McDowell & Rackner PC

WENDY L. MCINDOO
Direct (503) 595-3922
wendy@mcd-law.com

August 8, 2008

VIA ELECTRONIC FILING AND FIRST CLASS MAIL

PUC Filing Center
Public Utility Commission of Oregon
PO Box 2148
Salem, OR 97308-2148

Re: Docket UM 1286 – Joint Testimony

Enclosed for filing in the above-referenced docket are the original and five copies of the Joint Reply Testimony of Ken Zimmerman, Brian Hirschkorn, Katherine Barnard, Alex Miller and Paula Pyron.

A copy of this filing has been served on all parties to this proceeding as indicated on the attached certificate of service.

Very truly yours,

Wendy McIndoo

Wendy L. McIndoo
Legal Assistant

Enclosure

CERTIFICATE OF SERVICE

I certify that I have this day served the foregoing document in OPUC Docket No. UM 1286 by electronic mail and first class mail to the following parties or attorneys of parties:

David J Meyer
Vice President & Chief Counsel
Avista Corporation
PO Box 3727
Spokane WA 99220-3727
david.meyer@avistacorp.com

David Hatton
Assistant Attorney General
Department Of Justice
1162 Court St NE
Salem OR 97301-4096
david.hatton@state.or.us

Ken Zimmerman
Public Utility Commission Of Oregon
550 Capitol St NE, Ste 215
Salem OR 97301
ken.zimmerman@state.or.us

Lawrence Reichman
Perkins Coie LLP
1120 NW Couch St, 10th Floor
Portland OR 97209-4128
lreichman@perkinscoie.com

Edward A Finklea
Cable Huston Benedict
Haagensen & Lloyd LLP
efinklea@chbh.com

Chad M Stokes
Cable Huston Benedict
Haagensen & Lloyd LLP
cstokes@chbh.com

Katherine Barnard
Director - Regulatory Affairs
Cascade Natural Gas
kbarnard@cngc.com

Jon T Stoltz
Sr Vice Pres.—Regulatory & Gas
Cascade Natural Gas
jstoltz@cngc.com

Lowrey R Brown
Citizens' Utility Board Of Oregon
lowrey@oregoncub.org

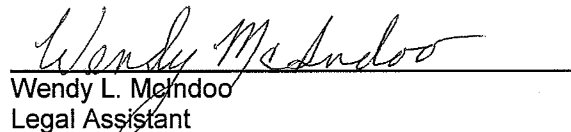
Jason Eisdorfer
Citizens' Utility Board Of Oregon
jason@oregoncub.org

Robert Jenks
Citizens' Utility Board Of Oregon
bob@oregoncub.org

Paula E Pyron
Executive Director
Northwest Industrial Gas Users
ppyron@nwigu.org

Dated August 8, 2008

McDOWELL & RACKNER PC



Wendy L. McIndoo
Legal Assistant

BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON

UM 1286

In the Matter of THE PUBLIC UTILITY COMMISSION OF OREGON Investigation into the Purchased Gas Adjustment (PGA) Mechanism Used by Oregon's Three Local Distribution Companies

JOINT REPLY TESTIMONY

OF

KEN ZIMMERMAN

BRIAN HIRSCHKORN

KATHERINE BARNARD

ALEX MILLER

and

PAULA E. PYRON

August 8, 2008

1 **INTRODUCTION**

2 **Q. Please state your names, occupations, and business addresses.**

3 A. My name is Ken Zimmerman. I am employed by the Public Utility Commission of
4 Oregon ("Staff") as a Senior Utility Analyst. My business address is 550 Capitol
5 Street NE, Suite 215, Salem, Oregon 97301-2551. My qualifications are shown in
6 Parties Exhibit 101.

7 My name is Brian Hirschkorn. I am employed by Avista Corporation ("Avista") as
8 Manager, Retail Pricing. My business address is 1411 East Mission Avenue,
9 Spokane, WA 99220. My qualifications are shown in Parties Exhibit 102.

10 My name is Kathie Barnard. I am employed by Cascade Natural Gas Corporation
11 ("Cascade") as Senior Director Gas Supply and Regulatory Affairs. My business
12 address is 222 Fairview Avenue North, Seattle, WA 98109. My qualifications are
13 shown in Parties Exhibit 103.

14 My name is Alex Miller. I am employed by Northwest Natural Gas Company ("NW
15 Natural") as Managing Director Regulatory Affairs and Assistant Treasurer. My
16 business address is 220 NW Second Ave, Portland, Oregon, 97209. My
17 qualifications are shown in Parties Exhibit 104.

