UM 1717
NWIGU 100
Finklea

BEFORE THE

PUBLIC UTILITY COMMISSION OF OREGON

TESTIMONY

OF

EDWARD FINKLEA

ON BEHALF OF

NORTHWEST INDUSTRIAL GAS USERS

May 11, 2015

Q. Please state your name, business address and occupation?

A. My name is Edward Finklea. My business address is 326 Fifth Street, Lake Oswego, Oregon 97034. I am the Executive Director of the Northwest Industrial Gas Users ("NWIGU").

Q. Please summarize your educational background and experience.

A. My resume is attached as Exhibit 101 to this testimony.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of the NWIGU. NWIGU member companies purchase sales and transportation service from Oregon local distribution companies, including Northwest Natural Gas Company ("NW Natural" or the "Company").

Q. What is the purpose of your testimony?

A. I will respond to the Company's Application for a Prudence Review of Costs related to drilling certain gas reserves in Wyoming's Jonah Field. As described below, this drilling took place as part of an amendment ("Amendment") to the Carry and Earning Agreement ("Agreement") between NW Natural and Encana Oil & Gas (USA) Inc., ("Encana") to develop and drill certain gas reserves in Wyoming's Jonah Field.

Q. Please summarize your testimony.

A. First, my testimony briefly discusses the original Agreement with Encana, the performance of the carry wells under the original Agreement, and the Amendment to that Agreement that is the subject of this proceeding. Next, my testimony discusses the additional risks associated with the post carry wells under the Amendment and I give my opinion on the reasonableness and prudence of NW Natural's decision to invest in the post carry wells. I then discuss my conclusion that NW Natural's actions were not reasonable or prudent under the circumstances based on the information known to NW Natural at the time of the decisions. Finally, I give my recommendation that NW Natural should absorb the costs of gas from the post carry wells compared to the cost of gas purchased through long term hedges. If the Commission adopts this approach, further proceedings are needed to discuss the proper price of a long term hedge, and the proper date to determine the 10 year hedge pricing.

Q. Was NWIGU a party to the original NW Natural Agreement with Encana?

A. Yes. As described above, NW Natural and Encana entered into the Agreement to develop and drill certain gas reserves in Wyoming's Jonah Field. These reserves were intended to be a customer asset and developed for the benefit of customers, and NWIGU was a signatory to the Agreement. Under the Agreement, NW Natural and Encana agreed to jointly fund the drilling of 102 "carry wells." In return, NW Natural would receive a share of the gas produced in specific sections of the field. Under the Agreement, after the 102 wells had been drilled, NW Natural could elect to participate in the drilling of additional wells called "post carry wells." For each post carry well NW Natural elected to participate in, NW Natural would receive a percentage of the gas produced from that specific well.

Q. Was the Agreement between NW Natural and Encana deemed prudent by the Commission?

A. Yes. On May 25, 2011, the Commission issued Order No. 11-176, adopting the Stipulation in UM 1520. In its Order, the Commission clarified that its prudence finding applied to only NW Natural's decision to enter into the Agreement. The Commission was clear that the prudence finding did not apply to any subsequent NW Natural decisions or actions under the Agreement. The Commission determined that the Agreement was prudent and in the ratepayers' interest because: "(1) the average expected cost of natural gas falls at the low end of a reasonable range of forecasts of future gas prices and indicative prices for other long-term supply arrangements;

(2) the cost of gas acquired through the transaction is expected to be stable and offers a hedge against sharp price increases in the future; (3) many of the risks associated with developing gas reserves have been mitigated; and (4) the remaining risks and rewards are fairly shared in the annual purchased gas adjustment (PGA) mechanism." Order 11-176, p. 1.

Q. Did the wells drilled under the Agreement perform as expected?

A. No. As explained by NW Natural witness Barbara Summers, NW Natural is receiving lower volumes than it anticipated receiving under the Agreement. *See* NWN/100/Summers/7.

Q. What happened after the original Agreement was signed?

A. After 72 of the 102 carry wells were drilled, NW Natural informed the parties that Encana signed an agreement to sell its interests in the Jonah Field to an affiliate of TPG Capital (TPG) for a purchase price of approximately $1.8 billion. This transaction took place on March 28, 2014. Also in March 2014, NW Natural and Encana executed the Amendment, terminating NW Natural's opportunity and obligation to participate in the drilling of the last 30 carry wells.

Q. What else did the Amendment provide for?

A. The Amendment to the Agreement increased the NW Natural ownership percentages in the sections of Jonah Field that had been drilled under the original Agreement, and also provided the opportunity to invest in certain undeveloped post carry wells. NW Natural or TPG could propose development of any post carry well and the other party could elect to participate in the development of the well(s).

