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VIA ELECTRONIC FILING & U.S. MAIL

Oregon Public Utility Commission
Attn: Filing Center
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Re: In the Matter of NORTHWEST NATURAL GAS COMPANY, dba NW Natural Investigation of Interstate Storage and Optimization Sharing
Docket No. UM-1654

Dear Filing Center:

Enclosed please find the original and five (5) copies of the Northwest Industrial Gas Users' Prehearing Brief in the above-referenced docket.

Thank you for your assistance with this filing. Should you have any questions, please feel free to contact me.

Very truly yours,

Tommy A. Brooks

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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 INDUSTRIAL GAS USERS' PREHEARING BRIEF

I. INTRODUCTION

Pursuant to ALJ Pine's Ruling dated October 31, 2013, the Northwest Industrial Gas Users ("NWIGU") submit this Prehearing Brief. NWIGU did not sponsor expert testimony as part of this proceeding. However, NWIGU has reviewed the filing and the other parties' testimony, and NWIGU was also a party to the stipulation in Docket UG 221 that eventually resulted in Northwest Natural Gas Company's ("NW Natural" or "Company") initiation of this proceeding.

As explained in more detail below, NWIGU urges the Public Utility Commission of Oregon ("Commission") to: (1) adopt the proposal set forth by the Citizens' Utility Board of Oregon ("CUB") to temporarily continue the current 20/80[1] sharing mechanism for revenue from NW Natural's Interstate Storage Services, until such time as a more-detailed cost analysis can be performed; (2) acknowledge that ratepayer assets are necessary to NW Natural's Optimization activities, and adjust the sharing of revenue from those activities accordingly; (3) adopt the position set forth by Commission Staff ("Staff") and CUB to require all income earned from the optimization of ratepayer-owned

[1] Consistent with the other parties' description of sharing mechanisms in their testimony, NWIGU will refer to a sharing mechanism a "XX/YY" where "XX" is the percent of revenue shared with ratepayers and "YY" is the percent of revenue retained by NW Natural.

assets to be included in NW Natural's Results of Operations ("ROO") filed annually with the Commission.

II. ARGUMENT

A. Revenue Sharing from Interstate Storage Services

It is clear from the record that there is no substantial evidence to support the current 20/80 sharing mechanism for revenue generated by NW Natural's Interstate Storage Services. That sharing mechanism exists as the result of an informal agreement by the Company, Staff, and unidentified stakeholders before NW Natural started actually providing Interstate Storage Services, and before the full value of those services, or the costs and risks incurred to provide those services, could be known. In fact, the Commission appears to have approved the 20/80 sharing mechanism without any formal analysis or written opinion. Now that the Company has more than a decade of experience providing these services, and the risks, costs, and benefits of those services can be quantified, it would be imprudent to allow the indefinite continuation of the sharing mechanism without a more formal analysis.

In the late 1990's, NW Natural began exploring efforts to provide Interstate Storage Services at its Mist storage facility.[2] In doing so, the Company eventually decided to develop incremental capacity at Mist, leveraging existing facilities, as opposed to constructing completely new and separate facilities to provide that service.[3] In order to recognize that the Interstate Storage Services relied in part on existing ratepayer-owned assets, and in part on new investments made by NW Natural's shareholders, the Company proposed a 20/80 sharing mechanism to share some of the revenue it received from Interstate Storage Services with ratepayers.[4] The Commission approved that

[2] NWN/100, White/4 lines 12-17.
[3] NWN/100, White/4 line 18 to White/5 line 1.
[4] NWN/100, White/7 line 21 to White/8 line 2.

sharing mechanism, but apparently did so orally at a Public Meeting and not as part of any formal analysis or process.

