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VIA ELECTRONIC FILING AND FIRST CLASS MAIL

PUC Filing Center
Public Utility Commission of Oregon
PO Box 1088
Salem, OR 97302-1088

Re: Docket UM 1654 – In the Matter of Northwest Natural Gas Company - Investigation of Interstate Storage and Optimization Sharing

Attention Filing Center:

Enclosed for filing in the above-referenced docket is an original and five copies of Northwest Natural Gas Company's **Redacted** Post Hearing Brief. The Confidential pages will be mailed via U.S. Mail

A copy of this filing has been served on all parties to this proceeding as indicated on the enclosed Certificate of Service.

Please contact this office with any questions.

Very truly yours,

Wendy McIndoo

Wendy McIndoo
Office Manager

Enclosure

cc: Service List

BEFORE THE PUBLIC UTILITY COMMISSION OF OREGON

UM 1654

In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW NATURAL, Investigation of Interstate Storage and Optimization Sharing.	**NORTHWEST NATURAL GAS COMPANY'S POST-HEARING BRIEF**

I. INTRODUCTION

Pursuant to the Prehearing Conference Memorandum of the Administrative Law Judge dated June 26, 2014, Northwest Natural Gas Company ("NW Natural" or "Company") submits this Post-Hearing Brief. The first hearing in this matter was held on February 3, 2014. At the end of that day scheduled for hearing, the Public Utility Commission of Oregon ("Commission") determined that it wished to serve Bench Requests and allow the Citizens' Utility Board of Oregon ("CUB") to serve additional data requests on NW Natural, and it continued the hearing to allow for this additional process. Thereafter, the Commission convened a second day of hearing on July 10, 2014. This Post-Hearing Brief will not repeat the arguments made in NW Natural's Pre-Hearing Brief, filed on January 27, 2014, and instead will focus on the testimony at hearing and matters raised by the Commission's Bench Requests.

NW Natural's Mist storage services ("Storage Services") and resource optimization activities ("Optimization Activities") reflect the Company's expansion and innovative use of utility and non-utility resources to create additional value for the Company and its customers. To date, under the arrangement approved by the Commission, customers

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have received over $80 million in credits through the sharing arrangements[1] and have received an estimated $21 million through 2012 in storage recall benefits—all without incurring any incremental cost or bearing any additional risk. The current net revenue sharing arrangements have resulted in fair and reasonable rates for customers, while at the same time providing shareholders with the incentives to make substantial discretionary investments and to assume additional risk. For these reasons the Commission should affirm and maintain the current sharing framework.

CUB has argued for several changes to the current sharing framework. First, CUB argues that the Company's Optimization Activities represent basic local distribution company ("LDC") activities and therefore do not require the incentives awarded under the current framework. The record is to the contrary. The Company's Optimization Activities involve speculative transactions that are above and beyond what is expected of an LDC in the normal course of its operations. In fact, absent an Asset Management Agreement ("AMA"), NW Natural could not, on its own, engage in the Optimization Activities. In this case, Staff agrees that these activities exceed the normal expectations for an LDC. This is consistent with Staff's position in past cases, where Staff has been explicit that LDCs should not engage in market speculation.

The record in this case further demonstrates that the Company's Optimization Activities are not commonplace for LDCs. In fact, [redacted] Similarly, the parties to this case were able to identify only a few LDCs across the country engaged in similar resource optimization activities. And in every single case, the LDC is specifically incented to engage in the activities through revenue sharing; in the vast majority of the

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[1] The $80 million is calculated through 2012. Credits through 2013 are in excess of $90 million.

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cases the sharing arrangement is closer to NW Natural's current sharing arrangement than the 90/10 sharing recommended by CUB.

Second, CUB argues that the current method of allocating net revenues for Mist-related Optimization Activities is unreasonable. The current allocation is based on total Mist deliverability of 520,000 Dth/day. Of that total, 47 percent of deliverability is attributable to the non-recalled shareholder expansion at Mist, while 53 percent of deliverability is due to Mist assets in core customer rates. Therefore, 47 percent of Mist Optimization Activity net revenues are shared on the 20/80 basis, while the remaining 53 percent are shared at 67/33.

CUB, however, argues that all Mist Optimization Activity net revenues are attributable only to core customer assets and so is arguing that 100 percent of the net revenues should be allocated as core customers' capacity, and zero percent be allocated as shareholder/interstate storage capacity. As a result, CUB would have the Commission apply a uniform sharing to Mist Optimization Activity net revenues regardless of whether that activity is made possible by shareholder-funded resources or customer-funded resources. This proposal should be rejected. Shareholders have invested $65 million to expand Mist to allow for the provision of Storage Services and Optimization Activities. As demonstrated by the Company's Responses to Commission Bench Requests, the current level of Mist storage Optimization Activity would not be possible without the investments made by shareholders to create additional deliverability and working gas capacity. Therefore, it is reasonable that a portion of the net revenues generated by these shareholder-funded facilities are shared 20/80, like the net revenues from Storage Services. This approach is consistent with how the facilities are included in general rates and provides a reasonable balance of customer credits and a return to shareholders on their discretionary investments.

