

**BEFORE THE PUBLIC UTILITY COMMISSION**

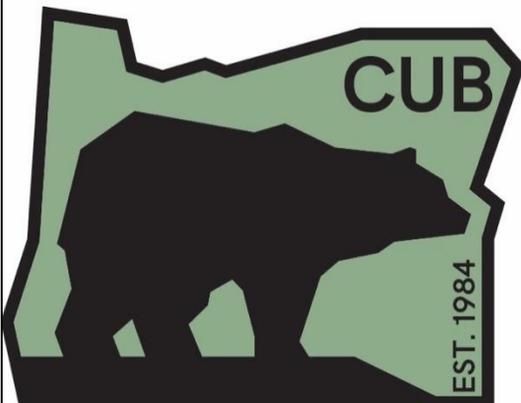
**OF OREGON**

**UG 344**

In the Matter of )  
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NORTHWEST NATURAL GAS )  
COMPANY, dba NW NATURAL, )  
 )  
Request for a General Rate Revision. )  
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**REPLY BRIEF  
OF THE  
OREGON CITIZENS' UTILITY BOARD**

August 29, 2018



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OF OREGON**

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**I. INTRODUCTION**

Pursuant to Administrative Law Judge (ALJ) Arlow’s August 9, 2018 Ruling, the Oregon Citizens’ Utility Board (CUB) hereby submits its Reply Brief in docket UG 344. In this Brief, CUB responds to arguments on the remaining issues in this docket raised by Northwest Natural Gas Company (NWN or the Company) in its Opening Brief, filed August 14, 2018.

On December 29, 2017, NWN filed a Request for a General Rate Revision for the first time in six years.<sup>1</sup> After several settlement negotiations, CUB, NWN, Staff of the Public Utility Commission of Oregon (Staff), and the Alliance for Western Energy Consumers (AWEC) agreed to settlement terms on all but three outstanding issues. Subsequently, a stipulation agreement signed by the aforementioned parties was

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<sup>1</sup> NWN’s last general rate case, UG 221, was filed on December 30, 2011. *See in re Northwest Natural Gas Company, dba NW Natural*, Request for a General Rate Revision, OPUC Docket No. UG 221, Request for a General Rate Revision (Dec. 30, 2011).

submitted to the Public Utility Commission of Oregon (Commission) on August 6, 2018.<sup>2</sup> As a result of the good-faith settlement negotiations, only one outstanding issue remains—the revenue sharing resulting from asset optimization at the Company’s Mist storage facility and how the Company reports these revenues. While CUB, Staff, and NWN have reached an agreement on the treatment of the Company’s increasingly expanding pension balancing account and treatment of the Company’s tax benefits in light of the passage of the federal Tax Cuts and Jobs Act (TCJA), AWEC is not a party to that agreement.

A. *Burden of Proof*

As will be expanded upon further in this Brief, NWN has objectively failed to meet its requisite burden of proof to be granted relief regarding its requests in this general rate case proceeding. In a utility dispute before the Commission, the burden of proof consists of two discrete components—the burden of persuasion and the burden of production.<sup>3</sup> In a utility proceeding, the burden of persuasion and the ultimate burden of producing sufficient evidence to support its claims is always with the utility.<sup>4</sup> Other parties to the proceeding have the burden of producing evidence to support their argument in opposition to the utility’s position.<sup>5</sup> In a case in which a utility is requesting a change in rates or a schedule of rates—such as a general rate case—the utility bears the

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<sup>2</sup> *In re Northwest Natural Gas Company, dba NW Natural*, Request for a General Rate Revision, OPUC Docket No. UG 344, Stipulating Parties’ Partial Stipulation between NW Natural, Staff, CUB, and AWEC (Aug. 6, 2018).

<sup>3</sup> *In re Portland General Electric Company Application to Amortize the Boardman Deferral*, OPUC Docket No. UE 196, Order No. 09-046 at 7 (Feb. 5, 2009).

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 7-8.

burden of showing that its proposed change will result in rates that are fair, just, and reasonable.<sup>6</sup>

## II. ARGUMENT

### A. *Mist Optimization Revenue Sharing Percentages and Reporting*

The history of attempts to discern the Company's Mist Optimization practices and attendant revenue sharing is a tale of NWN continuously being reluctant to move the process forward in the manner requested by the Commission.<sup>7</sup> The Company's optimization sharing revenue percentages have been an unresolved issue since NWN filed its last general rate case (UG 221) in December 2011.<sup>8</sup> Subsequent to a stipulation in that proceeding, parties requested that a new docket be opened to evaluate the Company's interstate storage and optimization sharing percentages.<sup>9</sup> A Commission decision was expected to be issued by December 31, 2013.<sup>10</sup> That docket—UM 1654—began in May 2013, and the first phase ended with the Commission ordering that a “neutral third party [] conduct an evaluation and cost allocation study of NW Natural's optimization activities.”<sup>11</sup> The idea was “to determine with greater clarity how costs are generated and shared.”<sup>12</sup> It has taken three years, but that cost study is now complete and

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<sup>6</sup> ORS 757.210(1)(a).

