

**BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION**

COST MANAGEMENT SERVICES,
INC.,

Complainant,

v.

CASCADE NATURAL GAS
CORPORATION,

Respondent.

DOCKET UG-061256

NARRATIVE STATEMENT REGARDING
SETTLEMENT AGREEMENT

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

CASCADE NATURAL GAS
CORPORATION,

Respondent.

DOCKET UG-070332

NARRATIVE STATEMENT REGARDING
SETTLEMENT AGREEMENT

In re Notification of Contract and
Arrangement between

CASCADE NATURAL GAS
CORPORATION,

and its subsidiary

CGC ENERGY, INC.

DOCKET UG-070639

NARRATIVE STATEMENT REGARDING
SETTLEMENT AGREEMENT

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

CASCADE NATURAL GAS
CORPORATION,

Respondent.

DOCKET UG-072337

NARRATIVE STATEMENT REGARDING
SETTLEMENT AGREEMENT

1. In accordance with WAC 480-07-740(2)(a), Cascade Natural Gas Corporation ("Cascade"), Staff of the Washington Utilities and Transportation Commission ("Staff"), Public Counsel Section of the Washington Attorney General's Office ("Public Counsel"), Northwest Industrial Gas Users ("NWIGU"), and Cost Management Services, Inc. ("CMS") (collectively, the "Parties" and individually, a "Party") hereby file this narrative statement regarding the Settlement Agreement ("Agreement") filed with the Commission on February 7, 2008 to resolve issues in four dockets pending before the Commission, Dockets UG-061256, UG-070332, UG-070639, and UG-072337 (collectively, the "Dockets").

2. The Settlement Agreement embodies a full settlement of each of the Dockets. The Parties respectfully request that the Commission approve the Settlement Agreement and grant the other approvals requested therein¹ with an effective date no later than March 7, 2008. The need for this effective date is explained herein in paragraphs 16 and 23.

3. This narrative statement will first discuss the procedural background of the Dockets and then summarize the terms of the Settlement Agreement and how they resolve the issues raised in the Dockets. It will conclude with statements of the Parties as to how the settlement satisfies the Parties' interests and the public interest.

I. PROCEDURAL BACKGROUND

A. Docket UG-061256

4. On or about August 1, 2006, CMS filed a Complaint against Cascade with the Commission, docketed as Docket UG-061256. CMS claimed that Cascade's retail sales of natural gas to customers that take transportation-only service under Retail Rate Schedule Nos. 663 and 664 ("On-System Unbundled Retail Sales") were unlawful because they were not made pursuant to tariffs or special contracts filed with the Commission. Among other things, CMS

¹ In addition to requesting approval of the Settlement Agreement and a closing of all the Dockets, the Parties request that the Commission issue the following specific approvals:

- Approve the revised tariffs attached as Exhibit A to the Agreement and lift their suspension (*see* paragraph 17 of this narrative statement); and
- Approve the transfer of contracts from CGC Energy to Cascade (*see* paragraph 18 of this narrative statement).

requested the Commission to order Cascade to cease and desist from making On-System Unbundled Retail Sales and to declare existing agreements for On-System Unbundled Retail Sales void or voidable. Later in the proceeding, CMS also raised issues regarding Cascade's retail sale of gas supply to transportation-only customers of other LDCs in the state of Washington ("Off-System Unbundled Retail Sales"). (On-System Unbundled Retail Sales and Off-System Unbundled Retail Sales are referred to together as "Unbundled Retail Sales.") CMS also claimed that Cascade violated RCW 80.28.090 and 80.28.100 in making its Unbundled Retail Sales. Cascade filed its Answer to the Complaint on August 22, 2006. On November 15, 2006, Cascade and CMS filed cross-motions for summary determination.

5. On January 12, 2007, the Commission issued Order 03 in Docket UG-061256 ("Order 03"), addressing the cross-motions for summary determination. Among other things, Order 03 required Cascade to file tariffs with the Commission to make On-System Unbundled Retail Sales. The Commission also required Cascade to file its existing contracts for Unbundled Retail Sales for further review and investigation.

