ORDER NO. 08-107

ENTERED 01/28/08

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UI 276

In the Matter of	)	
	)	
NORTHWEST NATURAL GAS COMPANY,	)	ORDER
dba NW NATURAL	)	
	)	
Application for Affiliated Interest Agreement	)	
with Palomar Gas Transmission, LLC.	)	

DISPOSITION: APPLICATION APPROVED WITH CONDITIONS

On November 1, 2007, Northwest Natural Gas Company, dba Northwest Natural (NW Natural) filed an application with the Public Utility Commission of Oregon (Commission) pursuant to ORS 757.495, OAR 860-027-0040 and OAR 860-027-0041, requesting approval of two interstate pipeline Precedent Agreements with Palomar Gas Transmission, LLC (PGT). PGT is a wholly-owned subsidiary of Palomar Gas Holdings, LLC, of which NW Natural is a 50 percent owner. A full description of the filing is contained in the Staff Report, attached as Appendix A and incorporated by reference.

Based on a review of the application and the Commission's records, the Commission finds that the application satisfies applicable statutes and administrative rules. At its Public Meeting on January 22, 2008, the Commission adopted Staff's recommendation.

OPINION

Jurisdiction

ORS 757.005 defines a "public utility," and NW Natural is a public utility subject to the Commission's jurisdiction.

Affiliation

An affiliated interest relationship exists, as defined under ORS 757.015.

Applicable Law

ORS 757.495 requires public utilities to seek approval of contracts with affiliated interests within 90 days after execution of the contract. Since NW Natural entered into the contract with PGT on August 3, 2007, its application date of November 1, 2007 satisfies the statutory timing requirement.

ORS 757.495(3) requires the Commission to approve the contract if the Commission finds that the contract is fair and reasonable and not contrary to the public interest. However, the Commission need not determine the reasonableness of all the financial aspects of the contract for ratemaking purposes. The Commission may reserve that issue for a subsequent proceeding.

CONCLUSIONS

1. NW Natural is a public utility subject to the jurisdiction of the Commission.

2. An affiliated interest relationship exists.

3. The agreement is fair, reasonable, and not contrary to the public interest.

4. The application should be granted, as modified herein, including certain conditions.

ORDER

IT IS ORDERED that the application of Northwest Natural Gas Company, dba Northwest Natural to enter into two interstate pipeline Precedent Agreements with Palomar Gas Transmission, LLC, is approved, subject to the conditions stated in Appendix A.

Made, entered, and effective JAN 2 8 2008.

BY THE COMMISSION:

PUBLIC UTILITY COMMISSION OF OREGON

Becky L Beier

Becky L. Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements in OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480-183.484.

ITEM NO. CA10

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: January 22, 2008

REGULAR ____ **CONSENT** X **EFFECTIVE DATE** N/A

DATE: January 2, 2008

TO: Public Utility Commission

FROM: Dustin Ball DB

THROUGH: Lee Sparling, Marc Hellman, and Michael Dougherty

SUBJECT: NORTHWEST NATURAL GAS COMPANY: (Docket No. UI 276) Application for affiliated interest agreement with Palomar Gas Transmission, LLC.

STAFF RECOMMENDATION:

The Commission should approve NW Natural's (NW Natural or Company) application for two interstate pipeline Precedent Agreements with Palomar Gas Transmission, LLC (PGT), an affiliated interest, subject to the following conditions:

1. NW Natural shall provide the Commission access to all books of account, as well as all documents, data, and records that pertain to any transactions with Palomar Gas Transmission, LLC.

2. The Commission reserves the right to review, for reasonableness, all financial aspects of these transactions in any rate proceeding or alternative form of regulation.

3. NW Natural shall notify the Commission in advance of any substantive changes to the contracts, including any material change in price. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

DISCUSSION:

NW Natural filed this application on November 1, 2007, pursuant to ORS 757.495, OAR 860-027-0040, and OAR 860-027-0041. PGT is a wholly owned subsidiary of

Palomar Gas Holdings LLC, of which NW Natural is a fifty percent (50 percent) member. Therefore NW Natural and PGT are affiliated interest pursuant to ORS 757.015.

