

**BEFORE THE WASHINGTON  
UTILITIES AND TRANSPORTATION COMMISSION**

WASHINGTON UTILITIES AND	)	DOCKET UG-111233
TRANSPORTATION	)	
COMMISSION,	)	ORDER 05
	)	
Complainant,	)	
	)	APPROVING AND ADOPTING
v.	)	SETTLEMENT STIPULATION;
	)	GRANTING LEAVE TO
NORTHWEST NATURAL GAS	)	WITHDRAW TARIFF FILING
COMPANY,	)	
	)	
Respondent.	)	
.....	)	

**SUMMARY**

1     **PROCEEDING.** On July 7, 2011, Northwest Natural Gas Company (NW Natural or Company) filed with the Washington Utilities and Transportation Commission (Commission) a revision to its Tariff WN U-6. The Company filed a revised Schedule P “Determination of Company’s Purchased Gas Cost Adjustments and Weighted Costs of Gas,” with a stated effective date of August 6, 2011.<sup>1</sup> The filed revisions, if allowed to become effective, would change the definition of gas commodity costs recovered via the Company’s PGA to include the costs of developing gas reserves NW Natural acquired through a joint venture with Encana Oil and Gas (USA) Inc. (Encana). NW Natural requests an express finding that the Company’s decision to enter into the transaction with Encana was prudent, authorization to recover in rates the associated costs (including rate base treatment for the initial \$251 million fixed cost investment), and approval of the proposed revisions to Schedule P.

2     The Commission scheduled a prehearing conference for August 22, 2011, but subsequently granted NW Natural’s request to cancel the conference to give the parties an opportunity to complete an alternative dispute resolution process. On

---

<sup>1</sup> NW Natural and Staff requested and were granted three extensions of time to file their settlement. On the third occasion, we required them to waive the suspension date for 30 days. Hence, the suspension date now is July 6, 2012.

September 23, 2011, NW Natural and Staff filed their Joint Motion To Allow Withdrawal of Tariff Filing. The Joint Motion stated that as a condition of its agreement to withdraw, NW Natural required:

A clear statement that the Commission will not at some later date seek to include in Washington rates, directly or indirectly, either the costs or the benefits of the Transaction, so long as all of the costs and benefits continue to be reflected in rates approved by the [Oregon Public Utilities Commission].

3 The Commission, by entry of Order 02 on October 12, 2011, granted the Joint Motion to the extent of giving NW Natural leave to withdraw its tariff filing, but declined to make the commitment the Joint Motion proposed as a condition for withdrawal. Order 02 required NW Natural to state whether it wished to withdraw, or go forward with, its tariff filing. NW Natural, by letter filed with the Commission on October 19, 2011, elected to go forward.

4 The parties again embarked on an alternative dispute resolution path and, on April 24, 2012, they filed a Settlement Stipulation supported as required by the Commission's rules.<sup>2</sup> The Commission elected to resolve this matter on the basis of the prefiled record of evidence, without conducting a live hearing, and gave notice of this process determination on May 10, 2012.

5 **PARTY REPRESENTATIVES:** Lisa Rackner, McDowell Rackner & Gibson PC, Portland, Oregon, represents NW Natural. Chad M. Stokes and Tommy A. Brooks, Cable Huston Benedict Haagensen & Lloyd, Portland, Oregon, represent the Northwest Industrial Gas Users (NWIGU). Simon ffitch, Assistant Attorney General, Seattle, Washington, represents the Public Counsel Section of the Washington Office of Attorney General (Public Counsel). Sally Brown, Senior Assistant Attorney

---

<sup>2</sup> WAC 480-07-730 ("Parties who file a full settlement should file supporting evidence at the same time . . . or within a reasonable time following filing of the settlement agreement."); WAC 480-07-740(2) ("When filing a proposed settlement agreement, parties must also file supporting documentation sufficient to demonstrate to the commission that the proposal is consistent with law and the public interest, and that it is appropriate for adoption.").

