State of Utah
Department of Commerce
Division of Public Utilities

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Director, Division of Public Utilities

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Governor

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Lieutenant Governor

M E M O R A N D U M

To: Public Service Commission

From: Division of Public Utilities
Constance B. White, Director
Energy Section
Marlin H. Barrow, Utility Analyst
Artie Powell, Acting Manager

Date: October 28, 2005

Subject: Questar Gas, Account 191 Pass Through, Docket No. 05-057-11.

ISSUE:

Questar Gas Company (QGC) filed on October 25, 2005 an amended application to adjust rates for natural gas with the Public Service Commission (PSC). The original application was filed on September 8, 2005. This filing asks for a total increase in revenues of $196,481,000. This increase in revenues in based on projected Utah gas costs of $845,341,000. The commodity portion of rates will increase $196,452,000 while the supplier non-gas portion of rates will increase $29,000. If approved by the PSC, a typical residential customer, assuming a usage of 115 decatherms per year, will see an average increase in their monthly bill of $18.11 or an additional 20.3% increase over current rates approved in June, 2005.

RECOMMEND APPROVAL:

After a preliminary review of this application the Division of Public Utilities (Division)

recommends, on an interim basis, the application be approved as filed with the proposed rates becoming effective November 1, 2005.

DISCUSSION:

QGC's current filing (Docket No. 05-057-11), is based on expected firm sales volumes in Utah of 101,639,000 decatherms, for the 12 months ending September 30, 2006, and reflects the gas purchases, company owned production, transportation, gathering, storage and royalty costs necessary to meet those projected sales requirements. This current pass through request, coupled with the increase requested in Docket 05-057-06 last June represents an overall increase of 42% in gas prices since the 2004-05 winter heating season and results in the highest dollar amount per decatherm (Dth) that QGC has ever charged. It should be noted that 3% of this 42% increase is due to the termination of the $0.29/Dth credit for the CO2 refund ordered by the PSC in Docket 04-057-09 which ended effective October 1, 2005.

As noted in the filing, and as provided in QGC's Tariff for Natural Gas Service in Utah, PSCU 400, §2.10, pp. 2-11-2-17, the $845,341,000 of costs represent a direct pass through of costs QGC expects to incur in the next twelve months in order to meet the anticipated requirements of its customers and does not impact the operating profit or rate of return of QGC except for $4,073,000 which is the return on the working storage gas inventory approved by the PSC in Docket No. 93-057-01.

Price History Recap:

Nationally, natural gas prices are at an all time historic high. These high prices are a result of a tight gas market supply/demand dynamic due to a 14% to 22 % hotter summer season which experienced a 15% increase in natural gas demand over the summer of 2004 for increased electrical generation. To further exacerbate the supply/demand dynamic, Hurricanes Katrina and Rita have disrupted much of the nation's natural gas production capabilities in the Gulf region. These forces have

pushed the forward price curve for natural gas to its current historic high. The application QGC filed on September 8, 2005 did not reflect the impact the Hurricanes have had on natural gas prices. Therefore QGC requested a delay in the implementation of the rates requested in that application so that the hurricane effects could better be reflected in this amended filing. The Henry Hub price is expected to average $13.00/Dth during the 2005-06 winter heating season which translates nationally to an average increase of 48% in natural gas costs when compared to last winter.[1]

Locally, Utah's gas prices are expected to increase some 37% from those prices in effect in October 2004 based on a 14% increase in prices authorized in Docket 05-057-06 beginning June 1, 2005 and this request of 20%. This is coupled with a 3% increase which occurred October 1, 2005 due to the expiration of the CO2 processing credit Utah gas customers had been receiving over the past twelve months. For a typical residential customer using 115 Dth per year, this represents an increase of about $347 per year in gas costs and $33 per year due to the termination of the CO2 refund for a total of $380 per year from the rates effective during the last winter heating season.

