**Exhibit No. \_\_\_ (RSF-2T)**

**Docket UG-111233**

**WITNESS: RANDOLPH S. FRIEDMAN**

**BEFORE THE**

**WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

|  |  |
| --- | --- |
| **WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,**  **Complainant,**  **v.**  **NORTHWEST NATURAL GAS COMPANY,**  **Respondent.** | **Docket UG-111233** |

**NORTHWEST NATURAL GAS COMPANY**

**TESTIMONY OF**

**RANDOLPH S. FRIEDMAN**

**SUPPORTING STIPULATION**

**April 24, 2012**

**Q. Please state your name, business address, and occupation.**

A. My name is Randolph S. Friedman. My business address is 220 NW Second Avenue, Portland, Oregon 97209. My current position is Director, Gas Supply for Northwest Natural Gas Company, d/b/a NW Natural (“NW Natural” or the “Company”). Please see Exhibit No. \_\_\_(RSF-1T), filed on July 7, 2011, for testimony describing my education and relevant experience.

**Q. What is the purpose of your testimony?**

A. My testimony supports the Settlement Stipulation (“Stipulation”) filed on April 24, 2012. Specifically, my testimony describes how the Company will exclude from Washington rates all of the costs and benefits associated with NW Natural’s joint venture with Encana Oil & Gas (USA) Inc. (“Encana”) (the “Transaction”). I will first describe the role of the Transaction in our gas supply portfolio and then discuss how the Company will calculate the costs of a Washington-specific portfolio that will exclude Transaction costs and benefits, while continuing to provide our Washington customers with reliable gas service at fair and reasonable rates. My testimony will conclude with a discussion of how the allocation of Transaction costs and benefits to only NW Natural’s Oregon customers affects the portfolio for Washington customers and my testimony will discuss the prudence of that Washington portfolio.

**Q. Please describe the Company’s overall portfolio purchasing strategy?**

A. NW Natural’s goals in purchasing gas for our core utility market are reliability, lowest reasonable cost, price stability, and cost recovery. An important aspect of our overall gas purchasing strategy is hedging, through which we typically, at the beginning of the gas year, lock in a significant portion of our annual purchasing requirements with financial arrangements or through storage. By ensuring access to gas at guaranteed prices we are able to provide price stability for our customers. In the past, we have entered into financial hedges with terms up to three years. We also have entered into longer-term physical transactions up to 15 years, but the prices in those transactions typically have floated with the market.

**Q. How does the Transaction fit into the Company’s overall portfolio?**

A.The Transaction will operate as a longer-term physical and financial hedge for our Oregon customers. As described more fully in the testimony of Barbara J. Cronise (Exhibit No. \_\_\_BJC-1T), the terms of the Transaction allow for the physical delivery of gas supplies by Encana to NW Natural from the wells being developed in the Jonah Field. The amount delivered is proportional to the number of wells drilled in the Jonah field under the Transaction. The Transaction is a long-term hedge against fluctuations in the month-to-month market price of natural gas because the price of the physical gas supplies are tied to certain drilling and production costs, most of which will not vary significantly over time.

Alternatively, the Transaction also allows the Company the option to have Encana market NW Natural’s share of the gas from these wells. If the Company chooses to have Encana market its share of the gas, Encana sells NW Natural’s share of the gas at the first-of-month index price at the Opal hub in the Rockies. NW Natural then uses the funds to financially hedge like volumes of supplies in the Rockies, where NW Natural has firm pipeline capacity and acquires physical gas supplies at first-of-month index prices.

The Company currently has elected to have Encana market the gas, with the revenue sent to NW Natural for crediting to its customers. Under this arrangement, the Transaction currently resembles a financial swap. That is, the primarily fixed costs of drilling are paid by NW Natural, while in return NW Natural receives revenue based on the month-to-month market price of the gas supplies it otherwise would have received.

**Q. Please describe generally the terms of the Stipulation.**

A. The Stipulation has two basic parts. First, the Parties agree that NW Natural should be granted leave to withdraw the tariff filing. Second, the Parties agree that NW Natural will not include in its Washington rates any of the costs or benefits associated with the Transaction. Rather, the Company will calculate a gas supply portfolio specific to Washington customers. This Washington-specific portfolio will be consistent with the Company’s past practice and will consist of financial hedges, storage inventories, and market purchases. The rates for the Company’s Oregon customers will be allocated 100 percent of the costs and benefits of the Transaction.

**Q. How will the Company manage the Washington portfolio to ensure that the gas allocated to Washington customers is consistent with the Company’s overall gas purchasing goals of reliability, lowest reasonable cost, and price stability?**

A. Overall, the Company will calculate the Washington portfolio the same as it has done in the past, and very similarly to its Oregon portfolio. Historically, the Company managed its customers’ gas requirements with a combination of hedged supplies—including storage gas and financial hedges—and gas purchased on the spot market. These hedged supplies have comprised approximately 75 percent of the Company’s expected requirements in recent years, which is reviewed regularly within the Company as part of its gas acquisition process.

