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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 are an original and five copies of Northwest Natural Gas Company's Pre-Hearing Brief.

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 PRE-HEARING BRIEF**

I. INTRODUCTION

Northwest Natural Gas Company's ("NW Natural" or "Company") Mist storage services ("Storage Services") and resource optimization activities ("Optimization Activities") reflect the Company's expansion and innovative use of utility resources to create additional value for the Company and its customers. The Company's Storage Services are the result of a $65 million dollar investment by NW Natural's shareholders to expand capacity at Mist. Optimization Activities are the result of NW Natural's partnership with an asset management company engaged in cutting-edge trading activities. Since 2000, under current sharing arrangements under Schedules 185 and 186, customers have received a total of $80 million in credits from these activities. Customers have also received a very substantial benefit provided by the ability to recall the portions of the expanded Mist storage in increments as needed, and at a depreciated book cost. To date, the recall benefit realized is estimated at $21 million. *And importantly, customers have received these benefits while assuming absolutely no additional costs or risks.*

This docket was opened to consider whether the revenue sharing arrangements applicable to these activities should be revised or remain the same. NW Natural believes that the current sharing percentages fairly reward the Company and its customers for their

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respective contributions, costs, and risks, and therefore should not be changed. Staff agrees with NW Natural that the sharing percentages should remain the same, but, argues that the Company's revenues should be counted as utility revenues for the purposes of the earnings review—which under many circumstances could substantially reduce or even eliminate any benefit to NW Natural's shareholders. CUB also proposes that the Company's revenues be included in utility earnings. In addition, CUB would decrease the Company's share of revenues for Optimization Activities, and require a cost study to determine whether the sharing allocation for Storage Services fairly rewards customers for the use of shared assets. Taken together, CUB's recommendations would diminish the Company's incentive revenues in all years, and in some years could eliminate them altogether.

In the end the parties' positions present three fundamental questions:

1) With respect to Optimization—should the Public Utility Commission of Oregon ("Commission") continue to provide an incentive for local distribution company's ("LDCs") to engage in activities that go above and beyond their normal business operations, and that benefit customers through the innovative use of existing resources and development of new opportunities, while protecting customers from the risks of such activities?

2) With respect to Storage Services—should the Commission alter the premise upon which NW Natural made investments and initiated activities, simply upon the position of CUB that the deal should be made more beneficial to customers?

3) Should the Commission implement an earnings test policy that would significantly diminish the rewards that it has determined are appropriate to incentivize behaviors beyond the normal course of business that benefit the Company and its customers?

NW Natural believes that the answers to these questions are simple: Yes, No, and No.

First, the Commission should continue to provide LDCs with the incentive to maximize customer benefits by engaging in innovative use of existing resources, while at the same time protecting customers from any added costs or risks. To be clear, NW Natural does perform extensive optimization activities on its own, as part of its normal utility operations, and it flows benefits of those activities to its customers through the Purchased Gas Adjustment ("PGA") process. However the Company's Optimization Activities that are the subject of this docket are the product of an active collaboration with its asset manager and involve a level of effort and risk far beyond those required of a local distribution n LDC in the normal course. The Commission has wisely provided NW Natural with a fair sharing percentage to reward these activities to date. No party has provided any justification for diminishing that incentive in the future.

Second, the Commission should honor the sharing percentages accorded to the Company's Storage Services, based upon which NW Natural's invested $65 million of shareholder money. The original percentages were agreed to by all parties and the Company relied upon that agreement in its decision to commit shareholder dollars to Mist expansion. CUB's proposal for a cost of service study reflects an attempt to alter the original rationale for the revenue allocation without any real justification and should therefore be rejected.

And third, the Commission should reject Staff and CUB's call to include the Company's Storage Services and Optimization Activities incentive revenues in utility earnings. From a practical perspective, this recommendation would effectively reduce the Company's sharing allocation and thereby reduce the incentives that have worked in customers' favor to date. Equally importantly, including revenues from activities that go beyond base LDC expectations in utility earnings would represent a drastic change to current Commission policy, which requires the utilities to carefully segregate utility costs and revenues from those attributable to non-utility activities. CUB and Staff's recommendation to abandon that important principle would have deleterious and possibly unintended consequences.

