

ORDER NO. 15 066

ENTERED: MAR 05 2015

**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.

ORDER

DISPOSITION: COST STUDY ORDERED

I. INTRODUCTION

We opened this docket to consider whether the current sharing arrangement for NW Natural Gas Company, dba NW Natural's interstate storage and optimization activities should be revised. We maintain the current sharing arrangement, but order the company to conduct a cost study to determine with greater clarity how costs are generated and shared.

II. PROCEDURAL HISTORY

In docket UG 221, NW Natural's most recent general rate case, certain parties raised concerns about the sharing arrangements applied to NW Natural's Mist storage service and resource optimization activities under the company's Schedules 185 and 186. The parties reached a settlement in the rate case that extended the current sharing arrangement while requesting that a new docket be opened to evaluate Mist storage and optimization sharing.

We opened this docket in May of 2013. NW Natural, the Citizens' Utility Board of Oregon (CUB), the Northwest Industrial Gas Users (NWIGU), and the Commission Staff participated as parties to this proceeding.

III. DISCUSSION

A. Background

The parties' dispute concerns NW Natural's use of its Mist storage, which utilizes depleted gas reservoirs located near Mist, Oregon. The original utility storage and related

pipeline development went into service in 1989, with subsequent expansions for utility customers in 1991, 1997, and 1999.¹ These early expansions were intended to serve core customers, and the capital costs were therefore included in utility rate base. In the late 1990s, NW Natural decided to develop additional incremental capacity and develop additional storage to serve the broader Pacific Northwest regional market. The company invested shareholder dollars to add capacity at Mist in 2001, with subsequent shareholder investments for additional expansions in 2004, 2005 and 2007. To date, these non-rate base investments have totaled over \$65 million.

NW Natural decided to “optimize” its storage capacity through wholesale trading and a separate business segment created to conduct storage services and optimization activities. Optimization activities initially included sale and trading of excess gas, existing Mist storage, and excess capacity on upstream pipeline contracts on the Northwest Pipeline (NWP) and other upstream pipeline systems. The company later added new wholesale trading activities such as the exchange of gas commodity contract purchases at different trading locations (portfolio optimization), the use of off-system, underground storage contracts at Jackson Prairie and in Alberta, and the extraction of natural gas liquids (NGLs, or liquids).

NW Natural contracts with a third party wholesale natural gas trading company, Tenaska, for optimization activities. NW Natural develops strategies with the optimization partner to maximize value while maintaining reliability standards for core utility and storage service customers. The cost of NW Natural’s involvement in optimization is allocated to the separate non-utility Gas Storage business segment in which the costs and revenues of Storage Services and Optimization Services are recorded.

B. Sharing Percentages

We require NW Natural to share revenues derived from these activities based on the use of shareholder-funded assets and customer-funded assets. For the expanded interstate and intrastate storage service at Mist, which is provided using primarily shareholder-funded assets, we require NW Natural to share 20 percent of net margins with customers. For optimization activities that primarily use resources that are included in customer rates, we require NW Natural to share with customers 67 percent of net margins.

These sharing arrangements are reflected in Schedules 185 and 186. Schedule 185, titled “Special Annual Interstate and Intrastate Storage and Transportation Credit,”² applies to core customers receiving firm sales service, whose rates include costs related to the Mist storage facility. Schedule 185 credits these core customers for the Oregon share of net margins received by the company for (1) interstate storage and related transportation services provided under FERC jurisdiction, (2) intrastate storage activities and related transportation services under Schedule 80, and (3) optimization of total Mist storage capacity. Eligible customers receive a 20 percent share of the net margin received from

¹ See Order No. 89-1372 (Oct 18, 1989) (Docket Nos. UG 81, UG 84).

² Schedule 185 was approved during a public meeting in April 2000 (Advice No. 00-4).

non-utility interstate and intrastate storage services, and the net margin attributable to optimization of non-utility Mist capacity not included in rates.