6. On October 12, 2007, the Commission issued Order 06 in Docket UG-061256. Among other things, this order allowed CMS to amend its complaint to pursue claims of undue preference and discrimination under RCW 80.28.090 and 80.28.100.

7. On November 27, 2007, the Commission issued its Second Prehearing Conference Order scheduling further proceedings in Docket UG-061256.

8. Cascade has provided documents and information to Staff as Staff requested in the course of its informal investigation.

B. Docket UG-070332

9. On February 12, 2007, Cascade filed with the Commission proposed tariff revisions to govern On-System Unbundled Retail Sales as well as its existing contracts for Unbundled Retail Sales, as required by Order 03. The Commission opened Docket UG-070332 to consider the tariff revisions, for which Cascade had proposed an effective date of March 15,

2007.

10. On March 14, 2007, the Commission issued a Complaint and Order suspending Cascade's tariff revisions.

C. Docket UG-070639

11. On March 30, 2007, Cascade submitted a letter to the Commission (subsequently revised with the same effective date) indicating that Cascade intends to reactivate a subsidiary, CGC Energy, Inc. ("CGC Energy"), as of April 1, 2007, with the purpose of making Unbundled Retail Sales, in view of the Commission's suspension of Cascade's proposed tariffs in Docket UG-070332 and the impending expiration of several agreements for Unbundled Retail Sales. Cascade also filed a revised Cost Allocation Manual and other documents relating to CGC Energy and its transactions with Cascade. The Commission opened Docket UG-070639 to consider issues raised by this filing.

12. On October 12, 2007, the Commission issued Order 01 in Docket UG-070639, consolidating this docket with Docket UG-070332.

13. On November 27, 2007, the Commission issued a Prehearing Conference Order scheduling further proceedings in consolidated Dockets UG-070332 and UG-070639.

D. Docket UG-072337

14. On December 7, 2007, the Commission issued a Complaint against Cascade alleging that Cascade's making Unbundled Retail Sales through CGC Energy and not sharing the net margin from such sales with Cascade's customers violates the Commission's order approving the settlement in Cascade's recent general rate case, Docket UG-060256. The Complaint seeks penalties and other relief from Cascade. Cascade filed its Answer to the Complaint on December 27, 2007.

II. SUMMARY OF SETTLEMENT AGREEMENT

A. Settlement Discussions

15. On January 4, 2008, the Parties met at the Commission's offices in Olympia to discuss a settlement of the issues raised in all of the Dockets. These discussions continued among the Parties through the date of execution of the Settlement Agreement, February 6, 2008, and resulted in an agreement to settle all issues in all of the Dockets.

B. Wind-down and Termination of Unbundled Retail Sales (Brokering) Activity

16. Cascade has agreed that it will wind-down and terminate its business of making Unbundled Retail Sales with a delivery point at the city gate of any LDC located in the state of Washington by October 31, 2008. (This would still permit Cascade to sell natural gas at delivery points upstream of any Washington LDC's city gate, so that Cascade may continue to sell surplus gas to mitigate its costs for the benefit of core customers.) The first substantive provisions of the Settlement Agreement (paragraphs 13 through 17) detail the manner in which Cascade will wind-down and terminate these sales, and Exhibit A to the Settlement Agreement is Cascade's wind-down plan. Cascade agrees that neither it nor its subsidiaries will make any Unbundled Retail Sales on or after November 1, 2008. In addition, Cascade and CGC Energy will not renew or extend any existing contracts for Unbundled Retail Sales that may expire on or before October 31, 2008, nor will they enter any new contracts for Unbundled Retail Sales prior to October 31, 2008. (Agreement ¶ 14.) Cascade also agrees in the wind-down plan that it will notify its customers by March 1, 2008, that Cascade and CGC Energy will be exiting the brokering business by October 31, 2008, and will not renew or extend any existing contracts. Some of these contracts expire on March 31, 2008. One of the reasons the Parties are requesting approval of the Agreement by March 7, 2008, is so Cascade may provide timely notice to its customers which will allow them to make alternative arrangements for gas supply.