For all of these reasons, the Commission should maintain the current sharing percentages and policies, to ensure that the Company and its customers continue to enjoy the benefits they have received in the past.

II. OPTIMIZATION ACTIVITIES

A. Overview of the Company's Optimization Activities.

The Optimization Activities that are the subject of this docket fall into five general categories: (1) Mist Storage Optimization; (2) Liquids Extraction; (3) Commodity Contract ("Portfolio") Optimization; (4) Pipeline Capacity Optimization; and (5) Off-System Storage Optimization.[1] Due to the complexity of these activities the Company has engaged a third-party to provide optimization services through an Asset Management Agreement ("AMA").[2] The Company's current third-party optimizer is Tenaska Marketing Ventures.[3]

The sharing for Optimization Activities includes two different arrangements. For Optimization Activities that utilize resources in customer rates—including that portion of Mist capacity in rates—the Company retains only 33 percent of the net margins and customers receive 67 percent.[4] For Optimization Activities that utilize shareholder-funded

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[1] NWN/200, Friedman/6.

[2] NWN/100, White/7.

[3] NWN/100, White/7.

[4] 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.

resources, that is, that portion of Mist storage that is not included in rates, the Company retains 80 percent of the net margin and customers receive 20 percent.[5]

B. The Current Optimization Sharing Arrangement is Reasonable and Should Not be Revised.

In this case, Staff and NW Natural provide support for why no change to the current sharing arrangement is warranted. CUB, however, proposes changes without any solid basis for doing so. For Optimization Activities that use assets included in customer rates, CUB recommends a reduction in the Company's share from the current 33 percent to 20 percent, and then to 10 percent at the conclusion of the Company's next general rate case.[6] CUB also recommends that all storage optimization be subject to the same sharing percentage as all the other Optimization Activities (regardless of whether it was paid for by shareholders or customers).[7] CUB's recommendation is not supported by the facts in the record and is based on poor policy.

Staff and CUB also recommend that the Company's Optimization Activity revenue be included in its Results of Operations reports used for future earnings reviews. This recommendation is inconsistent with Commission precedent, and would undermine the very purpose of the incentive mechanism itself.

1. The Optimization Activities are Beyond the Scope of Normal LDC Activities; Therefore an Incentive is Appropriate.

NW Natural's central obligation as an LDC is to distribute natural gas to end-use core utility customers.[8] To fulfil this obligation, NW Natural purchases natural gas, utilizes gas

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[5] NWN/100, White/10.

[6] CUB/100, Jenks-McGovern/26, 32.

[7] CUB/100, Jenks-McGovern/19.

[8] NWN/500, White/4.

storage, engages in a variety of wholesale transactions, and generally optimizes its utility assets to reduce costs and, where possible, generate revenue.[9] This "first level" optimization is the result of concerted efforts on the part of the Company's skilled gas supply staff, and is the source of savings that are passed through to customers through the PGA.[10]

The Optimization Activities that are the subject of this case, however, are fundamentally different,[11] involving market speculation and the execution of complex transactions that are not required for the Company to fulfill its basic LDC obligations.[12] In fact, the complexity of the transactions at issue in this case are beyond the expertise of the Company's in-house staff, and can only be achieved by a close collaboration with an AMA partner.[13] The AMA allows NW Natural to leverage its partner's knowledge and skill, as well as its partner's nationwide operations to produce value for shareholders and customers.[14]

The current sharing arrangement provides an appropriate and necessary incentive for NW Natural to continue these discretionary Optimization Activities and seek new opportunities.[15] As demonstrated in the Opening Testimony of Keith White, this sharing

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[9] NWN/400, Friedman/1-2.

[10] NWN/400, Friedman/2.

[11] NWN/100, White/6; NWN/400, Friedman/2.

[12] NWN/100, White/6; NWN/500, White/3.

[13] NWN/100, White/6-7.

[14] NWN/100, White/7.

[15] NWN/100, White/8.