18 My name is Paula E. Pyron. I serve as the Executive Director of the Northwest
19 Industrial Gas Users ("NWIGU"). My business address is 4113 Wolf Berry Court,
20 Lake Oswego, OR 97035-1827. My qualifications are shown in Parties Exhibit 105.

21 **Q. What is the purpose of your joint testimony?**

22 A. This testimony replies to the testimony filed by Citizens' Utility Board of Oregon
23 (CUB) on July 25, 2008 regarding the Stipulation and supporting testimony dated
24 May 2, 2008 (the "Stipulation") of Staff, Avista, Cascade, NW Natural and NWIGU
25 (together, "the Parties") to settle all of the issues arising from Phase I of this

1 investigative Docket. The Stipulation was submitted to the Commission on May 2,
2 2008 as Parties Exhibit 106.

3 **Q. Please summarize the major issues addressed in your testimony.**

4 A. *First,* we respond to several of CUB's sweeping and unsubstantiated generalizations
5 regarding the form and operation of the Purchased Gas Adjustment ("PGA")
6 mechanism proposed in the Stipulation (the "Stipulated PGA");

7 *Second,* we respond to specific factual errors made by CUB in describing the current
8 and the Stipulated PGA;

9 *Third,* we provide some simple numeric examples that illustrate the functioning and
10 impact of the Stipulated PGA in comparison with the PGA currently employed by the
11 Commission. Through these examples we refute both CUB's claim that the
12 Stipulated PGA mechanism is overly complex and difficult to implement, and CUB's
13 claim that the Stipulated PGA harms customers compared to the current PGA
14 mechanism; and

15 *Fourth,* we challenge CUB's insistence on an overly mechanistic PGA mechanism
16 that fails to meet the current needs of either the LDCs or their customers in terms of
17 minimizing both gas costs passed on to customers and the volatility of that pass
18 through while simultaneously setting up the opportunity for the LDCs to experience
19 rewards and penalties based on their natural gas purchasing acumen.

20 **CUB's UNSUBSTANTIATED STATEMENTS**

21 **Q. Would you please describe the problems with CUB's sweeping generalizations**
22 **regarding the form and operation of the Stipulated PGA?**

23 A. CUB makes two sweeping generalizations about the Stipulated PGA that are as
24 incorrect as they are central to the positions taken in its testimony. First, CUB claims
25 that the Stipulated PGA mechanism is like a "platypus," a collection of parts that do

1 not and cannot work effectively together.[1] CUB may not understand the Stipulated
2 PGA, but that does not mean it cannot be understood or effectively implemented.
3 On the contrary, the Stipulated PGA represents only a variation on the existing PGA
4 mechanism which allows the Stipulated PGA to more effectively address and handle
5 the complexities and risks of the current natural gas market. This is demonstrably
6 shown by a comparison of the operation of the current and Stipulated PGAs,
7 presented below.

8 Second, CUB claims that the Stipulated PGA will shift the bulk of gas
9 purchasing risk to core customers. This simply is not the case, as we'll demonstrate
10 below.

11 **CUB'S ERRORS OF FACT**

12 **Q. Does CUB's testimony contain errors of fact?**

13 A. Yes. *First*, throughout its testimony CUB says that it is unclear what is
14 included in the two variance calculations. [2] However, the language of the stipulation
15 and the testimony is quite clear. The first variance calculation is between the
16 Embedded WACOG calculated at the time of the annual PGA filing and the Monthly
17 WACOG Benchmark. This is the "Monthly WACOG Variance." The Embedded
18 WACOG is calculated based on (a) fixed price hedges; (b) storage fill completed on
19 or before September 30; and (c) forecasted unhedged volumes (price forecasted
20 based on a 60-day NYMEX strip as of September 30). This Embedded WACOG is
21 the amount built into base rates. The second variance calculation is between the
22 Unhedged Benchmark for the month as calculated based on either the FOM (First of
23 Month) or the NGI (Natural Gas Intelligence's Gas Daily) and the LDC's actual cost

[1] CUB Testimony, p.1.

[2] CUB Testimony, pp. 8-9

1 of unhedged gas whose price is not fixed either financially or physically (storage).
2 This is the "Unhedged Benchmark Variance." A complete description of these
3 variance calculations, together with an example, is provided in the next Section of
4 testimony in Exhibit 201.

