

**BEFORE THE PUBLIC UTILITY COMMISSION  
OF OREGON  
LC 60**

In the Matter of )  
 )  
NORTHWEST NATURAL GAS )  
COMPANY dba NW NATURAL )  
 )  
2014 Integrated Resource Plan )  
\_\_\_\_\_ )

**OPENING COMMENTS OF THE  
CITIZENS' UTILITY BOARD OF OREGON**

November 24, 2014



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_____	)	

**I. Introduction**

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3       The Citizens' Utility Board of Oregon (CUB) appreciates this opportunity to comment on  
4 NW Natural's 2014 Integrated Resource Plan (IRP). CUB also appreciates the work NW Natural  
5 (the Company) has put into this IRP and its efforts to reach out to stakeholders in this process,  
6 particularly since the draft IRP was issued. In its comments, CUB will focus on issues related to  
7 long-term hedging practices.

**II. Long-Term Hedging**

9       CUB notes that though the general projections of the natural gas industry seem to forecast  
10 low gas prices for years to come, relative analysis shows that current gas prices are roughly one-  
11 third of their peak when observed over the last ten years.<sup>1</sup> This suggests that prices have much  
12 more latitude on the positive side (upward mobility) than on the down side. For example, the  
13 recently issued EPA proposed rule 111(d), designed to limit carbon emissions from existing coal

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<sup>1</sup> See <http://www.nasdaq.com/markets/natural-gas.aspx?timeframe=10y>

1 plants, could positively impact gas prices as utilities move away from coal and toward lower-  
2 carbon fuels like natural gas as a possible bridge fuel to a cleaner future.

3 In its IRP, the Company lists a number of other factors that may impact the price of  
4 natural gas both nationally and within the region, despite general projections of continuous  
5 supply streams in the future. These other factors, which include renewable energy mandates,  
6 methanol manufacture, transportation, and Liquefied Natural Gas (LNG) exports, may also  
7 impact the availability of pipeline capacity:

8 But on the demand side, the Company's view continues to be that the country is at  
9 an inflection point. Power generation will lead the way, spurred by both coal plant  
10 retirements and renewable energy mandates that will push the need for more  
11 gas-fired electric generation to replace retired units and support the grid. LNG  
12 exports will add to the demand for natural gas, with the first terminal expected to  
13 begin operation in 2015. Then there is the expected industrial renaissance, with  
14 cheap U.S. natural gas fueling a surge in the petrochemical industry. An example is  
15 the announcement in April 2014 that a multinational group is evaluating three sites  
16 in the Pacific Northwest for the construction of plants that will convert natural gas  
17 to methanol for shipment to China. And of course there are other possibilities for  
18 accelerated natural gas demand growth, for example, as a transportation fuel for  
19 ships, trains, trucks and automobiles.<sup>2</sup>

20 CUB agrees that additional demand for gas will pose a challenge for the  
21 maintenance of low gas prices, but CUB also wishes to commend the Company for  
22 working with stakeholders to incorporate potential future carbon impacts into its IRP.  
23 CUB understands that the 111(d) regulations are new and not yet finalized, but it is  
24 essential that all parties understand the potential effects of these rules and model what a  
25 carbon constrained world will look like. CUB appreciates that NW Natural has  
26 attempted to do that.

27 It is CUB's view that long-term hedging is a valuable consideration in IRP  
28 planning. CUB is appreciative of the Company's recognition of the upward price risk

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<sup>2</sup> Docket No. LC 60. NW Natural 2014 IRP, p. 79.

1 in its long-term hedging analysis. However, at this time, CUB does not agree that an  
2 aggressive long-term hedging strategy of 25-35% is an appropriate approach to long-  
3 term hedging. Stakeholders have not been given enough time to properly examine NW  
4 Natural's evidence for supporting this strategy. In addition, NW Natural's IRP fails to  
5 discuss certain elements that are critical to evaluating a long-term hedging proposal,  
6 which CUB discusses below. Additional review of this issue is important, and CUB has  
7 suggestions for what might be included in that additional analysis.