Under Schedule 186, titled “Special Annual Core Pipeline Capacity Optimization Credit,” eligible customers are credited with the Oregon share of net margins received by NW Natural for the optimization of core customer pipeline, gas processing, commodity supply, and non-Mist storage capacity.³ Schedule 186 provides that NW Natural will share with eligible customers the net margin attributable to third-party optimization for the entire portfolio of upstream capacity contracts. The company shares revenues with its firms and interruptible sales customers on a two-thirds basis, with 67 percent credited to customers.

This sharing methodology has been used since 2002, although the specific percentages applied have been updated in those years where the relative proportions of deliverability capacity between core customers and interstate storage have changed due to Mist capacity recall.

C. Parties’ Positions

NW Natural urges the Commission to retain the status quo, arguing that its customers are properly compensated for use of their resources in optimization activities. Staff, CUB, and NWIGU recommend retaining the status quo for now with regard to sharing arrangements, but each party proposes modifications moving forward, including a proposed cost study, inclusion of optimization profits in the company’s profit reports to the Commission, and other changes

1. NW Natural

NW Natural argues we should retain the current Mist storage and optimization arrangements, because they properly account for the discretionary shareholder investments to expand Mist. NW Natural states that before deciding to expand Mist, the company worked with stakeholders to gain approval of a sharing arrangement that would fairly account for the costs and benefits of the activities for utility customers and shareholders.

NW Natural adds that Oregon customers have benefitted significantly under this arrangement. First, NW Natural contends that customers have received over \$72 million in credits under Schedules 185 and 186 over the last 11 years. Second, NW Natural argues its core customers have realized over \$70 million in bill credits from the company’s ability to recall capacity for their use, as needed in the future.

NW Natural opposes arguments that it should report revenue derived from its optimization activities in its annual Results of Operations (ROO) and subject the earnings to the company’s Spring Earnings Review. NW Natural states the annual ROO is intended to report earnings from utility services, and optimization activities are above and

³ Schedule 186 was approved during a public meeting in May 2003 (*See* Advice No. 03-6).

beyond the normal expectations for a Local Distribution Company (LDC). In addition, NW Natural emphasizes that, including optimization revenues in the earnings review, will significantly mute the incentives provided by the sharing percentages. NW Natural explains that, because the company may be required to forfeit a portion of the revenues that exceed the earnings review threshold, customers would receive a double-sharing of these revenues, both through the sharing percentage and through the earnings review threshold.

Finally, NW Natural argues a traditional cost study is unnecessary, but states that it will work with the parties to develop an appropriate study if the Commission requests it.

2. *Staff*

Staff recommends no change to the sharing percentages for interstate storage and optimization revenue in Schedules 185 and 186. Staff notes that NW Natural's optimization activities go beyond the requirements of a typical regulated local distribution company, and that NW Natural is earning income that benefits both customers and shareholders.

Staff argues NW Natural should be required to report income derived from Schedules 185 and 186 in its ROO report because the income is derived or made possible by the use of customer-funded assets. Staff agrees with NW Natural that inclusion of this income may result in a *de facto* reduction in current sharing percentages, depending on earnings in a particular year, but states that the combination of the sharing percentages and reporting the income in NW Natural's ROO report still provides an incentive for the continuation of optimization activities.

Staff does recommend that NW Natural revise the wording of Schedules 185 and 186 to more clearly state what optimization revenues each schedule captures, and that the company hold a workshop before the next purchased gas adjustment (PGA) filing, to show Staff and parties that customers are protected from potential harm that could occur if the company were to sell physical gas to cover a financial transaction resulting from its optimization activities.

