Exhibit QGC 5.0R

BEFORE THE
PUBLIC SERVICE COMMISSION OF UTAH

Questar Gas Company

PREPARED REBUTTAL TESTIMONY OF
BARRIE L. MCKAY
FOR QUESTAR GAS COMPANY

October 4, 2002

Q. Please state your name and business address.

A. My name is Barrie L. McKay. My business address is 180 East 100 South, P.O. Box 45360, Salt Lake City, Utah 84145.

Q. Did you submit direct testimony in this Docket?

A. Yes.

Q. Attached to your written testimony are Exhibits QGC 5.5R, 5.6R, 5.7R and 5.10R through 5.14R. Were these prepared by you or under your direction?

A. Yes.

Q. What is the purpose for your rebuttal testimony?

A. I will address various rate-allocation and rate-design issues and recommendations submitted by other witnesses in their respective direct filings: Division witness Darrel S. Hanson; Committee witnesses Hugh Larkin, Anthony J. Yankel, Michael J. McFadden and Kelly A. Francone; witnesses Kevin C. Higgins and Bryan G. Hassler, representing the UEA Group and the United States Executive Agencies; Utah Energy Office witness David Nichols; witnesses Jeffrey V. Fox, Elizabeth H. Wolf, Charles E. Johnson and Michael R. Johnson, representing Utah

Ratepayer Alliance; Alan Chalfant, representing the Utah Industrial Energy Consumers; and Roger J. Swenson representing U.S. Magnesium Corporation. These parties have raised numerous rate design proposals, only a few of which I concur with as specifically mentioned in my testimony. The remaining recommendations should not be adopted. In particular, I will address the main/service line extension policy, CIAC issues, CO_2 cost recovery, general cost of service, and other rate design issues.

MAIN/SERVICE LINE EXTENSION POLICY

Q. Please describe the Company's recommendation with regard to main and service line extensions.

A. For GS-1 customers, the Company has proposed that the current appliance-based footage allowances be replaced with a simpler structure. What I have recommended is that any new residential customer who is committed to install both space and water heat and "stub" for a gas range and dryer will be allowed a total construction allowance of $1,300, $730 for main extensions and $570 towards construction of the service line. This is reflected in Sections 9.01 and 9.02 of the proposed tariff in my Exhibit QGC 5.3. For a typical new customer, this will require a contribution in aid of construction (CIAC) of about $500, an increase of $100 from current practice. This was illustrated in Exhibit QGC 5.2, page 1. The Company has also recommended to eliminate the new premises fee that is currently collected from new customers. This fee is a $12 per month surcharge for the first 12 months that the customer receives natural gas service.

Q. What have the other parties recommended in this case?

A. Mr. Hanson supported the Company's proposal to revise extension allowances and charges while eliminating the new premises fee.

Mr. Larkin has recommended that extensions be justified on a cost-benefit analysis.

Mr. McFadden recommended elimination of the new premises fee and a further increase in the customer's CIAC (or put another way, a reduction of the allowance) to recover the excess cost of new facilities over the expected revenues to be recovered in rates. He recommended that the total allowance be reduced from the Company's proposal of $1,300 to $571. The main allowance would be reduced from $730 to $232, and the service line allowance from $570 to $339. This results in an average CIAC of $1,235. He recommended that the Commission adopt this increase in CIAC immediately or phase it in over a three-year period.

Mr. Higgins recommended that the total construction allowance for a new service be reduced to $600, which results in an average CIAC of $1,200.

I have prepared Exhibit QGC 5.11R that summarizes the different parties' recommendations on this issue and compares the CIAC recommendations to what is currently required.

Q. What is your response to these recommendations?

A. I believe that a balance needs to be reached that recognizes the interests of both existing and new customers. Considering that averages and costs fluctuate over time, the Company is opposed to increasing the CIAC as witnesses Larkin, McFadden and Higgins have proposed.

Q. Have you prepared any analysis that demonstrates that the Company's proposal to change CIAC to an average of $500 per customer is appropriate?

A. Yes. We have prepared Exhibit QGC 5.12R which is a rough analysis that shows on Column A, line 6, that the Company has invested $571 in direct investment in a typical GS customer plus $193 in other rate base investment. This totals to $764 on investment per GS customer. The annual DNG cost of service shown on lines 10-15, Column A, for this typical customer is approximately $314. These costs include return on investment, operating and maintenance expense, depreciation, other taxes and

gathering.