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Both Staff and CUB recommend that the Optimization Activity net revenues be included in the Company's Results of Operations ("ROO") and be subject to sharing under the Spring Earnings Review and the Site Remediation Recovery Mechanism ("SRRM"). The Company's ROO reflects earnings from the provision of utility service to core customers and should not include earnings related to discretionary activities that even Staff agrees are outside the scope of normal LDC operations. Moreover, subjecting earnings from these activities that go beyond normal LDC operations to a clawback through inclusion in ROO could result in a de facto reduction of the Company's share, which will significantly undermine the incentive that is at the heart of these sharing arrangements.

For the past 14, years the current sharing arrangements have been successful in achieving the goal of providing a benefit to customers as well as to shareholders. CUB has failed to demonstrate that these sharing arrangements are now unreasonable. The Company has shown that the Optimization Activities and Storage Services have not changed since 2000 in a way that would suggest that the sharing percentages should change, that the current sharing has resulted in significant customer benefits, and that the current sharing has incented shareholders to continue to invest in these services and assume the accompanying risks. Therefore, as a whole, the current sharing arrangements result in rates that are fair, just, and reasonable and should be maintained.

II. ARGUMENT

A. The Current Sharing Percentages for Optimization Activities are Appropriate and Produce Fair and Reasonable Rates.

In recognition of the unique nature of the Optimization Activities, the net revenues generated are shared between customers and shareholders under the approach approved by the Commission. For Optimization Activities that use resources in customer rates—including that portion of Mist capacity in rates—customers receive 67 percent of the net

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margins and the Company receives 33 percent (referred to as "67/33").[2] For Optimization Activities that use shareholder-funded resources—including that portion of Mist capacity not included in rates—customers receive 20 percent of the net margins and the Company receives 80 percent (referred to as "20/80").[3] The current sharing arrangement has been in place since shortly after the Optimization Activities began and,[4] as discussed below, the record demonstrates that this arrangement is reasonable. Further, this arrangement is consistent with regulatory constructs around the country related to similar activities.

CUB recommends that the 67/33 sharing percentage be revised in favor of customers. However, CUB has failed to demonstrate that the current arrangement is unreasonable or that its proposal is justified based on the nature of the Optimization Activities.

1. CUB's Claim that "Everyone is Doing It" is Wrong.

CUB's primary argument for decreasing the Company share of Optimization Activity revenues is that these activities are "no longer unusual; they are now basic natural gas utility activities—everyone is doing it . . ."[5] Thus CUB reasons that the Company should not require a substantial incentive to engage in these type of activities. The record does

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[2] NWN/100, White/10. When the Company first began engaging in the Optimization Activities, the Company, Staff, and interested parties agreed to the same 20/80 sharing for Optimization Activities as those applicable to Storage Services. At the time, the Company assumed that the primary Optimization Activity would involve optimization of shareholder-funded Mist storage. Over time, however, it became clear that the opportunity for optimization of other, non-Mist resources was greater than expected. The majority of the Company's Optimization Activities now leverage resources that are included in customer rates, and so the Company proposed and the parties agreed to the current arrangement. NWN/100, White/8.

[3] NWN/100, White/10.

[4] NWN/100, White/8-9. Originally, the Optimization Activity was subject to the same 20/80 sharing as the Storage Services. Once the Company had experience and realized that much of the Optimization Activity utilized assets in customer rates, rather than the shareholder-funded Mist expansions, the Company proposed changing the 20/80 sharing to the current 67/33.

[5] Citizens' Utility Board of Oregon's Pre-hearing Brief at 9 ("CUB's Pre-Hearing Brief").

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not support CUB's contention. On the contrary, LDCs such as NW Natural do not typically engage in market speculation on their customers' behalf. And only a handful of LDCs have entered into AMA contracts with an optimization structure such as the one NW Natural has with Tenaska.

a. Optimization Activities involve Speculative Transactions that Require an AMA.

The Optimization Activities involve market speculation far beyond that in which a typical LDC would engage. As defined by Oregon Staff: "[S]peculators try to guess which direction price in the market will go and based on that guess seek to make a profit."[6] Staff concludes that "[t]his is not appropriate behavior for an LDC."[7] Further, when describing the impact of speculation on natural gas markets and prices, Staff notes that while LDCs participate in natural gas futures markets for hedging purposes, "no Oregon LDC participates in speculation in any market."[8]

Speculation like that involved in the Optimization Activities is prohibited by NW Natural's Gas Supply Risk Management Policy,[9] which states: "[redacted]."[10]

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[6] *Re Avista Utilities*, Docket UG 135/UM 1215, Order No. 05-1053, Appendix A at 12 (Sept. 29, 2005).

