

UG 221 Data Response to NWN – DR 41 - 49
May 18, 2012
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TO: Mark R. Thompson
Manager, Rates & Regulatory Affairs
NW Natural
220 NW 2nd Avenue
Portland, OR 97209

FROM: Matt Muldoon
Economic Research & Financial Analysis Division

OREGON PUBLIC UTILITY COMMISSION
Northwest Natural (NWN or Company) Data Request to OPUC
Due May 22, 2012
NWN Data Request No DR 47

NWN Request:

47. Reference Staff/1200: Please provide the basis for Staff's recommendation related to the disallowance of 50% of the interest rate hedge loss, to the extent not presented in the testimony of Mr. Muldoon. Please include any precedent, studies, data, or other information relied upon to the extent not provided in testimony, to support the proposed disallowance of 50%.

OPUC Response:

47. Please see: Staff's Response to NWN DR 47 Muldoon Confidential Attachment 1 for Staff's detailed response to this data request. Staff reviewed a substantial amount of material provided by the Company that is partially recapped in the Company response to Staff data request (DR) 496 and subject to protective order.

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spite of such an analysis being requested in Staff data requests 292, 396, 397, 398, 299, 400, 401, 402 and 403; the Company has not provided any evidence of performing an independent analysis.

C. Review of Materials Provided by the Company.
Staff considered whether bank-provided discussion and presentation materials constituted adequate advice on which to base a financial decision. The Company's response to Staff data request 496 provides a reasonable example of Staff's findings:

1. Wells Fargo Bank – Discussion – September 21, 2007,
Excerpts from "Important Explanations and Disclaimers" on page 31.
 - a. All derivative transactions are arm's length transactions.
 - b. We are not giving you...advice or recommendations.
 - c. We are not acting in a fiduciary relationship with you.
 - d. You should consider a thorough and independent review ...consulting with such advisors as you consider appropriate.
 - e. All amounts, terms and conditions...for indicative purposes only.
 - f. They [materials provided by the bank to the Company]...not be relied on as amounts, terms or conditions on which we or anyone else would at any time be willing to enter into, terminate or transfer a transaction with you or relied on...
 - g. They [materials provided by the bank to the Company] may be based on market information we obtained from secondary sources without independent verification.
 - h. They [materials provided by the bank to the Company] are not binding on us in any way.
2. Merrill Lynch – Presentation – September 12, 2007,
Excerpts from "Disclaimers" on page 19.
 - a. Merrill Lynch is not an expert on and does not render opinions...
 - b. You should consult with your advisors concerning these matters before undertaking the proposed transaction.
3. Wachovia Bank – Presentation – September, 2007,
Excerpts from "Disclaimers" on page 3.
 - a. The Bank...acts solely on an arm's length basis in connection with the proposed transaction with the customer.
 - b. Neither the Bank, nor any of its affiliates is acting as the customer's agent, broker, advisor, or fiduciary in any respect.
 - c. The customer must rely on its own evaluation and upon advice from its own...advisors.

The above sampling of the cautions provided the Company is consistent with Staff's recommendations provided in testimony.

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D. Illustrative Example

Staff reviewed all material provided by the Company carefully and relied heavily on this information in forming Staff's recommendation inclusive of prior application and compliance filings and responses to standard data requests, as well as information provided verbally by the Company in a phone workshop. This material is extensive. References cited above are representative rather than all-inclusive.

E. Bloomberg and Historical SNL Market Data.

Staff examined Bloomberg and SNL historical market data to better understand conditions at the time of each material decision point regarding the hedge. For example, Staff looked at Bloomberg Forward Curve Analysis USD US Utility (A) FWCV (FMC #36) with curve and settlement dated October 24, 2007.

This sensitivity exercise assisted Staff in clarifying the timing of decisions on the Company's part and with respect to differential October 2007 market conditions from those a year later. Similarly Staff looked at Company Bloomberg Screenshots on screen for US Government Treasuries (GT) to obtain better color contrast for easier understanding. Staff reviewed the options and context the Company had at each decision point, including for some such decision points, a bond issuance without an interest rate swap.

F. Textbooks

The primary textbook Staff utilized was the fifth edition of "Futures, Options and Swaps" by Robert W. Kolb and James A Overdahl. Staff referenced, but relied less on the June 2006 printing of "New Regulatory Finance" by Roger A. Morin, PhD.

G. Accounting Rules and Best Practices

Staff reviewed the Financial Accounting Standards Board (FASB) online materials and discussions of hedge effectiveness testing and the accounting treatment of highly effective and other than highly effective portions of hedge gains and losses. Discussions viewed by Staff on the www.fasb.org website under the Derivatives Implementation Group appear to call into question investment banks' suggestions in the Company's response to DR 496 that non-challenging tests of high effectiveness are likely adequate to meet FASB standards.

H. Staff also looked at the U.S. Commodity Futures Trading Commission "Final Rules Regarding Further Defining 'Swap Dealer', 'Major Swap Participant' and 'Eligible Contract Participant' available at www.cftc.gov to evaluate whether an investment bank would be tightly restricted regarding its representations of risk were that bank to provide a swap which the customer affirmed was an integral component of a bond issuance. The loosening of

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rules and the exemption for banks in this scenario, suggested Staff concerns articulated in testimony were not duplicative and already addressed elsewhere.

1 **CERTIFICATE OF SERVICE**

2 I certify that on August 24, 2012, I served the foregoing Staff Hearing Exhibit upon the
3 parties in this proceeding by electronic mail only as all parties waive paper service.

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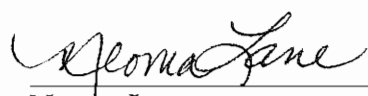
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