The Company has identified several risks it believes its shareholders bear by providing Interstate Storage Services and that it uses to justify continuation of the 20/80 split. For example, NW Natural states that its primary risk is the "price risk associated with the Company's interstate storage contracts for Mist."[5] The Company also identifies "historical risks associated with the development of the storage reservoirs" from permitting delays and variations in construction costs.[6]

Staff's testimony in this proceeding appears to agree with NW Natural that the Company's shareholders bear some risk when providing Interstate Storage Services, but that testimony simply describes the risk as "normal business risk."[7] Specific risks Staff identifies (e.g. regulatory risk and other risks associated with operating a business outside the normal scope of gas distribution) all relate to optimization activities and not to the risks NW Natural identified with respect to the provision of basic Interstate Storage Services.[8]

Even if NW Natural's and Staff's testimony in this proceeding can be read to describe a risk to the Company's shareholders for providing Interstate Storage Services, the existence of some risk does not automatically justify a precise 20/80 split for sharing revenue. Nor did such risks serve as the factual basis for developing the 20/80 sharing mechanism in the first place. As Staff acknowledges, the 20/80 split was based on the then-current weighted average cost of gas sharing percentage adopted for the Purchased Gas Adjustment ("PGA") sharing mechanism.[9] Further, as CUB points out in its testimony, NW Natural's decision to propose a 20/80 sharing mechanism was simply an estimate of the overall value and NW Natural previously acknowledged that "the

[5] NWN/100, White/12 lines 15-16.
[6] NWN/100, White/14 lines 3-5.
[7] Staff/100, Colville/12 line 6.
[8] Staff/100, Colville/12 line 8 to Colville/14 line 3.
[9] Staff/100, Colville/4 lines 17-20.

Company's consultant was unable to find enough data to support an industry standard on sharing percentages or cost recovery allocation mechanisms"[10] that could be used to develop a different split in the sharing mechanism.

Based on the foregoing, it is clear that the record contains no factual basis to support continuation of the 20/80 split in the current sharing mechanism. Accordingly, NWIGU urges the Commission to adopt CUB's proposal, which is that the Commission approve temporarily the 20/80 sharing mechanism, but that the Commission also require the Company to model interstate storage in its cost of service model "to identify the share of system costs that should be allocated to storage if it were treated like all other services that share in the common investment."[11] In Docket UG 221, Staff similarly proposed that the Commission order NW Natural to conduct an independent review of the operation and financing of the Mist storage facility to justify continuing the current sharing percentages.[12]

NW Natural's and Staff's responses to CUB's proposal provide no compelling basis for not adopting that proposal. NW Natural asserts that reliance on a cost of service model should be rejected because: it is a "radical departure" from the original framework of the sharing mechanism; it "would distort the economic incentives" for future investments in Mist; it would not be useful for allocating revenues from investments at Mist; and it is insufficient to quantify embedded costs.[13] Staff asserts that CUB's proposal is misplaced because there are no "cost studies" to update[14] and because there have been no "significant changes in business conditions and risks since the sharing percentages were established."[15]

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[10] CUB/100, Jenks-McGovern/7 lines 16-20.
[11] CUB/100, Jenks-McGovern/12 lines 2-4.
[12] Staff/100, Colville/2 lines 14-17; [12] CUB/100, Jenks-McGovern/5 liens 18-27.
[13] NWN/300, White/4 line 11 to White/5 line 3.
[14] Staff/100, Colville/4 lines 14-17.
[15] Staff/200, Colville/5 lines 14-18.

NW Natural's responses ignore the nature of CUB's proposal. First, even if a subsequent study were to result in a "radical departure" from the original framework of the sharing mechanism, such a departure would be based on factual information and analysis as opposed to unsupported guesswork. Second, NWIGU does not understand CUB to propose that an analysis be performed in order to allocate costs. Rather, the analysis CUB seeks serves more like an audit and would identify the various components of NW Natural's system that drive the costs and revenues associated with Interstate Storage Services. That information would in turn inform whether the split in revenue between ratepayers and shareholders is equitable. Thus, all of NW Natural's arguments against performing a cost of service analysis are irrelevant to the outcome CUB seeks in its proposal.

Staff's response serves better as a reason to support CUB's proposal than as a reason to oppose it. It was originally Staff's position in UG 221 that the sharing percentage was based on certain "cost studies" that had not been updated.[16] Staff's new position is that there were no cost studies to update. That conclusion, however, only further illustrates that the original decision to allow the 20/80 sharing mechanism was wholly divorced from any facts relating to the costs and benefits related to NW Natural's provision of Interstate Storage Services.