In comparison, column B shows a new customer would require a net incremental investment of $1,306, along with a $500 CIAC. The annual cost of service for this new customer would be approximately $304, assuming that no incremental gathering is required and that 50% of operating and maintenance costs are fixed and would not increase with one new customer.

Q. How does this compare with the proposals to increase the CIAC to $1,235?

A. Column C, line 15, shows that, if the CIAC is increased to $1,235, the revenue requirement for the incremental customer would be approximately $168 per year.

Q. What conclusions do you draw from this analysis?

A. Although the analysis is rough, a CIAC of $500 appears to be fair from the viewpoint that a new customer will have approximately the same annual cost of service as a typical customer. The proposal to increase the CIAC to $1,235 clearly goes too far because the incremental annual cost of service for customers required to contribute $1,235 is about half of what an existing typical customer requires. Additionally, this demonstrates that QGC gains in efficiency as it grows and that it is not proper to have new customers pay the entire incremental cost of adding them to the system. Ultimately their revenues, if lost, would work to the detriment of existing customers as efficiencies were lost, assuming a correctly designed contribution is charged.

Q. Is your proposed $100 increase a sufficient change to the existing balance?

A. Yes. First, the current policy has been in place for decades. It has been a regulatory policy in Utah that connecting new customers to the system provides a long-term revenue benefit by helping to achieve economies of scale that lower average fixed costs to all customers. This is based on the assumption that up-front costs are somewhat offset by the benefit of increased future revenues. From this historical backdrop, it would

be a drastic change to reduce this new-customer allowance to the current system average cost when the current policy has been in place for so many years. It is too large a step to reduce the current new-customer allowance from $1,400 (today's average footage allowance calculated in dollars) to $571. Put another way, while all current customers have been added under a balanced main extension policy, the Committee's and Mr. Higgins's proposals imply we want our children and grandchildren to pay significantly more than their balanced costs to enjoy the benefits of gas service.

Q. Doesn't Mr. McFadden's recommendation gradually increase the CIAC paid by new customers?

A. His proposal would scale down the allowance to $1,171 beginning January 1, 2003, and then reduce it to $871 in one year and $571 by 2005. This is a stepped approach, but I believe that the Company's proposal is sufficient and should not be accelerated at this time. In fact, prior to May 2002, the Company was effectively assessing the average new customer a CIAC of about $307. After an internal audit of our compliance with the tariff provisions, we have unilaterally increased the CIAC to an average amount of $407. See Exhibit QGC 5.11R, column A, line 3. The proposal in this case is to increase this amount by another $100. This is a 65% increase to the amounts that were collected prior to the filing of this case. Mr. McFadden's proposal amounts to an immediate 100% increase, with a further 50% increase to be imposed 12 months later.

Q. Mr. McFadden states that his proposed addition of $828 to the required CIAC would have a negligible effect on the cost of new home construction and would amount to less than a ½% increase in the typical monthly mortgage payment. Isn't this correct?

A. While his math may be correct, he fails to consider the impact that may occur on fuel choice and the long-term revenue effect from not adding new customers. An

immediate construction increase of over $800 will definitely deter many builders from stubbing for natural gas appliances when their profit margins are already thin. Mr. McFadden tries to downplay this concern by saying, "The only real competition would be electric service, which is still priced significantly higher than gas for heating purposes." This is a statement with no supporting evidence. The Company is acutely aware of the competition for heating load that it is already experiencing in some areas of the system, such as in Washington County. We are also seeing some large institutions installing ground-source heat pumps. I don't think it is proper to look at contributions in isolation without also considering O&M expense contributions and revenues to be received by the addition of new customers.

Q. What is the significance of this?

A. The Company believes that the drastically higher contribution levels proposed by the witnesses will result in a pronounced decline in new gas hook-ups. I would expect that new customer growth in southern Utah will decline sharply. So, while QGC's capital investments would be lowered, it raises serious questions about the wisdom of a policy that would discourage customer development and cause ultimate revenue loss for all customers on QGC's system.

