-BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH-

IN THE MATTER OF THE APPLICATION OF QUESTAR GAS COMPANY FOR AN INCREASE IN RATES AND CHARGES	))))	DOCKET NO. 02-057-02

DIRECT TESTIMONY OF

RONALD L. BURRUP

FOR THE

DIVISION OF PUBLIC UTILITIES

DEPARTMENT OF COMMERCE

STATE OF UTAH

August 30, 2002

Q. Please state your name, business address, and present position with the Division of Public Utilities.

A. My name is Ronald L. Burrup and my business address is the Heber Wells Building, 160 East 300 South, Salt Lake City, Utah. My position with the Division is a Technical Consultant.

Q. Could you please discuss your education and regulatory experience?

A. I have a Bachelors Degree in Business Administration and a Masters Degree in Public Administration from Brigham Young University. I am a Certified Public Accountant and have been with the Division for more than 26 years. I have testified in a number of cases involving PacifiCorp, and Questar Gas Company, generally relating to accounting issues.

Q. What is the purpose of your testimony in this filing?

A. I have four purposes,

1) I present the Division of Public Utilities' (DPU's or Division's) reasons for adopting a partial future test year with end of period rate base. I discuss test period options and illustrate the differences in test periods.
2) I discuss the progress that has been made in developing quality of service standards for Questar.
3) I recommend three adjustments, dealing with the lead lag study, depreciation expense and employees hired after the test period.
4) I recommend that the Commission require Questar Gas Services to perform a depreciation study in 2003 and use its results in the next general rate case.

TEST PERIOD

Q. What is the test period that the Division believes is appropriate for this case?

A. The Division believes that a partial future test period, January to December 2002, with end of period rate base, including changes that have occurred to January 1, 2003 is appropriate in this docket.

Q. How is this test year different than that filed by Questar?

A. It is the same test period that Questar filed.

Q. Please discuss how the Division approached the test year issue.

A. Our position in founded on prior decisions of the Utah Supreme Court, previous Commission orders, the Division's Position Statement on Test Year prepared in 1995 in Docket 95-057-02, and the economic conditions of this case.

The Division's position that the test period should be representative of the rate effective period is based on Utah Supreme Court decisions and Commission orders.

The Utah Supreme court stated[1]:

"We agree that one of the fundamental goals of rate making is to select a test year that reasonably approximates the rate-effective period."
"…a public service commission cannot rely on a particular test year as an exclusive standard when the evidence shows that another test year would better approximate the rate-effective period."

The Division is persuaded that the significant difference in rates of return between the historical test period and the 2002 test period clearly indicates that the test period proposed by QGC, as tested and adjusted by DPU witnesses, is a better representation of conditions that will exist in the rate effective period than a historical test period.

The Utah Commission acknowledges that a historical test year may deny a utility the opportunity to earn a reasonable return.

"Events may occur and conditions may ensue which may preclude a utility, operating under traditional regulation based on an historical test period, from the opportunity to earn a reasonable rate of return and avoid financial harm. …the Utah Legislature passed three pieces of legislation to protect utilities. …the third statute, the one referred to above, gives the Commission discretion to consider anticipated changes in the utility's financial condition and to adopt a future or partial future test period rather than the normal historical period" [2].

The Commission went on to state the criteria for a future test period.

"By this Order the Commission restates and emphasizes its preference for an historical test period and hopes to make clear the criterion for substitution of a future or partial future test period or out-of-period adjustments. A party which elects to project a future or partial future test period or to propose out-of-period adjustments has the burden of showing on the record that there exists general economic conditions, such as inflation or technological change, or a major event, which would subject the utility or rate-payers to substantial economic harm.[3]

Q Did the Division find economic conditions that support the use of a partial future test period?

A Yes, the chart below shows the return on equity (ROE), before any rate change, as calculated by both Questar and the Division.

Test Period	Questar ROE	DPU ROE[4]	Rate Change with DPU ROE[5]
2001 Historic Average test period	10.97%[6]	12.13%	$(7,055,000)
2001 Year End test period	9.81%[7]	11.03%	$(2,457,000)
2002 Average test period	8.04%[8]	9.98%	$ 2,453,000
2002 End of Period test period	7.84%[9]	10.16%	$ 1,590,000

The difference in earnings between the 2001 and 2002 test period is 200 basis points.