Moreover, Staff's assertion that there have been no significant changes in business conditions and risks since the sharing percentages were established is not supported by the evidence in the record. First, business conditions have changed. NW Natural's testimony, for example, describes the fact that FERC regulations have changed over the past several years and parties are subject to different regulations than they used to be.[17] Also, the mere fact that there is now a well-established interstate storage option in the region (Mist) where there used to be no such option when NW Natural began this

[16] Staff/100, Colville/2 lines 14-18.
[17] NWN/300, White/19 lines 12-20.

service is a major change in the business conditions that existed at that time. Second, NW Natural's testimony indicates that the level of risk in its activities is different than it used to be, even if that risk has not been eliminated.[18]

In summary, the Commission should not approve the indefinite continuation of the current 20/80 sharing mechanism without first establishing clear facts that support such a sharing split. Instead, the Commission should approve continuation of the current split temporarily and require a more robust evaluation of the risks, costs, and benefits associated with NW Natural's Interstate Storage Services. Only then will the Commission be able to have confidence that it has approved an equitable split in revenue sharing.

B. Ratepayer Assets Used in Optimization Activities

NWIGU agrees with CUB's contention that the Commission should revise Schedule 186 to reflect the fact that some of the Company's "Mist Optimization" activities rely on the use of ratepayer-owned gas that is currently allocated to Interstate Storage Services. Revenue from those activities should therefore be shared with ratepayers at a higher percentage.

As part of providing service to customers of its Interstate Storage Services, NW Natural contracts with a third party through an Asset Management Agreement to "optimize" its gas assets.[19] Because "the majority" of NW Natural's optimization activities use resources that are included in customer rates,[20] NW Natural shares revenue from those activities with ratepayers at different rates depending on which assets are being leveraged. Revenue from the portion of Mist capacity that is "non-utility" is shared 20/80, whereas revenue from the portion of Mist capacity that is included in rates (i.e. that relies on "ratepayer assets") is shared 67/33.

[18] NWN/300, White/19 lines 12-20.
[19] NWN/300, White/13 line 23 to White/14 line 1.
[20] NWN/100, White/8 lines 15-16.

NW Natural's optimization activities include, but are not limited to, the sale and trading of excess gas and "portfolio" optimization in the form of exchanges of gas commodity contract purchases at different trading locations.[21] As CUB points out in its testimony, the only gas that NW Natural has a right to use for such activities is the gas owned by its utility retail ratepayers.[22] However, the optimization activities that rely on use of that ratepayer asset are conducted as if the gas is largely a non-utility asset. Specifically, NW Natural allocates 47% of net revenues from Mist Optimization activities to Interstate Storage Services.[23] As a result, revenue from that portion of optimization activities is shared with ratepayers using the 20/80 sharing mechanism rather than the 67/33 sharing mechanism.

Staff disagrees with CUB's testimony and asserts that the optimization activities involving gas trades and portfolio optimization do not involve "trading of the physical gas" and, instead, are merely financial transactions "secured by physical gas."[24] This is a distinction without a difference. First, and most notably, Staff does not assert that the gas being used to secure these financial transactions is *not* a ratepayer asset. Second, if the gas is necessary to secure a transaction for storage optimization, then it is being used as the basis for that transaction whether or not it physically gets traded. In support of its argument, Staff offers the analogy of "securing a loan with collateral." According to Staff, such a loan does not require surrender of the collateral, unless the borrower defaults.[25] That analogy only explains Staff's view of why no physical gas is traded as part of the Company's optimization activities; it does nothing to undermine CUB's argument that the "collateral" being used in the "loan" is a ratepayer asset.

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[21] NWN/100, White/6 lines 5-9.
[22] CUB/100, Jenks-McGovern/16 lines 7-11.
[23] CUB/100, Jenks-McGovern/13 liens 4-6.
[24] Staff/200, Colville/10 lines 4-7.
[25] Staff/200, Colville/10 lines 7-9.

NW Natural also disagrees with CUB's testimony, characterizing CUB's argument as asserting "that the gas alone is what is being optimized."[26] NW Natural takes the same position as Staff that the optimization activities involving gas trades and portfolio optimization "occur without any physical movement of gas."[27] These responses also fail to grapple with CUB's argument that, whether or not gas physically moves as part of these transactions, it is the physical gas that makes the transactions possible. NW Natural's testimony enforces this fact and the Company acknowledges that "the gas does serve as a backstop"[28] to these transactions and that the sale of gas and its later purchase at a lower price "generates revenue that would not otherwise have been obtained from **this asset**."[29] The phrase "this asset" refers to the physical gas.