General, Olympia, Washington, represents the Commission's regulatory staff (Commission Staff or Staff).<sup>3</sup>

- 6 **COMMISSION DETERMINATION:** The Commission approves and adopts the proposed Settlement Stipulation, and grants NW Natural leave to withdraw its tariff filing.

### MEMORANDUM

- 7 **BACKGROUND.** During the early part of 2011, NW Natural and Encana negotiated and entered into a joint venture. They executed a so-called Carry and Earning Agreement establishing their respective rights and obligations relative to the exploration and development of certain natural gas leases and wells in the Jonah Field, located in the Green River Basin in Sublette County, Wyoming. The transaction became fully effective on May 1, 2011, following approval by the Oregon Public Utilities Commission (OPUC). The Company required OPUC approval as a pre-condition to entering into the transaction because of its unique nature, the size of the investment, and because approximately 90 percent of NW Natural's gas sales are to Oregon customers.<sup>4</sup>

- 8 NW Natural, under the terms of the agreement, will partially fund the drilling of a significant number of wells in the Jonah Field. The Company, in return, will earn a working interest in the reserves in the field.<sup>5</sup> Over 5 years, NW Natural will invest \$251 million and expects to receive about 93.1 BCF of gas from the transaction over the life of the wells in which it participates. NW Natural expects to acquire about 26 percent of the volumes in the first 5 years, 63 percent in the first 10 years, 83 percent in the first 15 years, and 94 percent by the end of year 20. The remaining volumes will be received until the wells are finally capped at the end of their useful life—estimated to be approximately 30 years from signing. The transaction will provide about 10 percent of NW Natural's total annual gas requirements during the first ten

---

<sup>3</sup> In formal proceedings, such as this, the Commission's regulatory staff participates like any other party, while the Commissioners make the decision. To assure fairness, the Commissioners, the presiding administrative law judge, and the Commissioners' policy and accounting advisors do not discuss the merits of this proceeding with the regulatory staff, or any other party, without giving notice and opportunity for all parties to participate. *See* RCW 34.05.455.

<sup>4</sup> Miller, Exh. No. CAM-2T at 3:8-21.

<sup>5</sup> Miller, Exh. No. CAM-1T at 6:11-22.

years of the agreement, and will taper off over the remaining expected life of the wells.

9 Mr. Friedman testifies that the Company regards this transaction as being a long-term physical and financial hedge, which it believes is an important component of its overall gas purchasing strategy.<sup>6</sup> He testifies that NW Natural “typically, at the beginning of the gas year, lock[s] in a significant portion of [its] annual purchasing requirements with financial arrangements or through storage. By ensuring access to gas at guaranteed prices [the Company is] able to provide price stability for [its] customers.”<sup>7</sup> NW Natural has entered into financial hedges with terms up to three years and longer-term physical transactions up to 15 years, but the prices in these transactions typically have floated with the market.<sup>8</sup> The joint venture with Encana, by contrast, has an expected life of up to 30 years.

10 The agreement allows 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 joint venture.<sup>9</sup> The agreement alternatively gives the Company the option to have Encana market NW Natural’s share of the gas from these wells. If the Company elects this option, 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.<sup>10</sup>

11 At this time, NW Natural 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 resembles a financial swap. That is, the primarily fixed costs of drilling

---

<sup>6</sup> Friedman, Exh. No. RSF-2T at 1:20-2:9. Mr. McVay testifies, however, that “the Transaction is fundamentally different from a traditional hedge or long-term gas supply contract, [but] has characteristics similar to these types of transactions.” McVay, Exh. No. KSM-1T at 2:1-3.

<sup>7</sup> *Id.* at 1:23-2:6.

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

<sup>9</sup> *Id.* at 2:10-13.

<sup>10</sup> *Id.* at 2:17-23.

