

NW Natural's Conservation Tariff

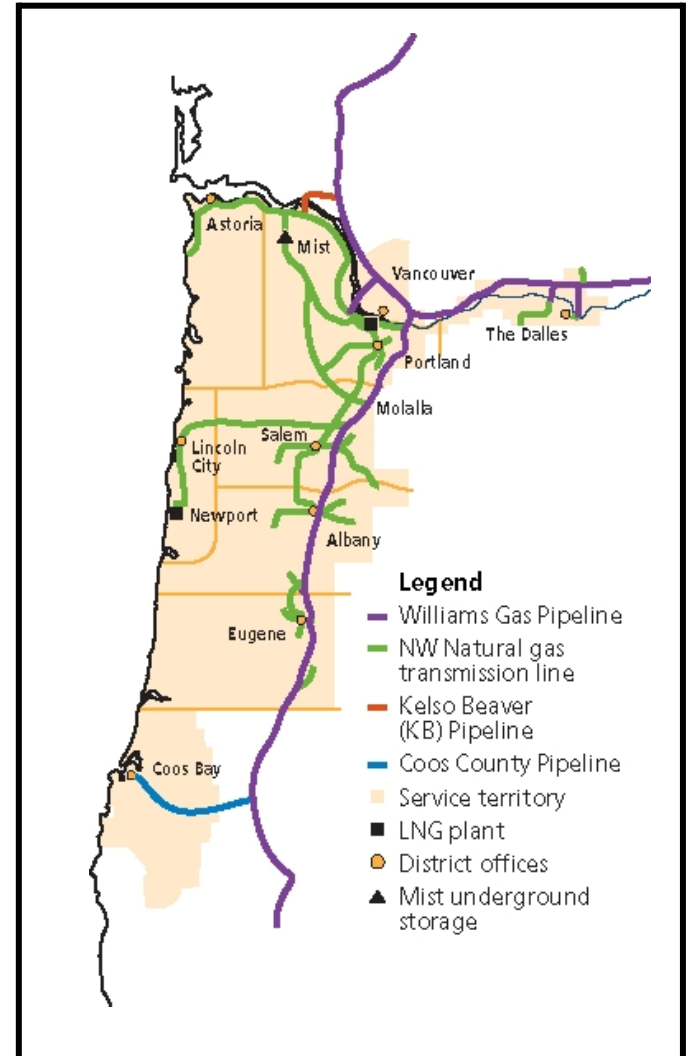
**NARUC Winter Meeting
Washington D.C.
February 14, 2006**



Who we are

Natural Gas Distribution Company

- ▶ 147 year-old LDC headquartered in Portland, Oregon
- ▶ Serving western Oregon and southwestern Washington
- ▶ 620,000 customers
- ▶ 1,300 employees
- ▶ More than 3% customer growth for 19 consecutive years
- ▶ Serve a little over 50 percent of the homes in our service territory