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[1] Utah Supreme Court Opinion No. 910051, filed September 28, 1993, pages 9 and 10.
[2] U S West Communications, Docket 92-049-05, issued August 10, 1992, page 4.
[3] Ibid, page 5
[4] Source: DPU Witness Marlin Barrow, Exhibits 1.1, 1.2, 1.3, and 1.4
[5] Source: DPU Witness Marlin Barrow, Exhibits 1.1, 1.2, 1.3, and 1.4
[6] Questar revenue requirement model adjusted for average test period.
[7] Questar witness Gary Robinson exhibit no. QGC 4.3, column f line 52.
[8] Questar revenue requirement model adjusted for average test period.

This indicates a historical test period would not be reflective of the 2003 rate effective period. It is principally due to events that occur during 2002 that are reflected in the more current test period. The four major events included in QGC filing are, the decline in customer usage ($4 million), increase in number of customers ($3.7 million), Section 29 tax credits termination ($2.7 million), and labor annualization ($1.7 million). These events are significant and would be ignored by using a historic test period.

Q On the above table, the 2001 Historic Test Year shows the Questar ROE is 10.97% and the DPU ROE is 12.13%. Why does it appear that Questar earned in excess of its authorized rate of return, using the Division's ROE calculations, in 2001?

A DPU Exhibits 1.3 and 1.4, column G, lists each of the Division accounting adjustments, which total nearly $6 million. The difference between the QGC requested ROE of 12.60% and the Division's recommended ROE of 10.50% is also included on line 29. To correctly conclude that QGC earned in excess of its authorized ROE in 2001, one would have to assume that the Commission adopted the Division's adjustments. As of this date the Division doesn't know which adjustments or what ROE the Commission will adopt.

Q In US West Communications docket 92-049-05, issued April 15, 1993, the Commission summarized its arguments for avoiding a future test period. How did you address these concerns?

A The order states:

Summing the argument, should consideration of proposed post-test-year adjustments

[9] Questar witness Gary Robinson exhibit no. QGC 4.5, column f line 52

> force the use of a future test year, there is little reason to believe, absent compelling circumstances, that a more accurate representation of the rate-effective period would result than with a historical test period, unadjusted for post-test-year events. Moreover, there are good reasons to avoid a future test year. It diminishes economic examination and accountability, replaces actual results of operations data with difficult-to-analyze projections, and plays to the Company's strength, which is the control of critical information. The efficiency incentive conferred by regulatory lag is dampened, and the risks of the future are transferred to ratepayers.[10]

The Division found compelling circumstances in the economic conditions I have discussed above such that we believe a historic test period would not be an accurate representation of the rate effective period. At the same time we feel the Commission's concerns are valid and have responded to them in large measure. The Division has thoroughly examined and tested the significant areas where projections were made (such as usage per customer and number of customers) and in some cases made adjustments to reflect more current information, our own views or corrections. In other cases projections will be replaced by actual data before the hearing date. The DPU also examined the first half of 2002 for data and events that occurred or were annualized to make adjustments to the QGC filing.

Q What test periods did the Division consider?

We considered 5 types of test year.

1) A December 2002 Year End Rate Base, Revenues and Expenses filed by Questar with adjustments to January 1, 2003.
2) A January and December 2002 Average Rate Base, Revenues and Expense with adjustments through January 1, 2003.
3) A July 2001 to June 2002 Average Rate Base, Revenues and Expense with adjustments through June 2002.

[10] U S West Docket No. 92-049-05, issued April 15, 1993, page 14.

4) A 2001 Historical Average test period with no post-test-period adjustments.

5) A 2001 Historical End of Year test period with no post-test-period adjustments.

Q Discuss the reasons the Division selected its test period.

A. We recognize that all of these test periods have problems. The DPU believes that a partially forecasted test period is the one that will best represent the rate effective period and that the problems presented were manageable, as I explained above. The Division selected a 2002 end of period rate base test period with adjustments to January 1, 2003, because it is closest to the rate effective period allowing the utility the opportunity to earn its authorized rate of return, by including significant current known and measurable events.

Q Why didn't the Division use July 2001 to June 2002 test period?