17. Cascade may continue to make Unbundled Retail Sales under existing contracts through October 31, 2008, subject to the 50 percent revenue-sharing provisions agreed to and approved by the Commission in Cascade's last general rate case, Docket UG-060256. Such sales

will be conducted pursuant to tariffs to be approved by the Commission. The Parties agree that the Commission should approve the revised tariffs as set forth in Exhibit B to the Settlement Agreement, and lift the suspension of the tariffs that the Commission previously ordered, as part of the Commission's approval of this settlement. These tariffs are essentially the same as the ones that Cascade filed on February 12, 2007, with the addition of an expiration date of October 31, 2008, and Cascade's current Unbundled Retail Sales are consistent with these tariff provisions. Upon Commission approval of this settlement, Cascade will file compliance tariffs. (Agreement ¶ 16.)

18. Upon Commission approval of this settlement, CGC Energy will transfer any existing contracts for Unbundled Retail Sales to Cascade. The Parties request that the Commission approve such transfers pursuant to RCW 80.16.020, as part of the Commission's approval of this settlement. Cascade will share 50 percent of the net margin received pursuant to these contracts for the time period between the effective date of such transfer and October 31, 2008, according to the methodology agreed to in the settlement in Docket UG-060256. (Agreement ¶ 17.) This transfer may not be made if Cascade and CGC Energy sell their "book" of gas supply business, as discussed in paragraph 20 of this narrative statement.

C. Sharing of Revenue From CGC Energy Gas Sales With Cascade's Customers

19. To address the Commission's Complaint in Docket UG-072337, Cascade has agreed to defer, for amortization during the annual PGA process, an amount equal to 50 percent of the net margins generated by CGC Energy from Unbundled Retail Sales from April 1, 2007 through the effective date of the transfer of agreements for Unbundled Retail Sales from CGC Energy to Cascade. (Agreement ¶ 18.) Cascade will include an additional \$24,000 with the deferred amount. (Agreement ¶ 19.)

20. The Parties have also addressed the possibility that CGC Energy may sell its "book" of gas supply business (as defined in Exhibit A to the Agreement) before the Commission approves the Agreement and before CGC Energy transfers its agreements for

Unbundled Retail Sales to Cascade. In the event that CGC Energy assigns some or all of its contracts for Unbundled Retail Sales to any party other than Cascade, Cascade agrees to defer, for amortization during the annual PGA process, an amount equal to 50 percent of the Net Gain (as defined in Exhibit A to the Agreement) generated by CGC Energy for such assignments. Cascade also commits that the Net Gain shared with customers in the event of such a sale will not be less than the amount of net margin that would have been shared with customers absent such a transaction. The Net Gain will be distributed among customers according to the methodology agreed to in the settlement in Docket UG-060256 (paragraph 12(b)(ii) of the Settlement Agreement) for the sharing of Net Margins from Gas Management Services. (Agreement ¶ 20.)

D. Revisions to Cascade's Gas Procurement Practices for Core Customers

21. In the course of investigating the allegations in Docket UG-061256, Staff raised some questions regarding Cascade's gas procurement strategy for core customers which has resulted in limited access to Rockies supply. Cascade has agreed to revise its gas procurement strategy for core customers to address Staff's questions. (Agreement ¶ 21.)

22. In 2005, Cascade revised its gas procurement strategy to include the acquisition of physical supplies on a rolling five-year basis, such that 100% of year one, 80% of year two, 60% of year three, 40% of year four, and 20% of year five would be covered by contract. Cascade will further revise its gas procurement strategy to enhance its ability to take advantage of disparities between supply basins, as is currently occurring within the Rockies basin, and maximize opportunities to purchase lower-priced Rockies supplies. The Parties agree that these revisions to Cascade's gas procurement strategies and practices, and the steps to be taken to implement such strategies, are presumptively prudent and appropriate as part of this overall settlement. Cascade's transactions implementing these strategies may be analyzed as part of Cascade's annual PGA and deferred amortization filings, or in a general rate case, for purposes of verification of lowest reasonable cost for core customers, based on information reasonably

available to Cascade at the time of each transaction.

