ORDER NO. 02-672

ENTERED SEP 27 2002

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 151/ UM 1062

In the Matter of	)	
	)	ORDER
NORTHWEST NATURAL GAS COMPANY	)	
	)	
Filing for revisions and additions to its Tariffs P.U.C. Or. 22 and P.U.C. Or 23. **UG 151**	)	
	)	
Application for Reauthorization to Defer Certain Expenses or Revenues. **UM 1062**	)	

DISPOSITION: APPLICATIONS APPROVED

On August 19, 2002, the Public Utility Commission of Oregon (Commission) received two applications from Northwest Natural Gas Company proposing: (1) a rate decrease, effective October 1, 2002; and (2) authorization to use deferred accounting pursuant to its Purchased Gas Adjustment balancing account. The filing decreases the company's annual revenues by $100.1 million, or 15.5 percent.

Based on a review of the applications and the Commission's records, the Commission finds that the applications satisfy applicable statutes and administrative rules. At its special public meeting on September 26, 2002, the Commission adopted Staff's recommendation to approve the applications. Staff's recommendation is attached as Appendix A and is incorporated by reference.

ORDER

IT IS ORDERED that:

1. Amortization of deferred accounts, base gas cost changes, and rate changes as requested in Docket No. UG 151 is approved.

2. The reauthorization of deferred accounting for Northwest Natural Gas Company's Purchased Gas Balancing Account mechanism, Schedule No. 177, for one year beginning October 1, 2002, is approved.

3. The associated tariff sheets of Advice No. 02-12 are allowed to go into effect October 1, 2002.

Made, entered and effective ________________________________.

____
Roy Hemmingway
Chairman

____
Lee Beyer
Commissioner

____
Joan H. Smith
Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements of OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order to a court pursuant to applicable law.

ITEM NO. 5 and 6

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 26, 2002

REGULAR __X__ **CONSENT** ____ **EFFECTIVE DATE** **October 1, 2002**

DATE: September 18, 2002

TO: John Savage through Lee Sparling, Ed Busch and Bonnie Tatom

FROM: Ray Nuñez and Judy Johnson

SUBJECT: NORTHWEST NATURAL: (Docket No. UG 151/ Advice No. 02-12): Reflects the changes in the cost of purchased gas and technical adjustments; makes adjustments to base distribution rates for Mist IIIb recovery, bare steel and geo-hazard risk mitigation. The total effect of the proposed adjustments is a decrease of $100,139,201, or 15.5 percent. (Docket No. UM 1062) Requests reauthorization of the PGA deferral mechanism.

STAFF RECOMMENDATION:

We recommend the Commission allow Northwest Natural's (NWN, NW Natural, or company) proposed tariff sheets in Advice No. 02-12 to become effective with service on and after October 1, 2002. This filing decreases the company's annual revenues by $100.1 million, or 15.5 percent.

We also recommend the Commission approve the company's request for reauthorization to use deferred accounting pursuant to its Purchased Gas Adjustment (PGA) balancing account.

DISCUSSION:

On August 19, 2002, NW Natural submitted its annual gas cost tracking and technical adjustment filing, commonly known as its PGA filing. In Advice No. 02-12 (docketed as UG 151), the company proposed to decrease annual rates effective October 1, 2002, to reflect changes in the cost of purchased gas, recovery of its investment in bare steel replacement and Geo-Hazard Mitigation Program, a refund of the gain realized on the sale of the company's Vancouver service center, a long run incremental cost (LRIC) adjustment to certain schedules based on the results of the company's most recent LRIC study, and technical adjustments in its deferred revenue and gas cost accounts. In a separate filing docketed as UM 1062, NW Natural requested reauthorization of deferrals under its PGA mechanism for the 12 months beginning October 1, 2002.

UG 151

This application requests authority to decrease rates to: (1) track decreases in purchased gas costs; (2) recover investment in bare steel replacement and geo-hazard mitigation; (3) refund the gain realized on the sale of the company's Vancouver service center; (4) include a long run incremental cost (LRIC) adjustment to certain schedules based on the results of the company's most recent LRIC study; and (5) make technical adjustments to amortize NWN's deferred revenue and gas cost accounts. The change in annual revenues is summarized below and shown in Attachment A, page 1 of 2.

