ORDER NO. 09-180

ENTERED 05/22/09

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

DR 43

In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL Petition for a Declaratory Ruling.	ORDER

DISPOSITION: PETITION DENIED

On March 27, 2009, Northwest Natural Gas Company, dba NW Natural, filed a Petition for Declaratory Ruling pursuant to OAR 860-022-0070. There has been a dispute about whether gas cost variances retained by NW Natural through the sharing provisions of the PGA mechanism should be included in the regulated earnings for purposes of the gas utility's Spring Earnings Review. A description of the petition terms, as well as the procedural history of this filing, is contained in the Staff Report attached as Appendix A and incorporated by reference.

At its Public Meeting on May 19, 2009, the Commission adopted Staff's recommendation to deny NW Natural's petition.

ORDER

IT IS ORDERED that Northwest Natural Gas Company's request for a declaratory ruling is denied.

Made, entered, and effective MAY 2 2 2009.

Lee Beyer
Chairman

John Savage
Commissioner

Ray Baum
Commissioner

ITEM NO. 1

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: May 19, 2009

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

DATE: April 9, 2009

TO: Public Utility Commission

FROM: Judy Johnson

THROUGH: Lee Sparling and Ed Busch

SUBJECT: NORTHWEST NATURAL: (Docket No. DR 43) Petition for a Declaratory Ruling regarding the application of OAR 860-022-0070.

STAFF RECOMMENDATION:

I recommend that the Commission deny Northwest Natural's petition for a Declaratory Ruling.

DISCUSSION:

On March 27, 2009, Northwest Natural (NW Natural) requested a petition for a Declaratory Ruling regarding the application of OAR 860-022-0070. There has been a dispute about whether gas cost variances retained by the utility through the sharing provisions of the PGA mechanism should be included in the regulated earnings for purposes of the gas utility's Spring Earnings Review. NW Natural asks for a declaratory ruling because NW Natural as part of its weather normalization adjustment excludes retained gas cost variances from earnings for purposes of the Spring Earnings Review.

Staff has been in discussions with NW Natural on this issue and on September 25, 2008, sent out a draft letter to UM 903 participants stating that staff had modified its position and now agreed with NW Natural's methodology and invited comments from the parties.

Cascade Natural Gas and the Citizens' Utility Board (CUB) both submitted comments that disagreed with staff's and NW Natural's position. See Appendixes A and B.

After Order No. 08-504 in Docket UM 1286 was issued, staff and staff's attorney were convinced that the Commission had decided the issue. On page 14 the Order states: "CUB states that Staff and NW Natural do not agree whether earnings related to gas costs are counted in an earnings review. Staff proposes to include the earnings; NW Natural proposes to exclude them. CUB agrees with Staff."

On page 15 the Order states: "CUB states that it shares Staff's view that commodity cost differences, positive or negative, retained by the company, are properly accounted for in the company's earnings for purposes of the earnings review."

On Page 18, under Conclusions of Law, item 2, the Order states: "CUB's proposal, as modified above should be adopted." Staff interprets this to mean that the Order adopts CUB's position that all gas cost variances (including the utility's sharing) should be included in results of operations and earnings reports.

Staff subsequently, on February 5, 2009, wrote another letter to the UM 903 participants and stated that: "Because the Order did not modify this aspect of CUB's proposal, staff's counsel advises that CUB's recommended treatment was adopted."

NW Natural states in its petition on page 6 that: "With respect to the Spring Earning Review the Commission only stated: 'The spring 2009 earnings review will be conducted under the ground rules applicable under the now current mechanism, in recognition that ten months of the 2008 will have been conducted under the current rules.'" Staff does not believe that the Commission intended to allow NW Natural an additional year of making adjustments to its Spring Earnings Review differently than adopted by Order 08-504. Staff believes that the Commission was referring to the methodology of calculating the earnings bands for sharing purposes.

PROPOSED COMMISSION MOTION:

Northwest Natural's petition for a Declaratory Ruling be denied.