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.<sup>11</sup>

12 In terms of ratemaking treatment, as approved in Oregon and proposed via NW Natural's filing in this case, the Company includes its drilling costs in rate base, while the operational costs are recovered as ordinary gas cost expenses. The Company proposes to account for and recover these expenses through the Purchase Gas Adjustment (PGA) process by including depreciation—or depletion—expenses associated with rate base and estimated operational costs in the weighted average cost of gas (WACOG), to be trued up to actual the following year.<sup>12</sup>

13 Mr. Miller contends that it is appropriate for NW Natural to earn a return on these gas purchases because the Company is acquiring a long-term property interest in gas reserves.<sup>13</sup> Unlike financial hedges, he testifies, “the transaction is an investment in assets used to provide utility service.”<sup>14</sup> Mr. Miller's perspective is that, “the Company is acquiring a capital asset that is properly included in rate base, as opposed to being expensed, as is the case with costs associated with short-term hedges.”<sup>15</sup>

14 Mr. Miller testifies that “there is no *functional* difference from the customers' perspective between the gas acquired under the Transaction and other fixed price gas acquisition contracts.”<sup>16</sup> In contrast, he says, there are significant differences from the shareholder's perspective. He explains:

---

<sup>11</sup> *Id.* at 3:1-6.

<sup>12</sup> Miller, Exh. No. CAM-1T at 9:2-8. Mr. McVay testifies the Company will calculate the price of gas for purposes of the WACOG by dividing the projected annual cost of service by the therms expected to be received under the transaction. According to Mr. McVay, “[t]he cost of service will consist of five components: (1) depletion, (2) operating expenses, (3) midstream costs, (4) severance and ad valorem taxes, and (5) return on the investment (carrying costs).” McVay, Exh. No. KSM-1T at 2:9-14.

<sup>13</sup> *Id.* at 9:17-10:2.

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

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

<sup>16</sup> *Id.* at 10:3-13 (emphasis added). We note this apparent careful choice of the word “functional.” There most certainly is a *financial* difference from the customers' perspective considering that they will pay a significant return on NW Natural's investment in this gas, particularly in the early years of the joint venture.

NW Natural typically pays for hedged gas on a monthly basis, as it is delivered. In contrast, NW Natural will pay the bulk of the costs of the Transaction over the relatively short five-year drilling period, while customers will receive the benefit throughout the 30 year period. To a significant extent, then, the Company will be required to finance the Transaction up front. Including the investment in rate base would be consistent with the Commission's treatment of other utility investments used to provide service to customers. It would also provide shareholders a reasonable rate of return on their investment.<sup>17</sup>

- 15 Using current costs of capital and tax rates, the Company estimates the all-in projected cost of gas under the transaction is approximately \$0.539 per therm over the 30-year period of analysis.<sup>18</sup> The near term costs range from \$0.545 per therm in 2011 to \$0.511 in 2015. The Company projects that the gas costs after 2015 will increase steadily, reaching \$0.568 per therm in 2030, then decrease for five years to \$0.527 per therm, followed by increases over the final six years of the expected 30 year term to \$0.714 per therm.<sup>19</sup> Using the 12-month period November 2011 through October 2012, Mr. McVay provides a "Sample of 2011-2012 PGA Input" showing about 31 percent of the weighted average rate per therm being attributable to carrying costs (*i.e.*, returns on equity and debt), 25 percent attributable to operating expense and taxes (*i.e.*, severance and ad valorem taxes), with the remaining 44 percent representing "delivery value" (*i.e.*, rate per therm multiplied by total therms).<sup>20</sup>
- 16 **TARIFF FILING.** Important context to our consideration of this matter is provided by a brief discussion of the full regulatory process to which it has been subject, including process before the OPUC. NW Natural, during the course of its negotiations with Encana, filed with the OPUC on January 31, 2011, its Application for Deferred Accounting to implement such accounting treatment to track anticipated expenses incurred from the effective date of its anticipated transaction with Encana

---

<sup>17</sup> *Id.*

<sup>18</sup> McVay, Exh. No. KSM-1T at 8:8-11.

<sup>19</sup> Exh. No. KSM-3.

<sup>20</sup> Exh. No. KSM-2.

through October 31, 2011.<sup>21</sup> NW Natural stated in its accounting petition its intention, once the terms of its agreement with Encana approached finality, to make a tariff filing with the OPUC to incorporate the expenses associated with the gas purchase into rates on an annual basis, through the Company's PGA mechanism. The Company requested expedited review.