Assuming for illustrative purposes that hedged supplies continue to be targeted at 75 percent of the Company’s total portfolio, then the Company will continue to purchase approximately 25 percent of its overall supply needs without any form of hedging. As with all supplies, these unhedged supplies will continue to be allocated to Oregon and Washington customers consistent with current practice, based on each state’s forecasted load used in the annual Purchased Gas Adjustment (PGA) filing. Similarly, the Company will rely on storage gas as it always has in an identical fashion for both Oregon and Washington customers. Finally, the Company will continue to allocate its financially hedged gas to Oregon and Washington customers consistent with the matter described above —with one exception. Given that the gas attributable to the Transaction will not be allocated to Washington customers, the Company will allocate to Washington customers an additional “slice” of the gas attributable to hedges out of the Rockies, to make up for the proportion of the Transaction gas that would otherwise be allocated to Washington customers.

Q. **Could you provide an illustration showing how the Company would allocate supplies as you have described?**

A. Yes. Exhibit No. \_\_\_(RSF-3T) provides a table illustrating how this portfolio could be developed. First, the Company will determine the total volumes of physical gas that will be delivered in each month of the year. To simplify this illustration, it is assumed that 10 percent is the Washington jurisdictional allocation of the Company’s total volumes. Of course the actual Washington allocation factor will match whatever is used in the PGA filing, as updated each year.

Second, the Company will determine the total hedged volumes for Rockies gas and develop a weighted average price of hedged Rockies gas based on the non-Transaction financial hedges. Third, using the elements developed in step 2, the Company will allocate to Washington customers the appropriate state allocation of total Rockies hedged volume and cost, such that Washington forecasted load that would have been met by the Transaction will be met by Rockies hedged volumes, at a price that will exclude gas received under the Transaction. Thus, for Washington customers, the volume of Rockies gas that is hedged will be identical to current practices, but the weighted average price of the Rockies financial hedges will exclude the Transaction from the weighted average. In this way, the price for the Washington allocation of hedged volumes in any given year will reflect the average price of the Company’s total hedge portfolio *excluding the Transactional volumes*. In essence, the price for Washington customers will be determined as if the Company never entered into the Transaction at all.

**Q. Is this the methodology the Company would use to maintain a separate portfolio for Washington customers for the life of the Transaction?**

A. The Company believes that this approach is the prudent course, and is likely to continue to be so. However, the Company recognizes that events could cause the Company to reevaluate this approach. At any rate, the Commission will have an opportunity to judge the prudence of the Company’s purchasing strategy for Washington customers on an annual basis, through the PGA. The effect of the Commission’s adoption of the stipulation would be only to determine that the Company is not required to pass costs and benefits of the Transaction through to Washington customers in order to maintain a prudent gas supply portfolio, and that the Company can maintain a prudent portfolio through using other gas procurement methods, like the ones it has used in the past.

**Q. How will the Company’s purchasing practices affect the relative Weighted Average Cost of Gas (“WACOG”) for Oregon and Washington customers?**

A. As described above, the Oregon WACOG will be allocated 100 percent of the Encana gas reserve costs, lowering its proportion of traditional derivative transactions (financial swaps and options) by an equivalent volume. Meanwhile, the Washington WACOG will have approximately the same proportion of traditional derivative transactions as in past years. Those financial transactions are necessarily shorter term in nature than the very long-term Encana gas reserves, and so the Oregon WACOG should exhibit somewhat lower volatility from year-to-year than the Washington WACOG.

The Washington WACOG, because it will have a higher proportion of gas hedged at current market prices, is expected to be slightly lower cost than Oregon for the next few years. If the market price of gas rises as expected, there could be a cross-over point, after which the Oregon WACOG would be slightly lower than the Washington WACOG. All of this depends, of course, on the future prices of natural gas in the market, which cannot be known at this time.

**Q. What is the effect on Washington customers if all of the Encana gas reserves are physically allocated to Oregon customers?**

A. Washington customers would continue to rely on NW Natural’s abilities to secure traditional gas supplies in the Rockies, and from other sources. Supplies in the Rockies are expected to be plentiful, at least for the foreseeable future, so there is no quantifiable risk associated with the sole allocation of Encana physical supplies to Oregon customers.

**Q. What is the effect on Washington customers if all of the Encana gas reserves are financially allocated to Oregon customers?**

A. The analyses performed by NW Natural in 2010 and 2011, as verified by an independent consultant on behalf of the Public Utility Commission of Oregon, estimated significant customer savings as a result of the Transaction. These savings are based on price forecasts, so the actual savings could be more or less than predicted. Also, these savings accrue over the life of the Transaction, which is anticipated to be approximately 30 years. Due to the current low market price of natural gas, the annual results are expected to have a pattern that starts with losses and only gradually moves to savings as market prices rebound. Whatever the actual annual savings or costs, all of the financial results are to be allocated to Oregon customers. In effect, Washington customers will remain indifferent compared to the current and past practices in Washington. The Company will continue to hedge its financial costs for Washington customers as has been done in previous years. And given that the Commission has consistently found that NW Natural’s gas portfolio has been prudently maintained, the Company expects that the Commission will similarly regard the Washington portfolio in the future. The only difference will be that given that the Washington portfolio will no longer be identical to the Oregon portfolio, the Company will continuously separately monitor the portfolio to ensure that it is made up of a prudent mix of hedged and unhedged gas given current market conditions and Commission direction.

**Q. Does this conclude your testimony?**

A. Yes.