Janet I. Jenson (Utah Bar No. 4226)
Jenson & Stavros, PLLC
350 South 400 East, Suite 201
Salt Lake City, Utah 84111
Telephone: (801) 363-4011
Fax: (801) 746-0174

Attorneys for Petitioners

BEFORE THE UTAH PUBLIC SERVICE COMMISSION

In the Matter of the Application of Questar Gas Company to Adjust Rates For Natural Gas Service in Utah	Dkt. No. 04-057-04
In the Matter of the Investigation of Questar Gas Company's Gas Quality	Dkt. No. 04-057-09
In the Matter of the Application of Questar Gas Company to Adjust Rates For Natural Gas Service in Utah	Dkt. No. 04-057-11
In the Matter of the Application of Questar Gas Company for a Continuation of Previously Authorized Rates and Charges Pursuant to its Purchased Gas Adjustment Clause	Dkt. No. 04-057-13
In the Matter of the Application of Questar Gas Company for Recovery of Gas Management Costs in its 191 Gas Cost Balancing Account	Dkt. No. 05-057-01

REQUEST OF PETITIONERS FOR RECONSIDERATION OF THE REPORT AND ORDER OF THE UTAH PUBLIC SERVICE COMMISSION, ISSUED JANUARY 6, 2006, APPROVING A GAS MANAGEMENT COST STIPULATION

Petitioners use natural gas for space or water hearing in their homes or in their businesses, or both, in Utah. The gas is delivered by Questar Gas Company, and the bills are paid by them, or paid on their behalf, or paid by landlords who then bill them or include these utilities in their rent, or pass the gas costs on to them in some other way that ensures that, sooner or later, it costs them more when gas rates increase. Some petitioners are also shareholders of Questar Corporation. A list of petitioners, alphabetically by name, giving their addresses and status as either ratepayer or shareholder, is attached as Appendix A to this pleading. Petitioners submit this request, pursuant to *Utah Code Ann*. § 54-7-15, for reconsideration of that certain "Report and Order," issued by the Utah Public Service Commission (the "UPSC" or "Commission") January 6, 2006 (the "January 2006 Order"), approving a certain "Gas Management Cost Stipulation" which was made by the Questar Gas Company ("Questar Gas" or the "Utility"), the Utah Division of Public Utilities (the "UDPU" or "Division") and the Utah Committee of Consumer Services (the "UCCS" or the "Committee") on October 11, 2005 (the "2005 Stipulation").

I. INTRODUCTORY STATEMENT

The January 2006 Order approved the 2005 Stipulation, which is yet another attempt by Questar Gas to achieve a negotiated solution (the most recent in a series of stipulations) to a long-standing controversy respecting allowance -- for ratemaking purposes -- of costs associated with a gas processing facility, the so-called "CO2 Plant" or "Plant." The Plant was built to process a type of gas -- coal-seam gas -- which, absent this processing may be unsafe for use in residential and business premises appliances of Utah ratepayers. The Plant began operations as an interim emergency measure, pending

implementation of a retrofitting program that would adjust appliances so that gas processing would become unnecessary. Plant construction commenced in 1998, and through no fewer than 12 dockets and for 8 years, at the UPSC and in the Utah Supreme Court, Questar Gas has been attempting to recover Plant-related costs ever since. The retrofitting program -- 8 years into the Plant's life, and 2 years shy of original projections for complete recovery of Plant costs -- only recently has been launched. The regulatory parties in interest have consistently resisted efforts (until now) for cost recovery on the primary ground that those expenses -- arising out of a contract between the Utility and an unregulated affiliate, Questar Transportation Company ("Questar Transportation" or "QTC") -- were not qualified for allowance under so-called "prudence" standards as mandated by legal precedent and Commission practice. What is more, even if the decision to build a Plant and process the gas was prudent in some sense, that decision nevertheless was and is irredeemably tainted with affiliate influence and conflict of interest and, therefore, these expenses could not be and cannot be allowed for ratemaking purposes.

Utilities are state-franchised monopolies. Regulatory authorities, rather than market forces, are expected to check the excesses of management. Questionable expenses must be justified by utility managers. This justification must demonstrate that, at the time the expense being questioned was in contemplation or took place, the utility's actions or inactions were the result of a conscientious review of all circumstances.[1]

[1] Effective February 25, 2005, the Utah legislature recently enacted prudence standards for ratemaking purposes. These standards are found in *Utah Code Ann.* § 54-4-4(4). Given the date of enactment, Section 54-4-4(4) may not apply retroactively to the time Questar Gas decided to build the Plant in 1998. *See, Utah Code Ann*. § 68-3-3. Nevertheless, Section 54-4-4(4) appears largely to codify existing rules respecting prudence review at the Utah Commission.

Moreover, where the expense under review arises from a transaction between the utility and its affiliate, that expense is to be placed under a regulatory microscope and subjected to heightened scrutiny. If the Commission finds affiliate influence in the making of the deal, the contract must be disapproved and all costs disallowed. *See,* Order*, In the Matter of the Application of Questar Gas Company to Adjust Rates for Natural Gas Service in Utah,* Dkt. No. 03-057-05, at 45-46 (August 30, 2004). This rule is designed as a palliative for conflicts of interest with utility affiliates, to insure that a utility's inter-corporate dealings remain subordinate to ratepayer interests, and in all events to preserve what some courts have called the "trust" relationship between utilities and ratepayers.[2]

Whether an expense arises in the ordinary course of business or pursuant to a transaction with affiliates, however, all authorities agree that a review of the utility's

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[2] *See, e.g., Committee of Cons. Serv. v. Pub. Serv. Comm'n,* 595 P.2d 871, 874 (Utah 1979) (*Wexpro I*), as explained in *Utah Dept. of Admin. Serv. v. Pub. Serv. Comm'n,* 658 P.2d 601, 618-619 (Utah 1983) (*Wexpro II*).

Heightened scrutiny as an antidote for conflicts of interest in affiliate transactions has been emphasized by the Utah Supreme Court. In *U. S. West Communications v. Public Serv. Comm'n,* 901 P.2d 270, 274 (Utah 1995), the Court distinguished between review of affiliate and nonaffiliate expenses, citing *Boise Water Corp. v. Idaho Pub. Util. Comm'n,* 555 P.2d 163, 169 (Idaho 1976), among other cases, which noted that the reason for this distinction "appears to be that the *probability* of unwarranted expenditures corresponds to the *probability* of collusion." (Emphasis supplied.)

This distinction also is codified in our utilities code. *Utah Code Ann.* § 54-4-4(4) may apply (post-February, 2005) to prudence review in ordinary situations, but *Utah Code Ann*. § 54-4-26 speaks directly to dealings between a utility and an affiliate. It provides as follows: "Every public utility when ordered by the commission shall, before entering into any contract for construction work or for the purchase of new facilities or with respect to any other expenditures, submit such proposed contract, purchase or other expenditure to the commission for its approval; and, if the commission finds that any such proposed contract, purchase or other expenditure diverts, directly or indirectly, the funds of such public utility to any of its officers or stockholders or to any corporation in which they are interested, or is not proposed in good faith for the economic benefit of such public utility, the commission shall withhold its approval of such

action must be made <u>as of the time when that action was taken</u>. We are rightly suspicious of the Monday Morning Quarterback who, with the benefit of hindsight, would have played a better game. But more than just hindsight, the utility must show, at a minimum, that the game in fact was actually played, that questionable expenses were subjected to a reasonably prudent decision-making process of some sort. And regulators are expected to review this showing, making sure that utility deliberations were timely, thorough, relevant, and fair, protecting ratepayers, both substantively and procedurally, from the influence of any conflict at issue. Because the focus is on the decision-maker and decision-making at the time the action was taken, articulations of the rule respecting prudence often forbid or disparage any after-the-fact reconstruction of events to either warrant or disapprove a particular expense. This approach to prudence review has become an established practice at the UPSC. *See, e.g.,* Report and Order, *In the Matter of the Application of Mountain Fuel Supply to Adjust Rates for Natural Gas Service in Utah,* Dkt. Nos. 91-057-11 and 91-057-17 (September 10, 1993); Final Standards and Guidelines for Integrated Resource Planning for Mountain Fuel Supply, *In the Matter of the Analysis of an Integrated Resource Plan for Mountain Fuel Supply Company,* Dkt. No. 91-057-09, at 7 (September 26, 1994); Order, *In the Matter of the Application of Questar Gas Company to Adjust Rates for Natural Gas Service in Utah,* Dkt. No. 03-057-05, at 27-33 (August 30, 2004). And, as noted above, this practice now appears to be codified in Utah Code Annotated, Section 54-4-4(4)(a)(ii)("judged as of the time the action was taken").

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contract, purchase or other expenditure, and may order other contracts, purchases or expenditures in lieu thereof for the legitimate purposes and economic welfare of such public utility."

In addition, one cannot know the "facts and circumstances" as they existed "at the time the action was taken," including whether that action was the subject of a timely, conscientious, and disinterested decision-making process -- and we may not be able to resist the sort of hindsight speculation and after-the-fact reconstruction that the rule prohibits -- absent records or other evidence that is contemporaneous with the event in question. The UPSC, therefore, has required utilities to present this caliber of evidence in order to satisfy their burden of showing prudence. *See,* Order, *In the Matter of the Application of Questar Gas Company to Adjust Rates for Natural Gas Service in Utah,* Dkt. No. 03-057-05, at 33, 35, 43, and 49 (August 30, 2004).

In other words, there must be reciprocity in the application of the rules respecting prudence. Just as regulators may not be revisionist historians, unfairly second-guessing the business judgments of utility managers, so also a utility which has failed to timely forecast events and plan prudently, or which cannot prove with contemporaneous evidence, the quality and fairness of the decision-making with which it encountered those events, may not cure this lack of foresight with the speculations of hindsight.

II. HISTORICAL, FACTUAL, AND PROCEDURAL BACKGROUND

Questar Gas is no stranger to regulatory problems respecting affiliate transactions. As early as the 1970s, Questar Gas's predecessor in interest, Mountain Fuel Supply Company, spun off gas properties to a wholly owned subsidiary, Wexpro. The legitimacy of this transaction was bitterly contested, resulting in regulatory scrutiny and judicial precedents, all of which affirmed the requirements of prudence review as well as the so-called "*no profits to affiliates*" rule. *See, Committee of Consumer Services v. Public Service Comm'n,* 595 P.2d 871 (Utah 1979) ("*Wexpro I*") and *Utah Department of*

Administrative Services v. Public Service Comm'n, 658 P.2d 601 (Utah 1983) ("*Wexpro II*").

Over the years, these businesses continued to divide and multiply. In the 1990s, during the period when controversy over coal-seam gas and gas processing was gathering steam, these entities included a holding company, Questar Corporation ("Questar Corporation"), which owned and controlled a subsidiary entity, Questar Regulated Services ("Questar Regulated"), which in turn owned and controlled two subsidiaries, the sister corporations "Questar Gas" and "Questar Pipeline." Questar Pipeline owns and controls the subsidiary entity which built the Plant, Questar Transportation. This pleading, for convenience, hereafter sometimes will refer to these companies collectively as the "Questar Companies" or the "Questar System." Questar Regulated, Questar Pipeline, and Questar Gas have the same management personnel; in other words, Questar Gas does not have independent management. This pleading, for convenience, hereafter sometimes will refer to this common management as the "Questar Management." *See,* Order, *In the Matter of the Application of Questar Gas Company to Adjust Rates for Natural Gas Service in Utah,* Dkt. No. 03-057-05, at 19 (August 30, 2004) (hereinafter sometimes called the "August 2004 Order").

In the early 1990s, the development of conflicts of interest among the Questar constellation of corporate entities became probable if not inexorable. Alert to this development, the Commission treated these risks of conflicts by promulgating standards and guidelines for "integrated resource planning" among these related companies. *See,* Final Standards and Guidelines for Integrated Resource Planning for Mountain Fuel Supply, *In the Matter of the Analysis of an Integrated Resource Plan for Mountain Fuel*

Supply Company, Dkt. No. 91-057-09 (September 26, 1994) (hereinafter sometimes called the "1994 Planning Standards").

This "integrated resource planning" for Mountain Fuel was defined to mean "a planning process in which all known resources are evaluated on a consistent and comparable basis, in order to meet current and future natural gas energy service needs at the lowest total resource cost to MFS and its ratepayers, and in a manner consistent with the long-run public interest. The process should result in the selection of the optimal set of resources given the expected combination of costs, risk and uncertainty." 1994 Planning Standards, at 13.

In this regard, the Utility was ordered to submit planning reports twice a year. *See,* 1994 Planning Standards, at 13. Each biennial report was to be prepared *after* consultation with the Commission, Division, Committee, and other interested parties, a consultation that was to occur "on a regular basis during the year *preceding* the submittal of a plan." *Id.* at 13 and 14. (Emphasis supplied.)

The process of consultation was premised upon a free-flowing information exchange. *See,* 1994 Planning Standards, at 5. The information exchanged would be current with the problems under discussion, consistent with the "Commission's position that gas acquisition decisions should be judged on the basis of information available at the time such decisions are made." *Id.* at 7. This consultative process, moreover, was to include "ample opportunity for public participation." *Id.* at 13-14. To insure that the process was followed, the Commission ordered consultations to occur at least quarterly. *See, id.*

The Utility was ordered to file reports *after consultation* in an *open process*. This meant, conversely, that analysis and reports were *not* to be prepared by the Utility in isolation and then foisted on regulators after the fact. *See,* 1994 Planning Standards, at 5. A planning report, when submitted, was to be comprehensive in scope and detailed in analysis, including anything and everything that might touch upon gas resources, acquisition, processing, and delivery to customers in Utah. These directions are delineated in 15 paragraphs of the order, ¶ 4.a. to ¶ 4.o, <u>nearly every one of which can be read to embrace the gas processing cost recovery issue being addressed in this docket</u>. *See, Id.* at 15-18. The planning report, moreover, was to include a list of "[c]onsiderations permitting flexibility in the planning process so that the Company can take advantage of opportunities *and can prevent the premature foreclosure of options*." *Id.* at 18. (Emphasis added.) Once filed, a planning report was subject to review and comment by the public and approval by the Commission. *See, Id.* 18-19.

Prudence review of Utility expenses, especially in light of proliferating affiliates in the Questar System, was a central concern of the 1994 Planning Standards. In its order, the Commission recognized the advantages of corporate restructuring, but admonished that, "Mountain Fuel's position in the corporate structure of the Questar Companies . . . must not constrain, in a manner adverse to the interests of ratepayers, the pursuit of the cost-minimizing objective." 1994 Planning Standards, at 2. The Commission further stated that, " . . . in past proceedings, [we have] articulated . . . concern[s] about Mountain Fuel's relations with affiliates and the possible constraints that such relations may place on MFS's gas acquisition and *planning process*. Affiliate relations remain a concern of this Commission. We do not presume that affiliate

transactions are biased and not in the customers' best interests. *However, the Commission puts the Company on notice that with regard to cost recovery of MFS's expenditures, we will view MFS's customers' interests as primary. Such interests shall not be subordinated to those of corporate affiliates. All planning options that potentially benefit MFS's ratepayers shall be investigated, whether or not they benefit subsidiaries of the Questar Corporation."* *Id.* at 3. (Emphasis added.)

