- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of QUESTAR GAS COMPANY to Adjust Rates for Natural Gas Service in Utah	)	DOCKET NO. 03-057-05
In the Matter of the Application of QUESTAR GAS COMPANY to Adjust Rates for Natural Gas Service in Utah	)	DOCKET NO. 01-057-14
In the Matter of the Application of QUESTAR GAS COMPANY for a General Increase in Rates and Charges	)	DOCKET NO. 99-057-20
In the Matter of the Application of QUESTAR GAS COMPANY for Approval of a Natural Gas Processing Agreement	)	DOCKET NO. 98-057-12 ORDER

ISSUED: August 30, 2004

SYNOPSIS

The Commission determined that Questar Gas Company failed to meet its burden of proving it acted prudently in response to increasing deliveries of low heat content coal-seam gas to its distribution system by affiliate Questar Pipeline Company. The Commission rejects the parties' carbon dioxide stipulation, denies Questar Gas Company's request for carbon dioxide processing plant rate recovery The Commission will conduct further proceedings, in a separate docket, to address treatment of funds collected from ratepayers and address a long term solution to coal-seam gas delivered to customers.

BACKGROUND AND PROCEDURAL HISTORY

A. Docket No. 98-057-T02

Following a series of meetings and discussions beginning in January 1998 with the Commission, the Division of Public Utilities (Division), and the Committee of Consumer Services (Committee) to notify us of an imminent safety problem associated with heat-content levels in the natural gas supplies it was receiving from Questar Pipeline Company (Questar Pipeline), an affiliated company, and the incompatibility of that gas with current appliance set points, Questar Gas Company (Questar Gas or Company) filed Advice Letter 98-02 on April 21, 1998, reducing the heat-content operating range in its tariff from 1020 to 1320 Btu per cubic foot (cf) to 980 to 1170 Btu/cf. The Division filed a memorandum on April 30, 1998, supporting the change, and no party objected to it. The change became effective on May 1, 1998.

B. Docket No. 98-057-12

Questar Gas filed an application on November 25, 1998, in Docket No. 98-057-12, requesting approval of a contract with Questar Transportation Services Company (Questar Transportation), a subsidiary of Questar Pipeline, for removal of carbon dioxide (CO_2) from coal-seam gas tendered by shippers for transport on the pipeline. The application also requested authorization to include CO_2 removal costs, then estimated at $7.5 to $8.5 million annually, in the 191 Gas Cost Balancing Account (Account 191). Questar Gas requested a Commission finding that the contract was prudent. The Division and Committee presented testimony about the CO_2 processing plant but argued that it was not necessary for the Commission to determine the prudence of the contract at that time and that inclusion of the CO_2 removal costs in Account 191 was inappropriate because the costs did not qualify for pass-through treatment under Utah Code Ann. §54-7-12(3).

The parties conducted substantial discovery and presented extensive evidence in the case regarding Questar's decision to process CO_2. On February 1, 1999, Questar Gas filed

the direct testimony of Alan K. Allred, Manager of Regulatory and Gas Supply Services for Questar Regulated Services Company (Questar Regulated Services); Gary W. DeBernardi, Vice President of Technical Services for Questar Regulated Services; George K. Schroeder, Director of Research and Development for Questar Gas; and John P. Snider, an outside consultant from Grimm Engineering, Inc. On April 1, 1999, the Division filed the direct testimony of Darrell S. Hanson, Technical Consultant in the Division's Energy Section, and Neal Townsend, Division Rate Analyst. On the same day, the Committee filed the direct testimony of Michael J. McFadden, a consultant from McFadden Consulting Group, Inc., and A.E. Middents, an independent consultant retained by McFadden Consulting. Questar Gas then filed the rebuttal testimony on April 26, 1999 of Messrs. Allred, DeBernardi and Schroeder and of Branko Terzic, who is both a former Federal Energy Regulatory Commission (FERC) commissioner and a former state regulator.

The Division and Committee filed a joint motion for summary judgment, arguing that the CO_2 removal costs could not be included in Account 191 because they did not qualify for pass-through treatment under the pass-through statute as a matter of law. Following the filing of memoranda, the motion was argued in a hearing on June 7, 1999. Following the hearing, the Commission denied the motion without prejudice. Accordingly, the Division filed the testimony of Charles E. Olson, consultant from Zinder Companies, Inc., on June 17, 1999 and the rebuttal testimony of Mr. Hanson on June 22, 1999. Evidentiary hearings were held on June 22 and 23, 1999. Thereafter, the parties filed opening briefs on September 1, 1999 and

responsive briefs on September 30, 1999.

The Commission issued its Report and Order in Docket No.98-057-12 on December 3, 1999 (1999 Order), ruling that the CO_2 removal costs could not be recovered through Account 191 because they were not appropriate pass-through costs under section 54-7-12(3). The Commission specifically declined to rule on the prudence of the contract. The Commission stated that the request for approval of the contract and recovery of costs must be considered either in a general rate case or an abbreviated proceeding as defined by the Utah Supreme Court in *Utah Dept. of Business Reg. v. Public Serv. Commn*, 614 P.2d 1242 (Utah 1980).

C. 2001 Supreme Court Decision

Questar Gas sought review of the 1999 Order before the Supreme Court. Following briefing and oral argument, the Court reversed the 1999 Order on October 23, 2001, holding that Account 191 was a separate rate-changing mechanism not tied to the pass-through statute and that the Commission was required to consider Questar Gas's application according to previously established Account 191 procedures.

By the time the case was remanded, the Commission had already issued its Report and Order in Docket No. 99-057-20, (a non gas pass-through general rate case) discussed below. Accordingly, the remand of Docket No. 98-057-12 was consolidated with Docket No. 01-057-14, the then-pending gas cost pass-through docket, also discussed below.

D. Docket No. 99-057-20

On December 17, 1999, Questar Gas filed an application in Docket No. 99-057-20 to increase its general rates by $22,227,000, $7.3 million of that amount being for CO_2 removal costs. The application included direct testimony from Mr. Allred relating to the CO_2 removal cost issue. Questar Gas sought emergency interim rate relief of approximately $7 million, which was granted following hearing.

Thereafter, additional discovery took place and the Division, Committee, Large Customer Group (LCG) and MagCorp filed testimony on April 9, 2000 related to CO_2 removal costs. Division witnesses Messrs. Hanson and Townsend and George Compton, Technical Consultant in the Division's Telecommunications Group, filed testimony on the CO_2 removal cost issue and Lowell Alt, Manager of the Division's Energy Section and the Division's policy witness, filed testimony

recommending that 50% of the CO_2 removal costs be allowed in rates. Committee witness Mr. McFadden recommended that none of the costs be allowed in rates. LCG witness Kevin C. Higgins, a consultant, and MagCorp witness Roger C. Swenson, MagCorp's Energy Manager, also recommended that none of the costs be allowed in rates.