Q. What is the Company's recommendation with respect to construction allowances in this case and in the future?

A. I strongly recommend that the Commission adopt the proposed main construction allowance of $730 and the service line allowance of $570. As I mentioned, this is a 2/3 increase over what customers have experienced during the past year. This issue could then be reviewed in future rate cases to determine if further changes in the construction allowance are warranted. In addition, it appears that the recommendation to eliminate the new premises fee from the Company's tariff has unanimous support.

Q. Mr. McFadden proposes two different allowances based on appliances installed for main extension. He also proposes changes to the Company's service line appliance-based allowances. Do you agree with these proposals?

A. The main line is usually installed by the developer before the lots are sold. What appliances will be installed is unknown at that time. Conversely, at the time the service line is installed, the lot has been sold and construction begun. This is close to the time the appliance installation decision is made and the correct time to influence appliance selection.

Q. Mr. McFadden proposes that construction allowances be updated during every rate case and that the Company update estimated costs of investment per customer with an annual filing to the Commission and that appliance allowances be changed. What is your response to these recommendations?

A. In future rate case, parties will be interested in our construction allowances, and we expect to provide relevant information in the normal course of those cases. However, the Company does not see the benefit in filing annual investment-per-customer numbers. We question how it will actually be used by those who receive it outside of a rate case proceeding. We are frankly concerned about the resources we are being asked to devote to a large number of proposals for new studies, reports and task force efforts and our ability to undertake all of these new activities. We would rather submit a CIAC analysis and review with our next general rate case filing when the issue should be reviewed.

Q. Please review the Company's recommendation with respect to commercial main extensions.

A. The main-extension allowance for a commercial customer is based on a formula that multiplies the expected receipts from distribution non-gas (DNG) revenue by 2.5. Once this allowance amount is determined, it is compared to total costs. If the total costs are more than the calculated allowance, then the customer is required to make a CIAC for the difference. This is not different from the current policy.

Mr. McFadden mistakenly criticizes this approach, stating that the Company did not indicate that the cost of extending service to commercial customers differed from the cost of extending service to residential customers. The Company made no mention of the issue because no change is being requested.

Q. Mr. McFadden recommends that the language on pages 76 and 80 of the tariff where assessment for excess construction costs will be required "in the Company's judgment" be removed. What is the Company's position with this proposed change?

A. This is a reasonable change to the tariff. The Company adopts Mr. McFadden's suggestion.

CIAC ACCOUNTING

Q. How have the parties responded to the Company's proposed change in CIAC accounting?

A. All parties support the Company's proposal. Mr. McFadden proposes that default payments and interest received by the Company be treated as contributions in aid of construction, while Mr. Higgins suggests an alternate proposal to phase in the treatment of contributions with only new CIAC costs treated as a reduction to rate base.

Q. What is the Company's response to these recommendations?

A. Currently, default payments are accounted for as revenues. Assuming that the proposed change is approved by the Commission, default payments will be recorded as CIAC and treated as a reduction to rate base in the future. Interest on these amounts is currently treated as income. The Company's position is to continue to treat this interest amount as income. To account for interest as contributions would not be consistent with GAAP and would not be proper accounting for these amounts.

Q. Mr. Higgins has requested that the price impact of the Company's proposed CIAC accounting change be quantified. What is the impact of this proposed change?

A. This was identified in Exhibit QGC 5.6, line 15, in the Company's original filing. The exhibit shows that recording CIAC as a reduction to rate base rather than revenue has an overall impact of $4.4 million. This results in about a 5¢ per Dth increase to the typical customer. Going forward, this accounting treatment will decrease the revenue requirement over the life of the plant (currently 33 years) instead of all at once, as currently occurs by treating CIAC as income. Future rates will be lower because of this change.

CO_2 COST ALLOCATION

Q. How are CO_2 costs currently allocated among customer classes?

A. The June 5, 2000, Allocation and Rate Design Stipulation approved by the Commission in Docket No. 99-057-20 incorporated a "double weighted" allocation of CO_2 costs to transportation customers, resulting in about 5% of such costs being recovered from these classes.

