

ORDER NO. 99-284

ENTERED APR 21 1999

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

AR 357

In the Matter of a Rulemaking Proceeding)
to Adopt Procedures and Standards for) ORDER
Reviewing Gas Utility Rates in the Context)
of Purchased Gas Adjustment Mechanisms.)

DISPOSITION: ORDER OF RULEMAKING ADOPTED

On October 20, 1998, the Public Utility Commission of Oregon (Commission) opened this docket to consider a new rule that would establish procedural steps for Purchased Gas Adjustment (PGA) filings and associated earnings reviews. Comments were solicited and received from interested parties prior to the formal opening of this rulemaking docket.

On October 26, 1998, the Commission filed a Notice of Proposed Rulemaking with the Oregon Secretary of State. Written initial comments were filed by November 20, 1998. Interested parties were invited to and attended a workshop held on December 1, 1998, which identified and attempted to resolve the concerns raised in the initial comments. Written reply comments were subsequently filed by December 22, 1998.

The Commission considered this matter at its Public Meeting on April 20, 1999. The Commission decided to adopt the new rule as modified and set forth in Appendix A to this order.

Background

An investigation docket, UM 903, was initiated on May 19, 1998, to examine policies and procedures related to the recovery of purchased gas costs by Oregon's three regulated gas distribution companies. A petition for adoption of an administrative rule was submitted by Northwest Natural Gas Company (NW Natural) on August 17, 1998, during the course of a second prehearing conference in the UM 903 case. The request was denied in part at the Commission's September 15, 1998, Public Meeting. However, the Commission did conclude that the issues associated with the

structure and review of PGA filings should be bifurcated and addressed in two dockets: a rulemaking docket, AR 357, to establish the procedural steps for PGA filings and associated earnings reviews, and a contested case docket, UM 903, to determine the specific standards for the earnings review and sharing mechanisms.

The Proposed New Rule

The parties agreed to certain changes to the proposed rule at the workshop held on December 1, 1998. The Staff of the Commission (Staff) modified its proposed rule to reflect those changes. The final version of the proposed rule is set forth in Appendix A to this order, and includes the workshop modifications as well as the Commission's revisions to the rule.

The proposed new rule establishes a process for reviewing gas utility rates prior to making changes to rates resulting from changes in base gas costs under the PGA mechanism.

Comments were filed by five parties: Staff, the Citizens' Utility Board of Oregon (CUB), NW Natural, Portland General Electric Company (PGE), and the Northwest Industrial Gas Users (NWIGU). The positions of the parties are summarized below.

Position of CUB: If the purpose of the new rule is to ensure that a local distribution company's (LDC's) earnings are not excessive, then the rule should contain a provision for the establishment of an upper earnings threshold limit, beyond which all earnings are returned to customers.

Position of PGE: The statutes regarding earnings reviews apply to ordinary deferrals, not PGAs, thus there is no statutory authority for an earnings review in this context. The exemption in Section (8) of the rule (that the earnings review will not apply if the LDC has a risk sharing mechanism that allocates 33 percent of the risk to the LDC) is arbitrary and capricious and without an evidentiary basis. The rule lacks adequate procedural safeguards, such as a method to contest the application of standards in the earnings review. PGE recommends adding language that a party can request a hearing on unresolved issues. The rule should specify how key decisions will be made, (the standards for the contested case procedure), such as the ratemaking adjustments, earnings threshold, sharing percentage, and allocation method. Section (5)(c) of the rule should specify the standards and procedures for updating the earnings threshold. If not, there should be an opportunity for comment on each update.

Position of NW Natural: The PGA earnings review process amounts to retroactive ratemaking, and the statutory basis for such a review remains open to question. NW Natural notes that the earnings test is not symmetrical, i.e., while high

earnings due to cold weather may be shared, Staff does not propose to allow LDCs to recover lower earnings due to warm weather. If such a process is developed, however, the Commission should look at actual, unadjusted earnings; otherwise the process will become a mini rate case. In addition, a utility is usually left alone to manage its business as it sees fit once just and reasonable rates have been set in a general rate case. In contrast, a PGA earnings review process that includes normalization and adjustments will allow interference in the day-to-day management of the company, and the process will be contentious and unpredictable. The rule's exclusion of weather normalization is a problem because cold weather years are necessary to balance the results from warm weather years. However, the lack of weather normalization would not be a problem if the earnings threshold is high enough to allow LDCs to manage their weather risk. The annual update of the earnings threshold should consider other factors that may affect an LDC's cost of capital, such as changes in international markets.

