BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF UTAH

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

REBUTTAL TESTIMONY OF DAVID NICHOLS ON BEHALF OF THE UTAH ENERGY OFFICE UTAH DEPARTMENT OF NATURAL RESOURCES

Q. Please state your name.

A. I am David Nichols. I am the same David Nichols whose direct testimony was filed in this docket.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Utah Energy Office (UEO) in the Department of Natural Resources of the State of Utah.

Q. What is the purpose of your testimony?

A. My testimony addresses portions of the direct testimony of Anthony J. Yankel in this docket. I address his arguments and information regarding:

- The need for Questar to develop and submit an embedded cost of service study.
- The need to redesign Questar rate GS-1.

Q. What are Mr. Yankel's recommendations regarding Questar's costs of service?

A. According to Mr. Yankel's analysis, there is little cost of service foundation for the structure of rate classes, the allocation of embedded costs of service amongst the rate classes, or the design of individual tariffs. He recommends that a cost of service task force be established and that Questar file a cost of service study by November 1, 2003.

Q. Are Mr. Yankel's recommendations reasonable?

A. Mr. Yankel's recommendations that I have just summarized are eminently reasonable and I support them fully. I suggest that a task force be given a fairly broad suite of key issues. Developing and implementing a sound cost of service methodology is basic, as Mr. Yankel suggests. The use of load research and cost of service data to review the structure of the rate classes themselves is another critical issue. The role of cost of service results in tariff design should also be addressed. Since rate designs are never determined by cost of service results only, the relationship between cost of service and other rate design criteria should be part of the rate design issue. Finally, the issue of costs of service and rate design are relevant to the commodity cost portion of rates in Utah, particularly in light of the dual supply sources --company-owned and market-based-- used by Questar.

Q. Is a sound cost of service study a sufficient basis for guiding future cost allocation and rate design?

A. No. Cost of service studies are imperfect -- they employ varying methods, and necessarily intermix judgment and data. They are not a "magic bullets" that provide unambiguous answers to cost causation questions. However, a professionally executed cost of service study

would provide a vastly better starting point for cost allocation and rate design than anything available from Questar at this time.

To inform the rate design process, I believe that an updated integrated resource plan should also be developed by Questar. While IRP is useful in guiding system planning, it also provides information that can be quite relevant to rate design. One key piece of information that is best developed in the context of an integrated resource plan is whether the costs of gas delivery and gas supply may be expected to increase in future years. If so, consideration must be given to inclining block rates independently of what the embedded cost data may show. I am not suggesting that there is a need to use a future test year to set rates. I am suggesting that tariffs communicate price signals that inform consumer investment in equipment and buildings which will be used over several years. For this reason it is proper to reflect the longer-run economic (and environmental) benefits of efficiency in the use of gas in the process of rate design.

As I pointed out in my direct testimony, embedded cost of service is not the only basis for rate design. Several other criteria for a sound rate structure are widely recognized in utility regulation. I append one traditional formulation of rate design criteria (Exhibit DN-1).

Q. What are Mr. Yankel's recommendations regarding Questar's proposed rate designs?

A. Mr. Yankel's rate design recommendations focus on rate GS-1. At pages 39 and 40 of his testimony he analyzes some information on the pattern of energy use by customers which suggests that the rate could be broken in two: one for residential customers with lower us-

age levels and higher load factors than the customers in the current rate; the other for business customers with higher usage levels and somewhat lower load factors than the residential group. While Mr. Yankel does not explicitly call for dividing rate GS-1, his data and argument strongly support the recommendation to divide the rate which is made in my direct testimony. Mr. Yankel does recommend that the second block of rate GS-1 be increased by 33 percent from the level proposed, with the first block decreased to offset revenue gains from that change.

Q. What is your opinion of Mr. Yankel's recommendation to increase the second block of rate GS-1?

A. Mr. Yankel's analysis of several comparable gas utilities shows that Questar has the biggest difference of all between two blocks, based on the utility rates that he felt it useful to compare. Given this background, plus Mr. Yankel's analysis suggesting that the customers whose usage falls into the second block of GS-1 may actually have a higher cost to serve than those whose usage is all in block 1, I do not think his 33% increase proposal goes far enough. At the end of a process of thoughtful rate redesign informed by cost of service and integrate resource planning studies, I believe it quite likely that an inclining block structure will be clearly indicated for GS-1 or the two rates succeeding it. Therefore, the existing rate should be "flattened," i.e. simplified to a one-block volumetric charge, in the present case. Additionally, the Commission should indicate that it expects to see designs for two inclining block rates to replace GS-1 in the next rate case. If Questar does not wish to propose

them, it should be directed to, at a minimum, present the designs as part of its next rate case.

Q. Does this conclude your testimony?

A. Yes, it does.