BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1654

In the Matter of	)	
NORTHWEST NATURAL GAS COMPANY, dba NW Natural	)	CITIZENS' UTILITY BOARD OF OREGON'S PRE-HEARING BRIEF
Investigation of Interstate Storage and Optimization Sharing	)	***Redacted***

I. The Role of Pre-Hearing Briefs

The Citizens' Utility Board of Oregon (CUB), pursuant to ALJ Pines' Ruling of October 31, 2013, herewith submits its Pre-hearing Brief in this matter. CUB views Pre-hearing Briefs as providing an opportunity for the parties to identify and frame the unsettled issues - discussed and responded to in testimony - that may be raised in cross-examination, in oral argument, or in post hearing briefs. In addition to those issues, CUB will also address any new issues raised by NWN in the Supplemental Reply Testimony of Keith White.

II. Framing the Unsettled Issues

The Public Utility Commission of Oregon (OPUC) initiated this UM 1654 docket in accordance with the Stipulation entered in UG 221. In that case, CUB and Staff had raised questions about the sharing arrangements applied to NW Natural's (NWN or the Company) Mist Storage Services and also its resource optimization activities conducted under Schedules 185 and

186.[1] Rather than litigate these issues in the UG 221 docket, the parties reached a settlement extending the current sharing arrangement for one additional year and calling for the initiation of a new investigatory docket to deal with those issues.[2]

Specifically, the issues that CUB will address relate to NWN's use of the shared resources of the retail natural gas distribution system. In particular, how the revenues from NWN use of the shared resources are then shared between ratepayers and the Company, and how any and all revenues are reported within the Results of Operations.[3]

Interstate storage, for example, would not concern CUB if it was conducted in a manner that was fully separate from the regulated retail system. However, when ratepayer-financed assets are used for activities which benefit shareholders, great care must be exercised to ensure that ratepayers are not improperly subsidizing those activities and also to ensure that ratepayers are being fairly compensated for the use of their assets.[4]

Storage operations at Mist commenced in 1989.[5] The current method of resource sharing was proposed during the infancy of the Interstate Storage and Optimization programs, before

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[1] UG 221 CUB/100 Jenks-Feighner/46-47; UG 221 Staff/1000 Zimmerman/12-20.
[2] UG 221 Second Partial Stipulation, filed October 2, 2013, at 7 Section 29:

> 29. Staff and CUB proposed altering the existing sharing mechanism for Schedule 185—Special Annual Interstate Storage and Transportation Credit and Schedule 186—Special Annual Core Pipeline Capacity Optimization Credit. The Parties agree that the sharing mechanisms set forth currently in these schedules will remain in place for the time being. However, the Parties will jointly request that a new contested case docket be opened to evaluate these sharing mechanisms. The Parties agree that they will request that the Commission decision in this new docket be issued on or before December 31, 2013. All Parties reserve the right to take any position in the new proceeding.

[3] UM 1654 CUB/100 Jenks-McGovern/1 lines 4-8.
[4] UM 1654 CUB/100 Jenks-McGovern/1 lines 8-11 and at 2 lines 1-2; UM 1654 CUB/104 Jenks-McGovern/1; UM 1654 CUB/105 Jenks-McGovern/1; UM 1654 CUB/107 Jenks-McGovern/1; UM 1654 CUB/108 Jenks-McGovern/1; and UM 1654 CUB/109 Jenks-McGovern/1.
[5] UM 1654 CUB/110 Jenks-McGovern/1.

there was any experience with the programs themselves, and it has not been revisited.[6] It is, therefore, time to review and analyze NWN's activities under each individual program and to see whether ratepayers are being fairly compensated for the use of ratepayer financed assets in each program.[7]

As noted in CUB's Reply Testimony filed January 10, 2014, CUB takes issue with *Current Staff's* (Eric Coleville) reversal of the positions previously taken by *Prior Staff* (Ken Zimmerman) in the UG 221 docket.[8] Because there is no evidentiary foundation supporting *Current Staff's* change in position, CUB will largely ignore *Current Staff's* testimony when briefing this docket; CUB has already responded to *Current Staff* in its Reply Testimony. CUB will devote its Pre-hearing Brief to refuting the positions of the Company instead.

III. The Unsettled Issues

The unsettled issues are as follows:

1. Whether NWN has an obligation to maximize the value of regulated assets, including the use of those assets in a manner which generates revenue from non-retail markets and uses that revenue to reduce its revenue requirement from the customer who financed the assets.
   - A. Other utilities do engage in optimization .
   - B. NWN's sharing percentages are in line with those of the other utilities.
   - C. CUB's position and recommendation to the Commission.
2. CUB is concerned about the makeup of the gas that NWN is using for collateral in its Optimization program.
   - i. Electric ratepayer gas?
3. NWN should have to include optimization costs and revenues in its Results of Operations (ROO).

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[6] UM 1654 CUB/110 Jenks- McGovern/1.
[7] UM 1654 CUB/100 Jenks-McGovern/2 at lines 2-10 and 18-19.
[8] UM 1654 CUB/200 Jenks-McGovern/1 at lines 1-12 and at 2 lines 1-1.

4. Whether a cost study is needed in order to understand the value of the ratepayer asset being used for interstate storage.
5. Customers have not been overpaid for Inter/Intrastate storage, as alleged by NWN.
6. While CUB erred in not identifying the cushion gas that is shareholder gas, the point remains that if optimization revenues are going to be allocated to Mist gas, cushion gas should be included. CUB's error does/does not in any way affect the rest of CUB's Analysis.