The 1994 Planning Standards, in at least 7 places, at 2, 3, 5, 6, 7, 12-13, and 19, emphasize the coordination between Utility planning and prudence review, concluding that, while "[t]he Plan will provide one basis for assessing the Company's decision-making process[,]" nevertheless, "[s]trict conformance to the Plan does not relieve the Company of its burden of proof to show that its expenditures are prudent." Indeed, in language that would be echoed later with specific reference to gas processing cost recovery, the Commission ruled that its "evaluation of prudence will be based on the reasonableness of the Company's decision-making process given the information available at the time the decision is made." *Id.* at 19.[3]

In the early 1990s, while the 1994 Planning Standards, discussed above, were being formulated, the Questar Companies were becoming aware that, as a result of certain Questar Management decisions, the nature of gas for use in Utah was changing --

[3] After *Wexpro I* and *Wexpro II,* many if not most of the Utah precedents dealing with affiliate conflicts and prudence review have been issued as a result of corporate transactions in the Questar System. *See, e.g., In the Matter of the Application of Mountain Fuel Supply to Adjust Rates for Natural Gas Service in Utah,* Dkt. Nos. 91-057-11 and 91-057-17 (September 10, 1993); Final Standards and Guidelines for Integrated Resource Planning for Mountain Fuel Supply, *In the Matter of the Analysis of an Integrated Resource Plan for Mountain Fuel Supply Company,* Dkt. No. 91-057-09 (September 26, 1994); Order*, In the Matter of the Application of Questar Gas Company to Adjust Rates for Natural Gas Service in Utah,* Dkt. No. 03-057-05 (August 30, 2004); *Mountain Fuel Supply v. Public Serv. Comm'n,* 861 P.2d 414, 428 (Utah 1993); *Consumer Services v. Public Service Comm'n,* 75 P.3d 481 (Utah 2003).

to so-called "coal-seam" gas. Coal-seam gas is virtually pure methane with lower heat content that cannot be deployed safely in many if not most homes -- without either special adjustments to residential appliances or processing at a facility to remove CO2.

This change in supply was forced upon Questar Gas's attention by an affiliate, Questar Pipeline, which, as early as 1989, had recognized a future in coal-seam gas and sought to exploit that opportunity. Questar Pipeline had begun to enter so-called "future capacity" transportation contracts with producers of coal-seam gas in the Ferron Basin in Emery County, Utah. By the mid-1990s, Questar Pipeline had invested approximately one million dollars ($1,000,000) to improve a network to carry coal seam gas, and it had committed for additional investment as production of this commodity grew. At this stage, Questar Corporation was projecting $6.3 million per year for its Pipeline affiliate from carrying charges for coal-seam gas. By carrying the coal-seam gas "by displacement" through its southern main line, Questar Pipeline "*ensured*" that this gas would enter Questar Gas's distribution system at the Payson Gate. *See,* August 2004 Order, at 24-25 and 20.

By 1994, when the Planning Standards noted above had become final and effective, the amount of coal-seam gas entering Questar Gas's distribution system "accelerated significantly." By 1997, coal seam gas was flooding the system at "dramatically accelerated rates." The Questar Companies, including Questar Gas, were fully aware of this development, and the likelihood that it would continue as a consequence of Questar Management's decisions. This awareness is confirmed by the increased capital contributions, noted above, that were made and promised for Pipeline infrastructure -- as well as the revenue projections for carrying charges that were being

made. This awareness likewise is acknowledged in Questar Corporation shareholder reports of this period, a circumstance which, because of disclosure requirements in securities law, signifies the materiality of these facts. *See,* August 2004 Order, at 20.

Facing these developments in the early to mid-1990s, the Questar Companies -- and Questar the Utility specifically -- had available to it a wide range of alternatives to address the safety concerns of coal-seam gas in the local distribution network. Those alternatives included at least the following:

(A) **The Early Retrofitting Option.** Questar Gas could have proceeded immediately to require Utah customers to re-tool appliances so that those appliances safely could accommodate coal-seam gas. The cost of re-tooling reportedly would have been substantial, but at that time this transition appeared inevitable in any event. (Indeed, customers now will bear this expense through a so-called "Green Sticker Program." *See,* January 2006 Order, at 22, note 3.) Exercising this option in the mid-1990s would have imposed a re-tooling charge sooner rather than later, but would have avoided imposing the *double burden* of this charge *plus* the added expense of gas processing. The Questar Companies, however, may have leaned towards gas processing so that they could shift the expense of constructing a Plant to Questar Gas and Utah ratepayers, while at the same time profiting from processing contracts with third parties in an unregulated affiliate, Questar Transportation. Clearly, early implementation of appliance adjustment would not have served both these ends.

In any event, there is no evidence that Questar Gas, as the Utility charged with a duty of prudent planning and disinterested decision-making, even *considered* early implementation of appliance adjustment or the conflict of interest that might ensue from

Plant construction in Questar Transportation. In any event**, it is undisputed that Questar Gas did not pursue in a timely fashion the alternative respecting appliance adjustment, an alternative which would have saved ratepayers millions in processing costs. By the time Questar Gas approached the Commission on the subject of safety issues and coal-seam gas, in 1998, as described below, this option was foreclosed.** *See,* August 2004 Order, at 35 and 47-48. *See also,* Report and Order, *In the Matter of the Application of Questar Gas Company for a General Increase in Rates and Charges,* Dkt. No. 99-057-20, at 27 (August 11, 2000) ("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") (hereinafter sometimes called the "August 2000 Order").

(B) **The FERC Options.** The Questar Companies could have invoked a provision in the FERC tariff of Questar Pipeline, section 13.5, which might have allowed the Pipeline to refuse gas, including coal-seam gas, the quality of which was incompatible with safety standards for end-users. In a variation on this strategy, the Questar Companies could have sought declaratory relief in a FERC proceeding, insisting that processing costs be allocated to producers or others. Either approach might have resulted in allocation of processing costs to parties other than Utah ratepayers -- either through negotiations or victory at the federal agency.

FERC precedent at the time appeared to support the prospects for success in this regard. *See,* August 2000 Order, at 43 (dissenting opinion, Chairman Mecham). In a worst case scenario, playing the tariff/FERC cards might have ended in an adverse judgment, forcing Questar Gas to pay some or all of the processing costs connected with

coal-seam gas. But even this worst case scenario, had it materialized in the early to mid-1990s, merely would have eliminated one of several alternatives otherwise available to the Questar Companies in addressing coal-seam gas. At that juncture, the Questar Companies still could have exercised their remaining options.

Questar Pipeline may have eschewed a tariff/FERC strategy for a variety of reasons, including a desire to avoid business complications with available producers or a fear that those business opportunities might be lost altogether. *See,* August 2004 Order, at 22-23. Or Questar Pipeline may have worried that tariff review might lead to untoward changes, unrelated to gas quality, in rates or rate-structure. Indeed, the Questar Companies may have foregone these choices simply because they wanted to build the Plant at Utah ratepayer expense. A FERC ruling that required producers to bear the cost of processing the coal-seam gas would not have deprived the Questar Companies of the corporate opportunity to build the Plant, since a market for CO2 removal as part of gas processing apparently existed then and continues to exist. But it would have deprived the Questar Companies of any excuse for recovering that expense from Utah customers.

In any event, it is undisputed that Questar Gas, notwithstanding its duty of prudent planning and disinterested decision-making, <u>never even researched FERC precedents on these subjects</u>**.** *See,* August 2004 Order, at 21. And the Questar Companies did not test the waters or conduct negotiations for gas processing cost allocation to producers or shippers. *Id.* at 21-22. By the time Questar Gas notified the Commission, in 1998, as described below, that there were safety concerns with coal-seam gas, any opportunity to pursue a strategy at FERC had been foreclosed. *See,* August 2000 Order, at 27.

(C) **The Pipeline Reconfiguration Option.** The Questar Companies could have reconfigured their pipelines in order to divert or *delay* the introduction of coal-seam gas at dangerous levels into Questar Gas's local distribution network. Even though a dramatic increase in coal-seam gas was projected by the Companies at that stage, they could have re-routed transmission sufficiently to *allow time* for Utah customers to make adjustments to household appliances at a lower aggregate cost. As noted above, however, <u>any strategy such as this pipeline alternative that lessened a perceived need for gas processing would likewise have lowered the odds that processing costs might be recaptured from Utah customers</u>. In any event, there is no evidence that Questar Gas engaged in prudent planning or disinterested decision-making respecting any option for pipeline reconfiguration. Accordingly, this option, like every option other than building the Plant, died before it could be born. *See,* August 2004 Order.

(D) **Plant Construction and Ownership Options.** The Questar Companies could have determined to construct the CO2 Plant, but to have Questar Gas, rather than Questar Transportation, an unregulated affiliate, own the facility. Under this scenario, assuming the "prudence" of this choice in view of all others, the costs associated with the Plant might be borne by ratepayers, but the benefits to be derived from the ongoing business of processing gas for third parties also would have inured to the benefit of those same customers.

The *Wexpro* decisions, cited above, dealing with not dissimilar circumstances, might have been cautionary precedents in the evaluation of this option, but there is no evidence that the Questar Companies even considered Plant ownership by Questar the Utility as a viable course. Those Companies apparently preferred to have Plant costs

defrayed by ratepayers through regulated rates, while Plant revenues flowed exclusively to shareholders via an unregulated affiliate.

Moreover, the Questar Companies had further options, even if they determined to construct the Plant within their System but outside the Utility; they could have "conducted a well-defined capital expenditure analysis to determine the most cost effective long-term structure by which to construct, own, and operate the [facility]," and they might have benefited from an "open bid process." The Questar Companies, however, did not follow any of these avenues for the avoidance or mitigation of expense. *See,* August 2004 Order, at 24-25.

As noted above, at least by 1994, the Questar Companies, including Questar Gas, were aware that the flow of coal-seam gas into the local distribution network was accelerating and substantial. But notwithstanding this awareness, there is no evidence that Questar Gas, throughout these years, "took proactive measures" to analyze or address the problems, including safety concerns, associated with coal-seam gas or any of the options, detailed above, for remediating or resolving those problems. Nor is there evidence that, as required by the 1994 Planning Standards, Questar Gas notified state regulators concerning this important development and developing emergency. *See, id.* at 20-21.

The Questar Companies did not begin to address these issues until the end of April, 1997, when Questar established its so-called "Gas Quality Team". Indeed, notwithstanding the establishment of the Gas Quality Team in April, the problems associated directly with "the issue of increased production of coal-seam gas" were not

addressed or analyzed for alternatives until several months later on August 20, 1997. *See,* August 2004 Order, at 23.

At least three things are noteworthy respecting formation of this Gas Quality Team. First, as early as 1994 if not earlier, the Commission had ordered Questar Gas to consult with regulators concerning developments such as the influx of coal-seam gas on the distribution network, and to file reports biennially on such subjects. These reports were to include, among other things, an analysis of problems with remedial alternatives, a list of "[c]onsiderations permitting flexibility in the planning process so that the Company can take advantage of opportunities *and can prevent the premature foreclosure of options*." 1994 Planning Standards, at 18. (Emphasis added.) Questar Gas, however, flouted this order, a violation which resulted, as described more fully below, in a predictable reduction of strategic choices which could have lessened the eventual cost to ratepayers.

Second, the 1994 Planning Standards provided that the consultation process, noted above, should involve a freely flowing information exchange between the Utility and regulators, and should not involve decision-making in isolation by Questar management. *See,* 1994 Planning Standards, at 5. Here again, however, Questar Gas disregarded the Commission's order, forming the Gas Quality Team which met in private and then -- waiting until the beginning of 1998 -- foisted a "safety crisis" and a limited range of remaining remedies upon the Commission and others.

Third, the Gas Quality Team was formed by Questar Regulated, and initially determined to focus on the FERC tariff in a search for remedial options. Indeed, in May 1997, in furtherance of this approach, the creation of a "Tariff Task Force" was

suggested. This never was done, however, and after three more meetings (all of which, in continuing violation of the 1994 Planning Standards, were conducted in isolation and apart from the regulators) there was a shift in concern, with desiderata for the decision-making "explicitly" turning to "include maintenance of *Questar Corporation's* financial performance." August 2004 Order, at 21 (emphasis added).

Indeed, the "divided allegiance" between Questar the Utility and Questar Affiliates was apparent -- if not inherent and unavoidable -- in these discussions since the Gas Quality Team was composed of management members from Questar Corporation and Questar Pipeline. Hence, "[Questar Gas], as one participant in this team, was not independent in searching for the cheapest way to permanently solve the [coal-seam gas] safety problem. Said more forcefully, it appears that possible permanent solutions to the . . . safety problem were not thoroughly analyzed because of potential adverse impacts on [Questar Pipeline]." August 2004 Order, at 22. This "divided allegiance" between Questar the Utility and the Questar Affiliates not only violated the procedural mandates in the 1994 Planning Standards, but also undercut the purpose and spirit of those Standards which, as noted above, were designed, in major part, as a palliative for conflicts of interest within the Questar System.

Although the Questar Companies had literally years to explore and even to experiment with the multiple options outlined above, and even though at least Questar the Utility was under compulsion to do so pursuant to the mandate of the 1994 Planning Standards, <u>*nothing*</u> was done. As noted above, the Questar Companies, through their Gas Quality Team or otherwise, did not analyze alternatives to the coal-seam gas safety issue *until a meeting held in the fall of 1997. See,* August 2004 Order, at 23. At this juncture,

however, the window of opportunity was closed, and, by year's end, Questar Management had concluded that only two choices remained: (1) Plant construction and CO_2 removal, or (2) consumer appliance adjustment. This latter option, moreover, was projected to take 4 years, even on an expedited basis, and therefore would be difficult to accomplish before the projected deadline of Summer 1999, when the safety issues associated with the coal-seam gas could not be remedied by any means except Plant processing. Given these exigencies, the question whether to build a Plant was at this point more rhetorical than debatable. *See,* August 2004 Order, at 23-24. *See also,* August 2000 Order, at 27.

Faced with a self-made crisis that was caused by imprudence at best and affiliate conflicts at worst, Questar Management compounded these sins: Without doing any disinterested analysis and without considering open bidding or any other cost-saving procedures, Questar Management decided to pursue the Plant construction, to have Questar Transportation build the facility and then to contract with Questar Gas for processing services, with all associated costs to be included in the Utility's rates to Utah customers. *See,* August 2004 Order, at 24-25.

In early 1998, for the first time, and again in stunning defiance of the 1994 Planning Standards, the Utility presented to regulators its pre-determined solution, the Plant, to the problem of coal-seam gas and consumer safety. Thereafter, various dockets were opened to address whether the contract between Questar Gas and its affiliate, Questar Transportation, should be approved and the costs associated with that transaction allowed for ratemaking purposes. The question of prudence as a pre-condition to allowing these expenses also was raised, but went undecided initially in these dockets.

Then, in August of 2000, in docket number 99-057-20, with prodding from the Division, the Commission approved the so-called CO2 Stipulation which blessed the contract between Questar Gas and Questar Transportation and authorized recovery of a portion of the costs associated with the Plant. *See,* August 2000 Order, at 23-28 and 47-49.