NW Natural requests approval from the Commission of two interstate pipeline Precedent Agreements with PGT for the proposed construction and operation of a new pipeline that will be known as the Palomar Pipeline. This is expected to be a two hundred twenty (220) mile natural gas pipeline extending from Madras, Oregon to Molalla, Oregon (the "Eastern Zone"); from Molalla, Oregon to the Nehalem Interconnection in the vicinity of the Nehalem River proximate to the town of Mist, Oregon; and from the Nehalem Interconnection northward to an interconnection with the Bradwood Landing Pipeline or other mutually agreed upon delivery points (the "Western Zone"). Separate interstate Pipeline Precedent Agreements exist between NW Natural and PGT for the Eastern and Western Zones.

Currently, NW Natural relies on a single pipeline, the Northwest Pipeline GP ("NWP"), for the final transportation of gas that serves its core customers in Oregon and Washington. According to the Company, this dependence on a single pipeline is a significant risk, and has been identified by Standards & Poor's Rating Service as a weakness among major credit rating factors. NW Natural contends that adding a new direct connection with an alternate interstate pipeline makes sense from a reliability and risk management perspective.

In 1995, 1996, 1997, and 1999, NWP experienced pipeline ruptures and compressor station outages in addition to the imposition of operational flow orders on NW Natural and other shippers that restricted or threatened to restrict their use of NWP. Additionally in 2003, NWP experienced pipeline failures that resulted in a Corrective Action order being issued from the U.S. Department of Transportation and NWP's abandonment of two hundred sixty eight (268) miles of 26 inch pipeline between Sumas and Washougal, Washington.

The Company asserts that the Eastern Zone of the Palomar Project will assist NW Natural's ability to maintain high-reliable service to customers while gaining access to gas in different geographic supply regions of Canada or the U. S. Rocky Mountain region to help mitigate price volatility. As for the Western Zone, its importance lies in moving gas supplies received from the Eastern Zone to other parts of its system (besides Molalla) where such gas supplies are needed. The Western Zone would also allow NW Natural to receive LNG supplies in the event that an LNG project is built along the Columbia River.

Currently, the SMPE (South Mist Pipeline Extension) extends in the same general path as the proposed Western Zone (from Molalla to Mist). NW Natural has identified three potential benefits that their core customers would receive from the use of the proposed Western Zone as opposed to the use of the SMPE. These benefits are as follows:

- First, the Western Zone is expected to provide an additional access to market for Mist Interstate Storage for both generators and gas LDC's in eastern Oregon and Washington from the Gas Transmission Northwest Corporation (GTN) mainline. While NW Natural cannot directly bundle PGT interstate capacity with its Mist Interstate Storage service, it may release any of its PGT capacity to interested customers according to PGT's Capacity release procedures. Core customers share in twenty percent (20 percent) of the pre-tax income from this interstate storage business activity (without incurring any risks or incremental costs).

- Second, if an LNG import terminal is permitted and constructed along the Columbia River, then NW Natural will need expanded pipeline capacity from such facility in order to bring these supplies into the Portland metro service area. In the case of the Bradwood Landing LNG project, a combination of the Bradwood Landing Pipeline coupled with the North and South Mist pipelines may be sufficient for a while; however, NW Natural expects Mist storage requirements to grow over time to eventually fill or restrict available SMPE capacity.

- Third, NW Natural believes that, if built, the PGT Western Zone will give NW Natural the ability to economically serve local communities where natural gas is not currently available. For example, NW Natural has attempted to determine how to deliver gas to Dayton for a number of years, but has not been able to economically justify the cost of a dedicated LDC transmission line extension. Depending on the final route for the PGT Western Zone, it may pass close enough to Dayton and other smaller communities to support a LDC connection.

On August 3, 2007, NW Natural and PGT entered Precedent Agreements for Firm Natural Gas Transportation on the Eastern and Western Zones of the Palomar Pipeline. The agreements set forth terms upon which PGT will construct, operate and provide NW Natural with firm natural gas transportation service on the Palomar Pipeline. In addition, the agreements document the rates at which NW Natural will be charged for such service. Many of the terms and conditions contained in the Precedent Agreements constitute trade secrets and were filed as confidential with the Commission.

Due to the affiliated relationship with PGT, NW Natural implemented internal guidelines to impose certain "firewalls"[1] within their organization during negotiations of the Precedent Agreements.

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[1] The ethical (not physical) barrier between different divisions of an institution to avoid conflict of interest.

At this time, no attempts have been made to negotiate any rights-of-way or easements with land owners, and none are likely until at least the Draft Environmental Impact Study has been issued (which is projected for late 2008). The proposed Palomar route will not be firmed up by PGT until it makes its FERC filing, which is not scheduled until the third quarter of 2008. Additionally, PGT does not expect to start working on project financing until late 2008, when PGT is closer to receiving a final FERC Certificate and has a better understanding on the final cost.