<sup>7</sup> See UG 344 – CUB/200/Jenks/13 (“[T]he Company has been the one to coordinate most of this, and it has not had a sense of urgency. This is not surprising, since the completed [Liberty] study was expected to show NW Natural's sharing percentages for optimization are overly generous.”).

<sup>8</sup> UG 344 – CUB/200/Jenks/8.

<sup>9</sup> *In re Northwest Natural Gas Company Request for a General Rate Revision*, OPUC Docket No. UG 221, Order No. 12-408 at 10.

<sup>10</sup> *Id.*

<sup>11</sup> *In re Northwest Natural Gas Company Investigation of Interstate Storage and Optimization Sharing*, OPUC Docket No. UM 1654, Order No. 15-066 at 6 (Mar. 5, 2015).

<sup>12</sup> UG 344 – CUB/200/Jenks/8.

is before the Commission in this proceeding. CUB believes that the Commission has an adequate record with which to review the issue.

CUB continues to advocate for the same core customer storage optimization revenue sharing ratio that it has since the issue first arose—90/10 (customer/shareholder).<sup>13</sup> Since that time, the Company’s shareholders have continued to enjoy a disproportionate share of revenue generated from ratepayer assets. As confirmed by the recent Liberty consulting report (Liberty Report), this revenue sharing percentage is out of alignment with NWN’s peer utilities and unreasonably over-compensates the Company’s shareholders without attendant risk.<sup>14</sup> Liberty’s conclusion was the “percentage that NW Natural ownership receives as a clear outlier among the population for which we have been able to secure information.”<sup>15</sup> As core customer gas is purchased to benefit customers, the Company is obligated to maximize its value to the system.<sup>16</sup> In order to align with the practices of similarly situated utilities and provide customers an appropriate benefit for use of their assets, NW Natural’s optimization sharing percentages must be changed.

1. *NWN has failed to meet its burden of proof regarding retaining the existing optimization revenue sharing percentages.*

Despite the evidence that has come to light in the Liberty Report—and the fact that not one non-Company party to this proceeding agrees that the current sharing percentage should be retained—the Company continues to request that the Commission

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<sup>13</sup> *Id.* at 8.

<sup>14</sup> *Id.* at 13-14

<sup>15</sup> *Final Report on The Liberty Consulting Group’s Evaluation of NW Natural’s Optimization Activities*, November 21, 2017, available at UG 344 – NW Natural/1301/Friedman/54.

<sup>16</sup> UG 344 – CUB/200/Jenks/9.

make no changes to the existing sharing percentages.<sup>17</sup> The Company’s arguments to retain the existing sharing percentages are unpersuasive, and it has continuously failed to introduce the requisite evidence to meet its burden of proof. The other parties, however, properly rely on the expert consulting services requested by the Commission to make a practical recommendation regarding fair sharing percentages. Both Staff and CUB have proposed that the Company be directed to adopt a 90/10 sharing arrangement for optimization revenues associated with core customers, while AWEC has proposed an 85/15 sharing arrangement.<sup>18</sup> The Company’s arguments in support of retaining the status quo are easily dispelled.

It should be noted that in UM 1654, CUB advocated a 90/10 sharing for all optimization activities, believing that the core/non-core distinction relating to Mist optimization was not reasonable. However, based on the Liberty Report, CUB is no longer advocating changing the allocation of optimization between core and non-core Mist storage.<sup>19</sup> CUB is only proposing to change the allocation of optimization revenues that relate to core customers.

Aside from failing to provide requisite evidence to support retaining the current optimization sharing percentages—nor providing requisite evidence to prove that the Liberty Report’s recommendations are unreasonable—the Company misleadingly conflates optimization revenues with storage revenues at several points in its brief. For example, in support of retaining the current sharing percentages, the Company states “since 2000, customers have received a total of \$133.5 million in credits under Schedules

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<sup>17</sup> UG 344 – NW Natural’s Opening Brief at 7-8.