E. Release of Capacity and Notification to CMS

23. At the request of CMS, Cascade agreed to release certain pipeline capacity from the Rockies to Bellingham, Washington through the pipeline's Electronic Bulletin Board (EBB) for the summer month periods in 2008 and 2009, at the maximum allowable rate paid by Cascade to Northwest Pipeline at the time of the release. (Agreement ¶ 21.) The volume of these releases and the locations of the receipt points are set forth in Exhibit C to the Agreement. These releases will be posted by Cascade on the EBB on or before March 21, 2008, provided the Commission has approved this settlement by that date. Cascade also agreed to provide CMS with at least 48 hours (2 business days) advance notice of the posting of such releases on the EBB. These releases will be subject to recall rights under Operational Flow Order or pipeline entitlement conditions (the current version of the Northwest Pipeline language Cascade will use is attached as Exhibit D to the Agreement). The timing of these releases is another reason the Parties are requesting approval of this Agreement by March 7, 2008.

24. All Parties agree that the volume, timing, and rate of these releases is presumptively prudent and appropriate as part of this overall settlement. The outcome of these transactions may be analyzed as part of Cascade's annual PGA and deferred amortization filings, or in a general rate case, for purposes of verification of lowest reasonable cost for core customers, based on information reasonably available to Cascade at the time of the transactions; however, the Parties will not challenge the rate received for these releases on the ground that Cascade could have received a higher rate for some or all of these releases pursuant to FERC rules adopted or amended after the Effective Date of this Agreement. Cascade will hold its customers harmless from any costs in the event the Federal Energy Regulatory Commission determines that the provisions of paragraph 21 of the Agreement are in violation of any of its rules or requirements.

F. Suspension and Closing of Dockets

25. Pursuant to the Parties' request, on February 8, 2008, the Commission issued a notice suspending further proceedings in the Dockets pending consideration of the Agreement. The Parties also agreed to ask the Commission to close each of the Dockets upon approval of this settlement.

26. The Parties agreed to release Cascade from all claims which (a) arise out of or relate to the issues raised in any of the Dockets and (b) are based on facts or occurrences existing before the Effective Date of the Agreement.

III. PUBLIC INTEREST CONSIDERATIONS

27. The Parties agree that the Settlement Agreement is in the public interest and produces a resolution of each of the Dockets that is fair, reasonable, and sufficient. The Parties recommend that the Commission approve and adopt the Agreement as a resolution of the contested issues in each of the Dockets.

28. The Agreement represents a compromise in the positions of the Parties, and was entered into in order to avoid further expense, inconvenience, uncertainty, and delay. By executing the Agreement, no Party approves, admits, or consents to the facts, principles, methods, or theories employed in arriving at the terms of the Agreement. No Party agrees that any provision of the Agreement is appropriate for resolving issues in any other proceeding.

29. In the following sections, each Party explains why adoption of the Settlement Agreement is in each Party's interests and the public interest.

30. Staff. The Settlement Agreement, resolving the issues raised in four dockets, achieves a resolution that furthers both Staff's interest and the public interest for several reasons. First, Cascade has agreed that effective November 1, 2008, it will terminate its unbundled retail sales brokering activities in Washington. Thus, most significantly, Cascade will cease the activity that is the basis of CMS's complaint, and that has raised concerns for Staff in its effects on Cascade's core customers. The Settlement Agreement provides for a wind-down period prior to termination of Cascade's brokering activities, so that existing contract customers of Cascade

will not be harmed.