NW Natural opposes NWIGU's proposal of a mandatory rate restatement after four years. There is no statutory basis for doing this, and it would inappropriately shift the burden of proof to the company, which ordinarily would have the burden only if it initiated a rate filing or rate increase. Since the PGA process is intended to flow through commodity costs, which NWIGU's clients do not ordinarily use, it is inappropriate for NWIGU to use this process to attempt to shift costs from transportation customers to core sales customers. In any event, a remedy for NWIGU's concerns already exists, as NWIGU can ask the Commission to initiate a show cause proceeding. NW Natural supports a flexible approach to rate spread of any margin reduction produced by operation of the rule, therefore it can support NWIGU's equal percent of margin approach. NW Natural also believes that Subsection 8 of the proposed rule effectively changes an agreement that the company entered into with Staff following its 1997 PGA filing, thus it objects to subsection 8 to the extent that the Commission does not adopt NW Natural's proposed treatment of financial derivative products in the contested case docket, UM 903.

Position of NWIGU: The rule should specifically state that the allocation amounts will be allocated among customer classes on an equal percentage of margin among the LDC's nonincentive or cost-of-service sales and transportation rate schedules, since the simplified review process won't provide for a cost-of-service study regarding the allocation of costs, and this method will provide allocations that cause the least distortion from existing margins. The rule should also contain a provision that if the LDC fails to file a rate case after four years, the Commission will order a restatement of rates in which the LDC will have the burden to show that its rates continue to be just and reasonable. NWIGU fears that the PGA earnings review process will inherently forestall the filing of general rate cases by LDCs, which in turn will prevent other issues from being addressed in the context of a major rate case. The Commission should clarify how Section (8) is to work, and should add separate headings over Sections (1) through (7), and over Section (8).

Position of Staff: Staff recommends that the Commission adopt a list of ratemaking adjustments in the contested case docket, UM 903; the rule should only state that the Commission will establish ratemaking adjustments by order. Staff disagrees with NW Natural on the issue of normalizing adjustments because there are certain items regarding nonutility operations and prior reporting periods that should be excluded from a utility's results of operations, and it is inconsistent to exclude the costs of certain activities in setting base rates but allow them to be recognized in the PGA earnings reviews. There is no need to mandate either the inclusion or the exclusion of weather normalization in the rule itself. The allocation basis for amortization of refund amounts is an issue in UM 903, and the decision should be made in that case and not in the rulemaking docket. Staff disagrees with NWIGU's suggestion that a provision for a mandatory rate restatement be added to the rule. Staff believes that this rulemaking docket is not the proper forum for determining whether periodic rate cases should be required.

DISPOSITION

The Commission declines to include an upper earnings threshold limit, as suggested by CUB.¹ The earnings review in the context of the PGA mechanism is not a substitute for a major rate case, but instead is designed to get a general picture of whether an LDC's earnings are unduly excessive prior to that LDC passing through its prudently incurred base gas costs in rates. In a major rate case, the Commission may find that a utility is overearning, and adjust its rates downward on a going-forward basis. However, such a rate case will generally entail an audit and a more thorough review of the evidence, with consideration given to all relevant factors, while the PGA earnings review makes a compromise between thoroughness, and efficiency and ease of administration. If CUB believes that an LDC's earnings are so high that all earnings above a certain point should be returned to customers, then it can request the Commission to initiate a show cause proceeding.

While NW Natural questions the statutory basis for the PGA earnings review process, it admits that the statutes are susceptible to different interpretations, and indicates that it would not oppose the process if the outcome of this rulemaking docket and the contested case, UM 903, results in a regulatory framework that is fair to the Company. The proposed new rule applies only to LDCs and not to electric utilities, thus PGE will be unaffected by the rule. The Commission notes PGE's reservation of its right to object should a similar process be proposed for electric utilities.