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arrangement is consistent with the arrangements approved for LDCs in other states engaging in the same types of Optimization Activities.[16]

Staff agrees with the Company that the Optimization Activities are "beyond the normal course of an LDC business model or what would be expected of an LDC to serve core utility customers."[17] Staff recognizes that the Storage Services and Optimization Activities represent an innovative application of commodity trading activities that create revenue for both customers and shareholders through the use of under- or unutilized assets.[18] While certain Optimization Activities rely on customer-funded assets, Staff correctly concludes that NW Natural's "obligation to optimize the use of core utility customer assets is not unlimited . . . [NW Natural] is not required to engage in potentially risky activities that are not directly related to providing regulated services to [NW Natural's] core utility customers."[19] For this reason, Staff supports the continued use of the current sharing percentages.[20]

CUB insists that the Optimization Activities are in fact traditional LDC activities for which the Company does not require an incentive. To make this point, CUB compares revenues from NW Natural's Optimization Activities to those from an electric utility's sales for resale and arbitrage, which are not subject to an incentive mechanism.[21] CUB's analogy is inapt. Unlike the Optimization Activities, the electric utility activities CUB

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[16] NWN/100, White/19-20; NWN/103.

[17] Staff/100, Colville/14; Staff/200, Colville/4.

[18] Staff/200, Colville/5.

[19] Staff/100, Colville/9-10.

[20] Staff/200, Colville/1, 12.

[21] CUB/100, Jenks-McGovern/21-22.

describes have long been considered a part of basic electric service.[22] The costs of maintaining sophisticated trading desks are included in electric customers' rates and the risks associated with those activities are accounted for when determining an electric utility's rate of return. On the other hand, LDCs do not maintain the same trading capacities, nor are risks associated with speculative activities accounted for in LDC rates of return.

There is another important distinction between natural gas and electric utilities in this regard. Electric utilities earn a return on the optimized assets, and may be regarded as bearing a higher obligation to incur costs and risks to optimize. In this case, assets that are the subject of Optimization Activities are physical supply and pipeline contracts, upon which the Company does not earn a return.[23]

CUB also argues that Avista Utilities ("Avista") and Portland General Electric Company ("PGE") engage in resource optimization, such as pipeline capacity optimization, as part of their normal course of business and that the revenues generated from resource optimization are passed through to customers.[24] However, CUB provides no evidence that supports its claim. On the contrary, the one specific example CUB provides regarding PGE's optimization suggests is more descriptive of what NWN does in its own PGA optimization, and not the more sophisticated optimization performed by NW Natural with its AMA partner. And CUB has provided no information whatsoever to suggest that Avista's optimization activities are of either the sophistication or scale of the activities that are the subject of this docket.

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[22] NWN/300, White/17-18.

[23] NWN/300, White/18.

[24] CUB/200, Jenks-McGovern/13-15.

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2. The Optimization Activities Increase Shareholder Risk while Protecting Customers.

The Company's Optimization Activities create a significant regulatory risk due to the Federal Energy Regulatory Commission's ("FERC") complex regulatory framework, which is intended to discourage anticompetitive behavior by market participants.[25] Staff recognizes these risks, and accordingly points out that while increasing customers' percentage of revenues may provide them with short-term benefits, customers may ultimately lose in the long-term if shareholders are not rewarded for their risk and subsequently curtail the Optimization Activities.[26] CUB, on the other hand, minimizes the regulatory risk borne by shareholders, pointing out that the Company has yet to be fined for non-compliance.[27] Given the numerous and significant fines that have been levied against other companies, NW Natural's compliance to date does not suggest that it bears no risk, but rather that the Company has effectively managed that risk.[28]

CUB also argues extensively that the Company's Optimization Activities impose real risks on NW Natural's customers—repeating this vague and general claim throughout its testimony. However, despite the arm-waving, CUB identifies only one supposed risk: that the Company's Optimization Activities may require it to use customer purchased gas to cover a financial transaction, such that the "Company would sell the customer owned gas stored in Mist at the agreed upon price, and repurchase equivalent gas for customer use at the higher market price, resulting in cost to the customers."[29] This is similar to the

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[25] NWN/100, White/12; Staff/100, Colville/12.