IV. The Standard of Review for the unsettled issues

As noted above, this docket was opened for the specific purpose of conducting an investigation into Interstate Storage and Optimization Sharing. The process for review in such a docket is set forth in ORS 756.515.[9] It is CUB's position that the standard of review in such a docket should be similar to that in a rate case challenge, or a deferral amortization, wherein the Company carries the burden of persuasion throughout the proceeding to prove that the position it argues for will result in rates that are fair, just and reasonable.[10] From CUB's point of view, for

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9 ORS 756.515 states:

> (1) *Whenever the Public Utility Commission believes* that any rate may be unreasonable or unjustly discriminatory, or that any service is unsafe or inadequate, or is not afforded, or *that an investigation of any matter relating to any public utility* or telecommunications utility or other person *should be made*, or relating to any person to determine if such person is subject to the commission's regulatory jurisdiction*, the commission may on motion summarily investigate any such matter*, with or without notice.
> * * * *
> (3) *Thereafter proceedings shall be had* and conducted in reference to the matters investigated in like manner *as though complaint had been filed with the commission relative thereto, and the same orders may be made in reference thereto as if such investigation had been made on complaint.*
> (4) The commission may, after making an investigation on the commission's motion, but without notice or hearing, make such findings and orders as the commission deems justified or required by the results of such investigation. Except as provided in subsections (5) and (6) of this section such findings and orders have the same legal force and effect as any other finding or order of the commission.
> * * * *

10 ORS 757.210(1); *Pacific Northwest Bell Tel. Co. v. Sabin*, 21 Or App 200, 213-214 (1975) ("Any increase in rates must be preceded by the submission of 'revised schedules,' and is dependent upon a showing by the utility that the proposed rates are 'just and reasonable.'" *citing to* ORS 757.210); UE 115 Order No. 01-777 at 6 (Aug. 31, 2001);

purposes of this investigatory docket, this means that the burden of persuasion remains with the Company throughout the proceeding. NWN must prove that the methodology it wishes the Commission to retain is in fact the methodology that will result in appropriate sharing percentages and thus rates that are fair, just and reasonable.

NWN argues *reliance* but the Commission, pursuant to ORS 756.515, can go back and revisit its decisions at any time, indeed, it is required to in order to ensure that rates are at all times fair, just and reasonable.[11] And, as is clear from the Commission's prior rulings, no rate or methodology is set in stone, methodologies evolve – take for example the TAM Guidelines, PGA Guidelines, and PCAM processes. The Commission does not, in this investigatory docket, have to adhere to methodologies adopted 13 years ago.

UE 196 Order No. 09-046 at 7-8 *(emphasis added);* UE 228 Order No. 11-432 (Nov 2, 2011)*(emphasis added). See also In Re Northwest Natural Gas Company,* Docket No. UG 132, Order No. 99-697 at 3 (Nov 12 1999) *In Re PGE, Application to Amortize the Boardman Deferral,* Docket No. UE 196, Order No. 09-046 at 7-8. Although the burden of production shifts, the burden of persuasion is always with the utility.

[11] 756.040 General powers. (1) In addition to the powers and duties now or hereafter transferred to or vested in the Public Utility Commission, the commission shall represent the customers of any public utility or telecommunications utility and the public generally in all controversies respecting rates, valuations, service and all matters of which the commission has jurisdiction. In respect thereof the commission shall make use of the jurisdiction and powers of the office *to protect such customers, and the public generally, from unjust and unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates.* The commission shall balance the interests of the utility investor and the consumer in establishing fair and reasonable rates. Rates are fair and reasonable for the purposes of this subsection if the rates provide adequate revenue both for operating expenses of the public utility or telecommunications utility and for capital costs of the utility, with a return to the equity holder that is:

(a) Commensurate with the return on investments in other enterprises having corresponding risks; and

(b) Sufficient to ensure confidence in the financial integrity of the utility, allowing the utility to maintain its credit and attract capital.

(2) The commission is vested with power and jurisdiction to supervise and regulate every public utility and telecommunications utility in this state, and to do all things necessary and convenient in the exercise of such power and jurisdiction.

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V. CUB's Arguments in regard to the unsettled issues

1. NWN has an obligation to maximize the value of regulated assets, including the use of those assets in a manner which generates revenue from non-retail markets and uses that revenue to reduce its revenue requirement from the customer who financed the assets.

"[I]f a utility takes up revenue generating opportunities and uses customer resources to make those opportunities a reality then the utility has a coincident duty to reward customers whose resources its uses."[12,13] And failure to take up revenue generating opportunities would be a failure to run a utility in a least cost/least risk manner.[14] Clearly resource optimization is not, as *Current Staff* and the Company would have the Commission believe, "beyond the normal course of an LDC business model."[15,16] NW Natural's management is well compensated by customers and one of the things they are compensated for is managing the Company's assets on behalf of its customers.

A. Other utilities do engage in optimization.

Other utilities such as Avista and PGE engage in optimization solely for financial gain and share the profits with customers.[17] Some, like Avista and PGE, are also optimizing gas – for

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[12] UM 1654 CUB/200 Jenks-McGovern/8 lines 19-22.
[13] UG 221 Staff/1000 Zimmerman/19 lines 19-23: "In all instances, as a public utility NWN is obligated to optimize the use of core utility storage and pipeline capacity, particularly that owned by NWN, and to credit all of the benefits in terms of revenue from such optimization activities to its core utility customers."
[14] UM 1654 CUB/200 Jenks-McGovern/8 lines 17-18.
[15] UM 1654 CUB/200 Jenks-McGovern/10-11 critiquing a quotation from UM 1654 Staff/200 Colville/7 line 5.
[16] NWN states at NWN/100 White/19 lines 12-16 "That the sharing percentage available to shareholders should, at a minimum, be at least 20% (80/20). In other words, 80/20 sharing sets the lower end of the reasonable range for sharing. Further, sharing above 20% to shareholders can be justified because the Company's Optimization Activities go beyond normal expectations of what a gas LDC can perform within its normal gas supply activities."
[17] UM 1654 CUB/200 Jenks-McGovern/13 lines 15- 28 and at 15 line 4.

