222 FAIRVIEW AVENUE N., SEATTLE, WASHINGTON 98109-5312 206-624-3900
FACSIMILE 206-654-4039

December 4, 2007

Public Utility Commission of Oregon
Attn.: Filing Center
550 Capitol Street NE #215
Salem, OR 97310-1380

Re: **UM 1286** – In the Matter of THE PUBLIC UTILITY COMMISSION OF OREGON Investigation into the Purchased Gas Adjustment (PGA) Mechanism Used by Oregon's Three Local Distribution Companies.

Dear Filing Center:

Enclosed for filing please find Cascade Natural Gas Corporation's opening comments in Phase 1 of docket UM 1286.

Thank you for your assistance.

Sincerely,

/s/ Curt Lulias

Curt Lulias
Regulatory Affairs

Enclosure

cc: UM 1286 Service List

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1286

Investigation into the Purchased Gas Adjustment (PGA) Mechanism Used by Oregon's Three Local Distribution Companies	Opening Comments of Cascade Natural Gas Corporation

Cascade Natural Gas Corporation hereby submits its initial comments in Phase 1 of docket UM 1286. In a letter to Judge Powers, dated September 25, 2007, the parties proposed that the docket be split into two phases with the first phase addressing mechanisms for the recovery of gas costs, including any proposed incentive arrangements. The letter proposed that the following issues would be addressed during phase 1:

1. What mechanism(s) should the Commission approve for the recovery of gas costs by Oregon's three natural gas utilities? The proposed mechanism(s) shall address recovery of gas costs and may include an incentive piece.

2. Explain the proposed cost recovery and incentive mechanisms.

3. Explain how the proposed mechanisms correct any deficiencies of the current mechanisms.

COMMENTS

Question 1: What mechanism should the Commission approve for the recovery of gas costs by Oregon's three natural gas utilities? The proposed mechanism(s) shall address recovery of gas costs and may include an incentive piece.

In general, Cascade believes that the existing Purchased Gas Adjustment ("PGA") mechanism is appropriate for the recovery of gas costs by a natural gas utility ("LDC"); however, the mechanism should be modified to allow LDCs to defer and recover 100% of their prudently incurred gas costs. Cascade proposes that the Commission terminate the 1/3 sharing portion of the current mechanism because it does not work in today's highly volatile natural gas market and does not provide a true incentive to lower gas costs; rather, it is simply a mechanism to share the risk of fluctuating prices, which are outside the control of the LDCs. The current sharing mechanism imposes an unreasonable and unnecessary risk

on LDCs when prices are higher than anticipated, and also deprives customers of receiving the full benefit of gas prices that are lower than expected.

The original intent of the PGA mechanism was to allow LDCs to recover the changes in wholesale gas costs on a periodic basis outside of a general rate case. In most jurisdictions, the PGA allows for 100% pass-through of prudently incurred gas costs. By contrast, the Oregon mechanism in place today requires LDCs to absorb a portion of any variance between the LDC's weighted average cost of gas (WACOG) commodity rates and the actual WACOG as calculated on a monthly basis. For Cascade, that sharing percentage is 33% of the cost difference. The baseline commodity rate which serves as the benchmark against which actual gas costs are measured is set annually through the PGA filing and is based on estimated commodity costs for the upcoming year made at the time of the filing. The difference between the estimated costs and the actual costs is primarily due to market factors completely outside an LDC's control and on the uncertainties and complexities inherent in forecasting prices.

Requiring LDCs to absorb any portion, let alone 33% of such differences does not provide any real incentive to LDCs to obtain gas at the lowest reasonable cost; rather, it simply requires LDCs to absorb a portion of the increased gas costs which are outside its control, regardless of the accuracy of the LDC's forecast or the prudency of its purchasing practices. Likewise, when actual costs are lower than the estimate, the 33% sharing mechanism simply deprives customers of receiving the full benefit of such lower costs. Instead of continuing an outdated sharing mechanism, the Commission should allow LDCs to recover 100% of prudently incurred gas costs. In order to help ensure that LDCs pay the lowest reasonable amount for gas, the Commission should focus its efforts on monitoring the LDCs' purchasing practices. Eliminating the sharing mechanism will significantly reduce the Commission's workload while continuing to ensure that customers pay the most reasonable price for gas commodity. It will also eliminate a mechanism that has developed to the point that it now unfairly requires LDCs to bear the risk of upward market fluctuations and, at the same time, denies customers the benefit of prices that are lower than anticipated.