<sup>18</sup> UG 344 – Staff/1300/Glosser/12; UG 344 – CUB/200/Jenks/18; UG 344 – AWEC/400/Finklea/7.

<sup>19</sup> UG 344 – CUB/200/Jenks/15.

185 and 186.”<sup>20</sup> It is unclear why the Company is conflating the benefits accrued through both optimization **and** storage in support of its position to retain the current core customer optimization sharing percentages. The storage revenue percentages are not at issue in this case. It seems the Company may be using irrelevant evidence in an attempt to further its unpersuasive position.

As noted by the Company, the Commission—after a full contested case and two separate hearings—determined that it required additional information and directed the parties to hire an expert third-party to perform an independent study and cost-allocation evaluation.<sup>21</sup> That independent study is now complete, and, as the Company notes, the Liberty Report “concludes that . . . the Company’s percentage of revenues attributable to optimization activities might be appropriately decreased.”<sup>22</sup> The evidentiary record put forth in this proceeding by non-Company parties supports this conclusion.

*2. The Company’s arguments for retaining the current sharing percentages are easily dismissed.*

First, NWN argues that the Liberty Report contains shortcomings that suggest it should not be relied upon, despite the fact that the Company provided all of the information to Liberty that informed its final report and the Commission ordered the report to gain further clarity on the Company’s practices.<sup>23</sup> In support of this contention, the Company argues that the Liberty Report should go beyond comparing NWN to

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<sup>20</sup> UG 344 – NW Natural’s Opening Brief at 11; *see also* UG 344 – NW Natural’s Opening Brief at 1-2 (“customers have received \$133.5 million in credits, and customers have also benefitted through the ability to recall expanded portions of Mist Storage to serve customers on an as needed basis.”); *and* UG 344 – NW Natural’s Opening Brief at 15 (“Specifically, customers have received a cumulative \$133.5 million in credits since 2000.”).

<sup>21</sup> UG 344 – NW Natural’s Opening Brief at 11, citing UG 344 – NW Natural/1300/Friedman/30.

<sup>22</sup> UG 344 – NW Natural’s Opening Brief at 12.

<sup>23</sup> *Id.* at 13.

various optimization sharing percentages used by peer utilities across the country, and should provide actual revenue amounts received by customers.<sup>24</sup> The Company posits—without any supporting evidence—that “[i]t is entirely possible that while NW Natural’s sharing may provide customers with a relatively smaller sharing percentage, NW Natural’s customers *may* well be receiving significantly greater revenues than the peer utilities’ customers.”<sup>25</sup>

In the absence of concrete evidence, it appears the Company’s best argument to undercut the Liberty Report’s findings is based upon unabashed speculation. To use the Company’s logic, it is also entirely possible that NWN’s customers are receiving both a relatively smaller sharing percentage and significantly fewer benefits than the peer utilities’ customers. Further, if the Company believes that this information is essential to evaluate peer utilities’ sharing arrangements, then the Company providing similar information is essential in order to support the current arrangement.

It should also be noted that if NWN’s unsupported speculation is correct, then a change in sharing percentages to get to the industry average would still leave NWN with greater revenues than its peer utilities. The argument that we “might” have more revenues overall than other utilities does not suggest that such revenues should be shared any differently. If retaining 10% of \$1 million in optimization revenues is fair to other utilities, it is unclear why retaining 10% of \$2 million would be unfair to NWN.

Second, the Company continues to argue that its level of participation in optimization activities go beyond that of its peer utilities to such an extent that the

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<sup>24</sup> *Id.* at 13-14.

<sup>25</sup> *Id.* at 13 (emphasis added).

sharing percentages should not be revisited.<sup>26</sup> The Company believes its optimization activities go above and beyond the efforts typically expended by LDCs in the optimization of customer assets, noting that it has daily interactions with its third-party asset-manager.<sup>27</sup>

The assets being optimized are just those—assets owned by NWN’s customers. Because the investments in Mist serving core customers are ratebased assets, the Company is obligated to maximize its value to the system.<sup>28</sup> The Company has failed to produce any evidence on the record of either: a) it actually has an increased level of participation, or b) that an increased level of participation would justify retaining the current sharing percentage. As noted in CUB’s testimony, “work[ing] harder than do other LDCs” is subjective and unquantifiable.<sup>29</sup> The Liberty Report’s analysis examined this argument and found NWN optimization activities to be “of a nature and extent similar to what others would be expected to do.”<sup>30</sup> Through prudent utility asset management, the Company is responsible for maximizing these assets with the majority of benefits flowing to customers that pay for them.<sup>31</sup> This is common in the industry. Within Oregon, Avista Utilities has an asset optimization program through which 100% of its net revenues flow to customers in its Purchased Gas Adjustment (PGA).<sup>32</sup> The Company’s arguments that its level of optimization engagement merits retaining the

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<sup>26</sup> *Id.* at 14

<sup>27</sup> *Id.*

<sup>28</sup> UG 344 – CUB/200/Jenks/7, 9.