5 *Second*, in its press release summary of its position CUB states that Oregon LDCs
6 are "... being paid a rate of return to manage the company and secure the lowest
7 possible cost" for gas supply. The implication from this generalization is incorrect.
8 The rate of return ("ROR") authorized for each Oregon LDC is based on the risk
9 profile applicable to an LDC. This ROR, like that for most other LDCs in the nation,
10 does not include consideration of the risk profile involved with purchasing gas in
11 today's market. If it did, the ROR would be higher in recognition of the higher and
12 more diverse risks involved with gas purchasing compared to operating a gas
13 distribution company. LDCs in Oregon and elsewhere in the country have generally
14 continued (for a variety of reasons) to purchase gas for their customers, even in the
15 face of the increased risks in the market; and in most instances as reviewed under
16 state regulatory authority for their prudence, the LDCs have done an at least
17 adequate job of making such purchases.

18 *Third*, CUB at many points in its testimony concludes that the incentive mechanism
19 included in the Stipulated PGA is not, in fact, a real incentive for the LDC to seek a
20 gas supply portfolio that is well balanced in terms of overall cost of gas and gas price
21 volatility. For example, CUB claims that an LDC with storage, assumed by CUB to
22 be the lowest cost option in the LDC's supply portfolio, might choose to make spot
23 purchases, for which it could earn a share of any savings vs. using storage gas,
24 which does not have this opportunity attached. CUB could be correct in its
25 conclusion if there was no one monitoring both the LDCs' overall gas supply portfolio
26 and their decision making regarding both short-term and long-term gas purchasing.

1 But this is not the case. Commission Staff and other interested parties meet with the
2 LDCs at least quarterly to consider and discuss just such topics as the one CUB
3 brings up. Based on the results of these meetings and related analyses, the
4 Commission always has the option to hold LDCs accountable if such problems occur
5 through prudence reviews and cost pass through disallowances. We will not
6 speculate on how likely the problems described by CUB regarding LDC abuse of the
7 PGA mechanism are or could become but point out that an incentive based PGA is
8 not intended to be the only option available to the Commission to address and
9 correct such problems. Incentive mechanisms, even those included in the Stipulated
10 PGA, do not remove the need for continual oversight and review of LDC gas
11 purchasing actions by the Commission.

12 **COMPARISON OF OPERATION OF CURRENT AND STIPULATED PGA MECHANISMS**

13 **Q. What are the variance calculations and sharing included in the Stipulated PGA**
14 **mechanism?**

15 A. This is described by the Parties in the testimony supporting the Stipulation as
16 follows:

17 [T]he Monthly Benchmark WACOG is the actual unhedged volumes at the Unhedged
18 Benchmark Price plus the costs of fixed price hedges and storage withdrawals
19 divided by total actual volumes.

20 (1) The difference between the annual Embedded WACOG and the Monthly
21 Benchmark WACOG will be calculated each month and multiplied by total
22 actual volumes ("Monthly WACOG Variance") and deferred for later collection
23 or refund. The Monthly WACOG Variance will be shared at 95/5, meaning
24 that 95 percent of any variance will be collected from or refunded to
25 customers. This variance calculation reflects the movement of market prices
26 during the interval between the time the annual Embedded WACOG is

1 calculated and a particular later month. *This movement is beyond the control*
2 *of the LDC or any other party.* This is the primary reason a 95/5 sharing level
3 was chosen.

4 (2) The LDC's actual costs for the Unhedged Gas are determined each month.
5 The difference between the actual costs for Unhedged Gas and the product
6 of the Unhedged Benchmark Price and the actual unhedged volumes
7 ("Unhedged Benchmark Variance") will be deferred for later collection or
8 refund. The Unhedged Benchmark Variance will be shared with customers at
9 the percentage selected by the LDC each year by August 15 at one of the
10 following levels: 67/33, 80/20 or 90/10 (meaning that 67, 80 or 90 percent of
11 any variance will be collected from or refunded to customers).

12 The first level of incentive is provided by the sharing on a 95/5 percent basis of the
13 variance between the Embedded WACOG and the Monthly Benchmark WACOG.
14 The Embedded WACOG is based upon forecasts of volumes made at the beginning
15 of the gas year for hedged supplies, storage usage, and unhedged supplies.
16 Hedged volumes are reflected at hedged prices. Storage usage is passed through at
17 100% of cost[3], and unhedged supplies are priced using the 60-day NYMEX strip.
18 The Monthly Benchmark WACOG reflects actual volumes for hedged supplies,
19 storage usage, and unhedged supplies. Hedged supplies reflect hedged prices,
20 100% storage costs and either the FOM index or daily index for unhedged supplies.[4]
21 Thus, this first level incentive operates similarly to the current PGA but replaces the
22 actual price for unhedged supplies with the benchmark price, thus measuring how

[3] Storage supplies from refills after November 1 are treated as unhedged supplies and not included in the Embedded WACOG.

