ORDER NO. 03-587

ENTERED OCT 01 2003

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 156/UM 1106

In the Matter of	)	
	)	ORDER
NORTHWEST NATURAL GAS COMPANY	)	
	)	
Application for Tariff Revisions Related to Purchased Gas Adjustments, Technical Adjustments, and Adjustments to Base Rates for Bare Steel and Geo-hazard Risk Mitigation and Price Elasticity. **UG 156**	)	
	)	
Application for Reauthorization of Deferred Accounting for the PGA (Purchased Gas Adjustment) Mechanism. **UM 1106**	)	

DISPOSITION: APPLICATIONS APPROVED

On August 15, 2003, the Public Utility Commission of Oregon (Commission) received two applications from Northwest Natural Gas Company (NW Natural or company). A description of the filings and their procedural history is contained in the Staff Report, attached as Appendix A, and incorporated by reference.

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 public meeting on September 23, 2003, the Commission adopted Staff's recommendation to approve the applications.

ORDER

IT IS ORDERED that:

1. Amortization of deferred accounts, base gas cost changes, and other rate changes as requested in Docket No. UG 156 are approved.

2. The reauthorization of deferred accounting for NW Natural's Purchased Gas Balancing Account mechanism, Schedule No. 169, for one year beginning October 1, 2003, is approved.

3. Tariff sheets associated with Advice No. 03-19 and subsequent replacement sheets are allowed to go into effect October 1, 2003, with approval of the company's request for an LSN (Less than Statutory Notice).

Made, entered and effective ______________________________.

______________________	______________________
Lee Beyer Chairman	**John Savage** Commissioner
	______________________
	Ray Baum 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.

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 23, 2003

REGULAR __X__ **CONSENT** ____ **EFFECTIVE DATE** __October 1, 2003__

DATE: October 2, 2003

TO: Lee Sparling through Ed Busch and Bonnie Tatom

FROM: Reed Harris and Judy Johnson

SUBJECT: NORTHWEST NATURAL: (Docket No. UG 156/ Advice No. 03-19) Reflects changes in the cost of purchased gas and technical adjustments and makes adjustments to base rates for bare steel and geo-hazard risk mitigation and price elasticity.
(Docket No. UM 1106) Requests reauthorization of the PGA deferral mechanism.

STAFF RECOMMENDATION:

We recommend the Commission approve the company's request to waive statutory notice (LSN) and allow Northwest Natural's (NW Natural or company) proposed tariff sheets in Advice No. 03-19B to become effective with service on and after October 1, 2003. This filing increases the company's annual revenues by approximately $26.6 million, or 4.7 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 15, 2003, NW Natural submitted its annual gas cost tracking and technical adjustment filing, commonly known as its PGA filing. In Advice No. 03-19 (docketed as UG 156), the company proposed to increase annual rates effective October 1, 2003, to reflect changes in the cost of purchased gas, recovery of its investment in bare steel replacement and Geo-Hazard Mitigation Program, a price elasticity adjustment, and technical adjustments in its deferred revenue and gas cost accounts. In a separate filing docketed as UM 1106, NW Natural requested reauthorization of deferrals under its PGA mechanism for the 12 months beginning October 1, 2003.

On September 12, 2003, the company made a substitute filing, along with an application to waive statutory notice, to make corrections to the company's initial calculations for the effects of changes in purchased gas costs and for the further effect of removing old and applying new rate increments for bare steel, geohazard risk mitigation and price elasticity.

On September 15, 2003, the company made further corrections to its filing. The final filing, Advice No. 03-19B, increases revenues by $26,621,721, or 4.7 percent.

UG 156

This application requests authority to increase rates to: (1) track increases in purchased gas costs; (2) recover investment in bare steel replacement and geo-hazard mitigation; (3) make a price elasticity adjustment; and (4) make technical adjustments to amortize NWN's deferred revenue and gas cost accounts. The change in annual revenues is summarized below.

PGA Base Gas Cost Increase	$ 23,698,557
Bare Steel Replacement Program Increment Increase	471,383
Geo-Hazard Mitigation Program Increment Increase	37,782
Price Elasticity Adjustment	1,352,151
Removal of Prior Year Temporary Credit Increment	3,500,000
Adding New Temporary Credit Increment	(2,438,152)
Total Proposed Increase	$ 26,621,721

Summary of Bill Effects

With these PGA-related changes, the average monthly bill of a typical residential customer on Schedule No. 2 using 61.5 therms per month will increase by $2.67, or 4.5 percent. A typical residential customer's average monthly bill would increase from $60.04 to $62.71. In January, a typical residential customer's consumption of 131 therms would result in a billing increase from $121.11 to $126.80.