31. Under the Settlement Agreement, Cascade also has agreed to revise its gas procurement strategy for core customers, which has resulted in limited access to Rockies supply. Gas supply contracts that were entered into four and five years ago, although selected at the time as the lowest cost alternative, have provided essentially all the core's needs, thereby precluding the need for supplies out of the Rockies which have actually become a lower cost supply than Gas from Sumas and AECO. Cascade will also revise its gas procurement strategy to enhance its ability to take advantage of disparities between supply basin, and to maximize its opportunities to purchase lower-priced Rockies supplies. Staff believes these changes will benefit Cascade's core customers.

32. Finally, the Settlement Agreement satisfactorily resolves the issues raised in the Complaint in Docket UG-072337, by reimbursing Cascade's core customers as required by the Commission's order accepting and adopting the settlement in Cascade's most recent rate case (Docket UG-060256). Cascade has agreed to share with all of its customers, including its core customers, 50 percent of the net margin earned by CGC Energy from its conduct of the gas supply business from April 1, 2007, through the date contracts are assigned to Cascade (or 50 percent of the net gain if the business is sold to a third party), and will continue to share 50 percent of the net margin received under these contracts until October 31, 2008. Cascade has also agreed to add an additional \$24,000 in deferred revenue. In this manner, Cascade's core customers will be fully protected and made whole from Cascade's brokering activities.

33. Cascade. Cascade thinks that the settlement achieves a fair and reasonable resolution of the issues in all the Dockets. With respect to Docket UG-061256, the settlement would remove Cascade from the market for gas supply at the city gate, which Cascade understood to be CMS's objective in bringing its complaint. While Cascade leaves this market reluctantly, it realizes that Cascade's continued participation in the market would be controversial with companies like CMS and would therefore likely require a greater level of Commission oversight than has occurred in the past. The settlement avoids the burden to the Commission for

any greater involvement in this aspect of Cascade's business.

34. The settlement also requires Cascade to revise its gas procurement practices, which may achieve lower gas costs for core customers. The settlement permits Cascade the flexibility to sell its gas supply business if that would create greater value than retaining it through October 31, 2008, and ensures that customers will share 50 percent of the net gain from any such sale. The Agreement allows Cascade to sell some of its excess pipeline capacity at the current maximum allowable FERC rate.

35. The settlement also avoids the need for further proceedings in Dockets UG-070332 and UG-070639. Cascade believes that its proposed tariffs, which will now be in effect only through October 31, 2008, reflect reasonable terms for its wind-down of the gas supply business, and are consistent with Cascade's and CGC Energy's outstanding contracts. In addition, with the transfer of the business from CGC Energy to Cascade and Cascade's agreement to share with customers the net margin earned by CGC Energy, there will be no need for the Commission to review Cascade's revised Cost Allocation Manual or CGC Energy's transactions with Cascade in Docket UG-070639.

36. Cascade's agreement to share with customers 50 percent of the net margin earned by CGC Energy from its conduct of the gas supply business from April 1, 2007 through the date contracts are assigned to Cascade (or 50 percent of the net gain if the business is sold to a third party) puts core customers in at least as good a position as if Cascade had continued in the business during this time period (which it was unable to do in view of the suspension of its proposed tariffs). Cascade has also agreed to add \$24,000 to that deferred revenue. While Cascade strongly denies any wrongdoing in this regard, the Agreement provides very reasonable terms for the settlement of the Commission's complaint in Docket UG-072337.

37. Public Counsel. Public Counsel agrees to support the Settlement Agreement as a compromise resolution of outstanding issues. While Commission Staff and CMS have taken the lead in these cases, Public Counsel has reviewed the proposed settlement in an attempt to ensure that the underlying company activity and its impact on core customers are adequately addressed.