Q. How have the parties addressed the CO_2 cost-allocation issue?

A. Mr. Hanson recommended that CO_2 costs be allocated on an annual throughput basis, including volumes from the first two blocks of FT-1 customers. Mr. McFadden proposed that costs also be allocated on annual throughput, with a separate CO_2 rate rider to account for the ultimate "sunset" of the recovery of these costs. Mr. Chalfant recommended no allocation of CO_2 costs to transportation customers. However, if CO_2 costs were assigned to transportation customers, then he recommended the stipulated factor agreed to by the parties in the former case be used. Mr. Higgins agreed to the current allocation, with recognition of the cap imposed in Docket No. 99-057-20. Both he and Mr. Swenson opposed any further allocation of CO_2 costs to transportation customers.

Q. What is your response to these proposals?

A. Allocation of CO_2 costs to industrial customers is problematic for two reasons. First, CO_2 removal is required to maintain residential and small commercial customers' safety and is not needed for the normal industrial use. Typically, these customers are continually adjusting their equipment for heat-value efficiency. Thus, on a cost-causation basis, it is not reasonable to allocate these costs to industrial customers. Note that the 99-057-20 stipulation not only allocates CO_2 costs to the transportation class based on their overall cost-of-service allocation, but also doubles the classes' allocation percentages.

Q. In response to the Utah Supreme Court's remand of the recovery of CO_2 costs, the Commission has required that transportation customers bear a portion of the $3.76 million of costs relating to the period from January 1 through August 10, 2000. Additionally, the Committee has recommended that all ongoing CO_2 removal costs be collected using a separate tariff rider. Would you please comment on these issues.

A. I think that both of these issues can be resolved by removing the CO_2 costs from general rates and including them in the 191 Account for sales customers and including the costs as an additional rider for the portion allocated to transportation customers. Costs would be matched one-to-one with revenues collected, and there would be no concern of under- or over-collecting. A simple tariff language change would provide that only the CO_2 costs being tracked and accounted for in Account 813 (which is included in the 191 Account) would be included in transportation rate schedules. I think this treatment would satisfy the Committee's underlying concern that the CO_2 removal costs could remain in rates without additional Commission review, and it allows the Company and the parties to track the costs, including the remand portion.

GENERAL COST OF SERVICE

Q. What are the parties' positions concerning the Company's recommendations?

A. In Exhibit QGC 5.7, the Company identified that simply allocating the rate increase on a uniform percentage basis, as has been done in all recent cases, would result in a substantial under-allocation of costs to the interruptible classes. The Company proposed to allocate to the interruptible classes 33% of the under-allocation differential in addition to the percentage increase. The Division, recognizing that there is a larger gap between a uniform percentage increase to all customer classes and using the COS results, agreed with the Company to move 1/3 of the way to the COS results. This "1/3 of the way" proposal results in a smaller increase to the GS and F-1 classes.

Q. Does the Committee agree with this recommendation?

A. The Committee is not satisfied with this gradual movement and instead tries to justify a significant change by criticizing the Company's cost-of-service study and the resulting allocations as being outdated and inaccurate.

Q. Please review QGC's approach to cost of service and what has been done since the filing of direct testimony in this case.

A. As described in Exhibit QGC 5.4, cost-of-service allocation is determined using several different allocation factors or "bases." Mr. Yankel takes issue with QGC's use of allocation base 6 to allocate mains. (Allocation base 6 is the factor used to allocate distribution plant-related costs.) Main, service line and meter-related costs are allocated using this factor. It should be noted that the allocation of distribution plant-related costs is performed only after large-diameter main and feeder costs are removed from the distribution function.

Q. Mr. Yankel identifies the sample used to develop the allocation percentages as being outdated. Do you agree?

A. Yes. The random sample used to support allocation base 6 was taken about 17 years ago.

Q. What has the Company done to address this problem?

A. Since the filing of the direct case, we have performed a new random sample of 757 customers to determine the average cost for various categories of plant in-service. This sample size has a confidence level of 95%, with a margin of error of plus or minus 3.6%.

Q. How are individual plant costs determined from the sample of customers?

A. For each sampled customer, the length, diameter and cost of the service line is determined. The specs for the customer's meter are also determined. For mains, the average cost of main within 1,000 feet of the customer's premises (500 ft. upstream and 500 ft. downstream) is determined. From this sample information, an average cost of each category of plant is calculated.