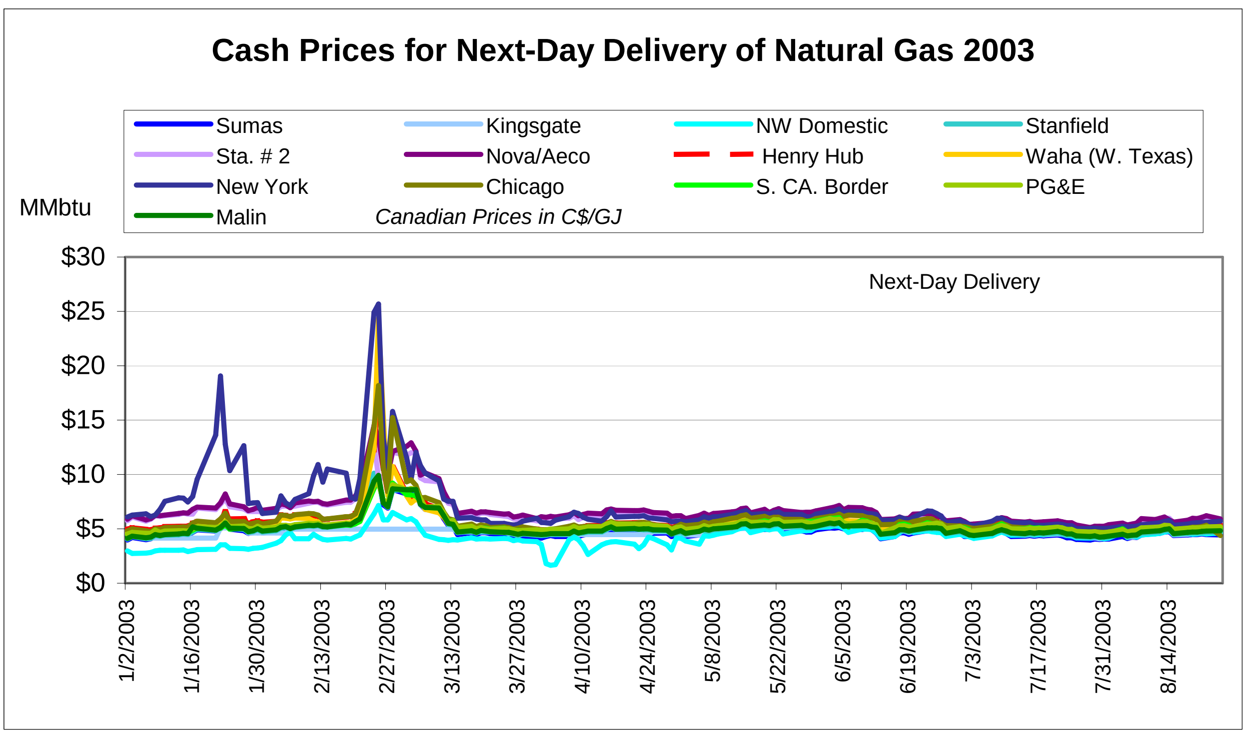
When these PGA changes are combined with the effects of the September 1, 2003 rate changes allowed by Order No. 03-507 in Docket UG 152, the total impact on NW Natural's typical residential customer's average monthly bill would be an increase of $4.19. That same typical residential customer's January bill can be expected to reflect an increase of $7.81, from $118.99 to $126.80, when compared to last January's bill. 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 A, along with the current rates and rate and bill impacts on Cascade and Avista Utilities customers of their PGA filings.

Staff Review of Gas Costs

National, Region and Local Trends

Extreme volatility in wholesale natural gas prices surfaced again this past year. The long winter that hammered the Northeast increased demand and strained supplies from both production and storage, with the result that natural gas prices soared in markets east of the Mississippi. In the final week of February, the cash index price for delivery at the Henry Hub in Louisiana spiked at $18.85/MMBtu. At the same time delivery to the New York City city gate hit $25.67/MMBtu and prices for next-day flows into New England reached $35+/MMBtu.