[4] Storage supplies from refills after November 1 are treated as unhedged supplies and not included in the Embedded WACOG.

1 the LDC's overall portfolio compared with the movement of the market. While the
2 LDC has no control over the market movement, this step serves to reward (or
3 "penalize") the LDC's longer-term decision making processes such as how much it
4 hedged or how it used it filled its storage.
5 The second level of incentive is provided by the sharing of the difference between
6 the Unhedged Benchmark as applied to actual unhedged volumes, and actual
7 unhedged gas costs. Because the Unhedged Benchmark Price is based upon a
8 current market price, this second incentive rewards (or penalizes) the LDC based on
9 its day-to-day performance. *These two sharing mechanisms together provide the*
10 *LDCs with more effective incentives to construct reasonable long-term gas*
11 *procurement strategies and effectively manage day-to-day gas purchasing, to the*
12 *benefit of customers as well as shareholders.*
13 **Q. Can you compare the results of the current PGA mechanism with the results of**
14 **the Stipulated PGA for a sample month using the same prices and volumes?**
15 A. Yes. That comparison is presented in Exhibit 201. This Exhibit is based on
16 indicative values for prices and volumes but are not specific to any Oregon LDC.
17 **Q. Can you compare the results of the current PGA mechanism with the results of**
18 **the proposed PGA for a sample month using the same prices and volumes?**
19 A. Yes, that comparison is shown in Exhibit 201. It shows illustrative calculations for
20 three different scenarios for both the Current Mechanism and the Stipulated PGA.
21 The Exhibit assumes that 6 million dekatherms are sold during the month; 60 percent
22 come from hedged volumes (either hedged supplies or a mix of hedged supplies and
23 storage gas), and 40% from unhedged volumes. The Exhibit further assumes that
24 projected volumes for the month equal actual volumes, thereby isolating the effect of
25 changing prices.

1 Under the Current Mechanism, the only relevant prices for purposes of calculating
2 the PGA incentive are the Embedded WACOG and the Actual Costs for Unhedged
3 Gas. The Embedded WACOG does not change; it is set annually. Actual costs
4 reflect the cost actually paid by the utility for spot purchases when those purchases
5 are made.
6 Scenarios A and B demonstrate results when prices decline while Scenario C depicts
7 rising prices. In Scenario A, actual gas costs are $2.4 million less than embedded; in
8 Scenario B, actual gas costs are $4.8 million less; and in Scenario C, actual gas
9 costs are $4.8 million more than embedded. In each scenario 80/20 sharing is
10 assumed.
11 It is important to keep in mind when reviewing the example that under the current
12 mechanism, the benchmark for unhedged supplies has typically been based on the
13 60-day NYMEX strip ending on September 30, or some other forecast made near the
14 time of the filing. This benchmark is not updated to reflect changes in the market
15 after the effective date of PGA. The comparison of actual gas costs to the
16 Embedded WACOG does not demonstrate whether the LDC is realizing prices for its
17 unhedged supplies that are at, above or below market prices prevailing at the time of
18 purchase. Rather, it reflects the comparison between the actual costs incurred by
19 the LDC and the future market prices prevailing at the time the LDC's PGA was filed.
20 In the Stipulated PGA, on the other hand, a measure of then prevailing market prices
21 is explicitly included in the mechanism. As shown on Exhibit 201, the Stipulated
22 PGA has two comparisons. In the first step, the Embedded WACOG is compared to
23 a recalculated WACOG that replaces the prices for unhedged supplies in the PGA
24 with a market-based benchmark price, either the FOM Index or the Daily Index.[5] In

[5] If possible, the LDC may change out hedges completed prior to the PGA filing if lower prices for such hedging become available later in the year. Increased costs for hedges completed and
(continued...)

1 the second step, unhedged supply costs based on the benchmark price for each
2 month are compared to actual unhedged supply costs. Because two prices are now
3 used for comparison purposes – actual prices and benchmark prices – we need to
4 know not only whether actual prices increased or decreased relative to the
5 embedded prices, but also whether actual prices realized by the LDC were above or
6 below the benchmark price for each month.
7 Scenario A show a case where prices have dropped relative to the embedded prices,
8 and the LDC was able to purchase its unhedged supplies at the benchmark price.
9 This could occur, for example, if the LDC were to purchase all of its unhedged
10 supplies at the FOM Index. In step 1 of the Stipulated PGA, embedded prices are
11 compared to a recalculated WACOG using the Benchmark Price. This results in a
12 total Monthly WACOG Variance savings of $2.4 million. This equals the savings
13 calculated in the Current Mechanism because the Benchmark Price is assumed
14 equal to actual prices realized by the LDC for its unhedged supplies. However, in
15 the Stipulated PGA, the sharing used in step one is 95/5, so instead of receiving
16 savings of $1.92 million under the Current Mechanism, customers receive $2.28
17 million. The LDC's share is reduced from $480,000 to $120,000. Furthermore,
18 because the Unhedged Benchmark Price equals the price realized by the LDC, step
19 2 results in no Unhedged Benchmark Variance.
20 In Scenario B we assume that market prices drop but that the LDC did not realize
21 prices for its unhedged supplies that were as low as the benchmark price. This could
22 occur, for example, if the LDC did not purchase all its unhedged supplies at the FOM
23 Index and prices rose during the month when the LDC did buy unhedged supplies.

