ORDER NO. 04-575

ENTERED OCT 05 2004

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UG 160/UM 1163

In the Matter of 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 160)** Application for Reauthorization of Deferred Accounting for the PGA (Purchased Gas Adjustment) Mechanism. **(UM 1163)**	)	ORDER

DISPOSITION: APPLICATIONS APPROVED

On August 16, 2004, 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 28, 2004, 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 160 are approved.

2. The reauthorization of deferred accounting for Northwest Natural Gas Company's Purchased Gas Balancing Account mechanism, Schedule No. 169, for one year beginning October 1, 2004, is approved.

3. Tariff sheets associated with Advice Nos. 04-11A, 04-11B, and 04-11C are allowed to go into effect October 1, 2004, with approval of Northwest Natural Gas Company's request for an LSN (Less than Statutory Notice).

4. Northwest Natural Gas Company's request for an extension of the time frame for true-up of final SMPE costs to no later than the October 2005 PGA filing, is approved.

Made, entered and effective ___________________________________.

BY THE COMMISSION:

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BECKY L. BEIER
Commission Secretary

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 & 6

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: September 28, 2004

REGULAR __X__ CONSENT ____ EFFECTIVE DATE ______October 1, 2004______

DATE: September 22, 2004

TO: Lee Sparling through Ed Busch, Bonnie Tatom and Judy Johnson

FROM: Reed Harris and Ed Durrenberger

SUBJECT: NORTHWEST NATURAL: (Docket No. UG 160/Advice No. 04-11) Reflects changes in the cost of purchased gas and technical adjustments and makes adjustments to base rates for various programs.
(Docket No. UM 1163) Requests reauthorization of the PGA deferral mechanism.

STAFF RECOMMENDATION:

We recommend the Commission approve Northwest Natural's (NW Natural or company) request to waive statutory notice (LSN) and allow the company's proposed tariff sheets in Advice No. 04-11 to become effective with service on and after October 1, 2004. This filing increases the company's annual revenues by approximately $120.6 million, or 20.9%.

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, and extend the timeframe for true-up of South Mist Pipeline expenses to no later than the October 2005 PGA filing.

DISCUSSION:

On August 16, 2004, NW Natural submitted its annual gas cost tracking and technical adjustment filing, commonly known as its PGA filing. 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. In Advice No. 04-11 (docketed as UG 160), the company proposed to increase annual rates effective October 1, 2004, to reflect changes in the cost of purchased gas, recovery of its investment in bare steel replacement and geo-hazard mitigation, a price elasticity adjustment, and technical adjustments in its deferred revenue and gas cost accounts. The company further proposed to adjust permanent base rates to include the completed 11.7-mile phase of the South Mist Pipeline Extension (SMPE) project and include a portion of the Mist storage capacity previously used for upstream sales activities. The filing also includes the Commission-ordered adjustments related to the company's accounting for parking (see Order No. 04-439, in docket UM 1148). In a separate filing docketed as UM 1163, NW Natural requested reauthorization of deferrals under its PGA mechanism for the 12 months beginning October 1, 2004.

On September 15, 2004, the company made a substitute filing, Advice No. 04-11A, along with an LSN, 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, geo-hazard risk mitigation and price elasticity. In addition, the company's revised filing included the permanent rate effects of including the entire 61-mile, completed SMPE, not merely the 11.7-mile portion included in the company's initial filing. In doing so, the company withdrew a separate filing, Advice No. 04-12, in UM 161. On September 17, 2004, the company filed Advice No. 04-11B to correct typographical errors in two tariff sheets filed in Advice No. 04-11A. On September 22, 2004, NW Natural filed Advice No. 04-11C to correct typographical errors in four other tariff sheets filed in Advice No. 04-11A.

UG 160

This application requests authority to increase rates to: (1) track increases in purchased gas costs, (2) adjust permanent base rates for certain approved programs, and (3) make technical adjustments to amortize NWN's deferred revenue and gas cost accounts. The change in annual revenues is summarized in the table below. Details on each line item are included in this Staff Report and in Attachment A.

