

# McDowell Rackner & Gibson PC



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April 3, 2013

## **BY OVERNIGHT DELIVERY**

Steven V. King  
Acting Executive Director and Secretary  
Washington Utilities & Transportation Commission  
1300 S. Evergreen Park Drive SW  
P.O. Box 47250  
Olympia, WA 98504-7250

**Re: Docket No. UG-121434 – Northwest Natural Gas Company**

Dear Mr. King:

This letter is filed on behalf of Northwest Natural Gas Company (“NW Natural” or “Company”) and responds to issues raised at the March 22, 2013, Recessed Public Meeting of the Washington Utilities and Transportation Commission (“Commission”) regarding Docket UG-121434, the proceeding for NW Natural’s Annual Purchased Gas Adjustment (“PGA”) and Deferred Gas Cost Amortization (“Deferral”) mechanisms. At that time, NW Natural’s Director of Gas Supply, Randy Friedman, described the Company’s gas hedging practices and supported the Company’s position that its gas costs for the 2011-2012 heating year—for which Public Counsel is proposing a disallowance—were prudently incurred. The Commission requested additional argument for April 5, to address the question as to whether hearings should be scheduled to further consider Public Counsel’s recommendations. The purpose of this letter is to explain why any disallowance of NW Natural’s hedged gas costs for 2011-2012 would violate the rule against retroactive ratemaking, and why, therefore, such hearings should not be held.

### **The PGA and Deferral Mechanisms**

In order to understand why Public Counsel’s proposed disallowance would constitute retroactive ratemaking, it is important to review the workings of the PGA process.

The PGA and Deferral mechanisms are designed to pass through NW Natural’s actual cost of natural gas to customers on an annual basis. Each year by August 31, NW Natural files the PGA

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to establish for the upcoming year an estimate of the utility's gas costs using both known and estimated gas costs and volumes. The **known** inputs include the costs of both physically and financially hedged volumes, while the **estimated** inputs include the costs associated with unhedged supplies— those additional gas purchases that will be made during the course of the PGA year. This filing is then updated in October of each year, to reflect any additional hedges entered into by NW Natural for the upcoming PGA year, as well as changes to the forward prices that determine the cost of unhedged volumes. Upon filing, Staff and the parties review both the gas costs associated with the hedges that the Company has already entered into, as well as its estimate for gas costs to be incurred throughout the year, and make recommendations as to whether the costs as proposed by NW Natural should be included in rates. If no change is made by the Commission, the rates go into effect as filed, on November 1.

Each year the Company also makes a Deferral filing associated with the PGA. The Deferral represents the difference between the estimated gas cost and the actual gas cost experienced by the Company in the **previous** PGA year. The variance between these amounts is deferred and ultimately amortized back to customers with interest, as a surcharge or refund in the following year's PGA filing. Significantly, because the costs associated with the completed hedges are already known at the time rates are set, there can be no cost variance associated with them. For that reason, the deferral does not relate to hedged volumes.

### **Public Counsel's Proposed Disallowance Would Constitute Retroactive Ratemaking**

As discussed in NW Natural's March 19, 2013, letter in this docket, Public Counsel's proposed disallowance is based on hedges the Company entered into in August and September 2011, for the 2011-2012 PGA year.<sup>1</sup> These hedges were included in the PGA filing made for the 2011-2012 PGA year and were therefore addressed in Docket UG-111587, the Company's last PGA docket. Public Counsel filed comments in Docket UG-111587 and did not challenge the reasonableness of these hedges.<sup>2</sup> Staff also reviewed the Company's filing and recommended that the proposed PGA rates go into effect:

The PGA reflects a projection of gas costs for the coming 2011-2012 winter season. . . Commission Staff has completed its review of the company's supporting financial documents, prospective gas cost and deferral amortization filing. Staff's review shows that the expenses are reasonable and requires as part of the company's

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<sup>1</sup> *Wash. Util. and Transp. Comm'n v. Northwest Natural Gas Co.*, Docket UG-121434, Report on Natural Gas Procurement Practices of Northwest Natural Gas Company Docket UG-121434 on Behalf of Public Counsel at 12 (Mar. 8, 2013) (hereinafter "Public Counsel Report").

<sup>2</sup> See Docket UG-111587, Letter on Behalf of Public Counsel (Oct. 21, 2011).