On May 24, 2000, Questar Gas filed the rebuttal testimony of Messrs. Allred, Snider and Terzic relating to CO_2 removal costs. On the same day, LCG filed the rebuttal testimony of Mr. Higgins responding to the Division testimony on rate design associated with recovery of CO_2 removal costs. Surrebuttal testimony on CO_2 removal cost issues was filed by Dr. Compton for the Division on May 31, 2000.

On June 2, 2000, Questar Gas and the Division filed a CO_2 Stipulation, agreeing that $5 million (approximately 68%) of CO_2 removal costs could be included in rates and that up to $5 million could be included in rates each year for five years, subject to further regulatory review of the reasonableness of the costs. They also agreed that if Questar Gas wished recovery of CO_2 removal costs after May of 2004, it would be required to seek further regulatory approval.

An allocation and rate design stipulation was filed by Questar Gas, the Division, LCG and the Utah Industrial Gas Users (UIGU). Based on the rate design for recovery of CO_2 removal costs provided in the latter stipulation, LCG and UIGU withdrew their opposition to recovery of CO_2 removal costs in the amount provided in the CO_2 Stipulation.

A hearing was held on June 5 and 6, 2000, for the purpose of hearing testimony in support of and in opposition to the CO_2 Stipulation. Based upon a request of all parties, the Commission took administrative notice of the entire record in Docket No. 98-057-12. Questar Gas and Division witnesses presented testimony in support of the Stipulation and were cross examined by the Committee, which was the only party that opposed approval of the Stipulation. The Committee also cross-examined Messrs. Hanson and Townsend and Dr. Compton, in an attempt to elicit support for its position that no recovery of CO_2 costs should be allowed. Questar Gas, the Division, UIGU and LCG waived both cross examination of testimony challenging the prudence of Questar Gas and the submission of further surrebuttal testimony, but reserved their right to cross-examine adverse witnesses and to present further testimony if the Stipulation were not approved by the Commission. Public witnesses, two of whom represented coal-seam gas producers, presented sworn testimony on the Stipulation during the continued hearing in the case on June 7, 2000.

A further hearing consisting of both testimony and argument on the CO_2 issue was held on June 23, 2000, at the Commission's request. Thereafter, the parties submitted opening briefs on June 30, 2000 and responsive briefs on July 14, 2000.

On August 11, 2000, the Commission issued its Report and Order in Docket No. 99-067-20 (2000 Order). The 2000 Order approved the CO_2 stipulation, concluding that

> The record is insufficient to permit us to determine whether the Company's analysis of options prior to early 1998 was sufficiently objective and thorough, that is, to reach a conclusion whether options were ruled in or out as a result of the influence of affiliate interests. Nor can a sufficient record be developed. . . . The record leaves no doubt, however, that by early 1998, the number of effective alternatives had narrowed to two: process the coal-seam gas or keep it off the distribution system. [Questar Gas] chose to process the gas. If the gate had been closed to coal-seam gas, [Questar Gas] states, demand on the southern part of its system could not have been met. This assertion is uncontroverted.
>
> The most troubling question is whether the contract between [Questar Gas] and its unregulated affiliate, [Questar Transportation], was prudently entered. . . . Clearly, [Questar Gas] has the burden to demonstrate the decision to enter the contract is a prudent one. Parties differ as to whether it did so successfully. But whether or not [Questar Gas] met this burden, we can and do conclude that its decision to procure gas processing has yielded the required result, that is, it has effectively protected the safety of its customers. This means the costs of gas processing can be legitimately recovered in rates.
>
> . . . .
>
> We conclude that the Stipulation offers a fair and reasonable settlement of the cost recovery issue. We accept the Stipulation.

E. <u>2003 Supreme Court Decision</u>

The Committee sought review of the 2000 Order before the Utah Supreme Court. Following briefing and oral argument, the Court reversed the 2000 Order on August 1, 2003, holding that

> [T]he real issue in this case is whether the Commission may rely on a "safety exception" that relieves Questar Gas of its burden to demonstrate the prudence of its contract with Questar Pipeline to construct and operate the CO_2 plant under terms that caused Questar Gas to incur the costs it now seeks to pass on to ratepayers.
>
> . . . We hold that the Commission's safety rationale is neither an adequate nor a fair and rational basis for departing from its prudence review standard. While safety concerns may have necessitated the construction and operation of a CO_2 plant, they do not establish who should bear the cost of these measures.

Even before the Court issued its remittitur on August 22, 2003, the parties made filings based on the 2003 Decision. These filings are discussed below.

F. Docket No. 01-057-14

On December 14, 2001, in Docket No. 01-057-14, Questar Gas filed a pass-through application requesting an annualized cost decrease. After the Court's 2001 Decision reversing the Commission's 1999 Order in Docket No. 98-057-12, the Commission consolidated that docket with Docket No. 01-057-14. The Commission authorized the rate decrease to become effective on January 1, 2002 on an interim basis. The decrease was made final by the Commission in an order issued on August 14, 2002 in Docket No. 01-057-14 (2002 Order).

The 2002 Order addressed recovery of CO_2 removal costs through Account 191 pursuant to the 2001 Supreme Court decision. Because Questar Gas had been recovering $5 million of CO_2 costs annually in general rates since the 2000 Order in Docket No. 99-057-20, the Commission was concerned only with recovery of CO_2 removal costs for the period from June 1, 1999 through August 10, 2000. The Commission found that the CO_2 Stipulation, which included the $5 million annual cap, should govern their determination of the methodology to be used for the recovery of the CO_2 costs from June 1, 1999 to August 10, 2000. Within that framework the Commission authorized the recovery of an additional $3.76 million for the prior period on the same rate spread as was approved in Docket No. 99-057-20. Because the rate design stipulation in Docket No. 99-057-20 recovered a portion of CO_2 removal costs from customers whose rates are not subject to Account 191, the Commission directed that recovery of a small portion of the $3.76 million would be through rate changes made in a new pending general rate case, Docket No. 02-057-02.

On October 7, 2002, the Committee sought review of the Commission's 2002 Order in this docket by the Supreme Court. That appeal was consolidated with the Committee's prior appeal of the 2000 Order in Docket No. 99-057-20.

G. Docket No. 02-057-02

Questar Gas filed an application in Docket No. 02-057-02 on May 3, 2002, for a general rate increase of

$23,017,000. The parties, including the Committee, ultimately settled all issues (except for gas processing costs which were not at issue) in the case by stipulation except return on equity and capital structure. The stipulation provided for future recovery of CO_2 removal costs through Account 191 in the amount specified in the CO_2 Stipulation. In its Report and Order issued December 30, 2002, the Commission approved the stipulation of the parties. No party appealed this decision.

H. Docket No. 03-057-05

On May 30, 2003, in Docket No. 03-057-05, Questar Gas filed a pass-through application requesting an annualized gas cost increase to become effective on July 1, 2003. CO_2 removal costs of $5 million were included in this application. The Commission issued an order authorizing the proposed rate increase on an interim basis, effective July 1, 2003.