When the initial mechanism was established in 1989, the natural gas markets were stable, if not declining, far more predictable, and considerably lower priced. At that time, over two-thirds of the Company's gas purchases were Northwest Pipeline's ODL service at FERC tariffed rates. When the mechanism was reviewed in 1996 in docket UM 903, the markets were still generally stable and wholesale commodity prices at the Northwest receipt points typically ranged between $1 and $2 per mmbtu. During 1996, the gas cost commodity component of Cascade's rates was $.12013 per therm ($.12298 adjusted for revenue sensitive costs) and represented roughly 22% of the Company's overall per therm rate of $.55559 charged to residential customers. By comparison, Cascade's current gas cost commodity rate component is $.78594 ($.80502

adjusted for revenue sensitive costs) and represents 67% of the Company's overall residential rate.

Since 1996, natural gas market conditions have changed drastically and the lower priced, less volatile market as described above no longer exists. Over the past 5 years price volatility has become the rule as opposed to the exception. We have seen first of the month prices at the Northwest price points range between $1 and over $11 and the range of daily prices within any given month have typically included more than $1 difference between the high and low. (See attachment A). The demand for natural gas has continued to grow, particularly in the electric generation sector. Meanwhile, it has been difficult for the supply of natural gas to keep up with the demand, due to the maturity of the supply basins. Now that the supply and demand are closely balanced, any significant change in supply (such as a supply disruption due to a hurricane or a pipeline rupture) or demand (such as unusually cold winter weather or unusually hot summer weather) can create significant increases in the price of gas. This situation is exacerbated by the financial players in today's natural gas commodity market who make their money based on speculation of price movements. The impact of the financial players is that natural gas pricing is often disconnected from the fundamentals of supply and demand, with speculation driving the market. None of these market conditions are under the control of Cascade or the other Oregon LDCs.

As noted above, the current sharing mechanism requires Cascade to absorb 33% of the difference between the cost of gas included in rates and its actual gas costs, whether positive or negative. The cost of gas included in rates is determined at the beginning of the PGA year based on the estimated index costs for the volumes that are un-hedged at the time of the PGA filing. This creates two problems as described below.

First, under the current mechanism, an LDC can have positive or negative sharing of gas costs solely as a result of market fluctuations causing the actual price to be different from the estimated price, regardless of how well the LDC procured supplies for its customers. Cascade believes this creates even more risk for the LDCs, since, under the current mechanism, the utility could purchase its core supplies prudently, even lower than market costs, and still be at risk to absorb 1/3 of the actual differences, should the market prices be greater than those forecasted at the time of the PGA, due to some event over which the Company has no control, such as prolonged cold weather on the East coast. Unlike our electric counterparts, who have several options for generating the energy commodity (wind, hydro, natural gas-fired generation to name a few), the natural gas utilities do not produce their supplies and must purchase natural gas in order to meet their core load requirements.

To the extent an LDC has limited storage options, as is the case for Cascade, this risk is even greater. Based on today's market, the exposure associated with

sharing 1/3 of the commodity differences could have a far more detrimental effect on the Company's overall earnings than it did at the time the mechanism was originally implemented. To manage this risk, for the past several years Cascade has utilized a programmed buying approach and ultimately has hedged approximately 80% of its anticipated load requirements for the upcoming year through fixed price financial swap instruments. However, even with only 20% of the estimated Oregon load requirements un-hedged, a 50-cent change in the average annual wholesale price per mmbtu could result in an increase in Cascade's Oregon commodity gas costs of close to $670,000 for the year. This difference represents 10.5% of Cascade's Oregon net operating income reported for FY06. If the Company were to hedge only 50% of its Oregon supplies, that same 50-cent change in price would result in almost $1.7 million in additional gas costs. Absorbing 1/3 of those additional costs would decrease the Company's Oregon net operating income by over $500k, which is close to a 10% decrease in the Company's net operating income.