Q. What was the result of this analysis in connection with allocation base 6?

A. When we applied the sample averages to the total number of customers, the expected average cost for each category turned out to be extremely close to the actual (booked) total cost for the customer population. That is, the expected total cost of providing the individual cost-of-service components of service lines and mains was extremely close to the actual total. This tended to confirm the accuracy of the new sample results. When this exercise was done with the "old" sample, the results were not as close, which confirmed our belief and Mr. Yankel's observation that the study needed to be updated.

Q. Have you incorporated the results from the new sample to update allocation base 6 and changed the COS allocation?

A. Yes. I have prepared revised/updated Exhibits QGC 5. 5R, QGC 5.6R, QGC 5.7R and QGC 5.10R to incorporate the new information for allocation base 6 and for the

Company's revised revenue requirement increase of $19.4 million, as explained and calculated by Mr. Robinson in Exhibit QGC 4.4R. Updating allocation base 6 by this method increases costs to transportation customers (FT-2 and IT) by .3% more than they would have using the old allocation. While this demonstrates that the Company's previous, albeit old, study was still producing similar results, the new study is helpful and should be incorporated. The GS and F-1 class costs are lower as compared to the old allocation.

Q. Do you think this update will satisfy Mr. Yankel and Mr. McFadden?

A. It's doubtful. Both of them claim that more costs should be allocated to transportation and larger volume customers. Mr. Yankel accomplishes this by proposing that volumetric throughput be used to allocate mains. He criticizes the Company's development of main-cost/customer as being fundamentally unsound.

Q. Do you agree with these observations?

A. No. Mr. Yankel's approach is not consistent with the fundamental principle that these expenses are primarily related to the amount of facilities associated with a rate class, as opposed to the usage levels. His recommendation allocates plant and related costs to interruptible customers that are associated with providing service for the GS class. Additionally, Mr. Yankel fails to recognize that the extension policy has consistently required interruptible customers to pay a greater portion of the main-extension costs required to connect them to the system than residential customers. Stated another way, if Mr. Yankel's allocation of mains were accepted, interruptible customers would pay for a portion of the costs of mains twice: once as a CIAC and once through the allocation of mains associated with residential customers in the COS model.

Q. Please comment on Mr. McFadden's criticism of allocation base 6.

A. Mr. McFadden theorizes that in "most circumstances" costs allocated to various

classes "should not exceed its percentage of peak day throughput and should not be less than its percentage of annual throughput." Since the GS class's peak-day and volumetric percentages are about 93% and 67%, respectively, and since the GS allocation base 6 percentage is 99%, Mr. McFadden claims that the Company's methodology is "flawed." What he ignores is the fact that shared or common costs could have been removed from a total, such that the only costs left to be allocated are directly related to a specific class. Through the removal of large-diameter mains and feeders, this is what has occurred with the costs allocated on factor 6.

Q. Please address the other cost-of-service recommendations of the parties.

A. Mr. McFadden proposes to allocate peak-day costs to both firm and interruptible customers. This is contrary to his positions in other cases. Let me quote what Mr. McFadden has said in a Public Service Company of Colorado case on this subject:

> Interruptible customers do not have any demand or level of service that is guaranteed . . . [the Office of Consumer Counsel's] 100% imputed demand proposal makes the fictitious assumption that interruptible customers have a guaranteed right to use the system to the extent of their average daily throughput every day of the year . . . In fact, interruptible customers have no right to use the system at any throughput level any day of the year . . . Interruptible customers can and will be interrupted on design days and, therefore, this is an inferior class of service.

McFadden Cross Answer Testimony, pp. 14, 17, Docket No. 94I-430EG, Colorado PSC, 1995.

I agree with Mr. McFadden's reasoning and only wish he would have followed it here.

The Company has been consistent in adhering to the accepted principle that the distribution system plant capacity is not designed to serve interruptible loads. The Company does not include interruptible customers' volumes in its peak-day capacity analysis because they will be interrupted. There is no basis to assign costs required to meet the peak-day demand of firm customers to interruptible customers.

Q. Mr. Yankel recommends that a task force be directed by the Commission to consider a new cost-of-service study with revised allocations. Do you agree with this proposal?

A. I am concerned that this task force will require a substantial dedication of Company resources, especially when added to the other task forces, studies and reports. It certainly appears that the current methodology is yielding a reasonable result, especially with the updated allocation base 6. Thus, I do not believe Mr. Yankel's recommendation is worthwhile.