The Committee filed a petition in this docket on August 8, 2003, following issuance of the 2003 Supreme Court Decision, requesting that Questar Gas's rates be immediately reduced by $5 million and that a refund of the entire amount of CO_2 removal costs included in rates to date be implemented through Account 191. The portion of the docket dealing with the Committee's petition was consolidated with Docket Nos. 98-057-12, 99-057-20 and 01-057-14, as discussed below.

I. Docket No. 03-057-10

Questar Gas filed an application in Docket No. 03-057-10 on September 4, 2003, requesting an annualized gas cost decrease to become effective on October 1, 2003. The application specified that Questar Gas was seeking recovery of all its ongoing CO_2 removal costs, but was leaving recovery at $5 million per year on an interim basis pending the outcome of this proceeding. Questar Gas, the Division and the Committee entered into a stipulation on September 25, 2003, providing that the proposed rate reduction could be implemented and that future recovery of CO_2 removal costs would be deferred for later decision following completion of the consolidated dockets. The Commission approved the stipulation on September 30, 2003.

J. Consolidated Dockets

On August 6, 2003, Questar Gas filed a motion requesting a scheduling and procedural conference in Docket Nos. 98-057-12, 99-057-20 and 01-057-14 "to allow the parties in the case to discuss, determine and schedule such additional

proceedings as may be necessary" in light of the 2003 Decision. The Commission scheduled a hearing on August 26, 2003. At the outset of the hearing, Chairman Ric Campbell announced that he, Commission Executive Staff Director Lowell Alt and Commission Attorney Douglas C. Tingey were recusing themselves from any participation in this matter as a result of the fact they had participated as Division Director, Division policy witness and Committee attorney, respectively, in earlier stages of this dispute. Accordingly, Chairman Campbell requested that Commissioner White act as Chair for purposes of these proceedings and informed the parties that he would request that the Governor appoint a Commissioner Pro Tem to hear the case along with the remaining two commissioners.

After hearing the positions of the parties, including the Committee's request that its petition in Docket No. 03-057-05 be considered in the case, the Commission set a schedule for the parties to address jurisdictional and procedural matters arising from the 2003 Decision. Pursuant to that schedule, Questar Gas and the Committee filed opening briefs on September 25, 2003. Those parties and the Division, UAE Intervention Group (UAE), successor in interest to the LCG, and U S Magnesium LLC (US Mag), successor in interest to MagCorp, filed responsive briefs on October 23, 2003. Questar Gas and the Committee filed reply briefs on November 5, 2003. Questar Gas and the Division argued that the Commission had authority to proceed to consider whether the CO_2 removal costs were prudently incurred. UAE agreed that if the Commission determined it had not previously made a finding on whether or not Questar Gas was prudent in incurring the CO_2 removal costs, then the Commission had the authority to determine prudence. The Committee and US Mag argued that the Commission was barred by the 2003 Supreme Court Decision from further proceedings, except to reduce rates going forward and order a refund of past amounts collected by Questar Gas pursuant to the CO_2 Stipulation.

Governor Leavitt appointed W. Val Oveson to act as Commissioner Pro Tem in this matter. Commissioner Oveson was provided with the complete record in Docket No. 98-057-12 and the portion of the record in Docket No. 99-057-20 relevant to the CO_2 removal cost issue. He was also provided with the complete record in this consolidated matter. From and after the date of his appointment, Commissioner Oveson has participated fully in all proceedings and deliberations in this matter.

A hearing was held on December 11, 2003, at which the parties presented oral argument in support of their positions and responded to questions from the Commission.

On December 17, 2003, the Commission issued its Order in the consolidated dockets (2003 Order), concluding that statements in the 2000 Order (Docket No. 99-057-20) that appeared to cause the Court to believe that the Commission had already determined that it could not find the CO_2 removal costs prudent were "an ambiguous use of dicta." The Commission concluded that it "ha[d] not yet put Questar [Gas] to its burden of proof that its decisions were prudent and rates including some, if any, recovery of processing costs are just and reasonable."

The Commission further stated:

> The Supreme Court's reversal of a portion of the August 2000 [Order] places the case in the same position it was before the Commission's approval of the CO_2 Stipulation. . . . At that point in time, Questar [Gas] and other parties had put on their cases in chief and all that remained was final cross-examination of witnesses (Questar [Gas], at oral argument has said that this is no longer needed by the company), a marshaling of the evidence and final arguments.
>
> Wherefore, we conclude that the parties should now have the opportunity to marshal the evidence from the existing records in Dockets 98-057-12 and 99-057-20 relating to the prudence of Questar [Gas]'s actions and decisions. We will determine whether Questar [Gas] has met its burden to show that its actions were prudent and that inclusion of any costs relating to remedial actions affecting CO_2 levels in the natural gas delivered to customer results in just and reasonable rates.

The Commission also set a conference for January 7, 2004, to set a schedule for the presentation of positions. The Division and Committee requested that the scheduling conference be delayed to allow the Committee to determine if it was going to seek interlocutory review of the 2003 Order in the consolidated dockets. On January 21, 2004, the Committee filed a Petition for Extraordinary Relief with the Supreme Court. The Commission, Division and Company responded on February 6, 2004. On March 22, 2004, the Court issued its order denying the Committee petition.

Thereafter, pursuant to an agreed scheduling order issued March 26, 2004, Questar Gas, the Division and Committee filed briefs marshaling the evidence on May 7, 2004, and responsive briefs on May 21, 2004. A hearing was held on May 27, 2004, at which the parties presented further argument and citations to evidence and responded to questions from the Commission. Questar Gas and the Division argued that the evidence in the record supported a finding that an unaffiliated, reasonable local distribution company (LDC) could have prudently incurred $5 million per year in costs in addressing the heat-content issue. The Committee maintained that the record did not support a finding of prudence for any CO_2 removal costs.

In addition to considering the briefs of the parties and their argument and responses to questions during oral argument, the Commission has studied the entire record in Docket No. 98-057-12 and the portions of the record in Docket No. 99-057-20 relevant to the CO_2 issue.

FACTUAL BACKGROUND

Questar Gas and Questar Pipeline are subsidiaries of Questar Regulated Services, which is in turn a subsidiary of Questar Corporation. Questar Transportation Services is an unregulated subsidiary of Questar Pipeline. Questar Regulated Services, Questar Gas, and Questar Pipeline are managed by the same management team. Questar Gas and Questar Pipeline have no independent management, but are both managed by Questar Regulated Services. Prior to 1996, Questar Gas and Questar Pipeline did not share management personnel, but both companies' management teams reported to their corporate parent, Questar Corporation.