PGA Base Gas Cost Increase	$ 86,780,079
Removal of Prior Year Temporary Credit Increment	$ 2,438,000
Addition of New Temporary Debit Increment	$ 11,363,511
Permanent Base Rate Adjustments	$ 20,057,758
Total Proposed Increase	$ 120,639,348

With these changes, the monthly bill of a typical residential customer on Schedule No. 2 using 56 therms per month will increase by $10.40, or 18.0%, from $57.64 to $68.04. In January, a typical residential customer's consumption of 135 therms would result in a billing increase from $130.49 to $155.56.

A summary of the proposed tariff changes for NW Natural's major rate schedules is shown in Attachment B. That summary also compares the impact of this year's

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proposed PGA rate changes, on both an annual and January basis, for NW Natural, Avista and Cascade residential customers. The table below shows the rates the Commission has approved for NW Natural's residential customers on Rate Schedule No. 2 between 2000 and 2003, and the current proposal.

Date	Customer Charge	Rate per Therm	Percentage Change*
October 2000	$5.00	$0.82692	
December 2000	$5.00	$0.82589	-0.1%
October 2001	$5.00	$0.99654	20.7%
October 2002	$5.00	$0.87016	-12.7%
September 2003 (UG 152)	$6.00	$0.87870	1.0%
October 2003	$6.00	$0.92213	4.9%
October 2004 (Proposed)	$6.00	$1.10784	20.1%

NW Natural offers customer assistance programs. Specific information on these programs is readily available to customers on their monthly bills, by telephone, in person at the company offices, and on the company's web site.

Staff Review of Gas Costs

Regional Natural Gas Market

Wholesale cash prices for next-day delivery of natural gas to Pacific Northwest (PNW) points have averaged over $5/MMbtu ($0.50/therm) since October of 2003. Looking forward, even though current average spot prices for September Northwest delivery are in the mid-$4/MMBtu range, prices for delivery in the coming 2004 - 2005 heating season remain near $6/MMBtu. The September 8, 2004 NYMEX screen, adjusted for PNW delivery, projects natural gas prices at more than $5/MMBtu until April of 2007.

One of the factors contributing to price strength in western markets is the Kern River Pipeline expansion that was completed in 2003, allowing additional Rockies gas production to be delivered to California markets. Since then, Rockies domestic gas prices have escalated to parity with the prices for Canadian gas delivered to Pacific Northwest points.

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* The percentage change reflects only the change in the rate per therm, and does not include the effect of the monthly customer charge on the bill. In 2004, when the rate per therm is combined with the monthly customer charge of $6.00, the average customer's bill is increased about 18.0%, as shown on Attachment A.

Storage inventories in the western region, as of September 3, 2004, totaled 362 Bcf. That is 25 Bcf higher than at the same time last year, and 21 Bcf above the 5-year average inventory for the date.

According to the Northwest Gas Association's presentation at the June 24, 2004, Natural Gas Supply and Price Outlook public meeting, the Northwest is geographically well-situated between supply basins with ample gas available to meet regional needs. Assuming continued robust injections into storage and uninterrupted pipeline flows, supplies to Oregon natural gas customers, while more expensive than last year, should remain stable this winter.

NW Natural's Natural Gas Purchasing Strategy

As the natural gas market evolves, increasingly similar market conditions and options are becoming available for Oregon's natural gas local distribution companies (LDCs). For example, long-term, fixed-cost supply contracts are no longer the norm; they have been replaced by fixed-year supply contracts that are priced at some index. The prices of the fixed-supply contracts can be fixed by the use of financial derivatives. Staff's review of the Oregon LDCs' natural gas portfolio purchasing practices, in conjunction with the Commission's 2004 Objectives, should be completed by the end of the year.

NW Natural's gas supplies are both Canadian-sourced in the Alberta and British Columbia production fields, and domestic from the Rockies production areas, with less than 1% from local production in the Mist field. Alberta gas is transported from the AECO C hub in Canada on TransCanada's former ANG and GTN-NW pipelines through Kingsgate to Stanfield, and alternatively, to Sumas by way of the Canadian Southern Crossing Pipeline. British Columbia gas flows from Station 2 through Duke's former Westcoast Energy line to the border at Sumas, and from Sumas to NW Natural on Williams Gas Pipeline (Northwest Pipeline). Domestic flows from the Rockies are transported on Northwest Pipeline through Stanfield.