Ric Campbell, now the Commission Chairman, was the director of the Division at that time. In pressing for approval of the CO2 Stipulation, the Division, with Campbell at the helm, admitted that "a well-documented [Questar Gas] decision process, showing how all available alternatives were objectively analyzed, that is, at arms-length from affiliate interests, and the reasons why gas processing is the best among them, *does not appear to exist*[,]" and, accordingly, that, "[a]s a result, and even with the added time afforded by the present Docket, [we] cannot determine whether the choice of gas processing, and the contract which facilitates it, is prudent." August 2000 Order, at 28. (emphasis added).

Absent a record, contemporaneous with the events at issue, the only reasonable conclusion is that Questar Gas failed to meet its burden to show prudence. But Campbell and the Division were willing to disregard this long-standing principle of prudence review. Testifying alternatively that they were unable to "conclude the choice was imprudent," and that the contract was "'not entirely prudent,'" the Division and Campbell nevertheless requested approval of the affiliate contract and recovery of the costs because of their concerns respecting customer safety associated with the coal-seam gas which they viewed as paramount.

The Commission also was troubled by the lack of a record showing prudence, especially since Questar Gas, at that point, had had two and one-half years to produce evidence showing prudence in connection with the contract at issue. Indeed, the Commission, in unequivocal terms, concluded that, given the history of proceedings, and consistent with the Division's statement, quoted above, a record of prudence did not exist and could not be produced: "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*." August 2000 Order, at 27 (emphasis added).[4] But the Commission also was swayed by the concerns expressed over customer safety, and, accordingly, approved the CO2 Stipulation, even though the Utility had failed to demonstrate prudence in connection with its affiliate transaction.

The August 2000 Order was appealed by the Committee to the Utah Supreme Court which reversed the Commission's approval of the CO2 Stipulation and its

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[4] The Commission later ruled, inexplicably, that this language was "an ambiguous use of dicta." Order, *In the Matter of the Application of Questar Gas Company for Approval of a Natural Gas Processing Agreement,* Dkt. No. 98-057-12, at 4 (December 17, 2003). Any ambiguity in the language, however, is the product of hindsight. Everybody else at the time took this wording at face value and in context to mean that, not only had Questar Gas failed to produce evidence of prudence, but also that the Utility was unable to document this process in any way whatsoever. The Utah Supreme Court, for example, read this language as stating that a record of prudence could not be made: "If the record had permitted, the Commission could have carried out its initial obligation to review the prudence of the CO2 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 its affiliate relationship with Questar Pipeline. *Since the Commission found that no such record was or could be made available*, it should have refused to grant a rate increase that included CO2 plant costs." *Consumer Services v. Public Service Comm'n,* 75 P.3d 481, 486 (Utah 2003) (emphasis added). What is more, later events would demonstrate that Questar Gas, in fact, could not produce any evidence of prudent decision-making in connection with the gas processing Plant. *See,* August 2004 Order.

allowance of the gas processing costs. Justice Durham, writing for a unanimous court, stated the obvious: "While safety concerns may have necessitated the construction and operation of a CO2 plant, they do not establish who should bear the cost of these measures." *Consumer Services v. Public Service Comm'n,* 75 P.3d 481, 486 (Utah 2003) (hereinafter sometimes called the "2003 Supreme Court Opinion"). In other words, the questions of safety and prudence are logically unrelated and not mutually exclusive insofar as approval of the transaction is concerned. Questar Gas has a duty to provide safe service to all customers. Performance of this pre-existing duty does not automatically guarantee the allowance of costs.[5] The relevant question is whether those costs were incurred prudently as a reasonable means to the ends of service -- however exigent the concern for safety. If the Utility has mismanaged in the selection of means, then shareholders, not ratepayers, will -- and rightly should -- bear the cost of this imprudence. State statutes mandate that utilities provide safe service in any event. Regulators may not allow utilities to use safety as an excuse to imprudently inflate the cost of that service by gouging ratepayers through sweetheart dealings with unregulated affiliates.

The Court reminded the UPSC that the Commission, as "established practice," always had required a prudence review in connection with affiliate transactions, *id*. at 485, and chided the Commission for "abdicating" this "responsibility" to hold Questar

[5] The Court opined that, "[w]hile the Commission correctly recognized Questar Gas's obligation to ensure the safety of its customers, it incorrectly concluded that this fact 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." *Consumer Services v. Public Service Comm'n,* 75 P.3d 481, 487 (Utah 2003).

Gas to these same standards in connection with the transaction involving Questar Transportation and the CO2 Plant. *Id*. at 486.

Following the 2003 Supreme Court Opinion, the Commission commenced proceedings to review the prudence of gas processing costs. By this time, however, Ric Campbell had been appointed to serve as chairman of the Commission, leaving his post as director of the Division. On August 18, 2003, at an opening hearing on the affiliate contract, now-Chairman Campbell announced that, due to issues respecting bias, he would not participate in UPSC deliberations in this regard. In so doing, Campbell implied that his earlier role as Division director, especially in view of the Division's sponsorship, as advocate, of settlement stipulations, might create an appearance of partiality.[6]

After Campbell's recusal, the Governor appointed Val Oveson to serve as commission pro tempore for the balance of the proceedings, s*ee Utah Code Ann.* § 54-1-1.6(1), and the Commission scheduled hearings that would resolve the question of prudence. Pre-trial and trial proceedings in this regard would last another year. After allowing parties an opportunity to marshall evidence that had been developed in 5 dockets over 6 years, and after giving Questar Gas still further opportunity to submit evidence showing that the decision in favor of the CO2 facility was timely, adequately

[6] Campbell announced his disqualification from the bench, stating as follows: "To begin with I just need to make a statement that I will not be participating in this case because of the appearance of any bias caused by my former role as the Director of the Division of Public Utilities. I was director at the time that this case was heard and argued, and I was involved in the policy decisions taken by the Division." Reporter's Transcript of Proceedings, *In the Matter of the Application of Questar Gas Company for Approval of a Natural Gas Processing Agreement,* Dkt. No. 98-057-12, at 4-5 (August 18, 2003).

and prudently undertaken,[7] the Commission ruled that the Utility utterly had failed to satisfy any burden of proof in this regard, and that, by all appearances, the transaction between Questar Gas and Questar Transportation was tainted with a conflict of interest. *See,* August 2004 Order.[8]

Boiled to essentials, the Commission found that from 1989 to late 1997 and in the teeth of the 1994 Planning Standards, a regulatory edict to plan for gas-related contingencies, there was no evidence that Questar Gas had engaged in *any* planning, let alone prudent planning, to find a conflict-free solution to the developing coal-seam gas safety problem. *See,* August 2004 Order.[9] The Commission also found respecting the Questar Gas/Questar Transportation contract that "affiliate influence is clear." *Id.* at 45.

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[7] As noted above, in the August 2000 Order, the Commission had concluded that, based on its review of evidence at that time (after more than 2 years of dealing with the problem), a sufficient record to demonstrate prudence could not be made. The 2003 Supreme Court Opinion interpreted this statement to mean that a record showing prudence could not be established, implying that, on remand, the contract and associated costs perforce would be disallowed. The Commission, however, later ruled that the "[n]or can a sufficient record be developed" language in the August 2000 Order was "an ambiguous use of dicta" and, showing extraordinary lenience, allowed Questar Gas this further opportunity to produce evidence demonstrating prudence in the decision to build the Plant. As seen below, however, even with this additional time and opportunity for making a case, the Utility could not bring any evidence to bear upon the questions of prudence in planning and conflicts of interest.

[8] In these 2003-2004 hearings, as in earlier dockets, the Division maintained the position that the Utility should receive partial recovery of the gas processing costs. In a rebuke of this position, the Commission stated that, "[d]espite years of analysis encompassing several dockets," and notwithstanding an ongoing desire to award costs, in some measure, to Questar Gas through the CO2 Stipulation and other compromises, "the [UDPU] has never concluded that Questar Gas's decision to pursue CO2 processing was prudent. Neither can we." August 2004 Order, at 45-49.

[9] The Commission's August 2004 Order acknowledged the continuing relevance of the 1994 Planning Standards by citing them at several points, and then, in the same vein, noted that "[t]he form and content of such evidence [for proving prudence] 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." August 2004 Order, at 33.

The Commission also confirmed the established practice of requiring contemporaneous evidence rather than hindsight reconstruction to prove these matters by stating that "we cannot

Hence, because there was a complete absence of prudent planning by Utility Management during this critical period, there was no timely consideration given to the various alternatives, noted above, that were available as possible solutions for the safety issues posed by coal-seam gas.[10]

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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." August 2004 Order, at 33.

This proscription of after the fact justifications (in lieu of timely preparation to encounter the future) was stated and re-stated in the course of the Commission's ruling. For example, at one point, while noting that, in the early to mid-1990s, Questar Gas had several potential solutions to the coal-seam gas dilemma, the Commission stated: "Unfortunately, while Questar 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." August 2004 Order, at 35. And as another example, while observing that Questar Management had not analyzed the prudence of having Questar Gas contract with Questar Transportation for building the Plant and processing the gas, the Commission stated: "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 benefited if Questar Gas owned and operated the plant." August 2004 Order, at 43.

And finally the Commission ruled as follows: "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." August 2004 Order, at 49.

[10] The Commission found that Questar Gas, "probably by 1994," knew or should have known that the coal-seam gas would pose safety concerns in the distribution network. And even though there was a regulatory expectation of "prudent utility planning to reveal the risks associated with the possibility of [such] changing conditions," it could be found that "Questar management looked after the interests of its shareholders and Questar Pipeline," but there was "no evidence that it

The Utility dropped the ball in terms of early retrofitting of customer appliances. Indeed, the Commission repeated the Utility's testimony that resetting appliances would be "'[t]he best long term alternative,'" but found that the lack of timely planning by Utility Management had caused a "postponement" of this "best" alternative, requiring consumers, in effect, to pay for two solutions to the same problem: first a gas processing Plant for a Questar affiliate, and then appliance adjustment at a later date. August 2004 Order, at 35-36. What is more, the conflict of interest evident in this "neglect" and "postponement," and the possibility of prolonging the injury flowing from that conflict even after construction of the Plant were not lost on the Commission, which noted, at one point, that "customer modification of appliances may be at odds with Questar interests. Customer appliance changes or modifications obviates [sic] a need for CO2 processing, perhaps eliminating any need for the CO2 plant before the end of it's [sic] asset life." August 2004 Order, at 25.

The Utility dropped the ball in terms of seeking relief under the Pipeline tariff or in FERC proceedings. Some analysis or steps taken towards either of these alternatives might have fulfilled the "expect[ation] that a reasonable, unaffiliated utility would have seriously considered any option to keep this [coal-seam] 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)." August 2004 Order, at 36.

For example, the Questar Companies might have asked FERC to alter the tariff, seeking gas quality standards more compatible with the needs of Utah customers, and possibly obtaining a ruling that required producers of coal-seam gas to bear some or all of

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considered or undertook such planning anytime during the period 1989 to 1997." August 2004 Order, at 33-34.

the processing costs that would have been required to meet these standards. Whatever the outcome of this effort, according to the Commission's findings, "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 [percent] of the costs to adjust, replace or retrofit customer appliances." August 2004 Order, at 38.

The Commission emphasized that FERC proceedings need not have produced an ultimate victory of cost allocation to gas producers in order to benefit Utah ratepayers. A proceeding at FERC might have served to "delay[] 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." August 2004 Order, at 39. The Commission found, however, that "[t]here 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." August 2004 Order, at 39. And by "no evidence" the Commission meant "**no evidence**:" "[T]here is nothing in the record -- no contemporaneous legal memorandum, no meeting minutes, no e-mail, no testimony -- to indicate that, prior to 1997, Questar management conducted any sort of analysis -- legal, financial, or otherwise -- concerning [the tariff/FERC options] or, indeed, consideration of other approaches to obtain sufficient time to retrofit customer appliances." August 2004 Order, at 39-40. To the contrary, the evidence suggested and the Commission found that the primary concern expressed in inter-corporate minutes was for the holding company's financial interest, especially a fear

that FERC proceedings might work to foreclose the capture of coal-seam gas transportation business by Questar Pipeline. *See, id.* at 40.

The Utility also dropped the ball in terms of re-routing the coal-seam gas and other, related solutions. Questar Gas, arguing in hindsight, asserted that this approach would have been more expensive than the gas processing Plant. The Commission found, however, that no review of pipeline options was conducted by the Utility when such a review might have solved the problem. The Commission ruled that these second thoughts and revisionist thinking were no substitutes for thorough review in the first instance, because hindsight is never as helpful as foresight, and because this lack of foresight caused a loss of options in this instance, options that otherwise might have borne fruit, saving ratepayers from unnecessary and, in the end, duplicative costs. *See,* August 2004 Order, at 41-42.

The Utility again dropped the ball in terms of constructing the Plant through an affiliate rather than the Utility. The Commission found that, even if Plant construction were a prudent option under the circumstances described above, it could not endorse the no-bid contract between Questar Gas and Questar Transportation for building the facility and processing the gas. The Division had advised the Commission in an earlier docket that "a well-documented record demonstrating a reasoned, arms-length process by which Questar Gas decided to contract with Questar Transportation does not exist." August 2004 Order, at 43.[11]

Indeed, the Questar Companies, through the testimony of Alan Allred, in effect, admitted that there had been no prudent planning -- and hence there was no record -- by their attempt to justify the decision to build the Plant on the basis of exigent, safety

concerns. *See,* August 2004 Order, at 43. In fact, Allred confessed "that *Questar management conducted no in-depth financial analysis because management assumed Questar Gas would recover any costs from its ratepayers*." *Id.* Consistent with the mandate of the Utah Supreme Court, however, the Commisson ruled that "safety concerns such as existed in this case do not trump Questar Gas's burden of demonstrating prudence." *Id*. at 43. Moreover, the Commission refused to countenance the bald-faced presumption revealed in Allred's testimony, wherein Questar Management merely "assumes" that the Utility's ratepayers will pay for an affiliate's asset, absent any demonstration that those customers would benefit from the Plant and despite the Utility's refusal to give them any ownership share in that facility.

In short, the Commission found that, "[d]espite years of analysis encompassing several dockets," the UDPU "never [had] concluded that Questar Gas's decision to pursue CO2 processing was prudent . . . [and] [n]either can we." In a ringing refrain in the last 5 pages of factual findings, "no evidence," "no evidence," "no evidence," the Commission ruled that the Utility had not satisfied the burden of persuasion to show that the Plant expenses were prudently incurred. August 2004 Order, at 45-49.

Finally, the Commission previously had recognized that, under appropriate circumstances, "prudence review need not be an all or nothing outcome," August 2004 Order, at 45 (citations omitted), that partial recovery of some expenses might be allowable if the decision to incur those expenses was "adequately reviewed without the decision-maker being inappropriately influenced by its affiliate." *Id.* The Commission found, however, that even a *partial* recovery of Plant expenses was not warranted in this case -- for three reasons.