example, PGE through price differentials between hubs – pipeline arbitrage, and Avista through pipeline and storage optimization.[18]

B. NWN's sharing percentages are in line with those of the other utilities.

Pipeline Arbitrage. NWN argues against CUB's analogy to pipeline arbitrage and provides its own assessment of the type of arbitrage PGE is doing. NWN is wrong. CUB described a particular type of arbitrage in which PGE does engage. What CUB described was the buying and selling of gas on the open market and the optimization of pipeline capacity. It was not simply using different market hubs to reduce fuel costs. Thus, what CUB described was, and is, analogous to NWN's activities. In addition, Avista, a gas utility regulated by this Commission, engages in pipeline capacity optimization in a manner that is similar to NWN.

Centralia Plant. CUB finds NWN's argument in regard to the analogy to Centralia fascinating. After stating that the purpose of the incentive for Centralia was to maximize the value of the plant, NWN then goes on to say that this is different than why NWN should have an incentive here because the incentive here is for "the Company to engage in more speculative activities that it would not otherwise undertake."[19] This was certainly not the reason that CUB agreed to an incentive for NWN in regard to optimization. The incentive in CUB's mind has always been for NWN to maximize the value of the assets available to it – in this case through use of ratepayer paid assets. The idea that ratepayers would incent NWN to do "more speculative activities" with ratepayer assets is mind bending. In addition, it makes little sense to state that customers should be compensated less when the Company engages in "more

[18] UM 1654 CUB/100 Jenks-McGovern/22 lines 1-13.
[19] UM 1654 NWN/400 Friedman/8 lines 10-12.

speculative activities" with customer financed assets than customers would be if the Company engaged in a less risky activity.

Electric Utility Sales for Resale. In order to maximize the value of the assets that are financed by retail ratepayers, electric utilities are expected to sell power into the wholesale market whenever there is a margin on that sale.[20] In Oregon, revenues generated from these sales are forecast and flow through the annual power cost dockets to retail ratepayers with no allocation to shareholders. Any variances are largely required by the mechanisms to be absorbed by the utilities before being shared with retail ratepayers. This means that retail ratepayers generally received 100% of the revenues on a forecasted basis and the utilities take a significant risk on whether this forecast is accurate.[21] NWN argues vehemently against CUB's use of this analogy saying that NWN does not engage in sales for resale,[22] but the analogy sticks. Utilities are expected to use the assets in their regulated system to maximize the value to customers even when this involves engaging in wholesale markets. The "option" sales that NWN engages in are still sales for financial gain.

Electric Utility Arbitrage. Arbitrage is a principle of resource optimization, and so utilities are also expected to engage in price arbitrage where it is possible on their systems. See, for example, PacifiCorp's TAM filings. PacifiCorp's retail ratepayers receive 100% of the forecasted net revenues from arbitrage.[23] Once again NWN argues against CUB's analogy that arbitrage is similar to option sales but it should be noted that Mr. Friedman states that "[he] is not familiar with PacifiCorp's TAM filing and cannot specifically comment on whether their

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[20] UM 1654 CUB/100 Jenks-McGovern/21 lines 4-6.
[21] UM 1654 CUB/100 Jenks-McGovern/21 lines 9-16.
[22] UM 1654 NWN/400 Friedman/5 lines 11-20 and at 6 lines 1-7.
[23] UM 1654 CUB/100 Jenks-McGovern/21 lines 17-23.

arbitrage is similar to that included in [NWN's] Optimization Activities."[24]CUB is all too familiar with PacifiCorp's TAM – the analogy sticks. The arbitrage that is engaged in by PGE and PacifiCorp includes arbitrage of natural gas pipeline capacity that PGE and PAC do not get to earn a return on, as well as wholesale market sales and purchases that are not connected to any company-owned generating asset. These are not, contrary to what NWN argues, rate based assets. And besides, CUB is not asking that NWN be treated just like the electrics – if it were, we would be asking for a 100% pass through – we are asking only for an 80/20 then 90/10 split.

NWN argues that electric excess power sales are not analogous because they have long been regarded as basic electric utility activities and that the risks involved in those activities are incorporated into the electric utilities' returns on equity.[25] In CUB's opinion Mr. White makes our point for us. More than ten years have now passed and the activities that NWN engages in for optimization are no longer unusual; they are now basic natural gas utility activities – everyone is doing it – the risks have been reviewed and are evidently no longer feared. It is time that NWN's optimization revenues were accounted for in the same manner as the excess sales for electric utilities.