[7] *Id.*

[8] *Re Avista Utilities*, Docket UG 191, Order No. 10-445, Appendix A at 20, n. 6 (Nov. 5, 2010).

[9] Tr. 30 (White); Tr. 38-39, 54 (Friedman). Unless otherwise indicated, all references to the transcript refer to the transcript of the February 3, 2014, hearing.

[10] The Gas Supply Risk Management Policy further states: "[redacted]" The Company's Gas Supply Risk Management Policy is filed with the Commission each year as part of the Company's PGA filing.

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Thus, absent risk mitigation measures, such as those provided by NW Natural's AMA, the Company could not engage in the Optimization Activities in the normal course of its LDC business.

Further, the record demonstrates that relatively few LDCs have AMAs comparable to NW Natural's agreement with Tenaska. Indeed, NW Natural and CUB could identify only a handful of gas-only LDCs that have AMAs.[11] And even in the cases where an LDC has an AMA, the LDC is not necessarily engaged in the same type of activity. [redacted] On the other hand, due to NW Natural's incentives—both in its AMA and in Schedules 185 and 186—the Company works closely with Tenaska to realize significantly more Optimization Activity revenue through more speculative and coordinated transactions—transactions that NW Natural could not enter into on its own.[14]

For example, in docket UG 262, the Gas Supply Risk Management Policy was filed confidentially as part of Exhibit C to the Company's initial filing. Pursuant to OAR 860-001-0460(1)(d), the Company requests that the Commission take official notice of the Gas Supply Risk Management Policy.

[11] NWN/103, White/1 (identifying six utilities engaged in comparable optimization activities); CUB's List of Exhibits to be Entered into the Record (Jan. 29, 2014) (identifying two additional utilities and one jurisdiction that have comparable optimization activities).

[12] NW Natural Hearing Exhibit 10 at 2-6.

[13] *Id.*

[14] Tr. 30 (White); Tr. 38-39, 54 (Friedman).

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b. [redacted]

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[15] [redacted]

[16] [redacted]

[17] NW Natural Hearing Exhibit 10 at 4.

[18] NW Natural Hearing Exhibit 10 at 5-6.

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[redacted]

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[19] NW Natural Hearing Exhibit 10 at 5-6.

[20] NW Natural Hearing Exhibit 11. Hearing Exhibit 11 is Highly Confidential.

[21] NW Natural Hearing Exhibit 10 at 4-5.

[22] NW Natural Hearing Exhibit 10at 6.

[23] Tr. 140 (Friedman); NW Natural Hearing Exhibit 5.

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c. NW Natural's Current Optimization Activity Incentive is Consistent with Other Commissions.

Both NW Natural and CUB identified several other instances where LDCs are engaged in optimization activities similar to those engaged in by NW Natural.[24] In virtually every case, the LDC is provided an incentive. Further, the incentives provided are more in line with the current sharing percentages than CUB's 90/10 proposal.[25] For example, CUB points out that Washington Gas Light, which operates in both Maryland and Virginia, has a three-tiered sharing arrangement where customers receive 100 percent of the initial revenues, 75 percent of revenues in the second tier, and 50 percent of the revenues in the third tier.[26] However, Washington Gas Light's three tiers produce an effective 75/25 sharing percentage, which is consistent with the other examples provided by the Company and similar to NW Natural's current 67/33 sharing.[27] The Company's testimony identified seven gas-only LDCs with AMAs for resource optimization similar to NW Natural's Optimization Activities. Five of those LDCs have 75/25 sharing, one has 70/30 sharing, and one has 60/40 sharing. These sharing percentages are far more comparable to the Company's current arrangement than CUB's 90/10 proposal.

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[24] CUB testified at hearing that NW Natural's Optimization Activities are not unusual for gas utilities, based on commission orders from other states. Tr. 161 (Jenks).

[25] NWN/100, White/19-20; NWN/103, White/1; CUB's List of Exhibits to be Entered Into the Record (Jan. 29, 2014).

[26] CUB's Pre-Hearing Brief at 10-11.

[27] CUB relies on the commission orders approving stipulations that established the sharing arrangement. At CUB's request, the Commission has taken official notice of these orders. In the hearing before the Virginia State Corporation Commission regarding the stipulation, a witness on behalf of Washington Gas Light testified that the "overall formula is in the three tiers, if you simply apply it to the most recent three-year average, it actually works out to, this is mathematics, it actually works out to an exact sharing percent of 75/25; 75 to customers, 25 to the Company." *Re Washington Gas Light Co.*, Case No. PUE-2010-00139, Hearing Transcript Volume III at 72 (Dec. 5, 2011 Va. State Corp. Comm'n). Pursuant to OAR 860-001-0460, the Company requests that the Commission take official notice of this transcript. The transcript is available at the following website: http://docket.scc.virginia.gov/vaprod/main.asp.

