

ITEM NO. CA1

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: July 16, 2009**

REGULAR CONSENT EFFECTIVE DATE _____ N/A _____

DATE: July 2, 2009

TO: Public Utility Commission

FROM: Carla Owings

THROUGH: Lee Sparling, Ed Busch and Judy Johnson

SUBJECT: NORTHWEST NATURAL: (Docket No. UM 903) 2009 Spring Earnings Review.

STAFF RECOMMENDATION:

Staff recommends that the Commission accept Staff's finding that Northwest Natural's (NW Natural or Company) 2008 earnings are below the earnings threshold designated in UM 903 and there should be no earnings shared in this filing.

DISCUSSION:

In Order Nos. 99-272 and 99-284 (Dockets UM 903 and AR 357), the Commission adopted Purchased Gas Adjustment (PGA) Procedures and Standards for Oregon's three regulated natural gas distribution companies – Northwest Natural, Cascade Natural Gas, and Avista Utilities. One of the primary issues dealt with in these orders is the role and structure of earnings reviews. The earnings reviews were originally scheduled to sunset in 2002 but were extended twice, first in Order No. 03-198 (AR 449) until 2006 and then again in Order No. 07-019 (AR 512), through 2008. On October 21, 2008, the Commission issued Order No. 08-504 (UM 1286) adopting revisions to the current mechanism and eliminating the sunset provision.

The Commission's findings, as they apply to earnings reviews, are summarized below:

- Annual Election: Not later than August 1st of each year, each Local Distribution Company (LDC) shall make an annual election for the applicable gas year

beginning November 1st whether to choose 90/10 sharing¹ or 80/20 sharing with a corresponding earnings review threshold. On October 28, 2008, NW Natural filed Advice 08-9 electing an 80/20 sharing for the gas year beginning November 1, 2008.

- Spring Earnings Review: An earnings review will be performed each spring (pursuant to OAR 860-022-0070) based on the most recent fiscal year's results of operations. The earnings review will apply to the sharing election made by the LDC the previous August (e.g., the 2008 election will apply to the 2009 Fiscal Year results of operations which are the subject of the 2010 spring earnings review); if earnings are found to be above a specified return on equity (ROE) level, a portion of those revenues will be booked to a deferred account.
- The ROE Earnings Threshold: Beginning with the 2010 Spring Earnings Review, an LDC that elects 90-10 sharing will be subject to an earnings threshold 100 basis points above its ROE, adjusted to reflect changes in conditions in capital markets. An LDC that elects 80-20 sharing is subject to an earnings threshold 150 basis points above its ROE, adjusted in the same manner.² However, for the current 2009 Spring Earnings Review, the earnings review is calculated using the method applied in last year's review. Accordingly, the earning threshold for NW Natural for this 2009 Spring Earnings review (for reviewing 2008 results of operations) is 13.14 percent.
- Structure of Earnings Reviews: By May 1, each year, the LDC will file results of operations for the twelve months ended the prior December 31. Staff will complete its review and distribute summary conclusions by June 10 to all parties. At the first regular public meeting in July, Staff will present the results of the earnings review. If there are unresolved issues, a settlement conference will be held. If there are still outstanding issues, parties will file position statements by August 1 and the Commission would issue its decision on unresolved issues by August 15. These rate changes will include amortization of credit amounts in the deferred account, if any, resulting from the spring earnings review.

¹ Sharing of the variance between the LDC's weighted average cost of gas (WACOG) included in its rates and its actual WACOG. For example, 90/10 designates 90 percent of the variance will be deferred for subsequent charge or credit to customers, and 10 percent is absorbed or retained by the LDC.

² See Order 08-504 at 17. The earnings threshold is adjusted each year by 20 percent of any change in the risk free rate for the twelve-month calendar year preceding the annual earnings review (See Order No. 04-203 at 3-4 and OAR 860-022-0070(5)(c)).

- Earnings Adjustments: Recorded results of operations will be adjusted for Type 1 adjustments set forth in Order No. 99-272. NW Natural made a one-time election to include a weather normalization adjustment in its spring 1999 earnings review filing and each subsequent annual filing.
- Earnings Performance: If adjusted earnings are below the earnings threshold, there will be no rate adjustment. If adjusted earnings are above the earnings threshold, the amount of revenue in the test year representing 33 percent of the earnings exceeding the threshold level will be shared with customers.
- Effective Date of Rate Adjustment and Applicable Interest: Upon completion of the earnings review, any amount of earnings over the sharing dead band determined to be returned to customers will be booked to a deferred account. Interest shall apply beginning the previous January 1. The rate adjustment and amortization will be effective with the date of the subsequent base gas cost change.

NW Natural's Earnings Review

On May 1, 2009, NW Natural submitted its 2008 results of operations report for the twelve months ending December 31, 2008. The company states that its report was developed in a manner consistent with Commission Order No. 99-272 and reflects applicable adjustments per Commission Order No. 03-507 for its general rate filing, UG 152. The Company calculates its ROE as 9.51 percent after application of its Type 1 adjustments, which is below the 13.14 percent threshold authorized by the Commission.

Staff has examined the Company's filed earnings report. In its calculation of Miscellaneous Revenues, Staff disagreed with the method employed by NW Natural to adjust the revenues. Upon Staff's recommendation, the Company agreed that it is appropriate to revise the adjustment, resulting in an ROE after Type 1 adjustments of 9.59 percent rather than 9.51 percent initially reported by the Company. Both the revised ROE and the original ROE reported by NW Natural include the 2008 WACOG sharing retained by the Company's shareholders as operating revenues.

As required by OAR 860-022-0070(6), on June 10, 2009, Staff has submitted these findings to the parties in Docket No. UM 903. Staff received no comments in response.

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PROPOSED COMMISSION MOTION:

Accept Staff's finding that NW Natural's 2008 earnings are below the earnings threshold designated in UM 903 and that there should be no earnings shared in this filing.