CASE: UM 1520 / UG-204
WITNESSES: Moshrek Sobhy, Ken Zimmerman, and Carla Bird

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 400

Supplemental Testimony
Supporting Joint Parties' Stipulation

April 19, 2011

Q. PLEASE STATE YOUR NAMES.

A. Our names are Moshrek Sobhy, Kenneth R. Zimmerman, and Carla Bird.

Q. ARE YOU THE SAME COMMISSION STAFF WITNESSES THAT PREVIOUSLY TESTIFIED IN THIS DOCKET?

A. Yes. Our Witness Qualification Statements are found in Exhibit Staff/101 and Staff/ 202.

Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

A. The purpose of our supplemental testimony is to explain why Staff is willing to enter into a stipulation that does not contain: (1) Staff's proposed 5-year benchmark mechanism, and (2) Staff's proposal to exclude the Proposed Transaction from utility rate base.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. Our testimony addresses each of these issues in a separate section.

Section 1: 5-year Benchmark Mechanism

Section 2: Exclusion from Utility Rate Base

SECTION 1: 5-YEAR BENCHMARK MECHANISM

Q. WHY HAS STAFF ENTERED INTO A STIPULATION WHICH DOES NOT ACCEPT STAFF'S RECOMMENDED 5-YEAR BENCHMARK MECHANISM?

A. Staff entered into the stipulation even though it does not contain the 5-year benchmark mechanism because Northwest Natural Gas Company (NW Natural or Company) agreed to fully share through the annual PGA mechanism and gas cost deferrals: (1) the normal variances in annual gas cost from the Proposed Transaction (relating both to price and volumes), and (2) the benefits and cost arising from NW Natural's option to have Encana sell the Company's share of gas production at Opal and replace that gas with purchases at Opal or other locations.

Q. DID NW NATURAL ORIGINALLY PROPOSE TO EXCLUDE ELEMENTS OF THE PROPOSED TRANSACTION FROM THE ANNUAL PGA MECHANISM?

A. Yes.

Q. WHAT REASONS DID NW NATURAL GIVE FOR ITS PROPOSAL?

A. Under the Company's original proposal, the Proposed Transaction is defined as a "fixed-price hedge" with 100% of the true-up savings allocated to the Company while 100% of the true-up costs were allocated to the ratepayers, which is normal for fixed-price hedges included in rates by the Commission. The Company based this position on its characterization of the Proposed Transaction as a "long-term fixed-price arrangement." Mr. Miller stated:

"First, the Proposed Transaction is considered a proxy for a long-term fixed price arrangement for which there would be no variance and therefore no sharing. While in the case of the Proposed Transaction there is an expected level of price variability over time, that variably is expected to be relatively minor and therefore it is appropriate that the variances between the forecasted and actual costs and volumes be excluded from sharing. Second, perhaps more importantly, the sharing mechanism in the PGA is intended to provide the Company with an incentive to obtain the most reasonably priced gas supplies. In the case of the Proposed Transaction, the only costs that might vary materially, such as operational costs, tax rates, etc., will be almost entirely outside of NW Natural's control. Finally, given that the Commission will approve the Proposed Transaction only if it determines that it will provide substantial benefits to customers, it is reasonable that the customers bear the risk of this cost variation." *See* Miller/7, NWN/100.

Q. HAS NW NATURAL AGREED IN THE STIPULATION TO TREAT THE PROPOSED TRANSACTION JUST LIKE ANY OTHER GAS PURCHASE CONTRACT?

A. Yes. The Company has agreed that the Proposed Transaction is not a fixed-price hedge and that its gas will be subject to the normal review under the Commission's PGA and Portfolio guidelines and other applicable rules[1] for purposes of calculating the Weighted Average Cost of Gas (WACOG) and gas cost deferrals. Since the Company has agreed in the Stipulation that the

[1] *See* Oregon Administrative Rule 860-022-0070.

Proposed Transaction is not a fixed-price hedge and to treat the transaction no differently than other gas supply contracts for purposes of variance sharing, true-up, and updates of estimated volumes and costs, there is no longer any need for the rolling 5-year benchmark mechanism.

Q. WHY IS IT IMPORTANT TO STAFF TO INCLUDE THE PROPOSED TRANSACTION IN THE ANNUAL PGA MECHANISM?

A. The Proposed Transaction is different from NW Natural's other gas supply contracts in one particular way that makes it is important to include the Proposed Transaction in the PGA mechanism. The Company's independent reserve evaluator, Netherland Sewell and Associates Inc. (NSAI), used a conservative recovery factor of 85% in its analysis. This means that there is more than a 90% probability that 85% of the gas in place will be recovered.[2] Furthermore, NSAI confirmed that the Proposed Transaction's reserves are defined as Proved Reserves. This means that there is 90% chance that the actual volumes will equal or exceed the estimates. *See* Cronise/15, NWN/200. When volumes from the Proposed Transaction exceed estimates during a month this reduces the cost per therm. When the gas from the Proposed Transaction is excluded from the PGA, it is excluded from variance sharing. This means the customers would not receive their share of this reduced cost per therm, compared to the original estimate included in the PGA WACOG.