8 CUB suggests that the Company consider approaches to long-term hedging strategies  
9 taken by other utilities. One example can be found in PacifiCorp's 2013 IRP (LC 57). In that  
10 docket, PacifiCorp included in section 5a. of its Action Plan a request for acknowledgment of its  
11 intent to convene a workshop for stakeholders to discuss potential changes to the process for  
12 evaluating bids for future natural gas requests for proposals (RFPs). The idea was that this would  
13 give PacifiCorp a chance to explore whether it could secure additional (if any) long-term natural  
14 gas hedging products.<sup>3</sup> On October 29, 2013, PacifiCorp held the workshop with stakeholders.<sup>4</sup> It  
15 is CUB's belief that the RFP process that PacifiCorp used is a low-risk method to test product  
16 availability.

17 CUB appreciates that NW Natural has proposed a workshop for its stakeholders to review  
18 its long-term hedging strategy. Such a workshop should give all stakeholders more information  
19 upon which to base their decisions as to whether to support 25-35% long-term hedging. Until  
20 that time, CUB does not recommend acknowledgment of the proposed 25-35% long-term  
21 hedging.

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<sup>3</sup> Docket No. LC 57. PacifiCorp 2013 IRP, p. 247.

<sup>4</sup> See [http://www.pacificorp.com/content/dam/pacificorp/doc/Suppliers/RFPs/RFP\\_NaturalGas2012/PacifiCorp-2013NaturalGasRFP-ProcessImprovement\\_10-29-13.pdf](http://www.pacificorp.com/content/dam/pacificorp/doc/Suppliers/RFPs/RFP_NaturalGas2012/PacifiCorp-2013NaturalGasRFP-ProcessImprovement_10-29-13.pdf).

1 In docket UM 1520, NW Natural entered into a 30-year deal with Encana to invest in gas  
2 extraction. In its Opening Testimony, CUB states,

3 This is a unique transaction, undergoing a unique review, in unique  
4 circumstances. Rarely have gas prices been as low as they are now. Never before  
5 has a utility sought to enter into this kind of farm-in agreement with a producer,  
6 and rarely have Staff and Intervenors been asked to review a transaction on such a  
7 short timeline. Because of the above reasons, review of this transaction has  
8 proved very challenging. Challenges have been posed by the inability of the  
9 Company to timely provide finalized copies of transactional documents and to  
10 provide them in redline, the newness of the subject matter, and the shortness of  
11 the docket.

12 It is the shortness of the docket that concerns CUB the most. As of Saturday  
13 March 26, 2011, CUB, NWIGU, and their expert witnesses were still receiving  
14 new documents for review. This means that the experts hired by NW Natural  
15 (KPMG, ENVIRON, NSAI etc.) and experts retained by CUB and NWIGU (Lear  
16 & Lear, Salt Lake City, Utah) to review this matter also frequently lacked access  
17 to final documents. As of Tuesday, March 29, 2011, the parties were still  
18 receiving responses to data requests. Also as of Tuesday, March 29, 2011, many  
19 data request responses were yet to be updated from pre-finalized contract  
20 document references to post contract finalization references, making it very hard  
21 for the intervenors to assess this case. It is with these caveats that we rely on the  
22 statements of all of the experts made in the course of reviewing this transaction.<sup>5</sup>