Second, the current approach puts tremendous pressure on getting the estimated forecast "right", which in today's environment is much like trying to predict the price of gasoline or stock prices for the next year. Some would contend that the current approach provides an incentive for LDCs to overestimate the forecasted prices for the upcoming year. Although Cascade would disagree with the assumption that the current methodology provides an incentive for the utilities to overestimate its un-hedged costs, the Company believes the current methodology makes the process of estimating forward index prices far more contentious than it needs to be.

As the wholesale price of natural gas has increased, the financial risk associated with the 1/3 sharing mechanism has likewise increased. The significance of this financial risk makes it difficult for the utilities to develop Gas Supply Procurement and Hedging Strategies that focus solely on obtaining reliable supplies at reasonable prices with moderate protection from price spikes for our core customers. The utility must also include strategies to minimize this financial risk.

For the reasons stated above, Cascade believes that the PGA mechanism should be modified to allow 100% of prudently incurred gas costs to be passed through without any sharing. This arrangement has worked well in other jurisdictions, including Washington, while still holding the LDC responsible to purchase its gas portfolio prudently.

Question 2: Explain the proposed cost recovery and incentive mechanisms.

Cascade's proposed mechanism is quite straightforward. One hundred percent of the difference between the gas costs collected from customers in rates and the actual costs incurred would be deferred and amortized the following year through the PGA process. Basically, the current PGA mechanism would stay in place

without the sharing component, because of the problems with this component as described earlier in this document. Staff would continue to review actual gas costs for prudency and any costs deemed imprudent would be disallowed and adjusted, as is the case under today's mechanism. Currently, the Company provides detailed documentation on the actual gas costs and the deferral balances to Staff on a quarterly basis, and this would continue. Under the existing mechanism, the utilities already defer 100% of the differences between the utilities' actual fixed gas cost component (primarily pipeline transportation related charges) and those collected through rates. The commodity differences would be recovered the same way, with 100% recovery of the commodity differences.

In Phase II of this docket, specific guidelines can be developed regarding any additional work papers and/or supporting documentation that may be necessary to facilitate Staff's review of the prudency of the purchases. As noted above, Cascade believes that focusing on the prudency of an LDC's purchasing practices while allowing pass-through of 100% of an LDC's actual gas costs is the best way to ensure that customers pay the most reasonable price for gas.

Question 3: Explain how the proposed mechanism corrects any deficiencies of the current mechanism.

In today's volatile and often speculative natural gas commodity market, price swings can lead to LDCs sharing amounts that weren't anticipated when the mechanism was established in 1989 or renewed in 1996, when natural gas prices were far lower. Cascade's proposal to modify the existing mechanism to allow 100% recovery of commodity costs resolves the improper risk allocation of market fluctuations and the other issues associated with the sharing piece of the existing mechanism. No longer will an LDC sustain a profit or loss based on market factors that are completely outside of its control. With 100% pass-through, customers will benefit fully from prices that are lower than anticipated.

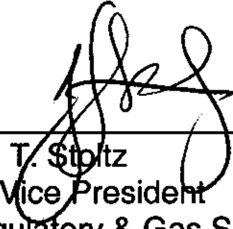
In addition, allowing 100% pass-through of prudent natural gas costs should remove the burden and contentiousness associated with forecasting gas prices at the time of the PGA, which clearly exists under today's approach. For example, as noted in the 2007 PGA memos, Staff stated the utilities should use a weighted fundamentals price forecast to forecast pricing while Cascade believes the use of forward market price information is more representative of the pricing that will be seen in the coming year particularly since the Company cannot purchase gas based on the fundamental price forecasts. Under the current sharing mechanism, utilities are at risk for up to 1/3 of the difference between the forecast and the actual pricing, and therefore have a substantial interest in the ultimate price forecast. Commission Staff's and the companies' time would be better spent focusing on the development and execution of gas procurement and hedging strategies that focus solely on the needs of the customers, rather than

engaging in the inherently speculative practice of forecasting gas prices. It is Cascade's belief that the current mechanism without the sharing piece provides the best solution to the problems described above.