NW Natural uses a combination of storage, forward purchasing strategies combined with financial instruments, and recall agreements to minimize gas costs and hedge price volatility. NW Natural utilizes off-system storage with Williams/Northwest pipeline at Jackson Prairie and the Plymouth LNG facility in Washington. NW Natural's market area storage is comprised of the underground natural gas storage in the Mist field and on-system LNG facilities at Gasco in Portland and in Newport. The hedging of indexed gas supply contracts include both swaps of supply at indexed prices for supply at fixed prices through financial instruments, and call options that cap prices. Finally, the company has recall agreements with several industrial customers to help meet short term peaking demand. The recall agreements, together with ....

storage, reduce the costs of purchasing pipeline capacity to meet temporary peak loads. The fixed and capped prices are used to reduce price volatility and provide stability in the commodity component of NW Natural's rates. NW Natural's South Mist Pipeline Extension will also be in service by the coming heating season, allowing increased flexibility both in use of the Mist storage field and in balancing pipeline capacities and flow to demand within the company's system.

NW Natural's Natural Gas Costs

NW Natural, together with the other two regulated gas utilities, is required to file annually for rate changes related to purchased gas costs. The annual cost of gas includes both natural gas commodity and transportation costs. The rate changes are associated with changes in the company's natural gas sales volumes, the costs of the gas, and certain transportation costs.

Last year, the weighted average cost of gas (WACOG) embedded in customers' rates was $0.41567 per therm, based on projected sales volumes of 726,019,715 therms. This year, in work papers submitted to Staff, the company's projected sales volumes total 733,353,247 therms at a WACOG of $0.54154 per therm, an increase of 30.3%.

Staff has reviewed the current PGA filing to determine the basis for the proposed gas cost changes. In the review, Staff examined the filing's work papers that include gas supply contracts, the prices paid for the gas, and the volumes of gas delivered to customers. Staff concludes that NW Natural's proposed WACOG of $0.54154 is an accurate reflection of the company's annual commodity cost. In this year's PGA filings, the WACOGs proposed by each of the Oregon LDCs differ only slightly. Staff also reviewed NW Natural's proposed tariff sheets and verified their accuracy.

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 $2,438,000.
- Addition of new temporary increments to the company's deferred revenue and gas cost accounts as detailed below. The Commission previously authorized all of the deferred amounts subject to amortization.

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Temporary Debit (Credit) Increments	Amount
Commodity and demand costs	$5,962,767
Decoupling costs	$2,154,501
Demand Side Management & Weatherization costs	$2,207,447
Fish Block Return	($1,386,079)
Line of Credit Guarantee Return	($58,770)
Vancouver Property Sales Return	($40,446)
Intervenor Funding costs	$161,799
SMPE costs	$2,362,292
Total	$11,363,511

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 $13,801,511 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. Staff audited NW Natural's costs for this program through June 2004, and verified that the company made the appropriate corrections based on Staff's review. The rate impact of the revenue requirement for this program is an increase of $408,000 over the $930,000 currently in rates. For the period October 1, 2004 to September 30, 2005, a total of $1,338,000 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. Staff audited NW Natural's costs for this program through June 2004, and verified that the company made the appropriate corrections based on Staff's review. The rate impact of the revenue requirement for this program is an increase of $5,000 over the $336,000 currently in rates. For the period October 1, 2004 to September 30, 2005, a total of $341,000 will be collected.

South Mist Pipeline Extension: This new base rate increment applies the permanent effects of the completed 61-mile SMPE pursuant to Commission Order No. 03-507 in Docket UG 152. The 61 miles of the SMPE connect NW Natural's Mist storage fields to Williams' Northwest Pipeline at Molalla. The SMPE provides additional capacity to expand the use of the Mist storage facility, while at the same time reinforcing pressure and volume deliverability to the southern portions of the company's distribution system. NW Natural's 2000 Integrated Resource Plan, acknowledged by the Commission in Order No. 00-782, identified Mist area storage to be a lower cost option for meeting future natural gas load requirements than reserving natural gas transmission capacity on pipelines from the major production areas. The SMPE provides the necessary inflow and takeaway capacities to fully utilize Mist storage capabilities.

