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	)
	)

REPLY TESTIMONY

OF THE

CITIZENS' UTILITY BOARD OF OREGON

January 10, 2014

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Our names are Bob Jenks and Jaime McGovern. CUB's Reply Testimony will address Staff Supplemental Testimony (UM 1654 Staff/200/Colville and Staff/300/Garcia).

1) INTRODUCTION

CUB takes issue with Staff's apparent reversal of position since the filing of Staff's testimony in the UG 221 docket.[1] Within this reversal, CUB first, rejects the position now taken by Staff that further exploration in the way of a cost based study is unwarranted in the treatment of Interstate/Intrastate Storage,[2] second, rejects the assertion by Staff (we will adopt Staff Debora Garcia's AMA Optimization term here to mean Asset Management Asset Optimization)[3] that AMA optimization sharing percentages remain fair and are based on sufficient and accurate information,[4]and third, refutes Staff's assertion that NWN is unique in its attempts to optimally utilize customer

[1] Compare UG 221 Staff/1000/Zimmerman/8-21 and UG 221 Staff/1900/Zimmerman/9-13 with UM 1654 Staff/100/Colville and UM 1654 Staff/200/Colville.
[2] UM 1654 Staff/200/Colville/7, lines 2-10.
[3] UM 1654 Staff/300 Garcia/2.
[4] UM 1654 Staff/200/Colville/4, line 17 – 6, line 2.

resources even when the Company is not required to do so.[5]

With that said, CUB supports Staff's treatment of AMA optimization revenue and resulting transparent approach which includes all utility earnings in the Results of Operations (ROO) report.[6] CUB will then conclude its Reply Testimony with its recommendations to the Commission.

2) CUB'S RESPONSE TO STAFF

A. Response to Erik Colville

These issues related to storage and optimization grew out of UG 221. The position of the OPUC Staff has apparently changed drastically since the UG 221 docket, and so far as CUB can see, without the benefit of any new evidence to support such a change. Testimony proffered in UM 1654 Staff/200 opposes Prior Staff testimony in UG 221,[7] (the term we use to refer to the UG 221 testimony of Ken Zimmerman) and does not demonstrate a more informed view of the issues. Also, as discussed in our introductory paragraph, Current Staff (referring to the testimony of Eric Colville) asserts that the Company is unique in its optimization ventures and is not responsible for maximizing value of customer resources at minimal cost and risk. This assertion is also in opposition to Prior Staff's testimony in UG 221 and CUB will demonstrate that the assertion made by Current Staff is faulty. CUB will further demonstrate that even PGE ratepayers may unknowingly be absorbing risk related to NW Natural's optimization activities, and all without any compensation.

Not surprisingly, it is CUB's opinion that continuing to allow NWN to engage in uncompensated risk taking with other person's gas options, is unacceptable, given the

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[5] UM 1654 Staff/200/Colville/9, line 4 – 10, line 18.
[6] *See* UM 1654 Staff/300/Garcia.
[7] UG 221 Staff/1000/Zimmerman/8-21 and UG 221 Staff/1900/Zimmerman/9-13.

details that CUB is now bringing to light and presenting to the Commission for review. Especially when, as here, with full disclosure of information, and inclusion of AMA Optimization revenue in Results of Operations more than a decade after initiation of AMA optimization, all parties would be in a better position to fully understand and assess where the true costs and benefits lie and to whom revenues should be assigned.

In short, CUB maintains the positions it presented in its previously filed Response Testimony, and seeks to amplify and emphasize those recommendations herein.

I. Consistent Ratemaking

CUB finds disturbing the significant reversal of Staff position between UG 221 Staff/1000 and Staff/1900 and UM 1654 Staff/200 today. Moreover, CUB is concerned by both the current direction of Staff testimony, and the lack of rigor in the analysis allegedly supporting it. Current Staff does not present new data in its Supplemental Testimony (UM 1654 Staff/200) to support its analysis. Consider the following chart, which highlights the changes in Staff's position which CUB discusses as individual elements later in this testimony.