As early as 1989, recognizing a business opportunity, Questar Pipeline began entering into future capacity transportation contracts with the producers of coal-seam gas in the Ferron Basin in Emery County, Utah. In order to transport this gas, Questar Pipeline had, by the mid-1990s, invested approximately $1 million to expand its transportation facilities and promised further investment as production increased. By transporting the coal seam gas by displacement through its southern main line, Questar Pipeline ensured that this gas would enter Questar Gas's local distribution system at the Payson Gate. Because coal-seam gas is almost pure methane, its heat content is significantly lower than the heat content of the gas historically provided to Utah customers. Producers of this gas are required to process it to the three percent total-inert level required by the FERC-approved tariff specifications of Questar Pipeline. However, if not further treated or blended, this gas would pose a significant safety threat to Utah consumers whose appliances have historically been set to burn higher heat content gas.

Questar Pipeline began transporting coal-seam gas in 1992. In 1994 and again in 1995, the quantity of coal-seam gas transported by Questar Pipeline, and coincidentally entering Questar Gas's distribution system, accelerated significantly. We take notice that in its 1996 annual shareholder report, Questar Corporation reported the increasing quantities of coal-seam gas being transported on Questar Pipeline's system. By 1997, these quantities of coal seam gas entering the

system were increasing at dramatically accelerated rates. Throughout this period, Questar Pipeline blended the coal-seam gas with other gas on its transportation system in efforts to ensure that the gas ultimately reaching Utah customers complied with the heat content requirements of Questar Gas' tariff. Inexplicably, however, from 1992 to mid-1997, despite clear indications that coal-seam gas would continue to account for an increasing percentage of southern system gas supply, we find no evidence Questar Gas took proactive measures to analyze the long term (including the potential safety) impact of this gas on its Utah distribution system.

On April 25, 1997, Questar Regulated Services formed a Gas Quality Team to "Determine the operating and economic impact of the existing QPC [Questar Pipeline] gas quality specifications with respect to interconnecting pipelines and the MFS [Questar Gas] and QPC systems and suggest possible modifications to the specifications and other potential methods to deal with gas quality issues. (Consider enforcement mitigation issues.)" Initially, the team focused its attention on tariff specification issues. By May 26, 1997, it was suggested that a "Tariff Task Force" be created; however it was not. Indeed, the team's focus evolved and after three meetings, its draft mission statement read: "Develop and maintain safe and cost effective solutions to transporting natural gas of variable BTU values while improving customer satisfaction and maintaining Questar financial performance." Thus, we observe a shift in goal from considering the utilities' gas quality issues to explicitly include the maintenance of Questar Corporation's financial performance.

In its investigation of the CO_2 processing plant decision, the Division asked the Company to provide its review of FERC cases wherein the quality of gas being delivered to a marketing area was an issue. The Company could not identify where any review had been made. The Division also asked about any negotiations with producers or shippers over appropriate CO_2 and BTU levels for coal bed methane gas being delivered to QPC. The Company said that negotiations with coal bed methane producers or shippers had not been conducted.

Several comments in the Gas Quality Team minutes explain why the Questar Corporation Companies did not pursue changes to pipeline tariff specifications:

> If QPC raises its BTU requirement we will not be able to ship gas for anyone but MFS. We would ultimately be a "gathering" system for MFS. (12/31/97 Minutes)

> Under the discussion of "Southern System Options - Shut in River Gas" one bullet reads "Largest Development on QPC System".(Presentation made to Nick Rose, President of QGC and QPC latter part of November 1997)

> When we talk about shutting in coal seam gas it is always brought up that if we don't transport the gas someone else will my question is if someone else can build a pipeline to transport the gas and it is economically feasible why can't we? (12/3/97 Minutes)

The Gas Quality Team's changing mission statement, the evolving focus of the team and these comments indicate the Company's divided concerns about the success of QPC and the safety of QGC retail customers. QGC, as one participant in this team, was not independent in searching for the cheapest way to permanently solve the low BTU safety problem. Said more forcefully, it appears that possible permanent solutions to the low BTU safety problem were not thoroughly analyzed because of potential adverse impacts on QPC. This divided allegiance of team participants highlights the need for vigilant scrutiny of affiliate transactions and the burden on a regulated utility affiliated with unregulated entities to prove the prudence of its actions when dealing with its affiliates.

This team did not focus on the issue of increased production of coal-seam gas until August 20, 1997, at which time team members were tasked to analyze alternatives to address the issue. At a meeting on September 25, 1997, the team reviewed alternatives and discussed the possibility of adjusting customer appliances and CO_2 removal. By the end of 1997, Questar Gas finally recognized that, by the spring or early summer of 1999, the blending operations would no longer be sufficient to ensure the delivery of safe, tariff-compliant gas to Questar Gas's customers at Payson Gate.

In January 1998, Questar Gas informed the Commission, the Division and the Committee of the accelerating decline in the heat content of its gas supplies generally, as well as the issue specifically related to coal-seam gas. Prior to May 1, 1998, Questar Gas's Commission-approved Utah tariff specified a heat-content operating range of 1020 to 1320 Btu/cf. Appliances are required by building codes to be set to burn gas within the tariff's specified range to ensure customer safety. Questar management concluded that the long-term solution to its coal-seam gas problem was to lower the Btu range specified in Questar Gas's Utah tariff and make a corresponding change to recommended appliance set points. We approved the amended tariff effective May 1, 1998, to reduce the heat content to an operating range of 980 to 1170 Btu/cf. However, Questar Gas had already determined that even an expedited appliance adjustment program would take at least four years and would cost over $100 million, meaning that the vast majority of customers would not be able to adjust their appliance set points before the level of coal-seam gas exceeded Questar Pipeline's blending capacity.

From late 1997 through mid-1998 Questar management considered several alternatives to deal with the impending safety problem, including adjusting customer appliances, injecting higher Btu hydrocarbons into the gas stream at Payson Gate, and other pipeline projects. However, by February or March of 1998, Questar Gas had confirmed that by removing CO_2 from the coal-seam gas so that the total CO_2 level was one percent or less, it could provide a safe solution to the problem and that it could implement this solution by spring or early summer of 1999. Its rough analysis of this and other possible solutions led Questar management to determine that the other solutions cost more, were not as reliable, and likely could not be completed in time because of the need for FERC certification proceedings, environmental compliance and permitting.

Questar Gas then entered into a contract with Questar Transportation, by which Questar Transportation would construct, own, and operate a CO_2 removal plant between the Ferron field and Questar Pipeline's main southern line. Under the contract, Questar Transportation would provide CO_2 removal services for natural gas tendered by shippers on the pipeline sufficient so that the commingled gas delivered to Questar Gas's delivery points was safe to burn. This was done without benefit of an open bid process and without having conducted a well-defined capital expenditure analysis to determine the most cost effective long-term structure by which to construct, own, and operate the plant. The contract provided for cost-of-service pricing for the CO_2 removal services. Since beginning operations in 1999, the CO_2 removal plant has produced gas that is safe to burn in customers' appliances at the set points specified in Questar Gas's tariff. Although CO_2 removal operations began in 1999, a majority of Utah customers have not replaced or reorificed their appliances, meaning that CO_2 removal must continue to ensure customer safety. Indeed, customer modification of appliances may be at odds with Questar interests. Customer appliance changes or modifications obviates a need for CO_2 processing, perhaps eliminating any need for the CO_2 plant before the end of it's asset life.