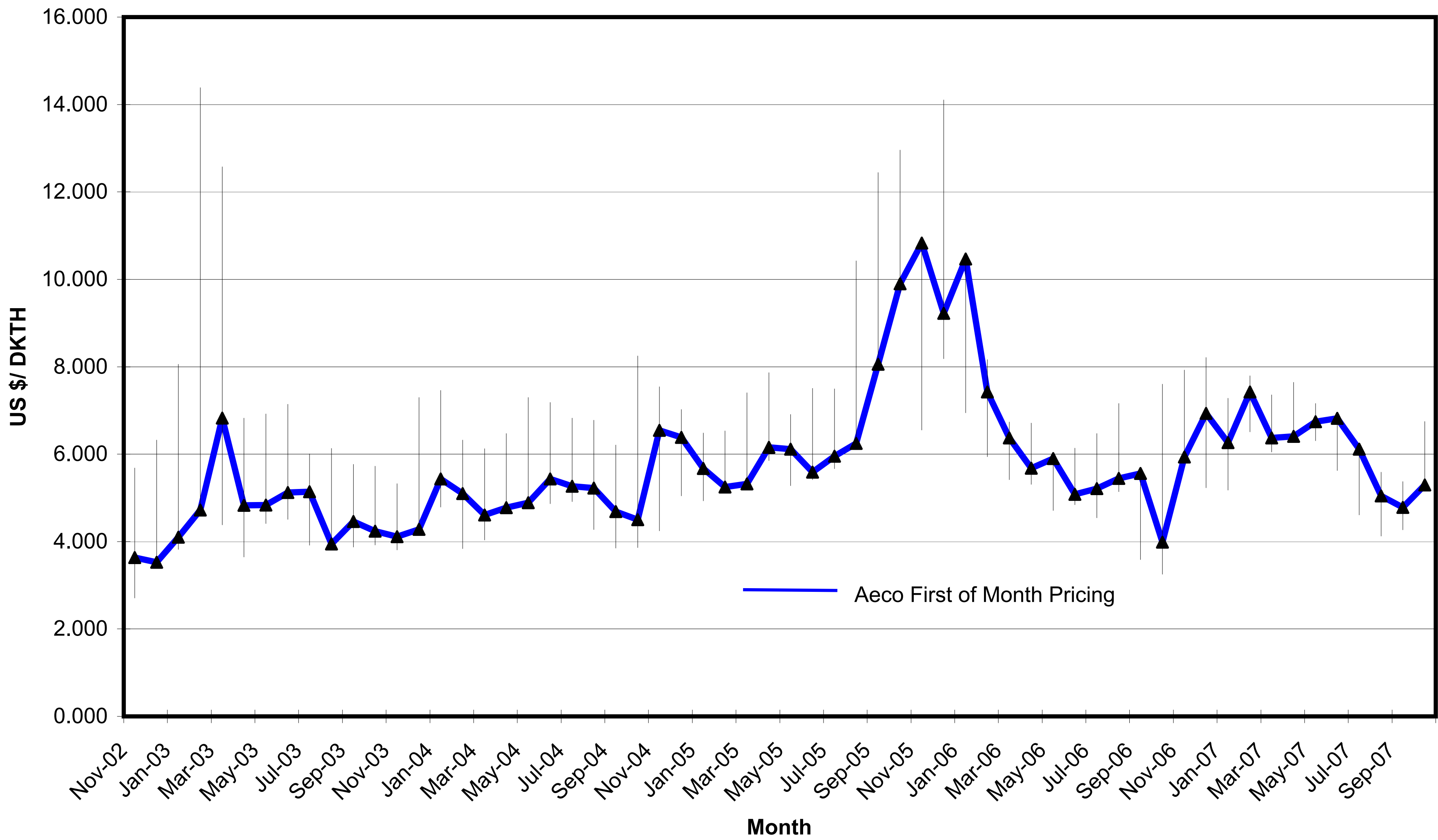
DATED this 4th day of December 2007.

