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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of
Questar Gas Company for a general Increase in Rates and Charges, and
other proceedings

UTAH COMMITTEE OF CONSUMER SERVICES MARSHALING OF EVIDENCE INITIAL BRIEF

Docket Nos.98-057-12
99-057-20
01-057-14
03-057-05

Pursuant to order of the Public Service Commission of Utah ("Commission"), the Utah Committee of Consumer Services ("Committee") files this initial brief.

INTRODUCTORY STATEMENT

The Commission has decided to re-examine the evidence in the record of these proceedings and determine anew whether the management of Questar Gas Company ("Questar Gas" or "utility"), a publicly-regulated gas distribution monopoly, prudently incurred the CO_2 processing costs at issue.

The service objectives which prudent utility management decision-making must serve, and by which such management decision-making must therefore be judged, are the utility's legal duties to charge just and reasonable rates and to provide customers the most favorable rates reasonably possible.

In addition to those basic utility service objectives, this particular prudence review is further framed by the conflicting affiliate interests and responsibilities of Questar Gas' management evident from the record. Questar Gas has no management of its own. Its operations are managed by a surrogate management group – that of its parent, Questar

Regulated Services Company ("Questar Regulated Services"), a Questar Corporation second-tier holding company. The same team of managers manages not only (1) Questar Regulated Services, but also provides management for its operating subsidiaries: (2) the Utah public utility, Questar Gas; (3) the federally-regulated interstate pipeline, Questar Pipeline Company ("Questar Pipeline"); (4) an unregulated retail energy services company, Questar Energy Services, Inc.; and (5) the further operating subsidiaries of the above four entities, such as Questar Transportation Services, Inc. ("QRS"). QRS is an unregulated Questar Pipeline subsidiary that was created to own and operate the CO_2 plant which Questar Regulated Services management implemented as a remedy for the coal seam gas threat to Questar Gas' gas supply, which remedy – along with its attendant operating costs – is at issue in these proceedings.

The record discloses that increasing volumes of Price-area coal seam gas moving in Questar Pipeline Company's ("Questar Pipeline") southern system during the decade of the 1990s posed a foreseeable threat to the utility's gas supply that grew as the volumes of coal seam gas being transported grew. The record further discloses that those increasing coal seam gas volumes – and the threat they created – were a direct consequence of earlier Questar Pipeline and Questar Corporation decisions to capture the profitable business opportunity of gathering and transporting that gas by expanding and upgrading Questar Pipeline's southern system. An undisputed Division of Public Utilities' ("Division") analysis shows that coal seam gas gathering and transport business earned an estimated $6.3 million in revenues for Questar Corporation in 1999, and those revenues have undoubtedly grown in subsequent years.

The linchpin facts in these proceedings are the conflicting affiliate interests and responsibilities of Questar Regulated Services management. While supposedly attending to and protecting the interests of the utility and its ratepayers, that surrogate management group was at the same time vested with the management responsibility of protecting and furthering the interests of Questar Pipeline, including Questar Pipeline's business opportunity of gathering and transporting the coal seam gas that was creating the threat to the utility's gas supply. During the almost decade-long development of that threat, Questar Pipeline's interest was to see more coal seam gas flow on its southern pipeline system; whereas Questar Gas' natural interest would have been to see the flow of that coal seam gas diminished.

How does a parent company management group, vested with the responsibility to manage both a utility and an affiliate with conflicting interests, adequately demonstrate to a regulatory body that its management decision to have the utility contract with that affiliate for services was a prudent *utility decision*? Beyond after-the-fact assertion, how does that management group demonstrate its decision was not really contrary to the best interests of the utility and in the best interests of the affiliate? Questar Regulated Services management has asserted that the prudence standard by which it should be judged is "whether a reasonable person, with the information available at the time, could have made the decision to contract for CO_2 processing to manage the heat content of gas reaching Questar Gas' customers." But, as the testimony of Division witness Darrell S. Hanson correctly points out, that defined standard is obviously incomplete. It fails to specify on whose behalf and in whose interests that "reasonable person" is supposed to act. Questar Regulated Services management may have acted prudently in seeking to have a Questar Pipeline subsidiary build and own and operate the CO_2 plant at utility ratepayers' costs, *if the standard is whether it properly represented and protected the interests of Questar Pipeline or Questar Corporation*. But, that is not the standard in this case. The applicable prudence standard is whether Questar Regulated Services management, acting as the management of the public utility, *acted in the best interests of the utility and its ratepaying customers* in remedying the coal seam gas threat to the utility's gas supply in the time and manner selected.

