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Division of Public Utilities

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MEMORANDUM

To: Public Service Commission

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

Date: January 31, 2006

Subject: Questar Gas, Account 191 Pass Through, Docket No. 06-057-01.

ISSUE:

Questar Gas Company (QGC) filed on January 27, 2006 an amended application to adjust rates for natural gas with the Public Service Commission (PSC). This amended filing asks for a total decrease in revenues related to gas costs of $93,731,000. This decrease in revenues is based on projected Utah gas costs of $765,928,000. The commodity portion of rates decreases $93,030,000 while the supplier non-gas portion of rates decreases $701,000. If approved by the PSC, a typical residential customer, assuming a usage of 115 decatherms per year, will see an average decrease in their monthly bill of $8.67 or a decrease of 8.08% over current rates.

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 February 1, 2006.

DISCUSSION:

QGC's current filing (Docket No. 06-057-01), is based on expected sales volumes in Utah of 102,674,000 decatherms, for the 12 months ending January 31, 2007, and reflects the gas purchases, company owned production, transportation, gathering, storage and royalty costs necessary to meet those projected sales requirements.

This amended pass through request by QGC is based on Global Insights' January 2006 forecast of projected natural gas prices in the Rocky Mountain area for February 2006 through January 2007. Although the projected prices have declined from the previous amended filing pass through filing in October 2005 (Docket 05-057-11), natural gas prices are still projected to be higher than what has been experienced in recent years.

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 $765,928,000 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. These gas costs do not impact the operating profit or rate of return of QGC except for the $4,237,000 noted on line 13, column (e) of revised Exhibit1.5, which is the return on the working storage gas inventory approved by the PSC in Docket No. 93-057-01.

Efforts To Mitigate Gas Price Volatility:

Traditionally, QGC meets its customer's gas requirements by using company owned production (WEXPRO volumes) to supplement third party purchases. 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.

The WEXPRO production and QGC's storage practices play an important role in QGC's plan to "hedge" against the high gas prices while meeting their overall supply plan. These practices allow QGC to keep WEXPRO production flowing during the summer months in order 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. In response to the increase in natural gas prices, WEXPRO has undertaken an aggressive drilling program. This has resulted in an increase in the total volumes available from WEXPRO which has helped to mitigate the total effect of the current high prices of natural gas to QGC customers.

In the October 2005 filing, WEXPRO production accounted for 48% of the gas supply mix at a weighted cost of $3.64/Dth (adjusted for the impact of the transfer of the gathering costs associated with the system-wide gathering agreement with Questar Gas Management (QGM) requested in the October 2005 pass-through filing). In the current filing, WEXPRO production accounts for 51% of the supply mix at a weighted cost of $3.43/Dth. This reduced cost of the WEXPRO production is reflective of the lower prices in the market as well as maximizing the value of the company owned production for the benefit of QGC's customers.

Historically speaking, natural gas prices remain high and volatile. For example, in a recent summary report, the Division provided the Commission with information on the first-of-month prices for Questar Pipeline. This information is provided in the table below along with a graphical representation comparing the daily spot prices of natural gas to the QPC first-of-month price as well as the commodity price in the GS-1 rates for 2005. For the month of January 2006, the first-of-month price is approximately the same as what it was during the energy crises of the winter of 2000/2001, but approximately four times what it was the previous winter (1999/2000) or the winter of 2001/2002. Beginning in November 2002, prices have continued to increase but without seeing much if any decline during the ensuing summer months.

Natural Gas Prices
Questar Pipeline - First of Month Index

(Bold Italic numbers are projections)