It is likely that if an LNG facility is not constructed along the Columbia River, the Western Zone of the Palomar Project may not be built. However, if the Western Zone is built without an LNG facility, Palomar will still be able to serve the Portland metropolitan area via the planed interconnection at Molalla and via probable future interconnections with NW Natural's distribution system between Molalla and the terminus of the Western Zone.

Issues
Staff investigated the following issues:

1. Terms and Conditions of the Agreements
2. Transfer Pricing
3. Public Interest Compliance
4. Records Availability, Audit Provisions, and Reporting Requirements

Terms and Conditions of the Precedent Agreements
Staff did not observe any unusual terms and conditions of the Agreements. Under the terms of the Precedent Agreements the parties intend to execute Firm Transportation Service Agreement's (FSTA) for the Eastern and Western Zones that will deliver a predetermined number of dekatherms per day for a predetermined number of years. The agreements also outline a specific date by which service is requested to commence.

NW Natural will pay pre-negotiated rates, as outlined in the Precedent Agreements, for firm transportation services on the Eastern and Western Zones. This rate will be based on the tariff rate approved by FERC and be subject to a cap and floor. For the Eastern Zone, not withstanding the rate cap and floor, an Alternate Rate (as described in the Agreement), may be charged.

As of the date of the filing, NW Natural was unable to provide an estimate of the amount that NW Natural would pay annually for service under the FTSA's. However NW Natural did provide a spreadsheet that demonstrated an estimated calculation of the rate cap as agreed under the terms of the Eastern Zone Precedent Agreement. Based on this spreadsheet, NW Natural estimates a potential maximum increase in transportation costs of approximately $800,000. Because this is based on the rate cap, actual service cost on the Palomar Pipeline could result in less of an increase or potentially a decrease to transportation costs.

These Precedent Agreements also contain contingencies under which NW Natural may terminate the Agreement. However, depending on the circumstances, NW Natural may be required to pay certain termination penalties equal to the Company's proportioned share of the project costs. Because the Western Zone does not have the same strategic importance as the Eastern Zone, the terms of the termination penalties for the Western Zone are more favorable to NW Natural. Additionally, NW Natural may, under certain conditions, be required to provide collateral to PGT if the Company's credit ratings fall below specified levels.

Transfer Pricing

As previously mentioned, the FTSA charged to NW Natural will be based on the tariff rate approved by FERC and will be subject to a cap and floor. Pursuant to OAR 860-027-0048 (4)(e), Allocation of Costs by an Energy Utility:

> "When services or supplies (except for generation) are sold to an energy utility by an affiliate, sales shall be recorded in the energy utility's accounts at the approved rate if an applicable rate is on file with the Commission or with FERC."

Because the FTSA rates will be based on the tariff rates subject to approval by FERC, the Agreement's pricing meets the Commission transfer pricing standard.

However, to ensure costs borne by customers are fair and reasonable, Staff will monitor the tariff rate as determined by FERC. If FERC allows for a significantly higher rate-of-return on the pipeline assets than what the Commission has authorized for NW Natural, Staff may recommend a cost adjustment associated with the FERC-authorized rate-of-return, as compared to the OPUC authorized, in subsequent rate proceedings, to the extent consistent with federal law.

Public Interest Compliance

Natural gas transportation service is a federally regulated product offered pursuant to terms and conditions approved by FERC.

Customers will benefit from the decreased dependence on NWP, the increased reliability that the Palomar Project offers, and NW Natural's ability to gain access to gas in different geographical supply regions of Canada or the U.S. Rocky Mountain region.

In addition, if the Western Zone is built, NW Natural may release some of its PGT capacity to interested customers, and as a result core customers will share in twenty percent (20 percent) of the pre-tax income from this Interstate storage business activity (without incurring any risks or incremental costs).

Records Availability, Audit Provisions, and Reporting Requirements
Order Condition Number 1, listed above in the Staff recommendations; affords the necessary Commission examination of NW Natural's records concerning this application.

Based on the review of this application, Staff concludes the following:

1. The application involves an affiliated interest transaction that is fair and reasonable and not contrary to the public interest, with the inclusion of the proposed ordering conditions.
2. Necessary records are available.

PROPOSED COMMISSION MOTION:

NW Natural's application for approval of the two interstate pipeline Precedent Agreements with Palomar Gas Transmission, LLC be approved subject to the three recommended conditions.