PGA Base Gas Cost Decrease	$ (94,194,999)
Recovery of Bare Steel Replacement Program Investment	458,617
Recovery of Geo-Hazard Mitigation Program Investment	298,218
Refund of gain on sale of Vancouver service center	(1,444,151)
LRIC Adjustment	33,501
Removal of Prior Year Temporary Increment	(3,235,030)
Adding New Temporary Increment	(2,055,357)
TOTAL Proposed Decrease	$ (100,139,201)

Summary of Bill Effects

With these PGA-related changes, the monthly bill of a typical residential customer on Schedule No. 2 using 59.8 therms per month will decrease by $9.08, or 14.1 percent. A typical customer's bill would decrease from $64.59 to $55.51. During January, a typical customer's usage would be 120.0 therms and the bill would decrease from $124.58 to $106.35. A summary of the proposed tariff changes for NW Natural's major rate schedules is shown in Attachment A, page 2 of 2. A summary of the impact of the rate changes on NW Natural's customers on both an annual and January basis is shown in Attachment B, along with the current rates and rate and bill impacts on Cascade and Avista Utilities customers of their PGA filings (addressed in agenda items 1 and 3).

However, as a result of the Commission's Order No. 02-634 in Docket UG 143 that approved an elasticity mechanism, bill payment assistance and public purpose charges, NW Natural's customers will see less of a decrease than is indicated in Attachment B. Staff has included Attachment C to show the net impact on rates and bills for NW Natural's customers to be effective on October 1, 2002.

Staff Review of Gas Costs

National/Regional/Local Trends

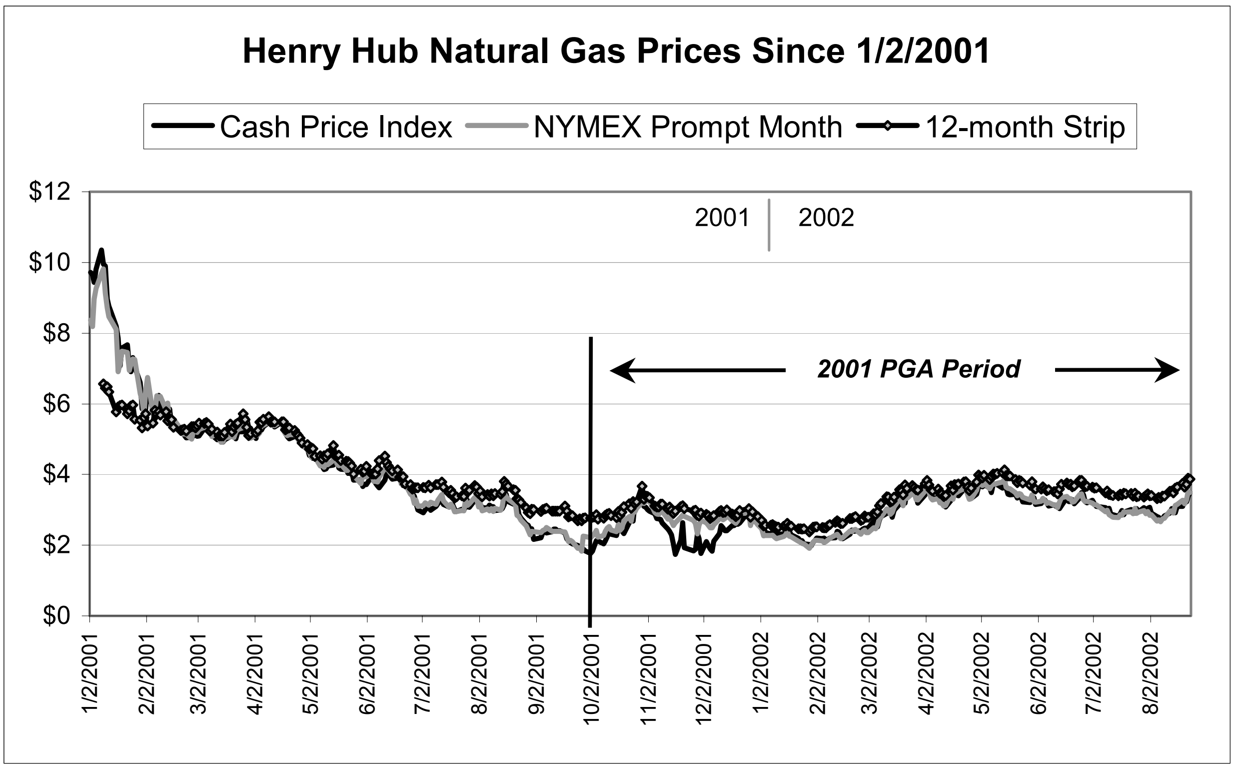
Wholesale prices for natural gas did not exhibit the extreme volatility this past year that was experienced in the winter of 2000-2001, when cash prices for delivery at Sumas were bouncing around $50.00/MMbtu. In contrast, wholesale prices last heating season reflected a relatively mild winter, record storage inventories and an absence of industrial gas demand in a floundering economy. Supplies outpaced demand and the unprecedented storage inventory compressed wholesale natural gas prices. At the same time, many wholesale customers acted on lessons learned the previous winter and entered into longer-term contracts to hedge the risk of cash market volatility. By effectively removing those loads from active trading in both cash and futures markets, the increase in long-term pre-purchasing actually exacerbated the deteriorating demand picture and weakened support for natural gas prices.