Furthermore, at this point in the proceedings, the issue is not so much whether Questar Regulated Services management did or did not act prudently under the circumstances, as *whether it has adequately demonstrated* it acted prudently under the circumstances. The Commission and the Utah Supreme Court ("Court") have made clear that a Commission finding that utility costs *resulting from a transaction with an affiliate* were prudently incurred is a prerequisite to recovery of those costs from ratepayers. The Court also stated such a finding is a prerequisite to a determination that the resulting rates are "just and reasonable." The Court has stated in previous cases that any such Commission finding must be supported by:

> subsidiary findings in sufficient detail that the critical subordinate issues are highlighted and resolved in such a fashion as to demonstrate that there is a logical and legal basis for the ultimate conclusions. It was the burden of Questar Regulated Services management in these proceedings to provide sufficient evidence to permit the Commission to make

those requisite findings. It was not the burden of other parties to prove the contrary.

Questar Regulated Services management's burden of proof is compounded in this case by the affiliate control and conflicting affiliate interests that are present – present in that surrogate management group itself. The costs at issue are not the result of any identifiable and documented bargained-for transaction between separate company managements where it might at least be claimed each side's interests were represented and protected. The costs are the result of a single parent company management's allocation of costs and benefits among conflicting subsidiary interests. Questar Pipelines subsidiary got the plant asset and revenue stream and the utility got the costs.

The utility's burden of proof with regard to that affiliate paper agreement, and the conflicting interests and responsibilities of its Questar Regulated Services management, was fatally undermined by that management's disingenuous efforts to circumvent the issue of its conflicting affiliate interests and responsibilities. Its claim that the coal seam gas threat to the utility's gas supply arose as a simple consequence of FERC open-access rules that burdened Questar Pipeline and Questar Gas equally with their consequences is belied by a record that indisputably shows the threat arose from the *increasing volumes* of coal seam gas moving in Questar Pipeline's southern system throughout the decade of the 1990s. Those increasing volumes occurred not as a result of FERC open-access rules but rather as a direct result of Questar Pipeline and Questar Corporation decisions to capture a profitable business opportunity.

Well-recognized principles of agency law impose upon a management beset by a conflict of interest the duty to promptly and forthrightly disclose that conflict to its principal so the principal can make informed decisions. Questar Regulated Services management breached that duty by not forthrightly acknowledging its conflicting affiliate interests and responsibilities in these regulatory proceedings and instead attempting to divert inquiry from those issues. Its diversion was unfortunately fatal to its case for rate recovery, for the only way it could demonstrate that its decision to procure gas processing was a prudent utility decision was by forthrightly disclosing its conflicting interests and responsibilities and *then* demonstrating how its decision was prudent *despite* those conflicting interests and responsibilities.

Earlier in these proceedings this Commission concluded that Questar Gas had failed to provide sufficient evidence to demonstrate its actions were not influenced by affiliate interests. A subsequent Utah Supreme Court

decision gave legal effect to that conclusion. Notwithstanding that disposition, the Commission has now decided its earlier evidentiary conclusion was not a binding determination, and that a further review of the record and prudence analysis is in order.

As is evident from the Committee's earlier petition for extraordinary relief filed with the Utah Supreme Court in response to the Commission's re-interpretation of its evidentiary conclusion, the Committee objects to the Commission's post-appeal decision that its evidentiary conclusion was not the finding of fact or conclusion of law it appeared to be. In the Committee's view, such post-appeal reinterpretation subverts a binding appellate Court decision and is therefore contrary to law. The Committee will not further discuss this issue in these proceedings, but reserves the right to further contest it once a final Commission order has issued.

The Commission's evidentiary conclusion stands as a valid and accurate assessment of Questar Regulated Services management's failure to address the pivotal issues of affiliate control and conflicting interests evident in the record. Affiliate control, and the obvious conflicting interests and responsibilities of that affiliate control, are a fatal taint upon any claim by Questar Regulated Services management that the CO_2 processing costs were prudently incurred in this case; a taint made all the worse by that management's failure to forthrightly disclose its conflicting interests and responsibilities and instead attempt to divert inquiry away from those issues in these proceedings.

A second evidentiary review will not repair the deficiency in the record. Questar Regulated Services management, in its capacity as manager of Questar Gas, clearly failed to meet its burden of proof. It failed to adequately and properly demonstrate the CO_2 processing costs were prudently incurred *despite* the affiliate control and conflicting interests evident in the record.

ARGUMENT

QUESTAR REGULATED SERVICES MANAGEMENT FAILED TO DEMONSTRATE THE CO_2 PROCESSING COSTS WERE PRUDENTLY INCURRED.