- 17 On February 18, 2011, NW Natural filed with the OPUC in docket UG-240 revisions to its PGA tariff sheets to add provisions that would allow the Company to assign to its Oregon customers the benefits and costs of the proposed joint venture with Encana. NW Natural also requested a determination by the OPUC that its entry into the joint venture was prudent. The Company again requested expedited review, stating that OPUC regulatory approval was required by April 26, 2011, because it was necessary for the transaction to close quickly, by May 1, 2011, in order to preserve its economic benefits. The OPUC consolidated NW Natural's tariff filing for consideration with the related accounting petition in docket UG-1520. Following several rounds of prefiled testimony by NW Natural, OPUC regulatory Staff and intervenors, NW Natural filed on April 25, 2011, an unopposed stipulation to resolve all issues, and supporting testimony.
- 18 The OPUC conducted proceedings "on an extremely expedited basis" according to its Order No. 11-140, issued on April 28, 2011, and approved the unopposed stipulation agreed to by NW Natural, OPUC regulatory staff, and others. This provided the necessary regulatory approval for the transaction to be finalized and become effective on May 1, 2011.<sup>22</sup> The OPUC followed this with Order 11-176 on May 25, 2011, providing its analysis supporting the decision it announced in Order 11-140.

---

<sup>21</sup> The OPUC docketed the application as UG-1520. The facts we relate concerning the OPUC process are available from the record of the agency's proceedings, which is available on its Internet web pages at:  
[http://cms.oregon.egov.com/puc/Pages/search.aspx?cx=005482606056434223770%3Aauq7asij-tbc&cof=FORID%3A10&ie=UTF8&ot=UG1520&rs=0&as\\_siteSearch=edocs.puc.state.or.us%2fefdocs&q=UG1520&sa=Search&as\\_epq=&as\\_oq=&as\\_eq=&as\\_filetype=&as\\_qdr=&as\\_occt=&siteurl=http://cms.oregon.egov.com/puc/Pages/search.aspx](http://cms.oregon.egov.com/puc/Pages/search.aspx?cx=005482606056434223770%3Aauq7asij-tbc&cof=FORID%3A10&ie=UTF8&ot=UG1520&rs=0&as_siteSearch=edocs.puc.state.or.us%2fefdocs&q=UG1520&sa=Search&as_epq=&as_oq=&as_eq=&as_filetype=&as_qdr=&as_occt=&siteurl=http://cms.oregon.egov.com/puc/Pages/search.aspx). We take official notice of this record.

<sup>22</sup> *Re Northwest Natural Gas Company*, Dockets UM 1520 and UG 204, Order No. 11-140 (Apr. 28, 2011). This order was subsequently corrected by Order No. 11-044 issued on May 2, 2011.

19 The OPUC determined NW Natural's joint venture with Encana to be prudent and in ratepayers' interest because:

- The average expected cost of natural gas of \$5.15 per dekatherm falls at the low end of a reasonable range of forecasts of future gas prices and indicative prices for other long-term supply arrangements.<sup>23</sup>
- The cost of gas acquired through the transaction is expected to be stable and offers a hedge against sharp price increases in the future.
- Many of the risks associated with developing gas reserves have been mitigated.
- The remaining risks and rewards are fairly shared in the annual PGA mechanism.<sup>24</sup>

20 A little more than two months after receiving regulatory approval in Oregon and finalizing its transaction with Encana, NW Natural filed with the Washington Commission on July 7, 2011, seeking a determination of prudence and approval of tariff revisions mirroring to a large extent those approved in Oregon. The Company's revised tariff sheets bore an effective date of August 6, 2011. The Commission followed Staff's recommendation and suspended the tariff filing on July 28, 2011, and set the matter for hearing.

21 Mr. Miller testifies that soon after its tariff filing in Washington, NW Natural initiated discussions with Staff and it became clear to the Company that Staff was unlikely to support the proposed tariff revisions.<sup>25</sup> Mr. Miller also states that Public Counsel indicated it would likely oppose the tariff filing.<sup>26</sup> The Company, based on these reactions, assumed it could not obtain regulatory approval in Washington without participating in a lengthy proceeding. A complicating factor from NW Natural's perspective was that the transaction's greatest costs are in its early years while the

---

<sup>23</sup> We note this cost of gas is significantly lower than the average \$5.39 per dekatherm to which Mr. McKay testifies in this proceeding.