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[11] Notwithstanding all of these fumbles, Questar Management is handsomely paid by ratepayers.

First, the Utility could not satisfy this more limited test for partial recovery of questionable expenses -- as articulated in the cited precedent -- as the test requires a showing of *some* decision-making review and the Utility, in this case, was not able to show even this, let alone make a showing that the expenses were "adequately reviewed" or reviewed "without the decision-maker being inappropriately influenced by its affiliate." *See,* August 2004 Order, at 45.

Second, given the circumstances of neglect by the Utility in discharging its duty to undertake a prudent decision-making process -- a neglect that allowed the crisis to develop and mature, prevented a timely, adequate response, and foreclosed opportunities for possible solutions that might have been less expensive than the CO2 facility -- the Commission was "unpersuaded that any unique economic benefit has accrued to Utah ratepayers to justify rate recovery." August 2004 Order, at 45-46. To the contrary, "Utah ratepayers are left with an imperfect, costly, and temporary solution to a long term problem." *Id.* at 48.[12]

Third, no mitigating circumstances were present in this case in any event because "[o]n this record, we find that affiliate influence is clear." August 2004 Order at 45. While Utah ratepayers are unfairly saddled with the double taxation of Plant costs in the

[12] The Commission's ruling, echoing again the 1994 Planning Standards, especially bemoaned these lost opportunities and foreclosed options, leaving regulators and ratepayers with no recourse against Utility management to either quantify the loss or redeem the time: "These additional two years [from 1995, when Questar Gas knew about the problem, to 1997, when Questar Gas first started planning to address the problem] may have rendered some of the options later discarded due to imminent safety concerns more desirable both financially and operationally." But in the final analysis, even this lost window of opportunity, and "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." August 2004 Order, at 35.

"short" term and the expense of appliance adjustment in the long term, "Questar Pipeline has been able to pursue its interest in expanding its pipeline business opportunities[.]" *Id.* at 48.

Questar Gas sought reconsideration of the August 2004 Order. In particular, the Utility wanted assurance that the ruling respecting mismanagement and conflicts of interest only dealt with requests for the allowance of Plant costs through 2004. The ruling of the Commission on reconsideration stated, in effect, that an adjudication respecting prudence, by definition, deals with historical facts, facts known to the regulated entity at the time the decision respecting the expense in question was made, and that perforce only pre-2004 matters could have been treated in the August 2004 Order. The Commission further noted that Questar Gas was free to seek any further relief that the Utility deemed appropriate and that, should this occur, all parties in interest could raise whatever rights and defenses might be available to them at that time. This, of course is nothing more than a restatement of the statutory rights given all utilities in the state of Utah. *Utah Code Ann.* § 54-7-11. In short, the Commission declined to pre-judge issues or to give an advisory opinion on matters not before it. *See,* Order on Request for Reconsideration or Clarification, *In the Matter of the Application of Questar Gas Company for Approval of a Natural Gas Processing Agreement,* Dkt. No. 98-057-12 (October 20, 2004) (hereinafter sometimes called the October 2004 Reconsideration Order). After denial of its plea for reconsideration, the Utility did not appeal the Commission findings in the August 2004 Order. <u>Those factual determinations, accordingly, became final and conclusive</u>.

In 2004, the Commission opened a new docket respecting coal-seam gas safety issues. This docket presumably was instituted pursuant to a clause in paragraph 3 of the August 2004 Order which had promised that the Commission "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." August 2004 Order, at 50. Over a period of months, "technical conferences" (6 altogether) were held in this docket.[13] These technical conferences were used by the Utility to instruct not only on the issues of appliance adjustment but also on considerations of "prudence" in connection with ongoing costs for gas processing. Although Chairperson Campbell earlier had recused himself in connection with prudence-related litigation that led to the August 2004 Order, he fully participated in the informal discussions at these technical conferences.

In January, 2005, Questar Gas filed a new application seeking rate recovery of CO2 processing costs -- $5.7 million per year -- effective February 1, 2005. The application further "reserved all rights" of Questar Gas to seek recovery of these costs from the inception of the Plant. Ignoring the findings of the August 2004 Order that the Utility had failed to demonstrate prudence, the Utility demanded the right to show, in this new docket, that its decision to charge ratepayers for Plant costs after 2004 -- on a go-forward basis -- would be entirely justified.

In the early stages of this proceeding, Questar Gas, the Division, and the Committee adopted adversarial postures. Hence, in March 2005, a scheduling order for conducting discovery and pretrial proceedings was established. Trial was set for early

[13] Such technical conferences may have been Questar Gas's belated attempt to comply with the 1994 Planning Standards. If so, they came 10 years too late to effectively address the coal-seam gas safety issue.

October 2005. At least -- this is what the public record stated. But behind the scenes, regulatory positions were softening and settlement negotiations were being conducted. The 2005 Stipulation was the offspring of these discussions. Like prior compromises, such as the August 2000 CO2 Stipulation endorsed by Campbell and the Division, the 2005 Stipulation allows for the recovery of a portion of gas processing expenses -- 90% of non-fuel costs from and after January 31, 2005 -- or approximately $4 million per year going forward.

On October 11, 2005, the 2005 Stipulation was filed with the Commission. If we are to believe Questar Gas, the Division, the Committee, and the Commission, this compromise is a "new" approach -- in light of "changed" circumstances -- to the gas processing cost issue that has plagued regulators for the past 8 years. Despite the "freshness" of this approach, this "change" in circumstances, and, as far as the public could discern from the Commission's docket, this abrupt "about face" from the parties' adversarial mode with a pending trial date to sudden settlement approval, the Commission gave curiously short "notice" for a hearing on approval of the Stipulation. The 2005 Stipulation was first filed on October 11th. The date of the hearing was October 20th. Parties in interest, whether public or private, had only 9 days in which to study the matter and prepare for hearing. What is more, as set out in detail below, the "notice" itself was woefully flawed in every sense: regulatory, statutory, and constitutional.

At the hearing on October 20th, the Division and Committee recommended approval of the Stipulation on a variety of grounds: Gas processing at the CO2 Plant is necessary to customer safety; the investment in Plant was necessary to process the coal-

seam gas and that gas is cheaper by millions of dollars to Utah ratepayers; and these savings in gas prices more than offset processing costs.

The "evidence" on October 20th, 2005, however, was not germane to the 1990s when the Utility made the decision to build the Plant. Indeed, all of the evidence was directed to the present time, and how best to deal with gas safety from this point forward. Not surprisingly, given the *fait accomplis* of the CO2 Plant, everyone now argued that processing costs were a "necessary" expense in light of these safety concerns.

Most of the "evidence" on the 20th of October was adopted by reference from an entirely different docket, the 2004 docket in which technical conferences were held. A few witnesses testified in person October 20th , but these were mere spokespersons for the parties explaining why, in their view, rate recovery of Plant costs pursuant to the 2005 Stipulation was in the public interest. None was qualified to opine as an expert under the rules of evidence, nor was a foundation laid by the utility to qualify any of them as an expert. And since the parties to the 2005 Stipulation -- Questar Gas, the Division, and the Committee -- were the only players at the approval hearing, and since these parties each had covenanted in writing only to endorse and never to oppose the deal, nobody was subjected to cross-examination**. Every scrap of "evidence," in the record, in any event, is hearsay**.

Notwithstanding these procedural irregularities and evidentiary shortcomings, the Commission, with Chairman Campbell presiding (and no longer recused), adopted the recommendations of the parties and approved the 2005 Stipulation.

III. GROUNDS FOR RECONSIDERATION

In view of the history, factual background, and procedural evolution of this matter, as outlined above, Petitioners believe that there are numerous grounds for reconsideration of the January 2006 Order approving the 2005 Stipulation. These grounds are elaborated below. If reconsideration is denied, and Petitioners are forced to appeal this matter to the Utah Supreme Court, they will contend that each and every one of these grounds, whether standing alone or taken together, satisfies conditions for reversal under *Utah Code Ann.* § 63-46b-16.[14]

A. The August 2004 Order Bars Allowance of Any Costs.

The gas processing costs are not allowable absent a finding of "prudence." This much is established by Commission practice and judicial precedent. What is more, the gas processing costs, because they involve a transaction with an affiliate and therefore a potential for conflict of interest, are not allowable absent even closer scrutiny, and proof that the deal was not tainted with affiliate influence. This much also is established by Commission practice and judicial precedent, and, as noted above, is mandated under Section 54-4-26 of our utilities code.

The Commission made no finding on prudence in the initial dockets addressing the gas processing costs. The Commission's August 2000 Order allowed the costs in part, pursuant to the CO2 Stipulation which had been made by Questar Gas and the Division,

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[14] Section 63-46b-16 provides that agency action may be reversible and reversed on various grounds, any or all of which may apply in this case. They include circumstances where the agency has erroneously interpreted or applied the law, where the agency has engaged in unlawful procedure or failed to follow prescribed procedure, where the agency has acted on the basis of findings of fact that are not supported by substantial evidence when viewed in light of the record as a whole, where the agency has abused lawful discretion, where the agency has acted contrary to prior practice, unless the agency justifies the inconsistency by giving facts and reasons that

but without any finding of prudence.   The August 2000 Order was reversed by the 2003 Supreme Court Opinion because <u>these costs, as a matter of law, could not be approved, even in part, without a finding of prudence</u>.

Thereafter, pursuant to the mandate of the 2003 Supreme Court Opinion, a consolidated docket was established, evidence from prior years was marshalled, further evidence was introduced, hearings were held, briefing was conducted. In this adversary proceeding, the Division again argued that the costs should be allowed in part. But after 6 years of investigation, pre-trial effort, and trials, after review in several dockets from various angles, after considering "mountains" of paper and hours of testimony, the Commission, in a detailed, comprehensive ruling, denied allowance for these costs. This ruling, of course, was the August 2004 Order which found, as a matter of historical fact, that in the mid-1990s the coal-seam conundrum was the result of "crisis management," that the decision to address this dilemma through gas processing in an affiliate's facility was "not prudent," and, even worse, the decision was the product of a conflict of interest.

It bears repeating that the Commission, in so ruling, considered whether a portion of the costs should be allowed, something it believed might be possible under a UPSC precedent involving a telecommunications carrier. The Commission declined to apply this precedent or to approve even a portion of the gas processing costs, however, in view of three distinct and explicit findings: (1) the gas processing costs had not conferred any economic benefit upon Utah ratepayers; (2) Questar Gas presented "no evidence" that it conducted timely, adequate, and disinterested decision-making in relation to the costs,

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demonstrate a fair and rational basis for the inconsistency, or where the agency action otherwise is arbitrary or capricious.

and therefore failed to satisfy its burden of proof; and (3) on the record before it, the transaction was tainted with a conflict of interest because "affiliate influence is clear."

Neither Questar Gas nor the Division challenged these findings or this ruling through an appeal to the Utah Supreme Court. Accordingly, the August 2004 Order still stands, final, conclusive, and impervious to challenge through "collateral actions or proceedings." *Utah Code Ann.* §54-7-14. It is, as to the instant case, *res judicata.*

The dockets opened in the fall of 2004 and in January 2005, which in turn led to technical conferences and the 2005 Stipulation as approved by the January 2006 Order are nothing more than collateral attacks on this August 2004 Order. Questar Gas and the Division (now joined by the Committee) again seek recovery of a portion of the costs associated with the CO2 Plant. There was no effort in these new dockets, however, to reargue or modify the findings in the August 2004 Order, and, indeed, as noted above, any such effort would have collided with the absolute bar of Section 54-7-14.[15]

The parties to the 2005 Stipulation and the January 2006 Order may attempt to finesse these findings by arguing that the October 2004 Reconsideration Order "authorized" the Utility to file a new petition for cost recovery in connection with post-2004 gas processing, and that the grant of this "right," in essence, overruled the defense of issue preclusion in relation to any claim for future costs. This attempt would fail, however, for at least two reasons.

First, the October 2004 Reconsideration Order, in effect, said that the August 2004 Order adjudicated questions respecting prudence and costs which had been

[15] In addition to the mandate of Section 54-7-14, it is hornbook law that the doctrines of claim and issue preclusion apply to administrative agencies such as the UPSC. *See generally* A.C. Aman, Jr. and W.P. Mayton, Administrative Law, § 11.1 (1998). The Utah cases following this rule and its variations are legion.

submitted by the parties at that time, and perforce would not entail future events. According to the Commission, Questar Gas was free to petition for additional relief, but others were free to respond and defend against any such petition -- on whatever grounds were available, including, presumably, the ground of issue preclusion. In other words, the October 2004 Reconsideration Order cannot be read to mean that issue preclusion would not bar relief in the event that Questar Gas attempted to revisit the questions of prudence and costs in any other docket.[16] In fact, the October 2004 Reconsideration Order expressly declined to "pre-judge" any issues or outcome in the event the Utility sought further relief at a later time. *See,* October 2004 Reconsideration Order.

Second, even if the Commission had attempted to authorize a collateral attack on the findings and conclusions respecting prudence and costs in the August 2004 Order, this attempt would be unlawful in the face of *Utah Code Ann.* § 54-4-14.

The parties to the Stipulation and the January 2006 Order also may attempt to overcome the preclusive effect of the August 2004 Order by suggesting that the August 2004 Order dealt with "past" or pre-2004 gas processing costs, while the January 2006

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[16] The January 2006 Order, at page 1, states that the August 2004 Order itself expressed an intent to open new dockets in order to "identify a long-term solution to the concerns raised by increasing volumes of coal bed methane on the Questar Gas system." This statement presumably is designed to excuse the subsequent collateral attack on the August 2004 Order that resulted in the January 2006 Order. However, the August 2004 Order expressed no such intent. The entire text of that ruling is opposed to any such intent; it finally, unequivocally, and conclusively disallows any and all gas processing costs. The language of the ruling confirms this by ordering: "Questar Gas Company to file appropriate tariff revisions to reflect our determination that there be *no cost recovery* authorized for CO2 processing operations." (Emphasis added.) The only language in the August 2004 Order which refers to additional proceedings or a separate docket is found in paragraph 3 of the ordering clauses. That language indicates an intent to conduct further proceedings to dispose of "funds collected to recover the cost of CO2 processing[,]" in other words to handle the refund that would follow the ruling, and an intent to 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." Ratepayers still are waiting for that docket to open.

Order deals with "future" or post-2004 gas processing costs,[17] and that this distinction somehow makes a difference in the allowability of these costs.

But this distinction makes no difference in the justification of the gas processing costs, either in logic or law. All gas processing costs, whether they "accrued" before or after the August 2004 Order, have the same cause, the same history, and the same effect. They arise from and were "incurred" in connection with the decision to build the CO2 Plant. They resulted historically from the Utility's neglect and mismanagement in the 1990s. This neglect and mismanagement were compounded by the Utility's failure and refusal to obey the clear directives in the Commission's 1994 Planning Standards. Still worse, the affiliate contract for Plant construction, creating all gas processing costs, was the product of "affiliate influence" in 1998. In other words, had Questar Gas remained unblinkered by conflicts, and but for this infidelity to ratepayers and incest with affiliates, there might have been no gas processing costs -- before 2004 or even after January 31, 2005. Since all gas processing costs are the result of management imprudence and affiliate influence, none may be allowed, not then and not now. This well was polluted at inception; the flow of water has not been cleansed through the passage of time.[18]

The Commission's faulty justification for seeking gas processing costs for the period after January 31, 2005 -- even though the Plant construction in 1998 which gave

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[17] As noted above, the January 2006 Order allows a portion of the gas processing costs -- effective as of January 31, 2005.