The $5.00/MMbtu to $7.00/MMbtu cash prices for the 2001–2002 heating season that were predicted by several trading houses as late as July 2001, never materialized. At the same time, storage volumes remained high, as cash prices undercut the withdrawal price of much of the huge volume in storage. (Consequently, almost 1.5 Trillion cubic feet of that expensive gas remains in storage going into the 2002-2003 heating season.)
Within West Coast markets, the implementation of electric price-caps in December of 2001 further pulled the rug out from under prices for Northwest delivery of natural gas, by eliminating the motivation for electric generators to bid natural gas up to the exorbitant levels seen in the winter of 2000-2001.

Since October 1, 2001, cash prices for Northwest delivery have ranged from a nickel shy of $3.50/MMbtu at Stanfield down to a one-time low of $0.53/MMbtu for NW Domestic gas. In a complete reversal from traditional trends, wholesale natural gas prices bottomed in January, and have been progressively increasing since. Meanwhile, the failure of industrial loads to return to the marketplace, as predicted, has enabled the diversion of large volumes of gas into storage facilities.

Yet despite this continuing absence of industrial load, the federal Energy Information Administration (EIA) projects that U.S. demand for natural gas will increase by 3% during 2002. At the same time, the EIA projects that domestic gas production will have fallen by 2.3% by year's end, and some industry analysts estimate that decline in production is now between 3% and 4%. The increasing demand and declining production are currently on a collision course, with that huge mountain of gas in storage serving to both obscure and delay the point of impact.

On September 3, 2002, the price for the twelve-month strip for natural gas futures at NYMEX settled at $3.695/MMbtu, and the winter strip for 2002–2003 delivery settled at $3.768/MMbtu, after topping $4.00/MMbtu the previous week.



<u>NW Natural's Gas Cost Situation</u>

This year, NW Natural obtained approximately 64% of its gas supply from Canada, 35% from Rocky Mountain regions and 1% from local production in the Mist field. NW Natural increased its take from the Rocky Mountain sources to capture downward movements in price. As a result, takes from Alberta-sourced gas shrank by one third. British Columbia-sourced volumes did not change. Prices for Canadian-sourced gas are down $.76 to $2.50/ MMbtu from the high gas price environment of 2001.

All of NW Natural's annual gas supply volumes change price at least once a year. As a result, these annual renegotiations took place in an environment of moderating natural gas prices. NW Natural uses the Mist storage resource and financial derivatives to minimize gas costs and price volatility. Hedging activities for the year include a large increase of call option trade volumes and a much lower increase of swap trade volumes. In addition, volumes fixed in price, either directly with suppliers or through swaps, decreased by 2%.

Swaps are increasingly used to serve the purpose of spreading the price risk of fixed price contracts.