Phone Directories.[26] The purpose of CUB's reference to phone directories was to demonstrate that each utility, regardless of type, has been expected – from day one – to maximize the value of the assets available to it whether the asset is phone books, pipelines, or

[24] UM 1654 NWN/400 Friedman/6 lines 11-13.
[25] UM 1654 NWN/300 White/17 lines 20-23.
[26] UM 1654 CUB/100 Jenks-McGovern/22 lines 14-18.

excess electricity. CUB's expectations for NWN are no different than CUB's expectations for any other gas, electric or telecom utility.[27]

C. <u>CUB's position and recommendation to the Commission.</u>

A simple review of the pleadings shows that CUB has not advocated that the incentive be entirely removed but has advocated that the optimization incentive be reduced to 10% for optimization activities and that 80% of interstate storage revenues continue to flow to the Company pending the review of the requested Cost Study.[28] That review might show that the incentive should be more, or it might indeed show that it should be less; those are findings that will need to be addressed if and when the Cost Study is in fact ordered by the Commission and completed by the Company. CUB's research is clear. NWN's 33/67 sharing percentage, which is applied to a share of the optimization activities, is not in line with those of the other utilities; NWN's claims of significant regulatory risk[29] - when compared to risks faced by other utilities - are no different than the risks faced by the other utilities; NWN's actions to manage gas supply and optimization costs[30] are no different than those taken by other utilities both gas and electric; NWN's arguments are unpersuasive.[31]

It is also important to note that NWN Exhibit 103, which lists other optimization sharing agreements, fails to support NWN's current arrangement. First, it fails to include Avista, which is a gas utility regulated by this Commission. Second, the majority of the utilities listed share optimizations on a more generous basis with customers than NW Natural. Third, For 2 states,

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[27] And hopefully CUB will know enough soon to add references about water!
[28] UM 1654 CUB/200 Jenks-McGovern/20 lines 9-13.
[29] UM 1654 NWN/300 White/16 lines 18-20.
[30] UM 1654 NWN/400 Friedman/2 lines 8-15.
[31] UM 1654 CUB/100 Jenks-McGovern/23 – 26 at line 4.

Maryland and Virginia, NWN shows a 50/50 sharing of the tailblock, but the Company fails to include the sharing that happens *before* the tailblock. In both cases, the sharing begins with a block that is passed through 100% to customers.[32] In both cases there is a second block where customers get 75% of the net revenues.[33] It is only in the case where net revenues are great enough to fall into the third block does the sharing percentage fall to 50/50.[34] Only one of the examples, AGC resources, has sharing that is clearly less generous to customers (60/40) than NW Natural's 67/33 sharing of a segment of optimization revenues. But even that would change if one were to look at NW Natural's overall sharing of optimization revenues, since they are blended between 67/33 and 20/80.

It is, therefore, CUB's intent to include the following recommendation in its Closing Brief, if no evidence to the contrary has been provided:

> In the UG 221 docket, CUB recommended 90-l 0 for schedule 186 with customers receiving 90%. However, because our investigation of this issue has led us to conclude that NW Natural has been misallocating net revenues from Mist Optimization to interstate/intrastate storage, and CUB is recommending correcting that misallocation, CUB is modifying our proposal for sharing. CUB recognizes that a proposal to shift the sharing from 67-33 to 90-10, coming along with shifting 47% of Mist Optimization Revenues from 20-80 to 90-10, while fair will still be a significant adjustment to the amount of optimization revenues the Company receives. Because of the total effect of combining these two changes, CUB believes that the Commission could decide to phase in the sharing percentage at 90-10 sharing, by first moving it to 80-20 today and then moving it to 90-10 in the next rate case. This is similar to how the Commission looks at rate shock associated with rate classes. While a cost of service study may show that one customer class is not paying its full cost of service, the rate changes associated with getting that class to cost-of service rates can be phased in over multiple rate cases. Thus CUB's overall recommendation is that the sharing

[32] *In re Petition of Commission's Staff for an Investigation into Washington Gas Light Company's Asset Management Practices and Cost Recovery of Natural Gas Purchases*, MD PSC Case No. 9158, Order No. 85059, 15 (Aug. 16, 2012); Washington Gas Light Company – Virginia Tariff Va. S.C.C. No. 9 (issued Aug. 1, 2012), accessed at http://www.washgas.com/FileUpload/File/Tariffs/VA/va7579.pdf.
[33] *Id.*
[34] *Id.*

percentage for Optimization net revenues be changed with 90% going to retail ratepayers, but recognizes that the PUC may wish to phase this in by setting the sharing at 80-20 today with the expectation that this will be reexamined in the next rate case, after a thorough exploration of the subject with supporting data, where there will be the opportunity to make further changes.[35]

2. CUB is concerned about the makeup of the gas that NWN is using for collateral in the Optimization program.[36]

There are two kinds of gas stored at Mist: gas purchased by NWN for use for retail customers (customer gas) and gas purchased by wholesale customers who are purchasing a storage service from NW Natural (wholesale gas).

In Opening testimony, Mr. Friedman described the "backdraft" activity where the Company sells gas at Mist in February and repurchases it in April.[37] Since NW Natural has no rights to sell wholesale gas, this activity has to involve customer gas.

In Reply testimony, Mr. Friedman states that CUB does not understand that it is not actually gas that is being optimized but capacity. While the activity may involve an initial "backdraft" position, it is completed without any physical movement of gas.[38] It is the capacity at Mist that allows for the optimization activity, not the gas itself.[39] However, the contract with the optimization partner makes clear that the optimization partner [redacted][40]

CUB does not dispute that much of optimization does not use the gas physically but

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[35] UM 1654 CUB/100 Jenks-McGovern/26 at lines 5 – 23 and at 27 lines 1-3.

[36] UM 1654 CUB/100 Jenks-McGovern/12 line 18 to page 16 lines 1-2. This section of CUB's Response Testimony provides a detailed summary of the makeup of the gas stored at MIST and also of NWN's relationship with its third party optimizer under the Asset Management Agreement.

[37] UM 1654 NWN/400 Friedman/11, lines 13-24 and 1-7.

[38] UM 1654 NWN/400 Friedman/10 lines 6-8.

[39] UM 1654 NWN/400 Friedman/10 line 9.