To support its view that the Company should receive a lesser share of Optimization Activity revenues, CUB relies on a 2000 decision from the Connecticut Department of Public Utility Control ("CDPUC"). CUB points out that in that case, the CDPUC approved an 85/15 sharing arrangement for the revenues flowing from a gas supply, delivery, and optimization agreement between an LDC and a third-party.[28] What CUB fails to explain, however, is that in the arrangement in question, customers bore both the upside and downside risk. Significantly, in its order, the CDPUC repeatedly states that 85/15 sharing is a "risk and reward allocation," meaning that if the agreement resulted in higher gas costs customer pay 85 percent of those costs.[29] Thus, the Connecticut sharing is more comparable to the current PGA sharing, which is 90/10, and is of limited comparability to NW Natural's Optimization Activities.

2. Mist Storage Optimization's 53/47 Allocation Percentage is Reasonable.

The allocation of revenues to be shared from Mist-related Optimization Activities is currently based upon deliverability. Total deliverability at Mist is 520,000 Dth/day, the portion of that deliverability that is to attributable core customer assets is 53 percent, while the portion that is attributable to the unrecalled shareholder expansion at Mist is 47 percent. For this reason, the Company has referred to the split of revenues from Mist

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[28] CUB's List of Exhibits to be Entered Into the Record at 3.

[29] *Re Southern Connecticut Gas Co.*, Docket No. 00-02-13, 2000 Conn. PUC LEXIS 62 at 2 (Mar. 15, 2000) ("the Company requested that the Department consider the Agreement a secondary sale to be given the same regulatory treatment, including the approval of the 85%/15% risk and reward allocation"); *id.* at 3 (LDC "will set the risk and reward allocation of margin at 85% to ratepayers and 15% to shareholders"); *id.* at 5 (management fee paid to LDC intended to offset the potential for higher gas costs being passed through to customers via the asset management agreement); *id.* at 4 (margin calculation does not guarantee positive margin). The agreement at issue in this case also appears to impose significant risks on customers because the utility provides the third party with "exclusive use of the capacity without material restrictions or control by [the utility]." *Id.* at 2.

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optimization as 53/47—meaning that 53 percent of the net revenues are shared with customers at a 67/33 basis, while 47 percent of the revenue is shared on a 20/80 basis.[30]

CUB opposes the 53/47 split of Mist Optimization revenues, and instead proposes that they be split 100/0. In other words, CUB argues that the all Mist Optimization Activities flow solely from customer assets so that 100 percent of those revenues should be subject to the same sharing percentages as those flowing from Optimization Activities related to resources whose costs are fully included in NW Natural core natural gas rates. CUB's primary position is based on its view that the physical working gas that partially backs the Company's storage Optimization Activities is owned by customers, and that therefore all Mist optimization revenues should be regarded as flowing from customer assets only.[31] CUB's argument, however, is flawed. First, the proportion of revenues associated with core NW Natural customer capacity is already shared 67 percent with customers. CUB appears to be arguing that NW Natural customers should receive an increased percentage (67 percent versus the existing 20 percent) for the proportion of net revenues associated with wholesale storage capacity even though the customers are not paying for this capacity. This position overestimates the role of the core customer working gas and does not give proper weight to the shareholders' significant investment in building out the Mist capacity that is necessary to provide the wholesale services. Essentially, CUB argues that even though NW Natural's shareholders have made an investment in Mist at their own cost, the benefits associated with optimizing that resource should all be attributed to core customers. This is inconsistent with any principle of fairness, and is not mirrored anywhere else in the industry.

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[30] NWN/500, White/6.

[31] CUB's Pre-Hearing Brief at 14; CUB/100, Jenks-McGovern/14-16.

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CUB also, somewhat curiously, makes a secondary argument, presented in its pre-hearing brief, that NW Natural may be leveraging gas in Mist that is there for interstate storage customers (such as PGE) when it performs Mist Optimization Activities. CUB implies that this would be inappropriate. This argument demonstrates a misunderstanding of industry practices, and also actually makes NW Natural's point in response to CUB's primary argument.

As NW Natural has stated, much of the ability to optimize Mist is due to the fact that NW Natural's shareholders have invested in Mist in order to provide interstate storage services to customers like PGE. CUB's secondary argument actually acknowledges that it is *this investment by shareholders* that helps facilitate the degree to which NW Natural can optimize Mist. NW Natural is under no obligation to pass on optimization revenues to its interstate storage customers, and such a practice is not standard in the industry. This is because, as NW Natural has explained above, the optimization activities are made possible by *investments in Mist deliverability and capacity*. No interstate storage customer would expect to receive the revenues associated with optimizing Mist capacity and deliverability. By pointing out that interstate storage customers have working gas in Mist, CUB actually makes the point that the revenues associated with optimization of storage do not follow the customers whose gas is in Mist, and therefore should not be attributed solely to core customers on that basis either.

a. Shareholder Investment at Mist Allows Greater Optimization Activities.