Withdrawals from storage to supplement pipeline supplies reached record volumes. As a result, the 3,172 Bcf storage inventory of October 25, 2002 was reduced to a record low inventory of 623 Bcf by April 11, 2003.



Prices for Northwest delivery were not immune from this volatility. With the increasing interconnectivity between pipelines and markets across the country, traders found that

West Coast markets are no longer isolated from eastern demand, and must compete with eastern markets for diminishing volumes of natural gas.

At the same time that prices at the New York City city gate hit $25+/MMBtu, cash-market deliveries at Sumas, which only the year before were going for $2.22/MMBtu, jumped to $9.68 and deliveries at Stanfield hit $9.37/MMBtu, compared to $2.02 the previous year.

While prices have retreated from the peaks of February and March, basis-adjusted prices for delivery to the Northwest in the coming heating-season were still running between $4.50 and $5.25/MMBtu at the end of August.

One additional factor impacting prices for natural gas delivered to Pacific Northwest points was the opening in May of the Kern River Pipeline expansion. The capacity expansion on Kern River's system effectively doubled the takeaway capacities for deliveries into the Nevada and California markets. By providing an additional outlet to the south, the Kern River expansion effectively eliminated the production "surplus" in the region. The effect on Oregon is that the previously inexpensive Rockies gas supplies are now being priced at parity with Canadian-sourced natural gas.

NW Natural's Gas Cost Situation

This year, almost 61% of NW Natural's gas supply came from Canada, 39% from the Rocky Mountain region and less than 1% from local production in the Mist field. NW Natural again increased its take from Rocky Mountain sources to capture downward movements in Rockies prices prior to the Kern River Pipeline expansion coming online in May. Since the Kern River expansion exposed Rockies gas production to expanded California markets, prices for domestic gas from the Rockies are running at parity with the Canadian gas delivered to Pacific Northwest points. NW Natural's gas supply volumes change price annually. This year, these annual renegotiations took place in an environment of comparatively high 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 again include both call options and swap trades of index-based purchases for fixed price volumes. These fixed and capped prices, either directly with suppliers or through swaps and options, are used to contain the risk from price volatility and provide stability in the commodity component of NW Natural's rates.

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. The annual cost of gas includes both natural gas commodity and transportation costs.
In work papers submitted to Staff, NW Natural shows a gas cost total of $257,786,292. Overall, NW Natural's annual commodity cost increased by $24,427,564, while demand costs decreased $729,007, for a total change in base gas costs of $23,698,557 as shown on page 2 of this memo.

Staff reviewed the PGA filing to determine the merits and basis for the proposed gas cost changes. 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.

Last year, NW Natural had purchased actual volumes totaling 739,297,068 therms and a weighted average cost of gas of $0.37668. 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 645,033,562 therms at a weighted average cost of gas of $0.41567. While the volume of gas sold decreased by 14.6%, the cost of each therm increased 10%.