Party Positioning of issues in UM 1654*

Cost Study		Wholesale Storage Revenue allocation	
Staff UG 221	needed	Staff UG 221	50/50
CUB	needed	CUB	80/20
NWN	not needed	NWN	80/20
Staff UM 1654	not needed	Staff UM 1654	80/20

Storage Optimization Revenue Allocation		Pipeline Optimization Revenue allocation	
Staff UG 221	10/90 & 20/80**	Staff UG 221	10/90 & 20/80**
CUB	10/90	CUB	10/90
NWN	33/67 & 80/20***	NWN	33/67
Staff UM 1654	33/67 & 80/20***	Staff UM 1654	33/67

*all sharing ratios are listed as: shareholder/customer
** staff position changed from opening testimony in rebuttal
***blended between the two sharing percentages based on the deliverability of gas

CUB is concerned by the lack of consistency in Staff's positions when there is also a lack of evidence to support a change in direction.

II. <u>CUB Refutes Current Staff's Dismissal Of The Need For A Cost Study Of Inter/Intrastate Storage</u>

(a) *Staff originally (UG 221) recommended a well informed independent cost study and now (UM 1654) does not, stating that there is no new information.*

In UG 221, Staff took the following position:

> I recommend NWN be ordered to conduct an independent study of Mist storage and related issues. The Commission should get to approve the parameters of the study and selection of an independent party to carry out the work. I recommend that the study occur in 2013 and that at the conclusion of the study any interested party can raise challenges at the Commission that changes should be made to the sharing structure based upon the new study.[8]

[8] UG 221 Staff/1900/Zimmerman/13, lines15-20.

Who could argue with Staff's recommendation that Commission policy be based on reliable information, rather than a lack of it? Current Staff. Current Staff refutes prior Staff and CUB recommendations for a cost based study and cost based ratemaking, which could potentially adjust sharing percentages. Current Staff does not believe that a cost study is necessary or relevant because current Staff believes that sharing should be based solely on currently perceived risk, regardless of costs or revenues.[9] Current Staff also cites a lack of new information as the basis for its recommendation:

> I would look for significant changes in business conditions and risks since the sharing percentages were established.[10]

However, in UG 221, Prior Staff did find that significant changes in business conditions had evolved[11] and that there was cause for concern.[12] 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.[13] Current Staff states:

> I am not aware of any changes in business conditions and risks associated with this activity.[14]

Current Staff may be unaware of an evolving marketplace but such lack of knowledge cannot be because the market was stagnant, it was not. Rather it must be because parties failed to request the details of NWN's marketplace activities, creating the asymmetric provision of information in various filings, an asymmetry which could now be corrected through implementation of a cost based study. Given that the entire sharing arrangement was modeled on an ad-hoc basis when first created, before the

[9] UM 1654 Staff/200/Colville/7, lines 2-10.
[10] UM 1654 Staff/200 Colville/5, lines 16-18. Also including gaming of the system (*See* Staff/200/Colville/5, line21).
[11] UG 221 Staff/100/Zimmerman/20, lines 8-15.
[12] UG 221 Staff/1000/Zimmerman /11, line 19 -12, line 7.
[13] UG 221 Staff/1000/Zimmerman/20, lines 12-16.
[14] UM 1654 Staff/200/Colville/5, lines 22-23.

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, it seems to CUB that the time is ripe for any new information that could be gleaned from a cost study.

It is CUB's position that the ad hoc arrangements which have persisted without the benefit of full disclosure, such as would be available through an independent study (as originally recommended by Prior Staff), and the inclusion of earnings in the ROO (as recommended by Staff (Ms. Garcia)) today, must end. CUB strongly recommends that the Commission order the implementation of a cost based study with appropriate in-depth analysis.

(b) Staff has changed its position on the risks associated with interstate storage.