NW Natural's 2001-2002 gas costs reflect changes in the mix of purchase volumes. First, baseload supply resources, as captured by the annual supply contracts, show gas volumes decreased 11% over the last PGA period. Annual contract volumes follow established trends, yet there was an effort to reduce volumes on annual contracts that have high prices. Next, storage usage patterns show storage withdrawals increased a modest 4%. Winter swing volumes increased by 10% and are still way below the levels in prior years. On the whole, purchase volumes show a 12.2 million or 1.6% decrease. In general, NW Natural's purchasing strategy has been to maximize, to the extent possible, the trend of falling gas prices, while creating flexibility to balance the need for gas reliability.

Staff's Review of NW Natural's Gas Costs

NW Natural, together with the other two regulated gas utilities, is required to file for rate changes related to purchased gas costs each year. In work papers submitted to Staff, NW Natural shows a gas cost total of $267,544,208, which represents a 28% decrease over last year. The annual cost of gas includes both natural gas commodity and transportation costs.

Staff reviewed the PGA filing to determine the merits and basis for the proposed gas cost decrease. Staff examined the gas supply contracts, the prices paid for the gas, and volumes of gas delivered and used for customers. Staff also duplicated the calculations and examined supporting documents and cost data used in the spreadsheet models for the gas cost exhibits. In addition, Staff analyzed the company's purchasing operations and submitted data requests to NW Natural. Quarterly and monthly operational reports were also examined. Finally, reviews of the gas cost spreadsheet model occurred throughout the year.

Last year, NW Natural had purchased actual volumes totaling 751,528,817 therms and a weighted average cost of gas of $0.52391. The weighted average cost of gas, or WACOG, is the annual commodity cost per therm. This year, the company has contracted with suppliers for volumes totaling 739,297,068 therms at a weighted average cost of gas of $0.37668. The number of therms actually decreased 1.6%, while the WACOG decreased 28%. Overall, NW Natural's annual commodity cost decreased by $104,166,965. This number, when added to the adjustments for uncollectibles, city franchise fees, gross revenue fees and demand charges, results in the decrease in the base gas cost shown in Attachment A. With falling gas prices, NW Natural purchased 73% more spot volumes than in the 2001 PGA period. This is significant because in the

2001 PGA period, spot purchase volumes were reduced more than half due to then rising gas prices. Consequently, by increasing spot purchase volumes by 73% at much lower prices during this 2002 PGA period, NW Natural reduced the cost of spot resources by one-third. NW Natural also increased purchase volumes of winter base supply by 46%, while slightly increasing this resource cost by less than half of one percent. Also, NW Natural's decision to reduce its purchases of annual contract supplies by 11%, resulted in a 35% drop of this resource cost. NW Natural's change of the resource mix as reflected in its purchases for this year's PGA period captured the drop in gas prices.