Q. Please summarize the various cost-of-service revisions proposed by the witnesses.

A. Mr. Yankel attempts to convince the Commission that the Company's allocation methodology is outdated and flawed and that simply changing the allocation of mains will temporarily solve his problem while the issue is studied. I am concerned that this is merely an effort to shift more costs from the GS class to interruptible customers. It ignores the basic fact that fixed expenses are more related to facilities while variable expenses are related to usage levels. In a general rate case, the vast majority of expenses are fixed not variable.

Many industrial customers have bypass alternatives that must be considered. As described in Mr. Allred's rebuttal testimony, the Mountain Fuel/Questar experience in Wyoming is instructive. It shows very clearly that at a certain point the cost allocations to industrial customers reach a "drop-dead point," at which they can economically choose to bypass QGC's system. When this occurred in Wyoming, the Company lost these customers and the GS-1 class lost the benefit of their contribution to fixed costs. Mr. Yankel does not address this at all. The Company believes its allocation methodologies are correct and that the current methods have successfully retained appropriate revenue contributions from the transportation classes. This is not an issue to experiment with. It should only be considered if someone shows conclusively that QGC's current methods

are wrong. This has not been demonstrated, nor do we believe that it can be.

Mr. McFadden also states that GS-1 customers are over-allocated and that transportation customers should be given a greater allocation of costs. Like Mr. Yankel, Mr. McFadden proposes to increase the costs allocated to interruptible customers. My response to these proposals is, again, that they ignore the competitive options that transportation customers have. On the other hand, Mr. Chalfant recommends that the Company's proposal with revenue responsibility to transportation customer be treated as a cap and that feeder costs should not be allocated on a 50/50 basis.

In general, the Company's recommended cost-of-service allocation recognizes the costs of providing service to transportation customers and recognizes the fact that they have other choices.

GS-1 RATE SCHEDULE

Q. What changes have the parties recommended to the Company's current GS-1 rates schedule that serves almost all residential and small commercial customers?

A. Mr. Yankel, Mr. McFadden and Mr. Nichols have all questioned whether the GS-1 rate class should be separated into separate residential and commercial customer classes. This is based on their general belief that residential and commercial customers typically have different usage patterns and load factors. This proposal is not new: It has been analyzed and discussed since the early 1980s rate filings as a way to shift fixed costs away from low-usage customers. I believe this violates the basic rate-design principle of matching cost coverage with cost causation.

Q. Please explain.

A. First, let's discuss Mr. Yankel's proposal to raise the GS-1 second block. He justifies this change by implying that the commercial customer whose usage reaches the second block has a 5% worse load factor than residential customers and should, therefore, not get a reduction in rates in the higher block. Mr. Yankel's analysis includes customers who do not have a full 12 months of history; this improperly skews the results. Correcting for this error shows that no real difference in load factors exists between business customers (18.43%) and residential customers (18.22%).

Q. Are there reasons that the second GS-1 block should be lower?

A. Yes. The issue of whether the GS-1 class should be split into the residential and commercial subclasses has been considered in prior rate cases. Each time, the analysis has shown that the residential classes' rates would go up because, if properly allocated, the cost to serve the commercial customers is lower not higher. Therefore, the commercial customers' rates would go down. The concern of splitting these groups into two separate rate classes has been consistently rejected.

Q. Some parties have recommended a design change from the current declining-block structure used for GS-1 customers. Does the Company agree with changing its GS-1 block rate structure?

A. No, the current structure is essentially a flat block-rate, with 96% of GS-1 customers receiving all of their gas usage in the first block. The second block accommodates service to a small group of very large volume GS customers and recognizes their lower costs. There was a time that the GS class had a 5-block structure. These declining blocks were eliminated, and the second block for larger-volume customers was retained.

Q. Do you agree with Mr. Nichols's rationale for an inverted-block rate structure?

A. No. An inverted rate structure that penalizes increased energy use may make

sense for an electric utility, but it will only exacerbate QGC's current usage-per-customer problem.