[18] Indeed, the August 2004 Order not only made findings, as noted above, that the Utility's misconduct caused the coal-seam gas safety problem in the first instance and that affiliate conflicts explained the Plant as the "solution" to this self-inflicted wound, but also that these conflicts may continue to injure ratepayers since the Questar Companies naturally prefer those customers to pay for the Plant in full through rates before addressing a permanent solution with appliance adjustments. *See,* August 2004 Order, at 25.

rise to these costs was deemed imprudent and even illegal by a formal adjudication in August of 2004 -- is illustrated by the following hypothetical: A utility company president burned down the headquarters building. Through neglect, he had forgotten to maintain insurance to cover the loss. Faced with a "housing" crisis of his own creation, the president "fixes" the problem by contracting for construction of a new office complex. He does no investigation of different types of buildings, and he requests no bids on the construction. Rather, he chooses as the building contractor XYZ Corporation, which is owned and operated by the president and his nephew. The XYZ Corporation also finances the construction for the benefit of the Utility -- taking back a 10 year note with annual installment payments. The local utilities board naturally refuses to allow the recovery of costs under this arrangement -- when the loss is so obviously due to either misfeasance or malfeasance by the president and while there are suspicions about self-serving relations with the nephew -- and issues a sternly worded order to this effect. The president builds the building anyway. He waits 5 years and then files a new application for cost recovery. He holds 4 or 5 technical conferences with regulatory personnel, showcasing the new building complex, and reviewing 10 or 11 "other options" for "warehousing" the business. All agree that, 5 years into the deal, with a new building already on the block, and the pressing need for a company headquarters, these "other options," although thoroughly examined with a lot of data requests, aren't as attractive as the XYZ facility. The regulators conclude that, since the "other options" aren't as good at present as the XYZ building, the remaining costs in the note balance must be "prudent." The local utilities board concurs and therefore rules that the final 5 years of the installment obligation are recoverable in costs.

Even an apprentice logician can see that the conclusion reached by all the regulators in this hypothetical, i.e., the current costs for XYZ construction are "prudent," does not follow from the premise being invoked, i.e., that "other options" (none of which is any longer viable after 5 years) aren't as attractive as keeping the XYZ building. In short, having 10 or 11 (or even 100) alternatives less attractive than the XYZ complex -- 5 years into the deal -- does not mean that the costs associated with building the complex were prudent in the first instance.

It is readily obvious that present circumstances -- that is, circumstances 5 years into the deal when the new application is being made -- cannot be used to justify the prudence of actions in the past -- when the building burned, the insurance lapsed, and XYZ Corporation was hired. Even if the XYZ building is the only game in town after 5 years, the historical cause for this particular expense (as well as the present predicament) was management misconduct. In other words, prudence must be determined in light of circumstances as they existed <u>at the time of the decision under review</u>. The time of the decision under review is when the building was constructed pursuant to the contract between the Utility and XYZ Corporation. And the circumstances at that time included the loss of headquarters through management misconduct.

The January 2006 Order, like this hypothetical, suffers from these flaws in logic and law. The Commission artificially bisects time and divorces cause from effect. It ignores what is past and concentrates instead on existing alternatives under present circumstances to justify the processing costs going forward. But any lack of comparatively better alternatives to gas processing on January 31, 2005, does not establish "prudence" respecting Plant construction 7 years ago in 1998. *Indeed, the lack*

of comparatively better alternatives to gas processing on January 31, 2005 is arguably the direct result of company imprudence in 1998. In fact, this is exactly what the Commission found in its August 2004 Order -- that the Utility's negligence had *foreclosed potentially comparatively better options,* leaving ratepayers with the double burden of paying for both a temporary fix through Plant construction and the long term cost of appliance retrofitting.

The Commission's approach ignores the 2003 Supreme Court Opinion's admonition that prudence requires a look at the "*source*" of the costs, an examination of the "cost-*incurring* activity," and a review of "how the initial threat to safety *arose* or how the utility *sought* [using *past* tense] to alleviate it." 2003 Supreme Court Opinion, at 486 and 487.

In addition, this approach violates a fundamental principle of prudence review, namely, that in order to determine whether the utility acted prudently, we must look at facts as they existed at the time the decision respecting the costs at issue was made, and we may not engage in hindsight reconstructions in this regard.

The decision, under review in this case, was Questar's determination to build the Plant in its affiliate, Questar Transportation. The facts respecting that decision antedate Plant construction in 1998. The Commission's "second look" at Plant construction, in light of circumstances which had come to be as of 2004, in order to see whether, under present circumstances, these costs are justified, does violence to this long-standing principle of rate regulation and cannot overcome the conclusive findings of the August 2004 Order.

Finally, the parties to the 2005 Stipulation and the January 2006 Order may argue that a "change in circumstances" or "new circumstances" now justify the allowance of a portion of the gas processing costs. But there has been no change respecting the circumstances relevant to prudence review for Plant costs, namely, the circumstances that existed at the time that the decision to build that facility was made in 1998. No one can change the past. Hence, on inspection, these purportedly "changed circumstances" are nothing more than an entirely speculative re-evaluation of the past and a self-serving recharacterization based upon hindsight -- all in an unlawful effort to reverse, through collateral attack in a new proceeding, the preclusive effect of the findings of fact in the August 2004 Order.

For example, in this docket, the Committee reversed its longstanding opposition to any cost recovery in connection with the CO2 Plant, concluding that cost recovery, at least in part, now is in the "public interest" because of changed circumstances. *See,* January 2006 Order, at 13. The Commission followed this lead in approving the 2005 Stipulation.

The Committee noted and the Commission concurred that, since voicing opposition to cost recovery in previous dockets, there has been a "significant increase" in the purchase of coal-seam gas for use in the Questar Gas distribution network. The Committee interprets this development (with Commission concurrence) to mean that the Questar Companies were not as self-interested as once perceived in allowing the un-arrested flow of coal-seam gas into the Utah system, especially since, price-wise, this gas has proved beneficial to ratepayers. *See,* January 2006 Order, at 13-14.

But this "re-evaluation" is eyewash, and it is beside the point to boot. It is eyewash because the Commission already has found that the Questar Companies, as early as the mid-1990s, knew about or should have anticipated this precise development. By 1994, the amount of coal-seam gas entering Questar Gas's distribution system "accelerated significantly." By 1997, coal seam gas was flooding the system at "dramatically accelerated rates." The Questar Companies, including Questar Gas, were fully aware of this development, and the likelihood that it would continue. Indeed, the use of coal-seam gas at all was entirely at their discretion. This awareness is confirmed by the increased capital contributions that were made and promised for Questar Pipeline infrastructure at that time. This awareness likewise is acknowledged in Questar Corporation shareholder reports of this period. What is more, Questar Pipeline, at that time, had an incentive of $6.3 million in revenues per year to continue and enlarge the flow of this gas into the Utah system. Questar Pipeline, through a process of "displacement" was "ensuring" that this gas would enter Questar Gas's distribution system at the Payson Gate. These are all explicit findings set out in the Commission's August 2004 Order. No amount of Committee or Commission "re-evaluation" from 2004 to 2006 can alter the preclusive effect of these findings of historical fact.

And any price-savings from the coal-seam gas -- no matter how much, in hindsight, this may have benefited ratepayers -- is beside the point as well. The quantity of coal seam gas and whether that gas, at cheaper prices, benefits ratepayers are not the problem. The Utility, as a regulated monopoly, has a duty "to operate in such manner as to give to the consumers the most favorable rate reasonably possible." This means purchasing gas at low rates. This means treating safety issues in connection with that

gas, through processing or other means, as prudently as possible. The problem is whether the decision to process the gas through a facility owned by an affiliate satisfied this duty. The Commission answered this question in August of 2004 with a resounding "no." That answer allowed for the purchase of cheap gas, but disallowed the means selected for handling the safety concerns associated with that product. Indeed, the August 2004 Order found that the Utility's misconduct had foreclosed alternatives that might have obviated the need for gas processing altogether.

The approach adopted in the 2005 Stipulation and the January 2006 Order to the same problem is that, so long as Questar Gas performs the pre-existing duties of every regulated monopoly, to get gas inexpensively and to deliver that gas safely to the homes of consumers, regulators should wink at any prudence issues, self-dealing, or conflicts of interest in the manner by which the Utility has fulfilled these duties. In a reprise of the August 2000 CO2 Stipulation, the Commission, with Committee support, in effect has added a "cheap gas" exception to prudence review. This is contrary, however, to the reasoning of the 2003 Supreme Court Opinion which overruled exceptions to the requirements of prudence with reasoning that would apply, with equal force, to any "cheap gas" rationale. To rule otherwise would mean that a regulated utility could hold ratepayers hostage, refusing to fulfill its duty "to operate in such manner as to give to the consumers the most favorable rate reasonably possible" unless the requirements of prudence are waived. The Committee, which purports to represent those ratepayers, should refuse to barter away one duty in exchange for fulfillment of another. The

Commission, as a matter of law, may not abdicate its regulatory responsibility in this regard.[19]

Finally, it may or may not be, as the Commission argues, that the settlement process is an ideal process for the closure of disputes with less acrimony, effort, expense, and delay.[20] These ends, especially the virtues of economy and expedition in the resolution of disputes, would have been better served in this case by enforcing the rules of issue preclusion, as our statute requires, long ago.

Indeed, had the Commission properly applied the doctrines of *res judicata*, claims preclusion, collateral estoppel, and issue preclusion at appropriate junctures in this controversy over the CO2 facility, ratepayers and regulators would have been spared tens of thousands of dollars and years of effort.

These proceedings commenced in 1998. The Utility was given over 2 years to show prudence. The Utility could not make this showing as of the August 2000 Order.

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[19] The Committee may have believed that it obtained other, valuable rights from the Utility in exchange for these concessions. These rights included the Utility's promise to forego an application for gas processing costs accruing in 2004 and to waive the "reservation of rights" to pursue historical costs prior to that time. The "value" of these "rights," however, is doubtful. The Utility's claim for gas processing costs through August, 2004, had been fully adjudicated in the August 2004 Order. When the Utility failed to appeal this ruling, the ruling became final. No "reservation" of rights, however hopeful, will overcome the finality of that ruling. Moreover, as argued above, the August 2004 Order found that all gas processing costs were imprudently incurred at best, as a matter of historical fact, and, since this finding cannot be challenged collaterally in any other proceeding, it effectively precludes any relief for the Utility in connection with these costs from and after August 2004. What is more, our utilities code, by statutory fiat, requires just and reasonable rates which rates may include only prudent costs untainted by conflicts of interest. Petitioners believe that neither utilities nor regulators may bargain away these statutory obligations. This view was confirmed by the 2003 Supreme Court Opinion which refused to sustain the CO2 Stipulation which, like the 2005 Stipulation, was a compromise in derogation of statutory principle that had been implemented through well-established regulatory practice.

[20] The CO2 Stipulation and other, proposed compromises respecting the gas processing costs in these particular dockets have not demonstrated the virtues of settlement or the efficacy of that

At that time, the Division and the Commission concurred that no record of prudence had been or could be established. They nevertheless endorsed a "settlement" for the recovery of costs that was reversed at the Utah Supreme Court. That should have ended the matter. Both Commission and Court at that time, after all, admitted that no record of prudence was available or could be created. But the Division, completely abdicating its duty to advocate in the public interest and within the law, wanted to give the Utility another bite at the apple, another chance at a "compromise" recovery of half these costs. There was, accordingly, further litigation ending in what should have been seen as the dispositive resolution of this contest in the August 2004 Order. However, rather than giving these findings the conclusive and preclusive effect which our statute requires, our regulatory agencies allowed the Utility additional Mulligans in two more dockets, including approval of the 2005 Stipulation in the January 2006 Order. They could have exited this merry-go-round of litigation in 2000, but instead they have given the Utility another 6 years in numerous dockets to press for recovery of these costs. Under these circumstances, the Commission's speech about the economies of settlement is unpersuasive. Enough already. The statute should be enforced and the August 2004 Order, which found a lack of prudence and a conflict of interest as the source of these costs, should be given the effect of *res judicata*.

means of dispute resolution. This is largely because the parties involved, with Commission endorsement, continue to ignore the law of prudence.

B. The January 2006 Order Violates the Established Practice of Prudence Review Which Requires that Prudence Must Be Shown Only By Reference to the Circumstances at the Time the Decision in Question Was Made.

The Utah Supreme Court has overturned Commission orders respecting gas processing costs on two occasions. In both instances, the ground for reversal was the same: the Commission had acted contrary to prior practice, failing to follow an established principle or procedure. In *Questar Gas Company v. Utah Public Service Comm'n,* 34 P.3d 218, 224 (Utah 2001), the Commission was reversed for failing to explain a departure from customary procedures in the handling of a gas balancing account. In *Consumer Services v. Public Service Comm'n,* 75 P.3d 481, 485-486 (Utah 2003), the Commission was reversed again for lack of adherence to a long-standing practice respecting prudence review.

As elaborated above at length, utilities have the burden of showing that expenses are justified under a prudence review, and this burden is heavier where affiliate contracts are involved. The Commission has required utilities to satisfy this burden with evidence that is contemporaneous with the events under review, as opposed to hindsight reconstructions and after-the-fact rationalizations. This has been the policy and practice at the Commission for no less than 12 years. *See, e.g.,* Report and Order, *In the Matter of the Application of Mountain Fuel Supply to Adjust Rates for Natural Gas Service in Utah,* Dkt. Nos. 91-057-11 and 91-057-17 (September 10, 1993); Final Standards and Guidelines for Integrated Resource Planning for Mountain Fuel Supply, *In the Matter of the Analysis of an Integrated Resource Plan for Mountain Fuel Supply Company,* Dkt. No. 91-057-09, at 7 (September 26, 1994); Order, *In the Matter of the Application of*

Questar Gas Company to Adjust Rates for Natural Gas Service in Utah, Dkt. No. 03-057-05, at 27-33 (August 30, 2004). And, as noted above, this practice now appears to be codified in *Utah Code Ann.* § 54-4-4(4)(a)(ii)("judged as of the time the action was taken").

The reasons for this policy and practice are sound. The requirement of evidence that is contemporaneous with the event at issue insures the best record for evaluating the sources and causes of the problem at hand. It also insures that the process was followed at the appropriate time. We count on the process, followed in a timely manner, to produce the best planning and the optimum results. When the process is neglected, we are left with "what ifs" and "might-have-beens," or worse, the foreclosure of alternatives with lost time.[21] The anti-hindsight policy, as noted above, is a prophylactic against Monday Morning Quarterbacking. So long as and to the extent that the process is followed, regulators may not second guess management, and by the same token, management may not second guess history. Moreover, the allowance of hindsight might encourage rather than deter mismanagement, by forgiving rather than penalizing the failure to plan.