---

storage injections made after the PGA filing may also increase the overall cost during any month for hedged and storage gas withdrawals.

1 In this case, it is assumed that actual prices realized by the LDC were $2 below
2 embedded prices, but the FOM Index dropped $3.
3 In step 1, embedded is compared to the Benchmark Price, resulting in a total
4 Monthly WACOG Variance savings of $7.2 million. Customers receive 95% of that
5 or $6.84 million. The LDC receives 5% or $360,000. But that is not the end.
6 In step 2, the Benchmark Price is compared to realized prices, which in this case are
7 higher than the benchmark. As shown in Exhibit 201, this results in a total Unhedged
8 Benchmark Variance of $2.4 million of additional costs. The sharing assumed for
9 this example is 80/20, so customers are responsible for $1.92 million of this higher
10 cost, and the LDC is responsible for $480,000.
11 The amounts from steps 1 and 2 are then summed to determine the combined
12 impact of the Stipulated PGA. In this Scenario B, customers receive a benefit of
13 $4.92 million (the net of a savings of $6.84 million from step 1 and an added cost of
14 $1.92 million from step 2), while the LDC ends up paying an additional cost or
15 penalty of $120,000 (the net of savings of $360,000 from step 1 and added cost of
16 $480,000 from step 2).
17 The "different signs," – i.e., a savings for customers and a penalty for shareholders –
18 results because even though prices declined and the LDC reduced costs below what
19 was assumed in the PGA, it did not purchase its unhedged supplies sufficiently close
20 to then prevailing market prices. As a result, the 5% LDC sharing of the savings
21 resulting from movement in the overall market was overwhelmed by the 20% sharing
22 of the loss from purchasing unhedged supplies above then prevailing market prices.
23 Compared to the Current Mechanism, customers received an additional $1.08 million
24 in savings, while the LDC is $1.08 million worse off.
25 Scenario C demonstrates the opposite case to Scenario B, with prices increasing but
26 the LDC able to buy at prices better than the Benchmark Price. In Scenario C under

1 the Stipulated PGA, customers pay $4.92 million while the LDC earns a benefit of
2 $120,000.

3 **Q. CUB's testimony claims that the Stipulated PGA mechanism comes close to**
4 **the initial proposal by Staff that LDCs be allowed to pass through to customers**
5 **100% of gas costs. Please explain why Staff made the proposal for 100% pass-**
6 **through and why it was willing to give up that position in the Stipulation.**

7 A. PGA incentive mechanisms should compare gas expenses actually incurred by the
8 LDCs with the prices actually available in the market at (or near) the time the
9 expenses are incurred. Instead, the current PGA relies on a forecast (or forward
10 strip) of prices set at the time the PGA is filed. In this respect, the current PGA
11 mechanism's sharing is based on an inadequate (or stale) comparison. A forecasted
12 price (the NYMEX future price strip) is compared with actual monthly natural gas
13 purchase prices. For all the hedging completed (fixing prices); storage injections
14 (fixing prices); and daily and monthly index or cash purchasing carried out by the
15 LDC after the PGA filing, this comparison only tells us whether LDC gas purchase
16 prices are higher or lower than the level expected at the time the PGA was filed. It
17 does not tell us whether LDC gas purchase prices were higher or lower than the
18 market prices available closer to the time the purchases were made. In Staff's view,
19 this is not an appropriate or reasonable comparison in today's volatile natural gas
20 market. Thus, Staff believes that the easiest and most direct fix for this situation was
21 simply to allow 100% pass through of gas costs by the LDCs in combination with a
22 separate gas purchase incentive mechanism (GPIM) based on a proper comparison
23 of LDC gas costs with relevant market prices. This solution was not acceptable to all
24 other parties, including CUB. From Staff's perspective relative to its original litigation
25 position, the Stipulation is a "second best" solution for this problem, but it is
26 supported by all Parties other than CUB and is a significant improvement to the

1 existing PGA structure. The goal is to put in place a PGA with an incentive
2 arrangement based on a direct comparison of LDC gas costs with the relevant gas
3 market prices and purchasing time periods for the various types of gas supply
4 included in the LDC's portfolio (e.g., financially hedged fixed price gas, storage gas,
5 monthly purchases, daily purchases). The Stipulated PGA properly moves in that
6 direction.