From 1985 through 1999, the GS-1 commodity gas component rate varied from a high of $2.66/Dth in January 1985 to a low of $1.04 in January 1996. At the beginning of 2000, the commodity gas component of the GS-1 rate was $2.23/Dth. At the same time, First of the Month (FOM) Rocky Mountain[2] gas was selling at $2.15/Dth.

During the year 2000, QGC filed one pass through effective October 1, 2000, which raised the commodity gas component rate to $2.91/Dth. However, QGC's filing came before the summer of 2000 when the price of natural gas rose substantially due to what many think was the effect of the energy crisis in California. The FOM Rocky Mountain price, for example, went from $2.15/Dth, at the beginning of 2000 to $6.14/Dth by the end of the year; and it jumped to $8.58/Dth in January 2001. QGC was caught in this

[1] Based on information contained in Inside FERC, October 17, 2005, "EIA presents 'particularly difficult outlook' for winter; gas price estimates jump again."
[2] First of month pricing is Questar Pipeline's posted price as reported in "Inside FERC'S Gas Market Report". It is the price monthly gas purchase contracts are settled at.

price run up and as a result filed their largest single pass through increase, which became effective Jan 1, 2001. This was an increase in the commodity rate of $1.75 bringing the new GS-1 rate to $4.67/Dth.

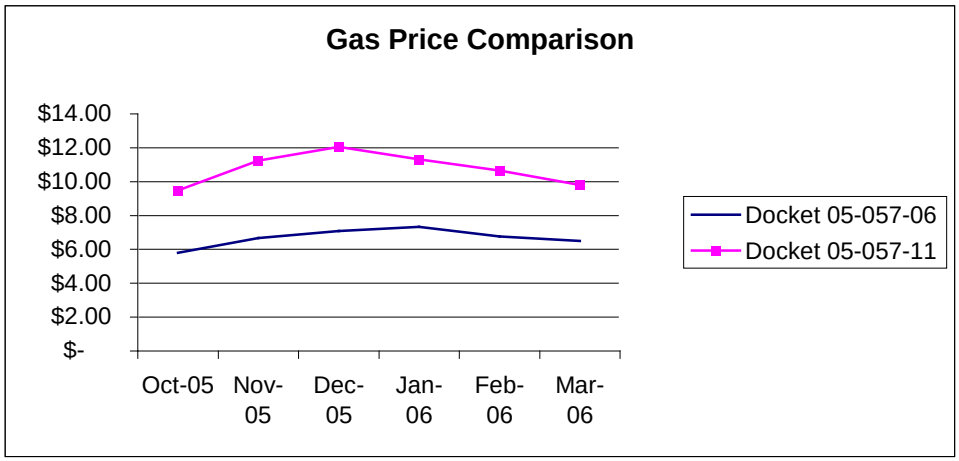
During the year of 2001, FOM natural gas prices again fluctuated dramatically, from a high of $8.58/Dth at the beginning of the year to a low of $0.97/Dth by October of 2001, ending the year at $2.02/Dth. QGC followed this trend by reducing the commodity gas cost component of the GS-1 rate from $4.67/Dth to $2.69/Dth, effective January 1, 2002.

Prior to 2003, the price of natural gas in the Rocky Mountain region was lower than the national market price at Henry Hub by approximately an average of $1.00/Dth. This phenomenon was attributed to a lack of pipeline capacity to move the gas out of the Rockies. However, by the summer of 2003, events occurred, both regionally and nationally, which have had a major impact on the price of natural gas. First, Kern River Gas completed a major expansion of its pipeline system capacity, allowing more Rocky Mountain gas to reach the gas-starved markets of California. This reduced the average basis between Rocky Mountain gas and the Henry Hub price by an average of $0.50/Dth. Secondly, instead of prices declining during the summer months, they increased to over $4.00/Dth in the Rocky Mountains and moved even higher, apparently due to increased demand for electrical generation to meet air conditioning load and gas storage requirements in the summer months coupled with a national forecast of tighter supplies. Because of these events, QGC filed for a pass through effective July 1, 2003, which increased the commodity gas cost component of the GS-1 rate to $4.22/Dth.