In docket UM 903, the Commission basically adopted NW Natural's proposed treatment of financial derivative products, thus its concerns regarding subsection 8 of the proposed rule are essentially moot. The proposed new rule applies only to LDCs and not to electric utilities, thus PGE will be unaffected by the rule. The

¹ The actual earnings threshold is addressed in docket UM 903.

Commission notes PGE's reservation of its right to object should a similar provision be proposed for electric utilities.

It is unnecessary to adopt a procedure for contesting the application of standards or requesting a hearing on unresolved issues, as suggested by PGE. ORS 756.500(5) provides that "any public utility . . . may make complaint as to any matter affecting its own rates or service with like effect as though made by any other person, by filing an application, petition or complaint with the Commission." In addition, a utility may request rehearing or reconsideration, pursuant to ORS 756.561, or may file suit to set aside any findings of fact, conclusion of law or order, pursuant to ORS 756.580. There is no need for further procedural safeguards.

The Commission determines that it is necessary to make provision in the rule for normalization and adjustments, in order to exclude certain items regarding nonutility operations and prior reporting periods from a utility's results of operations. However, the Commission finds that it would be more appropriate to make a decision concerning which adjustments to adopt in docket UM 903, where a better record has been developed concerning this issue.

NW Natural expressed concern about the proposed rule's exclusion of a weather normalization adjustment. The Commission agrees with Staff that it is not necessary to either include or exclude a weather normalization adjustment in the rule itself. Instead, each LDC may make a one-time election of whether to include or exclude weather normalization in its PGA earnings review. This will allow each LDC to make the selection with which it is most comfortable. Consequently, the Commission will delete the following sentence from subsection (5)(b) of the proposed rule: "The test year results will not be normalized for weather."

The Commission rejects NW Natural's premise that the annual update of the earnings threshold should automatically consider other factors that may affect an LDC's cost of capital, beyond changes in conditions in the capital markets. The PGA earnings review process should be designed to be efficient and simple to administer, with some certainty as to what will be considered. Nevertheless, the Commission deems it advisable to include some flexibility for unforeseen or unusual circumstances. Thus the Commission will include the following sentence at the end of subsection (5)(c): "Upon a showing of good cause, the Commission may consider other relevant factors in addition to changes in conditions in the capital markets." The Commission stresses, however, that consideration of other factors should be the exception.

While the Commission recognizes NWIGU's concern that the PGA earnings review process will forestall the filing of general rate cases by LDCs, it disagrees with NWIGU on the need for a mandatory rate restatement provision in the rule. The Commission agrees with Staff that this rulemaking docket is not the proper

forum for determining whether periodic rate cases ought to be required. As suggested by NW Natural, NWIGU may request the Commission to initiate a show cause proceeding if it believes a rate case is necessary. The Commission also agrees with NW Natural that NWIGU's proposed language would inappropriately shift the burden of proof in a rate case not initiated by the utility.

The Commission finds that the selection of an allocation method for shared amounts to be amortized among customer classes should be made in the contested case docket, UM 903, where a better record has been developed concerning this issue.

In summary, we conclude that the proposed new rule, along with the modifications made in the workshop and in this order, will establish and codify the procedural steps for PGA filings and associated earnings reviews. It should be adopted.

ORDER

IT IS ORDERED that proposed new rule OAR 860-022-0070, Procedures and Standards for Reviewing Gas Utility Rates in the Context of the Purchased Gas Adjustment Mechanism, is adopted as set forth in Appendix A. The new rule will be effective upon filing with the Oregon Secretary of State.

Made, entered, and effective APR 21 1999



BY THE COMMISSION:

Vikie Bailey-Goggins
Vikie Bailey-Goggins
Commission Secretary

A person may petition the Commission for the amendment or repeal of a rule pursuant to ORS 183.390. A person may petition the Court of Appeals to determine the validity of a rule pursuant to ORS 183.400.