CUSTOMER CHARGE AND BASIC SERVICE FEE

Q. Please review the Company's position with respect to the customer charge or basic service fee.

A. The Company proposed re-naming the current "customer charge" to a "basic service fee" and increasing the amount of the monthly charge from $5 to $6. This was addressed in my direct testimony. The purpose of this name change was to more properly reflect some non-variable cost coverage in a basic fee assessed to all customers while recognizing that the fee does not recover what are usually considered "customer based" charges.

Q. How have other parties responded to this recommendation?

A. Mr. Hanson supports the proposal. Witnesses for the Ratepayer Alliance and Ms. Francone have recommended leaving the charge at $5, although they do not challenge the fact that the Commission-approved methodology yields a result over $6. As set forth in Exhibit QGC 5.8, page 1, the cost of minimum customer plant and minimum O&M costs, billing expense, depreciation and other costs that are required (without regard to the amount of gas sold) would result in a $6.29 charge per customer. I believe that the increase in the basic service charge recommended by the Company and adopted by the Division should be approved by the Commission. The Company has proposed more realistic methodologies in past cases that would result in significantly higher basic fees more akin to those for telephone, cable television and internet service. QGC believes it is unwise to ignore the increase merited under the more conservative methodology previously approved by this Commission.

Q. With respect to meter categories 2, 3 and 4, Mr. Hanson has recommended that the basic service fee be adjusted for the applicable return on equity. Do you agree with the recommendation?

A. Yes. The amounts we recommend as basic service fees for these meter categories should be adjusted based on the return allowed by the Commission. This has consistently been the practice followed in past Commission orders.

ADMINISTRATIVE CHARGE

Q. Mr. Higgins recommended that the administrative charge assessed to large customers be reduced from $8,000 and $3,000 to $6,000 and $2,250, respectively, with differences in cost to be included in block rates. Do you agree with this proposal?

A. No. If I understand Mr. Higgins correctly, he is not arguing the fact that the administrative charge is designed to recover the fixed costs of tracking nominations and usage, separating transportation volumes from sales volumes, and generally tracking and accounting for day-to-day customer-owned gas. These costs include nomination system costs, transportation billing costs, telemetering, and account administration. Nor does he dispute that these direct costs support the $8,000 administrative charge and have not materially changed since the last rate case. (See Exhibit QGC 5.13R, which is a copy of the response to UAE Data Request 2.7). Instead, he wants to reduce the administrative charge and collect it in block rates.

Q. How do you justify the current level of administrative charges?

A. Aside from the cost basis for this charge, this charge fits within the Company's overall rate structure. It is likely that large volume customers in these classes will oppose this proposal. It would raise the volumetric portion of the rate. Since the costs collected by the administrative charge are fixed, they should be collected in the fixed-cost portion of the rate. Also, IT and FT customers who pay the $8,000 charge generally pay between $0.12 to $0.20 per decatherm transported. Firm sales customers pay almost ten times that

amount. The combination of the substantial administrative charge with the low volumetric rate makes for a cost that recognizes the benefits these customers provide the system. If interruptible customers' rate structure is redesigned to lower the administrative charge, many more firm sales customers would likely seek to migrate to this rate schedule. Therefore, if the administrative charge is reduced, the Commission must recognize the substantial reduction in DNG revenues that will necessarily result.

Between rate cases, this penalizes the Company and increases the problem the Company is experiencing in actually earning its allowed returns. Ultimately, it penalizes the smaller GS-1 customers who cannot economically migrate to the transportation rates but will ultimately have to make up the revenues lost from migrating customers.

FT-1 RATE SCHEDULE

Q. Mr. McFadden has recommended a revision to the FT-1 Rate Schedule. Do you agree?

A. No. Mr. McFadden has recommended that bypass customers be retained through special contracts rather than on a separate rate schedule. The Company does not agree that special contracts are in the Company's, regulators', or our customers' best interests. Introducing special contracts for every bypass customer will only result in higher administration costs. The contract administration and periodic review of each special contract will result in an unnecessary Company and regulatory burden, as resources must be allocated to administer, track and review each of these special contracts. Unless parties can show why the FT-1 Rate Schedule is not cost-effective or an effective bypass tool, no change is warranted. Parenthetically, I find it interesting that the Committee, which opposed special contracts for so long, is now supporting this expensive alternative. This costly proposal is a much less attractive alternative when compared to the anti-bypass tariff provisions that appear to be working well.

