ITEM NO. CA1

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 7, 2015

REGULAR ____ **CONSENT** X **EFFECTIVE DATE** N/A

DATE: June 18, 2015

TO: Public Utility Commission

FROM: Judy Johnson

THROUGH: Jason Eisdorfer and Marc Hellman

SUBJECT: AVISTA UTILITIES: (Docket No. UM 903) 2015 Spring Earnings Review.

STAFF RECOMMENDATION:

I recommend the Commission accept Staff's finding that Avista Utilities' earnings for the 12 months ended December 31, 2014, are below the earnings threshold established in UM 903 and there should be no earnings shared in this filing.

DISCUSSION:

Introduction

In this public meeting memorandum, Staff reports its calculations of (1) Avista's adjusted return on equity ("Earnings Threshold"), and (2) adjusted revenues for the 2014 fiscal year, both of which are used to determine whether Avista must share a portion of its 2014 fiscal year earnings with customers under Avista's Purchased Gas Adjustment mechanism. Based on these calculations, Staff concludes that Avista should not be required to share its 2014 earnings with customers in connection with its PGA.

Background

Avista and the other two Oregon-regulated natural gas distribution companies recover gas costs under an automatic adjustment clause known as the Purchased Gas Adjustment (PGA). The purpose of the PGA is to permit each natural gas utility to adjust revenue annually to reflect actual increases or decreases in gas costs.

The PGA has two components.[1] The first component is prospective and resets base gas costs each year to reflect changes in the utility's cost of purchased gas.[2] 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 and a portion of the differences between actual commodity-related costs and the base level in rates.[3] To ensure that earnings of a natural gas utility are not excessive prior to passing through prudently incurred base gas costs, Commission rule (OAR 860-022-0070) requires that an earnings review be conducted on an annual basis.[4]

Pertinent rules and Commission orders

The Commission adopted the PGAs in 1998 and the implementing rules in 1999.[5] The Commission has modified the PGAs and rules through the years.[6] Components of the PGA's are as follows:

<u>Annual Election</u>
Each Local Distribution Company (LDC) shall make an annual election to determine how the cost variance between the weighted average cost of gas (WACOG) that will be included in rates and the actual WACOG experienced during the upcoming gas year (WACOG Variance) should be allocated between the LCD and its customers (WACOG Sharing). This election must be made by August 1 and the LDC may choose either 90/10 or 80/20.[7]

<u>Spring Earnings Review</u>
An earnings review will 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 (e.g., the 2013 election will apply to the 2014 Fiscal Year results of operations which are the subject of the 2015 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.

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[1] *See e.g.,* Order No. 03-198 at 1 (Docket No. AR 449).
[2] Order No. 03-198 at 1.
[3] Order No. 03-198 at 1.
[4] Order No. 03-198 at 1.
[5] Order Nos. 98-503 and 99-284 (Dockets UM 903 and AR 357).
[6] See e,g., Order Nos. 07-019, 08-504 (Docket Nos. AR 512 and UM 1286).
[7] 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.

The Earnings Threshold
An LDC that elects 90/10 WACOG Sharing will be subject to an Earnings Threshold 100 basis points above its ROE, adjusted to reflect changes in conditions in capital markets.[8] An LDC that elects 80/20 WACOG sharing is subject to an Earnings Threshold 150 basis points above its ROE, adjusted in the same manner.

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.[9]

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. Avista 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.[10] If adjusted earnings are above the Earnings Threshold, the amount of revenue in the test year representing 33 percent of the earnings exceeding the threshold will be shared with customers (Earnings Sharing).

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.[11]

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[8] 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)).
[9] OAR 860-022-0070(6).
[10] OAR 860-022-0070(5)(c).
[11] OAR 860-022-0070(5)(e).

Staff's Review of Avista's Earnings

The Earnings Threshold for Avista for this 2015 Spring Earnings review (review of the 2014 results of operations) is 10.77 percent. Avista elected a 90/10 WACOG Sharing beginning November 1, 2013. Accordingly, ,calculation of Avista's Earnings Threshold began with Avista's authorized ROE of 9.65 percent,[12] the addition of 100 basis points (based on a 90/10 WACOG Sharing election), further adjusted by 20 percent of the change to the risk free rate for the twelve-month period preceding the annual earnings review, or in this case 0.08 percent.

Pursuant to the rules, Avista submitted its 2014 Results of Operations (ROO) report for the12 months ended December 31, 2014. Avista calculates its ROE as 4.66 percent after the application of its Type I adjustments, excluding weather normalization.

Staff reviewed the Company's ROO report and concludes that Avista's reported ROE has been calculated correctly. Because Avista's adjusted ROE is below the Earnings Threshold of 10.77 percent, no Earnings Sharing is required.

As required by OAR 860-022-0070(6), Staff submitted these findings to the parties in Docket No. UM 903 on June 10, 2015, and received no comments in response.

PROPOSED COMMISSION MOTION:

Accept Staff's finding that Avista's 2014 earnings are below the Earnings Threshold designated in UM 903, and therefore no Earnings Sharing applies to the 2014 Fiscal Year.

Avista UM 903, 2015 Spring Earnings Review

[12] ROE established at 9.65 percent by Order No. 14-015 (UG 246).