[26] Staff/200, Colville/5.

[27] CUB/100, Jenks-McGovern/26.

[28] NWN/300, White/19; NWN/306.

[29] CUB/200, Jenks-McGovern/12.

concern raised by Staff in its testimony, although rather than making a vague claim, Staff has instead offered a potential solution to their concern.[30] NW Natural has explained that this risk does not exist, given the structure of the transactions. Specifically, in his Supplemental Reply Testimony, Mr. White explained that when a storage transaction requires NW Natural to "sell" and later "replace" gas, the sale and purchase prices are structured as an exchange of gas with no net cost to the Company.[31] Thus, customers are not exposed to changes in the market in the way that CUB speculates. In the end, all of the evidence and reasonable inferences support NW Natural's position that Optimization Activities impose no costs or risks on NW Natural's customers.

3. The Current Sharing Percentages are Consistent with Commission Practice.

The current sharing percentages are comparable to other sharing arrangements approved by the Commission, such as the 80/20 or 90/10 sharing included in the Company's PGA. Like the Optimization Activity sharing, the PGA sharing is intended to incent the Company to achieve the lowest cost gas supply and protect shareholders from price risk volatility.[32] The fact that the Company can receive 20 percent of the gas supply margins through PGA sharing, which is an activity that falls squarely within the normal course of LDC operations, suggests that for activities that are beyond the normal scope of LDC activity sharing of at least 20 percent is reasonable.[33] Similarly, the Company retains 20 percent of the revenue generated from simple lower value pipeline capacity releases

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[30] Staff/200, Colville/10-11.

[31] NWN/500, White/4.

[32] NWN/100, White/18-19.

[33] NWN/100, White/19.

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under Schedule P.[34] Staff agrees, concluding that because the Optimization Activities "are beyond basic LDC expectations, the sharing percentage should reflect this difference, and be greater for [NW Natural] than 90/10 or 80/20."[35]

The current sharing percentages are also consistent with the incentives available to other gas-only LDCs in other states that engage in similar activities.[36] Precedent from other jurisdictions confirms that incentives are necessary for LDCs to engage in these types of activities and that the Company's sharing percentages are reasonable.[37]

4. CUB Misunderstands the Optimization Activities, which Rely on Mist Storage Capacity, Not Gas Inventory.

CUB argues that the physical gas that backs the Company's storage Optimization Activities is owned by customers and concludes that it is incorrect to claim that shareholders have funded the Mist storage-related Optimization Activity.[38] Therefore, CUB proposes that all Optimization Activity be subject to the 67/33 sharing percentages.[39] CUB's analysis is based in its misunderstanding of the nature of the storage Optimization Activity. The Company optimizes *capacity*, not gas inventory.[40] The ability of NW Natural's partner to trade gas on NW Natural's behalf is not based on the amount of gas inventory at Mist, it is based on the storage capacity at Mist.[41] Moreover, while the

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[34] NWN/100, White/19.

[35] Staff/100, Colville/16.

[36] NWN/100, White/19-20; NWN/103, White/1.

[37] NWN/100, White/20.

[38] CUB/100, Jenks-McGovern/14-16.

[39] CUB/100, Jenks-McGovern/19.

[40] NWN/400, Friedman/9.

[41] NWN/400, Friedman/9.

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physical gas at Mist provides a back stop for the Optimization Activities, the trading activities the gas supports far exceed the actual gas volumes at Mist.[42] Indeed, this fact is a key reason why the Company engages in a third party AMA and does not engage in these activities as part of its normal LDC business.[43]

5. Optimization Activity Revenues Should Continue to be Excluded from the Company's Earnings Reviews.

Both Staff and CUB recommend that shareholders' allocation of revenues from Optimization Activities should be counted as utility earnings in the Company's annual earnings reviews.[44] The inclusion of the Optimization Activities' revenue in the Company's earnings reviews would result in a de facto reduction of the current sharing percentages. This reduction is unwarranted, particularly in light of Staff's recommendation that the current sharing percentages are reasonable and should remain unchanged.[45] Adopting this recommendation could reduce the Company's incentive to participate in these discretionary activities.[46] And the inclusion of revenues from activities that Staff agrees are beyond the scope of normal LDC business activities is inconsistent with Commission precedent, which has included in the earnings review only revenues from activities tied to the Company's core utility obligations.[47]

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[42] NWN/400, Friedman/10-11.