Q. Did TPG offer NW Natural the opportunity to participate in the development of certain post carry wells as provided in the Amendment?

A. Yes. TPG offered NW Natural the opportunity to invest in post carry wells. NW Natural decided to invest seven (7) post carry wells.

Q. What was NW Natural's decision based on?

A. NW Natural based its analysis to invest in the post carry wells on a showing that the gas expected from the wells would be well-priced in comparison to other potentially available long term hedges. *See* NWN/100/Summers/3. NW Natural obtained quotes from two financial counterparties for 10 year swaps. *See* NWN/100/Summers/19.

Q. Was the investment in the seven (7) post carry wells riskier than the investment made under the original Agreement?

A. Yes. NW Natural's investment in the post carry wells was riskier than the investment made under the original Agreement. For post carry wells, NW Natural only received an interest in the output of the specific well drilled. This is different from the arrangement under the original Agreement, where NW Natural received an increased percentage of the gas in all producing wells in a section, including wells that had been drilled before the date of the original Agreement. *See NW Natural Application for Prudence Review of Costs of Post Carry Wells* at 4. This significantly reduced the risk of the carry well transactions under the original Agreement. In contrast, because NW Natural only received an interest in the output of the specific well drilled for post carry wells, there was an enhanced risk of hitting a dry or underperforming well. In addition, for post carry wells, the development costs associated with participation in a particular post carry well was not capped as it was under the original Agreement.

Q. Does NW Natural concede these were riskier transactions?

A. Yes. NW Natural admits there were two areas of increased risk presented by the post carry wells—volume risk and capital cost overruns. *See* NWN/100/Summers/13.

Q. How did NW Natural decide whether or not to invest in the post carry wells?

A. According to NW Natural's testimony, the Company employed the cost modeling from the original Encana deal, which includes three components: operating costs, depletion costs and carrying costs. NWN/100/Summers/16. Based on its cost modeling analysis, NW Natural decided to invest in the seven post carry wells based on its analysis showing that the gas expected from the wells would be well-priced in comparison to other potentially available long term hedges. See NWN/100/Summers/3.

Q. Did NW Natural account for the increased risk in its analysis of whether or not to invest in the post carry wells?

A. It does not appear that NW Natural properly adjusted its analysis from the original Agreement to account for the increased risk associated with the post carry wells. As stated above, NW Natural admits there were two areas of increased risk presented by the post carry wells—volume risk and capital cost overruns. NWN/100/Summers/13. Both of these factors should have been accounted for and justified a more thorough analysis of the decision to participate in the post carry wells. Further, at the time NW Natural was making its decision of whether or not to invest in the post carry wells, it knew that the volumes NW Natural was receiving under the original Agreement were lower than expected. *See* NWN/100/Summers/7. NW Natural admits that the only reason the volumes will materialize as expected under the original Agreement is because of the Amendment--which increased NW Natural's percentage ownership in the carry wells. The underperformance of the carry wells should have been a red flag and put the Company on notice that the expected volumes from the post carry wells may not materialize. At a minimum, because of the increased risk of the transactions, and the performance of the carry wells, NW Natural should have conducted a more thorough analysis of whether or not to invest in the individual post carry wells. Merely employing the cost modeling analysis that may have been appropriate for the original Agreement was not reasonable or prudent under the circumstances.

Q. What is NW Natural asking for in this docket?

A. NW Natural is seeking an Order from the Commission that: (1) NW Natural's decision to invest in the seven post carry wells was prudent; and (2) and that the costs of gas produced by the post carry wells may be included in the PGA in the same manner as the gas produced by the carry wells, as approved in UM 1520. This rate treatment would include the "cost of service" associated with the production of gas from the Jonah Field, which includes depletion costs, carrying costs, operating costs, severance and ad valorem taxes and midstream costs.

Q. Do you agree with NW Natural?

A. No. Given the actions taken by NW Natural associated with the post carry wells, including the failure to account for the increased risk of the transaction, ratepayers should not absorb the entire costs of the failed investment as proposed by NW Natural. It is my recommendation that the Commission require NW Natural to absorb the costs of gas produced from the post carry wells compared to the cost of gas purchased through long term hedge. NWIGU recommends further proceedings to determine the proper price of a long term hedge, and the proper date to determine the 10 year hedge pricing.

Q. Does this conclude your testimony?

A. Yes, it does.

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Edward A. Finklea

Primary Professional Experience

Lead counsel for the Northwest Industrial Gas Users ("NWIGU") from 1986 until 2008 in all regulatory interventions concerning Williams Gas Pipeline West and TransCanada Gas Transmission Northwest, and before state regulatory commissions concerning regulation of the five regional natural gas local distribution companies ("LDCs").