The current 53/47 allocation of Mist Optimization Activity revenue between core customers' capacity and the Company/Interstate capacity is based, in part, on the fact that shareholders—at their own discretion and risk—expanded Mist's deliverability and working gas capacity in order to provide service to wholesale customers.[32] The Company is at risk

[32] NWN/100, White/14.

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for these wholesale customer revenues; the incremental costs from these investments are not included in core customer rates. Although customer gas partially backstops the Optimization Activities at Mist in most years, the Company's ability to engage in backdraft transactions is a function of Mist's total deliverability and associated working gas capacity.[33]

As discussed in NW Natural's Supplemental Responses to Bench Requests, Mist optimization [redacted]

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[33] Tr. 133 (Friedman).

[34] [redacted]

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[redacted] That said, going forward NW Natural anticipates continuing to initially make available [redacted].

On the other hand, if NW Natural's shareholders had *not* financed the Mist expansion, total deliverability would be only 210,000 Dth/day, and the Company would be able to make [redacted] Thus, the Company has demonstrated that the shareholder investment in Mist substantially increases Optimization Activity—and, as discussed below, Optimization Activity revenues.

CUB argues that without customer gas in Mist there would be no Mist Optimization Activities and therefore all the Mist revenue should be subject to 67/33 sharing.[37] This claim is incorrect. Without core customer gas in Mist, the Company could optimize the resource; however, the Company would be more constrained in its storage Optimization Activities because it would have less total capacity to work with, would have relatively less predictability of firm customer withdrawal patterns, and would have to structure it differently in order to manage Federal Energy Regulatory Commission ("FERC")

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[35] [redacted]

[36] Tr. 14 (White) (July 10, 2014).

[37] CUB's Pre-Hearing Brief at 14.

compliance risk.[38] This fact undercuts CUB's claim that backdraft transactions are attributable 100 percent to customers and instead supports some allocation of Mist Optimization Activity revenue between each of the 20/80 and 67/33 percentages.

b. 53/47 Sharing is Reasonably Based on Ratio of Mist Facilities Included in Rates.

The Company recommends that the Commission affirm the current methodology used to determine the ratio of Mist Optimization Activity revenue subject to the 67/33 and 20/80 sharing percentages, which currently results in a 53/47 ratio (i.e., 53 percent is shared at 67/33 and 47 percent is shared at 20/80). As described above, CUB recommends a 100/0 ratio, claiming that none of the Mist Optimization Activity revenue is attributable to the shareholder investments that have expanded Mist to provide interstate storage services. The Company has presented two different bases upon which to verify the reasonableness of the 53/47 ratio and the unreasonableness of CUB's 100/0 recommendation.

First, the Commission can continue to assign sharing percentages based on **deliverability**—which is the method currently used by the Company. The assets that are included in core customers rates account for 53 percent of Mist deliverability, which is why the current methodology assigns 53 percent of the Mist Optimization Activity net revenue to 67/33 sharing. The deliverability attributable to the unrecalled shareholder investment in Mist is 47 percent, which is why 47 percent of Mist Optimization Activity net revenues are assigned to 20/80 sharing. As described above, deliverability is a significant factor in determining the extent of the Company's Mist Optimization Activities and deliverability is also the basis for making capacity recall decisions in the Company's Integrated Resource

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[38] NW Natural Hearing Exhibit 13 at 7.

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Plan.[39] Therefore, it is reasonable to continue to allocate Optimization Activity net revenue based on deliverability.

Second, the ratio could be based on the **working gas capacity** in Mist, which, along with deliverability, affects the extent of the Company's ability to perform Mist Optimization Activities. Currently, 62 percent of the working gas capacity is provided by assets that are in core customers' rates, while 38 percent of working gas capacity is provided by assets that are used for interstate storage customers.[40] Using this 62/38 ratio, 62 percent of Mist Optimization Activity net revenue would be subject to 67/33 sharing and 38 percent would be subject to 20/80. As described above, the Company believes that deliverability is the more appropriate basis, but recognizes that working gas capacity also plays a role in being able to achieve optimization revenues.

