yes, due to an administrative error, the expense described is included in the 2010 Results of Operations. This expense should have been excluded from the Results of Operations, consistent with the treatment of the relevant property tax refund, which was excluded.

The expense was included as Operations and Maintenance Expense in FERC account 921. As such, the expense flowed through the Company's state allocation for O&M expense and the Oregon allocation below is the amount erroneously included in the 2010 Results of Operations.

	Total Expense	Oregon allocation	Washington allocation
FERC 921	\$975,000	\$896,794	\$98,206
Allocation factor	3-factor formula	90.13%	9.87%

As a result of finding this administrative error, the Company will file a revised 2010 Results of Operations to exclude these expenses from its Results of Operations.

Please call if me if you have questions.

Sincerely,

*/s/ Natasha Siores*

Natasha Siores  
Rates and Regulatory Affairs

cc: Stephanie Andrus, Department of Justice  
Bob Jenks, CUB  
Paula Pyron, NWIGU



# Oregon

John A. Kitzhaber, MD, Governor

Attachment G  
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**Public Utility Commission**

550 Capitol St NE, Suite 215  
Mailing Address: PO Box 2148  
Salem, OR 97308-2148  
Consumer Services  
1-800-522-2404  
Local: 503-378-6600  
Administrative Services  
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July 19, 2011

ONITA KING  
NW NATURAL  
220 NW 2ND AVENUE  
PORTLAND OR 97209

LISA RACKNER  
MCDOWELL, RACKNER & GIBSON  
419 SW 11<sup>TH</sup> AVE., SUITE 400  
PORTLAND, OR 97205

RE:	<u>Docket No.</u>	<u>Staff Request No.</u>	<u>Response Due By</u>
	2010 Results of Operations Report	DR 8	August 2, 2011

Please provide responses to the following request for information. Contact the undersigned before the response due date noted above, if the request is unclear or if you need more time.

8. Please refer to Page 55 of NWN's most recent 10k filing. Beneath the heading "Other Income and Expense", NWN reports:

*2010 compared to 2009:*

Other income and expense – net increased \$3.4 million, ***primarily due to \$1.9 million of interest income related to property tax refund*** [emphasis added] plus a \$2.6 million increase in interest from regulatory account balances largely due to smaller balances in gas costs between 2010 and 2009, partially offset by a \$1.4 million decrease in income from life insurance due to higher policy gains realized in 2009.

Please explain whether this interest income has been included in NWN's previous responses related to the \$5.2 million in property tax refund.

Please provide an original and one complete copy of your response to the attention of Vikie Bailey-Goggins, PO Box 2148, Salem, OR 97308-2148, or 550 Capitol St NE Ste 215, Salem, OR 97301-2551, **and** send via electronic mail to ([puc.datarequests@state.or.us](mailto:puc.datarequests@state.or.us)). Confidential responses should not be sent via electronic mail. Confidential responses must be file filed on yellow paper or on a CD clearly marked "Confidential".



Northwest Natural  
2010 Results of Operations Report  
July 19, 2011  
Page 2

One complete copy also needs to be filed to the attention of counsel for PUC Staff, Stephanie Andrus, Department of Justice, 1162 Court St NE, Salem, OR 97301-4096; **and** electronically at ([Stephanie.Andrus@state.or.us](mailto:Stephanie.Andrus@state.or.us)).



Carla Bird  
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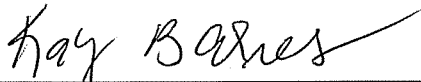
cc: Bob Jenks, CUB  
Paula Pyron, NWIGU

**CERTIFICATE OF SERVICE**

**UM 903  
Opening Comments**

I certify that I have this day served the foregoing document upon all parties of record in this proceeding by delivering a copy in person or by mailing a copy properly addressed with first class postage prepaid, or by electronic mail pursuant to OAR 860-001-0180, to the following parties or attorneys of parties.

Dated this 27th day of July, 2011 at Salem, Oregon.



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Kay Barnes  
Public Utility Commission  
Regulatory Operations  
550 Capitol St NE Ste 215  
Salem, Oregon 97301-2551  
Telephone: (503) 378-5763

UM 903  
SERVICE LIST (PARTIES)

<p><b>AVISTA UTILITIES</b></p> <p>ELIZABETH ANDREWS</p>	<p>PO BOX 3727 SPOKANE WA 99220-3727 liz.andrews@avistacorp.com</p>
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