1. The Applicable Prudence Standard.

The applicable standard of management *prudence* in this case is ultimately defined by a utility monopoly's duty to charge just and reasonable rates and to "operate in such a manner as to give to the consumers the most favorable rate reasonably possible." Utility management's duty of loyalty and fidelity to the interests of the utility, and hence to those duties the utility has to its ratepayers, includes a further fiduciary responsibility to ratepayers where ratepayer monies are involved. Such a duty does not tolerate conflicting management interests. In fact, the duty is deemed to have been breached by the discovered existence of a conflicting interest absent prior disclosure of that conflict:

> One of the primary obligations of an agent to his or her principal is to disclose any information the principal may reasonably want to know . . . The obligation to disclose is strongest when a principal has a conflicting interest in a transaction connected with the agency. . . An agent's failure to disclose information material to the agency thus constitutes a breach of the principal-agent relationship.

Given management's duty of loyalty and fidelity to the utility and its ratepaying customers, and given the utility's duty to charge just and reasonable rates and to operate so as to give ratepayers the most favorable rate reasonably possible, whether Questar Regulated Services management – acting in the capacity of utility management – prudently incurred the CO_2 processing costs it seeks to pass on to ratepayers must be answered by first considering whether that surrogate management met its duty of loyalty and fidelity in this case. Finally, that assessment must determine whether that management met its burden of proof of showing the costs at issue were prudently incurred *despite* management's conflicting interests and responsibilities.

2. Questar Regulated Services Management Has the Burden of Proof to Demonstrate the CO_2 Costs Were Prudently Incurred Despite the Circumstances of Affiliate Control and Conflicting Interests.

The Utah Supreme Court has already concluded that the Questar affiliate presence in this case necessarily imposes upon utility management the burden to demonstrate that the utility costs resulting from interactions with its Questar affiliates were prudently incurred. The presence of an affiliate transaction removes any presumption that might otherwise exist that the resulting costs were reasonable:

> [W]e do not think an affiliate expense should carry a presumption of reasonableness.

While the pressures of a competitive market might allow us to assume, in the absence of a showing to the contrary, that nonaffiliate expenses are reasonable, the same cannot be said of affiliate expenses not incurred in an arms' length transaction.

Questar Corporation's affiliate presence in this case goes far beyond a particular transaction or the CO_2 plant remedy itself. It involves the much more pervasive and continuing presence of Questar Regulated Services management making day-to-day decisions for the utility while simultaneously burdened with conflicting responsibilities for affiliate interests, including deciding when and how to make its case for cost recovery from utility ratepayers, when at no time were the interests of the utility or utility ratepayers independently or adequately represented in the course of those day-to-day management decisions.

Since Questar Regulated Services management is the surrogate for utility management in this case, its burden of proof must necessarily encompass those troubling concerns. It has the burden to explain how its decision to remedy the threat to the utility's gas supply when it did was prudent despite its evident conflicting interests and responsibilities.

3. Questar Regulated Services Management Failed to Show Questar Gas Responded to the Threat to its Gas Supply in a Timely Manner. Questar Gas applied for rate recovery of its CO_2 processing costs on the grounds they were incurred to avert an imminent safety crisis. The Court, however, explicitly rejected those grounds as a sufficient basis for rate recovery, and further stated:

[w]hile the Commission correctly recognized Questar Gas's obligation to ensure the safety of its customers, it incorrectly concluded that this factor provided a near-automatic justification for a rate increase regardless of how the initial threat to safety arose or how the utility sought to alleviate it.

When one considers "how the initial threat to safety arose" it is clear from the record that it arose several years prior to the 1998 customer safety crisis and as a consequence of Questar Corporation and Questar Pipeline business decisions. Whether the 1998 Questar Regulated Services management decision that awarded the asset and revenue stream benefit of a new CO_2 processing plant to an unregulated Questar Pipeline subsidiary while assigning its costs to utility ratepayers was prudent must also be assessed in light of the several years of utility silence and non-response prior to 1998. Precipitate management action to avoid a crisis, no matter how well executed, is not prudent management

conduct if the crisis resulted from prior management neglect.

Questar Regulated Services management's testimony on this point is woefully incomplete, and the little there is is troubling, at best. It sought to paint the 1998 crisis as an unforseeable problem "that required immediate attention:"

> The volume of coal seam gas developed more rapidly than anticipated. In the early and mid 90s there was speculation that the volume of gas from the Ferron Fairway could be substantial at some point. If QPC and QGC made operational changes or expanded their systems, as suggested by Mr. Hanson and Mr. McFadden on such speculation, the cost to customers would be very high. Operational changes and system expansions need to be based on customer transportation contract commitments which normally follow proven production.