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operation. The company's financial information supports the revised rates and charges are fair, just, reasonable, and sufficient.<sup>3</sup>

Thereafter, the Company's filed tariffs became effective by operation of law. *Thus, as a matter of law, the Commission found those hedges to be prudently entered, and included the costs of those hedges in customer rates. The Commission is therefore precluded by the doctrine prohibiting retroactive ratemaking from now disallowing those hedges based upon a view that, in hindsight, actual market results were below the hedged prices or below expectations at the time.*

The Commission adheres to the doctrine against retroactive ratemaking,<sup>4</sup> which "prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up for past errors in projections."<sup>5</sup> The Commission has previously stated that "retroactive ratemaking . . . is extremely poor public policy and is illegal under the statutes of Washington State as a rate applied to a service without prior notice and review."<sup>6</sup> However, that is precisely what Public Counsel has now invited the Commission to do. Public Counsel is asking the Commission to revisit its decision to approve the hedges in 2011, based on the actual results of the hedges, and adjust prospective rates accordingly. This request is improper retroactive ratemaking and should be rejected.<sup>7</sup>

Public Counsel may argue that the Deferral is an exception to the prohibition on retroactive ratemaking. While it is true that deferrals are a recognized exception to the prohibition on retroactive ratemaking,<sup>8</sup> this exception does not apply here because, as discussed above, the costs associated with these hedges were not deferred.

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<sup>3</sup> Docket UG-111587, Staff's Open Meeting Memorandum (Oct. 27, 2011).

<sup>4</sup> The Commission's statutes require that if the Commission determines that rates are unjust or unreasonable, it shall determine just and reasonable rates "to be thereafter observed and in force." RCW 80.28.020.

<sup>5</sup> *Re Application of Puget Sound Energy for Authorization Regarding the Deferral of the Net Impact of the Conservation Incentive Credit Program*, Docket UE-010410, Order (Nov. 9, 2001) Denying Petition to Amend Accounting Order (Nov. 9, 2001).

<sup>6</sup> *Id.*; see also RCW 80.28.020. The Commission denied Puget's petition on the basis that the "retroactive ratemaking doctrine prohibits the Commission from authorizing or requiring a utility to adjust current rates to make up for past errors in projections. With few exceptions (not applicable here), under RCW 80.28.020, the Commission is charged with setting rates on a prospective basis."

<sup>7</sup> See also *Wash. Util. and Transp. Comm'n v. Puget Sound Energy, Inc.*, Docket UE-031725, Order 14 ¶ 87 (May 13, 2004) ("we do not believe that prudence required PSE, under the circumstances, to enter into another long-term [gas] contract for the full amount, even if, in hindsight (**which cannot be our guide**) such a contract would have produced the intended savings.") (emphasis added).

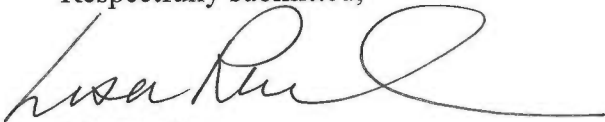
<sup>8</sup> *Re Petition of PacifiCorp for an Accounting Order Authorizing Deferral of Excess Net Power Costs*, Docket UE 020417, 3<sup>rd</sup> Supp. Order ¶ 24 (Sept. 27, 2002).

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The Company offers this letter to make clear its legal position regarding the unlawful nature of the disallowances Public Counsel proposes. In addition, we continue to encourage the Commission to reject Public Counsel's recommendations for the policy and other reasons offered at the Commission's public meeting on March 22<sup>nd</sup>, and raised in the Company's letter filed prior to that meeting.

The Company looks forward to answering any questions the Commission may have at the April 5, 2013 Public Meeting.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Lisa Rackner", with a long, sweeping horizontal stroke extending to the right.

Lisa Rackner

cc: Judge Adam E. Torem (by electronic mail)  
Parties of Record (by electronic mail)

## CERTIFICATE OF SERVICE

I hereby certify that I have this 3<sup>rd</sup> day of April, 2013, served the true and correct original, along with the correct number of copies, of the foregoing document upon the WUTC, via the method(s) noted below, properly addressed as follows:

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Washington Utilities and Transportation  
Commission  
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Olympia, WA 98504-7250

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I hereby certify that I this 3<sup>rd</sup> day of April, 2013, served a true and correct copy of the foregoing document upon parties of record, via the method(s) noted below, properly addressed as follows:

***On Behalf Of Public Counsel:***

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***On Behalf Of Commission Staff:***

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I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 3<sup>rd</sup> day of April, 2013, at Portland, Oregon.



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