<sup>29</sup> UG 344 – CUB/400/Jenks/4.

<sup>30</sup> UG 344 – NW Natural/1301/Friedman/65.

<sup>31</sup> UG 344 – CUB/200/Jenks/7, 17.

<sup>32</sup> UG 344 – CUB/200/Jenks/17. It should be noted that Avista’s net revenues that flow to customers may be impacted by the PGA’s 90/10 sharing mechanism.

current sharing percentage is unavailing, especially since the Company outsources this work to a third-party asset manager.<sup>33</sup>

Third, the Company continues to erroneously insinuate that it requires an incentive to maximize the ratepayer-funded assets used in its Mist optimization strategy. It argues that the current 67/33 revenue sharing percentage ratio enables it to maintain a “necessary incentive” to continue its optimization activities.<sup>34</sup> The Company goes on to say that its incentive to achieve favorable results in its optimization activities would be substantially altered if the sharing percentages are changed.<sup>35</sup>

To CUB, this argument flies in the face of traditional regulatory principles and utility asset management. As argued throughout this proceeding, utilities have a responsibility to maximize the value of ratepayer-owned assets.<sup>36</sup> This is an expectation of regulated utilities. The Liberty Report’s finding that 25% of gas utilities nationwide share 100% of optimization revenues with customers is not surprising—utilities are expected to do so under the normal prudence standard.<sup>37</sup> Through its argument, NWN is insinuating that it needs to be bribed (i.e., retain its outlier sharing percentage) in order to act prudently. Although the Company needs no incentive to optimize the value of ratepayer-funded assets, CUB does believe that a 90/10 sharing ratio is reasonable, as it is the midpoint for optimization sharing nationally and provides an adequate shareholder interest for NW Natural to provide an efficient optimization program.<sup>38</sup>

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<sup>33</sup> UG 344 – CUB/400/Jenks/5.

<sup>34</sup> UG 344 – NW Natural’s Opening Brief at 10.

<sup>35</sup> *Id.* at 15

<sup>36</sup> UG 344 – CUB/200/Jenks/17.

<sup>37</sup> *Id.*

<sup>38</sup> UG 344 – CUB/400/Jenks/6.

Finally, the Company notes that it specifically requested the current 67/33 sharing mechanism because, at the time, that allocation matched the weighted average cost of gas (WACOG) sharing percentage adopted for the PGA.<sup>39</sup> While this is true, CUB would like to add a finer point to the Company's argument in the interest of providing a clear record. In a 2008 final order in a generic investigation into the PGA, the Commission formally changed the WACOG sharing percentage to either 90/10 or 80/20 at the utility's election with a corresponding earnings review.<sup>40</sup> From what CUB has seen over the years, NWN typically selects a 90/10 sharing percentage. If the Company is arguing that optimization revenue sharing percentages should continue to match the WACOG sharing percentages, a 90/10 ratio is appropriate to continue this practice.

### 3. *Reporting optimization revenues in the Results of Operation (ROO.)*

CUB continues to recommend that the Company be required to include all optimization revenues associated with regulated activities in its ROO and exclude optimization revenues associated with interstate storage.<sup>41</sup> As the Company notes, Staff and AWEC support CUB's recommendation.<sup>42</sup> Since the Commission stated that it would address optimization revenue reporting after the now-complete cost study was completed, this issue is now ripe for Commission decision.<sup>43</sup> The Company proposes to provide optimization revenue data for informational purposes in a newly-filed annual

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<sup>39</sup> UG 344 – NW Natural's Opening Brief at 10.

<sup>40</sup> *In re Public Utility Commission of Oregon Investigation into the Purchased Gas Adjustment (PGA) Mechanism Used by Oregon's three Local Distribution Companies*, OPUC Docket No. UM 1286, Order No. 08-504 at 18 (Oct. 21, 2008).

<sup>41</sup> UG 344 – CUB/200/Jenks/25; *see also* UG 344 – CUB/400/Jenks/3.

<sup>42</sup> UG 344 – NW Natural's Opening Brief at 15.

<sup>43</sup> UG 344 – CUB/200/Jenks/20.