Why we proposed decoupling

1999 Rate Increase

- ▶ Commodity and cost of service increases about 9%

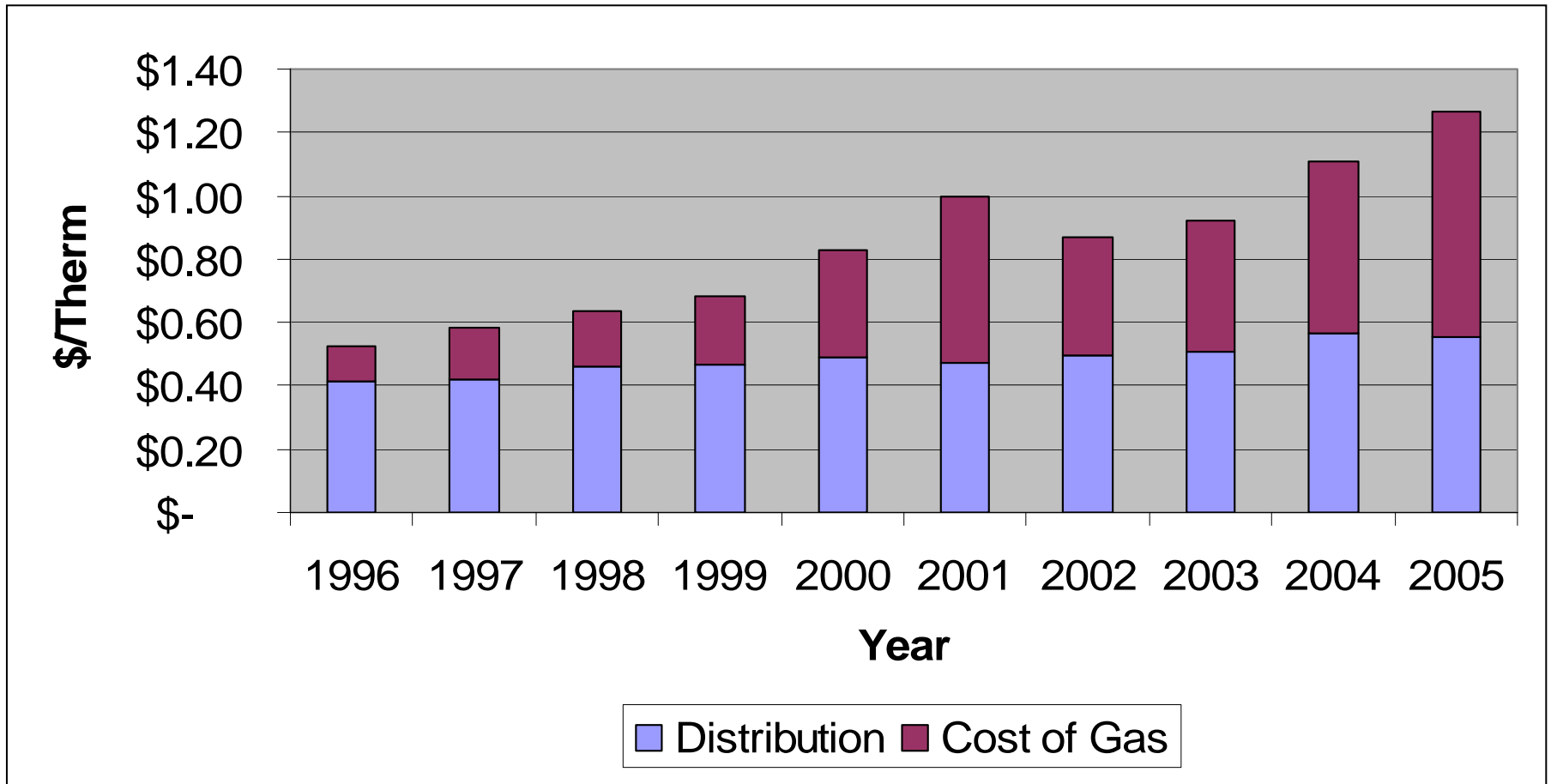
2000-2001 Energy Crisis

- ▶ Customers wanted help managing their billings
- ▶ Elected officials asked utilities to increase conservation/energy efficiency
- ▶ NW Natural stepped up
- ▶ Usage declined by nearly 15%
- ▶ Did the right thing for our customers ...at the expense of our shareholders

Wanted to Better Align Interests

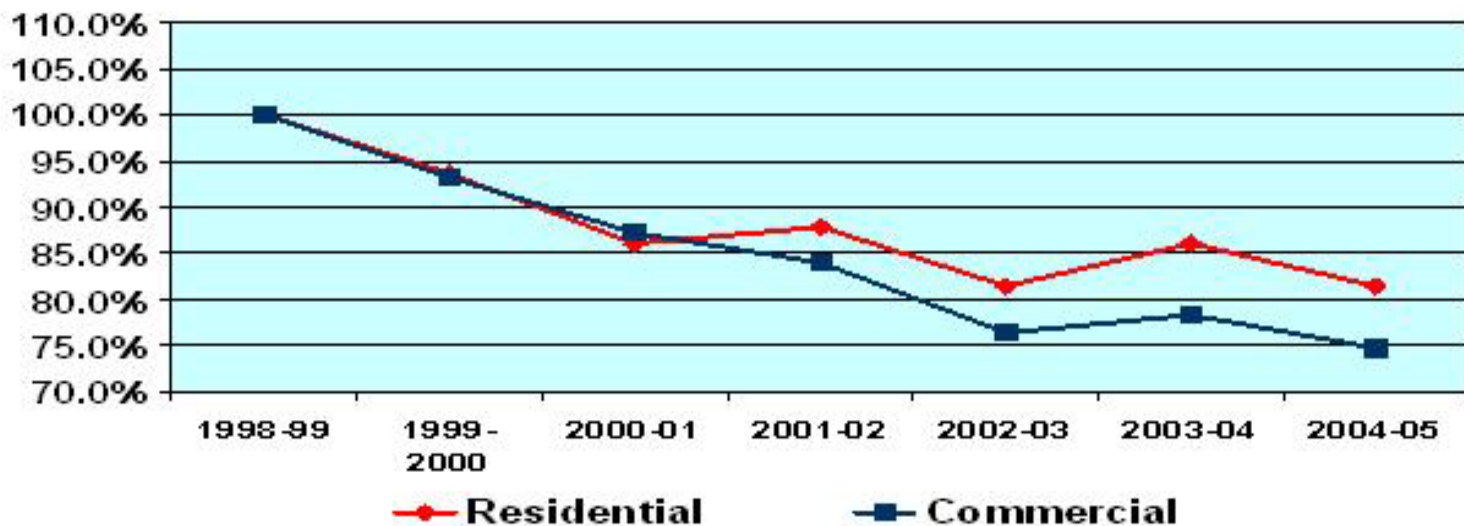
- ▶ Being at odds with your customers isn't good business
- ▶ Wanted our customers and shareholders to be on the same side of the table