The Company's analysis provided in response to Bench Request 2 provides a useful cross-check and illustration of these two allocation bases. In that request, the Commission asked the Company to compare actual Mist optimization revenues to those it could have expected (a) using only Mist facilities pre-existing the shareholder expansion – 210,000 Dth/day; and (b) using only those Mist facilities that would have been built out to meet core customer needs—a stepwise capacity increase to 320,000 Dth/day, of which 275,000 Dth/day is currently needed. The optimization revenues shown in the Company's responses in the 210,000 Dth/day scenario are 40.3 percent of actuals in years since 2007 (i.e., once deliverability has been built out to today's total of 520,000 Dth/day). Deliverability is 40.3 percent of today's total. In the 320,000 Dth/day scenario, revenues on needed capacity are similarly in proportion to deliverability – 53% in the last year where needed capacity equals the amount actually in core customer rates currently. These

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[39] Tr. 35-36 (White).

[40] Hearing Exhibit 13 at 10.

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results should not be surprising given the fundamental assumption the Company made in its analysis. In determining optimization revenues in the hypothetic scenarios, the Company scaled its 25 percent of Mist capacity risk-defined limit based on deliverability capacity. If the Company had instead applied the 25 percent risk limit based on working gas capacity, the analysis would have yielded different revenue numbers, eventually resulting in revenues from needed capacity in the last year of 62 percent of actuals, which is the proportion of working gas associated with assets currently included in core customer rates.

While the two bases referred to above result in different ratios, each approach would suggest an allocation of revenues in the same range as the one the Company views as the most reasonable methodology—an allocation based on deliverability. Importantly, either of these bases would yield results that demonstrate that CUB's recommended 100/0 ratio is entirely unreasonable and lacking in evidentiary support.

B. Storage Services Sharing Percentages are Reasonable.

For Storage Services provided with expansion capacity funded by shareholders in advance of core customer need (and not included in core customer rates), the Company retains 80 percent of the net margin and customers receive the remaining 20 percent.[41] This arrangement has been in place since the Company began providing Storage Services and reflects the fact that the services are provided using assets that were incrementally funded by shareholders, not customers.

CUB recommends a temporary continuation of the current arrangement, but argues that a cost of service study must be completed prior to the Company's next rate case to determine the correct sharing percentages on a going-forward basis. CUB specifically

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[41] NWN/100, White/10.

rejects the Company's position that its 80 percent share appropriately compensates shareholders for their $65 million investment. CUB is incorrect on both counts.

1. A Cost of Service Study is Not Necessary or Appropriate.

In his testimony, NW Natural witness Keith White explained that a cost of service study does not make sense in light of the nature of the investments made and the facilities through which Storage Services are provided. For example, the most significant utility resource used to provide Mist storage to core customers is the South Mist Pipeline and the South Mist Pipeline Extension.[42] It is true that non-utility Mist storage makes some limited use of this resource to connect to the interstate market—but only because the resource already exists and has unused capacity. The fact is that this existing resource represents a convoluted and expensive way to access the interstate pipeline system, and would not be used but for the fact that it already exists and is needed for serving core customers. If NW Natural were to build an efficient connection between Mist and the interstate market in order to provide non-utility storage, it would build a short pipeline to the north, connecting to the KB pipeline at significantly lower cost. For this reason it makes no sense to allocate any portion of the South Mist Pipeline and Extension to non-utility storage service.[43] Indeed, as explained by Mr. White at hearing, if a cost study were ordered it would show that customers should be allocated *significantly less than the 20 percent revenues currently allocated.*[44] Specifically, Mr. White explained that a long run incremental cost study, fairly conducted, would allocate all transmission costs to core customers because these customers have recall rights and therefore interstate storage

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[42] NWN/300, White/9-10, and NWN/303, White/1.

[43] NWN/300, White/9-11

[44] NWN/300, White/8-12; Tr. 99-119 (White).

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customers have no long-term claim on the expanded assets.[45] With respect to the storage and compression assets at Mist field, Mr. White demonstrated that the costs currently allocated between utility customers and Storage Services are roughly equivalent, and therefore no sharing is required.[46]

That said, Mr. White explained that nevertheless the Company supports a sharing allocation that keeps shareholder and customer interests aligned[47]—either at the current 20/80 or lowered to 10/90 at a minimum. As Mr. White expressed at hearing, the Company believes that it is important that shareholders and customers benefit from these activities. In fact, while the Company does not believe that the net benefits test should be applied to *utility services*, NW Natural does believe that the net benefit standard may appropriately be applied, and is satisfied when applied to Storage Services—which represent a "below the line" activity that makes some use of utility property. Thus, while there may not be a cost allocation basis to warrant customer sharing of storage services net revenues, some level of sharing can be justified as meeting the just and reasonable rates requirement from the perspective of providing net benefits to core customers. Whether the customer sharing is kept at 20/80 or lowered to 10/90 then becomes a determination of maintaining the proper balance of incentives for the Company's Storage Services and Optimization Activities as a whole.