7 **Q. Exhibit 201 employs 80/20 sharing for the variance of the total monthly gas**
8 **costs and the Embedded WACOG. Please explain why the Stipulation allows**
9 **Cascade to use a 67/33 sharing level and why this is appropriate.**

10 A. As discussed in the testimony supporting the Stipulation (pp 10-12), Cascade's
11 situation is unique due to the recent Merger/Show Cause commitments and as a
12 result, worthy of the higher threshold through 2012, providing Cascade chooses to
13 maintain the 67/33 sharing level. These commitments include guaranteed revenue
14 credits of $200,000 per year through 2012 as well as A&G Benchmarks which limit
15 increases in A&G expenses through 2012 to no more than the CPI.

16 **Q. CUB's testimony indicates that the use of the FOM and NGI benchmarks for**
17 **unhedged gas is not appropriate, particularly allowing each LDC to choose**
18 **each year between these two options for the benchmark and not requiring the**
19 **use of the same benchmark for all the LDCs. Please respond to these**
20 **contentions by CUB.**

21 A. The LDCs can purchase unhedged gas on a monthly or daily basis, or some
22 combination of both. If the LDC plans to purchase the majority of this gas on a
23 monthly basis, it only makes sense to use a monthly (FOM) benchmark; similarly, if
24 the LDC plans to purchase the majority of this gas on a daily basis, it only makes
25 sense to use a daily benchmark. The PGA mechanism incentive arrangement
26 thereby continues to carry through its major objective referenced above –

1 comparison of the LDC's gas cost to prices in the actual markets in which the LDC
2 made gas purchases.

3 **Q How does Cascade respond to CUB's claim that Cascade's answer to CUB's**
4 **data request "obscures what we might have learned about the proposed**
5 **mechanism's effect on Cascade and its Customers"?**

6 A. CUB's claim is based on the fact that Cascade's response utilized a FOM
7 Benchmark Price rather than a Daily Benchmark Price, which according to CUB is
8 "what the company intends to use". Although the Stipulation provides Cascade the
9 option of utilizing a daily benchmark, Cascade has never indicated any intentions to
10 utilize the daily benchmark, and CUB cites nothing to support its statement.
11 Therefore, the Company's comparison of the FOM Benchmark to the Embedded
12 WACOG was appropriate and was responsive to CUB's request.

13 **Q. If Cascade intended to use the FOM Benchmark, then why did the Company**
14 **include a disclaimer with its response that the backcast may not be accurate?**

15 A. Cascade's response included the comparison of the FOM Benchmark to the
16 Embedded WACOG approved by the Commission in the Company's prior PGA
17 filings. The Embedded WACOGs were developed under the current PGA Filing
18 mechanism which requires the LDCs to utilize historical weather-normalized
19 volumes. Under the proposed mechanism, LDCs would utilize their forecasted
20 volumes for the PGA year, along with the 60-day average NYMEX for the price
21 forecast. Both of these changes likely would have changed the initial calculation of
22 the Embedded WACOG upon which the requested comparison was based. The
23 Company did not attempt to backcast the Embedded WACOG calculation, and for
24 that reason chose to include the disclaimer referred to on page 28 of CUB's
25 testimony. Additionally, Phase II of this docket will result in a set of guidelines that

1 could impact Cascade's current purchasing strategies and that too would have an
2 impact on the development of the Embedded WACOG.

3 **OVERLY RIGID PGA MECHANISM PROPOSED BY CUB**

4 **Q. Does CUB propose that the identical PGA mechanism and "mechanistic" PGA**
5 **sharing arrangement be used by all Oregon LDCs?**

6 A. Yes.

7 **Q. Is this appropriate?**

8 A. No.

9 **Q. Please explain.**

10 A. The three goals of a gas supply portfolio, diversity, flexibility, and balance, can be
11 summarized in a single word, optionality. A portfolio without optionality places added
12 risks, sometimes quite large added risks (depending on the current market and
13 general societal circumstances) on both the LDC and its customers. CUB seems
14 opposed to most efforts to include optionality in the PGA mechanism. The result is
15 increased risks for both customers and their LDCs. CUB is correct that optionality
16 can be a two-edged sword. Applied incorrectly or not properly monitored, optionality
17 can also be used to shift risks away from the LDC onto its customers. The Stipulated
18 PGA does include optionality aimed at both reducing gas purchasing risks as much
19 as possible and distributing those risks fairly and appropriately between the LDC and
20 its customers. Staff will not forego monitoring the actual application of this PGA
21 mechanism to ensure it is utilized properly. Staff anticipates help from CUB and the
22 other non-LDC parties in this effort. At this stage, Staff has no reason, however, to
23 believe the Stipulated PGA would not be implemented and operated properly by the
24 LDCs.