[40] CUB Confidential Exhibit 102 "Natural Gas Asset Management Agreement Between Northwest Natural Gas Company And Tenaska Marketing Ventures, Article 3, Asset Management Agreement Description at Sections 3.1 and 3.3.

instead uses it as collateral, but thinks that distinction makes little difference, because it is still a question of whose gas is used for collateral.

In addition, CUB does not dispute that the total amount of optimization volume over the year is "approximately six times the peak quantity of physical gas used to "backstop" those transactions."[41] But this does not mean that the physical gas being used to "backstop" these transactions is not customer gas, because the same volume of gas can be used several times over the year to backstop different optimization opportunities. Nor does it mean that somehow it is capacity and not gas being optimized. All it demonstrates is that over the course of a full year, there is a significant amount of optimization activity.

Whether NWN is leveraging assets or trading assets is a distinction without a difference. NWN has stated that, "NW Natural buys **no** gas for speculative purposes – it all must tie to its utility business needs . . . ." [42] Thus, by declaration NWN has stated that it does not purchase gas for options trading or market optimization. Also, FERC jurisdiction does not give the Company rights to third party gas that the Company holds on behalf of its intrastate/interstate customers.[43] This means that all gas that NWN "owns," or has rights to, is actually owned by its regulated utility retail ratepayers. The fact that the majority of AMA optimization does not require the trading of physical assets does not diminish the importance of the physical aspect of the assets in providing the ability for NWN to leverage the assets.[44] "NW Natural's description of Mist Optimization clearly depicts gas trades in order to take advantage of price spreads that 'widen

[41] UM 1654 NWN/400/Friedman/11.
[42] UM 1654 – CUB Exhibit 103 at slide 12.
[43] M 1654 CUB/100 Jenks-McGovern/18 lines 27-33 and at 19 lines 1-13.
[44] UM 1654 CUB/200 Jenks-McGovern/11 lines 14 to 13 line 8.

and narrow on a day-by-day, minute-by-minute basis.' Ultimately this can only happen 'because the physical volumes exist at Mist to backstop the trade."[45]

Perhaps what troubles CUB most about all this is that it appears that NWN is optimizing gas that it has stored for its retail ratepayers but is allocating approximately half of the revenue to Interstate/Intrastate Storage which has the effect of increasing the Company's share of the revenues while simultaneously decreasing the ratepayers share of the revenues.[46] CUB's position is, therefore, that Mist Storage optimization should be moved to Schedule 186 along with the other optimization activities that are using core retail ratepayer-owned assets.[47] NWN's customers should not be required to bear the risk for these optimization activities without receiving adequate compensation for the trades.[48] The Company states that it believes that the current sharing arrangements are fair to all parties and should be continued without change.[49] CUB believes the risks to ratepayers are very real and that the sharing percentages need to be changed accordingly.

i. Electric ratepayer gas?

Currently optimization revenues that are developed from ratepayer owned assets are shared with ratepayers on a 67% to customers 33% to the Company basis. This sharing mechanism has been in place for 13 years without review.[50] If the Company leverages ratepayer gas, then CUB believes, as demonstrated in its Response Testimony, and also in its Reply

[45] UM 1654 CUB/100 Jenks-McGovern/18 lines 1-26.
[46] UM 1654 CUB/100 Jenks-McGovern/17 lines 2-5; UM 1654 CUB/100 Jenks-McGovern/19 lines 14 – 21: "[T]here is no basis to assign 47% of the Mist Optimization revenues to Interstate/Intrastate Storage."
[47] UM 1654 CUB/100 Jenks-McGovern/19 lines 19-21.
[48] UM 1654 CUB/200 Jenks-McGovern/13 lines 6-8.
[49] UM 1654 NWN/100 White/3 lines 10-18 ***(emphasis in the original)***.
[50] UM 1654 CUB/100 Jenks-McGovern/19 lines 24-26.

Testimony, that the Company is obligated to optimally utilize that ratepayer gas, and consequently must pass through the bulk of the resulting revenues to customers.[51] If, on the other hand, the Company leverages Wholesale Customer gas, then Commission policy must consider who the Wholesale Customer gas belongs to and what if any are the resulting implications.[52] PGE, for example, stores a lot of gas at Mist. CUB has previously demonstrated why it is inappropriate for shareholders to retain the revenues from gas optimization when the gas belongs to NWN ratepayers. As pointed out by Mr. Jenks and Dr. McGovern, that impropriety does not change if the gas belongs to PGE's ratepayers.[53]

3. NWN should have to include all optimization profits in its Results of Operation (ROO).

As noted previously, optimization is another everyday utility task. "The revenues from NWN's AMA Optimization are not exempt or special. They are . . . normal in the course of modern utility operations, and belong in the NWN ROO."[54] As Jenks-McGovern point out in their Response Testimony:

> It is standard operating procedure for utilities to report income earned from retail ratepayer owned assets as utility income. Earning associated with sales for resale, arbitrage and other activities built off the system are considered utility income for other utilities. If a utility is able to take a rate based asset and use it to earn revenue, but not report that as utility income, then that utility has an opportunity to earn above its authorized rate of return. Last December, the PUC set a new ROE for NW Natural. This represents an amount that the PUC feels it is reasonable for the Company to be allowed to earn off of its investment in rate base assets. But if the Company has millions of dollars in additional earnings gained off of those same assets that it is not reporting, then the Company is really being allowed to earn above its authorized level in a systematic way.[55]

[51] UM 1654 CUB/200 Jenks-McGovern/16 lines 9-12.
[52] UM 1654 CUB/200 Jenks-McGovern/16 line13 and at 17 lines 1-2 .
[53] UM 1654 CUB/200 Jenks-McGovern/17 lines 9-12 .
[54] UM 1654 CUB/200 Jenks-McGovern/18 lines 22-23 and at 19 line 1.
[55] UM 1654 CUB/100 Jenks-McGovern/28 lines 9-19.