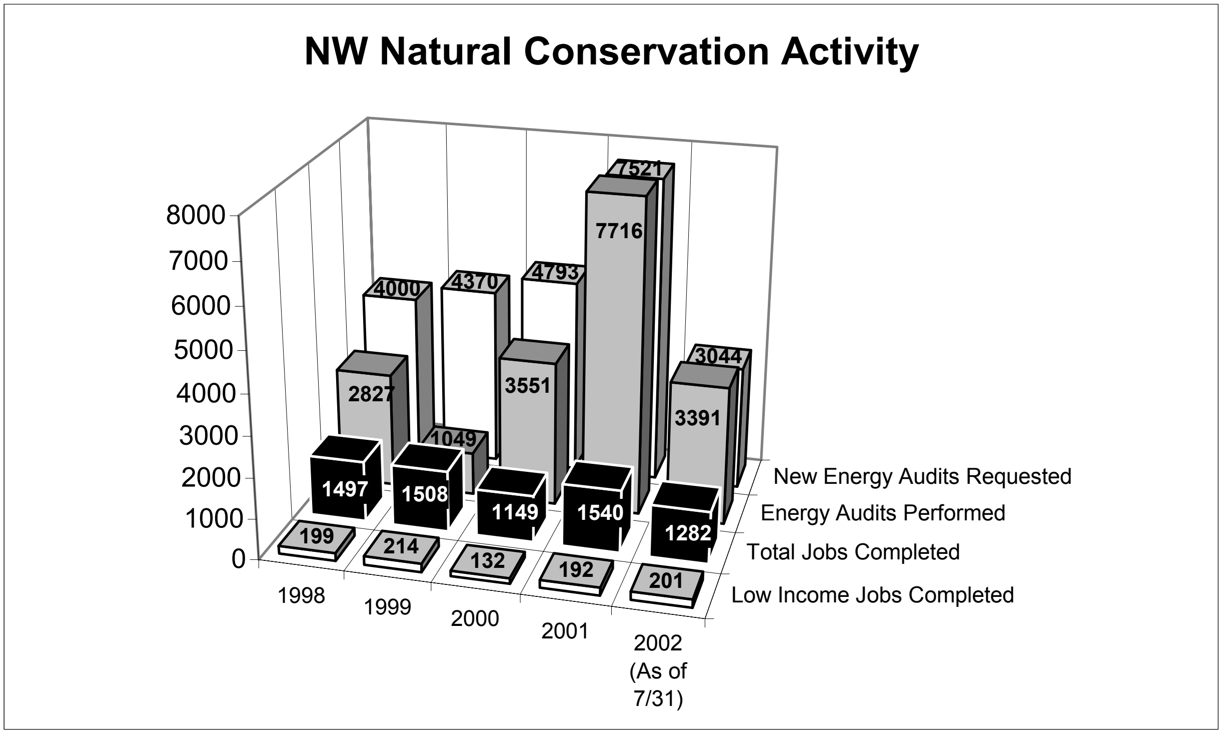
Following is a table of NW Natural’s Weighted Average Cost of Gas since 1993. These numbers are unadjusted for the effects of inflation. Staff concludes that NW Natural’s proposed WACOG of $0.37668 is an accurate reflection of the company’s annual commodity cost. Staff has inspected NW Natural’s proposed tariff sheets and verified their accuracy.

Year	WACOG	% Change
1993	.17654	
1994	.15241	-14%
1995	.11635	-24%
1996	.11051	-5%
1997	.16344	48%
1998	.17906	10%
1999	.22314	25%
2000	.34767	56%
2001	.52391	51%
2002	.37668	-28%

How does NW Natural expect to work with its customers in the next year?

- The company anticipates transferring the responsibility for the mandated energy audits under its Residential Energy Conservation and Commercial Energy Conservation Services Programs to the Energy Trust of Oregon over the next year, under the terms of the settlement adopted in UG 143.

  Conservation activities, including both energy audits and work completed, were significantly increased in 2001. This may be attributable to a combination of higher rates and a general economic downturn.