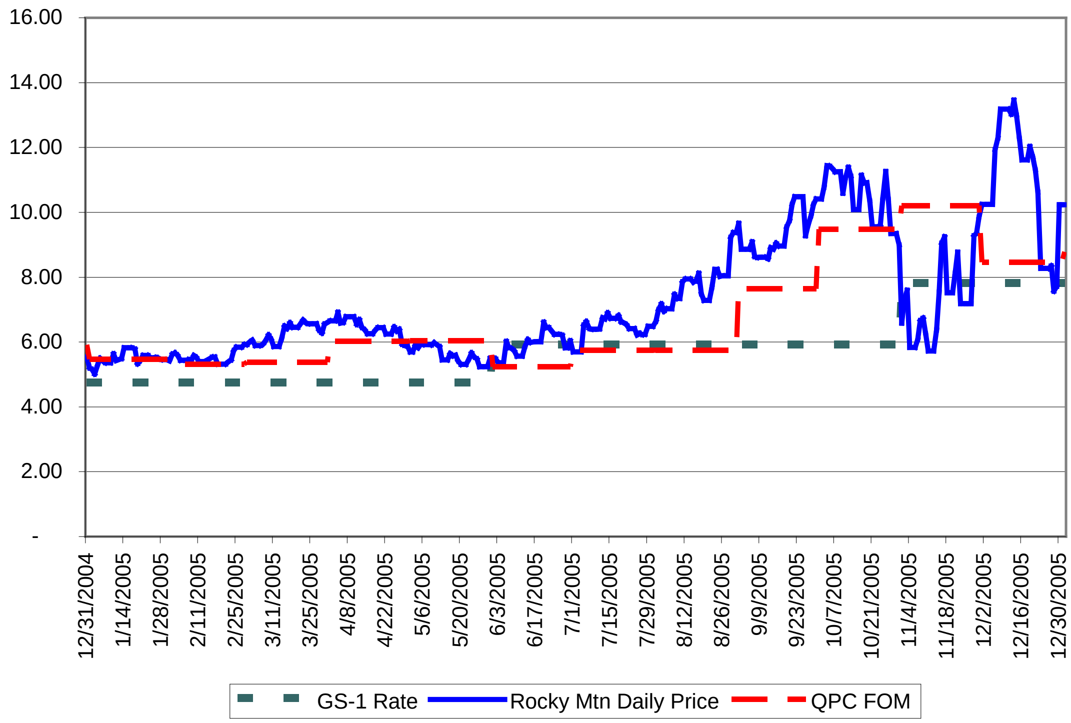
Winter Season

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
October		$4.17	$0.97	$1.17	$4.00	$4.42	$9.48	***$8.26***
November		$4.28	$2.38	$2.78	$3.91	$6.55	$10.21	***$9.50***
December		$6.14	$2.02	$3.29	$4.31	$5.91	$8.46	***$11.07***
January	$2.15	$8.58	$2.19	$3.09	$5.10	$5.47	$8.78	***$10.93***
February	$2.33	$6.42	$1.60	$3.05	$4.92	$5.32	***$6.82***	
March	$2.30	$4.79	$1.85	$5.00	$4.33	$5.38	***$7.57***	

Summer Season

	2000	2001	2002	2003	2004	2005	2006	2007
April	$2.62	$4.50	$2.67	$3.19	$4.19	$6.02	***$7.23***	
May	$2.62	$3.87	$2.09	$4.00	$4.89	$6.04	***$7.71***	
June	$3.41	$2.42	$1.53	$4.78	$5.52	$5.24	***$7.80***	
July	$2.66	$1.74	$1.15	$4.52	$5.20	$5.74	***$7.94***	
August	$2.92	$1.93	$1.47	$3.87	$5.22	$5.75	***$7.94***	
September	$3.25	$1.90	$1.09	$4.29	$4.39	$7.64	***$7.86***	

Rocky Mtn Natural Gas Prices



For QGC's gas purchase requirements, QGC attempts to manage gas price volatility, and thereby "hedge" or mitigate customers' exposure to that volatility, by continuing its planned purchase program. 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.

QGC continues to meet with regulators on a regular basis to provide updated information regarding this planned "hedging" program and current expectations in the gas market. 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 appear to be unattractive as a hedging tool, even though there continues to be in this plan as well as in previous filings, $2,000,000 set aside for such purposes. The Division is aware that the funds set aside for these financial hedges have not been utilized in the past couple of years but feel with prices declining, there may be some opportunities in the future where some types of financial hedges may be beneficial in realizing more price stability in the long term.

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, when they mature, will be "out of the money" when compared to current market prices. Because of this, QGC historically has been reluctant to enter into such arrangements without pre-arranged regulatory approval.

Gas Management Costs:

On January 6, 2006 the PSC issued its order dealing with the stipulation between the parties concerning costs associated with the processing of CO2 in QGC supply stream. The order approving the stipulation, allows for the recovery, in the pass-through filings, of 90% of the non-gas costs which QGC incurs, for the processing or management of CO2 in the gas supply, beginning in February 2005. The order also provides for the full recovery of the actual fuel used in the plant up to a limit of 360,000 Dth per year priced at QGC's weighted average cost of gas which is $5.50/Dth in this filing. This is the average price of storage injections as found in the revised Exhibit 1.4, page 2 of 3, Line 5. Annual credits of revenue above $400,000, received from third party processors is also to be shared on a 50/50 basis with customers of QGC. The order also directed that these costs be allocated to the various rate classes based on the same percentages used in the last general rate case (Docket 02-057-02). This filing includes projected gas management costs from February 2006 thru January 2007 of $4,951,000 as detailed in the revised Exhibit 1.6, page 4 of 4. The Division has reviewed the methodology QGC used in calculating and spreading the gas management costs and believes it complies with the Commission order.

Amortization of existing 191 Balance:

The current commodity rate, approved in the October 2005 pass-through filing, included a $0.32/Dth surcharge which was designed to amortize the under collection of $32 million dollars, over the projected twelve month period of that filing. However, because of extreme weather swings in December 2005, the 191 account balance has actually increased. According to information presented by Questar, at its January 2006 monthly update, temperatures in the first part of December 2005 were approximately 15% colder than normal, while temperatures in the latter part of the month were approximately 25%

warmer than normal. Due to the colder than normal weather in the first part of December, QGC was forced to purchase unplanned peaking gas at very high prices. When the weather flipped, QGC experienced a dramatic downward impact on sales volumes. The combination of these events eliminated the company's hope of being able to remove the $0.32/Dth amortization rate early and instead has caused the amortization rate to increase to $0.38/Dth because of a $38 million under collection balance in the commodity portion of the 191 account. ($5.1 million of this $38 million is due to inclusion of CO_2 gas management costs covering the time period from February 2005 thru January 2006 as provided for in the Commission order.)

SUMMARY AND CONCLUSION:

This amended filing represents a projected decrease in natural gas prices and we hope is reflective of the national trend in natural gas pricing. However, the Division recognizes the current volatility in the natural gas market. With this being the case, if the projected prices are higher than anticipated, then QGC will be required to increase prices in the future but if prices continue to decline then further price reductions will follow.

The Division is also painfully aware of the dramatic effect the past increases in natural gas prices has had on customers' household budgets. The Division also recognizes QGC's desire to be as accurate as possible in projecting future prices but also realize that actual results will vary from the projections and that weather patterns during the winter months influences the price of natural gas.

Because of this the Division feels it is important for customers to continue to conserve in their gas consumption. Conservation does play an important role in keeping downward pressure on gas prices.

As always, the Division will continue to monitor the published monthly index prices[1] and compare them to the prices used in this pass-through filing to see if any trend

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

develops which may warrant an out of period filing by QGC to further reduce the commodity gas cost rate.

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