“Optimization Report.”<sup>44</sup> While CUB appreciates the Company’s contention that transparency is important,<sup>45</sup> the Company’s proposal and accompanying unavailing rationale do little to dispel CUB’s concerns.

In support of its proposal, the Company argues that CUB’s recommendation is premature “because it is largely supported by an argument that the information would be needed to evaluate the impacts of incentive regulation—but to date, Oregon has not adopted incentive regulation.”<sup>46</sup> Second, the Company argues that including optimization revenues in the ROO would incorrectly imply that the revenues should be considered in the application of earnings reviews.<sup>47</sup>

In response to the Company’s first argument, it is puzzling to hear the Company say that Oregon has not yet adopted incentive regulation. While the Commission is currently grappling with the merits of performance-based ratemaking, various forms of incentive regulation have been in place for quite some time. Regulation is by definition government action to achieve explicit policy goals by incenting a utility to act in a certain way.<sup>48</sup> In that way, all regulation is incentive regulation.<sup>49</sup> The Company’s argument is especially puzzling because, in support of its argument to retain the current sharing percentages, it argues that it needs a “necessary incentive” to vigorously pursue optimization activities.<sup>50</sup> The Company cannot have it both ways—it cannot argue that it requires a “necessary incentive” to pursue optimization while also arguing that Oregon

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<sup>44</sup> UG 344 – NW Natural’s Opening Brief at 16.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*

<sup>47</sup> *Id.*

<sup>48</sup> Lazar, J (2016). *Electricity Regulation in the US: A Guide. Second Edition*. Montpelier, VT: The Regulatory Assistance Project at 7. available at <http://www.raponline.org/knowledge-center/electricity-regulation-in-the-us-a-guide-2>.

<sup>49</sup> *Id.*

<sup>50</sup> UG 344 – NW Natural’s Opening Brief at 10, *supra*, note 33.

has not yet adopted incentive regulation. When Company shareholders have a stake in the outcome of how primarily ratepayer-funded assets are optimized, the Company is incentivized to act more efficiently to fulfill its fiduciary obligation.<sup>51</sup> Because the optimization revenue sharing program is a form of incentive regulation, it is not premature for CUB to present this argument.<sup>52</sup>

Regarding the Company's second argument, CUB continues to believe that it is entirely appropriate for optimization revenues to be included in the ROO because they are earnings from the Company's regulated system.<sup>53</sup> These revenues are associated with core customer service and are derived from core customer assets.<sup>54</sup> If NWN's ROO report does not accurately reflect earnings from the Company's regulated systems, the ROO has the potential to be misleading. For example, if an analyst wanted to compare NWN and Avista's results in Oregon, the ROO would be misleading. Avista's would include its optimization earnings that derive from the 90/10 PGA sharing mechanism, but NWN's would not. It would imply that Avista is getting more favorable regulatory treatment than NWN.

The Company's proposal to include optimization revenues in an annual Optimization Report does not resolve CUB and other parties' concerns regarding reporting transparency. The Company's annual ROO is the traditional reporting instrument that details the revenues arising from NWN's regulated activities. Since core customer asset optimization is a regulated activity, the revenues arising from it belong in the ROO.

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<sup>51</sup> UG 344 – CUB/400/Jenks/3.

<sup>52</sup> *Id.*

<sup>53</sup> UG 344 – CUB/200/Jenks/21.

<sup>54</sup> *Id.* at 20.

4. *CUB's Recommendation*

As a result of the conclusions of the Liberty Report, CUB continues to recommend that the Company's optimization sharing revenue percentages be set to 90/10. Staff supports CUB's recommendation in this matter, and AWEC is close in recommending an 85/15 sharing ratio. All non-Company parties agree that the current revenue sharing percentages are unsupportable given the evidentiary record in this case. The Company has failed to meet its burden of proof that the current optimization sharing percentages are reasonable, and it has also failed to provide sufficient evidence to demonstrate that the parties' suggestions are unreasonable. CUB also continues to urge the Commission to direct NWN to include optimization revenues in its ROO.

III. CONCLUSION

For the foregoing reasons, CUB respectfully urges the Commission to adopt the recommendations put forth by Staff and CUB to adjust the Company's Mist optimization revenue sharing ratio to 90/10. This aligns with the recommendations of the Liberty Report, and adequately compensates ratepayers while enabling the utility's shareholders to retain a revenue share that aligns with that of its peer utilities.

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Dated this 28<sup>th</sup> day of August, 2018.

Respectfully submitted,

A handwritten signature in blue ink, appearing to read "Michael P. Goetz". The signature is stylized and cursive.

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