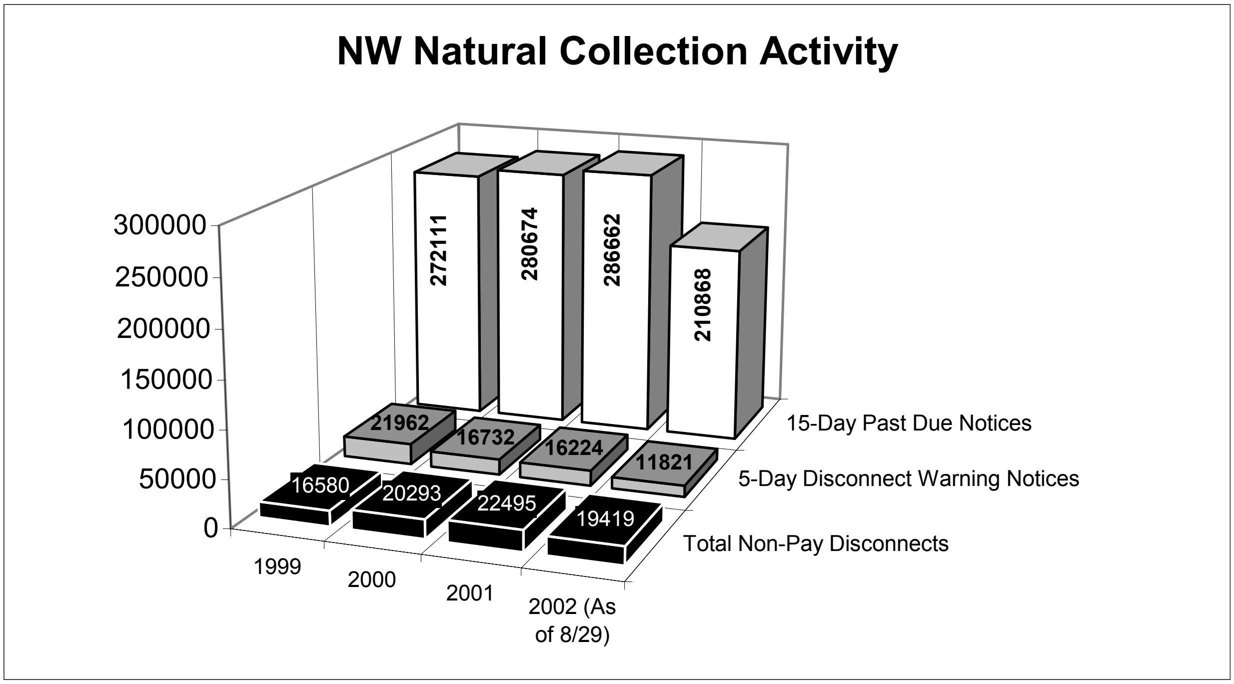


- The company has included an Oregon Low Income Gas Assistance program consistent with UG 143.

- The company will also continue to promote its *Gas Assistance Program (GAP)*, a below-the-line program that helps low-income customers pay their winter gas bills. In this program, customers can contribute to this fund, which the company matches with shareholder dollars. Industry contributions, primarily from the pipelines, have also been received the past two years. For 2002, the company contribution will be $55,000, bringing the total funds available in this program to date for the coming heating season to $144,924.

- The company will continue to offer its customers the required *Level Payment Plan* designed to average the monthly payments for gas service of any residential customer. By the end of July 2002, participation in the company's Level Payment Plan was within 2% of 2001 annual levels.

- NW Natural will also provide customers the required 12-month payment arrangements on arrearages. As of August 29, 2002, customer participation in arrearage Time Payment Agreements was already 12% above total 2001 levels. Monthly averages for involuntary disconnections of service for non-payment were 14% below last year's levels, levels of 5-day disconnect warning notices were down 27% and levels of 15-day disconnect warning notices were down 26% (also as of late August).



Technical Adjustments - Deferred Accounts

NW Natural's application proposes to make technical adjustments in amortizing credit and debit balances in its deferred accounts. This activity consists of the following components, as shown on Attachment A, page 1 of 2:

- Removal of temporary increments currently in place, decreasing revenues by approximately $3.2 million.
- Addition of new temporary increments to refund $2.1 million in net credit balances in the company's deferred revenue and gas cost accounts. The Commission previously authorized all of the deferred amounts subject to amortization.

Staff has reviewed the company's technical adjustments and determined that the proposed amortizations are appropriate. The revised amortization increments are incorporated in the energy charge component of the company's primary rate schedules. The net revenue effect of adding the new temporary increments and removing the current increments is a decrease of $5.3 million on an annual basis.

Other Rate Adjustments

Refund on Gain on Sale of Vancouver Service Center

On December 28, 2001, NW Natural sold its Vancouver Washington Service Center to Clark County Public Transportation Benefit Area Authority (C-Tran) as settlement to a condemnation process. The Commission adopted a Staff recommendation to approve the sale. The after-tax net gain associated with Oregon's share was placed in a deferred account, with interest calculated at the company's authorized rate of return from the date of the sale until the gain is fully refunded to customers. The rate impact of this refund is a decrease of $1,444,151.

Bare Steel Replacement Program

Commencing this year and continuing until 2021, NW Natural is removing bare steel pipe from its distribution system. Bare steel pipe is leaky and requires higher levels of cathodic protection. Pursuant to a stipulation between the company, NWIGU and OPUC staff, this investment cost is allocated 70% on an equal cents per therm basis to residential and commercial customers only and 30% on an equal percent of margin basis to all rate schedules. The rate impact of the revenue requirement for this program is an increase of $458,617.

Geo-Hazard Repair and Risk Mitigation

Commencing this year and continuing until 2006, NW Natural is repairing and mitigating landslide hot spots, erosion and other geo-hazards. The rate impact of the revenue requirement for this program is an increase of $298,218.