In sum, although the Company appreciate that transparency is an important aspect of the revenue sharing arrangements related to Mist operations, a cost study as proposed by CUB would do nothing to increase transparency. Instead, it would produce information that is not relevant to an appropriate revenue allocation from interstate storage operations.

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[45] NWN/300, White/9-11.

[46] NWN/300, White/11-12.

[47] Tr. 120 (White).

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2. Sharing Allows a Return on Shareholder's Discretionary Investment.

CUB argues that shareholders are fully compensated for their investment in Mist ***before*** sharing occurs and therefore customers' current 20 percent share is likely too low.[48] CUB is incorrect. To date, shareholders have received the return of only a portion of their $65 million investment and shareholders receive no return on their investment prior to sharing.[49] Therefore, while shareholders recover depreciation and O&M expenses prior to sharing, CUB is wrong to claim that shareholders are fully compensated. Without sharing, there would be no return on the investments not currently included in rate base.

Moreover, shareholders should be allowed a return on their investment commensurate with their risk—and the risks associated with the provision of Storage Services are greater than risks associated with the provision of utility service. Shareholders assumed all development risks and the price risk associated with the service.[50] The price risk is significant, as evidenced by steadily declining storage values and the fact that the Company has consistently sold storage below the FERC-approved maximum rate to meet market prices.[51]

3. The Company Reasonably Relied on the Current Sharing Arrangement When Investing in the Mist Expansion.

To facilitate Storage Services, the Company made a series of investments between 2001 and 2007 totaling $65 million. These shareholder investments were made in reliance on the original percentages, which were agreed to by all parties and approved by the Commission.[52] CUB argues that ORS 756.515 allows the Commission to "revisit its

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[48] CUB's Pre-Hearing Brief at 20.

[49] Tr. 77, 82-83, 85 (White).

[50] NWN/100, White/12-14.

[51] NWN/100, White/12-14.

[52] NWN/100, White/5.

decisions at any time" and therefore the Company improperly relied on the original sharing percentages when deciding whether to invest shareholder dollars to provide Storage Services.[53] CUB claims that the Commission is required by ORS 756.040 to ensure that rates are just and reasonable even if that requires changing the sharing percentages relied on by the Company.

NW Natural agrees with CUB that rates must be just and reasonable at all times, and that it is fair for the Commission to revisit rates at any time to ensure that they meet that standard. That said, the interests of NW Natural's shareholders are an important consideration. Establishing just and reasonable rates requires the Commission to balance customer and shareholder interests.[54] Rates must provide a utility the opportunity to earn a reasonable return on its investment. Here, the Company invested $65 million above and beyond what is required to provide utility service, based on the Commission's adoption of the current sharing percentages.[55] That reliance must be factored into the Commission's decision in this case. Moreover, the record demonstrates that the Company's Optimization Activities and Storages Services have not changed in way that would suggest that the current sharing percentages are now unreasonable.[56] And NW Natural has yet to recover the entire $65 million investment.[57] Therefore, it is reasonable to conclude that the current sharing percentages result in just and reasonable rates—just as they have since the Company offered Storage Services.

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[53] CUB's Pre-Hearing Brief at 5.

[54] ORS 756.040(1) ("The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates.").

[55] NWN/300, White/2-3.

[56] *See e.g.,* Staff/200, Colville/5.

[57] Tr. 85 (White).

C. The Optimization Activity Revenue should continue to be Excluded from Earnings Reviews.

CUB and Staff both argue that the Optimization Activity revenue must be included in the Company's ROO for purposes of earnings reviews.[58] This position is illogical and unprecedented, and if adopted, would result in harm to both the Company and its customers.

First, historically, the Commission has never included revenues from non-utility activities in the ROO, and for good reasons. The Company's earnings, as reflected in the ROO provide the Commission with the information it requires to determine whether the utility is fairly compensated for its provision of utility service. The Commission has therefore correctly excluded earnings from non-utility activities that would rightly be accounted for "below the line." Because NW Natural's Optimization Activities are beyond the scope of normal LDC operations,[59] there is no basis to include revenues from these activities in the Company's ROO.[60]

Moreover, it is undisputed that inclusion of the Optimization Activity net revenues in earnings reviews could cause a de facto reduction in the Company's revenue share. Such a clawback would diminish or potentially eliminate altogether the Company's incentive to engage in these activities. In docket UM 1635 both Staff and CUB recommend that the Optimization Activity net revenues be included in the SRRM earnings test, and also have recommended that the earnings test prevent NW Natural from being able to keep any revenues if it is earning at (or even below) its authorized ROE. This approach, coupled with an application of the earning test to optimization revenues, would seriously undermine the effectiveness of the incentive to engage in these types of Optimization Activities.

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[58] Staff/300, Garcia/2; CUB/100 Jenks-McGovern/29.

[59] Staff/200, Colville/4-5.