The earnings at issue here are earnings that are being produced by retail ratepayer owned assets, being used for optimization (CUB is not asking that interstate storage revenues be included in ROO). They are utility earnings. *Current Staff* agrees.[56] Effective utility regulation requires transparency and NWN should not be permitted to hide the earnings that it receives from its retail ratepayer owned assets by treating these earnings as "non utility."[57] The Company complains that CUB and *Current Staff* (Garcia) overstate the Company's earnings[58] but the very point CUB and Staff are making is that the ROO should accurately reflect the actual returns that the Company is actually earning from its investment in utility assets. By booking returns earned from utility assets as non-utility income, NWN is understating its earnings. At this point, CUB does not believe that it matters whether *Current Staff's* results are perfect – at least *Current Staff* is trying to figure out what the numbers are; the Company is just obfuscating and refusing to participate in the exercise, almost gleeful in pointing out when *Current Staff* and CUB fail in their attempts to reconstruct the Company's earnings when they don't have the documentation needed because the Company refuses to present its ROO in the same manner as other utilities. CUB praises and fully supports *Current Staff's* attempt to get a handle on the numbers. It is CUB's understanding that the point to *Current Staff's* testimony was to demonstrate that if you take optimization revenue and add it to ROO, then the Company will still earn above its

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[56] UM 1654 Staff/300 Garcia/2 lines 11-14: "I agree with CUB that all income earned using ratepayer-owned assets is utility income. All income earned by NWN that results from activities made possible by the optimization of ratepayer-owned assets should be included in its ROO as utility income, subject to the Spring Earnings Review." *See also* UM 1654 Staff/300 Garcia/5 lines 20-23 and at 6 lines 1-2: "Although NWN may account for the proceeds of AMA Optimization that rely upon ratepayer-assets under its nonutility business umbrella, the manner in which the utility accounts for revenues is not controlling for regulation. For regulatory purposes, these earned revenues should be included in regulated utility revenues because they are made possible by the use of regulated assets."

[57] UM 1654 CUB/100 Jenks-McGovern/29 lines 11-14; *See also* UM 1654 Staff/300 Garcia/6 lines 21 to 23 and at 7 lines 1-3: "Regardless of whether or not AMA Optimization activities are over and above the level of what could reasonably be expected to serve core utility customers, the income resulting from the use of regulated assets must be properly reported for regulatory purposes. The utility should not be able to artificially reduce earnings by avoiding the proper reporting of earned income that results from the use of assets paid for by rate payers."

[58] UM 1654 NWN/500 White/6 lines 9-12.

authorized ROE. In fact, by reflecting the full earnings the Company is receiving from utility assets, the ROO will show greater earning than it would otherwise show. While the Company is correct in stating that it would hit the earnings sharing band on an earnings test there is nothing inappropriate about this.

NWN also tries to argue that CUB is attempting, nefariously, to cause additional revenues to be subject to the environmental remediation earnings test.[59] CUB did explicitly make such an argument in UM 1635.[60] But the costs of environmental remediation are not costs that are related to current service or current assets. Using profits that are obtained from ratepayer assets, but are above the utility's reasonable rate of return for those assets, seemed like a way to fund the environmental remediation that was fair to customers and shareholders alike. It would have allowed customers' rates to be more closely aligned with the actual cost of providing current service, without impacting the utility's ability to earn a fair return on its utility investments. But, the Commission rejected both Stipulations entered in the UM 1635 docket. Once the docket is revived no one knows where it will end up in terms of earnings tests. Finally, we note that if the Company is over-earning from its ratepayer financed assets, including the use of those assets in wholesale markets, how could it be ethically or legally correct for the Commission to exclude additional over-earnings from any source from an appropriately instituted earnings test if such exists?

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[59] UM 1654 NWN/300 White/19 lines 21 to 25 and at 20 lines 1-17: "Specifically, as a result of the earnings review agreed to in that stipulation, the Company would be required to return to customers 10 percent of its earnings that are within 75 basis points of its authorized ROE, and 80 percent of any earnings above its authorized ROE. (citation omitted). Thus, under the stipulation, and if the Company's share of earnings from its Optimization Activities revenues were required to be included in the Company's result of operations, the Company would be forced to give such revenues back to utility customers . . . ." *See also* UM 1654 NWN/500 White/9 lines 13-23 and at 10 lines 1-4.
[60] UM 1635 CUB/100 Jenks/9-10 and 21.

CUB is frankly tired of hearing that the Company has to be incented to do something that it has a regulatory duty to do;[61] more than tired of hearing that an incentive to the Company must exceed 10% of revenues,[62] revenues that the Company claims should not be subject to any earnings test;[63] especially tired of hearing that CUB is arguing that the Company should get no incentive whatsoever;[64] and exasperated by the fact that all of the Company's protests are based on "could," "should," "might" when the Company is also arguing against the conducting of studies that would provide answers to what "could," "should," or "might," happen. Especially when the worst that the Company can find to say is that: "My exhibit indicates that under Staff's proposal, and using actual historical proportional earnings for each sharing category, the Company's overall share of revenues from all optimization activities – utility and non-utility - would be ***reduced to 27 percent***."[65] The Company then goes on to state that it could in fact be as low as 22%.[66] It is hard for CUB to imagine how a 22% incentive could provoke a statement such as: "As a result, Ms. Garcia's proposal could have the unintended but consequential effect of significantly diluting or eliminating altogether NW Natural's incentive to continue its participation in Optimization Activities."[67]

CUB recommends that the Commission order that the Company report all of is optimization earnings in the ROO.