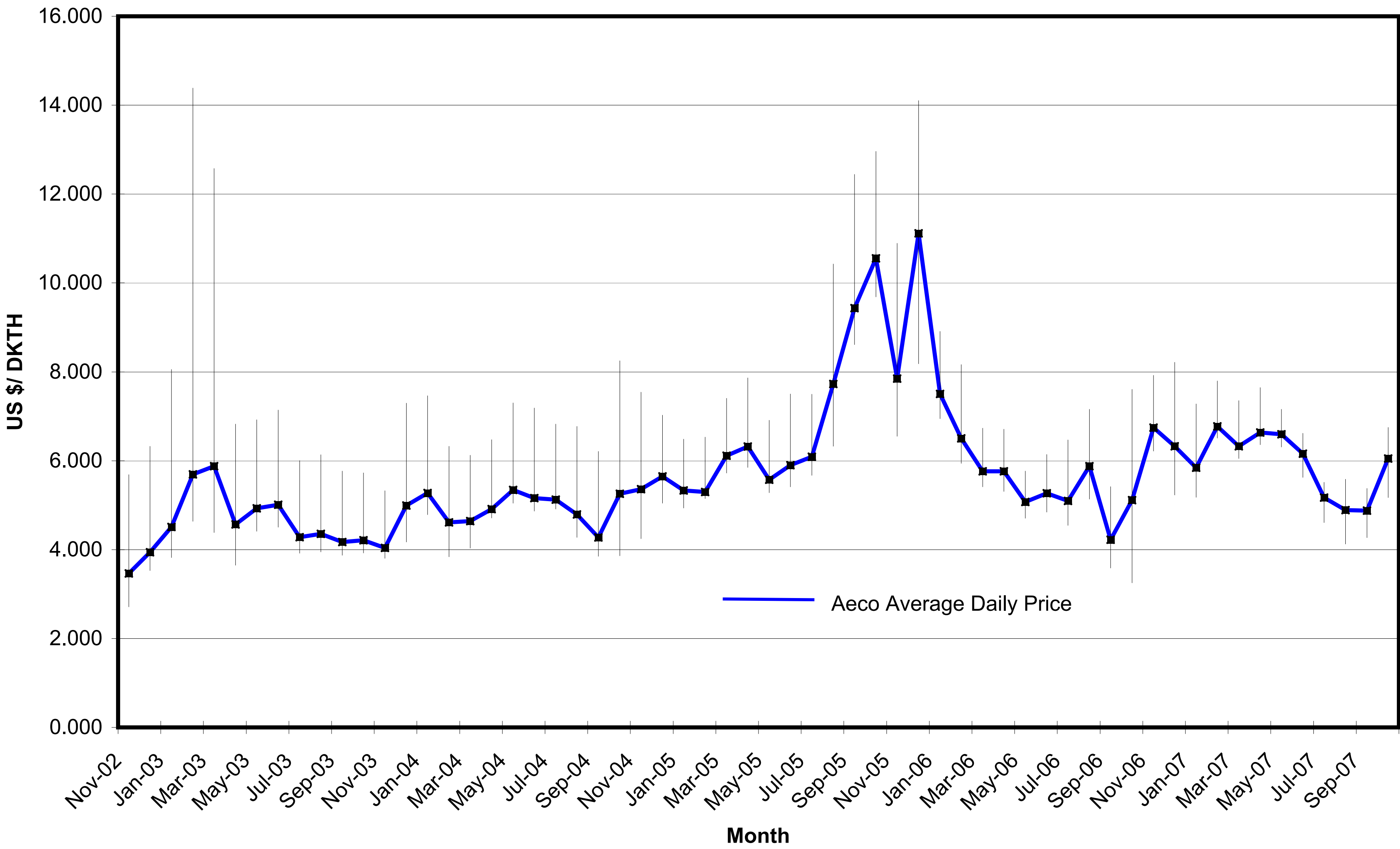
Respectfully Submitted,

Cascade Natural Gas Corporation



Jon T. Stoltz
Sr. Vice President
Regulatory & Gas Supply


AECO Price Volatility
Daily Prices vs First of Month
US $/ DKTH
16.000
14.000
12.000
10.000
8.000
6.000
4.000
2.000
0.000
Aeco First of Month Pricing
Nov-02
Jan-03
Mar-03
May-03
Jul-03
Sep-03
Nov-03
Jan-04
Mar-04
May-04
Jul-04
Sep-04
Nov-04
Jan-05
Mar-05
May-05
Jul-05
Sep-05
Nov-05
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Month


