BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION TO INCREASE DISTRIBUTION NON-GAS RATES AND CHARGES AND MAKE TARIFF MODIFICATIONS	Docket No. 07-057-13

DIRECT TESTIMONY OF JOHN J. REED

FOR QUESTAR GAS COMPANY

December 19, 2007

QGC Exhibit 4.0

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is John J. Reed. My business address is 293 Boston Post Road West, Suite 500, Marlborough, Massachusetts 01752.

Q. By whom are you employed and what is your position?

A. I am the Chairman and Chief Executive Officer of Concentric Energy Advisors, Inc. (Concentric).

Q. Please describe your duties and responsibilities in that position.

A. Concentric is an economic advisory and management consulting firm, headquartered in Marlborough, Massachusetts, which provides economic and financial services relating to energy industry transactions, energy market analysis, litigation, and regulatory support.

Q. Please describe your background and professional experience.

A. I have more than 30 years of experience in the energy industry, having served as an executive in energy consulting firms, including the position of Co-Chief Executive Officer of the largest publicly-traded management consulting firm in the U.S., and as Chief Economist for the largest gas utility in the U.S. I have provided expert testimony on a wide variety of economic and financial issues related to the energy and utility industry on numerous occasions before administrative agencies, utility commissions, courts, arbitration panels, and elected bodies across North America. A copy of my Curriculum Vitae is included as QGC Exhibit 4.1. A list of prior proceedings in which I have provided testimony is included as QGC Exhibit 4.2.

Q. Have you previously provided expert testimony?

A. Yes. I have provided expert testimony in dozens of jurisdictions in the United States and Canada.

Q. Are you sponsoring any exhibits in this case?

A. Yes. I am sponsoring QGC Exhibits 4.1 through QGC Exhibits 4.6, which are:

- QGC Exhibit -4.1 – Curriculum Vitae of John J. Reed
- QGC Exhibit -4.2 – Testimony of John J. Reed 1995 – 2007
- QGC Exhibit -4.3 –Situational Assessment – Performance Challenges
- QGC Exhibit -4.4– Individual 2006 Performance Measures
- QGC Exhibit -4.5– Sum of Merit Order Rankings 2002-2006
- QGC Exhibit–4.6–Time Series of Individual Performance Metrics

Q. On whose behalf are you testifying in this proceeding?

A. I have been asked by Questar Gas Company ("Questar Gas" or the "Company") to assess the Company's performance in controlling costs and keeping rates to its customers as reasonable as possible, and to address the regulatory policy issues related to recognizing that performance when setting return on equity ("ROE").

Q. What is the purpose of your testimony?

A. My testimony provides an assessment of Questar Gas' achievements in meeting its obligation to provide reliable gas service to retail customers at a reasonable cost, while maintaining a high level of service to customers. In addition, I evaluate how well the Company has fulfilled state policy objectives for efficient operations and discuss the regulatory policy issues and precedent for setting ROE in light of a utility's performance.

Q. Would you please summarize your approach to assessing the Company's performance?

A. Certainly. Providing reliable integrated retail gas service involves a complex array of infrastructure, commodity supply agreements, general corporate services, customer services and financial resources. Assessing whether a particular company and its management team have successfully achieved both its service

and just and reasonable cost obligations involves an evaluation of its economic efficiency. Economic efficiency can be measured both in terms of current cost diagnostics and trends displayed over time. In addition, one must ascertain whether any cost improvements that may have been achieved were done at a cost of reducing customer service. One final element to consider is a company's responsiveness to regulatory policy objectives in the states in which it operates. I have considered all of these aspects of Questar Gas' performance and, where possible, measured and quantified the associated customer benefit. I have measured the Company's performance relative to industry norms to the extent possible.

Q. How did you go about assessing Questar Gas' achievements in meeting its economic efficiency goals such that they are consistent with regulatory initiatives and policy?

A. I generally relied on two means of determining the Company's success. First, I made an assessment of its overall performance in meeting its utility obligation to provide reliable service at just and reasonable prices by reviewing metrics that reflect both its costs and cost effectiveness in serving its customers. Second, I reviewed the Company's programs established to meet the objectives of its regulators. These objectives include providing low-cost, reliable natural gas service to customers, increasing and inducing conservation and resolving key operational challenges such as infrastructure replacement, back office systems replacement and improving customer service.

One means of measuring the cost effectiveness of the Company's performance is to do so through comparisons to other similar companies through benchmarking. Benchmarking offers a view into utility performance and an analytical framework to measure key indicators that affect overall costs and performance. Benchmarking offers a "top-down" means of assessing performance in lieu of a "bottom-up," granular review of line-item expenses and attempting to second guess economic choices or combinations of choices. The benchmarking results

presented herein are designed to isolate economic efficiency metrics and the trended performance of the Company.

To round out my assessment I have looked beyond the benchmarking measures, and evaluated Questar Gas' actions from the perspective of industry norms and regulatory policy. Taken together the quantitative benchmarking and the qualitative assessment of performance inform my assessment of the Company and its performance. Finally, I consider the means of recognizing superior performance within the regulated utility construct, in particular as it relates to setting Questar Gas' allowed ROE.

