ITEM NO. CA3

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 JJ

THROUGH: Jason Eisdorfer and Marc Hellman

SUBJECT: NORTHWEST NATURAL: (Docket No. UM 903) 2015 Spring Earnings Review.

STAFF RECOMMENDATION:

I recommend the Commission accept Staff's finding that Northwest Natural's 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) Northwest Natural's adjusted return on equity ("Earnings Threshold"), and (2) adjusted revenues for the 2014 fiscal year used to determine whether Northwest Natural must share a portion of its 2014 fiscal year earnings with customers under Northwest Natural's Purchased Gas Adjustment mechanism. Based on these calculations, Staff concludes that Northwest Natural should not be required to share its 2014 earnings with customers in connection with its PGA.

Background

Northwest Natural 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] Various components of the current PGAs are as follows:

Annual Election
Not later than August 1st of each year, each Local Distribution Company (LDC) shall make an annual election for the applicable gas year beginning November 1st whether to choose 90/10[7] Weighted Average Cost of Gas (WACOG) sharing or 80/20 (WACOG) sharing with a corresponding earnings review threshold

Spring Earnings Review
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 sharing election previously made by the LDC (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.

[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] Sharing of the variance between the LDC's weighted average cost of gas (WACOG) included in its rates and its actual WACOG. For example, 90/10 designates 90 percent of the variance will be deferred for subsequent charge or credit to customers, and 10 percent is absorbed or retained by the LDC.
See Order 08-504 at 17. 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)).

The Earnings Threshold

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

Structure of Earnings Reviews

By May 1st of each year, the LDC will file results of operations for the twelve months ended the prior December 31st. Staff will complete its review and distribute summary conclusions by June 10th 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 1st and the Commission would issue its decision on unresolved issues by August 15th. These rate changes will include amortization of credit amounts in the deferred account, if any, resulting from the spring earnings review.[8]

Earnings Adjustments

Recorded results of operations will be adjusted for Type 1 adjustments as set forth in Order No. 99-272, Appendix B. NW Natural made a one-time election to include a weather normalization adjustment in its spring 1999 earnings review filing and each subsequent annual filing.

Earnings Performance

If adjusted earnings are below the Earnings Threshold, there will be no rate adjustment.[9] 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 level will be shared with customers.

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 1st. The rate adjustment and amortization will be effective with the date of the subsequent base gas cost change.[10]

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

Staff's Review of NW Natural's Earnings

The Earnings Threshold for the Company for this 2015 Spring Earnings review (review of the 2014 results of operations) is 10.58 percent. Northwest Natural elected a 90/10 WACOG Sharing beginning November 1, 2013. Accordingly, the calculation of Northwest Natural's Earnings Threshold begins with NW Natural's weighted average Return on Equity (ROE), which is 9.5 percent. This ROE is then added to 100 basis points and then 20 percent of the change in United States Treasury Risk Free Rate is subtracted. These calculations produce an Earnings Threshold of 10.58 percent for NW Natural.

NW Natural submitted its 2014 Results of Operations (ROO) report for the 12 months ended December 31, 2014. The Company states that its report is meant to satisfy the reporting requirements associated with the UM 903 investigation (Order No. 99-272) and AR 357 (Order No. 99-284) as well as the "standard Oregon annual reporting requirements". NW Natural calculates its ROE as 9.57 percent after the application of its Type I adjustments, including weather normalization and the Encana adjustment as specified in Order No. 11-176.

Staff reviewed the Company's revised earnings report and concludes that NW Natural's reported ROE has been calculated correctly. Because the Company's adjusted ROE is below the Earnings Threshold of 10.58 percent, earnings sharing are not 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 NW Natural's 2014 earnings are below the Earnings Threshold designated in UM 903, and that there is no earnings sharing for the 2014 Fiscal Year.