On September 22, 2004, Staff received the required attestation and Operations Certificate from the company stating that: (1) construction and operation testing of the SMPE was completed on September 21, 2004; (2) as of September 21, 2004, operation of the SMPE was released to the company's system dispatcher for full commercial operation; and (3) as of September 22, 2004, the SMPE has been in continuous operation for at least 24 hours.

Staff audited NW Natural's costs for this program through June 2004, and verified that the company made the appropriate corrections based on Staff's review. The total audited capital cost of the SMPE exceeds $103 million, more than originally estimated in UG 152. A portion of SMPE costs related to an earlier-completed 11.7-mile portion of the pipeline had been deferred (and is proposed to be recovered through the temporary increment shown in the table on page 6); the ongoing annual revenue requirement of $2,675,699 is now proposed to be added to base rates. When that amount is added to the cost of service for the remainder of the 49.3-mile pipeline completed this month, a total of $13,988,123 is proposed to be added to base rates beginning October 1, 2004. Costs of the total SMPE project to date have been trued-up in conformance with Order 03-507 in Docket UG 152[1], following Staff's audit of the project expenses to date. Due to the delays in construction associated with extended Energy Facility Siting Council approval and the resulting appeals, final actual costs for the SMPE are not available at the time of this 2004 PGA. Staff recommends that the timeframe be extended so that actual costs can be verified and trued up upon completion of Staff's audit of the final SMPE project costs.

<u>UM 1148 Parking Cost Elimination:</u> As part of the recent settlement of UM 1148, the company has adjusted permanent rates starting this year and continuing until 2013 to eliminate disallowed parking costs. From October 1, 2004 to September 30, 2005, a total of $331,162 will be returned to customers.

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APPENDIX A
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[1] The Third Partial Stipulation in Docket UG 152, incorporated into Order No. 03-507 as Appendix D, states, "The Parties further agree that the revenue requirement associated with the SMPE and CCDS investments may be placed in permanent rates when the SMPE and CCDS facilities are used and useful or at the next available filing, with an amortization in rates of the remaining deferred balances at the time of the 2004 Purchased Gas Adjustment." (See page 5, 14(c).)

Mist Recall Inclusion: This adjustment represents the permanent rate effects of accounting for the capital costs associated with the recall of 200,000 therms per day of Mist storage capacity from upstream market activities. The company's core customers will use the capacity during wintertime peaking periods to reduce commodity and demand costs. From October 1, 2004 to September 30, 2005, a total of $165,720 will be collected.

Price Elasticity Adjustment: This adjustment, included at the time of price changes in the company's PGA filings each year since 2002, accounts for the effect that rate changes have on customer usage. For the year starting October 1, 2004 through September 30, 2005, a total of $5,822,077 will be collected.

Earnings Review and 3% Test

Until 1999, as a matter of policy, the Commission conducted earnings reviews for both prospective purchased gas costs changes and PGA-related deferrals. The Commission then adopted OAR 860-022-0070, which requires an annual spring earnings review in lieu of an earnings review related to prospective purchased gas cost changes. In addition, Section (8) of the rule states that an earnings review is not applicable to amortization of deferred gas costs if the LDC assumes at least 33% of the responsibility for commodity cost differences in the risk sharing mechanism. NW Natural's mechanism includes a 33% sharing level, so amortization of deferred gas costs in this PGA filing are exempt from an earnings review.

ORS 757.259 (6) and (7) states that the overall annual average rate impact of the amortizations authorized under the statute may not exceed 3% 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% cap and may be implemented as proposed.

UM 1163

In this filing, NW Natural requests reauthorization of deferrals pursuant to its automatic adjustment clause, the Purchased Gas Adjustment (PGA) mechanism. 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 deferral mechanism, effective October 1, 2004.

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 160; 2) reauthorization of deferred accounting for NW Natural's Purchased Gas Balancing Account mechanism, Schedule No. 169, for one year beginning October 1, 2004; 3) waiver of statutory notice to allow the associated tariff sheets of Advice Nos. 04-11A, 04-11B, and 04-11C to go into effect October 1, 2004; and 4) the time frame for true-up of final SMPE costs be extended to no later than the October 2005 PGA filing, be approved.

Attachments

NW Natural 2004 PGA