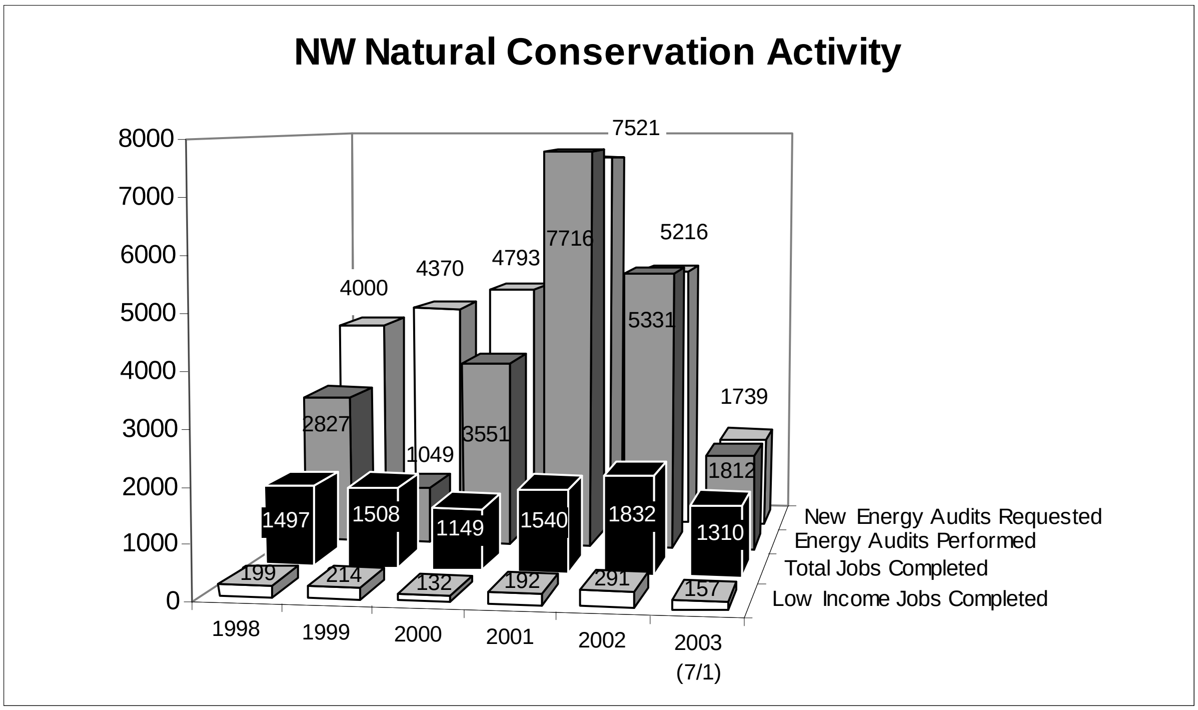
Following is a table of NW Natural's Weighted Average Cost of Gas since 1993. These numbers are unadjusted for the effects of inflation.

Year	WACOG	Change
1993	$0.17654	
1994	$0.15241	-14%
1995	$0.11635	-24%
1996	$0.11051	-5%
1997	$0.16344	48%
1998	$0.17906	10%
1999	$0.22314	25%
October 1, 2000	$0.34767	56%
October 1, 2001	$0.52391	51%
October 1, 2002	$0.37668	-28%
October 1, 2003	$0.41567	10%

Staff concludes that NW Natural's proposed WACOG of $0.41567 is an accurate reflection of the company's annual commodity cost. Staff has inspected NW Natural's proposed tariff sheets and verified their accuracy.

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

- Conservation activities, including both energy audits and work completed, peaked in 2001, and have been declining since. These activities are being transferred to the Energy Trust of Oregon under the terms adopted in UG 143.



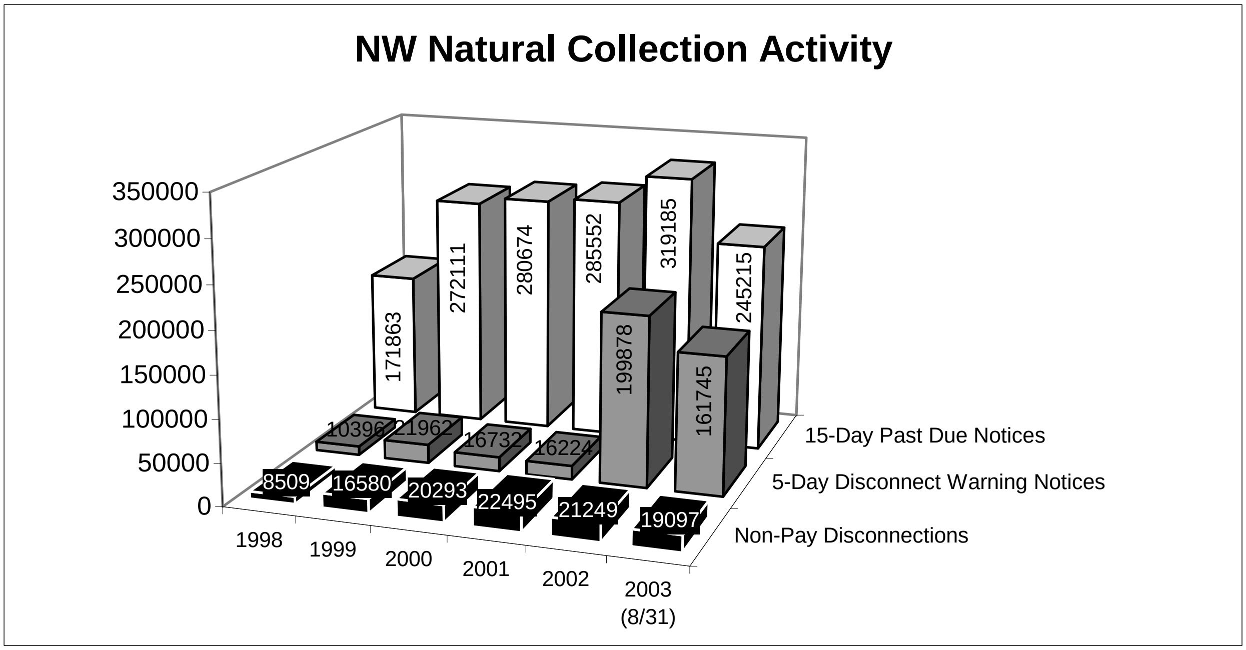
- The company has initiated an Oregon Low Income Gas Assistance (OLGA) program consistent with the agreement in the UG 143 docket. So far, $1,028,695 has been collected for low-income energy assistance. As of August 18, 2003, the balance for low-income energy assistance in the coming heating season was $445,348.