Q. HAS NW NATURAL AGREED IN THE STIPULATION TO INCLUDE THE BENEFITS AND COSTS OF HAVING ENCANA SELL THE COMPANY'S

[2] For the most part, this applies to 38% of the volume estimated from this Transaction since the remainder 62% will be received from existing production.

GAS PRODUCTION AT OPAL AND REPLACING THAT GAS WITH PURCHASES AT OPAL OR OTHER LOCATIONS IN THE ANNUAL PGA MECHANISM?

A. Yes. At Paragraph 22 of the Stipulation NW Natural not only agrees that any savings from Encana marketing NW Natural's gas will be shared through the PGA sharing mechanism, but also agrees to a process to address situations in which NW Natural purchases more expensive gas to replace the sold Encana gas. Paragraph 22 states:

"The Parties agree that any savings resulting from Encana marketing NW Natural's share of the gas will be subject to the PGA sharing mechanism. In the event that the Company purchases replacement gas as described under this paragraph at a price higher than the price at which Encana sells the gas under the marketing agreement, the Company agrees to provide written notice to the other Parties within 14 days of the transaction. The Parties also agree that if this occurs, the transaction will be placed on the agenda of the next quarterly meeting of the Gas Portfolio Review meeting, where the Company will explain the facts and provide documentation surrounding the purchase. Notwithstanding anything else in this paragraph, the Parties specifically agree that if the Company does purchase replacement gas at a price higher than the price the Company receives for gas sold by Encana, the purchase of replacement gas will be subject to ongoing prudence reviews as provided in Paragraph 16."

Q. DID NW NATURAL ORIGINALLY PROPOSE TO EXCLUDE THE BENEFITS AND COSTS OF HAVING ENCANA SELL THE COMPANY'S GAS PRODUCTION AT OPAL AND REPLACING THAT GAS WITH PURCHASES AT OPAL OR OTHER LOCATIONS IN THE ANNUAL PGA MECHANISM?

A. Staff understood the Company's proposal to be that it would exclude these benefits and costs from the sharing mechanism of the PGA. NW Natural explained in testimony:

"Also, under the JOA, NW Natural can elect to take its share of production in kind, to either sell the production or to transport it to NW Natural's distribution system. Alternatively, NW Natural may elect to have the operator (Encana) sell NW Natural's share of production at market prices. Then NW Natural could purchase similar quantities monthly at Opal or could split its purchases of those quantities between Opal and AECO depending on market prices." *See* Cronise/8, NWN/200.

NW Natural explains at Miller/7, NWN/100: "...the Company does not believe that it would be appropriate for variances associated with the costs of the Proposed Transaction to be included in WACOG sharing." This appeared to be NW Natural's position whether the Encana gas is delivered to the NW Natural distribution system or sold by Encana at Opal on NW Natural's behalf.

Q. WHY IS IT IMPORTANT TO STAFF TO INCLUDE THESE SALE AND PURCHASE TRANSACTIONS IN THE ANNUAL PGA MECHANISM?

A. It is important because inclusion in the annual PGA mechanism process will allow customers to receive a share of the cost savings that result from these

transactions. Also, inclusion in the PGA process is the foundation for the process described in Paragraph 22 of the Stipulation to address those situations in which NW Natural purchases more expensive gas to replace the sold Encana gas.

Q. WITH THESE CONCESSIONS TO MORE FULLY INCLUDE THE PROPOSED TRANSACTION IN THE ANNUAL PGA PROCESS, IS STAFF'S 5-YEAR BENCHMARK MECHANISM STILL NEEDED?

A. No. With the Company's agreement that the Proposed Transaction is not a fixed-price hedge and to share all variances arising from the Proposed Transaction through the annual PGA process and related gas cost deferrals, Staff concludes that the alternative rolling 5-year benchmark mechanism is no longer needed. The current PGA sharing mechanism and the terms of the Stipulation achieve the same goal, i.e. fair distribution of risks and benefits. With the Company's agreement that the Proposed Transaction is subject to the normal PGA review and variance sharing mechanism, the Proposed Transaction is suitable for acquiring a long-term gas supply at a reasonable price.

SECTION 2: EXCLUSION FROM UTILITY RATE BASE

Q. DOES THE STIPULATION AGREE WITH ALL THE RECOMMENDATIONS MADE IN STAFF/200?

A. Yes, with one exception. In Staff/200, Staff recommended that NW Natural not be allowed to include the initial capital out-lay in its utility rate base.

Q. PLEASE EXPLAIN WHY STAFF CAN NOW SUPPORT A RECOMMENDATION TO ALLOW THE COMPANY TO INCLUDE THE INVESTMENT IN ITS UTILITY RATE BASE.

A. Paragraph 17 of the Stipulation, as well as a portion of the Joint Testimony, explain that NW Natural is willing to make adjustments to its earnings test as well as adjustments to the methods used to book its cost of gas to appropriately reflect the impacts of the Proposed Transaction to avoid the issues raised by Staff in its Direct Testimony (*See*: Exhibits B and C attached to the Stipulation)..

Q. DOES THIS CONCLUDE STAFF'S SUPPLEMENTAL TESTIMONY?

A. Yes.