Whether the volume of coal seam gas developed as rapidly as anticipated or not, it was evident within Questar Corporation long before 1998 that those volumes were very likely coming. Otherwise Questar Corporation would not have invested the capital it did in expanding Questar Pipeline's southern system to accommodate them. Moreover, and more troubling, what is the factual accuracy of the statement "[i]f QPC and QGC made operational changes or expanded their systems . . . on such speculation," when Questar Pipeline and Questar Corporation had already repeatedly expanded Questar Pipeline's southern system in the years between 1991 and 1998 in response to, or in anticipation of, growing coal seam gas production?

The reality evident from the record is Questar Regulated Services management failed to confront the growing threat to the utility's gas supply, not because the safety crisis was unforeseeable, but rather because earlier effective utility action would have jeopardized Questar Pipeline and Questar Corporation efforts to secure the business opportunity of gathering and transporting the coal seam gas.

Questar Regulated Services management stated that a principal reason it selected the CO_2 plant remedy was because there was insufficient time to consider or implement other remedies. Had it earlier responded to what was clearly a foreseeable crisis there would have been ample time to explore other remedy options – even to try one or more and have them fail. The CO_2 plant remedy is characterized in the utility's application as a stop-gap measure, implemented to allow time for customers' appliances to be inspected and adjusted to efficiently operate within the utility's new BTU operating range. Had the utility's new BTU operating range been implemented earlier, the

periodic operational remedies which Questar Pipeline was apparently adequately undertaking prior to 1998 may well have sufficed as a transition tool and the costs of an expensive CO_2 plant and its operations thus completely avoided. Questar Regulated Services management's failure to address those possibilities, or why it otherwise did not respond sooner to a foreseeable threat, has made it impossible for this Commission to determine whether the 1998 remedy was timely and appropriate under the circumstances.

4. Questar Regulated Services Management Failed to Show that a CO_2 Plant Paid for by Ratepayers Was the Most Reasonable Remedy under the Circumstances.

Even if the CO_2 plant was an appropriate remedy, it should not have been paid for by the utility or utility ratepayers. The most reasonable utility remedy, one that springs from the record in these proceedings, would have been a prompt demand by an independent utility management upon an independent Questar Pipeline management that it remedy the foreseeable threat to the utility's gas supply caused by Questar Pipeline's new business opportunity. But, of course, there was no independent utility management to make such a demand. Nor was there any independent Questar Pipeline management to make the demand of. There was by 1995 only one management for both entities: Questar Regulated Services management, which was not about to harm its Questar Pipeline business interests in the prudent service of its Questar gas interests or those of its utility customers.

Questar Pipeline could have just as easily and quickly not only built and operated the CO_2 plant – which it did – but also paid for its operation – which it isn't. Such a remedy would have put the costs on a much more appropriate party than the utility and its ratepayers, and was obviously every bit as quick and sure as the remedy Questar Gas management is attempting to make ratepayers pay for.

Moreover, had such a prompt demand by a responsible utility management been made, Questar Pipeline would have had some incentive to revise its pipeline gas quality tariff in a manner that would have placed the responsibility for further processing the coal seam gas upon the coal seam gas producers. And, it would have also given the periodic operational remedies which Questar Pipeline undertook prior to 1998 some more legitimate basis than the purported acts of charity by which Questar Regulated Services management has characterized them in these proceedings. Finally,

had such prompt utility remedy efforts come to naught, either Questar Gas or Questar Pipeline could have filed an action with the FERC for a binding cost allocation.

That Questar Regulated Services management never proceeded with such a course of action, or otherwise demonstrated in these proceedings why such a course was unworkable, belies its claim that having the utility incur the CO_2 gas processing costs in 1998 was a prudent utility decision. In that regard, the Court has already stated:

> Questar Gas's decision not to seek a cost allocation determination from FERC, given the possibility that FERC might have imposed the entire cost on producers rather than on ratepayers, raises further questions regarding the utility's fidelity to its obligations to its customers.

5. *Questar Regulated Services Management Was Imprudent in not Disclosing its Conflicting Affiliate Interests and Management Responsibilities.*

Questar Regulated Services management's application, in the name of Questar Gas, for rate recovery of Questar Transportation Services' processing costs states:

> Increased production of coal seam gas on QPC's southern system is making it impossible to maintain the BTU content of the gas delivered through the southern system to QGC's customers within the 1020 to 1080 range.

In prepared testimony accompanying the utility's application, Questar Regulated Services management stated:

> Questar Pipeline is an open access interstate pipeline and must provide transportation on a non-discriminatory basis. As long as the coal seam gas meets quality standards and other tariff provisions, Questar Pipeline is obligated to provide transportation service at their FERC-approved rates to the extent that capacity exists.