[61] UM 1654 NWN/400 Friedman/1 lines 12-19.
[62] UM 1634 NWN/100 White/19 lines 11-16.
[63] UM 1654 NWN/300 White/20 lines 3-17.
[64] UM 1654 NWN/300 White/20 lines 13-17.
[65] UM 1654 NWN/500 White/8 (***emphasis added).***
[66] UM 1654 NWN/500 White/9 lines 1-3.
[67] UM 1654 NWN/500 White/2 lines 13-16.

4. Whether a Cost Study is needed in order to understand the value of the ratepayer assets being used for interstate storage.

While *Prior Staff* (Zimmerman) called for a company financed independent study,[68] CUB believes that the utility's cost of service study can be used to identify, on a marginal cost basis, the cost of interstate storage to the utility system.

There is no way to ascertain if customers are being fully compensated for the use of their resources without a Cost Study being done. It is CUB's position that a Cost Study is needed for Inter/Intrastate Storage because in the long years that this program has been in effect none has been done and also because *Prior Staff* found that, "in general since 2000, the price, supply, and use of natural gas has drastically changed, and the increased need for storage capacity is expected to continue."[69] Moreover, "the entire sharing arrangement [for the Inter/Intrastate Storage program] was modeled on an ad-hoc basis when first created, before the large increases in natural gas exploration, before the large increases in both utilization and storage, at a time when relevant benchmarks were few, and risks were unquantifiable . . ."[70] CUB does not think that Staff and the Intervenors should have to take the Company's word that the sharing percentage is fair, and should remain permanently in its favor.[71,72]

Using the current marginal cost study would allow the parties to identify what the costs of this service would be on a marginal basis. This tells us the value to the interstate service being

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68 UG 221 Staff/1000 Zimmerman/18.
69 UM 1654 CUB/200 Jenks-McGovern/5 lines 11-13; UG 221 Staff/1000 Zimmerman/20 lines 12-16.
70 UM 1654 CUB/200 Jenks-McGovern/5 lines 20-21 and at 6 lines 1-4.
71 UM 1654 CUB/200 Jenks-McGovern/7 lines 23-24.
72 UM 1654 NWN/100 White/17 lines 18-21: "The current sharing arrangement was in place when the shareholders invested over $65 million and the Company expectations were that these terms would remain in place. A deal is a deal, and the Company feels it is appropriate to continue the arrangement that was negotiated."

provided by current ratepayers. This information would be used to inform future decisions relating to the sharing percentage.

5. Customers have not been overpaid for Inter/Intrastate Storage, as alleged by NWN.[73]

NWN has alleged that customers may have been overpaid in regards to profits on MIST storage – this notwithstanding customers only receive 20% of the net revenues. NWN's allegation is based, in its opinion, on the fact that in addition to 20% profits customers also receive the benefits of recall.[74] This completely ignores the fact that the 20% noted above comes from net revenues.[75] It is only after shareholder costs are fully recovered that the Company shares the program's net revenues according to the 20/80 split.[76] So we know that shareholders are fully compensated[77] and then received net profits on top of that but do we know whether ratepayers are fully compensated for the use of their assets?[78]

The Company proposed the sharing mechanism be instituted after the "break even" point because it was concerned that to do otherwise might result in a situation "where customers are benefiting while the company is losing money."[79] In initial memos related to the period when the Company was working with Staff to develop the original program, the Company admits that "the basis for using the 20% number is somewhat anecdotal" and that the Company's consultant was

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[73] UM 1654 NWN/100 White/17 lines21-23.
[74] UG 221 NWN/100 White/17.
[75] CUB notes its unease with referring to these revenues as true net revenues because true net revenues would exclude all costs from the program (shareholder and ratepayer) whereas here the net revenues only exclude shareholder costs before applying the sharing percentages. UM 1654 CUB/100 Jenks-McGovern/10 lines 3-8.
[76] UM 1654 CUB/100 Jenks-McGovern/9 lines 13 – 15.
[77] UM 1654 CUB/100 Jenks-McGovern/11 Table "Net Income for Shareholders from Gas Storage".
[78] UM 1654 CUB/100 Jenks-McGovern/10 lines 9-14: "Suppose, the value of the items that ratepayers contribute is worth $3 million per year and the net revenues are worth $10 million. Then ratepayers are being asked to subsidize Company storage and Optimization activities to the tune of $1 million even though shareholders are earning $8 million from it (20% of 10 million equals $2 million and represents the ratepayer share that would partially offset $3 million of ratepayer costs)."
[79] UM 1654 CUB Exhibit 106 at Section 1D.

unable to find enough data to support an industry standard on sharing percentages or cost recovery allocation mechanisms.[80] Notwithstanding all the early uncertainty, and with no later in time studies, the Company still feels empowered to assert that is not interested in a Cost Study; CUB finds the Company's position both fascinating and frustrating.

Frustrating because the Company, without analysis, asserts vehemently that the Interstate/Intrastate Storage Program is fully funded by shareholders, shareholders take all the risk, and ratepayers are just along for the ride.[81]

Fascinating, and incorrect, because the assets used for the program were funded by retail ratepayers, are dedicated to serving retail ratepayers, and are used to support the Storage Program.[82] "Without the ratepayer owned infrastructure, the interstate/intrastate storage services, as currently operated by NW Natural would not be possible."[83] CUB does not find NWN's attempt to argue that recall, for core utility customers, makes ratepayers overpaid,[84] persuasive. In order to demonstrate this, we need to identify the value that customers contribute through the use of rate-based assets, and the value that customers receive through recall. The first part is the goal of including interstate storage in the marginal cost study.