Retail rates have risen 140% in ten years



Our customers conserve

Therms Per Customer Per Degree Day as % of 1998-99 Heating Season



Therms/DD

Residential	0.162	0.152	0.139	0.142	0.132	0.140	0.132
Commercial	0.730	0.680	0.636	0.612	0.557	0.571	0.545

What we proposed & what we got

Began with consumer advocate discussions

- ▶ Believed it had to benefit both customers and the company
- ▶ Filed “Conservation Tariff” in June 2001
- ▶ Approved in October 2002

Started with a full decoupling, including weather normalization

- ▶ Too much too quickly
- ▶ Dropped weather normalization

What emerged accomplished the parties objectives

- ▶ Process was key
- ▶ Product of negotiation and compromise
- ▶ Lots of ways to design a mechanism

How it works

Two components

- ▶ Price elasticity adjustment
- ▶ Conservation adjustment

Price elasticity Adjustment

- ▶ Increases or decreases in consumption due to changes in prices
- ▶ Applied anytime rates change: PGA's or rate cases
- ▶ Coefficient established
- ▶ Month-by-month usage forecast

Conservation Adjustment

- ▶ Applied on a monthly basis, using elasticity corrected volumes
- ▶ Difference multiplied by our distribution margin
- ▶ Dollars produced deferred for collection or refund at the end of the year

What we gave

Commitment to encourage conservation

Agreed to transfer conservation programs to Energy Trust

Collect a public purpose charge on our bills

- ▶ 1.25% for energy conservation and efficiency
- ▶ .25% for low income energy efficiency
- ▶ .25 cents per month/per bill for low income bill assistance

Agreed to service quality standards

Agreed to file rate case

- ▶ Filed two months later
- ▶ Included weather normalization

How it's performed

- **Approved as 3 year pilot**
- **Order required an independent assessment in year 3**
- **Parties selected an economic analysis & consulting firm**
- **Detailed financial analyses & stakeholder interviews**
- **Key questions identified by staff, consumer & environmental advocates and the company**
- **Assessment led to a renewal of the mechanism, with a few changes, for another four years**

How it's performed

Did the mechanism work as expected?

- ▶ Yes
- ▶ Elasticity and conservation adjustments self correct

Did it eliminate the relationship between the utility's sales and profits?

- ▶ Yes, but not completely
- ▶ Only 90% coverage initially

Did it reduce the company's risks, and if so, did it reduce its costs?

- ▶ Yes on both accounts
- ▶ But difficult to quantify due to other changes: rate case, weather normalization
- ▶ Upgraded S&P bond rating

Were the reduced risks shifted to customers?

- ▶ Yes, but appropriately, for increase gas prices
- ▶ No, for economic risk

Did it affect the quality of service?

- ▶ No
- ▶ Does not alter incentives to provide high quality service

How it's performed

Did the company game the mechanism in connecting new customers?

- ▶ No
- ▶ Did not change our policies for new connections

Did it change the company's culture or operating practices?

- ▶ Reduced marketing organization
- ▶ Employees assigned to work with ETO
- ▶ Shifted advertising budget to focus on conservation/ee info
- ▶ Highest referral rate to ETO of any Oregon utility
- ▶ Significant increases in HEF program

What was the impact on customers?

- ▶ \$15 million first year due setting of baseline usage: 3% of revenues
- ▶ \$578K second year: about 0.1% of revenues
- ▶ Only 26 complaints, all related to public purpose charge
- ▶ Public Purpose Funding: approximately \$9.4 million per year

How it's performed

“We have been impressed by the breadth of support that DMN has received. The Energy Trust of Oregon reports that NW Natural has been successful in creating a good working relationship with the ETO, and that NW Natural’s efforts to promote energy efficiency effectively complement their own efforts. HVAC distributors believe that NW Natural’s marketing efforts, in conjunction with its relationships with consumers, distributors, and the ETO have helped increase sales of high-efficiency furnaces to the point where Oregon has the highest share of high efficiency furnaces in the nation (as a percentage of new furnace sales). The Citizens’ Utility Board of Oregon, the Northwest Energy Coalition and a number of CAP agencies believe that the Public Purposes Funding established in conjunction with DMN is beneficial for consumers. The Natural Resources Defense Council and AGA released a joint statement regarding the positive environmental effects of decoupling, specifically citing NW Natural’s experience as an example of the positive outcomes that decoupling can yield. The negative feedback we received is limited to 26 customer complaints that questioned the appropriateness and/or legality of the Public Purposes Funding.”

Christensen Associates, March 31, 2005.

Lessons learned

- **Need shared commitment to sound energy policy**
- **Parties see shared customer/shareholder interests**
- **All parties willing to create a “win-win”**
- **Process is important**
- **Many ways to design the mechanism**