Either there is a monetary or real asset risk, or there is not. If there is a risk, it should be evaluated and, if prudent, customers should garner the financial gain that offsets the risk acquisition

Staff recently recognized that the risks of continuing Interstate Storage in fact pose minimal risk:

> Consequently, NWN could lose money on its build-out of Mist for the interstate market only if it failed to sell at the level assumed in the FERC-approved rates. And NWN has never experienced difficulty in marketing its Mist capacity in the interstate market. The latest filing with the Commission regarding such sales indicates NWN has sold about 90 percent of the available deliverability and almost 100 percent of the available capacity. The average net revenue from off-system storage sales under Mist's §284.224 certificate for the period 2007-2011 was just over $9 million per year. It appears the risk to NWN of this service is minimal.[15]

[15] UG 221 Staff/1000/Zimmerman/18, lines 6-14.

If the concept in the above quotation is correct, which it appears to be, then Staff's current position that sharing compensation should be based on risk, not costs, would suggest a possible recalculation of sharing from decreased risk that is generated from market experience. Just because Current Staff asserts that there is no justification for revisiting sharing rules, and that there have been no changes in business conditions and risks associated with storage of natural gas and its AMA optimization, does not, in and of itself, provide a factual basis with which to support the bald assertion.[16]

(c) Prior Staff was concerned that customers may be subsidizing shareholder revenue, an allocation that could incent overinvestment, for example in storage. Current Staff states concerns that any modification of the sharing arrangement could incent the company to act to the detriment of customers

In UG 221, Prior Staff had concerns about whether, under the current arrangement, the Company had chosen to overinvest in storage, citing that the Company, when including interstate/intrastate storage, could exceed the annual critical peak requirement on a daily basis.[17] Prior Staff was concerned that "NWN may have too much daily storage deliverability under contract or owned, even at the 61 to77 percent of normal peak demand deliverability level."[18] Staff was also "concerned about the sharing of the capital and operating costs between utility and non-utility customers using the facility,"[19] and about the "tracking and accurate assessment of the working capacity and deliverability of the facility over its life."[20] Unfortunately, since the UG 221 docket, the parties have not had access to additional deterministic information, in the form of a cost analysis or study, and are still subject to the Company's word that the sharing percentage is fair, and should remain permanently in its favor, merely because it

[16] UM 1654 Staff/200/Colville/5, lines 12-23.
[17] UG 221 Staff/1000/Zimmerman/10-11.
[18] UG 221 Staff/1000/Zimmerman/11, lines 19-21.
[19] UG 221 Staff/1000/Zimmerman/12, lines 2-4.
[20] UG 221 Staff/1000/Zimmerman/12, lines 2-7.

was established that way. Current Staff is no longer concerned that storage revenue sharing is overly generous and incentivizes the Company to overinvest: "[i]n short, the current sharing percentages work well to benefit core utility customers and NWN, and I do not see any reason to change them."[21] CUB continues to disagree with Current Staff's position.

II. CUB Refutes Staff's Acceptance Of Current Sharing Percentages In AMA Optimization

(a) Staff originally recommended that customers be compensated for use of their resources and now does not, stating that returns should be based on risk alone, not costs.

In UG 221, Staff insisted that customers be compensated fully for the use of their resources:

> 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[22].

To not do so would violate basic ratemaking principles requiring utilities to operate their system in a least cost manner. This is because failure to utilize prudent revenue generating options is equivalent to purposefully taking on increased costs. But if a utility does elect to take 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 it uses. Current Staff's position supports not doing a study to establish the costs and benefits related to storage and instead retaining present sharing percentages which were based on an ad-hoc arrangement established prior to recent industry experience and the resultant evolving market:

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[21] UM 1654 Staff/200/Colville/5, line 23 – 6, line 2.
[22] UG 221 Staff/1000/Zimmerman/19, lines 19-22.

> [T]he sharing percentage proposed by CUB should not be based upon use of customer assets (share of system costs, the result of a cost of service study), but rather upon risk.[23]

Simple expected value analysis demonstrates that both cost and risk are fundamental in determining net benefit and value of market activities:

$$Expected\ Value = EV = Expected\ Revenue - Expected\ Cost$$

$$EV = \sum_{n=1}^{N} r_n \times pr(r_n) - \sum_{m=1}^{M} c_m \times pr(c_m)$$

where

$$r_n = revenue\ in\ state\ n$$

$$c_m = cost\ in\ state\ m$$

$$pr(r_n) = probability\ of\ state\ n\ occurring$$

$$pr(r_m) = probability\ of\ state\ m\ occurring$$

Clearly, to assess the expected value of AMA optimization, parties must be knowledgeable of both the probabilities of various states of nature, and the costs and revenues that would occur with those eventualities. That is, when deciding whether to enter into a raffle, one would not only want to know the number of tickets being sold, and the process for selection, but also the value of the prize and the price of the ticket.