AECO Daily Price Volatility
November 2002 through October 2007
US $/ DKTH
16.000
14.000
12.000
10.000
8.000
6.000
4.000
2.000
0.000
Aeco Average Daily Price
Nov-02
Jan-03
Mar-03
May-03
Jul-03
Sep-03
Nov-03
Jan-04
Mar-04
May-04
Jul-04
Sep-04
Nov-04
Jan-05
Mar-05
May-05
Jul-05
Sep-05
Nov-05
Jan-06
Mar-06
May-06
Jul-06
Sep-06
Nov-06
Jan-07
Mar-07
May-07
Jul-07
Sep-07
Month

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing Opening Comments of Cascade Natural Gas Corporation in regard to Phase 1 of Docket UM 1286, by electronic mail upon all parties on the attached service list.

AVISTA CORPORATION
DAVID J MEYER
VICE PRESIDENT & CHIEF COUNSEL
PO BOX 3727
SPOKANE WA 99220-3727
david.meyer@avistacorp.com

CABLE HUSTON BENEDICT HAAGENSEN & LLOYD LLP
EDWARD A FINKLEA
1001 SW 5TH - STE 2000
PORTLAND OR 97204
efinklea@chbh.com

CHAD M STOKES
1001 SW 5TH - STE 2000
PORTLAND OR 97204
cstokes@chbh.com

CASCADE NATURAL GAS
JON T STOLTZ
SR VICE PRESIDENT--REGULATORY & GAS
PO BOX 24464
SEATTLE WA 98124
jstoltz@cngc.com

KATHERINE BARNARD
SR DIRECTOR – REGULATORY AFFAIRS
kbarnard@cngc.com

CITIZENS' UTILITY BOARD OF OREGON
LOWREY R BROWN
UTILITY ANALYST
610 SW BROADWAY - STE 308
PORTLAND OR 97205
lowrey@oregoncub.org

JASON EISDORFER
ENERGY PROGRAM DIRECTOR
610 SW BROADWAY STE 308
PORTLAND OR 97205
jason@oregoncub.org

ROBERT JENKS
610 SW BROADWAY STE 308
PORTLAND OR 97205
bob@oregoncub.org

DEPARTMENT OF JUSTICE
DAVID HATTON
ASSISTANT ATTORNEY GENERAL
REGULATED UTILITY & BUSINESS SECTION
1162 COURT ST NE
SALEM OR 97301-4096
david.hatton@state.or.us

NORTHWEST INDUSTRIAL GAS USERS
PAULA E PYRON
EXECUTIVE DIRECTOR
4113 WOLF BERRY CT
LAKE OSWEGO OR 97035-1827
ppyron@nwigu.org

NORTHWEST NATURAL
RATES & REGULATORY AFFAIRS
220 NW 2ND AVE
PORTLAND OR 97209
efiling@nwnatural.com

INARA K SCOTT
220 NW 2ND AVE
PORTLAND OR 97209
iks@nwnatural.com

PERKINS COIE LLP
LAWRENCE REICHMAN
1120 NW COUCH ST - 10 FL
PORTLAND OR 97209-4128
lreichman@perkinscoie.com

PUBLIC UTILITY COMMISSION OF OREGON
KEN ZIMMERMAN
550 CAPITOL ST NE, STE 215
SALEM OR 97301
ken.zimmerman@state.or.us

DATED at Seattle, WA, this 4th day of December 2007

/s/ Curt Lulias
Curt Lulias
Regulatory Affairs
Cascade Natural Gas Corporation