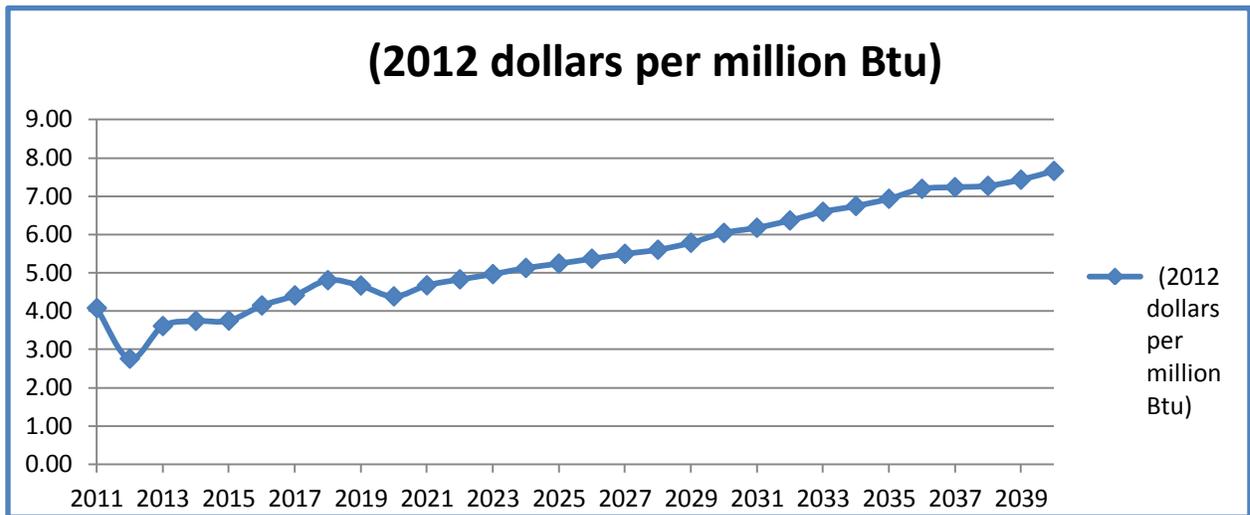
23 CUB supported NW Natural's proposal with Encana, in light of what was known at the  
24 time. However, the short timetable and the Company's insistence on pre-approval made UM  
25 1520 a difficult docket that should not be the basis of routine activity. CUB is concerned about  
26 the opportunity to vet alternatives to physical hedging, such as financial tools, before the  
27 Company proposes to more than double its long-term physical hedges.

28 Below is a chart showing EIA gas projections for Henry Hub spot prices.

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<sup>5</sup>Docket UM 1520. CUB/100/ Jenks/10 & 11.

1 *Figure 1: Natural Gas Supply, Disposition and Prices*<sup>6</sup>



10 While this is only a single metric, it is consistent with the Company's projections on page 2.26 of  
11 its IRP in that recent projections of Henry Hub market prices generally do not exceed  
12 \$5/MMBTU until after 2023. This is almost a decade from today. Additionally, from NW  
13 Natural's PGAs, Encana gas is consistently produced at a price above \$5/MMBtu.<sup>7</sup> This  
14 indicates that by the Company's current projections, NW Natural's long-term hedging agreement  
15 with Encana has not been profitable thus far, nor will it be for years to come. This gives CUB  
16 pause for concern when NW Natural is considering increasing percentages of long-term hedging.  
17 Similarly, in docket UG 278, the Company's most recent PGA filing, the Company proposed a  
18 purchased gas cost of \$.43383, well below the cost of the long-term hedge.<sup>8</sup> This is an inherent  
19 problem with long-term hedges: if they are out of the money, customers have to live with higher  
20 prices for years.

<sup>6</sup> "A13. Natural Gas Supply, Disposition, and Prices." U.S. Energy Information Administration (EIA). 2014. Accessed November 22, 2014. <http://www.eia.gov/analysis/projection-data.cfm#annualproj>.

<sup>7</sup> Docket UG 278. Exhibit B, p. 7.

<sup>8</sup> Docket UG 278. Public Utility Commission of Oregon Staff Report, p. 2.

1 CUB believes it is important not to rush into long-term hedging agreements, regardless of  
2 how lucrative they may appear, until stakeholders have had ample time to review the details of  
3 the Company’s proposals. For this reason, CUB cannot recommend acknowledgment of NW  
4 Natural’s long-term 25-35% hedging proposal.

5 CUB has also reviewed the Company’s consultant reports on hedging. The Company  
6 hired consultant Aether to do its long-term hedging analysis, but CUB does not believe that the  
7 reports are enough documentation upon which to justify such an aggressive hedging strategy. In  
8 CUB’s opinion, while price spikes may be generally expected, this is different from an upward  
9 trend. For example, consider lower gas prices that occur in the summer. Summer gas prices can  
10 dip below historical winter prices. This negates the need for long term hedges, since they allow  
11 gas utilities to fill up their storage capacity at lower prices. Having too much supply in long-term  
12 hedges could prevent a utility from taking advantage of the seasonal difference in prices. This  
13 makes annual storage potentially a better tool, and excessive long-term hedging unnecessary.