Current Staff is also now at odds with Prior Staff as to whether the Company would continue to optimally utilize customer resources through AMA optimization if the sharing percentages were adjusted. Mr. Colville warns the Commission:

> Ultimately, customers will lose if NWN's incentive to innovate and create additional revenue is reduced.[24]

[23] UM 1654 Staff/200/Colville/7, lines 7-9.
[24] UM 1654 Staff/Colville/5, lines 9-10.

This hollow warning is based on a dearth of information,[25] and a misunderstanding of the magnitude of revenue from AMA optimization. We know this in part because of the Supplemental Testimony filed by Ms. Garcia:

> In the years that this mechanism has been in place, NWN has successfully earned a significant amount of income. As illustrated in Staff Exhibit/302, the lowest NWN's AMA Optimization percentage could be is 39 percent, which far exceeds the sharing allocation of other sharing mechanisms such as the WACOG Sharing mechanism.[26]

Based on the only actual numbers available, Ms. Garcia can find no reason why the Company wouldn't want to continue to pursue AMA optimization for its ratepayers and its shareholders benefit alike. Since shareholders in NWN surely welcome additional revenue, if the large wealth from AMA Optimization was required to be shared more with customers, then the resulting shareholders' share of the pie would still be significant enough to provide an incentive to continue to optimize the Company's assets. As we will show below, other utilities regulated by this Commission do not require overly generous sharing mechanisms in order to optimize assets.

Prior Staff's testimony reflected its belief that the Utility manages customer resources, and therefore should direct its revenues toward paying down resource costs while allowing the shareholders their authorized ROE:

> 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.[27]

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[25] UG 221 Staff/1000/Zimmerman/17, lines 18-23 ("Staff's memo 4-25-2000 discusses several studies prepared by NWN regarding use of Mist storage to provide off-system sales and the sharing of revenues from such services. I have no reason to believe staff is mistaken when it accepts these studies as reasonable. However, I can find no indication that new studies have been prepared regarding the costs and sharing of revenues from off-system sales since 2000.").
[26] UM 1654 Staff/300/Garcia/4-5.
[27] UG 221 Staff/1000/Zimmerman/19, lines 19-23.

Current Staff argues against this view, stating that resource optimization is "beyond the normal course of an LDC business model."[28] Current Staff made this argument without discussing the evolution of its position or the evidence upon which it is based. In fact, the Supplemental Testimony refers to Staff/100 Colville/14,[29] where Mr. Colville offers his succinct analysis: that shareholders deserve to reap the rewards of "potentially risky" asset optimization "because optimization activities use core utility customer assets but are beyond what would be expected of an LDC."[30] Thus Current Staff is supporting the taking on of risk with customer owned resources without appropriate compensation. Such actions are not permitted or justified merely because the risky activity is not directly providing utility service. If such an act was deemed prudent by the Commission, then the Company must compensate those who own the leveraged assets.

To support its position Current Staff tries to find and assert a relevant distinction between leveraging assets and trading assets. To do this, Current Staff claims that there is a distinction between leveraging assets and trading physical assets. CUB understands that the majority of AMA optimization does not require the trading of physical assets.[31] This fact does not, however, diminish the importance of the physical aspect of the assets, in providing the ability to leverage the assets. That is, the ratepayer owned assets uniquely provide collateral for covered option contracts. Staff recognizes this fact,[32] when it uses the analogies of options trading and collateral for a loan:

> Options can be traded covered, with a backstop position in the underlying security.[33]

[28] UM 1654 Staff/200/Colville/7, line 5.
[29] UM 1654 Staff/200/Colville/7 line 7.
[30] UM 1654 Staff/100/Colville/14.
[31] UM 1654 CUB/100/Jenks-McGovern/16.
[32] UM 1654 Staff/200/Colville/10.
[33] UM 1654 Staff/200/Colville/10, lines 9-10.