There can be no dispute in this case that Questar Gas failed to plan for the coal-seam gas contingencies which materialized in the late 1990s. The August 2000 Order found, with Division concurrence, that there was no record that the Utility had followed

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[21] As the United States Supreme Court famously wrote in an analogous circumstance: "What is struck at in the refusal to enforce contracts of this kind is not only actual evil results but their tendency to evil in other cases." *Weil v. Neary,* 278 U.S. 160, 173, 49 S.Ct. 144, 149. Furthermore, the incidence of a particular conflict of interest can seldom be measured with any degree of certainty. The . . . court need not speculate as to whether the result of the conflict was to delay action where speed was essential, to close the record of past transactions where publicity and investigation were needed, to compromise claims by inattention where vigilant assertion was necessary, or otherwise to dilute the undivided loyalty owed to those whom the claimant purported to represent. Where an actual conflict of interest exists, no more need by shown in

any decision-making process in the face of these events. The 2003 Supreme Court Opinion echoes this finding. The August 2004 Order confirmed it. Having waited 7 years, from 1998 to the opening of docket number 05-057-01 in January of 2005, for Questar Gas to show any record that appropriate decision-making was conducted in a timely, adequate, and fair manner, there seemed little prospect that new evidence concerning the decision to build the Plant would be forthcoming in technical conferences and the adversary proceeding.

And in fact there was none. Contrary to prior practice, the Commission did not require the Utility to submit evidence that was contemporaneous with the event under review, that is, the prudence or imprudence of building the Plant in 1998. Instead, all of the "evidence" that was submitted at technical conferences and in the adversary proceeding was directed at current circumstances and present alternatives in an effort to justify the recovery of costs after January 31, 2005. Those costs were caused, however, by events that occurred prior to 1998. That is the relevant time for a prudence review. By failing to require and consider evidence that was contemporaneous with this event, the Commission departed, without explanation, from prior practice. This inconsistency, under the precedents cited above, is cause for overruling the January 2006 Order.

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this type of case to support a denial of compensation." *Woods v. City Nat. Bank & Trust Co. of Chicago,* 312 U.S. 262, 268 (1941).

C. The January 2006 Order Approved the 2005 Stipulation Without Considering Whether the Affiliate Contract and Cost Recovery Would Be In Derogation of *Utah Code Ann.* § 54-4-26 and the 1994 Planning Standards; This Failure Was Contrary to Law.

The Commission approved the 2005 Stipulation in the January 2006 Order pursuant to the settlement statute in our utilities code. *See, Utah Code Ann.* § 54-7-1. Although that statute permits an expedited review of various issues, the Commission may not approve any settlement without considering "the significant and material facts related to the case," without "evidence, contained in the record, support[ing] a finding that the settlement proposal is just and reasonable in result," and without finding in fact that the "settlement proposal is just and reasonable in result[.]" *Utah Code Ann.* § 54-7-1(3)(d)(ii), (i)(B), and (i)(A). In other words, the Commission cannot subvert the utilities code by using the process of settlement. Even when that process is employed, rates still must be "just and reasonable," expenses still must be prudently incurred, and other statutory mandates still must be observed.

One of those mandates is found in *Utah Code Ann.* § 54-4-26. That statute provides that:

> Every public utility when ordered by the commission shall, before entering into any contract for construction work or for the purchase of new facilities or with respect to any other expenditures, submit such proposed contract, purchase or other expenditure to the commission for its approval; and, if the commission finds that any such proposed contract, purchase or other expenditure diverts, directly or indirectly, the funds of such public utility to any of its officers or stockholders or to any corporation in which they are interested, or is not proposed in good faith for the economic benefit of such public utility, the commission shall withhold its approval of such contract, purchase or other expenditure, and may order other contracts, purchases or expenditures in lieu thereof for the legitimate purposes and economic welfare of such public utility.

It is accepted practice for public utilities to submit contracts for regulatory approval prior to execution, especially where those contracts involve substantial expenditures or questionable transactions. *See, e.g.,* M. T. Farris and Roy J. Sampson, PUBLIC UTILITIES: REGULATION, MANAGEMENT, AND OWNERSHIP, at 94ff. (1973). This practice is required by statute under the circumstances described in Section 54-4-26. <u>And those circumstances existed as to Questar Gas and the CO2 Plant in the 1990s.</u>

As noted above, the 1994 Planning Standards ordered Questar Gas to submit reports semi-annually respecting all gas supply issues, especially as they bore upon affiliate transactions. These reports, in turn, were subject to public input and Commission approval. In this regard, the Commission specifically decreed as follows: " . . . in past proceedings, [we have] articulated . . . concern[s] about Mountain Fuel's relations with affiliates and the possible constraints that such relations may place on MFS's gas acquisition and *planning process*. Affiliate relations remain a concern of this Commission. We do not presume that affiliate transactions are biased and not in the customers' best interests. *However, the Commission puts the Company on notice that with regard to cost recovery of MFS's expenditures, we will view MFS's customers' interests as primary. Such interests shall not be subordinated to those of corporate affiliates. All planning options that potentially benefit MFS's ratepayers shall be investigated, whether or not they benefit subsidiaries of the Questar Corporation."* 1994 Planning Standards, at 3. (Emphasis supplied.)

Having ordered the investigation of affiliate contracts between companies in the Questar System, those contracts are subject to the strictures of Section 54-4-26. The

contract between Questar Gas and Questar Transportation falls within the ambit of this order and qualifies for scrutiny under the statute. Questar Gas in fact has conceded these points by submitting the contract between Questar Gas and Questar Transportation to the Commission for approval in earlier versions of these proceedings.

However, the Questar Gas/Questar Transportation contract never has been approved by the Commission in a manner that is consistent with the requirements of our utilities code. The actual contract instrument appears nowhere in the record of this proceeding, and the terms and conditions of that document are not detailed in the evidence or discussed by the Commission in its January 2006 Order. These failures -- to consider the contract itself for regulatory approval in this docket, or to introduce evidence which explains the particulars and justifies all aspects of that transaction (independent of any putative superiority of the gas processing option) -- without more, appear to defeat the 2005 Stipulation as approved in the January 2006 Order.

Moreover, the contract, even if it had been produced for inspection and review, given what is known and admitted about this transaction, surely will reveal either a "diver[sion], directly or indirectly, [of] funds of [Questar Gas] to . . . its officers or stockholders or to any corporation in which they are interested," or that the contract "is not proposed in good faith for the economic benefit of such public utility[.]" The objective of cost recovery in this matter, after all, is to divert funds from Questar Gas to Questar Transportation, an entity in which the shareholders of Questar Gas are "interested." And the Commission's August 2004 Order found that this transaction was tainted with a conflict of interest, and, as such, could hardly be proposed in "good faith." The Commission also found, in the same order, that the transaction conferred no

"economic benefit" upon the Utility's ratepayers, and this is an indication, albeit indirect, that none was vouchsafed to the Utility either.

Under these circumstances, the Questar Gas/Questar Transportation agreement for Plant construction and gas processing is proscribed by the statute and must be disapproved by the Commission ("the Commission *shall* withhold its approval of such contract, purchase or other expenditure"). That disapproval means that costs cannot be allowed for ratemaking purposes. If costs are disallowed, the 2005 Stipulation must fail, and the January 2006 Order which approved that Stipulation must be vacated.

D. The January 2006 Order Is Not Supported by Record Evidence that Establishes All Material Facts.

As noted above, in order to approve the 2005 Stipulation pursuant to the settlement statute of our utilities code, the Commission must consider all "significant" and "material facts" and find that the "evidence, contained in the record, supports a finding that the settlement proposal is just and reasonable in result[.]" The settlement statute does not prescribe a particular quantum of evidence, only that the evidence "in the record" will support a finding that the result of settlement is "just and reasonable." The standard for review in this regard may be supplied by *Utah Code Ann.* § 63b-46b-16(g), which requires agency action to be supported by "substantial evidence when viewed in light of the whole record before the court[.]" The term "substantial evidence," of course, has a well-recognized meaning in administrative law. *See. e.g.,* K. C. Davis and R. J. Pierce, Jr., ADMINISTRATIVE LAW TREATISE, Volume II, Sections 11.2, *et seq.* (3d ed. 1994).

Because of procedural and evidentiary deficiencies, the January 2006 Order fails to satisfy these tests. The Commission did not consider all "significant" and "material" facts -- in relation to the gas processing costs -- in this proceeding. The Commission did not receive any evidence that was relevant to the question of prudence in relation to these costs. The Commission violated prescribed statutory procedures for the introduction of evidence in connection with approval of the 2005 Stipulation. The Commission could not have based any prudence findings in the January 2006 Order on evidence other than hearsay, a result at odds with the governing statute, judicial precedent, and the Commission's own rules.

Petitioners already have noted the failure of the Commission to review and consider the impact of Section 54-4-26 on the affiliate contract which created the costs at issue in this proceeding. The legislative judgment, embodied in Section 54-4-26, that affiliate contracts are to be scrutinized and disapproved under the circumstances articulated in that statute, by any measure, is a "material" and "significant" fact. The 1994 Planning Standards, promulgated by the Commission in the mid-1990s, which likewise put Questar Gas on notice that affiliate transactions are to be placed under a regulatory microscope, have continuing vitality, if the citations in the August 2004 Order are to be believed. But these standards were neither considered nor discussed in the January 2006 Order. The most material and significant facts that bear upon the allowance of gas processing costs, according to the prior standard of prudence review that has been adopted and applied by the Commission, are those which led to the construction of the Plant in 1998. These are the events which "caused" the problem with which all are attempting to cope in this docket. Yet none of these circumstances, events or causes was

examined by the Commission in connection with the January 2006 Order. Nor did the Commission consider the material and significant fact of the August 2004 Order itself, a ruling which, for a variety of reasons, likely imposes an absolute bar to any further recovery of gas processing costs -- in this or any other docket.

Finally, the Commission found in its August 2004 Order that, as of 1998, the Utility projected that 4 years would be required to implement any program for appliance adjustment -- so that residential appliances could become compatible with coal-seam gas, absent gas processing and the costs associated with the CO2 facility. *See,* August 2004 Order. In 1998, the CO2 facility was seen as an interim, emergency measure, so that the coal-seam gas could be processed and consumer safety preserved, pending implementation of the longer term, four year appliance adjustment program. If this strategy had been followed, when proposed by the Utility in 1998, the appliance adjustment program would have been completed in 2002. If the appliance adjustment program had been completed in 2002, there would have been no further need for gas processing after that date. If there had been no gas processing after 2002, we would not need the January 2006 Order which approves cost recovery for gas processing effective January 31, 2005. But if an appliance adjustment program had been implemented in 1998, as projected by the Utility, such a program would have eliminated the justification for gas processing cost recovery, and, hence, the Plant might not have been paid for at ratepayer expense. This inherent conflict of interest, as a continuing factor in the allowance of these costs, surely was a significant and material fact that should have been -- but was not -- considered by the Commission in connection with its January 2006 Order.

Even if the Commission had reviewed the "material" and "significant" facts that bear upon gas processing costs in these proceedings, that review should have been conducted in the light of "substantial evidence." "Substantial evidence," in major part, means relevant evidence. The Commission, however, did not consider any evidence that is relevant to the question of prudence in connection with gas processing costs. The standards for relevant evidence in a prudence review are fixed in prior pronouncements of this Commission. Those standards are clear: Prudence may be demonstrated only by reference to evidence that is contemporaneous with the circumstances that existed at the time that the costs in question were caused and created. Where the gas processing costs are concerned, that time is the mid- to late- 1990s, since the decision to build the CO2 facility was made in 1998. The January 2006 Order, however, was based upon "evidence" concerning circumstances in 2004 and 2005. The "evidence" introduced to adduce those circumstances, accordingly, was not relevant and perforce could not be substantial within the meaning of the applicable standard of review referenced above.

Even if circumstances in 2004, by some imaginative stretch, could be considered germane to the prudence of constructing the Plant in 1998, any "evidence" of such circumstances was presented and received, in large measure, in violation of judicial precedent and the rules prescribed in the Utah Administrative Procedures Act.

Much if not most of the evidence upon which the Commission relied in issuing the January 2006 Order was "introduced" during discussion sessions, so-called "technical conferences," involving the parties, the Commission, and others. These sessions were conducted in a docket different from the one in which the January 2006 Order was issued. There is no "record" of what people actually said at these gatherings. But even if there

were a "record," whatever "evidence" may have been heard in the technical conferences (in a separate docket) could not have been used for approval of the 2005 Stipulation in this docket. *See, Los Angeles & S. L. R. Co. v. Public Utilities Comm'n,* 17 P.2d 287, 290-291 (Utah 1932) (it is "fundamental" that evidence taken in one docket may not be used merely by administrative notice and without formal introduction in another docket).

The rule of *Los Angeles & S. L. R. Co.* is codified in *Utah Code Ann.* § 63-46b-8(1)(b)(iv) which permits the use of "facts" in a "record" from other proceedings where those "facts" could be "judicially noticed under the Utah Rules of Evidence." However, again, there was no "record" of the technical conferences in the other docket. This circumstance alone requires that the January 2006 Order be set aside. *See, Lewis Bros. Stages, Inc. v. Public Service Comm'n,* 452 P.2d 318, 319 (Utah 1969) (absent transcript of record, Commission order is vacated, since judicial review, under these circumstances, becomes impossible). And even if a transcript of any record could be fabricated or produced, "evidence" given in the technical conferences did not qualify for "judicial notice" under the Utah Rules of Evidence, and, hence, would not be admissible in support of the January 2006 Order. *See,* Utah Rules of Evidence, Rule 201.[22]

[22] The Commission Rules, R746-100-10 F. 3., provide that the presiding officer at an adjudicative hearing "may take administrative notice or official notice of a matter in conformance with Section 63-46b-8(1)(b)(iv)." Section 63-46b-8(1)(b)(iv) authorizes a presiding officer to "take official notice of any facts that could be judicially noticed under the Utah Rules of Evidence, of the record of other proceedings before the agency, and of technical or scientific facts within the agency's specialized knowledge." The Utah Rules of Evidence, Rule 201, permit judicial notice of "adjudicative facts" under certain circumstances. Readers of the January 2006 Order are not able to evaluate the admissibility of any evidence under Rule 201, because the "adjudicative facts" sought to be "noticed" are not identified, and the "necessary information" for recognition and evaluation of any proffer was not "supplied" as required under Rule 201(d). At bottom, since there is no "record" of the technical conferences, it is impossible for anybody, including a reviewing court, to assess the basis, let alone the quality, of the "evidence" upon which the Commission relied in formulating the January 2006 Order. This circumstance, in turn, makes it impossible to find, on review, that the Commission's decision in this case was based upon "substantial evidence." Finally, judicial notice is commonly limited to facts which are

In addition, none of the "witnesses" who made "presentations" at the technical conferences was sworn under oath, and, hence, whatever "testimony" they may have given was inadmissible in any docket under any circumstances in view of the requirements of *Utah Code Ann.* § 63-46b-8(f).