It is long past time for the commencement of a Cost Study to determine whether, as NWN alleges, ratepayers have been overpaid or, as CUB suspects, ratepayers have in fact been woefully undercompensated for the use of ratepayer assets for the benefit of the Interstate/Intrastate Storage Program.

CUB intends to recommend to the Commission when it files its Closing Brief that NWN

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[80] UM 1654 CUB/100 Jenks-McGovern/7 lines 16-20 citing to CUB Exhibit 106 at Section 1B.
[81] UM 1654 NWN/100 White/15 lines 1-7; UM 1654 NWN/100 White/17 lines 12-15.
[82] UM 1654 CUB/100 Jenks-McGovern/8 lines 8-19.
[83] UM 1654 CUB/100 Jenks-McGovern/9 lines 3-5.
[84] UM 1564 NWN/200 Friedman/5 lines 12-17.

be required to model interstate/intrastate storage in its cost of service model (marginal cost analysis) to identify the share of system costs that could be allocated to storage. CUB will also recommend that the Company be required to hold a workshop before its cost of service study to discuss the methodology for incorporating interstate/intrastate storage into that study which must be conducted before NWN's next rate case. Assuming the Commission finds as CUB is requesting, then - and only then – CUB recommends the continuation of the current 20/80 sharing mechanism on a temporary basis until the cost of service study is completed and has been reviewed in the next rate case.[85]

6. While CUB erred in not identifying the cushion gas that is shareholder gas, the point remains that if optimization revenues are going to be allocated to Mist gas, cushion gas should be included. CUB's error does/does not in any way affect the rest of CUB's Analysis.

CUB has demonstrated that the gas that is available for optimization is customer gas. In addition, CUB noted that if one were to allocate optimization to all the gas in Mist, that there is no reason not to also include cushion gas because cushion gas is necessary for other gas to be available for optimization. While CUB erred in not identifying that some of the cushion gas is shareholder gas, the point remains that if optimization revenues are going to be allocated to Mist gas, cushion gas should be included.

CUB now understands that ratepayers own $12.7M and shareholders own $3.8M of cushion gas at Mist.[86] CUB apologizes for the error in its testimony related to the inclusion of cushion gas in rate base[87] and now understands that only a portion of the total cushion gas is included in rate base. CUB notes, however, that its prior error does not have any impact on

[85] UM 1654 CUB/100 Jenks-McGovern/12 lines 1-17.
[86] UM 1654-OPUC-DR 4 *but see* UM 1651 Stipulation at section 3.
[87] *See* UM 1654 CUB/200/Jenks-McGovern/15 lines 15-17.

CUB's underlying analysis of the issues in this docket. This is because CUB's recommendation is that optimization revenues not be allocated because they utilize customer gas; with that being the case, the sharing of cushion gas between customers and shareholders has no effect on our recommendation.

VI. The Recommendations CUB intends to make to the Commission in its Closing Brief

Unless evidence to the contrary is elicited at Hearing, CUB intends to make the following requests to the Commission in its Closing Brief:

- That the Commission order the implementation of a cost based study with appropriate in-depth analysis to be included in the next marginal cost study which will then provide valuable information to consider concerning the sharing percentage associated with interstate storage. Pending the results of the Cost Study, and its review in the next Company rate case, CUB will not make any recommendation to change the Inter/Intrastate Storage sharing percentages.[88]
- That the Commission find that NW Natural has been misallocating net revenues from Mist Optimization to Interstate/intrastate storage and order that 47% of Mist Optimization Revenues be removed from Interstate/intrastate storage and the sharing percentage for all optimization activities be set at 90% customer/10% utility (similar to the sharing percentages used by Avista optimization). If the Commission wishes to phase this in in two steps by moving to 80/20 in this docket, CUB would not oppose such sharing.

[88] UM 1654 CUB/100 Jenks-McGovern/32 lines 1-6; UM 1654 CUB/200 Jenks-McGovern/19 lines 14-15.

- That the Commission find that all AMA Optimization revenues must be included in the Company's ROO.[89]

Central to all of CUB's recommendations is the idea that full information disclosure will assist all parties in making equitable, transparent, and agreeable solutions. In this interest, CUB supports all efforts to move this forward including, but not limited to, the cost of service analysis. However, while CUB supports the idea of interstate/intrastate storage and optimization providing a win/win[90] for everyone CUB's interpretation of win/win is clearly different than that of the Company. For CUB a win/win is where both ratepayers and investors are fairly compensated. It appears, however, that for the Company a win/win means that ratepayers are thrown a few scraps while the Company gets to make out like a bandit. CUB respectfully reminds the Commission that its statutory mission is to impose fair, just and reasonable rates for all.

VII. Conclusion

CUB intends to address the specific issues identified above at hearing. In addition, CUB reserves the right to address additional issues that may be raised by other parties at the hearing.

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[89] UM 1654 CUB/200 Jenks-McGovern/20 lines 14-22.
[90] UM 1654 NWN/500 White/12 at lines 12-15.

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Dated this 27th day of January, 2014.

Respectfully submitted,

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UM 1654 – CERTIFICATE OF SERVICE

I hereby certify that, on this 27th day of January, 2014, I served the foregoing **CITIZENS' UTILITY BOARD OF OREGON'S PRE-HEARING BRIEF** in docket UM 1654 upon each party listed in the UM 1654 PUC Service List by email and, where paper service is not waived, by U.S. mail, postage prepaid, and upon the Commission by email and by sending one original and five copies by U.S. mail, postage prepaid, to the Commission's Salem offices.

(W denotes waiver of paper service)

(C denotes service of Confidential material authorized)

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