Not only does the physical gas cover the financial AMA optimization contracts, but Current Staff recognizes that the Company "could sell physical gas stored in Mist to cover a financial transaction,"[34] resulting in additional cost to the customers.[35] This would occur if at the time the gas purchase agreement matured, market prices were higher than the price agreed upon in the contract. The Company would sell the customer owned gas stored in Mist at the agreed upon price, and repurchase equivalent gas for customer use at the higher market price, resulting in cost to the customers.

Next Current Staff asserts that customers could benefit from an equal but opposite market imbalance: “I recognize the situation of selling gas to cover a financial transaction could also present a benefit to customers if replacement gas for injection is purchased at a lower cost than stored gas."[36] However, simple analysis proves that customers would never benefit from this." Consider the market situation that would be required for this hypothetical example to play out in the customers' favor. At some early date, the Company (through their optimization partner) and a customer for optimization services (“Options Customers”), agree that at a specified date in the future, the Options Customer has the right to purchase gas from NWN for a specified price. When that date in the future arrives, the market price for gas is lower than the agreed upon price. Now, although the Options Customer would have the right to purchase the specified gas from NWN at the high price, allowing NWN to replace it at a discount, the Options Customer would never exercise this option. They too, would see the value in the lower market price, and allow their option with NWN to expire. The fortune of market fluctuations does not swing both ways for the customer. The revenue from the purchase prices of AMA optimization contracts (not the purchase of the gas itself) is the

[34] UM 1654 Staff/200/Colville/10 lines 19-21.
[35] UM 1654 Staff/200/Colville/11.
[36] UM 1654 Staff/200/Colville/11, lines 7-9.

financial benefit afforded to NWN, the downside is the risk of having to, in adverse market conditions, fulfill that options contract. The risk to the customer is real. Many situations that would cause a (short term) spike in natural gas prices, driving an Options Customer to exercise its contract would be the same conditions that would cause NWN to draw additional gas from Mist for customer use and reliability. Examples include, but are not limited to natural disasters and terrorist attacks on the system. NWN's customers should not be required to bear the risk for the options without receiving adequate compensation for the transaction.

III. CUB Refutes Staff's Assertion That LDC's Are Not Expected To Optimize Resource Value

(a) Utilities bear the responsibility to optimally utilize customer resources. Other LDCs fulfill this obligation.

A quick review finds OPUC treatment of utility revenues, in the areas of asset optimization, which support the view that the Utility is obligated to maximize the value of customer resources for the customer. Both PGE and Avista practice AMA optimization, solely for the purpose of financial gain, under the purview of the OPUC. Both companies share the revenues with customers through their power cost or purchased gas adjustment mechanisms. For Avista, this means that 90% of net revenues are shared with customers. Avista describes its optimization activities relating to pipeline capacity and storage in their 10-k:

> We optimize natural gas resources by using market opportunities to generate economic value that partially offsets net natural gas costs. Wholesale sales are delivered through wholesale market facilities outside of our natural gas distribution system and, when feasible, physical delivery may be avoided through offsetting purchase and sale book-out arrangements. Natural gas resource optimization activities include, but are not limited to:
>
> -wholesale market sales of surplus natural gas supplies, and

-purchases and sales of natural gas to optimize use of pipeline and storage capacity.[37]

One hundred percent of these revenues are then applied to the PGA, and subsequently passed through to customers as an offset to actual gas costs. Because the variance between forecasted and actual gas costs is shared on a 90/10 basis, this has the effect of passing 90% of the net revenues from optimization through to customers. In the State of Washington there is no 90/10 sharing of variances and 100% of Avista's net optimization revenues are passed through to customers. In UM 1286, Avista proposed 100% pass through of variances in Oregon, which would have passed through 100% of the net optimization revenues to customers.[38] However, the Commission retained the PGA sharing mechanism in that case, so Avista allocates these net revenues to customers based on 90/10 PGA sharing.[39] CUB finds it notable that Avista's reference would be a PGA that provided 100% of these revenues to customers.