FT-2 RATE DESIGN

Q. Have any parties recommended changes to the FT-2 rate?

A. Yes. Mr. Higgins recommended that the 50% load factor requirement of the FT-2 rate be eliminated. The Company does not agree with this proposal because this favorable rate is predicated on the benefit that high-load factor customers bring to the system. If the 50% requirement is eliminated, the FT-2 rate will have to be significantly modified to recognize the elimination of this system benefit. This proposal also suffers from the same problem of many of the other proposals to change rate designs. It fails to account for the costs of administration and the revenue effects of customers likely to migrate to this rate schedule.

DEMAND-SIDE MANAGEMENT

Q. Was demand-side management addressed by any party in this preceding?

A. Yes, Mr. Nichols proposed that the Commission establish a task force to determine effective demand-side management (DSM) measures that he hopes would result in a comprehensive assessment, a delivery framework, collaboration and recoupment of lost revenues caused by such efforts.

Q. Does the Company agree with this proposal?

A. No. Although DSM may be effective for the electric industry, it has little or no current application to a gas company that is experiencing a steep decline in usage per customer. Governmental programs, such as mandatory appliance efficiencies, are playing a prominent role in this trend. Volatile natural gas commodity costs have also contributed to customer conservation. Unlike the electric industry, increased demand for natural gas is being effectively dampened by these forces.

DSM measures have not gained universal acceptance in the gas industry because it has been hard to find cost effective programs that meet the various DSM tests. I'm not optimistic that the prospect of finding successful DSM measures is bright enough to

justify yet another time-consuming study effort without first addressing this problem. Mr. Nichols recognizes the usage-per-customer problem that QGC is facing and makes a constructive observation about a tracker mechanism to address this situation. Thus, if the Commission adopts QGC's proposal for a usage tracker, it would address some of the barriers to cost- effective DSM programs. In any event, Mr. Nichols correctly identifies that the most likely source of DSM savings are decreased commodity costs. These issues are better studied in conjunction with the least-cost resource planning addressed in QGC's Integrated Resource Planning dockets.

Q. What is your response to Mr. Nichols's suggestion that a mechanism be put in place to recover lost revenues from DSM programs?

A. QGC is proposing that a simple tracker be implemented that would address a large portion of the usage-per-customer problem that is facing QGC.

Q. Please explain how this tracker would work.

A. The GS class's annual usage per customer (116 Dth per year) that was used to develop the revenue requirement and the rate design in this case would be established as a standard. Column A, of Exhibit QGC 5.14R shows the development of the 116 Dth by month. Then, on a monthly basis, these "standard" monthly usages would be "tracked" or compared to the actual monthly usages as shown in column B. The monthly difference in usage, as shown in column C, would be multiplied by actual GS customers (column D) for the month, and the average DNG portion (column E) of the GS-1 rate for that month. The resulting revenue amount (column F) would be debited or credited into the 191 Account or a deferral account similar to the 191 Account. For illustration purposes, I have shown how this will both increase and decrease the amount of revenue collected by the Company. This method appears to treat fairly the concern that future usage may increase as well as decrease.

SEASONAL RATE DIFFERENTIAL AND
SNG/COMMODITY RATE DESIGN

Q. Mr. Nichols has also proposed to increase the DNG summer/winter rate differential and has requested that the design of SNG and commodity rates be considered in this case. Does this recommendation make sense?

A. No. Adoption of this recommendation will only confuse customers and will not result in the desired winter conservation. Instead, it is more likely to result in minimal increased consumption during summer months. This has no benefit to either QGC's system planning or its customers' needs. This is why the Company recommended discontinuing this difference in the last case.

Q. Did the Commission order an elimination of the summer and winter rate block differential as you proposed in the last general rate case?

A. No. Although I believe that elimination of this differential would be a positive simplification to the Company's rate structure, the Commission declined to approve its elimination.

Q. What is the Company's recommendation?

A. The Company again recommends discontinuing this difference.

Q. Please comment on Mr. Nichols's SNG/commodity rate-design proposal.

A. A review of the Company's current SNG costs reveals that they are charged to the Company on a relatively constant, level basis. For the same reason that QGC is opposed to the summer/winter DNG rate differential, it is opposed to any change in the SNG and commodity rate design.

Q. Does this conclude your rebuttal testimony?

A. Yes.