[43] NWN/400, Friedman/11.

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

[45] NWN/500, White/10; Staff/200, Colville/4-5.

[46] NWN/500, White/10.

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

Staff acknowledges that its recommendation could "indirectly result in an effective lower sharing percentage allocated to the Company."[48] Nonetheless, Staff concludes that this reduction is reasonable because the Company's share of Mist Optimization Activities could be no less than 39 percent, an amount that still exceeds the Weighted Average Cost of Gas ("WACOG") sharing mechanism.[49] Staff's conclusion, however, is based on incomplete and erroneous calculations.[50] Staff accounts for only Mist Optimization Activities and ignores the impact of their recommendation on the entirety of the Company's Optimization Activities. Correcting Staff's analysis using actual historical data demonstrates that under Staff's proposal, the Company's share of Optimization Activities revenues would be reduced to only 27 percent, not 39 percent.[51]

In addition, Staff recommends inclusion of revenue from the optimization of non-utility Mist storage in the earnings review,[52] a proposal that appears inconsistent with Staff's stated recommendation to include revenue from "ratepayer-owned assets."[53] More importantly, the inclusion of non-utility Mist storage in the earnings review would create a mismatch because the investment in non-utility Mist storage is not accounted for in customer rates and is therefore excluded from the earnings review. If the revenue from non-utility Mist storage is included in the earnings review, while the investment is excluded, the earnings review would artificially inflate the Company's earnings.[54] And if

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[48] Staff/300, Garcia/4.

[49] Staff/300, Garcia/4-5.

[50] NWN/500, White/6.

[51] NWN/500, White/8.

[52] Staff/302.

[53] NWN/500, White/7.

[54] NWN/500, White/8.

the non-utility Mist storage revenues are excluded from the earnings review, the Company's share drops even further to only 22 percent—well below the 39 percent level Staff concluded was reasonable.[55]

Finally, if Optimization Activity revenues are included in utility earnings for the purpose of the Site Remediation Recovery Mechanism ("SRRM") earnings review under consideration in docket UM 1635, in many years the Company's share of revenues could be reduced to zero.[56] Such an outcome would significantly erode NW Natural's incentive to continue to devote resources to these activities, and would destroy the alignment of interests that has benefited customers and shareholders to date.

III. STORAGE SERVICES

A. Overview of NW Natural's Storage Services.

NW Natural's Storage Service includes the injection, withdrawal, and underground storage of gas at Mist and the transportation of gas to and from Mist storage using NW Natural's high pressure pipeline system.[57] The Company provides both inter- and intrastate storage, the difference being that for intrastate storage the gas remains within NW Natural's Oregon service territory rather than being transported on to the Northwest Pipeline.[58] Under both of these services, NW Natural's customers are not its normal core utility customers—instead its customers are other utilities or marketers of gas. FERC exercises exclusive jurisdiction over the Company's interstate storage services, while the

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[55] NWN/500, White/8-9; NWN/502.

[56] NWN/500, White/9.

[57] NWN/200, Friedman/2.

[58] NWN/200, Friedman/3.

Commission has jurisdiction over the provision of intrastate storage services, which are governed by Schedule 80.[59]

The Company's original Mist storage, along with its related pipeline development, went into service in 1989.[60] Thereafter, in 1991, 1997 and 1999 the Company expanded the original Mist facilities in order to serve core customers.[61] The capital costs of these pre-2000 expansions were included in utility rate base.[62]

In the late 1990's, the Company investigated the opportunity to develop additional Mist storage on a non-utility basis to serve the broader Pacific Northwest regional market, rather than core utility customers.[63] After consultation with Staff, the Company chose to develop incremental Mist storage capacity from within the utility, rather than through an affiliate.[64] The incremental investment approach allowed NW Natural to leverage sunk costs and avoid the construction of unnecessarily duplicative facilities.[65] The Company was able to partially share the non-utility revenues with core utility customers after the Company recovered its incremental investment and operating costs.[66] The Company's approach also allowed core utility customers to benefit from the Company's early

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[59] NWN/100, White/4-5.