PGE also passes the costs and benefits of customer resource optimization back through to its customer. CUB provided evidence related to these practices in its Response Testimony,[40] but CUB's testimony was misinterpreted and mistakenly inferred that CUB was only discussing optimization by PGE to minimize the cost of fuel. CUB has confirmed with PGE's Patrick Hagar, directly, in a phone call, that PGE does in fact practice asset optimization using it gas pipeline capacity and solely for the purpose of financial gain, resulting in lower rates to customers.

Thus the Avista and PGE optimization practices are extremely similar to those of NWN with the exception that NWN retains much of the gain from its gas

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[37] Avista Utilities 2012 Annual Report, pg 6. http://www.avistacorp.com/home/Documents/Reports/Avista2012AnnualReport.pdf
[38] UM 1286, Avista's Comments Addressing Gas Procurement Incentive Mechanisms, page 5 (Dec. 4, 2007).
[39] *Re Investigation into the Purchased Gas Adjustment (PGA) Mechanism Used by Oregon's three Local Distribution Companies*, Docket UM 1286, OPUC Order No. 08-504 (Oct. 10, 2008).
[40] UM 1654 CUB/100/Jenks-McGovern/22, lines 1-13.

optimization practices for its shareholders. Current Staff's assertions that NWN's optimization activities are rare, and completely voluntary, ring hollow in light of the similar and successful optimization exploits of NWN's fellow Oregon regulated utilities.

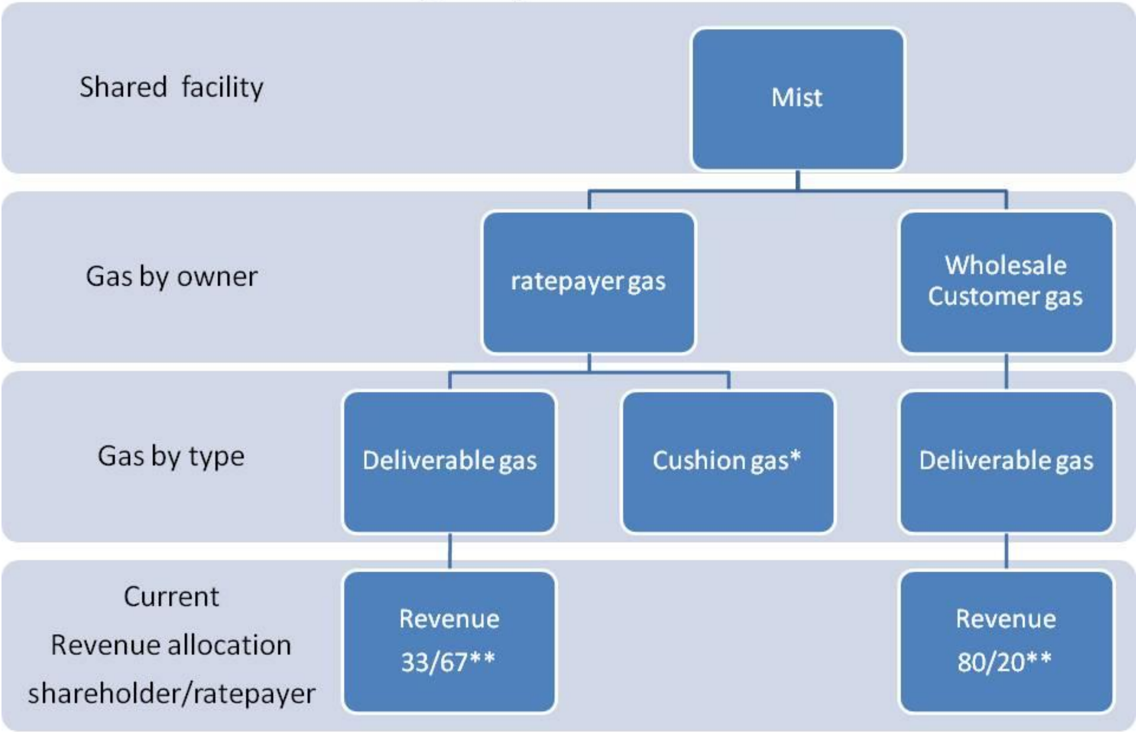
IV. CUB Raises The Concern Of Taking Uncompensated Risk On Ratepayers' Behalf