A The Division previously expressed its concern that auditing a rolling test year is difficult to accomplish in Mountain Fuel Supply docket 93-057-01. The same is true in this current docket. The June 2002 actual data would not have been available until mid August 2002. The Division was required to file testimony on August 28, 2002. There was not sufficient time between the receipt of June actual data and the DPU filing date to compete the work. Regulatory effectiveness would have been diminished.

Q Why did the Division use end of year figures rather than average?

A In the order in Mountain Fuel docket 89-057-15, issued November 21, 1990, the Commission discussed its reasons for using an average rate base in that docket.

"The Commission finds an average rate base appropriate for the following reasons. First, the Commission has relied on average base in recent US West Communications and Utah Power and Light dockets. The present docket has produced no compelling reason to depart from that practice. Second, an average-of year rate base provides an appropriate basis for matching the annual flows of revenue and expenses to the average annual stock of plant and equipment employed by the utility and to the manner in which the utility has been operated. An end-of-year rate base is a mere snapshot, a potentially misleading picture of rate base at one point in time. Third, an end-of-year rate base requires that substantial, difficult adjustments, fraught with policy implications, be made to revenues and expenses.[11]"

We have tried to cure the problems seen by the Commission by testing and examining projections and assumptions. In this docket we don't believe using end of period creates a misleading picture. The Division used end of period because it is closer to the rate effective period, yields a slightly lower revenue requirement, is the test period supported and documented by the applicant, and has been tested and audited by the DPU staff.

Q What problems did the Division find in using a 2002 Average test period?

A QGC calculated year-end revenues and the corresponding annualized expenses in the filing. When revenues were reduced to reflect average 2002 customers, there was no corresponding reduction in operating expenses causing the revenue requirement to be higher than expected. Based on this the Division believes the 2002 year-end figures, which we have audited and tested, portray a more accurate picture.

Q Is the Division's position on the test period in this docket applicable to other cases?

A No. The Division's general position is that the test period should be decided on a case-by-case basis. This case presents a unique set of circumstances; a partial future test period with end of period rate base may not be appropriate for other utilities, or for this utility under different conditions.

[11] Mountain Fuel Supply docket 89-057-15, issued November 21, 1990, page 8.

QUALITY OF SERVICE STANDARDS

Q Why are service standards important?

A Questar has changed its service level and standards in the past years, and in an effort to achieve its authorized rate of return may change its service levels and standards again after the order is issued in this docket. The Division believes it is important to determine what level of service gas customers expect and then measure Questar's performance to see if it is meeting the expected level. During the test year hearings on May 28, 2002 in this docket, the Division suggested creating a separate task force to set customer service standards. Commissioner White questioned why that could not be done as part of this docket. Consequently, the Division, Questar and other interested parties held several meetings dealing with quality of service issues. The meetings were attended by: Questar Gas Company (QGC), the Division of Public Utilities (DPU), the Committee of Consumer Services (CCS), the Salt Lake Community Action Program (SLCAP), and Crossroads Urban Center (CUC).

Q What was accomplished during these meetings?

A The Division first needed to determine what level of service was appropriate in view of recent changes. Questar asked Wirthlin Associates, its customer survey consultant, to make a presentation on what level of service Utah gas customers expected. This was useful in determining customer expectations. We found that customers expect Questar to keep appointments, respond to phone inquiries promptly and maintain safe and reliable service. The closure of local offices and changes in pilot light services were also discussed. Questar's intent is to remain flexible in meeting customer needs. Based on our understanding of customer expectations, PacifiCorp's current customer service guarantees, and the Division's historical complaint records, the Division drafted a set of standards. Questar's quarterly customer service report was reviewed and modified to include the Division's draft standards. In our discussions the parties have used the Questar Quarterly Customer Satisfaction Standards Report (as modified) as the beginning point for discussions of how to measure customer service levels over time. The parties are currently discussing five documents; a draft stipulation, a draft quarterly customer satisfaction report, a draft confidentiality statement, a draft quarterly non-confidential report for QGC's web site, and a draft bill stuffer on customer complaint resolution. If there is agreement, we anticipate filing these at a later date.

ADJUSTMENTS

Q Please explain your proposed adjustment to cash working capital?

A I reviewed the lead lag study used by Questar to calculate cash working capital. It was well done and complete, however I recommend one change. Questar bills for some customers include amounts for merchandise such as monthly payments for an air conditioner or new windows. This is not part of the regulated gas business, and I recommend that merchandise accounts receivable be excluded from the lead lag calculation. This reduces the revenue lag by .27 days, from 2.198 to 1.925 days. This change results in a reduction in revenue requirement of about $50,000.