NWN DR 47

Attachments

Citizens' Utility Board of Oregon

610 SW Broadway, Suite 308
Portland, OR 97205
(503) 227-1984 • (503) 274-2956 • cub@oregoncub.org • www.oregoncub.org

November 8, 2008

To: UM 903 Participants

Re: Appropriateness of including gas costs in PGA Earnings Review

CUB wishes to respond to Staff's September 25 letter which concludes that gas costs which are being shared as part of the PGA should be excluded from the Earnings Review. While we understand Staff's reasoning, we do not believe that excluding gas costs from the Earning Review is the best policy.

In UM 1286, CUB supported increasing the amount of risk that was placed on customers due to the volatility of gas prices in exchange for reducing the earnings threshold that triggers sharing of excess earning. In evaluating this trade off, we included excess earning due to gas costs within the Earning Review, believing, based on a response to a data request, that this was the position of the staff. (See UM 1296/CUB/Exhibit 106 at 3). CUB concluded that:

> Most of the traditional risk of providing utility service has been shifted to core customers. This proposed mechanism shifts most of the remaining risk of the variability of commodity prices to core customers. As mentioned earlier, decoupling shifted most of the risk of energy efficiency, recessions, and reduced load due to higher prices onto core customers. WARM shifts most of the weather risk onto core customers. As core customers are taking so much of what used to be the utility's risk, they should be compensated. This can happen through a significant reduction to each utility's ROE, but that is not a subject in this docket, or that can happen by sharing over-earnings with customers. As core customers are taking most of the risk of gas commodity variations, if gas commodity costs contribute to a utility's over-earning, then it is core customers who should share in that over-earning.

UM 1286/CUB/100/34.

Beyond the issue of the trade off that CUB made in UM 1286, CUB believes that including gas costs in the Earning Review is good policy.

It is simple. If the utility is earning above its earnings threshold, then the excess earnings are shared with customers – customers receive 33% of it. This is a very simple construct. It is easy to understand, easy to explain, and reasonably easy to implement.

It is fair. Customers now take most of the gas commodity risk. In exchange it is reasonable to share excess earning that are related to gas costs with customers. At 80/20

or 90/10, most of the risk of changes in gas forecasts falls on customers. Since customers are taking this risk, when gas costs contribute to a LDC's overearning, it is fair for customers to share in that overearning.

It will avoid sharing from a utility that is underearning. Excluding gas costs from the Earnings Review can lead to a gas company that is underearning having to provide a refund to customers. As demonstrated in the most recent NW Natural Earning Review, the earnings effect of gas cost volatility can overwhelm the non-commodity costs. This will likely lead to circumstances, where a LDC is overearning on its non-commodity costs, but its share of higher than forecast gas costs, overwhelms this overearning, leaving the LDC earning below its authorized rate of return. However, because of the overearning on the non-commodity costs, the LDC would be required to credit customers with 33% of the non-commodity overearning. This takes a LDC that is already earning below its authorized rate of return and reduces its earnings. While we are advocates for customers and not shareholders, even we are not convinced that this is good public policy.

It will avoid a triple whammy (with a back flip). The above example will take the SB 408 double whammy and turn it into a triple whammy for NW Natural and Avista. The LDC that is underearning due to gas supply costs, but is overearning on its non-commodity costs, may be required to refund to customers a share of the non-commodity overearning even though it is underearning overall. This becomes a triple whammy because the LDC is underearning overall and has to provide customers with a refund of the taxes that were overcollected (double whammy), and now has to provide an additional refund of overearning on the non-commodity costs. In addition, there is an iterative affect (back flip). When the LDC refunds the non-commodity overearning under the earning sharing mechanism, it will then reduce its earnings and this reduction in earnings will lower its taxes and require it increase the SB 408 refund.