(a) *PGE's customers are taking on risk (unknowingly) without compensation*

Staff reproduced the NWN flow chart that provides the Company's explanation of revenue flow and sharing.[41] CUB believes this representation conflates certain simple facts. CUB, therefore, focuses solely on Mist Storage and Optimization, providing a simple chart that depicts, straightforwardly, the gas contained in Mist storage, its associated parties and the current sharing mechanism which allocates revenue from optimization of the gas stored in Mist. In addition to the deliverable gas available for optimization, we depict the cushion gas, unavailable for delivery. The cushion gas, although it earns no revenue from optimization, is financed by customers and necessary for deliverability. Optimization from both retail customer gas and Wholesale Customer gas depends on cushion gas.[42]

[41] UM 1654 Staff/200/Colville/9.
[42] *See* UG 221/Staff/1000/Zimmerman/5, fn 10.

Mist Storage optimization revenue



*100% of Cushion gas is included in ratebase **all sharing ratios are listed as: shareholder/customer

This chart models what is actually occurring at Mist. All gas that is contained in Mist can be attributed to two different groups (1) NWN ratepayers and (2) Wholesale Customers. Although, in theory, the sharing percentages may be based on whose gas is leveraged, in a mixed facility, which contains mixed gas, the fact is, nametags cannot be affixed to the leveraged gas. CUB considers both (all) possibilities: Possibility (1) NWN collateralizes ratepayer gas, or, Possibility (2) NWN leverages Wholesale Customer gas.

If the Company leverages ratepayer gas, then CUB believes, as demonstrated in our Response Testimony, and also in this Reply 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.

If, on the other hand, the Company leverages, Wholesale Customer gas, then

Commission policy must consider who the Wholesale Customers are, and what all the resulting implications are.

For example, a large portion of the gas stored in Mist is stored on behalf of PGE customers. Since PGE is regulated by the OPUC, what questions must be answered and mechanisms set in place to establish fair ratemaking for PGE customers? Are PGE customers taking on risk without their knowledge? Is it prudently acquired risk? Are PGE ratepayers being compensated for that risk? The AMA optimization contracts leverage the gas asset stored in Mist and therefore, leverage, at the very least, customer gas, under the purview of the OPUC. CUB has demonstrated why it is inappropriate for shareholders to retain the revenues from gas optimization when the gas belongs to NWN customers. That impropriety does not change if the gas is owned by PGE's rate-paying customers.

If PGE customer gas is being leveraged for AMA optimization, then under the OPUC prudence review, PGE's deposits in MIST must be analyzed, and PGE's customers must be made whole for any risks. Would the Commission allow PGE to store customer gas in a third party storage facility if the retrievability of that gas was insecure and exposed customers to uncompensated risk, if the third party was not regulated by the OPUC?

The fact that NWN shares only 20% of optimization revenues which it attributes to *non-customer* brings additional problems. Consider the continuing growth of NWN shareholder return as companies like PGE begin to grow and expand their use of natural gas. If PGE, for example, builds another power plant that utilizes natural gas, and consequently needs to store additional reserve gas at Mist, the percentage of gas attributed to NWN customers decreases. Of course, this also means that the revenues shared with NWN ratepayers also decreases. Oddly enough, however, it is not PGE's customers or shareholders who will benefit from optimizing PGE's stored gas; it is NWN's shareholders. NWN shareholders will continue to retain 80% of the revenues from AMA optimization from wholesale gas, while NWN's ratepayers will continue to subsidize MIST and PGE ratepayers continue to pay storage fees. It is CUB's recommendation that the Commission find that NWN must not be allowed to leverage PGE gas without prudence review and adequate ratepayer compensation.