The central question now before the Commission is whether Questar Gas has met its burden to show that the actions it took and the costs it incurred were prudent.

APPLICABLE LEGAL STANDARDS

In deciding this case, we are guided by the Supreme Court's statements in reversing our 2000 Order:

> By accepting the CO_2 Stipulation with no consideration of the prudence of the underlying source of the new costs (i.e., the contract between Questar Gas and its affiliate Questar Pipeline), the Commission abdicated its responsibility to find the necessary substantial evidence in support of the proposed rate increase in the record. We are far from certain, moreover, that the Commission could conceivably determine whether a rate increase is just and reasonable without examining whether the underlying cost-incurring activity was reasonable, which in turn seems to require some attention to the utility's decision making process, most particularly where negotiations with an affiliate are involved. 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. . . . While the Commission correctly recognized Questar Gas's obligation to ensure the safety of its customers, it incorrectly concluded that this factor provides 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.

In our 1999 Order denying Questar Gas's request to include CO_2 processing costs in its 191 Account, we stated that we "do not intend, by this Order, to make any judgment on the issues of whether [Questar Gas's] decision to enter into the agreement with Questar Transportation Services Company was prudent, whether the terms of the agreement are reasonable, or whether the expenses incurred under the agreement are legitimate and reasonable utility expenses that may be recovered from utility customers." With the reversal of our 2000 Order, we now follow the Supreme Court's statement that, "the Commission [should carry] out its initial obligation to review the prudence of the CO_2 plant contract and its terms, holding Questar Gas to its burden of establishing that its decision to enter into the contract and the costs it agreed to were prudent and not unduly influenced by it's affiliate relationship with Questar Pipeline." Having been instructed by the Supreme Court that safety considerations are not an adequate basis for departing from a prudence review, we now turn to that inquiry.

A. Prudence Standard

It is well established that in conducting a prudence review we must analyze the decision-making process in light of the circumstances and the facts that the utility knew or reasonably should have known at the time of the decision. We do not substitute our judgment in hindsight for the reasonable decisions made by management, nor do we determine that a reasonable decision is imprudent merely because we conclude that a better, reasonable alternative was available for consideration or action. However, neither do we presume affiliate transactions to be reasonable. We long ago put Mountain Fuel Supply Company, Questar Gas's predecessor in interest, on notice that, while we do not presume affiliate transactions to be biased, we view customers' interests as paramount and will require in all instances that those interests not be subordinated to the interests of corporate affiliates.

Therefore, in assessing the prudence of Questar Gas's actions, we simply ask whether an unaffiliated utility

acting in the best interests of its customers, in light of the circumstances and possessing the same knowledge which Questar Gas had or should have had at the time, could reasonably have responded the way Questar Gas did to the increasing volumes of coal-seam gas entering its distribution system as a result of Questar Pipeline contracts to transport gas from coal seam producers or shippers in Emery County, Utah.

This inquiry necessarily requires a thorough review of the facts precipitating utility action and the process by which the utility chose to act. Our review of the time line of events and decisions preceding utility action is critical, particularly in the context of affiliate transactions, because prudence cannot be determined without first determining when a reasonable, unaffiliated utility would have been expected to undertake action for the protection of its customers. Our emphasis on planning and process should come as no surprise to the parties; in 1994 we counseled Questar Gas that "all planning options that potentially benefit [Questar Gas's] ratepayers shall be investigated, whether or not they benefit subsidiaries of the Questar Corporation."

One would expect a prudent gas distribution company faced with the risk of safety issue of the magnitude faced by Questar's distribution customers to clearly identify its objective ; to identify alternatives to meet the objective, to define the method and criteria by which it would evaluate the alternatives and to record or document the process in support of the ultimate decision. A review of the prudence of the actions, inactions and decisions of Questar Gas as they relate to receiving low heat-content gas into its distribution system and the attendant safety problems presented, necessitates an analysis of a wide range of activity and/or inactivity. For example, was Questar Gas prudent in timely recognizing the safety issue; was it prudent in framing the problem (ie. "What is the lowest cost solution long term management of the safety problem?"); was it prudent in identifying possible solutions; was it prudent in thoroughly analyzing potential solutions; was it prudent in taking (or not taking) appropriate actions once possible solutions were identified; did it prudently place the interest of the safety of its distribution customers before the economic interests of affiliate entities; was it prudent in developing and implementing means of postponing delivery of the increasing volumes of low heat-content gas to provide sufficient time to retrofit customers appliances, thereby achieving a truly long term solution to the safety problem; was it prudent in selecting the processing plant; was it prudent in selecting an affiliate to build, own and operate the plant; was it prudent in not causing the completion of appliance retrofitting within a limited period so the plant would not have to run longer, incurring continuing operation costs; and, was it prudent in seeking cost recovery of all of the costs of gas processing from distribution customers?

In making this determination, we believe that ratepayers are best served by reserving wide latitude to utilities' managerial experience and technical expertise. We therefore do not promulgate a checklist of actions which, if followed, might innoculate a utility's action against a finding of imprudence. Instead, we simply require substantial evidence that the utility's decision-making process, under the totality of the circumstances, was not the product of a conscious or unconscious favoring of affiliate over ratepayer interests. The utility's and its customers' interests must be paramount and affiliate interests subordinate. The utility's course of conduct need not, with benefit of hindsight, provide the best solution, but at the time the decision is made, knowing what that utility knew or should have known, the decision must provide a reasonable solution arrived at through a reasonable process.

B. Burden of Proof

The Commission and the utilities that we regulate have long been aware that "the burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the Commission, the Commission staff, or any interested party or protestant, to prove the contrary." The utility bears the burden of supplying substantial evidence in support of its position that requested rates are just and reasonable; the Commission bears responsibility for holding the utility to its burden. Failure to meet the burden or requiring adherence in applying the burden precludes a rate increase which seeks to recover claimed costs.

The form and content of such evidence is necessarily case-specific, but we recognize that regulated utilities are sophisticated entities long accustomed to standard business practices such as forecasting, planning, budgeting, capital expenditure, record keeping and auditing. Therefore, we cannot allow after-the-fact summarization of a complex decision-making process to substitute for substantial contemporaneous evidence of timely, thorough evaluation of conditions that may impact ratepayer interests, including an evaluation of the costs and effectiveness of the reasonable alternatives that may be undertaken to protect those interests. Additionally, where affiliate transactions are involved, a utility seeking recovery of costs from its Utah customers must show that it placed the interests of itself and its customers first, as it explored its options and that it was not influenced by the impact of a resolution upon an affiliate.

DISCUSSION AND FINDINGS

Application of this standard to the facts of this case leads us to conclude that Questar Gas has not met its

burden of proving the prudence of its actions.