From July 2003 through the end of 2004, the price of the Questar Pipeline First of Month (QPL FOM) Rocky Mountain gas continued to be volatile, ranging from a high of $6.55/Dth, reached in November 2004 to a low of $3.87/Dth reached in August 2003. Through August of 2005, the QPL FOM price has ranged from a low of $5.24/Dth in June to a high of $6.04 in the previous month of May. QGC filed a pass through in June of 2005 which set the GS-1 rate at $5.92/Dth.

Current Situation:

Since QGC's filing in Docket 05-057-06, which was effective June 1, 2005, the price of natural gas has continued to increase beyond what was projected in that filing due mainly to the hurricanes which have plagued the Gulf coast region. The 05-057-06 June filing projected those prices to range from $6.67/Dth in November 2005 to $7.34/Dth in January 2006. The current forward projections of natural gas prices are projected to be above $11.00/Dth for those same three months. The graph compares the difference between the pass-through filing in June (Docket 05-057-06) and this filing in Docket 05-057-11 in projected Rocky Mountain purchase gas prices for the six month period October 2005 - March 2006.



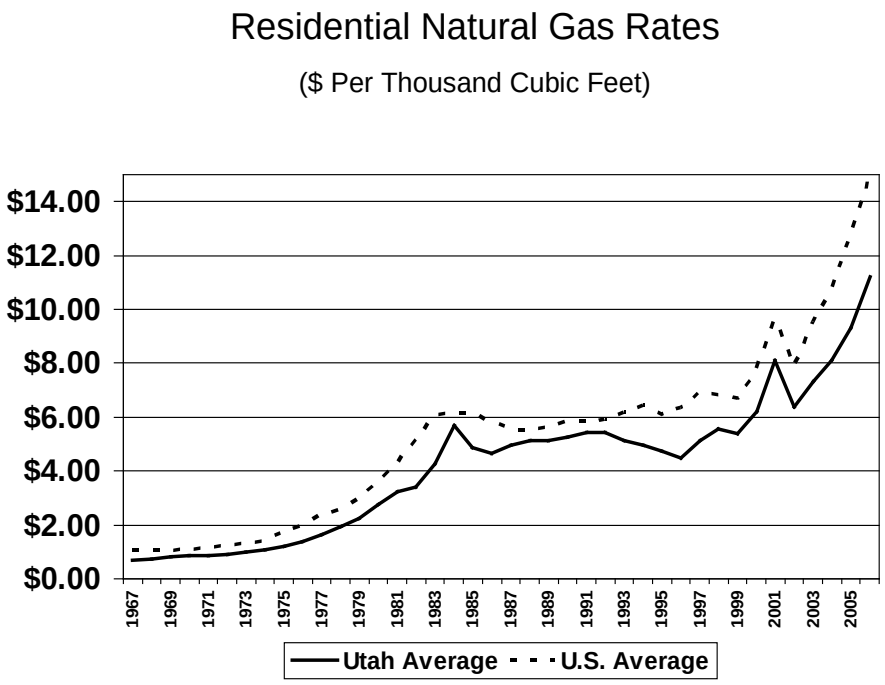
Despite the adverse affects discussed above, the price QGC customers pay for natural gas is lower than other parts of the country. In large part, this is due to QGC's WEXPRO agreement for Company Owned Production (WEXPRO production), which is a great benefit to those customers. Without this WEXPRO production, instead of looking at a commodity gas component price of $7.82/Dth, the price could be as high as $11.60/Dth, or approximately a 61% increase instead of the 20% increase requested in

this filing. The chart below shows the value WEXPRO production brings to Utah customers when compared to having to purchase those volumes at current market prices. Columns (a) and (b) show the annual cost to an average customer assuming 115 decatherms usage per year and the percentage increase or decrease of the pass through filings beginning in January 2003. Columns (c) and (d) show the annual cost to that same customer and percentage increase or decrease assuming the volumes that came from the WEXPRO production were competively purchased. Column (e) shows the percentage increase for a given pass-through filing that would have occurred if the WEXPRO production volumes had not been available.