LRIC Adjustment

This adjustment shifts costs from rate schedule 6, 90 and 91 (industrial customers) to residential and commercial customers. Pursuant to an agreement between OPUC staff, NWIGU and the company, the parties agreed to move toward LRIC study results. Specifically, rate schedule 6, 90 and 91 receive $877,227 downward movement toward LRIC-based rates. The net change in overall annual revenues is an increase of $33,501, essentially a revenue-neutral change.

Rate History

Natural gas rates paid by NW Natural's customers have increased at a slower pace than the commodity cost of purchased gas. The table at the top of the next page shows the rates the Commission has approved for the company's residential customers on Schedule 2 between 1994 and 2001.

Date	Customer Charge	Rate	+/-%
December 1, 1994	$4.00	$0.58869	
December 1, 1995	$4.00	$0.55247	-6.2%
July 1, 1996	$4.00	$0.54479	-1.4%
December 1, 1996	$4.00	$0.52604	-3.4%
December 1, 1997	$4.00	$0.58110	10.5%
April 1, 1998	$4.00	$0.61586	6.0%
December 1, 1998	$4.00	$0.63539	3.2%
December 1, 1999	$5.00	$0.68134	7.2%
October 1, 2000	$5.00	$0.82692	21.4%
December 1, 2000	$5.00	$0.82589	-0.1%
June 1, 2001	$5.00	$0.82529	-0.1%
October 1, 2001	$5.00	$0.99654	20.8%
October 1, 2002 (Proposed)	$5.00	$0.84459	-15.2%

Earnings Review and Three Percent Test

As a matter of policy, in past years the Commission conducted earnings reviews for both prospective purchased gas costs changes and PGA-related deferrals. In 1999, the Commission concluded its PGA Investigation in dockets UM 903 and AR 357. Order No. 99-284 issued in Docket No. AR 357 adopted a new rule, OAR 860-022-0070, Procedures and Standards for Reviewing Gas Utility Rates in the Context of the Purchased Gas Adjustment Mechanism. This rule enacted an annual spring earnings review to replace the earnings review related to prospective purchased gas cost changes[1]. In addition, Section (8) of this rule states: “An earnings review will not be applicable to amortization of deferred gas costs if the LDC assumes at least 33 percent of the responsibility for commodity cost differences in the risk sharing mechanism.” NW Natural has adopted a 33 percent sharing level and thus is exempt from an earnings review associated with this PGA filing.

ORS 757.259 (5) and (6) (as amended by House Bill 2630) states that the overall annual average rate impact of the amortizations authorized under the statute may not exceed three percent of the utility’s gross revenues for the proceeding calendar year, unless the Commission finds that allowing a higher amortization rate is reasonable under the circumstances. NW Natural's proposed amortizations are below the 3 percent cap and may be implemented as proposed.

[1] OAR 860-022-0070(7) states that the earnings review mechanism will be effective for four years, and that the mechanism will be reviewed for potential extension after the fourth year. The spring 2002 review was the fourth year the mechanism was applied. Accordingly, staff will contact interested parties to discuss whether the earnings reviews should be continued.

UM 1062

In this filing, NW Natural requests reauthorization of deferrals pursuant to its automatic adjustment clause, the Purchased Gas Adjustment (PGA) mechanism. The PGA allows the company to adjust tariffs annually for known and measurable changes in purchased base gas costs and for changes in amortization rates relating to the PGA balancing account.

The information contained in the application is consistent with the requirements of ORS 757.259, 757.210 and OAR 860-027-0300. The application states that continued deferral of these cost and revenue differences minimizes the frequency of rate changes and appropriately matches costs borne and benefits received by ratepayers, consistent with ORS 757.259(2)(e). The reasons cited for reauthorization are still valid. Staff recommends the Commission approve the request for reauthorizing the PGA, effective October 1, 2002.

PROPOSED COMMISSION MOTION:

NW Natural's request for: 1) amortization of deferred accounts, base gas cost changes, and other rate changes as requested in Docket No. UG 151 and 2) reauthorization of deferred accounting for NW Natural's Purchased Gas Balancing Account mechanism, Schedule No. 169, for one year beginning October 1, 2002, be approved and the associated tariff sheets of Advice No. 02-12 be allowed to go into effect October 1, 2002.

Attachments