<sup>24</sup> *Re Northwest Natural Gas Company*, Dockets UM 1520 and UG 204, Order No. 11-176 at 9 (May 25, 2011).

<sup>25</sup> Miller, Exh. CAM-2T at 4:19-21.

<sup>26</sup> *Id.* at 5:3-4.



greatest benefits occur in later years. Therefore, according to Mr. Miller, even if the “Commission were to approve the transaction, a late allocation of costs and benefits to Washington customers—without some type of complicated true-up mechanism--would result in an unfair burden on Oregon customers.”<sup>27</sup>

22 The Commission scheduled a prehearing conference to be held on August 22, 2011. NW Natural, however, informally contacted the presiding Administrative Law Judge shortly prior to that date, informing him that Staff and the Company had entered into discussions that were likely to lead to NW Natural seeking leave to withdraw its tariff filing. NW Natural requested informally that the scheduled prehearing conference be cancelled pending developments. On August 22, 2011, the Company formalized its request by filing an appropriate letter with the Commission. Later on August 22, 2011, the Commission issued its Notice Cancelling Prehearing Conference.

23 On September 23, 2011, the Commission accepted for filing the Joint Motion of NW Natural and Commission Staff To Allow Withdrawal of Tariff Filing. The Joint Motion stated that the Company wished to withdraw the tariff filing with the understanding that the Commission would not require the Company at any time in the future to include the costs or benefits of the transaction in Washington rates.

24 The Commission granted the Joint Motion “to the extent of giving NW Natural leave to withdraw its tariff filing, which will result in the docket being closed.”<sup>28</sup> The Commission declined, however, to provide “any commitment from the Commission concerning the current or future treatment of costs associated with the Encana contract.”<sup>29</sup> NW Natural elected not to withdraw its tariff filing and continued to work with the other parties in an attempt to resolve the issues. This led ultimately to the Settlement Stipulation filed on April 24, 2012, which is now before us.

25 **SETTLEMENT STIPULATION.** The terms of the proposed settlement are straightforward. NW Natural agrees to withdraw its tariff filing. The Company and Staff agree that NW Natural will not include in its Washington rates any of the costs

---

<sup>27</sup> *Id.* at 5:8-11.

<sup>28</sup> *Wash. Utilities and Transp. Comm’n v. Northwest Natural Gas Co.*, Docket UG-111233, Order 02 ¶12 (Oct. 12, 2011).

<sup>29</sup> *Id.* ¶10.

or benefits associated with the Encana transaction and the Company will maintain a Washington-specific gas supply portfolio. NW Natural commits to serve Washington customers consistent with past practice, using a mix of financial hedges, storage inventories, and market purchases, designed to produce an optimal level of risk and the least cost to customers.

- 26 Under the terms of the stipulation, the Commission will continue to 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.
- 27 **STAFF'S SUPPORT FOR THE SETTLEMENT STIPULATION.** Staff opposes the proposed tariff revisions and accordingly supports withdrawal of the Company's filing. Ms. Huang and Mr. Buckley filed detailed testimony explaining Staff's perspective on the transaction and NW Natural's proposed tariff. In the final analysis, Staff concludes Washington customers will be adequately protected and better served by having NW Natural continue its past practices as it manages risks in acquiring gas at least cost to customers.
- 28 Staff's objection to the proposed tariff rests, in part, on the fact that it would recover the costs of the Encana development investment via the Company's PGA. Ms. Huang testifies that the PGA is not designed to recover plant-related investments, including rate base items that are normally recovered in a general rate proceeding. She testifies further that Washington customers are better off with increased financial hedges from the Rockies in the Washington-specific portfolio, in lieu of the Encana gas. She illustrates this in the immediate term by comparing the respective Washington and Oregon weighted average costs of gas (WACOG) in the Company's most recent PGA filing, effective November 2011. The Oregon WACOG, including Encana gas, was \$4.7536/dekatherm. The Washington WACOG, excluding Encana gas, was \$4.7373/dekatherm.