[60] NWN/100, White/4.

[61] NWN/100, White/4.

[62] NWN/100, White/4.

[63] NWN/100, White/4.

[64] NWN/100, White/4-5.

[65] NWN/100, White/4-5.

[66] NWN/100, White/5.

development of additional Mist storage capacity by having the ability to recall the storage capacity in the future at a depreciated cost, when it is needed to serve them.[67]

After obtaining the necessary regulatory approvals, with both FERC and the Commission, the Company invested shareholder dollars to add capacity at Mist in 2001, with subsequent shareholder investments for additional expansions in 2004, 2005, and 2007.[68]

The sharing arrangement for the Company's Storage Services is governed by Schedule 185. For these Storage Services provided with expansion capacity entirely funded by shareholders and not included in core customer rates, the Company retains 80 percent of the net margin and customers receive the remaining 20 percent.[69] 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 not funded by customers.

B. The Storage Services Sharing Arrangement is Reasonable.

Both Staff and the Company agree that the current sharing arrangement for the Company's Storage Services is reasonable and should be continued. Staff and NW Natural point out that the current sharing was based on a fair assessment of the relative costs and risks—*i.e.*, the Company bears all costs and risks while the customers bear none. Staff and the Company also recognize the undeniable benefits to customers. In addition to revenue sharing, the shareholder funded Mist expansion provides additional customer benefit because the Company can recall Mist storage to serve core customers in smaller increments and as the need arises. This allows the Company to better match

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[67] NWN/100, White/5.

[68] NWN/100, White/5.

[69] NWN/100, White/10.

additional storage capacity with customer need to prevent customers from paying for more storage capacity than is needed.[70] And because the recalled capacity has already been constructed, customers bear none of the construction-related risks and the recalled capacity is included in customer rates at the depreciated book costs, not the actual costs.[71] The customer value of the recall benefit exercised to date is estimated at $21 million.[72]

CUB recommends a temporary continuation of the current arrangement pending the completion of a cost-of-service study prior to the Company's next general rate case. CUB's proposal represents a complete departure from the rationale for the original sharing framework upon which the Company made its historical investment decisions, and should be rejected.

1. Storage Services Were Made Possible by Shareholder Investment, and Shareholders Bear all Associated Risks.

Storage Services are the result of NW Natural's decision to invest $65 million dollars of shareholder money to expand Mist field. In making this investment, shareholders assumed all development risks, including the risks of permitting delays and construction cost risks,[73] and they assumed the price risk as well. As explained by Mr. White, although the Company's storage capacity has consistently been fully sold, the sales prices are dictated by the market, resulting in uncertain profitability from year to year.[74]

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[70] NWN/100, White/3.

[71] NWN/100, White/3.

[72] NWN/301.

[73] NWN/100, White/14.

[74] NWN/100, White/12-13.

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CUB attempts to minimize the price risk borne by shareholders, claiming that the Company has consistently sold its available storage capacity at its FERC-approved rates.[75] In making this argument, CUB relies exclusively on Staff's testimony from UG 221.[76] CUB ignores the fact that in this case Staff acknowledged that the assumption underlying Staff's UG 221 recommendation—that storage capacity is sold at the FERC-approved rate—is wrong.[77] In fact, Staff acknowledges that the Company's current and historical storage contracts are all priced at below the FERC-approved maximum rate in order to meet market prices.[78]

CUB also relies on Staff's testimony from UG 221 to argue that, "since 2000, the price, supply, and use of natural gas has drastically changed, and the increased need for storage capacity is expected to continue."[79] This claim is completely at odds with the evidence in this case. In fact, the intrinsic and extrinsic trading values related to gas storage have declined dramatically over the last few years, due to the abundant gas supply.[80] This abundant gas supply has not only lowered gas commodity prices, but, more importantly to storage values, has also depressed market volatility.[81] As a result, new storage development has slowed drastically and re-contracting risk on existing projects has increased.[82] If anything, the market changes identified by CUB *increase* shareholder

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[75] CUB/200, Jenks-McGovern/6-7.