25 At page 42 of its testimony CUB states,
26

1 Mechanistic consistency both for an individual utility and between
2 utilities, serves to allow customers to understand how they are being
3 charged, allows the Commission to compare the year-to-year
4 performance of a mechanism without having to account for annual
5 benchmark changes or sharing percentage elections, and helps to
6 ensure that customers of the three utilities are being treated equitably.

7 The "mechanistic consistency" proposed by CUB *may* have some of the
8 administrative advantages claimed by CUB. But what it doesn't have is optionality.
9 As already noted optionality is both the key for risk control and mitigation and for
10 establishing a fair and appropriate sharing of risks between the LDC and its
11 customers.

12 **EARNINGS REVIEW**

13 **Q. Do the Parties accept CUB's proposed changes to the earnings review to**
14 **require 33% sharing of LDC earnings above the threshold with half to be**
15 **shared only with core customers on an equal cents per therm basis and half to**
16 **all customers on an equal percent of margin basis?**

17 A. No.

18 **Q. Why do Parties find CUB's Reply Testimony proposal unacceptable?**

19 A. Other than for the 2009 earnings review for which the Parties have recommended
20 that the Commission use the 2008 Fiscal Year results and the earnings thresholds
21 currently allowed by the Commission, the Parties have agreed and recommended to
22 the Commission that beginning with the 2010 earnings review, the Commission
23 should adjust the sharing percentages for earnings above the threshold to account
24 for the impact of SB 408 as part of the overall settlement Stipulation. Based upon
25 current federal and state tax rates, customers of LDCs subject to SB 408 will receive
26 20% of earnings above the applicable threshold (which is subject to change as
27 federal and/or state tax rates change), and those not subject will remain at 33%.
28 Parties have agreed in the Stipulation that this structure is fair across all of the LDCs

1 and their respective customers as it is mathematically the equivalent when
2 considering two LDCs are subject to SB 408 and one is not.

3 Q **What other modifications do the Parties propose for the earnings sharing**
4 **mechanism?**

5 A. Parties have agreed to seek removal of the sunset provision through a subsequent
6 rulemaking as set forth in the Stipulation.

7 Q **Do the Parties support CUB' s new proposed allocation of excess earnings**
8 **above the threshold with 50% to core customers only based on equal cents per**
9 **therm and 50% to all customers based on equal margin?**

10 A No. Each spring since 1999, the Commission conducts a general earnings review
11 for each of the LDCs. If earnings are found to be above a specified return on equity
12 level, a portion of those revenues are booked to a deferred account with 33% of
13 earnings exceeding the threshold shared. In all instances of application, this sharing
14 has been allocated to all customers (other than special contracts or discounted
15 bypass tailblocks) on an equal percent of margin basis at the time of the next PGA.
16 See Order Nos. 00-448, 01-600, 03-397,& 07-305 as reflected in Cascade's
17 subsequent PGA filings in 2000, 2001, 2003, and 2007. Parties urge the
18 Commission to continue to apply the same method it approved in its most recent
19 application in Order 07-478 (2007 PGA filing by Cascade in Docket UG 179 with all
20 customers other than special contracts sharing excess earnings on an equal percent
21 of margin basis).

22 Q **Why should the Commission reject CUB's proposal for 50% of excess earnings**
23 **to go to core customers on an equal cents per therm basis?**

24 A. OAR 860-022-0070 (5)(e) currently provides that the Commission will determine by
25 order the method for allocating amounts to be amortized among customer classes.
26 Parties recommend that the Commission reject CUB's proposal and continue its

1 historic application on an equal percent of margin basis with the discretion as
2 embodied in OAR 860-022-0070 (5)(e) to make a specific finding if some unusual
3 situation arises in the future that merits a different and unique application to a
4 particular situation. Otherwise Parties maintain that it is equitable and fair to allocate
5 excess earnings sharing on an equal percent of margin basis to all customers,
6 excluding special contracts.

