Exhibit No. ___ (CAM-1T)
Docket UG-11_______
WITNESS: C. ALEX MILLER

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of **NORTHWEST NATURAL GAS COMPANY, dba NW Natural,** **Revision to Schedule P to include acknowledging the recovery of the cost of gas acquired through Gas Reserves.**	**Docket UG-11______**

NORTHWEST NATURAL GAS COMPANY

DIRECT TESTIMONY OF

C. ALEX MILLER

REDACTED

July 6, 2011

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

A. My name is C. Alex Miller. My business address is 220 NW Second Avenue, Portland, Oregon 97209. My current position is Vice President, Finance and Regulation for Northwest Natural Gas Company, d/b/a NW Natural ("NW Natural" or the "Company").

Q. Please summarize your educational background and business experience.

A. I received a B.A. in economics from the University of Oregon in 1980. I received an M.B.A. from Claremont Graduate School in 1984. From 1981 through 1997, I worked at Southern California Edison in various rate and finance positions, including Vice President and Treasurer. From 1997 to 2001, I worked at PacifiCorp in various positions, including Vice President of Business Development. I joined NW Natural in 2003. I have previously testified before the Washington Utilities and Transportation Commission ("WUTC" or "Commission").

Q. What is the purpose of your testimony?

A. My testimony provides an overview of NW Natural's request for approval of its proposed ratemaking treatment for its acquisition of natural gas reserves through a joint venture with Encana Oil & Gas (USA) Inc. (hereinafter, "Encana") (the "Transaction"). I will (1) summarize the testimony of the Company's witnesses in support of the Transaction; (2) explain how the Transaction benefits NW Natural's customers; (3) explain how NW Natural's proposal for recovering the costs associated with the Transaction is consistent with Commission policy; and (4) describe the action that NW Natural requests the Commission to take.

Q. Please list the Company's other witnesses and provide a brief description of their testimony.

A. Barbara J. Cronise, NW Natural's Director of Business Development, testifies on the structure and terms of the Transaction, the risks and benefits presented by the Transaction, and the due diligence that the Company performed with respect to the Transaction.

Randolph S. Friedman, NW Natural's Director of Gas Supply, explains how the Transaction fits into the Company's overall portfolio purchasing strategy and describes the price benefits of the Transaction. Mr. Friedman also discusses the reasons why it is a favorable time to enter into a long-term acquisition of natural gas.

Kevin S. McVay, Manager – Integrated Resource Planning, describes how the Company proposes to account for the costs and benefits of the Transaction, and the Company's proposed ratemaking associated with the Transaction.

BACKGROUND

Q. What is the purpose of this filing?

A. Since 2008, when natural gas prices spiked to more than $12 per dekatherm, and as prices have dropped over the last several years, NW Natural has come to believe that it would benefit its customers to add a portion of gas supplies—about 10 percent of annual requirements—to its portfolio in order to provide some long-term price stability. To that end, over the past 18 months, the Company made several attempts to obtain a long-term fixed-price gas supply. These attempts included bidding on a Volumetric Production Purchase, without success. Through continued exploration of the options available to the Company to procure a long-term supply of natural gas at a fixed cost, the Company was able to negotiate a deal with Encana to acquire gas at substantially fixed prices for a long term through participating with Encana in a joint venture to develop gas at the Jonah Field in Wyoming.

This filing requests (1) that the Commission issue a finding that the Company's decision to enter into the Transaction is a prudent one, and (2) that the Commission approve its proposed ratemaking treatment of the costs and benefits of the Transaction.

Q. Has the Transaction been finalized?

A. Yes. The Transaction became effective May 1, 2011. By its terms, the Transaction became effective only upon the Company obtaining satisfactory regulatory approval by the Public Utility Commission of Oregon ("OPUC"). The OPUC issued Order No. 11-040 on April 28, 2011, which provided the necessary regulatory approval for the Transaction to be finalized and become effective.[1]

Q. Why did the Company seek approval from the OPUC prior to closing?

A. Approximately 90 percent of NW Natural's gas sales are to Oregon customers. For this reason, because of the unique nature of the Transaction, and because of the size of the investment required, NW Natural was not willing to enter into the Transaction without an order by the OPUC (a) finding that its investment was prudent; and (b) adopting NW Natural's rate recovery proposal. Thus, the

[1] *Re Northwest Natural Gas Company*, Dockets UM 1520 and UG 204, Order No. 11-040 (Apr. 28, 2011). That order was subsequently corrected by Order No. 11-044 issued on May 2, 2011. On May 25, 2011, the OPUC issued Order No. 11-176 that set forth in greater detail the OPUC's analysis of the Transaction and its reasons for approval.