These and other disingenuous statements in the utility's applications and supporting testimony hide, and divert attention from, Questar Pipeline's and Questar Corporation's causal role in the threat to the utility's gas supply. Absent those affiliate undertakings to capture the business opportunity of gathering and transporting the coal seam gas, there would have been no need for a CO_2 plant remedy.

Questar Corporation was not compelled by the FERC or any other party to pursue that business opportunity, and it did not have to expand Questar Pipeline's southern system to do so. There is nothing wrong in Questar Corporation and Questar Pipeline pursuing a new business opportunity – even the coal seam gas gathering and transport opportunity.

There was also nothing necessarily wrong in Questar Regulated Services representing those affiliate interests. The wrongness lies in the failure of a *utility management* – surrogate or otherwise – to properly and timely respond to business activities of other parties – affiliates of the utility or otherwise – that posed a threat to the utility's gas supply. It may be understandable that where a utility subsidiary is wholly-owned and dominated by its unregulated parent it may be constrained in the actions it is able to take that conflict with the business objectives of its parent, but that such circumstances are understandable does not justify making ratepayers bear the resulting costs. To the extent the ability of Questar Gas to assert and protect its utility interests, and those of its ratepayers, is limited by conflicting Questar Corporation business objectives and affiliate control, the much broader regulatory issue arises whether Questar Corporation is properly abiding by the Commission's conditional approval of Questar's ownership of the utility granted in the Commission's 1984 order, an approval conditioned upon – at least in the subsequent view of the Court – Questar Gas and its management maintaining "an 'arms-length' relationship with Questar [Corporation] and its affiliates."

Questar Corporation's and Questar Pipeline's primal roles in causing the coal seam gas threat to the utility's gas supply is evident from the record. According to opposing party testimony and discovery data referenced in the record, Questar Pipeline, as early as 1991, voluntarily entered into "future capacity" transport agreements with the Price-area coal seam gas producers to install additional capacity on its southern system by a date certain. By 1993 Questar Corporation was publicly reporting on that Questar Pipeline expansion, and its own capital investment in that new business opportunity. It continued to periodically report in the years thereafter on further expansions to Questar Pipeline's southern system, and on its further capital investments, to accommodate transport of the growing coal seam gas production. For example, in 1996 it reported:

> An expansion project is under way near Price, Utah, the site of a large coal-seam gas-drilling program. An estimated 600 wells are planned to tap enormous methane reserves. Current daily production of 50,000 dth per day could increase to 250,000 dth by the year 2002. Questar Pipeline's initial investment will be $1 million, *with additional potential expenditures for new facilities as production increases.* [Emphasis added.]

The fact that affiliate business interests created the harm to the utility's gas supply – and thus the need for a remedy – while circumscribing the utility's ability to defend its interests in the face of that affiliate harm, is itself a

compelling reason to deny any cost recovery of CO_2 processing costs from ratepayers. An even more compelling reason, however – and the *linchpin fact in these proceedings* – is that Questar Regulated Services management was itself *necessarily* working at cross-purposes to the best interests of the utility and its ratepayers with regards to that threat and its proper and timely remedy.

By the mid-1990s Questar Corporation had restructured the already closely-affiliated managements of Questar Gas and Questar Pipeline into a single management structure which it describes as follows:

> All members of the Regulated Services group have common officers and share service functions, e.g., marketing, planning, business development, engineering, compensation, legal, regulatory affairs, accounting, and budgeting. All Regulated Services employees share base and incentive compensation programs and are expected to work together to improve customer service and operating efficiency. The integration of the entities has resulted in lower operating and maintenance costs and better coordination of activities and projects.

This integration of utility management into a Questar parent company management structure was confirmed at various times in these proceedings. For example, during cross-examination of Questar Regulated Services management witness Alan K. Allred he responded as follows:

> Q In terms of drawing your conclusion about the prudence of the CO_2 processing plant that is at issue in this case, from which of the Questar Company's (sic) standpoint are you defining prudence?
>
> A I'm defining it from the standpoint of Questar Gas. . .
>
> Q So in other words, the hat you're wearing today is that of Questar Gas?
>
> A Yes, I'm appearing on behalf of Questar Gas.
>
> Q But you stated on the stand that you represent Questar Regulated Services. And how does that fit into the overall corporate structure?
>
> A Questar Regulated Services provided certain services to both Questar Gas and Questar Pipeline. In my particular area, I am in charge of the regulatory activities for both Questar Gas and Questar Pipeline, as well as the gas supply activities of Questar Gas.
>
> Q So, in some sense, you wear two hats on occasion?
>
> A I have job responsibilities that deal with both Questar Gas and Questar Pipeline, so in common parlance, I guess that could be sporting two hats. . .
>
> Q And who do you report to at Questar Regulated Services?
>
> A I report to Mr. D.N. Rose, the president and CEO.