Although coal-seam gas began to flow on Questar Pipeline's system in 1992, Questar Pipeline was signing future capacity transportation contracts with coal-seam gas producers as early as 1989, eventually investing $1 million in an initial expansion of its transportation system to accommodate projected coal-seam production. Particularly because of the affiliate relationship and shared management involved here, it is reasonable to infer that whatever Questar Pipeline knew, and whenever it knew it, Questar Gas knew as well, including knowledge of Questar Pipeline's business plans and intentions concerning coal-seam gas transportation. The individuals making such plans and decisions were the same individuals managing the affairs of both companies. Thus, we find that, probably by 1994 and certainly by 1996, Questar Gas knew or should have known about the impact coal-seam gas would have on its distribution system and immediately started planning how to cost-effectively manage the risk of this impact and ensure the safety of its customers. We also would expect that Questar Gas would have undertaken sensitivity analyses to evaluate the potential impacts if there were possible variations in the assumptions, estimates and evaluations used in the decision making process. We expect prudent utility planning to reveal the risks associated with the possibility of changing conditions. Questar management looked after the interests of its shareholders and Questar Pipeline, but Questar Gas has provided no evidence showing that it considered or undertook such planning anytime during the period 1989 to1997.

From its first entry into Questar Pipeline's system in 1992, the amount of coal-seam gas being transported steadily increased. Questar Gas contends that it first recognized the imminent problem caused by increasing quantities of coal-seam gas in the latter half of 1997 when it says coal-seam gas production increased at an unanticipated level. However, its own exhibit presented at hearing shows that the first substantial increase in the rate of coal-seam gas production occurred in 1994 and continued at an even faster pace throughout 1995. For example, if Questar Gas had simply extrapolated from the historic increases at the end of 1995, it could have easily identified the risk that by early 1999 coal-seam gas volumes could exceed blending capacities. While the Gas Quality Team eventually reached this same conclusion, it did so nearly two years later. These additional two years may have rendered some of the options later discarded due to imminent safety concerns more desirable both financially and operationally. However, whether these options would have been chosen in 1996 rather than discarded in 1998 is not the point. The point is that we believe a reasonable, unaffiliated utility would have performed such analysis no later than early 1996, thereby affording all parties an additional two years within which to find and commence a

workable solution.

The record refers to several potential solutions. Unfortunately, while Questar Gas participated in the review of some of these in 1997 and early 1998, there is no evidence that Questar Gas conducted an independent, thorough, long-term cost-benefit analysis of these options prior to Questar management deciding upon its preferred CO_2 removal solution. Its summaries and analyses conducted after-the-fact indicate that CO_2 processing was the cheapest short-term solution (given the time remaining within which it could implement its CO_2 plant decision), but there was apparently no discussion or analysis of whether there were cost effective ways of avoiding the coal-seam gas problem altogether or, alternatively, of providing a cheaper, long term solution instead of the expensive, temporary fix selected by Questar Gas. Notwithstanding the testimony of Company witness Snider that, "The best long term alternative is to reset all the appliances. . ." it should be noted that building and operating the processing plant merely postponed the date by which customer's appliances will have to be adjusted, retrofitted or replaced at the customer's expense, presumably at a cost of over $100 million dollars adjusted for inflation, based on the testimony of Questar witnesses. In the interim, customers have also been paying the majority of gas processing costs.

Possible Alternative Solutions:

A. Invoke §13.5 of Questar Pipeline's FERC Tariff and Seek Tariff Change at FERC

Faced in 1992 with the introduction of lower Btu coal-seam gas into Questar Pipeline's system that feeds Questar Gas's southern local distribution system, we expect that a reasonable, unaffiliated utility would have seriously considered any option to keep this gas out of its system entirely (or provided some delay to provide customers time to change appliance capabilities to utilize supplies containing coal-seam gas). Early in these proceedings, the Division indicated, and Questar Gas admitted, that one option not pursued by Questar Gas was going to FERC to address the coal-seam gas and remedial cost allocation issues. This FERC option actually consists of two different tracks.

One track would have been for Questar Gas to push Questar Pipeline to invoke §13.5 of its FERC tariff which states, with respect to the pipeline: "Questar shall not be required to accept gas at any point of receipt that is of a quality inferior to that required by shipper or a third party at any point of delivery on Questar's system." Questar Gas, as the largest of

Questar Pipeline customers, presumably would have had considerable standing to contest the introduction, on the pipeline, of 'inferior' gas which creates significant safety problems for customers throughout Utah. We would not expect FERC to have turned a deaf ear to the safety problems attendant to the introduction of coal-seal gas on the pipeline; significantly the prospects of death and property damage as raised by Questar Gas before us. By invoking this provision, it may have been possible to have kept coal-seam gas off of the pipeline system so that it would never enter Questar Gas's distribution system (or have delayed volumes sufficiently to allow a more reasonable time for Utah customers to change or reset their appliances). Such action could have resulted in a number of reactions: producers/shippers who had been shut in by this decision may have complained to FERC, or they may have approached other pipeline companies about transporting their gas, or the producers/shippers might have built their own pipeline, or the parties may have agreed to some cost sharing to process the gas to Questar Gas specifications prior to placing it on Questar Pipeline's system. We cannot know what might have transpired, but it is reasonable to assume that an unaffiliated utility would have sought to protect its individual and customers' interests, even to the detriment of the pipeline and/or other shippers on the pipeline. If Questar Gas had set these events in motion, we would have been left with far fewer questions than we confront today. It is possible that the safety threat that confronted Utah ratepayers in 1999 might never have appeared.

The second FERC track that Questar management could have pursued was for Questar Gas to complain directly to FERC, seeking a change to Questar Pipeline's tariff's quality standards, so that lower Btu coal-seam gas would be processed by producers to meet the modified pipeline quality standards before the gas could be tendered for shipment. Questar management argues that, based upon FERC precedent, the most that could have been hoped for was a FERC order requiring producers to reduce the coal-seam gas CO_2 content from three percent to two percent –an amount that still would not have met Questar Gas's requirements. The Division speculates that had Questar Gas gone to FERC, the worst-case scenario may have been an order requiring Questar Pipeline to deliver the gas after processing in order to prevent a safety problem for Questar Gas's customers. In this view, Questar Gas, as Questar Pipeline's largest customer, may have been required to pay most of the processing costs. Alternatively, the producers and/or Questar Pipeline, as the beneficiaries of FERC's open access policies, may have been required to pay some or all of the processing costs. In either event, it appears that Questar Gas's customers would have been placed in no worse a financial position than they are now i.e., at risk of bearing virtually all, if not all, costs to make coal-seam gas safe to use. These costs include the gas processing costs and costs to meet the remaining long term

solution, 100% of the costs to adjust, replace or retrofit customer appliances.