Company negotiated a "regulatory out" providing that the Transaction would not close without regulatory approval that was satisfactory to NW Natural.

At the end of January of this year, the Company made its filing with the OPUC, requesting a prudence finding, and approval of the Company's rate recovery proposal. The Commission opened a docket to consider the filings, and the Citizens' Utility Board of Oregon ("CUB") and Northwest Industrial Gas Users ("NWIGU") intervened.[2]

Q. Did Commission Staff and the other parties support the Company's filing?

A. Initially, they did not support all aspects of the Company's filing. However, after extensive discovery, several workshops, and a settlement conference, the parties and the Company were able to settle their differences. In particular, the Company made certain changes to its rate recovery proposal, and provided the parties with additional information demonstrating that the Company had sufficiently mitigated the risks associated with the Transaction. To memorialize the agreement of the parties on how the costs of the Transaction should be treated, and other terms, the parties entered into a stipulation ("Stipulation") that was presented to the OPUC.

Q. Did the Commission adopt the Stipulation?

A. Yes. On April 28, 2011, the OPUC issued an order adopting the Stipulation. In that Order the Commission found that the Company's decision to enter into the Transaction was prudent. The Commission also approved the ratemaking proposal agreed upon by the parties. The Commission issued a second order on May 25 in which it explained its rationale for approving the Stipulation.

[2] Cascade Natural Gas Company also intervened, but did not participate in the proceedings.

Q. Why did the Commission explain its rationale for adopting the Stipulation in a subsequent order.

A. Because of the way the Transaction was structured, it was important that the deal close by May 1. The Commission had decided to approve the Transaction by that date, but found that it needed more time to draft its analysis supporting that decision. For that reason, it issued its analysis after the approval order.

Q. Is the Company seeking from this Commission the same approvals of the Transaction that it received from the OPUC?

A. Yes. Subject to some minor modifications to conform the determinations in the OPUC Order to WUTC policies, the Company is seeking the same determinations in Washington that it obtained in Oregon.

Q. What happens if the Commission does not issue the approvals of the Transaction that the Company is seeking?

A. In that case, the Company would not include the costs of the Transaction in its gas costs that are assigned to its Washington customers, and instead they would be included only in its Oregon customers' rates.

Q. If the Commission decides not to approve the Transaction at this time, would there be a future opportunity for the Commission to reconsider that determination and have NW Natural pass on the costs and benefits to its Washington customers?

A. No, the Company would not propose to allow its Washington customers to participate in the Transaction at some future period that does not coincide with (or compensate for) the investment in the Transaction that its Oregon customers will make. It would be inequitable to allow 10 percent of NW Natural's customers to receive the benefits of a transaction that is paid for by the other 90 percent on different terms. This would occur, for example, if the Commission determined that NW Natural should pass the costs of the Transaction on to Washington customers only in some future period when the costs were below market prices. This would be extremely problematic given that NW Natural's Oregon customers will be paying for the costs of the Transaction regardless of market prices, in order to obtain long-term price stability, and what is estimated to be a net benefit over a long term.

THE TRANSACTION

Q. Please generally describe the Transaction.

A. NW Natural has agreed to enter into a joint venture with Encana, under which NW Natural will partially fund the drilling of wells in the Jonah Field in Wyoming, one of the nation's top 10 producing natural gas fields. In exchange for providing these funds, NW Natural will earn a working interest in the reserves in the field. Over 5 years, NW Natural will invest about $251 million and expects that it will receive about 93.1 BCF of gas from the Transaction over the life of the wells from which it will receive gas. NW Natural expects to acquire about 26 percent of the volumes in the first five 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.

Q. How much of NW Natural's gas requirements does the Transaction represent?

A. The Transaction will provide about 10 percent of NW Natural's total annual gas requirements during the first ten years of the agreement, and will taper off over the remaining expected life of the wells.