	(a)	(b)	(c)	(d)	(e)
Effective Date	**As Filed Avg Ann Bill (1)**	**Increase (Decrease) %** (a)÷prev (a)	**WO WEXPRO Avg Ann Bill (2)**	**Increase (Decrease) %** (c)÷prev (c)	**WO WEXPRO To As Filed Inc (Dec) %** (c)÷prev (a)
1-Jan-03	$ 674		$ 721		
1-Jul-03	$ 867	29%	$ 1,042	45%	55%
10/1/2003	$ 816	-6%	$ 946	-9%	9%
7/1/2004	$ 856	5%	$ 963	2%	18%
10/1/2004	$ 906	6%	$ 1,060	10%	24%
6/1/2005	$ 1,037	14%	$ 1,229	16%	36%
10/1/2005	$ 1,070	3%	$ 1,262	3%	22%
11/1/2005	$ 1,287	**20%**	$ 1,723	**37%**	**61%**

1 Based on average annual usage of 115 decatherms per year
2 Assumes WEXPRO production costs as much as purchased gas.

Because QGC gas customers do have the benefit of the WEXPRO production, natural gas delivered to Utah customers continues to be one of the lowest priced in the nation as shown by the following graph. For comparison, even with this increase in natural gas prices, a gallon of gasoline delivered at the pump costs twice as much as a decatherm of natural gas delivered to the home, when compared on an equivalent Btu basis. (See Exhibit 1 at end of memo for calculations)



Source: U.S. Energy Information Administration

Efforts To Mitigate Gas Price Volatility:

QGC purchases about half of its annual requirements from third party suppliers to meet its customers' needs. However, due to its customers' load shape (i.e. residential heating), a much greater portion must be purchased from third parties for the heating season (October-May) when gas prices historically are higher. As a result customers are potentially exposed to market volatility.

Current purchased gas prices are, historically speaking, high and volatile. QGC attempts to manage gas price volatility, and thereby mitigate customers' exposure to that volatility, through a planned purchase program or "hedging". QGC develops a winter gas-purchase portfolio made up of fixed price contracts for approximately one-third of the portfolio, contracts with a price cap for about one-third and buying the other third under index price contracts. QGC uses various purchase contracts to achieve this mix but may use financial

hedge contracts if necessary. The WEXPRO production and QGC's storage practices play an important role in QGC's overall supply plan by allowing QGC to keep WEXPRO production flowing during the summer months to inject into storage and then withdraw the lower cost company production in the winter months, which minimizes the need to purchase as much gas in winter when prices are historically higher.

This plan, known as QGC's Integrated Resource Plan (IRP), was developed in consultation with the Division, Committee of Consumer Services (CCS) and PSC, and has been presented to regulators over the past few years and approved tacitly by regulators as a policy for QGC to pursue in gas procurement. QGC meets periodically with regulators to explain market conditions and provide the opportunity for regulators to provide input on the decisions QGC is making in developing its purchased gas portfolio. As the plan year progresses, QGC files quarterly variance reports with the PSC explaining why actual gas purchase results differ from planned IRP projections. The final report filed with the PSC for the May 2004-April 2005 IRP plan year shows actual gas purchases for the 2004-05 IRP plan year were lower than planned by only 0.5% while WEXPRO production was higher than planned by 1.6%. However, the actual average cost per decatherm of the purchased gas for the plan year was $5.36/Dth compared to $4.721/Dth resulting in a $33.7 million increase in purchase costs for the plan year ending in April 05. For the current 2005-06 IRP plan a base price for purchased gas was assumed to be $6.50/Dth which is below current price projections.

Unfortunately, in the environment of today's energy markets, the opportunity for QGC to obtain gas supply contracts for periods greater than one year has not been offered at acceptable prices or terms. At times of high price volatility, the market imbeds a high volatility premium for fixed price contracts and other options. In today's market, due to the price of gas, financial hedges are very expensive and may be unattractive as a hedging tool, even though there is in this plan as well as in previous filings, $2,000,000 set aside for such purposes.