B. Response to Deborah Garcia

I. CUB supports inclusion of earnings in ROO

The Commission, Staff, and other parties are not privy to the full amount of dollar activity that flows in and out of NWN's AMA optimization. However, it is certain that if these monies were treated in a manner consistent with that of the other utilities and other ratepayer owned assets, NWN's customer rates would change. In addition, one must consider the financial impact on amortization and remaining service value of a ratepayer owned asset that provides off-the books revenue. For example, if the rate of return is not intended to fully compensate the shareholders for the return on their investment in an asset and they are allowed additional returns on that asset, it would then be appropriate to adjust the rate of return to reflect that ratepayers are not the only source of compensation associated with investment in that asset. Consider Deborah Garcia's UM 1654 exhibit, which demonstrates how much revenue the Company is extracting from its customers.[43] If these revenues were not treated in some special manner off the books, then customers' rates would be reduced due to the PGA sharing of overearnings. The revenues from NWN's AMA Optimization are not exempt or special. They are, as CUB has demonstrated, normal in the course of modern utility

[43] UM 1654 Staff/302/Garcia/1.

operations, and belong in the NWN ROO. CUB will not support the position that status quo is necessarily the just or appropriate allocation, regardless of evolutions in technology, marketing, revenue sources, business models, regulation, and most importantly information.

3. CUB'S RECOMMENDATIONS AND CONCLUSIONS

CUB retains all of its original recommendations made in its Response Testimony concerning both storage and optimization.

- CUB believes that the best decisions are well informed decisions. A decade worth of information now exists for both storage and optimization. The Commission should require the commencement of a cost study, to be updated on a regular (annual) basis so that all parties are in the position to work together on prudency review, sharing arrangements, and the future course of investment for the Company.
- If a cost study is ordered, CUB is willing to leave sharing percentages for interstate/intrastate storage, managed by the company, at the current level.
- Concerning AMA optimization, CUB has larger concerns than merely the lack of information, and insists that the use of customer resources without adequate customer compensation is inappropriate, and sets a very dangerous precedent for ratepayers and their continually rising rates. Allowing the Company to effectively earn above its ROE by manipulating the treatment of particular customer assets distorts incentives and abuses the captive nature of ratepayers' relationship with the Utility. CUB respectfully requests that the Commission find that customers must be compensated for the use of their gas for optimization and that optimization activities are based on the use of

customer gas regardless of whether the gas is used as a physical asset or as a financial asset

- CUB further requests that the Commission find that the sharing percentage must reflect that the expectation that a utility maximize the benefits of customer assets with the benefits flowing to customers. CUB requests that the Commission find that the sharing percentage must be set at 90% (for the customer) and 10% for the shareholder (net third party share) similar to the sharing percentages used by Avista in Oregon.
- While CUB believes that, ideally, use of customer assets necessitates 100% of benefit, CUB recognizes that all parties may benefit if shareholders continue to be incentivized to perform their duty of optimally utilizing customer resources. The current allocation to shareholders of 80% is not necessary for incentive but the 10% proposed above might be.
- Finally, CUB commends Current Staff's strong stance on inclusion of AMA optimization in ROO. This will have the effect of transparency in ratemaking and will reduce the investigative burden in the future for all parties. These revenues have no justification for being treated separately from other revenues resulting from use of customer resources. They are not revenues generated from non-Utility assets. The Company has the obligation to include these revenues in ROO. CUB respectfully requests that the Commission find that AMA optimization revenues must be included in the Company's ROO.

In the current energy market, natural gas is becoming an increasingly important component for generation and security of power. Storage at Mist, and related activities, positions NWN to help secure low rates and adequate supply for its ratepayers. It is time, however, that Staff, Intervenors and the Commission paid closer attention to exactly how NWN is conducting both its storage and optimization efforts and whether customers are appropriately benefiting from NWN's successes with customer resources. CUB believes that the recommendations it is making today will help to make NWN's storage and optimization activities more transparent and less risky for both NWN's and PGE's customers.

UM 1654 – CERTIFICATE OF SERVICE

I hereby certify that, on this 14th day of January, 2014, I served the foregoing **REPLY TESTIMONY OF THE CITIZENS' UTILITY BOARD OF OREGON** 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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Respectfully submitted,

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