Represented NWIGU before the Federal Energy Regulatory Commission in interstate pipeline rate and certificate proceedings, before the Oregon Public Utility Commission in natural gas rate and other regulatory proceedings, before the Washington Utilities and Transportation Commission in natural gas rate, safety and other regulatory proceedings and in proceedings before the Idaho Public Utility Commission..

Employment History

Executive Director for the Northwest Industrial Gas Users, August 2012 to present

Adjunct Professor at Northwestern School of Law, Lewis and Clark College "Law and Economics" Current

Senior Counsel, NiSource Corporate Services Inc. Regulatory counsel to interstate pipeline, representing company before Federal Energy Regulatory Commission and advising company on federal regulatory compliance and business transactions. November, 2009 to November, 2011

Executive Director, Energy Action Northwest. Organization advocated for siting and permitting of interstate pipelines, liquefied natural gas terminals, and high voltage transmission projects in Oregon and Washington.

Represented organization before state legislature and in media relations. July, 2008 to October, 2009

Partner, Cable Huston Benedict Haagensen & Lloyd. Private law practice specializing in energy law. 2004 until July 2008.

Managing Partner, Energy Advocates LLP. Founded firm with offices in Portland, Oregon and Washington D.C. 1997-2003

Partner, Ball Janik LLP. 1994-1997

Partner, Heller Ehrman White & McAuliffe. 1990-1994

Partner, Tonkin Torp Galen Marmaduke & Booth. 1986-1990

Associate, Garvey Schubert. 1986-1988

Assistant General Counsel to Northwest Natural Gas handling state regulatory matters and providing counsel to the company on energy projects, including a landfill gas project. 1984-1986

Counsel to the Bonneville Power Administration litigating electric rate issues in administrative hearings and defending BPA before the Ninth Circuit Court of Appeals. 1982-84

Trial Attorney for the Federal Energy Regulatory Commission in hydroelectric licensing and co-generation regulation. 1981-82

Law Clerk for the Council on Wage and Price Stability, Executive Office of the President of the United States. 1980-81

Summary of Professional Engagements

Represented Columbia Gulf Transmission in general rate proceeding before the Federal Energy Regulatory Commission.

Represented applicants in proceeding before Federal Energy Regulatory Commission seeking authorization to provide incentive fuel mechanism and natural gas hub services.

Represented industrial gas consumers in contract negotiations for the purchase of natural gas commodity and interstate pipeline services.

Counsel to a medical center interconnecting a cogeneration plant with an investor-owned utility and advising client on long-term gas purchasing arrangement for electric generation.

Represented numerous clients to secure direct connections to interstate pipelines, addressing all regulatory issues involving certification of connecting facilities and operations of private pipelines.

Represented liquefied natural gas developer in governmental relations associated with securing federal and local permits for development of an energy project.

Represented customers in negotiating special contracts for purchasing natural gas distribution services from local utilities.

Represented public port authority in a pipeline siting issue.

Represented Eugene Water and Electric Board in select issues concerning Bonneville Power Administration.

Represented irrigation farmers in electric rate dispute involving FERC-licensed hydroelectric project before the Oregon Public Utility Commission.

Represented clients in trial court and appellate litigation on energy–related issues.

Represented industrial customer in anti-trust litigation and FERC refund proceedings stemming for 2000-2001 Western Energy Crisis.

Represented industrial electric customers in the restructuring of electric utilities in Oregon.

Represented an oil company shipper on an intrastate oil pipeline in rate proceeding before the Washington Utilities and Transportation Commission.

Individual clients while in private practice in addition to NWIGU included Alcoa, Armstrong World Industries, Blue Heron Paper, Boeing, ESCO, James River Paper (now Georgia Pacific) JR Simplot, Legacy Health Systems, MicroChip Technology, NorthernStar Natural Gas, Texaco Gas Marketing, Valley Medical Center, WaferTech, Wah Chang, West Linn Paper, and Weyerhaeuser.

Education

BA in Political Science from the University of Minnesota 1974

J.D. Northwestern School of Law, Lewis and Clark College 1980

Professional Memberships

Admitted to practice law in the States of Oregon and Texas and before several Federal district and appellate courts.

Adjunct Professor at Northwestern School of Law, Lewis and Clark College "Northwest Energy Law". 1984 to 2005

Past Chairman of "Energy, Telecom and Utilities" section of the Oregon State Bar.

Member of the Federal Energy Bar Association.

Lecturer: Buying and Selling Electric Power in the West, Law Seminars International Conference. Presentations on natural gas industry. 2004 to 2009.