In any event, whatever was said during the technical conferences is unvarnished hearsay in relation to the formal adjudication that led to the January 2006 Order. While hearsay is not inadmissible in agency proceedings, it may not be the sole basis in support of any factual finding. This is a matter of statutory prescription, *see, Utah Code Ann.* § 63-46b-10(3), and UPSC regulation, *see,* Utah Public Service Commission Rules, R746-100-10.F.1. (". . . no finding may be predicated solely on hearsay . . ."). This rule also is enforced by Utah appellate courts. *See, e.g., Yacht Club v. Utah Liquor Control Comm'n,* 681 P.2d 1224, 1226 (Utah 1984); *Lake Shore Motor Coach Lines, Inc. v. Welling,* 359 P.2d 1011, 1014 (Utah 1959); *Ogden Iron Works v. Industrial Comm'n,* 132 P.2d 376, 380 (Utah 1942); *Cordova v. Blackstock,* 861 P.2d 449, 450 n.1 (Utah App. 1993).

The parties to the 2005 Stipulation Order may argue that the "evidentiary" presentations at technical conferences are not needed to support the findings in the January 2006 Order. They may contend that the pre-filed testimony, with exhibits and schedules, in this docket, as well as the policy statements made by several witnesses at the hearing October 20th are enough to sustain those findings.

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indisputable and can be found in the public arena. Such facts would be, for example, that the 21st of March 2005 was a Monday, or that the dollar is the currency of the United States. The doctrine of "judicial notice" would not normally extend to and is not properly applied to a party's contention regarding "facts" such as costs and options that were presented in the technical conferences which are hardly indisputable.

Of course, pre-filed testimony, with exhibits and schedules, standing alone, will not satisfy a utility's burden to prove that costs are prudent and rates are just. *See, Utah Dept. of Business, etc. v. P. S. C.,* 614 P.2d 1242, 1245-46 (Utah 1980). And the testimony at the hearing merely restated what was in the pre-hearing submissions.

What is more, none of this testimony, whether pre-filed or given from the stand in October, was relevant, qualified, or admissible as evidence in support of the 2005 Stipulation. The witnesses, in effect, made policy statements; they did not give evidence. They were not and could not have been qualified to speak, as experts or otherwise, on the subject of prudence. All of the testimony, at best, was hearsay.

The procedural and evidentiary defects, outlined above, whether standing alone or taken together, require the Commission to reconsider and vacate the January 2006 Order.

E. The Commission Violated the Requirements of Fair Notice and Due Process in Entering the January 2006 Order.

Commission orders which are entertained and entered in violation of the principles of fair notice and "due process" must be reconsidered and reversed. What notice is fair and what "process" is "due" before administrative agencies such as the UPSC, of course, may depend upon the particular circumstances of any given proceeding. At a minimum, however, fair notice requires adherence to all applicable statutory and regulatory standards which govern the proceedings at hand. And, at bottom, due process requires notice which is adequate to the purpose being served, and a decision-making process with decision-makers having at least the cachet of neutrality. As shown below, the bare bones of fair notice and due process were lacking in connection with entry of the order in this case. Indeed, it does not appear that the Commission even considered the

question of what would be "fair" in terms of notice under the totality of circumstances. The Commission, instead, blindly followed an erroneous reading of a Commission rule (a rule that was uncertain of application in this matter, and, in any event, unclear in meaning) -- resolving 8 years of controversy with 5 days of notice.

(1) Notice Giving Opportunity to be Heard Was Inadequate and Unfair.

The settlement statute in our utilities code, in one section, encourages the use of informal discussion and negotiated agreements for the resolution of conflicts before the Commission. *See, Utah Code Ann. §* 54-7-1(1). That same statute, however, in a subsequent and distinct section, allows the Commission to approve a settlement only "after considering the interests of the public and other affected persons *to use a settlement proposal to resolve a disputed matter.*" *Utah Code Ann.* § 54-7-1(2)(a) (emphasis added). In other words, while settlement is encouraged in the abstract, before a settlement of particular issues in a specific docket is allowed, the Commission must consider the advisability of using a settlement process, as opposed to adjudicative processes or other means, as a method to resolve those questions. And this weighing and selection of the most appropriate procedure for the resolution of a particular dispute must take into account not only the needs and desires of the parties formally in the docket, but also the public interest and the interests of persons to be affected by a decision in that docket.[23]

[23] Petitioners believe that this cautionary language in the settlement statute of our utilities code may be derived from unhappy past experiences wherein the Commission was deemed to have abused rather than used the settlement process to resolve significant issues arising in rate cases. *See, Stewart v. Utah Public Service Comm'n,* 885 P.2d 759, 763 n. 2 (Utah 1994), which, in turn, cites, quotes, and discusses *MCI Telecommunications Corp. v. Public Service Comm'n,* 840 P.2d 765 (Utah 1992).

The Commission gives but the slightest tip of the hat to the virtues of settlement in its January 2006 Order. *See,* January 2006 Order, at 26. But that Order nowhere "considers," as mandated by Section 57-1-1(2)(a), whether the settlement process is the best process for resolving this particular dispute. And since the Order does not consider this question, it likewise fails to articulate any reasons for preferring settlement, as opposed to other forms of conflict resolution, in this instance. This failure of consideration and rationale, standing alone, requires reversal of the January 2006 Order.[24]

In any event, Petitioners submit that, if the Commission had obeyed the statute, and considered whether settlement was the preferred means of resolving this dispute, the Commission also might have given more thought to the question of what notice would be fair in this regard -- especially if it determined that settlement was the proper route to pursue.

That consideration should have included a review of the following circumstances. (a) The issue to be decided (the appropriateness of allowing recovery for gas processing costs) has been hotly contested for 8 years in 12 dockets at the UPSC. (b) It has been to the Utah Supreme Court and back on 3 occasions.[25] (c) Several settlements or proposed compromises, such as the CO2 Stipulation, have been waylaid during this regulatory

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[24] The Commission misquotes the requirements of Section 57-7-1(2)(a) and therefore misreads them. The Commission says that it may approve the 2005 Stipulation "after considering the interests of the public and other affected persons if it finds the stipulation or settlement in the public interest." January 2006 Order, at 25. Section 57-7-1(2)(a), in fact, however, says that the Commission may approve a stipulation "after considering the interests of the public and other affected persons to use a settlement process to resolve a disputed matter." The sentence points to a selection of procedures to resolve disputes, and whether the public interest and other factors will favor one process over another. Once this threshold decision to employ the settlement process (instead of another process) has been made, the substantive requirements for approval of settlements are found elsewhere in the statute. Those provisions, also contrary to the language in the Order, do not mention the "public interest," but instead require a finding that the compromise in question is "just and reasonable" in result. *See, Utah Code Ann.* § 57-7-1(3)(d)(i)(A).

[25] Two appeals resulted in formal opinions on the merits. One interlocutory appeal was denied.

pilgrimage. (d) At one point, in August 2004, the Commission found that the transaction between Questar Gas and Questar Transportation was infected with conflict of interest. (e) The public was outraged in the wake of this finding, and the Committee, as the champion for consumers, has been tenacious in opposing the recovery of these costs.

The very fact of so many dockets, 12 altogether, spread over time, opening, consolidating, lying dormant, is a daunting hurdle to the "public" and ordinary "persons affected" by these issues. *Cf. Utility Consumer A. Group v. Public Serv. Comm'n,* 583 P.2d 605 (Utah 1978) (consumer advocacy group denied due process in light of confusing circumstances in staggered proceedings). Even "cognoscenti," not to mention the "public" and "affected persons" who are the intended beneficiaries of the settlement statute, have experienced difficulty following and locating the next place where cost recovery will surface for decision in this regulatory shell game. Trade groups, businesses, and individuals who have an "interest" that is "affected" by gas processing cost recovery and who accordingly have obtained the status of parties through intervention in one or more of these dockets have been left to wonder whether that status goes by the boards when a new docket and then another and still another has been opened -- assuming that they have received notice of these additional dockets at all -- an assumption that absolutely cannot be verified on the "record" in this case.

The Commission's docketing system is a shambles. Its website is confusing and difficult to navigate. For example, after the Commission entered an order in August 2004 that all costs were to be denied -- ostensibly ending the controversy -- another docket was opened, docket number 04-57-09, which, judging from the style of the case, was nothing more than an investigation of "gas quality," and not cost recovery. There was no

pleading that initiated the docket, giving notice that specific issues were to be addressed or that particular relief was being sought. This impression would have been reinforced by the ordering clauses of the August 2004 Order which, as noted above, promised a separate docket for the purpose of exploring the issue of gas quality and appliance adjustment. What is more, Chairman Campbell, who earlier had disqualified himself from participation when cost recovery was at issue, became involved in this docket, signaling again that issues of prudence and the like would not be revisited.

The "public" and "persons affected" by cost recovery, however, would discover, after the fact, that the "evidence" introduced at technical conferences in this docket was to be submitted for use in still another docket for consideration in approval of still another proposed stipulation on recovery of CO2 processing costs. Hence, they were blind-sided and sand-bagged twice: once by the circumstances and caption under which the docket was opened and again by the notice of "technical conferences" rather than formal evidentiary hearings on cost recovery issues, a notice which would lull the public into the belief that no formal adjudication of their rights was taking place.

That other docket, number 05-057-01, was opened in January 2005 by Questar Gas. The Utility's application expressly sought to recover gas processing costs. If the public and persons affected were paying attention at this point, they would have expected the Committee, given its past performance, to vigorously oppose this relief. That expectation would have been increased by the entry of a scheduling order -- on March 28, 2005 -- with pretrial deadlines and a trial setting in the fall of 2005. That expectation would have continued until suddenly -- on October 11, 2005 -- the 2005 Stipulation was filed. Only then, <u>for the first time</u>, the public and persons affected by cost recovery

would have realized that their especial advocate, the Committee, had reversed its position, formerly refusing to give any quarter on the recovery of costs for the processing of gas, now agreeing to fold the tent and go home. In a separate order, the Commission criticizes 2 individuals for waiting to intervene until November, but it ignores the inescapable fact that no reasonable customer could have known that the Committee would surrender without a fight.

What is more, the issues that were raised and the lines that had been drawn in Questar Gas's opening petition in docket number 05-057-01, had been altered and redrawn completely, with the fashioning of an entirely new compromise, unlike any other in relation to this controversy, in the 2005 Stipulation. This had been accomplished in private negotiations during the mid-year months and filed for the first time in October, 2005.

The Commission, as indicated above, has shown a marked penchant for opening new dockets at every turn of this controversy. A new docket, at this juncture, might have been useful to explore the purportedly new provisions and changed circumstances that allegedly had produced the 2005 Stipulation. Such an exploration would have been useful to the persons affected by the stipulation, the real parties in interest, the ratepayers who would be paying an obligation that their regulatory proxies, tired of squabbling, now had agreed was due and owing. Indeed, such an exploration might be deemed imperative because the watchdogs had left the kennel, forsaking their regulatory duties as representatives of the public interest and advocates for consumers, and agreeing instead to become partisans in defense of their compromise, before the Commission and in

connection with any judicial review, at all costs.[26] After 8 years of investigation and a new turn of events, a few months to look at a "new deal," after all, does not sound like a radical proposition.

But the Commission did not open a new docket for the new deal on this occasion. The parties filed the 2005 Stipulation on October 11th. Without even waiting for the parties to move for approval, the Commission, on its own initiative, noticed up a hearing for approval of the agreement on October 20th. There was no pleading that put the matter "at issue" or that explained the purpose of the agreement in this docket or in light of prior events. Objections to approval were not invited and no deadline for opposition filings was mentioned. The notice referenced the stipulation on file with the Commission <u>but did not attach a copy</u>. The stipulation on file<u>, in footnote 4 on the fourth page</u>, asks the Commission to take administrative notice of "the information presented in the technical conferences in Docket No. 04-057-09," but the nature or location of this "information" is not specified. Had a member of the public or an affected person gone to the Commission's website, read the notice, and reviewed the stipulation on file, he would have had 9 days in which to prepare for a hearing. If he had attempted to prepare, he would not have had any testimonial information from the technical conferences (six in all) with which to do so, since no "record" in this regard ever has been available.

Petitioners have detailed these circumstances at length because they want the Commission to appreciate how petitioners, members of the public, persons affected as ratepayers and shareholders in this matter, with this longer view and enlarged perspective, perceive the truly dismal reality of these proceedings. The settlement statute

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[26] Please see the more extended discussion of this point found in "Petitioners' Response to Opposition of Questar Gas Company, the Division of Public Utilities, and the Committee of

demands that, in deciding whether to pursue a resolution through settlement, the Commission should consider the interests of the public and all persons who would be affected by the proposed compromise. If the Commissioners, as guardians of the public interest, had done what the statute demands, looking to the history of this matter as detailed above, they would have concluded that 9 days is not enough for effective input and, indeed, that this limited notice and allowance of time simply is unfair to the very class to be protected under that legislation.[27]

The Commission's response to concerns respecting notice did not consider any of the above. That response, instead of focusing, as required by the statute, on the "public" and "persons affected" by the settlement process, was leveled at two persons who had requested intervention: Roger Ball, former director of the Committee, and hence a special case, and Claire Geddes, a private citizen and well known consumer advocate. That response, instead of considering, as required by the statute, whether settlement instead of litigation should be pursued as a means to the end of conflict resolution, and, if so, how that process would impact the public and affected persons in view of the circumstances detailed above, showed an almost Pharasaic adherence to what the Commission believed was a 5-day notice requirement. *See,* January 2006 Order, at 30-31.

Consumer Services to Request for Intervention," at pages 3-9, on file in this docket.

[27] The settlement approval process in the Wexpro proceeding, by contrast, was "widely publicized," involved no fewer than 8 days of public hearings, numerous disinterested expert witnesses, and outside review. The public was given additional opportunity to make statements, written and verbal, to the Commission. *See, Utah Dept. of Admin. Serv. v. Pub. Serv. Comm'n,* 658 P.2d 601, 615 (Utah 1983). The Wexpro procedure is a studied contrast with the expedited, abbreviated, and limited review given to the settlement in this case from October 11th through October 20th.

The public is entitled to expect that the Commission's outlook would be more generous, showing a concern for what is *fair* procedure to the public at large rather than mere convenience to actual parties. Indeed, as argued above, this is what the settlement statute clearly requires. But even the Commission's hair-splitting analysis of the "5 day rule" is beside the point and misses the mark.