In general, Questar management challenges the proposition put forth by the Division and Committee that going to FERC would have been a viable option, claiming that the safety threat posed by the coal-seam gas was imminent, that proceedings before FERC can take years to resolve, and that FERC would likely not have decided this matter in favor of Questar Gas. Questar Gas's witness, Mr. Branko Terzic, testified that FERC would not have ordered a change in Questar Pipeline's tariff solely to benefit its affiliate, Questar Gas, and that Division and Committee witnesses misread §13.5 as a tool that Questar Pipeline could have used to keep coal-seam gas off its system. However, he also testified that he could not "state with certainty what conclusions FERC would have reached," nor did he know how long it would have taken FERC to resolve these matters. Unable to definitely opine on the time frame for resolution or its outcome, he confirmed the foundational point that one option open to Questar Gas was to petition the FERC. If addressing the safety issue was important and imminent for Questar Gas, it would also have been important and imminent to FERC. Indeed, Mr. Terzic's primary objection to Division evidence on this point was simply that, in his opinion, Division witness Dr. George Compton testified with too much certainty concerning the likely outcome of any FERC proceedings.

While we cannot divine what the FERC would have decided, it is possible either invoking §13.5 or going directly to the FERC to adjust the pipeline tariff might have solved the problem or delayed the introduction of coal seam gas for a period of time that would have permitted retrofitting of Questar distribution customer appliances, resulting in a long term solution to the safety issue. There is no evidence Questar management ever considered these or other methods to minimize the impact on Questar Gas and its customers of coal-seam gas or to buy additional time in which to modify the appliances.

That we are left today to attempt to divine what may have happened had Questar management petitioned or complained to FERC only serves to highlight the fact that we can not know what would have happened because Questar management did not seek resolution from FERC. Moreover, there is nothing in the record – no contemporaneous legal memorandum, no meeting minutes, no email, no testimony – to indicate that, prior to 1997, Questar management conducted any sort of analysis – legal, financial, or otherwise – concerning the possibility of invoking §13.5 or seeking a change to Questar Pipeline's FERC tariff , or, indeed, consideration of other approaches to obtain sufficient time to retrofit customer appliances.

Even when some options did finally come before Questar management, the minutes of the Gas Quality Team indicate a concern to protect Questar Corporation's financial interests rather than to do whatever was necessary to protect Questar Gas customers. According to these minutes, Questar management was concerned that changing Questar Pipeline's FERC Gas Tariff might effectively foreclose Questar Pipeline's ability to capture the coal-seam gas transportation business. This is not surprising – we would expect Questar Pipeline to voice its concerns about the potential loss of any business opportunity. However, we would also expect Questar Gas to have voiced with equal or greater force its concern about the impact Questar Pipeline's actions were having on its distribution customers, and its interest in mitigating that impact. One suggestion in the minutes of the Gas Quality Team of a ". . .rule of thumb might be, if it affects our ability to serve our customers, we will not accept gas." was apparently rejected out of hand and never mentioned again.

Because neither Questar Gas, Questar Pipeline nor their shared management at Questar Regulated Services approached the FERC on these issues, we can not know whether the problems posed by coal-seam gas were thrust upon Utah customers by Questar Pipeline's decision to pursue a potentially lucrative business opportunity or whether these problems would have inevitably reached Utah customers because of FERC open access requirements. We can not know how the costs associated with this coal-seam gas may have been allocated among producers, pipelines, distribution companies, and other customers. What we do know by Questar management's own admission is that there would be no need for CO_2 removal or any other remediation efforts if the coal-seam gas were not entering the Questar Gas distribution system or if the customer appliances were retrofitted or replaced. We are satisfied that a reasonable, unaffiliated utility, recognizing the potential danger posed by increasing quantities of this gas, would have analyzed all options, including invocation of §13.5 or petitioning FERC, in an attempt to permanently avoid or mitigate this danger.

B. Other Pipeline or Injection Options

Other options considered by Questar management in late 1997, but apparently not considered prior to formation of the Gas Quality Team, included injecting higher Btu hydrocarbons (such as propane) into the gas stream at Payson Gate, constructing a pipeline from Kern River to introduce additional higher Btu gas at Payson Gate for blending, and looping Questar Pipeline's Main Line 40 to Kern River so that coal-seam gas could be transported on one pipeline and the other used to transport higher Btu gas to Payson Gate for delivery to Questar Gas. The Division believes this looping would have effectively removed coal-seam gas from the Questar Gas distribution system, except during peak periods when limited

quantities of coal-seam gas could be delivered and blended as necessary.

Questar management asserts that each of these options would have cost more than CO_2 removal, but admits that rigorous financial analyses were not conducted and that Questar management quickly settled on its CO_2 processing option primarily because of the time constraints posed by its customer safety concerns. However, just as with the FERC options discussed above, we are left to speculate whether any of these options would have presented a more reasonable long-term solution had Questar Gas begun analyzing them at some point prior to late 1997. For instance, Questar Gas estimates that looping ML 40 may have cost significantly more in up front capital expenditure and some undetermined, ongoing gas processing costs, but this estimate fails to consider that it may have eliminated entirely the need for Utah customers to re-orifice at an estimated cost of $100 million. In addition, while some options, such as propane injection, may have been more expensive on a short-term annual basis, they may well have solved the safety crisis during the four or five years needed to reorifice and therefore have proven to be less costly in the long-term than the envisioned ten-year operation of the CO_2 plant. We do not know because that type of analysis was not undertaken. We posit these not as better solutions but as examples of some of the alternatives that we would expect a reasonable utility to analyze in thoroughly exploring every option. Unfortunately, there is no evidence to indicate that Questar management conducted anything but the most cursory analysis in ruling out potential long-term solutions in favor of its preferred shorter-term fix.

C. CO_2 Processing Plant Decision

When examined in isolation, rapid construction and operation of the CO_2 processing plant may have been within the range of reasonable responses to a “safety crisis” first recognized in late 1997. However, even were we to ignore the many opportunities available to Questar Gas prior to 1997 to avoid or address the problems associated with coal-seam gas, and assuming that we would continue to view construction and operation of the CO_2 processing plant to have been a reasonable course of action in 1998, we would nonetheless have difficulty concluding that the decision to contract with Questar Transportation for construction and operation of the plant was prudent.

When this issue was originally before us in Docket 98-057-12, the Division concluded that a well-documented

record demonstrating a reasoned, arms-length process by which Questar Gas decided to contract with Questar Transportation does not exist. Mr. Alan K. Allred, Manager of Regulatory Affairs for Questar Regulated Services, asserted at hearing in the consolidated dockets that decisions were made quickly because of the need to maintain customer safety and because of Questar management's knowledge that the cost-of-service contract with Questar Transportation provided the best financial deal for those customers. However, as the Supreme Court has made clear, safety concerns such as existed in this case do not trump Questar Gas's burden of demonstrating prudence.