29 Given the significant up-front costs of the transaction, this is not unexpected. While the comparison could go the other way at some point in the future, such a reversal assumes prices in the general gas market higher than the estimated cost per dekatherm to ratepayers over the life of the transaction. This cost is approximately \$5.39/dekatherm, including fixed capital costs, estimated variable costs, and the effects of certain allowed tax deductions for drilling carried out by partners with an operating or working interest.<sup>30</sup>

30 Mr. Buckley testifies at length concerning his evaluation of the prudence of the transaction taking what he describes as “a qualitative risk assessment analysis using the material provided in the Company’s filing, as well as through data requests.”<sup>31</sup> Mr. Buckley testifies that he reviewed various factors relevant to the transaction with attention to the risk each may have on Washington’s NW Natural customers. He explains that he adopted the same general categories of risks associated with the transaction as the Company and consultants who evaluated it. These are:

- Reserve/production rate risk.
- Drilling risk.
- Operations costs risk.
- Regulatory tax risk.
- Regulatory environmental risk.
- Price risk.
- Performance (*i.e.*, bankruptcy) risk.

31 Mr. Buckley is concerned about reserve/production rate risk because the reserves and production-related factors associated with the Company’s working interest in the Jonah Field would be an integral part of any Commission review of prudent gas costs

---

<sup>30</sup> McVay, Exh. No. KSM-1T at 8:8-11.

<sup>31</sup> Mr. Buckley cautions that “Staff does not have the expertise to evaluate the purchase and operation of an operating gas field or the associated reserves” and, facing budget constraints, elected not to hire an oil and gas consulting firm. Staff accordingly relied on materials provided by NW Natural, many of which were prepared by the Company or at its direction. Mr. Buckley testifies: “Although Staff is not claiming any undue bias in these studies, Staff is reluctant to take the results of such studies at total face value and would have preferred its own independent analyses if that had been possible.” These caveats are significant given that Staff has serious concerns about the cost effectiveness of the transaction even though its review is based on the Company’s analyses arguably supporting its prudence.

for Washington customers. This adds a level of site-specific analysis and complexity to NW Natural regulation that is not present now.<sup>32</sup> Mr. Buckley testifies that Staff's ability to evaluate such factors is limited, at best.

32 Staff finds that drilling risks are the most acceptable part of the transaction because NW Natural's share of the costs of drilling are capped.<sup>33</sup>

33 NW Natural is responsible under the terms of the transaction to reimburse Encana for operational costs based on its proportional interest in the entire field. As wells are drilled, this responsibility increases and there is no cap.<sup>34</sup> Mr. Buckley is concerned that while the record includes confidential evidence that suggests the possibility operating costs may increase significantly over the term of the transaction, a study by Netherland, Sewell, & Associates (NSAI) on which NW Natural depends in evaluating the transaction, holds these expenses relatively constant, even showing declining costs after 2015 in projections of reserves and revenue calculations. On the other hand, another study on which NW Natural relies, prepared by KPMG consultants, recognizes that NW Natural could be subject to increased operating costs, particularly increases in gathering and processing fees beyond those currently negotiated and to increased costs due to poorer than anticipated reservoir performance. KPMG studied net present value sensitivities based on changes in operating costs on a \$/MCF basis. The study shows a potential for increases in operating costs to erode customer benefits significantly, a matter of concern for Staff, according to Mr. Buckley's testimony.<sup>35</sup>

34 Staff also believes that "the operational cost category would be the battleground for other potential cost increases, such as those associated with environmental and/or wildlife mitigation efforts, clean air or clean water efforts, or any other costs brought about by regulatory action."<sup>36</sup> Mr. Buckley expresses his doubt that the terms of the

---

<sup>32</sup> Buckley, Exh No. APB-1CT at 16:16-20.

<sup>33</sup> *Id.* at 17:3-12.

<sup>34</sup> *Id.* at 17:16-18:5.