7 Q **Why do Parties support allocations of excess earnings generally on an equal**
8 **percent of margin basis to all customers (except special contracts)?**

9 A. Excess earnings are not generated in a defined manner by any specific source of
10 revenue generation or cost savings. They are the net result of income and expense
11 accounting for the entire operations of the LDC under specific guidelines, process
12 and orders of the Commission under OAR 860-022-0070. Accordingly an equal
13 percent of margin basis to all customers is the most fair allocation method possible
14 for excess earnings as the relative relationship and parity between the customer
15 classes relative to their distribution costs is not altered.

16 Q **Are there additional reasons why the Parties view CUB's proposal as**
17 **inequitable?**

18 A. Yes. Industrial sales customers of the LDCs make up significant volumes on each of
19 the utilities, with both interruptible industrial sales and firm industrial sales customers
20 on all systems. Industrial firm sales customers are not different than any other "core"
21 customers but would benefit by an equal cents per them application
22 disproportionately by CUB's proposal assuming it was intended to apply to all core
23 customers. If it was intended to apply only 50% of excess earnings just to residential
24 and commercial customers in some more narrow definition of "core" customers, while
25 limiting industrial sales and transportation customers to only sharing in the other 50%
26 of excess earnings along with the core, it is simply not reasonable and fair as a

1 permanent basis for allocation. All customers paid their properly determined

2 distribution rates that generated the relevant excess earnings.

3 **Q. Does this conclude your testimony?**

4 A. Yes.

	Sharing %	Scenario A Market Prices Drop and LDC meets Benchmark				Scenario B Market Price Drops significantly and LDC does not beat benchmark				Scenario C Market Price Increases significantly and LDC does beat benchmark		
STIPULATED MECHANISM			Volumes				Volumes				Volumes	
Annual Embedded WACOG		$10.00	6,000,000		$60,000,000	$10.00	6,000,000	$	60,000,000	$10.00	6,000,000	$60,000,000
Actual Gas Costs				$	57,600,000			$	55,200,000			$ 64,800,000
Monthly WACOG Benchmark Calculation:												
Fixed Price Hedges & Storage Withdrawals		$10.00	3,600,000	$	36,000,000	$10.00	3,600,000	$	36,000,000	$10.00	3,600,000	$ 36,000,000
Unhedged Benchmark Price (FOM)		$9.00	2,400,000	$	21,600,000	$7.00	2,400,000	$	16,800,000	$13.00	2,400,000	$ 31,200,000
Monthly Benchmark WACOG		$9.60	6,000,000	$	57,600,000	$8.80	6,000,000	$	52,800,000	$11.20	6,000,000	$ 67,200,000
Monthly WACOG Variance					**($2,400,000)**				**($7,200,000)**			**$7,200,000**
Customers	95%				($2,280,000)				($6,840,000)			$6,840,000
LDC	5%				($120,000)				($360,000)			$360,000
Unhedged Benchmark Variance Calculation:												
Unhedged Benchmark		$9.00	2,400,000	$	21,600,000	$7.00	2,400,000	$	16,800,000	$13.00	2,400,000	$ 31,200,000
Actual Costs for Unhedged Gas		$9.00	2,400,000	$	21,600,000	$8.00	2,400,000	$	19,200,000	$12.00	2,400,000	$ 28,800,000
Unhedged Benchmark Variance					**$0**				**$2,400,000**			**($2,400,000)**
Customers	80%				$0				$1,920,000			($1,920,000)
LDC	20%				$0				$480,000			($480,000)
Combined Impact of Benchmarks												
Customers					($2,280,000)				($4,920,000)			$4,920,000
LDC					($120,000)				$120,000			($120,000)
CURRENT MECHANISM												
Annual Embedded WACOG		$10.00	6,000,000		$60,000,000	$10.00	6,000,000		$60,000,000	$10.00	6,000,000	$60,000,000
Actual Costs:												
Fixed Price Hedges & Storage Withdrawals		$10.00	3,600,000	$	36,000,000	$10.00	3,600,000	$	36,000,000	$10.00	3,600,000	$ 36,000,000
Actual Costs for Unhedged Gas		$9.00	2,400,000	$	21,600,000	$8.00	2,400,000	$	19,200,000	$12.00	2,400,000	$ 28,800,000
Total Gas Costs		$9.60	6,000,000	$	57,600,000	$9.20	6,000,000	$	55,200,000	$10.80	6,000,000	$ 64,800,000
Variance					($2,400,000)				($4,800,000)			$4,800,000
Customers	80%				($1,920,000)				($3,840,000)			$3,840,000
LDC	20%				($480,000)				($960,000)			$960,000
Additional Benefit (Cost) of Proposed Mechanism												
Customers					$360,000				$1,080,000			($1,080,000)
LDC					($360,000)				($1,080,000)			$1,080,000