Because NW Natural's Mist Optimization activities rely heavily on a ratepayer asset (the physical gas), Schedule 186 should be revised to acknowledge the value ratepayers have provided to those activities and revenue from those activities should therefore be shared with ratepayers at a higher percentage than Schedule 186 currently provides.

C. <u>Appropriate Treatment of Revenue in Results of Operations Filings</u>

The record in this docket demonstrates that NW Natural fails to report all utility income in its ROO filed annually with the Commission. NWIGU urges the Commission to adopt the positions of Staff and CUB that all income earned using ratepayer-owned assets is "utility income" for purposes of the Company's ROO.

As CUB correctly points out, NW Natural's optimization revenues grow out of the retail ratepayer-owned gas the Company stores at Mist and Jackson Prairie.[30] Staff agrees, noting that the Company optimizes ratepayer-owned assets resulting from a third

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[26] NWN/400, Friedman/10 lines 2-3.
[27] NWN/400, Friedman/10 lines 5-7.
[28] NWN/400, Friedman/10 line 22.
[29] NWN/200, Friedman/11 line 22.
[30] CUB/100, Jenks-McGovern/29 lines 16-17.

party optimization agreement.[31] Both CUB and Staff have argued that all income earned using ratepayer-owned assets is utility income.[32] As such "income earned by NWN that results from activities ***made possible by*** the optimization of ratepayer-owned assets should be include in [NW Natural's] ROO as utility income."[33]

NW Natural objects to Staff's and CUB's position. However, NW Natural's objections are based on the *impacts* of reporting optimization revenue in its ROO and not on whether such reporting is required. For example, NW Natural responds that including optimization revenue in the ROO will impact the Company's earnings review, potentially eliminating the Company's incentive to participate in optimization activities.[34] Similarly, NW Natural asserts that Staff's analysis understates the potential impacts from Staff's analysis of a modified earnings review.[35]

It is notable that although NW Natural does take issue with how to determine which revenues are derived from ratepayer-owned assets, NW Natural's testimony responding to Staff and CUB never asserts that revenue from ratepayer-owned assets is not "utility revenue." Again, the only basis for NW Natural's arguments is that including this kind of utility revenue in its ROO is a "shift from past practice."[36]

As explained in more detail in the previous section, NWIGU agrees with CUB that all of NW Natural's Mist Optimization activities rely on the use of a ratepayer-owned asset – the physical gas. This is true even for those revenues that the Company accounts for under its non-utility business umbrella. As Staff notes, the manner in which a utility accounts for revenues is not controlling in the context of determining which revenues are to be reported in a ROO.[37] Therefore, all of the Company's revenue from

[31] Staff/300, Garcia/1 line 23 to Garcia/2 line 3.
[32] Staff/300, Garcia/2 lines 11-12.
[33] Staff/300, Garcia/2 lines 12-14 (emphasis added).
[34] NWN/500, White/2 lines 9-16.
[35] NWN/500, White/2 lines 16-18.
[36] NWN/500, White/11 lines 1-3.
[37] Staff/300, Garcia/5 lines 21-22.

Mist Optimization activities should be deemed utility revenue for purposes of the Company's ROO.

III. CONCLUSION

For the reasons stated, the Commission should: (1) adopt CUB's proposal to temporarily continue the current 20/80 sharing mechanism for revenue from NW Natural's Interstate Storage Services, until such time as a more-detailed cost analysis can be performed; (2) acknowledge that ratepayer assets are necessary to NW Natural's Optimization activities, and adjust the sharing of revenue from those activities accordingly; (3) require all income earned from the optimization of ratepayer-owned assets to be included in NW Natural's ROO filed annually with the Commission.

Dated this 27th day of January 2014.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I CERTIFY that I have on this day served the foregoing document upon all parties of record in this proceeding via electronic mail and/or by mailing a copy properly addressed with first class postage prepaid.

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