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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

COMMENT REGARDING QUESTAR GAS COMPANY'S RESPONSE TO REQUEST FOR RECONSIDERATION

Docket No. 02-057–02

The Committee of Consumer Services ("Committee") petitions the Public Service Commission of Utah ("Commission") to permit the following comment to Questar Gas Company's ("Company") response to the Committee's Petition for Reconsideration in this proceeding.

Introduction

1. On February 3, 2003, the Company filed a response to the Committee's Petition for Reconsideration ("Petition") of the return on equity ("ROE") portion of the Commission's December 30, 2002 Order in this Docket. The Company's response contains nothing that would in any way change the Committee's Petition on the issue of the relative weight given by the Commission to earnings ("EPS") forecasts and dividend (DPS") forecasts in its DCF analysis. The Committee continues to stand by the arguments and requests contained therein on this pivotal issue. However, the Company's response in the area of risk adjustments prompted the Committee to re-examine how the Commission addressed risk in its Order.

Company's Position Regarding Reconsideration

2. The Committee believes that its request to have the Commission "rethink" the substantial weight given to earnings (EPS) forecasts versus dividends (DPS) forecasts in its DCF analysis is clearly warranted based on the evidentiary record in this case and given the Commission's own admonition that "[a]pplying these [financial] models requires judgment at each important step and with the role of judgment comes the possibility of bias." (Order, page 25.)

3. As thoroughly demonstrated in the Committee's Petition, the 87.5% weight given by the Commission to EPS forecasts in its DCF analysis is unsupported in the evidentiary record and deviates markedly from current financial market realities. In short, the 87.5% EPA/12.5% DPS weighing formula applied by the Commission is biased and produces an ROE award that is excessive. If ratepayers are to be fairly treated, the Commission should reconsider and eliminate the inequity in the above weighting scheme.

The Commission Result is a "Sharp Departure"

4. The Company advances three arguments in this key section of its response. First, the Company contends that an increase from the previously authorized ROE of 11.0% to 11.2% is a relatively small change. However, the Company fails to note that the increase based on the Commission's DCF analysis was 50 basis points. The increase from 11.0% to 11.5% was subsequently adjusted downward by 30 basis points to reflect the Company's lower overall risk profile.

5. Second, the Company argues that in the last rate case (Docket No. 99-057-20) the Commission gave EPS forecasts a 75% weighting, and therefore an increase from 75% to 87.5% is ". . . hardly a sharp shift." In support of its argument, the Company references page 32 of the Commission's 2002 order. In examining that page, however, one sees the Commission merely states "[i]n the previous Questar Gas general rate case, the Division accorded dividend forecasts a 25 percent weight." The Commission says nothing about what weight it actually attached to DPS forecasts in the prior rate case. In its order in that rate case, the Commission entered the following finding: ". . . an <u>average</u> of dividend and earnings growth rates is appropriate (2002 order, page 11). It therefore appears to the Committee that the Commission has moved from weighting EPS forecasts by 50% to 87.5% during a period where analysts' EPS projections are viewed by investors with increasing skepticism.

6. Further, even if the Company were correct in its view that the Commission only increased the weighting of the EPS forecasts from 75% to 87.5%, that change materially impacts the ROE outcome in this rate case. If the Commission had applied as 75% EPS/25% DPS weighting formula in this case, the result for the proxy group would be an ROE of <u>10.9%</u>. Assuming that the Commission adjusted the 10.9% downward by 30 basis points to reflect the Company's lower risk profile vis-a-vis the proxy group, the ROE result would be 10.6%. Such a result is close to the Division of Public Utilities' ROE recommendation of 10.5%.

7. Third, the Company states that the Commission is empowered to render decisions diverging from established precedent if "the agency justifies the inconsistency by giving facts and reasons that demonstrate a fair and rational basis for the inconsistency." The Committee has no dispute with the Company's statement; clearly the Commission has the ability to exercise reasoned judgment in examining a case record and "change its mind." What is required,

however, is "a fair and rational basis" for changing its mind, and the Committee submits that such evidentiary underpinnings are lacking in the matter at hand. To increase the weighting in favor of EPS forecasts is contrary to the evidentiary record, which shows analysts' EPS forecasts are greatly inflated (double the growth rates actually experienced) and , therefore, unreliable.

Adjusting 11.5% to Reflect the Company's Circumstances

8. The Company alleges that the Committee engaged in an "apples-to-oranges exercise" in lowering its recommended ROE based on a number of factors relating to risk. It claims that the Committee applied risk adjustment factors to the proxy group in the last rate case instead of the proxy group in this case. The claim is simply unfounded. Regarding the Committee's ROE recommendation for the Company in this case, the Committee lowered the top end of its range of reasonableness from 11.0% to 10.5% (50 basis points) to recognize the Company's lower risk profile compared to the nine-company proxy group proposed by the Company.

9. While the Company's claim misses its mark, it did prompt the Committee to re-evaluate the Commission's adjustments relating to risk. First, the Commission eliminated Questar Corporation and National Fuel Gas from the proxy group because those companies were diversified entities (i.e., have different risk characteristics than a gas distribution company). (Order, page 25.) By removing those two companies from the proxy group, ". . . the Division's return calculation is reduced by 30 basis points." (Order, page 25.) Second, the Commission appropriately recognized various changes in regulatory practices and other factors since the last rate case that lower the Company 's overall risk. A downward adjustment of 30 basis points was ordered to reflect the Company's lower risk.

10. Thus, the Commission addresses risk in two related pieces that sum to 60 basis points. Upon further consideration, the Committee believes that the Commission has reasonably addressed and resolved the risk arguments presented by the parties in this docket.

Summary and Conclusion

11. On behalf of the residential and small business customers served by the Company, the Committee strongly urges the Commission to review and reconsider the evidence in the record in this docket as it relates to the pivotal issue of the Commission's almost exclusive reliance on EPS forecasts in its DCF analysis. The evidence in the record demonstrates that analysts' EPS forecasts are inflated and unreliable. The bias inherent in the Commission's EPS-DPS weighting formula produces an excessive ROE outcome that is unreasonable and unfair for ratepayers to bear.

Dated this ___ day of February, 2003.

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REED T. WARNICK
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Committee of Consumer Services

CERTIFICATE OF SERVICE

I hereby certify that copies of the **COMMENT REGARDING QUESTAR GAS COMPANY'S RESPONSE TO REQUEST FOR RECONSIDERATION** in Docket Number 02-057-02 were mailed or hand delivered on the ______ day of February, 2003 to the following:

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