Q. Why has the need for working capital increased from the prior case?

A. QGC's records show that gas customers are paying their bills slower than before. This increases the revenue lag and consequently increases the need for working capital.

Q. Did you review the work papers of Questar's independent accounting firm?

A. Yes.

Q. What do you recommend based on that review?

A. Ernst and Young is the accounting firm used by Questar Gas Services. After each yearly audit Ernst and Young prepares a list of suggested audit differences for Questar to make to their books. Two of the audit differences involve depreciation expense and apply to the test period.

The first adjustment is to remove depreciation expense in the test period that pertains to prior years. This reduces depreciation expense by $260,000. The second is to correct depreciation expense that was understated because of late recording of construction work in progress. This increases depreciation expense by $165.000. The net of these is a reduction in depreciation expense of $95,000, which applies to both the 2001 historical test period or the 2002 test period.

Q Please explain your adjustment to test year employees?

A Mr. Ronald Jibson states at page 9 of his testimony,

"Therefore, rather than an additional 26 employees, we can go into the rate-effective period with only 16 full-time-equivalent employees more than the year-end 2001 employee count if there is adequate cost coverage to justify these additional hires. Mr. Robinson has included the cost for these employees in his test-year calculations."

In describing this adjustment, Mr. Gary L. Robinson states at page 25 of his testimony, under labor annualization,

"This amount also includes the addition of two QGC and QGC's allocation of three QRS administrative employees and 12 operating employees as discussed by Mr. Jibson".

Exhibit No. QGC 4.6 page 2C is entitled, "Costs Related to New Employees Added to Maintain Current Level of Service to New Customers". It calculates the cost of adding 12 additional employees at $458,208.

Q **Why does the Division object to this adjustment?**

A QGC hangs this adjustment on the premise that "if there is adequate cost coverage" they would hire the employees. It is not known or measurable, it may not be ongoing in the rate effective period, it is not capable of independent verification. How will regulators know if QGC has achieved the goal of "adequate cost coverage" on which the hiring of the new employees hinges? This is simply not the type of adjustment that the Commission has allowed before, and the DPU recommends the Commission not allow it. Mr. Tom Peel includes this adjustment in his calculations.

<u>DEPRECIATION STUDY</u>

Q **Has Questar Gas Services ever had an independent study performed on their depreciation practices?**

A. No. Neither QGC nor an out-side third party have ever performed a deprecation study.[12] The company has never changed depreciation rates, plant lives or salvage values. They have, however, established new rates for new types of equipment. The company does not include removal costs of fixed assets in its depreciation system[13]. While removal costs may not be needed for underground pipe, there may be some fixed assets for which removal costs are appropriate.

Q. **How large is depreciation expense in this case?**

A. Exhibit QGC 4.5 shows depreciation, depletion and amortization expense total $40,557,000. This is more than 22% of total operating expenses for the test period. It should be reviewed periodically to ensure it is based on sound principles.

[12] See DPU data response 4.12 in this docket
[13] See DPU data response 4.14 in this docket

Q. What depreciation lives is Questar using in this case?

A. Questar uses a 33-year life for gas well equipment, mains and valves, compressors, and gas meters. A 5 or 7-year life for various office equipment and software, and a 5-year life for transportation equipment.

Q. What is the Division recommending regarding depreciation in this case?

A. The Commission should adopt the current level of depreciation expense and accumulated depreciation, (as adjusted by the Division) since we have no convincing evidence the current lives are inaccurate. The Commission should also order Questar Gas Services to undertake an independent depreciation study.

Q. Why?

A. Because depreciation is a major expense, the components should be examined periodically. A depreciation study will assure regulators that depreciation rates coincide with plant lives. John S. Ferguson of the Society of Depreciation Professionals writes,

> "Both regulated entities and their regulators have adopted practices of requiring periodic depreciation studies to test the continued validity of lives. For example, FERC compliance audits raise an accounting compliance issue if the latest depreciation study of an entity subject to its jurisdiction is deemed too old."[14]

Q. Does that conclude your testimony?

A. Yes.

[14] Journal of the Society of Depreciation Professionals, Volume 10, page 18