[60] NWN/500, White/10-11.

At hearing, CUB seemed to retreat from its position that Optimization Activity net revenues must be included in the ROO for the purpose of earnings reviews, and instead emphasized its argument that Optimization Activity net revenues should be included in the ROO for the sake of transparency.[61] To the extent CUB is moderating its initial position, NW Natural appreciates that movement. However, if CUB's real concern is transparency, there are better ways to achieve this goal than adding these revenues to the ROO—where they do not belong. The Company already files annual reports with the Commission detailing the Optimization Activity net revenues.[62] If CUB does not have access to these reports, the Company would be happy to provide them to CUB subject to a confidentiality agreement, or to modify their format to provide the information that would be useful.

D. NW Natural does not have the Burden of Persuasion in non-ORS 757.210 Dockets.

CUB argues that NW Natural has the burden of persuasion in this case to demonstrate that the retention of the current sharing arrangement results in just and reasonable rates.[63] CUB recognizes that this proceeding is governed by ORS 756.515, which governs Commission investigations, but nonetheless CUB argues that NW Natural carries the burden of persuasion as if this were a rate making proceeding under ORS 757.210.[64] The Company views this as a policy docket where the allocation of the burden of persuasion is not an issue; rather, any party proposing any sharing arrangement must demonstrate that their proposed arrangement will cause just and reasonable rates. However, to the extent a party carries the burden of persuasion, that party is the one requesting a change to NW Natural's tariffs.

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[61] Tr. 168 (Jenks).

[62] Tr. 57 (White).

[63] CUB's Pre-Hearing Brief at 4.

[64] CUB's Pre-Hearing Brief at 4.

First, as CUB admits, docket UM 1654 is not a proceeding under ORS 757.210. Under ORS 757.210(1) the utility bears the "burden of showing that the rate or schedule of rates proposed to be established or increased or changed is fair, just and reasonable." The Commission has clarified that the ORS 757.210 burden of persuasion applies narrowly to only cases arising under that statute.[65] Indeed, the Commission has observed that even a compliance tariff filing made by a utility under a stipulation resulting from an ORS 756.515 investigation is not a filing under ORS 757.210 wherein the utility bears the burden if a party chooses to challenge the new tariffs.[66] Here, NW Natural is not proposing any change to its rates or rate schedules and there is no dispute that this case does not arise under ORS 757.210. Therefore, NW Natural does not have the burden of persuasion as it would if the Company were requesting a change to the current sharing arrangement.

Second, this case is analogous to a complaint proceeding under ORS 756.500, wherein the party requesting relief bears the burden. ORS 756.515(3) provides that proceedings "shall be . . . conducted in reference to the matters investigated in like manner as though complaint had been filed with the commission relative thereto . . ." In complaint proceedings under ORS 756.500 the "moving party, the complainant, has the burden of persuasion."[67] Here, CUB is the party requesting that the Commission modify

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[65] *See e.g. Re PacifiCorp*, Docket UF 4000, Order No. 88-767, 95 P.U.R.4th 96, 102 (1988) (utility does not have burden to demonstrate reasonableness of rates in merger proceeding under ORS 757.480); *Re Portland Gen. Elec. Co.*, Docket UM 989, Order No. 01-152 (Feb. 2, 2001) (under ORS 756.500 the complainant bears the burden of persuasion even when complaint seeks to change utility rates).

[66] *Re Portland Gen. Elec. Co.*, Docket UE 100, Order No. 96-306, 173 P.U.R.4th 543, 545 (1996) (if any party challenged the stipulation and chose to proceed to a hearing, "that person will have both the burden of persuasion and the burden of going forward with evidence" because PGE's compliance filing was not a filing under ORS 757.210 wherein PGE had the burden of persuasion).

[67] Order No. 01-152.

the current sharing arrangement and therefore CUB is analogous to the complainant. As the complainant, CUB bears the burden of persuasion.

III. CONCLUSION

The current sharing percentages applied to Optimization Activities and Storage Services provide the Company with a meaningful incentive to focus its efforts on creating the greatest value from existing resources. In this fashion, the Commission has aligned customer and shareholder interests, driving the Company to "make the pie bigger" to the benefit of all. Now, in an attempt to increase the customer "slice," CUB's sharing proposal—and the earnings review proposal of both CUB and Staff—threatens to destroy the framework that has worked so well for the last 14 years. The Commission should resist these proposals and should affirm the continued use of the Company's current sharing percentages and the exclusion of Optimization Activity net revenues from the Company's future earnings reviews.

Respectfully submitted this 25th day of July, 2014.

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CERTIFICATE OF SERVICE

I hereby certify that I served a true and correct copy of the foregoing document in UM 1654 on the following named person(s) on the date indicated below by email addressed to said person(s) at his or her last-known address(es) indicated below.

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