Possibly in the future, if there is more stability in the market, QGC may be able to obtain multi-year term purchase agreements with acceptable terms and conditions with producers or even perhaps with Questar Market Resources as a means of providing more stability to QGC customers. Inherently, when long-term fixed price contracts are entered into, the purchaser of those contracts runs the risk that those fixed price contracts will be "out of the money" when compared to current market prices. In QGCs' situation, when such an event occurs, history has shown, QGC is criticized for being imprudent.

QGC must compete in the gas market with all the other LDCs in the country, with the only variables being pipeline capacity and nearness of supply. Fortunately, as discussed above, QGC does have one of the best hedges of any LDC in the country. The company owned production developed under the WEXPRO agreement provides almost half the gas used by sales customers. The cost of this gas, which is based on cost-of-service pricing, is about one third the current purchase price forecasted in this filing and plays an important role in reducing the overall price of gas for customers. Additionally the Company uses its storage capacity to provide price stability. WEXPRO production and lower priced summertime purchased gas are injected into storage in the summer months and then used in the winter in place of higher cost purchases. The combination of WEXPRO production, storage and fixed price contracts provided price stability on about 70% of the gas supplies for QGC sales customers last winter.

Comparative Analysis Docket No. 05-057-11 to Docket No. 05-057-06

Comparing the commodity gas cost component of the GS-1 rate in this filing with the commodity gas cost component rate in Docket No. 05-057-06, shows an increase from $5.919/Dth to $7.815/Dth, or a $1.896/Dth rate increase. As discussed in the filing, this is an amended filing to one originally filed on September 8, 2005. Besides the increase in purchase gas costs, an analysis of the differences between the two filings shows that in the September 8th filing, WEXPRO production accounted for 44% of the gas volumes. In the current filing, WEXPRO production volumes have increased to 48%. By

increasing WEXPRO production to 48% instead of the 44% used in the September 8th filing, QGC was able to reduce the Utah allocated commodity costs by $32.5 million thereby reducing the annual cost to the customer by $37.50. On a decatherm basis, assuming the purchase costs filed in this amended filing, a decatherm of WEXPRO production that replaces a decatherm of purchased gas results in a savings of $6.13/Dth.

The Summary Table below provides a reconciliation to the total requested increase of $196,481,000 (Line 4 col d) by rate and volumes.

SUMMARY TABLE

Line		(a) Inc (dec) Rate from prev filing (/Dth)	(b) Rate Inc (dec) Costs from prev filing (000)	(c) Vols Inc (dec) Costs from prev filing (000)	(d) Total Inc (dec) Costs from prev filing (000)
	GS-1 Current filed gas commodity rate	$5.919			
1	Production	$0.313	$ 31,173	$ 256	$ 31,429
2	**Gas Purchases**	**$1.642**	**163,778**	**735**	**164,513**
3	Gath,transp and Storage	$0.004	438	102	540
4	Total Utah Allocated Gas Costs	$1.959	195,389	1,093	196,482
5	Less (inc) dec F3,I4 credits	($0.064)	(6,356)	(21)	(6,377)
6	SNG adjustment	$0.001	104	(133)	(29)
7	**Total GS-1 Commodity Increase**	**$1.896**	**189,137**	**939**	**190,076**
8	Add back Commodity I4 Rate Class	-	6,356	21	6,377
9	**GS-1 Proposed Commodity Rate**	**$1.896**	**195,493**	**960**	**196,453**
10	Add back SNG Adjustment	-	(104)	133	29
11	**Total increase (decrease) gas costs**	**-**	**195,389**	**1,093**	**196,482**
12	191 amortization		-	54	54
13	GS-1 Proposed gas commodity rate	$7.815			

This filing also results in a transfer of gathering costs associated with the WEXPRO Production from the DNG rate to the SNG rate. As explained in the filing, the DNG rates for the GS-1, GSS-1, F-1, F-4, NGV, T-1 and E-1 rate schedules were reduced by $0.07902/Dth and their respective SNG rates were increased by the same amount. The F-3 rate schedule had its DNG rate reduced by $0.04744/Dth and its SNG rate increased by the same amount. This results in a revenue neutral transfer between rate schedules

but now places all costs associated with the gathering of the WEXPRO production into the 191 account, which is the way these costs were treated prior to 1996.