<sup>35</sup> *Id.* at 18:7-19:7.

<sup>36</sup> *Id.* at 19:8-17.

transaction adequately protect Washington customers from the significant risks this poses for increased operating expense in future years.

35 Assessing what he identifies as “regulatory tax risk”, Mr. Buckley says that site-specific tax treatment differences are unlikely. Since such changes would affect the overall gas market from the standpoint of regulatory tax risk, the transaction’s mitigation terms are most likely sufficient.<sup>37</sup>

36 This may not be the case, however, with environmental issues that arise from regulatory actions.<sup>38</sup> Mr. Buckley testifies that current drilling practices, including fracking wells to retrieve natural gas, is being increasingly scrutinized in terms of environmental concerns related to drinking water, ozone, greenhouse gas emissions, the potential for spills and wildlife endangerment. Each of these issues involves real areas of concern. While he says he cannot evaluate these concerns in detail, Staff is concerned that all of these environmental regulatory risks “have the potential to increase costs to ratepayers, as well as involve the Company, Commission, and Washington customers in a number of highly visible and highly contentious environmental issues.”<sup>39</sup>

37 Price or market risk associated with the transaction concerns Staff for two reasons. Staff has concerns about NW Natural’s analysis of long-term gas supply alternatives and the resultant claimed benefits for customers at the time the transaction was entered into. Mr. Buckley describes how the Company evaluated this question and expresses his view that the economic analysis of long-term gas supply alternatives did not provide a meaningful measure of the transaction’s benefits and, thus, the ultimate risk to Washington customers.<sup>40</sup>

38 Staff’s second area of concern is the price or market risk associated with comparing the transaction to what would be the Company’s gas supply costs under its normal historical gas supply portfolio mix acquisition strategies. Mr. Buckley testifies that

---

<sup>37</sup> *Id.* at 20:19-21:2.

<sup>38</sup> *Id.*

<sup>39</sup> *Id.* at 27:15-20.

<sup>40</sup> *Id.* at 28:18-29:23.

the transaction should not be measured against a hypothetical and likely unavailable long-term gas supply alternative, as done in NW Natural's analysis, but against a more traditional approach of varying-term gas hedges, the use of storage facilities, and short-term spot market purchases. Mr. Buckley says, "[t]his is essentially equivalent to the resource portfolio mix used by the Company today to serve its Washington customers."<sup>41</sup>

39 Mr. Buckley concludes that it is virtually impossible to measure, and carry out a meaningful evaluation of the risks associated with the transaction due to its length and assumed delivery characteristics. However, he believes these risks are significant from a Staff and Washington customer perspective.

40 Mr. Buckley, cautioning that he is not an attorney, testifies that Staff is concerned that NW Natural may not be protected in the event of an Encana bankruptcy. Considering NW Natural's shared property interests under the transaction an Encana bankruptcy could have financial consequences for the Company. There is also at least some risk of impairment to NW Natural's rights in the property and its underlying gas reserves.<sup>42</sup>

41 Staff concludes that the transaction, taking all these seven risk categories into consideration, carries an unacceptable level of risk for Washington customers given the other alternatives available. Mr. Buckley acknowledges that relying on the Company's past practice of serving Washington customers with a mix of financial hedges, storage inventories and market purchases does not entirely insulate them from these risks because they also exist in the general gas market to one degree or another. Mr. Buckley testifies, however, that maintaining the status quo does insulate customers from the specific risks of this transaction, which he regards as presenting a less acceptable level of exposure for Washington customers.

42 Mr. Buckley testifies that Staff has two additional concerns about the transaction and NW Natural's proposed treatment of it in rates. He specifically identifies the requirement of a fixed, five-year upfront \$251 million payment by NW Natural for

---

<sup>41</sup> *Id.* at 29:23-26.

<sup>42</sup> *Id.* at 33:1-32:10.

what he describes as “a risky and variable stream of benefits over 30 years.”<sup>43</sup>

According to Mr. Buckley, the transaction would raise less concern if this payment were to be spread out over the life of the transaction so that costs would better match benefits.

