

[REINVENTING REGULATION]

Decoupling Works

READY FOR NATIONAL ROLLOUT

By Mark Dodson



■ THE PACIFIC NORTHWEST is a unique region. Being environmentally conscious here is as much a part of daily life as enduring rainy winters and enjoying views of snowcapped peaks in late summer. Northwesterners have high expectations that their energy providers will go the extra mile to conserve energy and be responsible environmental stewards.

That made NW Natural Gas territory of western Oregon and southwest Washington a natural setting to pioneer a decoupling mechanism. While the story of how we broke the link between revenues and sales volume is unique, the mechanism is readily exportable to other states. In fact, there is no reason why electric utilities, which flirted with decoupling in the 1990s, shouldn't embrace the concept now.

By the mid 1990s, per capita use of natural gas was dropping. We detected this trend earlier than most utilities for two reasons. First, in the 1990s the Northwest enjoyed relatively low natural gas prices. As prices rose, customers felt the pinch and began to conserve aggressively. Second, a housing boom in the Northwest brought a large number of new homes with more efficient appliances and insulation.

With the Energy Crisis of 2000-2001, these forces converged. The pressure from all sides to help customers reduce consumption and manage bills became enormous. We stepped up and increased our conservation programs and in turn saw use decline even further. It didn't make sense that we were doing the right thing for our customers and being penalized financially. So we developed a mechanism we called the Conservation Tariff.

We worked closely with regulators, customer and environmental advocates instead of battling them. We found it more productive to put our shareholders on the same side of the table as our customers. It took a concerted effort, but eventually all saw that this was a sincere effort to encourage conservation while solving our business problem.

The tariff includes two adjustments, one for price elasticity and the other for conservation. The first occurs any time our prices increase or decrease. If they go up, they go up a little more to account for the expected decrease in demand. If prices are going down, they go down a little more to account for the

expected increase in usage. The conservation adjustment occurs on a monthly basis and is essentially a true up of what people used versus what we expected them to use. The difference is multiplied by our distribution margin, and the dollars produced are held in a deferral account for collection or refund at year-end.

As part of this new tariff, the company agreed to step up its energy-efficiency efforts, including adding a charge to our bills to help fund energy efficiency programs and to support bill-paying assistance for low-income customers. So today, we can promote conservation without working against our shareholders.

The Conservation Tariff went into effect in Oregon in 2002. In late 2005, our regulators renewed it for four years, actually increasing the amount we can recover from 90 percent to 100 percent of the decline in usage.

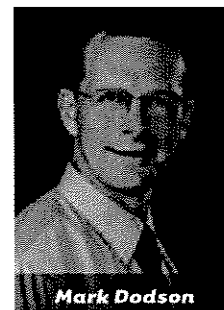
The Conservation Tariff proved popular with customer groups, environmental advocates and regulators. We're gratified that many other natural gas utilities are working toward similar decoupling mechanisms. Proposals are under consideration by regulators in Arizona, California, Montana, North Carolina, New Jersey, Indiana, Utah, Washington and Oregon.

It is time to reexamine our utility rates in light of current concerns about conservation and the environment.

Many rate mechanisms were originally designed in the 1930s to encourage the abundant use of energy. This was appropriate when we were building massive power projects to industrialize a nation. But do they still make sense for a forward-looking utility in the 21st century?

The key to a successful decoupling mechanism is to find a way to share the risks and benefits of lower volumes and volatile prices. The dynamics of a company's place in the energy market and its regulatory environment will dictate precisely how it should approach decoupling. But the principle of risk and benefit sharing is critical in any situation.

NW Natural's particular territory and its long-term commitment to environmental stewardship made our strategy unique. But it is clear that much has changed in the energy business in the last few years. We can't afford to be caught in the middle between regulators, shareholders and customers. Working cooperatively and productively with all of our key stakeholders is essential for long-term success.



Mark Dodson is president and chief executive officer of NW Natural Gas.

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LNG SURGES

The liquefied natural gas industry will need \$120 billion in investments for new plants in the next 15 years and \$30 billion for LNG terminals, according to Stephen Green, with Societe Generale.

Growth in the LNG sector between now and 2020 will outstrip growth in oil and other sectors of the natural gas industry, Green said, according to a Dow Jones & Co. report.