It will not interfere with the PGA incentives. The Staff seems to suggest that it is inappropriate to include the commodity overearning, because it will interfere with the PGA mechanism. That mechanism allocates 10% or 20% of the commodity variation to the LDC. Subjecting "their" share to further sharing though the Earnings Review, would reduce the incentive that is at the heart of the PGA. In response to this argument, we note that SB 408 already affects this sharing percentage. As we discussed in our UM 1286 Opening Brief, when an LDC is overearning, its net income is greater than projected, its taxes are higher than forecast and it is required to surcharge customers for the additional taxes. Because this is done at an effective tax rate of around 40%, it more than offsets the 33% share of the overearning that is shared with customers. While we do not propose that the Commission look at this as an offset to the SB 408 effects, we point it out to suggest that the basic incentives of the PGA are maintained when the gas commodity is included in the earnings review. We note that SB 408 does not apply to Cascade, so the SB 408 affect would not come into play. However, Cascade has been including the effects of gas commodity in its Earnings Review, so what CUB is supporting is not a change for Cascade.

For these reasons, CUB concludes that it is better public policy to include the earnings associated with gas supply when conducting the Earnings Review for Oregon's natural gas utilities.

Sincerely,

Bob Jenks
Executive Director

Appendix B

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www.cngc.com

November 7, 2008

To: UM 903 Participants

Cascade provides the following comments in response to Staff's letter of September 25, 2008, regarding the rate treatment of gas cost commodity sharing differences.

Cascade respectfully disagrees with Staff's position that the gas cost commodity sharing differences are a non-operating item that should be recorded as a below the line expense and therefore should be removed as a Type 1 adjustment. Cascade has closely reviewed both the Commission's Order 99-272 and Order 98-543, which approved Cascade's Stipulation in UM 903, and neither Order states that commodity gas cost sharing is a "below the line item" or a "non-operating expense". Rather, when discussing the 67/33 risk-reward sharing, the Order merely states that 33% of the costs are to be assigned to the Company, rather than deferred and passed back to ratepayers. Additionally, according to OAR-022-0070, (5) (b), Normalization and adjustments: The test year results will be adjusted with a predetermined list of rate-making adjustments equivalent to those applied in the gas utility's most recent general rate proceeding. For Cascade, the most recent general rate proceeding was Docket UM 173, and, in that case, no adjustment was made to remove the Company's portion of the gas cost sharing. That approach was consistent with the approach used in all of the Earnings Reviews filed by Cascade since the inception of the Earnings Sharing mechanism.

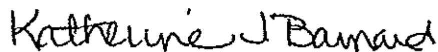
In Cascade's 2008 Annual Earnings Review (based on Calendar 2007 earnings), the Company included over $289,000 of gas cost benefits in its reported earnings. Unlike Northwest Natural, where the inclusion of the benefits did not result in their earnings exceeding the threshold, Cascade's earnings did exceed the threshold, and, as a result, the Company has begun to return excess earnings to ratepayers with the November 1st amortization. The same scenario was true in 2007, where Cascade's Type 1 earnings included approximately $385,000 of gas cost sharing benefits and, again, the utility earned above the threshold. As a result, the Company returned over $400,000 in earnings back to ratepayers during the 07/08 PGA year. However, due to the high spring/summer prices in 2008, it is likely that Cascade will have absorbed close to $500,000 due to the gas cost sharing mechanism, and, therefore, the timing of Staff's proposed change is even more alarming.

"In The Community To Serve"

Cascade sees this issue as being similar to the treatment of the weather normalization adjustment. Each of the utilities was given the option to choose whether or not to include weather normalization as a Type 1 or Type 2 adjustment. Cascade believes that if in colder weather, Company efficiencies and/or commodity sharing benefits result in real money earnings above the authorized threshold, then the earnings above the threshold should be shared. It is in those years that the utility is in a position to share benefits with ratepayers. However, when the opposite is true, and earnings are lower due to warmer weather and/or commodity sharing losses, then the utility is not in a position to share "phantom" earnings, when its earnings are already reduced because of those events. Therefore, Cascade believes that the gas costs sharing differences should be adjusted out for Normalizing purposes as a Type 2 adjustment, similar to the historical treatment of weather differences. At a minimum, the utilities should be afforded a one-time option, similar to the weather normalization adjustment, to elect whether it should be included as a Type 1 or Type 2 adjustment.

If there are any questions regarding these comments, please contact me at (206) 381-6824.

Sincerely,



Katherine J. Barnard
Senior Director
Regulatory & Gas Supply