Q And he's the top official at QRS, Questar Regulated?

A He is.

Q And who is the top official at Questar Gas?

A Mr. Rose is also the President and CEO of Questar Gas.

Q In this case, who was the, quote/unquote, prudent manager who was responsible for making the decision to go with the CO_2 processing plant as a means of solving the problem with the coal seam gas?

A As I recall, that decision was arrived at by Mr. Rose and his staff, of which I'm a member . . .

. . .

Q Did anybody, if there is such a person that could act just on behalf of just Questar Gas, make any effort to get Questar Pipeline to take steps to solve this problem?

A We certainly looked at and said what could Questar Pipeline do to solve this problem. We did not see a way to do that at any lower cost or any better solution than the one we chose. If we had, we would have pursued it.

This integration of utility and Questar Pipeline managements makes Questar Regulated Services management's conflicting interests, with regard to the threat to the utility's gas supply and its remedy, obvious. Note the statement:

> *We* certainly looked at and said what could Questar Pipeline do to solve this problem. *We* did not see a way to do that at any lower cost or any better solution than the one *we* chose. If *we* had, *we* would have pursued it. [Emphasis added.]

Given the growing stream of corporate revenues from gathering and transporting the coal seam gas and Questar Corporation's capital investments in expanding Questar Pipeline's system to accommodate that growing revenue stream, can there be any serious question where the loyalties of Questar Regulated Services management turned in this case?

> This illustrates that the Questar companies had a concern that if they solved the low BTU problem by changing the gas quality specifications in the QPC tariff it would upset the other QPC transport customers to the extent that they might look for another pipeline to build facilities into the area and transport their gas. *This presents a conflict of interest between QPC and QGC. QGC was not, and is not, independent in searching for the cheapest way to solve the low BTU problem.* [Emphasis added.]

Regarding the conflicting loyalties of Questar Regulated Services management, Division witness Darrell S. Hanson further observed:

> One incentive [for Questar parent company management not pursuing the option to make coal seam gas producers responsible for further decreasing the CO_2 content of their gas,

> ed.] would be to keep the producers happy as transportation customers. Questar did not want to lose this potential market. It didn't want to risk another pipeline being built into the area that would take away this additional transportation business.
>
> A more subtle reason is that it could increase profits that Questar companies could get from providing some of the services in the chain from the wellhead to the point where price is determined by market conditions. Examples of these services are gathering, transportation, storage, and marketing. Various Questar companies provide these services as the coal seam gas moves from the wellhead to the market. For example QPC transports the coal seam gas at discounted prices to meet market conditions. Adding another cost to the production costs reduces the margin available for paying for transportation and still being able to meet what the market will allow.

The principal witness for the UAE industrial group explained how Questar Regulated Services management apparently sought to resolve its conflicting interests:

> In its role as pipeline owner and local distribution company owner, the Questar Corporation faced a conflict of interest. From the point of view of the pipeline, transportation of enormous quantities of coal-seam gas represented significant potential revenues. On the other hand, Questar Corporation has obligations to the customers in the (utility's) territory to ensure a safe gas supply. It was in the pipeline company's interest to court the coal-seam producers to acquire their business. . . [P]rocuring a subsidy from captive customers for CO_2 removal costs would enhance the corporation's business development prospects, whereas ensuring a safe gas supply by having the producers of the coal-seam gas pay for CO_2 removal ran counter to Questar's corporate interest. In weighing the alternatives, it appears that Questar Corporation made a business decision that included a calculated risk that it could convince the Utah Commission to force the captive customers of QGC to pay for the costs of CO_2 removal.

Committee witness Michael J. McFadden testified regarding the inherent conflict of interest on the part of Questar Regulated Services management as follows:

> McFadden Consulting believes it may have been more appropriate for Questar Gas to extend its distribution system from Payson to Kern River. Instead of shipping gas from Payson to Kern River, Questar Gas could have purchased gas upstream of the interconnect on Kern River to flow gas to its distribution system. In other words, gas would flow from Kern River directly to Questar Gas, without utilizing Questar Pipeline transmission facilities. . .
>
> We addressed this alternative in our interviews with Questar Gas. They indicated that under such a scenario, Questar Gas would not have as much control on gas flowing on Kern River as it would with gas flowing on Questar Pipeline. However, it is important to note the reason Questar Gas is facing this problem is because its affiliate, Questar Pipeline, elected to flow the coal seam gas on its system. It seems Questar Gas would have as much control on Kern River as it does on Questar Pipeline. . . .
>
> . . . I can only guess as to the reason [for Questar parent company management not pursuing this remedy possibility, ed.]. Under this alternative, Questar Gas would be bypassing Questar Pipeline because gas that would otherwise be purchased on Questar

> Pipeline's system and transported by it, would now be transported by Kern River. In effect, this alternative would likely have had an adverse financial impact on Questar Corporation. My experience leads me to the conclusion that the corporate relationship at least contributed to the failure to more aggressively pursue this option.