This burden rests heavily on Questar Gas, yet Mr. Allred admitted that Questar management conducted no in-depth financial analysis because management assumed Questar Gas would recover any costs from its ratepayers. While Questar Gas did provide after-the-fact analysis that, in the view of its witnesses, its arrangement with Questar Transportation resulted in a lower cost to ratepayers than would have an open bid process, we would be hard pressed, solely on the weight of this evidence, to determine that Questar Gas has met its burden of proving it prudently analyzed the issues prior to entering into the contract. For example, there was no analysis of whether ratepayers would have benefitted if Questar Gas owned and operated the plant.

Too many questions remain unanswered. For instance, Questar Gas maintains that it entered into its agreement with Questar Transportation because Questar Gas did not have the experience necessary to build and operate the plant, but Division witness Hanson indicates that Questar Corporation has a history of moving people within the company to meet specific needs, so why did Questar Gas contract with an affiliate rather than simply request and obtain the expertise it needed? Questar Gas further claims that any affiliate relationship was mitigated by the fact that Questar Transportation bid out the design and construction of the plant, but that simply leads us to ask why Questar Gas could not have bid this work directly, instead of through its affiliate?

While we have previously recognized that under some circumstances our prudence review need not produce an all or nothing outcome, that reasoning does not apply here. Were we to focus solely on Questar management's decision to build the CO_2 processing plant, assuming we had substantial evidence of its analysis of the project, we might determine that some benefit accrued to Utah consumers such that Questar Gas is entitled to some level of rate recovery. The Division notes that "where there were other alternatives, the question should be whether they were adequately reviewed without the decision-

maker being inappropriately influenced by its affiliate. However, if there is some benefit, even with affiliate influence, complete disallowance could be inappropriate." Division Brief, at 8. The Supreme Court's opinion in the 2003 Decision, however, effectively requires us to deny recovery if Questar Gas fails to meet its burden of proving that its decision making process and decision to contract for the CO_2 processing was prudent and unaffected by affiliate interests. As explained above, our decision is based on much more than the discrete decision to build the CO_2 plant. On this record, we find that affiliate influence is clear. The degree to which it is "inappropriate," to use the Division's terminology, is unknown because explicit analyses by Questar management is absent. Because Questar Gas has not proven that the dangers posed by increasing amounts of coal-seam gas were inevitable and that it acted reasonably in perceiving and addressing those dangers, we are unpersuaded that any unique economic benefit has accrued to Utah rate payers to justify rate recovery. Despite years of analysis encompassing several dockets, and despite its continuing support for the CO_2 Stipulation, the Division has never concluded that Questar Gas's decision to pursue CO_2 processing was prudent. Neither can we.

We find no indication that Questar Gas, independent from other Questar company considerations, ever bothered to ask itself "What is the lowest cost long term solution to this emerging problem?" We find no evidence, written or oral, to indicate that the best interests of distribution customers were the paramount concern of Questar management. Questar management effectively ignored the potential problems coal-seam gas posed for Questar Gas and it's customers until 1998, when its safety concerns were so overwhelming that the only option it viewed as workable involved assigning all of the cost of the gas quality problem to its distribution customers. We find no evidence that Questar Gas acted as a reasonable, unaffiliated utility would have acted prior to 1997; to question, study, object to, or attempt to mitigate the gathering threat posed by the increasing presence of coal-seam gas in its distribution system. Furthermore, we find no evidence of the thorough financial and cost-benefit analysis that we would expect Questar Gas to have undertaken prior to acting upon a gas treatment option destined to impose significant expense on its distribution customers for the foreseeable future. Nor do we find any significant evidence of thorough analysis of other approaches that might have been taken to avoid or delay the introduction of coal seam gas into the distribution system until customer appliances could be adjusted.

Instead, five years into the CO_2 removal effort, Utah ratepayers are left with an imperfect, costly, and temporary solution to a long term problem. Meanwhile, Questar Pipeline has been able to pursue its interest in expanding its

pipeline business opportunities with most of the costs of gas processing picked up by Questar Gas's distribution customers. We find that a reasonable, unaffiliated utility possessed of the knowledge Questar Gas had or should have had and acting prudently in the best interest of its customers would have acted much earlier to protect those interests and would have more thoroughly identified, evaluated and pursued alternative approaches to the problem. To the degree affiliate interests were present, these interests should have been explicitly recognized, efforts made to avoid and counter conflicted interests, and have been reflected in the decision making process.

Despite the volume of documentation provided by Questar management in this case, it has been unable to pull from this mountain of paper the type of detailed, reasonable, and complete contemporaneous analysis we would expect of a utility to prove the prudence of its actions leading up to this requested rate increase. We find that a reasonable, unaffiliated utility properly focused on the best interests of its customers would have produced such documentation in the normal course of its analysis and deliberations.

CONCLUSIONS OF LAW

For the reasons set forth above, we conclude that Questar Gas has not met the burden of proving its actions constituted a prudent response to the introduction of lower Btu coal-seam gas into the Questar Gas distribution system. We conclude that, given the circumstances presented in the record, a reasonable unaffiliated utility would timely address growing risks to customers and perform an independent and documented evaluation of alternatives with the interests of those customers paramount and avoid being forced into crisis management to protect the safety of its customers with an ever diminishing choice of options. We therefore reject the CO_2 Stipulation and deny recovery of the processing costs during the period from June, 1999, to May, 2004.

ORDER

Wherefore, pursuant to our discussion, findings and conclusions made herein, we Order:

1. Questar Gas Company to file appropriate tariff revisions to reflect our determination that there be no cost recovery authorized for CO_2 processing operations.

2. The Division of Public Utilities shall review the tariff revisions for compliance with this Order.

3. The Commission will conduct further proceedings to address the treatment of funds collected to recover the cost of CO_2 processing. We will also address, in a separate docket, how to craft a long term solution to the compatibility of customer appliances with natural gas containing coal-seam gas consistent with the utility's obligation to provide safe commodity and service to its customers.

Pursuant to Utah Code 63-46b-12 and 54-7-15, agency review or rehearing of this order may be obtained by filing a request for review or rehearing with the Commission within 30 days after the issuance of the order. Responses to a request for agency review or rehearing must be filed within 15 days of the filing of the request for review or rehearing. If the Commission fails to grant a request for review or rehearing within 20 days after the filing of a request for review or rehearing, it is deemed denied. Judicial review of the Commission's final agency action may be obtained by filing a Petition for Review with the Utah Supreme Court within 30 days after final agency action. Any Petition for Review must comply with the requirements of Utah Code 63-46b-14, 63-46b-16 and the Utah Rules of Appellate Procedure.

DATED at Salt Lake City, Utah, this 30th day of August, 2004.

/s/ Constance B. White, Chairman

/s/ Ted Boyer, Commissioner

/s/ W. Val Oveson, Commissioner Pro Tem

Attest:

/s/ Julie Orchard

Commission Secretary

G#40094(Docket No. 99-057-20)

G#40154 (Docket No. 03-057-05)

G#40155 (Docket No. 01-057-14)

G#40156 (Docket No. 98-057-12)