As noted above, the notice of hearing for approval of the 2005 Stipulation was posted on the Commission's website on October 11, 2005, but that notice, on its face, does not reflect a mailing to any party in interest, including parties by intervention, in any of the 12 dockets that have covered the ground respecting Plant costs. Nor does the notice, on its face, reflect a mailing to any party in interest, including parties by intervention, in any of the 5 dockets that are listed on the caption of this case. The notice may well be deemed a notice of agency action under the Administrative Procedures Act, but it did not comply with the requirements of that statute, including the requirement that such notices give 30 days within which parties may respond. *See, Utah Code Ann.* §§ 63-46b-3(1)(a) and (2)(a)(vi). There is no evidence in the record that <u>any</u> of these parties, the public, or affected persons were invited to the settlement negotiations which gave birth to the 2005 Stipulation, despite the fact that such evidence is required by Commission Rule and the settlement statute. *See, Utah Code Ann.* § 54-7-1(3)(c) and Commission Rules R746-100-10 A. and R746-100-10 F. 5. b. Under these circumstances, we cannot conclude that notice of the hearing satisfied even the technical requirements for adequate notice under the Commission's own rules. *See, e.g., State, etc. v. Utah Merit System Council,* 614 P.2d 1259 (Utah 1980) (at a minimum, due process

requires an administrative agency to follow its own rules); *R.O.A. General v. Utah Dept. of Transp.,* 966 P.2d 840, 842 (Utah 1998) (same).[28]

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[28] Public Service Commission Rule, R746-100-10 A, provides that, "When a matter is at issue, the Commission shall set a time and place for hearing. Notice of the hearing shall be served in conformance with Sections 63-46b-3(2)(b) and 63-46b-3(3)(e) at least five days before the date of the hearing or shorter period as determined by the Commission." This Commission Rule, however, does not mesh easily with the circumstances in these dockets and the hearing on approval of the stipulation. Section 63-46b-3(2)(b) applies where adjudicative proceedings are commenced by the agency, and requires, among other things, that notice of that agency action shall be mailed to "each party," and to "any other person who has a right to notice under statute or rule." Section 63-46b-3(3)(e) governs the form and manner of notices issued under Section 63-46b-3(3)(d), which, in turn, requires the presiding officer of a given agency promptly to review requests for agency action and to "notify the requesting party" what action, from a series of alternate actions, is to be taken, including notification that "further proceedings are required to determine the agency's response to the request." Section 63-46b-3(3)(e), in subpart (ii), requires agencies, among other things, to "mail any notice required by Subsection (3)(d) to all parties [presumably all those parties requesting agency action as referenced in Subsection (3)(d)], except that any notice required by Subsection 3(d)(iii) may be published when publication is required by statute." The Commission, by issuing the notice for approval of the stipulation (especially where the parties had not requested this relief by motion), may have been an "agency requesting action" in these dockets and, hence, the notice requirements of Section 63-46b-3(2)(b) may have applied. *In that event, the statute requires a 30 day response period to the notice of agency action and this deadline for response must be included in the notice. See, Utah Code Ann.* §§ 63-46b-3(1)(a) and (2)(a)(vi). Section 63-46b-3(3)(e), which regulates notices to parties requesting agency action in specified circumstances, does not seem to apply at all under these circumstances. In all events, these statutes require notices to be mailed to all parties or persons otherwise entitled to notice, and it is unclear from the Commission's web/docket whether (a) notice of the hearing was mailed and whether, (b) if mailed, it was sent to all parties and persons otherwise entitled to notice in all relevant dockets.

Moreover, all pleadings in opposition to the request for intervention by Roger Ball are tantamount to an admission that Ball, in light of prior involvement in these dockets, was a *de facto* party in interest. *See, Utah Ass'n of Counties v. Tax Comm'n,* 895 P.2d 825, 827 (Utah 1995), *citing Utah Association of Counties v. Tax Comm'n of the State of Utah ex rel. American Telephone & Telegraph Co.,* 895 P.2d 819, 820-821 (Utah 1995) (even absent formal intervention petition, active participation in agency proceedings is *de facto* intervention and parties who allow such active participation without protest are deemed to have waived right to challenge intervention). But in all events, Ball did not receive any notice of the hearing by mail, as is apparently contemplated under Rule R746-100-10 A.

As a party, in addition to a right to notice that was not received in this matter, Ball would be entitled to invoke Commission Rule R746-100-10 F. 5. b., which mandates that, "[p]arties not adhering to settlement agreements *shall be entitled to oppose the agreements* in a manner directed by the Commission." (Emphasis added.) What is more, under the same Rule, the Commission, before accepting the settlement, "may require the parties offering the settlement to show that each party has been notified of, and allowed to participate in, settlement negotiations." This showing was not made in relation to Ball at the October 20th hearing, and could not be made in his case,

But the notice is fatally flawed in a more fundamental sense. The Commission's rule on notice is triggered "[w]hen a matter is at issue[.]" There is no pleading, such as a motion, however, that puts the stipulation "at issue" or requests a form of relief in connection with the same. And if the notice is deemed a notice of agency action, it clearly violates the disclosure requirements of the relevant statutes. *See, Utah Code Ann.* § 63-46b-3(2)(a)(i)-(xi).

The naked stipulation filed October 11, 2005 suggests a substantial departure from the relief sought in the initial application in docket number 05-057-01, but there is nothing to inform ratepayers who may be surfing the Commission's website for information about gas management cost recovery what these departures mean and why they have been presented to the Commission "all of a sudden" by stipulation.

The stipulation, in footnote 4 on page 4, requests "that the Commission take administrative notice of the information presented in the technical conferences in Docket No. 04-057-09[,]" but notice of the content of this "information" is neither described nor included with the stipulation, and, thus, interested persons are not given an opportunity to evaluate -- as argued above -- either the nature or the quality of evidence which apparently is being offered in support of this stipulated compromise. What is more, this "information" was taken from another docket, a circumstance which, all alone, violates rights to due process. *See, e.g., Los Angeles & S. L. R. Co. v. Public Utilities Comm'n,* 17 P.2d 287, 290-291 (Utah 1932). Indeed, the hearsay nature of this "information," as well

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since it is beyond cavil that, after departing from the Committee in March, 2005, he was not included in any settlement negotiations. These standards, fixed by Rule, supplement the statutory requirements for processing settlements found at *Utah Code Ann.* § 54-7-1(3)(d).

as the use of hearsay to the exclusion of any other "evidence" throughout review of the 2005 Stipulation, offends the "appearance of fairness" which is so vital to due process. *See, e.g., Tolman v. Salt Lake County Attorney,* 818 P.2d 23, 28-31 (Utah Ct. App. 1991).

Similarly, the stipulation as a whole appears to be predicated upon an agreement between Questar Gas and Questar Transportation Services, yet no copy of this agreement is attached to the stipulation for review by Commissioners or others. Hence, we are left in the dark, without notice, of the terms and conditions of this undertaking which is clouded in the background yet vitally important to the merits of the compromise.

Indeed, although the stipulation clearly contemplates a "partnership" and revenue sharing between these affiliates, Questar Transportation is not a signatory to the agreement, and all concerned remain un-notified whether, in the absence of such signature, the "contract" is binding upon that entity or whether it merely is an illusory agreement.

Even the lowest underclass of litigants, such as President Bush's "enemy combatants," is entitled to more "due process" than this. *See, Hamdi v. Rumsfeld,* No. 03-6696 (slip opinion, at 26) (June 28, 2004) (citizen-detainee seeking to challenge classification as enemy combatant "must receive *notice of the factual basis* for his classification, and a *fair opportunity to rebut* the Government's factual assertions before a neutral decisionmaker[ ]") (emphasis added). Given the circumstances described above, petitioners believe that the course pursued by our public agencies, including the Commission, does not satisfy the minimum requirements of constitutional due process. *See, e.g., Mullane v. Central Hanover Tr. Co.,* 339 U. S. 306, 314 (1950) ("An

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Likewise, in all events, Claire Geddes, even though not formally a party, as a person who specifically had requested notice directly of Chairman Campbell and therefore arguably was

elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections[ ]") (citations omitted).

(2) The January 2006 Order Was Not the Product of Impartial Decision-Making.

The Commission issued its January 2006 Order over the signature of Chairman Campbell -- who participated in the decision-making process that led to the Order -- after he had served for years as Director of the Division which had played, during his tenure there, a significant role in analyzing, negotiating, and litigating the question of gas processing cost recovery before the Commission -- and after he had recused himself (on account of issues respecting bias) from deliberations on this subject once he has made a transition from director of the Division to Chairman of the Commission.

By issuing the January 2006 Order under these circumstances and with Campbell's participation, the Commission violated the principles and holding of the Utah Supreme Court in *Anderson v. Industrial Comm'n of Utah,* 696 P.2d 1219 (Utah 1985). In *Anderson,* an injured employee had sought redress from a compensation fund at the Industrial Commission. The administrative law judge who initially presided in this proceeding retired and was replaced by Judge Allen who had served during an earlier phase of the case as counsel to the fund. The Court affirmed the principle that administrative agencies must insure impartial decision-making through an unbiased tribunal: "'A fair trial in a fair tribunal is a basic requirement of due process.' [Citation omitted.] Fairness requires not only an absence of actual bias, but endeavors to prevent

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entitled to some kind of notice, in fact received none.

even the possibility of unfairness." *Id.* at 1221. The Court then ruled that Judge Allen's change in roles, from participation on behalf of a party in interest in the case to a judge in the case, failed to insure the substance and appearance of fairness that due process requires. Following the precedent of *Amos Treat & Co. v. Securities and Exchange Commission,* 306 F.2d 260 (D. C. Cir. 1962), which held that an SEC Commissioner should not have participated in revocation proceedings where he earlier had been involved in the investigation of the company that led to those proceedings, the Court quoted *Amos* in holding that: "'The fundamental requirements of fairness in the performance of [quasi-judicial] functions require at least that one who participates in a case on behalf of any party . . . take no part in the decision of that case by any tribunal on which he may thereafter sit.'" *Anderson v. Industrial Comm'n of Utah,* 696 P.2d at 1221, quoting from *Amos Treat & Co. v. Securities and Exchange Comm'n,* 306 F.2d at 264, which, in turn, is quoting from *Trans World Airlines v. Civil Aeronautics Board,* 254 F.2d 90, 91 (D. C. Cir. 1958). *See generally,* J. O. Freedman, CRISIS AND LEGITIMACY: THE ADMINISTRATIVE PROCESS AND AMERICAN GOVERNMENT, ch. 15 (1978). The *Anderson* court further held that, under these circumstances, where the agency decision-maker has had prior involvement with a party in the case, disqualification is required *even without* a showing of actual bias: "The law <u>presumes</u> prejudice in such circumstances." *Anderson v. Industrial Comm'n of Utah,* 696 P.2d at 1221 (emphasis added). Chairman Campbell undoubtedly sensed this bias when he first moved from the Division to the Commission, and, hence, recused himself from questions concerning the Plant at that time. He should have continued to follow this

instinct, however, on all questions concerning cost recovery to the present time. This is not a case in which he may lawfully participate.

The January 2006 Order must be set aside in view of this violation of due process and Chairman Campbell should be disqualified from participation in any further proceedings or hearings respecting the 2005 Stipulation or gas processing cost recovery.

IV. ATTORNEYS FEES

Petitioners also request that the Commission award them their attorneys' fees under the *Stewart* private attorney general doctrine. *See Stewart v. Utah Public Serv. Comm'n*, 885 P.2d 759 (Utah 1994). The facts here are virtually identical to those in *Stewart* -- all the regulatory bodies abdicated their duties by stipulating to an agreement which was not in the public interest or the interests of the ratepayers; no one was left to advocate the public's interest; and Petitioners will "vindicate an important public policy benefiting all of the ratepayers in the state," and the "necessary costs in doing so transcend the individual plaintiff's pecuniary interest to an extent requiring subsidization." *Id.* at 783. It is noteworthy that the ratepayers are required to pay handsomely for the salaries of the Questar Management who dropped the ball repeatedly in determining what might be a prudent way to avoid these increased costs; they are required to pay for the private attorneys and the large law firms who defend these unwise management decisions, and they are required to pay for the government regulators and their attorneys when they rubber stamp these imprudent decisions. The Commission surely must now permit the ratepayers to retain their own attorneys to champion their own and the public interests when all other advocates have abandoned them.

V. CONCLUSION

Questar customers are paying the highest gas prices in the history of the company, a fact which is reflected daily in angry letters to the editors of Utah's newspapers. It is at times like these that the public's interest in the role of the Public Service Commission is the highest. It is at times like these that the power of monopolies is keenly felt in every household that relies on gas for heat. It is at times like these that the regulatory agencies are scrutinized most minutely, in the public's mind, for any hint of favoritism toward the companies they are supposed to regulate.

This case illustrates, like few others, the potential for the regulators to be co-opted by the regulated. In the real world of private industry, to which regulated utilities – as state-sanctioned monopolies – are only faintly related, the ill-advised or irrational decisions of managers are paid for either by the managers (who may lose their jobs) or by stockholders (who lose their profits). It is only in the world of regulated utilities that incompetent and unprofitable decisions can be foisted off on captive customers, if those who stand as watchdogs and protectors allow themselves to be worn down to the role of rubber stamps by aggressive and persistent utility companies who are always willing to parse the hidden meanings and invitations of "no."

Questar's decision to build the CO2 plant has never passed the "reasonable and prudent" tests which the law requires of utilities prior to the construction of facilities. It was unequivocally disallowed as a prudent business decision in the August 2004 Order. No other application for a charge to customers has been considered and rejected so many times and at so many levels – yet Questar's management comes back again and again, pressing for a "reconsideration" that has long since, under the statutes and precedents of

our state, been debarred. The 2005 Stipulation not only was entered by the regulators in a most curious turnabout, but it was done in a manner which was calculated to make it extremely difficult, if not impossible, for customers to know or understand what was happening. The ratepayers reasonably relied upon the continued opposition of the Committee. The public reasonably believed that it was protected by a clear and binding decision of the Utah Supreme Court ruling against Questar and the Commission. In announcing their surprise stipulation in October, every regulatory agency abandoned its duty to protect and defend the public interest and to uphold the law. In its January 2006 order approving the stipulation, the Commission trod upon not only the most minimal of due process requirements as to notice, but, more egregiously, ignored and violated the unavoidable bar of *res judicata*. Questar's highly-paid management made a risky decision to ignore the law and construct the CO2 Plant without seeking advance approval as the statutes require. The company failed to appeal the August 2004 Order denying recovery of costs. What was imprudent in the years 1996 through 2004 did not, magically, become prudent in 2005.

The Commission's January 2006 Order is reversible error, and it is the most egregious Commission gift to Questar's shareholders since the sly accounting for dry wells which resulted in *Wexpro I.* Even more so, because in that case, the defense of captive ratepayers was vigorously and relentlessly pursued by an aggressive and watchful Division of Public Utilities. Here, sadly, customers have been left, totally, to fend for themselves; and but for these petitioners and their attorneys, no one – not even the Commission – is looking out for their interests.

The CO_2 Plant, unquestionably, was an expensive investment. It was imprudent in 1998, and it is no less imprudent today. Someone must pay the freight, but not the customers. In a world where managers and executives bear the risk of their ill-considered decisions, and in the competitive business world utility regulation is supposed to approximate, it would be appropriate for some of those costs to be borne via a reduction in executive compensation, not to mention losses of jobs. If the Questar shareholders believe that their company's executives have injured their interests by wrongheaded business decisions, they have a choice -- they can seek redress through the corporate oversight shareholders have always had with respect to management functions or they can sell their shares and invest in better operated companies. Ratepayers, in contrast, have no ability to change or escape mismanagement. They are captive and vulnerable and entirely dependent upon the regulatory agencies to protect them from utility overreach. Here, the agencies have utterly failed them, and the Commission should reconsider and reverse its order imposing gas processing costs on the Company's customers.

Respectfully submitted this 6th of February, 2006.

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Janet I. Jenson