After considering the entire record evidence and discovery information in Docket 98-057-12 and the little additional new evidence in Docket No. 99-057-20, it was the Division's considered conclusion that the actions or non-actions of Questar Regulated Services management with regard to the utility's coal seam gas problem were influenced more by affiliate interests than the best interests of utility customers:

> In sum, after extensive review of information in this case and Docket 98-057-12, the Division believes that . . . QGC's actions, or in-actions, appear to be influenced by affiliate relations more than the financial interests of its customers.

What more telling judgment of utility management imprudence could there be than this considered Division conclusion? The precondition for any reasonable and prudent decision-making by a utility management is that the decision at least be prompted by a concern for what was in the utility's best interests – certainly not by what best serves conflicting affiliate interests.

The serious conflicting interests and responsibilities of Questar Regulated Services management fatally undermine its claim of prudence with regard to incurring the utility costs at issue in these proceedings. That it failed to forthrightly disclose those conflicting interests and responsibilities, makes its behavior all the more unacceptable and imprudent.

6.The Lack of any Contemporaneous Documentation Supporting the Claim of Prudent Decision-making by Questar Regulated Services Management further Undermines the Utility's Case for Rate Recovery.

These proceedings are about *evidentiary proof*. After-the-fact assertions and analyses later developed for purposes of seeking rate recovery are inadequate substitutes for such proof.

During discovery Committee and Division analysts "asked extensive data requests about the process leading to the solution this company chose:"

> In responses to our data requests we got memos, copies of slide presentations, and studies. We did not get what I would consider a reasonable analysis of the relevant facts that a prudent decision maker would use in making the decision. There should be something similar to a bid analysis that is usually part of a capital budget process. This would be true in all types of companies although it is more important here where the winning choice

> involves an unregulated affiliate. QGC has not been able to produce such a document. Without such a document it is impossible to determine that the choice was prudent. *The absence of a document or documents used by the decision maker that compares the alternatives from the perspective of QGC and its customers illustrates a lack of prudence.*
>
> *I have been told that the best comparison is the one included in the prefiled testimony of Mr. DeBernardi. I find it interesting that the best analysis was something that was created at a later point in time. That analysis was prepared at the time testimony was being prepared for this case*. [Emphasis added.]

The failure of Questar Regulated Services management to produce any contemporaneous documentation supporting its claim of having acted prudently in behalf of the interests of Questar Gas and the utility's customers includes the failure to produce any corporate minutes of meetings or other documentation that would at least tend to show the decision was a *utility decision* and not simply a Questar Regulated Services decision allocating costs and benefits among its managed subsidiaries. What little documentation it did produce shows the latter: that the analysis of options and remedy were simply Questar Regulated Services actions and decisions taken in the best interests of Questar Corporation and not of Questar Gas and its ratepayers.

The failure of Questar Regulated Services management to support its claims and assertions of prudent action with any contemporaneous documentation showing its actions were timely and taken in the best interests of, and on behalf of, Questar Gas and not other Questar affiliates is a further fatal deficiency in its burden of proof in these proceedings.

7. The 1998 Carbon Dioxide Extraction Agreement Is on its Face an Example of Imprudent Utility Management Decision-Making.

The Commission has already observed that the prudence of the 1998 Carbon Dioxide Extraction agreement between Questar Gas and Questar Transportation Services, a Questar Pipeline subsidiary, that gave rise to the CO_2 processing costs at issue was "[t]he most troubling question." That agreement defines the allocation of costs and benefits between Questar Pipeline and Questar Gas with regard to the CO_2 plant remedy, and how the costs are incurred and marked-up to provide a profit to Questar Pipeline's subsidiary.

Questar Regulated Services management ostensibly represented the opposing interests of both the utility and Questar Pipeline in the negotiation and finalization of that agreement. How did it do that with loyalty and fidelity to the

interests of both parties? More critically, for purposes of this prudence inquiry, how did it do that with loyalty and fidelity to the interests of the utility and its ratepayers? Conflicting interests were certainly present in the negotiation of pricing and ownership, but their presence went far beyond those immediate issues.