43 Finally, Staff is concerned with NW Natural’s inconsistent characterization of the transaction. On the one hand, Mr. Friedman testifies that the transaction functions much like a 10-year hedge for customers.<sup>44</sup> On the other hand, Mr. Miller testifies the transaction is an investment in fixed assets and therefore the costs should be properly included in rate base.<sup>45</sup> The matter is further complicated, in Staff’s view, because NW Natural already has exercised its option to have Encana market the Company’s share of production at the Opal Hub. This event converts what NW Natural defines as an acquisition of fixed assets, ostensibly justifying rate base treatment, to what is not even a physical hedge, but a financial hedge.<sup>46</sup>

44 All things considered, Staff concludes that the transaction carries an unacceptable level of risk for Washington customers given the other alternatives available. Staff accordingly supports the Settlement Stipulation providing that NW Natural will withdraw its tariff filing, will not include in its Washington rates any of the costs or benefits associated with the Encana transaction, and will maintain a Washington-specific gas supply portfolio consistent with past practice, using a mix of financial hedges, storage inventories, and market purchases, designed to produce an optimal level of risk and the least cost to customers.

45 **NW NATURAL SUPPORT FOR THE SETTLEMENT STIPULATION.** The stipulation, from NW Natural’s perspective, reflects a pragmatic solution to the question of how to account for the costs and benefits of the Encana transaction. By withdrawing the tariff filing and establishing separate portfolios for Oregon and Washington customers, the former including gas from the joint venture and the latter not including such gas, NW Natural avoids possible allegations from its Oregon

---

<sup>43</sup> *Id.* at 34:12-23.

<sup>44</sup> Friedman, Exh. No. RSF-1T at 4:13-5:2.

<sup>45</sup> Miller, Exh. No. CAM-1T at 9:17-10:2.

<sup>46</sup> Buckley, Exh. No. APB-1CT at 35:8-16.

customers that a late allocation of costs to Washington customers is unfair.<sup>47</sup> While it is true that some sort of balancing mechanism could be devised, if the tariff gained approval in Washington after whatever process the Commission would require to consider it further, NW Natural is concerned such a mechanism would be unduly complicated.<sup>48</sup>

46 **COMMISSION DISCUSSION AND DECISION.** We find, considering the record discussed above, that it is in the public interest to approve and adopt the parties' unopposed Settlement Stipulation. We authorize and require NW Natural to withdraw its tariff filing, as provided under the terms of the stipulation. We find NW Natural's maintenance of a separate gas portfolio for Washington customers that is unaffected by the costs or benefits that may be attributable to the Company's joint venture with Encana and that is consistent with past practice, using a mix of financial hedges, storage inventories, and market purchases, designed to produce an optimal level of risk and the least cost to customers is not, in itself, imprudent. The Commission will continue to evaluate the prudence of NW Natural's resource acquisitions for Washington customers via the PGA process.

### **ORDER**

#### THE COMMISSION ORDERS THAT:

- 47 (1) The Commission approves and adopts the Settlement Stipulation filed by NW Natural and Commission Staff on April 24, 2012, which fully resolves this matter by its terms.
- 48 (2) NW Natural is authorized, and required, to withdraw its tariff filing in this matter.
- 49 (3) NW Natural will not include in its Washington rates any of the costs or benefits associated with the Encana transaction discussed in the body of this Order, and will maintain a Washington-specific gas supply portfolio consistent with past practice, using a mix of financial hedges, storage inventories, and

---

<sup>47</sup> See Miller, Exh. No. CAM-2T at 4:18-5:16.

<sup>48</sup> *Id.*



market purchases, designed to produce an optimal level of risk and the least cost to customers.

- 50 (4) The Commission will continue to evaluate the prudence of NW Natural's resource acquisitions for Washington customers via the PGA process.
- 51 (5) The Commission retains jurisdiction to enforce the terms of this Order.

Dated at Olympia, Washington, and effective May 25, 2012.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

JEFFREY D. GOLTZ, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

**NOTICE TO PARTIES: This is a Commission Final Order. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 and WAC 480-07-870.**