[76] CUB/200, Jenks-McGovern/6-7.

[77] NWN/100, White/12.

[78] NWN/100, White/12.

[79] CUB/200, Jenks-McGovern/5.

[80] NWN/100, White 13-14.

[81] NWN/100, White 13-14.

[82] NWN/100, White 13-14.

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risk by lowering the demand for the Company's Storage Services and support a shift in sharing percentages in favor of shareholders.

2. Storage Services Sharing Should Not be Based on a Cost-of-Service Model.

CUB recommends that the Company perform a traditional cost-of-service study to determine the appropriate sharing percentages for Storage Services.[83] CUB recommends that the current sharing percentages should remain in place until the cost-of-service study is completed for the Company's next general rate case.[84]

In making this recommendation, CUB seeks to discard the framework on which the original sharing percentages were grounded, and the one on which the Company relied upon when it invested in the Mist field expansion. As discussed above, the original sharing percentages were based upon the understanding that Storage Services were enabled by a shareholder investment, with no incremental cost or risk to customers. The parties understood that the new services would utilize certain utility resources. However, those utility resources were already included in customer rates, and the use of them would impose no additional cost on utility customers. As such, the parties correctly viewed the arrangement as "all up-side" for customers. CUB's cost-of-service approach is fundamentally different from the one on which the Company relied, and as such represents a kind of "bait and switch" tactic that should be rejected.[85]

Further, the use of a cost-of-service model to allocate Storage Services revenues does not make sense in light of the nature of the investments made and the facilities

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[83] CUB/100, Jenks-McGovern/12.

[84] CUB/100, Jenks-McGovern/12, 30.

[85] NWN/300, White/5-6.

through which the Storage Services are provided.[86] For example, the most significant utility resource used to provide Mist storage to core customers is the South Mist Pipeline and South Mist Pipeline Extension ("SMP"). While non-utility Storage Services makes some limited use of it, this is only because it already exists. It is a convoluted and inordinately expensive way to access the interstate pipeline system. If the business purpose were to reach the interstate market, then it would make more sense to construct a shorter pipeline to the north connecting to the KB Pipeline at significantly lower cost. Furthermore, under a long-run incremental cost study, no SMP costs would be assigned to Storage Services customers because their pipeline rights are subject to recall and therefore not long-term.[87] Conversely, if SMP costs were to be assigned to Storage Service customers, then shareholders should no longer bear the substantial costs of recall.[88] This example demonstrates that the use of a cost-of-service model may well result in a significant shift of incentives such that shareholders may be incented to build Storage Service-specific resources, such as a shorter pipeline directly to the interstate pipeline, which would be redundant and not beneficial to customers.[89]

CUB's proposed cost-of-service study is also unnecessary to ensure transparency. NW Natural already provides all relevant cost and revenue information on the Company's Storage Services activities in annual reports to the Commission and the information that

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

[87] NWN/300, White/10.

[88] NWN/300, White/10.

[89] NWN/300, White/10-11. In addition to the allocation of transmission resources, CUB's proposed cost-of-service study would also address the storage facilities themselves. It is likely, however, that a cost-of-service study related to the storage facilities would support the current sharing percentages because on a per-unit basis the costs currently allocated between utility customers and Storage services are roughly equivalent. NWN/300, White/11-12; NWN/303.

would be provided as part of a cost-of-service study would do little to inform the appropriate sharing percentages.[90]

IV. CONCLUSION

The current sharing percentages applied to Optimization Activities and Storage Services provide the Company with a powerful incentive to focus all of its energies on creating the greatest value from existing resources. In this fashion, the Commission has aligned customer and shareholder interest, 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. The Commission should resist these proposals and should affirm the continued used of the Company's current sharing percentages, and the exclusion of Optimization Activity revenues from the Company's future earnings reviews.

Respectfully submitted this 27th day of January, 2014.

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[90] NWN/300, White/13, 23.

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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