3. *CUB*

CUB argues that NW Natural failed to provide any evidence to support its sharing arrangements, and contends that customers should receive a greater percentage of these revenues. CUB argues that NW Natural must maximize the value of regulated assets, and, when it generates revenue from those assets, it must reward the customers for the use of those resources. CUB argues that NW Natural fundamentally misrepresents the nature of its optimization activities, and maintains that the company cannot conduct those activities without physical gas, owned by its regulated utility retail ratepayers, to backstop the optimization trades. If the company leverages ratepayer gas, then the company is obligated to optimally utilize that ratepayer gas, and consequently must pass through the bulk of the resulting revenues to customers. CUB recommends that the

67/33 and 80/20 optimization sharing percentages be changed to one sharing percentage that provides customers with 90 percent of all revenues.

CUB argues all optimization profits must be reported in NW Natural's ROO, because if a utility is able to earn revenue from a rate based asset but not report that revenue as utility income, the utility has an opportunity to earn above its authorized rate of return. CUB states that effective utility regulation requires transparency, and NW Natural should not be permitted to hide earnings that it received from its retail ratepayer-owned assets by treating those earnings as non-utility earnings.

CUB requests that NW Natural be required to model interstate/intrastate storage in its cost-of-service model to identify the share of system costs that could be allocated to storage, because NWN has failed to provide modeling evidence to back up its sharing percentages. CUB argues a cost study is needed for inter/intrastate storage because the price, supply, and use of natural gas has drastically changed over the years, and the entire sharing arrangement for inter/intrastate storage was modeled on an ad hoc basis when first created. If a cost study is ordered, CUB is willing to leave sharing percentages at their current level until the cost study is complete.

4. NWIGU

NWIGU recommends that we temporarily continue the current sharing mechanism, until a more detailed cost analysis can be performed. NWIGU argues that there is no support in the record for the current sharing mechanism, which was created before the full value of NW Natural's services could be known, and that it would be imprudent to allow the indefinite continuation of the sharing mechanism without a more formal analysis.

NWIGU argues that all of NW Natural's optimization activities rely on the use of a ratepayer-owned asset—the physical gas—and that revenue from those activities should be shared with ratepayers at a higher rate. Finally, because NWIGU takes the position that optimization activities rely on ratepayer assets, it argues that all of the company's revenues from Mist optimization activities should be deemed utility revenue for purposes of the company's ROO.

D. Resolution

We determine that a neutral third party should conduct an evaluation and cost allocation study of NW Natural's optimization activities. The study will more robustly examine the risks, costs, and benefits of NW Natural's optimization activities, the assets being utilized for those activities, the allocation between regulated and unregulated services, and the various components of NW Natural's system that drive the costs and revenues associated with interstate storage services. We agree with NWIGU that the sharing mechanisms should be fact-based and reflect the true value of customers' and shareholders' contributions.

We direct the parties to this docket to form a steering committee that will develop the third-party contract, develop and articulate the elements of the study, interview and hire the third party who will conduct the study, and oversee the contractor's work. NW Natural will receive cost recovery for the cost of the study.

While the study is being conducted and reviewed, we will retain the company's current sharing percentage, and do not require that revenues be reported in the company's ROO. We will decide these issues after the cost allocation study is complete.

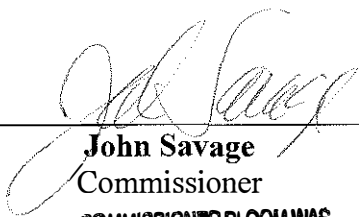
IV. ORDER

IT IS ORDERED that Northwest Natural Gas Company, dba NW Natural, will form a steering committee comprised of representatives from Commission Staff and all other parties to this docket to identify, retain, and supervise a neutral third party to conduct an evaluation and cost allocation study, as described in this order.

Made, entered, and effective MAR 05 2015.



Susan K. Ackerman
Chair



John Savage
Commissioner
COMMISSIONER BLOOM WAS
UNAVAILABLE FOR SIGNATURE



Stephen M. Bloom
Commissioner

A party may request rehearing or reconsideration of this order under 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 860-001-0720. A copy of the request must also be served on each party to the proceedings as provided in OAR 860-001-0180(2). A party may appeal this order by filing a petition for review with the Court of Appeals in compliance with ORS 183.480 through 183.484.