Q. What are the benefits of the Transaction for customers?

A. The Transaction benefits customers by:

- Providing a long-term supply of gas at essentially fixed prices;
- Increasing the diversity of the Company's supply;
- Helping to reduce overall portfolio price volatility and supply risk; and
- Delivering an expected pricing discount relative to the forward curve.

Q. What is the expected pricing discount relative to the forward curve?

A. As explained in the testimony of Barbara Cronise, the Company expects that in present value terms, customers save approximately $66.3 million in gas costs under the Transaction. However, this estimate relies on a comparison to a 10-year forward strip of prices. This is a very conservative view of the savings because the Transaction extends for longer than 10 years and, as explained in more detail by Ms. Cronise, it is unlikely that a 10-year financial hedge could actually be struck at the price assumed in this comparison.

Q. What are the benefits for the Company?

A. In addition to the factors listed for customers, the Transaction helps the Company lessen the competitive harms it would experience if gas prices spiked or rose and stayed high for an extended period. Even though the Transaction accounts for only a percentage of the company's total gas portfolio, it would help dampen the effects of price increases. Like other prudent utility investments, the Transaction also provides an opportunity for the Company to invest money on behalf of its customers and to earn a return on that investment.

Q. What are the financial terms of the Transaction?

A. Ms. Cronise will describe the financial terms in detail. However, for the purposes of my testimony, the terms can be summarized as follows: NW Natural will pay approximately $251 million over the first five years of the Transaction to pay a portion of the cost of drilling *[Confidential]**********[Confidential]* wells and receive in turn either a working interest in the reserves in the field, or a working interest in the reserves in the field plus 5 percent of the output of the drilled well, depending where the well is drilled. In addition, the Company will pay a portion of the costs to operate and maintain the well, and to gather and process the gas, over the life of the agreement.

Q. How will the Company finance the Transaction?

A. The Company proposes to finance its investment as it does all utility investments—with a mix of debt and equity. For the cost of debt, the Company plans to use the current imbedded cost of debt and for the cost of equity the current allowed return on equity of 10.1 percent. As these allowed costs are updated in future rate cases, the new costs of financing the investment will be used going forward.

RATEMAKING TREATMENT OF THE TRANSACTION

Q. Please briefly describe the ratemaking treatment requested by the Company.

A. The Company proposes to include the drilling costs in rate base, while the operational costs will be 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. Mr. McVay's testimony provides more detail on the accounting that the Company will employ to implement that result.

Q. Will variances between estimated and actual costs be borne by customers through the PGA?

A. Yes. The Company proposes subjecting all variances to the 100 percent pass-through in the Company's PGA that is in effect in Washington. In other words, the Company proposes that the costs of gas received under the Transaction would flow through to customers under the standard PGA approach.

Q. Why is it appropriate for the Company to earn a return on the drilling costs given that the Company does not generally earn a return on its gas purchases?

A. Through the Transaction, the utility is acquiring a long-term property interest in gas reserves. Unlike hedges that are primarily financial instruments, the Transaction is an investment in assets used to provide utility service. As such, 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.

Moreover, although there is no functional difference from the customers' perspective between the gas acquired under the Transaction and other fixed price gas acquisition contracts, there are significant differences from the shareholder's perspective. 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.

Q. Has the Commission ever before allowed a local distribution company ("LDC") to earn a return on purchased gas?

A. Yes. The Commission includes an adjustment to the Company's working capital to account for stored liquefied natural gas that will not be withdrawn from storage during the rate effective period.[3] Although the purchase of storage gas differs from the Transaction, both require the Company to finance the purchase of gas "up front" that will benefit customers over a longer term. Therefore it is consistent with Commission policy to allow the Company to include its investment in the Transaction in rate base.

[3] *See e.g. Wash. Util. and Transp. Comm'n v. Washington Natural Gas Comp.*, Docket UG-920840, 4th Suppl. Order (Sept. 27, 1993).

Q. Is there any precedent for the Commission recognizing the costs of new resources in its rates through mechanisms other than a general rate case?