14 In addition, the Company should analyze a broad range of risks and timelines associated  
15 with the full range of long-term products available, including products with a much shorter  
16 duration. As an example of the different ranges that may be considered “long-term,” the  
17 American Gas Association has listed long-term hedging to include anything beyond one year,<sup>9</sup>  
18 [REDACTED],<sup>10</sup> and as CUB has already stated,  
19 PacifiCorp’s RFP was slated for 10 years. The point is that there are a range of timelines  
20 associated with “long-term” hedges, and NW Natural has failed to provide analysis that  
21 distinguishes between the risks of two, four, or ten-year hedges and the risks of a 30-year hedge.

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<sup>9</sup> LDC Supply Portfolio Management During the 2012-13 Winter Heating Season.

<sup>10</sup> [REDACTED]

1           NW Natural’s approach to hedging can be contrasted to its peer utilities, Avista and  
2 Cascade Natural Gas Company (Cascade). It is notable that both have demonstrated a relatively  
3 conservative approach to long-term hedging in their IRPs and IRP workshops. While CUB does  
4 not necessarily agree with their approaches, CUB has encouraged Avista to include long-term  
5 hedging analysis within its IRP. Notwithstanding CUB’s support for the inclusion of long-term  
6 hedging analysis, CUB continues to believe that analysis of long-term hedging opportunities  
7 should be pursued cautiously and with adequate stakeholder input. It is CUB’s understanding  
8 that Cascade does not have any financial derivatives in its portfolio for reasons including  
9 concerns about recent financial regulations (e.g., Dodd-Frank). Similarly, Avista does not plan  
10 for any long-term hedges in its IRP.

11           CUB agrees with Commissioner Savage’s comments at the NW Natural LC 60 public  
12 meeting on November 4, 2014. There, Commissioner Savage stated that the long-term hedging  
13 strategy NW Natural has taken needs to be more fully examined by Staff. CUB agrees.

14           Staff and stakeholders should have the opportunity to review the Company’s rationale  
15 and evidence in support of a 35% long-term hedging strategy.

### 16 **III. Conclusion**

17           CUB believes that a 25-35% hedging strategy is likely too aggressive. CUB cites to NW  
18 Natural’s deal with Encana as proof that long-term hedges are not necessarily in customers’ best  
19 interests over the long term. At this point, CUB cannot support NW Natural’s proposal to  
20 increase its long-term hedging strategy to allow for up to 35% of its gas supply to be hedged for  
21 up to 30 years. NW Natural needs to provide additional analysis examining the time horizon of  
22 various long-term products, their relative risks, and a stronger demonstration that increasing  
23 long-term hedges is part of a least-cost/least-risk procurement strategy. CUB acknowledges that

1 the prudence of hedges is not determined retroactively, but the fact remains that 10% of the  
2 Company's gas supply is now hedged for many years at a price that is above current and future  
3 expected market prices. This clearly suggests that the more cautious approach taken by other  
4 utilities may well be appropriate.

5 CUB originally supported the Encana proposal because at the time, CUB believed it was  
6 economically justified. The market was low compared to historic conditions, and it seemed like a  
7 good time to lock in prices for the future. NW Natural wants to more than double the amount of  
8 gas in long-term hedges based on the same theory it used for Encana. Given what is currently  
9 known about the performance of long-term hedges and the availability of other long-term  
10 products, CUB believes a more risk-averse approach to hedging may be more responsible. In  
11 CUB's opinion, the Company has not demonstrated that increasing its percentage of long-term  
12 hedges from 10% to 35% should be acknowledged.

Sincerely,

A handwritten signature in black ink, appearing to read 'N. Hanhan', with a long horizontal stroke extending to the right.

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## LC 60 – CERTIFICATE OF SERVICE

I hereby certify that, on this 24<sup>th</sup> day of November, 2014, I served the foregoing **OPENING COMMENTS OF THE CITIZENS’ UTILITY BOARD OF OREGON** in docket LC 60 upon each party listed in the LC 60 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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