38. Several aspects of the settlement were important to Public Counsel in deciding that it satisfies the public interest standard. Of key importance was Cascade's commitment to terminate its unbundled retail sales (brokering) activities in Washington. The termination of these activities will bring to an end the conduct that initially harmed core customers' interests and gave rise to these proceedings. The settlement also ensures that Cascade will share with core customers the net margin earned from its gas supply business between April 1, 2007 and October 31, 2008. Core customers will also share in the gain if Cascade sells its "book" of business. The settlement also addresses the issue of penalties and/or interest, raised by Public Counsel, by including an additional \$24,000 in deferred revenue. Two other important provisions from Public Counsel's perspective are the representation that the capacity release agreement is not inconsistent with FERC requirements and the related "hold harmless" provision. These provisions ensure that Cascade and/or CMS, rather than Cascade's core customers, bear the risk on this issue. Finally, Cascade's agreement to revise its gas procurement strategy is also a valuable benefit for core customers.

39. NWIGU. NWIGU supports the Settlement Agreement as a reasonable resolution of the issues raised in these four dockets in a manner that is supportable for industrial customers and in the public interest. From the industrial customers' perspective, this Settlement Agreement includes appropriate provision for a wind-down plan that provides reasonable notice without harm to existing industrial customers who have contractual relationships with CGC Energy to allow them to pursue alternative business relationships with other marketers or suppliers. NWIGU neither supports nor objects to Cascade's cessation of activity as a marketer as provided by the Settlement Agreement, but NWIGU is concerned that the terms by which such business is conducted and ended are fair to all of the customers. NWIGU finds the terms of the Settlement Agreement to be a reasonable and appropriate way for a regulated entity and its affiliate to cease such activities without harming customers and urges the Commission's support. In addition, NWIGU supports the Settlement Agreement as it properly provides for the sharing by Cascade with all of its customers, 50 percent of the net margin earned by CGC Energy from its conduct of

its gas supply business from April 1, 2007, through the date contracts are assigned to Cascade (or 50 percent of the net gain if the business is sold to a third party), and with all customers continuing to share 50 percent of the net margin received under these contracts until October 31, 2008. Furthermore, all Cascade customers, including transportation customers, will share in the net margin gains because under the Settlement Agreement those revenues will be passed back to all customers on an equal percentage of margin basis.

40. CMS. CMS believes that the Settlement Agreement achieves a reasonable resolution of the controversies relating to Cascade's non-core gas sales. Issues that have arisen under various provisions of RCW Chapter 80 and under Commission regulations would be compromised and settled. Issues concerning Cascade's use of an affiliate for some non-core sales would be similarly compromised and settled. Cascade would wind-down its non-core gas sales business by October 31, 2008, and thereafter focus on gas sales to core customers. All Cascade customers electing non-core, transportation-only service under Cascade's Schedule 663 would thereafter procure their gas supplies through competitive markets independent of Cascade.

41. The Settlement Agreement would terminate the CMS complaint proceeding in Docket UG-061256 without the need for further hearing. In return, CMS would receive assurances that it can participate in Cascade's release of surplus pipeline capacity for the summers of 2008 and 2009. CMS is to receive a brief advance-notice of those releases, thereby leveling the playing field with larger shippers who monitor capacity releases by the hour and who would very likely take all of Cascade's released capacity for themselves in the absence of notice to CMS. The capacity release would be consistent with applicable regulations of the Federal Energy Regulatory Commission, 18 C.F.R. §284.8.

42. The Settlement Agreement would also benefit other parties. Cascade will benefit through the termination of four significant Commission proceedings involving its contracts and practices. Staff and Public Counsel would receive binding assurances from Cascade regarding the sharing of revenues from non-core gas sales through the end of the wind-down period and further assurances regarding Cascade's future gas-procurement practices. NWIGU would receive

assurances beneficial to Cascade's non-core customers. In all, the Settlement Agreement is a reasonable compromise that eliminates the need for further Commission proceedings.

CERTIFICATE OF SERVICE

I hereby certify that I have this day served this **NARRATIVE STATEMENT REGARDING SETTLEMENT AGREEMENT** upon all parties of record in this proceeding by causing a copy to be sent by electronic mail and U.S. mail to:

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Dated this 19th day of February, 2008.

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By 

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