860-022-0070

Procedures and Standards for Reviewing Gas Utility Rates in the Context of the Purchased Gas Adjustment Mechanism

(1) The purpose of sections 1 through 7 of this rule is to ensure that earnings of a natural gas utility local distribution company ("gas utility" or "LDC") with a purchased gas adjustment ("PGA") mechanism are not excessive prior to passing through prudently incurred base gas cost changes in rates through a mechanism which is fair to all parties and efficient to administer. For purposes of this rule, earnings are excessive only if a gas utility does not share with its customers past revenues related to earnings that exceed an earnings threshold determined by the Commission.

(2) Prudently incurred base gas cost changes will be included in rates through tracking filings, subject to the Commission's review of gas cost purchasing practices at the time of those filings.

(3) A separate, simplified earnings review will be conducted on an annual basis independent of and in advance of the PGA filings. The purpose of such an earnings review is to determine whether the gas utility's earnings are above an earnings threshold so as to require some sharing of revenue with customers before passing through base gas cost changes. The purpose is not to make a forward-looking, permanent change in rates.

(4) In an earnings review conducted under this rule, it is reasonable for PGA base gas cost changes to be passed through into rates if, in circumstances when the gas utility's earnings in the prior year were above an earnings threshold determined in section 5 of this rule, revenue representing a percentage of earnings in that year above that earnings threshold is shared with customers.

(5) The standards to be applied in an earnings review under this rule for each LDC are as follows:

(a) Test year: The test year for the earnings review will be the calendar year immediately prior to the year in which the PGA filing is made, unless otherwise specified by the Commission.

(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.

(c) Earnings threshold: There will be no revenue sharing required for years when a gas utility's return on equity from utility operations in Oregon is lower than the earnings threshold determined by the Commission for each LDC. Neither this value nor any of the components implied in establishing it will be precedential in a general rate case involving any Oregon public utility.

The Commission will update the value for the earnings threshold annually for each LDC, pursuant to a mechanism established by order of the Commission for each LDC, to reflect changes in conditions in the capital markets. Upon a showing of good cause, the Commission may consider other relevant factors in addition to changes in conditions in the capital markets.

(d) Sharing percentage: The amount of revenue in a test year representing a specified percentage of the earnings above the earnings threshold will be shared with customers. The Commission by order will determine the sharing percentage for each LDC.

(e) Deferral and amortization: Any revenue determined for the gas utility for a test year under section 5(d) of this rule will be deferred as of December 31 of the test year. The balance in the deferred account will accrue interest from that date at the LDC's rate of return on rate base determined in its last general rate case. Interest will continue to accrue at this rate during the amortization period, which will begin on the date of the next PGA rate change and extend for twelve months. The Commission by order will determine the method for allocating amounts to be amortized among customer classes.

(6) Each LDC will file test year results of operations by May 1. Any person may request to be placed on a list to receive all such earnings review filings at the time they are submitted to the Commission or may request a copy of individual filings. Any person wishing to participate as a party shall so notify the Commission and other parties via letter. Commission staff will complete its review and distribute summary conclusions by June 10 to all parties. Staff will present the results of the earnings review at the first regular public meeting in July; alternatively, if issues are unresolved among all parties, a settlement conference including all parties will be conducted. By August 1, the parties will file position statements with the Commission on unresolved issues, if needed. The Commission will issue its decision on unresolved issues, if any, by September 15. Unless otherwise directed by the Commission, each LDC will file its annual gas cost tracking filing by October 15, including amortization of credit amounts in the deferred account, if any, resulting from the earnings review.

(7) The earnings review mechanism established under the terms of this rule will be effective for four years, with earnings reviews conducted in 1999 counting as the first year. The mechanism will be reviewed for potential extension after the fourth year.

(8) Application of earnings reviews conducted under this rule to amortization of deferred gas costs: The results of the earnings review conducted under this rule will be applicable to amortization of deferred gas costs if the LDC has a risk sharing mechanism for variations in commodity gas costs, as defined in the PGA tariff, that allocates less than 33 percent of the risk to the LDC. 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. The Commission may modify this requirement if it authorizes an alternative incentive mechanism relating to variations in gas costs for an LDC.

Stat. Authority: ORS Ch. 183 & 757

Stats. Implemented: ORS 757.210 & 757.259

Hist: NEW