Questar Regulated Services management has neither acknowledged the inherent conflict of interest it faced in attempting to represent both parties' interests in finalizing that agreement, nor has it offered any explanation as to how utility interests and those of utility ratepayers were adequately protected in the cost and benefit allocation that resulted from that paper transaction.

The Division ultimately concluded that Questar Regulated Services management was less than prudent in failing to have the utility bid the CO_2 plant project itself and in having it contract instead with an unregulated affiliate.

Questar Regulated Services management never provided a satisfactory reason for its cost/benefit allocation between Questar Pipeline and Questar Gas. The only reason it gave was:

> Questar Gas does not own or operate transportation or processing facilities upstream of its city gates. In addition, Questar Pipeline has field personnel who are located in the vicinity of the CO_2 plant.

That the utility does not own processing facilities upstream of its city gates should come as no surprise. Commission Chairman Mecham called attention to the record testimony showing Questar Gas will be "the only gas distribution company [in the country] directly bearing the costs of processing gas" as a further convincing reason why Questar "Regulated Services management should have timely submitted this matter to the FERC instead of letting it fester into a safety crisis and then contracting for gas processing at utility expense.

Division witness Hanson responded to the justification of Questar Regulated Services management for placing ownership and control of the CO_2 plant with an affiliate as follows:

> Q Does the fact that QTS bid out the design and construction of the plant alleviate the affiliate problem?
>
> A No. But this does illustrate something important. QGC could have done exactly what QTS did. There is no need for the unregulated affiliate in the middle.
>
> Q What about the argument that QGC does not have in house expertise and the affiliate does?

A I don’t believe that argument has merit. The decision to have QTS build the plant was influenced by the larger interests of Questar Corporation. My experience is that Questar Corporation moves people between companies within the corporation to accomplish what it wants done. The necessary expertise could have been provided to QGC. To me it is obvious that Questar Corporation saw overall corporate advantages to setting it up the way they have proposed.

In summary, Questar Gas’ application for rate recovery presented an agreement for Commission approval where the conflicting interests of both parties to the agreement were supposedly (but necessarily impossibly) represented by Questar Regulated Services management. Such an agreement is, on its face, an imprudent agreement insofar as the best interests of the utility and its ratepayers are concerned. And, as already stated above, such imprudence is only heightened by management’s failure to even acknowledge the conflicting interests at play, let alone explain how the terms and conditions of that agreement were prudently undertaken on behalf of the utility and its ratepayers despite those conflicting interests and responsibilities.

CONCLUSION

______As stated in the beginning of this brief, the purpose of these present proceedings is not so much to determine whether Questar Regulated Services management conformed to the duties of a prudent utility management, in which capacity it claims to have acted in awarding the asset and revenue stream value of a new CO_2 processing plant to an unregulated Questar Pipeline subsidiary, but all plant cost to utility ratepayers, as it is to determine whether Questar Regulated Services management has satisfactorily *demonstrated* it was prudent in so acting.

Prior Court and Commission rulings place the burden of so demonstrating squarely upon the utility and its management. The burden is further compounded in this case by the record facts disclosing the conflicting interests and surrogate management responsibilities of Questar Regulated Services management with regard to the coal seam gas threat to the utility’s gas supply.

Instead of comporting to established legal principles by promptly and forthrightly disclosing its conflict of interest, Questar Regulated Services management sought to evade that issue in these proceedings and did not even acknowledge the conflict. Its actions fatally undermined its case for rate recovery, for it had the unavoidable burden to

demonstrate the CO_2 processing costs were prudently incurred *despite those conflicting interests and responsibilities*, an impossible burden for one who pretends those conflicts did not exist.

Questar Regulated Services management also failed to provide any contemporaneous documentation to support its after-the-fact assertions and analyses that its decisions were taken in the best interests of, and on behalf of, Questar Gas and its ratepayers.

These burden of proof failures by Questar Regulated Services Management are convincing support for the Commission's conclusion in its August 11, 2000 Report and Order that the record was insufficient to permit a determination that utility management's actions prior to 1998 were not the result of the influence of affiliate interests. Such failures are no less relevant in these present proceedings. They require a Commission determination that none of the CO_2 processing costs at issue are recoverable in rates because Questar Regulated Services management failed to meet its burden of proof to demonstrate those costs were prudently incurred.

Respectfully submitted this 7th day of May, 2004.

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CERTIFICATE OF SERVICE

I certify that I mailed or hand-delivered the foregoing **UTAH COMMITTEE OF CONSUMER SERVICES MARSHALING OF EVIDENCE INITIAL BRIEF** this ____________ day of May, 2004.

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