A. Yes. Although not the standard approach, the Commission has allowed utilities to recognize the costs of new resources other than in a general rate case.[4] Here, it makes sense for the Commission to do so. First, as I mentioned above, in order to maintain equity between Oregon and Washington customers, the costs of the Transaction should be included in the rates of both groups of customers in roughly the same time frame. Because the Company felt that it needed pre-approval of the Transaction from the OPUC, it is now in the position of asking for approval from this Commission at this time. Second, and more importantly, customers will not be prejudiced by this process. On the contrary, in this docket, the Company will present to the Commission and intervening parties the same information with respect to the Transaction that would be provided if the prudence determination were made at a later time during a general rate case. In many ways, determining prudence now is a more straightforward process because it is contemporaneous with the Transaction, avoiding the problems that would be associated with a look to the past to determine what the Company knew.

Q. Is the Company proposing to amortize the investment over the 30 year life of the Transaction?

A. Yes. However, it is important to note that the Transaction itself does not have a specified expiration date. Rather, the Company will continue to receive gas

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[4] *See e.g. Re Puget Sound Energy*, Dockets UE-072300 and UG-072301, Order 13 (Jan. 15, 2009) (Power Cost Only Rate case mechanism allows Puget Sound Energy to add resources to rate base outside of general rate cases).

volumes until the wells' useful lives have ended and they have been capped. It is expected that this will occur within 30 years, but it may be longer or shorter.

Q. Do you expect the Commission to conduct any ongoing prudence reviews of the Company's decision to enter into the Transaction?

A. No. Through its filings, the Company has presented the Commission with a full description of the risks and benefits of the Transaction. In addition, in the course of the proceedings, the Company and other parties will have the opportunity to comment on all aspects of the Transaction. Through this process, the Commission will be allowed to fully evaluate all aspects of the Transaction and to make a determination, based on all available information, as to whether the Transaction is in the best interest of customers—or, in other words, whether the Company's decision to participate in the Transaction is prudent. Once that decision is made, the Company does not expect that the Commission will re-evaluate whether the Company's determination to enter into the Transaction was prudent.

However, the Commission will have an opportunity to review for prudence any decision that the Company makes in carrying out its rights and responsibilities under the Transaction. For instance, the Transaction documents provide that there are certain circumstances under which the Company would have the option of suspending drilling activities, or selling its rights under the agreements. Each year, when the Commission examines the estimated and actual costs requested by the Company for recovery through the PGA, it will have an opportunity to review such decisions. If the Commission were to find that the

Company acted imprudently in exercising its rights under the Transaction, it may determine that it will make an adjustment on that basis.

Q. Specifically, what action does NW Natural request that the Commission take regarding the Transaction?

A. The Company requests that the Commission approve the tariff sheets in NWN Tariff WN U-6, filed concurrently with this testimony, with an express finding that the Company's decision to enter into the Transaction is a prudent one.

Q. Does the Company propose providing additional information to the Commission and interested parties as the drilling progresses and NW Natural begins receiving gas?

A. In the OPUC-approved stipulation the Company agreed to provide numerous reports relating to its obligations under the Transaction. The Company intends to file the same reports with this Commission as well. These reports include the following:

- Prior to the Company's 2016 PGA filing, the Company agrees to file a detailed report that describes the results of the Transaction. This report will include a comparison of actual results to forecast results and an assessment of the Company's actions with respect to its ongoing duties and responsibilities managing the Joint Operating Agreement and the Carry and Earning Agreement.
- Each quarter, as part of the regular quarterly portfolio review process, the Company agrees to report on the decisions it has made to manage the

Transaction's investment. NW Natural could provide similar information to the Washington Commission.

- The Company agrees to report to the Commission, within 10 days, of (1) any ratings downgrade of Encana; (2) any environmental liability or cleanup by Encana exceeding $50,000; or (3) any event that materially impacts the operations and drilling in the Jonah Field.

Q. By when does the Company seek to have an Order from the Commission?

A. By October 1st of this year. While we recognize that this is a short timeline for review, we believe that having an order by that time will be necessary in order to allow the Company to know whether it will include the costs of gas included under the Transaction in both its Oregon and Washington PGA filing, or only in its Oregon PGA.

Q. Does this conclude your testimony?

A. Yes.