- 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 are provided an opportunity to contribute to the fund, and the company contributes shareholder dollars. Industry contributions, primarily from the pipelines, have also been received the past several years. For 2003, the company contribution is budgeted at $75,000, and industry contributions in the amount of $8,750 are anticipated. Currently, the GAP program has $180,849 available for additional low-income bill payment assistance.

- 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. As of August 31 of this year, participation in the company's Level Payment Plan was at 95% of the 2002 annual level.

- NW Natural will also provide customers the required 12-month payment arrangements on arrearages. As of August 31, 2003, customer participation in arrearage Time Payment Agreements was at 83% of the 2002 level. This year, in accordance with the tariff revisions incorporated in the UG 152 docket, the company will be offering arrearage time payment agreements to non-residential customers when such an arrangement will be in the best interests of both the customer and the company.

- In 2002, the volume of 15-day disconnection warning notices sent increased by over 11% from 2001. The volume of 5-day disconnection warning notices increased 113% during the same period. However, the volume of customers actually disconnected for non-payment decreased by 5%. Collection activity for 2003, as of August 31, 2003, appears to be tracking 2002 levels. The company's addition of a non-residential time payment agreement program should further reduce actual disconnections of service.



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:

- Removal of temporary credit increments currently in place, increasing revenues by approximately $3.5 million.

- Addition of new temporary credit increments to refund $2.4 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 an increase of $1.1 million on an annual basis.

Other Rate Adjustments

Bare Steel Replacement Program

Commencing in 2002 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 $471,383 over the $458,617 currently in rates. For the period October 1, 2003 to September 30, 2004, a total of $930,000 will be collected.

Geo-Hazard Repair and Risk Mitigation

Commencing in 2002 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 $37,782 over the $298,218 currently in rates. For the period October 1, 2003 to September 30, 2004, a total of $336,000 will be collected.

Rate History

The following table shows the rates the Commission has approved for the company's residential customers on Rate Schedule No. 2 since 1994 including the proposed 2003 PGA adjustment.

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	$5.00	$0.87016	-12.7%
September 1, 2003 (UG 152) *****	$6.00	$0.87870	1.0%
October 1, 2003 (Proposed) ******	$6.00	$0.92213	4.9%

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[***]. In addition,

[*]This increase reflects only the change in the energy charge, not the customer charge. When combined, the increased bill to the customers is 2.6%.

[**]This increase reflects only the change in the energy charge. When combined with the customer charge, the average customer's bill is increased about 4.5%. The total bill increase from last year for the effects of both the PGA and general rate increase is about $4.19 or 7.2%.

[***] The earnings reviews were scheduled to sunset in 2002, but in Order No. 03-198 (AR 449) the Commission extended the earnings reviews for an additional four years to 2006.

Section (8) of OAR 860-022-0070 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 amortization of deferred gas costs in this PGA filing.

ORS 757.259 (6) and (7) states that the overall annual average rate impact of the amortizations authorized under the statute may not exceed three percent of the natural gas 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.

UM 1106

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, 2003.

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 156 and 2) reauthorization of deferred accounting for NW Natural's Purchased Gas Balancing Account mechanism, Schedule No. 169, for one year beginning October 1, 2003, be approved and the company’s LSN be approved and associated tariff sheets of Advice No. 03-19B be allowed to go into effect October 1, 2003.

Attachments