SUMMARY AND CONCLUSION:

In summary, the current filing represents a major increase in natural gas costs and is reflective of the national trend in natural gas pricing. The Division has reviewed the forward pricing curves used by QGC and believes, given the most current information available, those price curves do in fact reflect a realistic forecast of future prices here in the Rocky Mountain region. This dramatic increase again raises several concerns the Division has with this pass through filing:

First, many, if not most, of QGC's customers may mistakenly conclude that Questar Gas Company will profit from this increase. Some of this confusion probably arises from Questar's Corporate press releases on earnings which are being driven by Questar's Market Resources benefiting from these high prices. The Division wishes to emphasize to the public, that other than the carrying costs on the inventories in the storage gas, QGC does not profit from these increases but is only passing on the costs they incur from gas producers in providing the gas supply necessary to meet customer demand. The Division feels this fact is sometimes lost in press releases to the public as well as the fact that the impact of this increase is two-thirds less than what the impact could have been if QGC didn't have the benefit of the WEXPRO production to meet 48% of its supply needs as well as the significant savings that have been realized over the past few years because of the WEXPRO production.

Second, because this is another major increase following the increase in June, which, due to low summer month usage, many of QGC's customers may not totally be aware of, there will naturally be an effort on many to reduce usage as they see an approximate 40% increase over last winter's bill. This may impair QGC in their ability to recover its fixed costs due to current rate designs, which recover those costs through volumetric sales. Because of this, the Division will continue to closely monitor the price of Rocky

Mountain natural gas as compared to the prices in this filing and will make appropriate recommendations to adjust rates if necessary. The Division also will work with QGC to explore ways to mitigate the effect declining usage has on the Company so that conservation measures may be more fully undertaken as a joint effort on the part of QGC and their customers.

Third, the Division is concerned with the impact these prices may have, not only on residential users but also on the Utah economy as they impact industrial and commercial entities. The Division recognizes the pressure this places on entities to remain competitive and profitable while not becoming inflationary. This may cause undue pressure to be placed on the Commission to over regulate QGC in order to bring prices back to "normal". Every effort needs to be taken to educate the public that this price increase is the result of economic forces beyond the control of QGC.

Despite these concerns, and after reviewing QGC's application, the Division recommends the Commission approve the application on an interim basis in order to allow Questar Gas Company to continue to provide the required gas service during this period of high gas prices.

As always, the Division will continue to monitor the published monthly index prices[3] and compare them to the prices used in this pass-through filing to see if any trend develops which may warrant an out of period filing by QGC to reduce the commodity gas cost rate.

Cc: Questar Gas Company
Committee of Consumer Services
Rea Petersen
Francine Giani, Department of Commerce

[3] Published monthly in Platts "Inside FERC's Gas Market Report."

EXHIBIT 1

Gallon gasoline to Decatherm conversion:

1 gallon of gasoline equals approximately 112,750[4] Btus.
1 decatherm equals 1,000,000 Btus.
1 decatherm equals 8.7 gallons of gas.
1 gallon of gas at the pump costs $2.58[5]
1 decatherm delivered to house costs $10.07 in summer and $10.96 in winter. (Per proposed GS-1 rate schedule effective November 1, 2005.)
8.7 gallons x $2.58 equals $22.45
$22.45 for 8.7 gallons of gas compared to $10.07 or $10.96 for one decatherm of natural gas.

[4] Weighting of Btu/gal factors for pentanes, hexane and heptane (gasoline liquid components found in natural gas streams) from GPA publication 2145-93.
[5] Based on current price per gallon of 85 rated octane at local Tesero Station on October 27, 2005.