The balance of my testimony is organized in the following sections:

II. Executive Summary
III. Benchmarking Process
IV. Benchmarking Results – Questar Gas' Performance
V. Corporate Performance
VI. Regulatory Construct and Policy Review
VII. Conclusion

II. EXECUTIVE SUMMARY

Q. Would you please summarize the key elements of your testimony?

A. Certainly. My review of Questar Gas' performance has demonstrated that the Company has out-performed similarly sized companies across an array of financial metrics. It has achieved this result in spite of the fact that it is not particularly advantaged by the exogenous factors that are known to have an impact on efficiency. Questar Gas does not enjoy temperate weather, its customers are not located in densely populated areas, its system is aging and its credit rating, while strong, is mid-tier compared to other similarly sized companies. The Company's commitment to providing efficient operations and strong financial performance has resulted in significant customer benefits. In 2006 alone, Questar Gas provided customer benefits in excess of $300 million when

compared to the average costs for those same services provided by the comparables group.

Within the context of setting the Company's ROE, it is appropriate to consider its financial efficiency, customer service and the level of customer benefits resulting from that performance. The customer benefits from Questar Gas' superior performance are clear and substantial. The value differential at issue within the reasonable range of cost of equity estimate is relatively small compared to the customer benefits produced by Questar Gas' superior performance. It is consistent with both cost-based regulation and the long-standing latitude of regulators to recognize low-cost efficient service in setting an appropriate return. Based on my benchmarking results, I urge the Commission to authorize an ROE at the top end of the reasonable range of ROE presented by Mr. Hevert.

III. BENCHMARKING PROCESS

Q. How did you determine the process for evaluating Questar Gas' economic efficiency?

A. As mentioned above, the complexities of the issues and options involved in cost-effectively and reliably serving customers make a line-by-line cost assessment unwieldy. Benchmarking against similar companies in the industry enables one to assess more easily whether Questar Gas has been more or less effective than other utilities in controlling similar costs when faced with similar challenges.

Q. What was your objective in developing the financial metrics that you assessed?

A. I focused on three key questions that I wanted the benchmarking data to answer. Specifically, 1) How do the prices that Questar Gas' customers pay compare to those paid by similarly situated customers? 2) Is Questar Gas effective at managing controllable costs? and 3) Are there other factors that explain Questar Gas' cost performance relative to its peers? Accordingly, the data measures the pure level of rates and assess various economic efficiency measures. Where

possible, I have quantified the benefit to customers of Questar Gas' superior performance. In addition, outside of these traditional economic benchmarks, I have confirmed that Questar Gas continues to maintain its strong record of customer satisfaction and customer service levels to ensure that efficiency improvements are not gained by sacrificing service.

Q. How did you select the companies to include in your benchmarking study?

A. My objective in determining the sample set of natural gas distribution companies was to achieve the largest group for which consistent data were available and which were, broadly speaking, operationally similar to Questar Gas. I refer to this group as the "comparables group." For purposes of assessing management performance, it was important to select companies with opportunities for operational and economic efficiency that are comparable to Questar Gas'. Accordingly, we screened out of the available data set companies with a number of customers that was more than +/- 35% of Questar Gas in 2006 and which have a credit/debt rating within three notches of Questar Gas.

This screen provided us with 19 other companies to use as comparative benchmarks.

Q. Is the comparables group you rely on similar to the proxy group used by Mr. Hevert?

A. The two groups differ in so far as the focus and demands of our respective analyses differ. Mr. Hevert's group necessarily requires publically traded companies, whereas my focus is on similarly sized local distribution companies, for operational comparison, many of which are part of a larger integrated utility holding company, and do not have publically traded stock on their own.

Q. What are the implications of your analysis including companies outside of the peer group relied on by Mr. Hevert?

A. It does not affect the relevance of my results as compared to his. We each developed the largest set of data inputs for the attributes we needed to measure.

Simply put, his group is appropriate for cost of capital and mine is appropriate for cost benchmarking.

Q. Why did you focus on number of customers and relative credit/debt rating as the key measures for refining your comparables group?

A. The purpose of this benchmarking analysis is to develop a meaningful comparison of the Company's costs and economic metrics that are indicative of utility performance. Many of the challenges and opportunities for a company are a function of its size. The efficiencies and economies of scale available to one company are simply not the same as those of a company that is either one half its size or one that is twice its size. Since my focus is on *controllable* economic efficiencies, relative size is an important attribute. The second screening mechanism I applied was debt/credit rating; the comparables group includes all the companies for which data were available that were within three notches of Questar Gas' A- rating. As with size, this criterion helps develop a group that is viewed by the market as similar to Questar Gas. Companies with extremely poor credit ratings typically face pressures on capital availability that limit their opportunities for operational improvement, while companies with significantly higher debt ratings have a cost of debt advantage that enables them to have more competitive rates.

Q. What period of time did you analyze for trending improvements and other changes?

A. While I have relied heavily on 2006 data (the most recent year available), for those measures that look at changes in performance over time I present a five year review which encompasses 2002 through 2006, inclusive. There have been significant changes in the gas market over the past five years in terms of local distribution company (LDC) and pipeline mergers, commodity price escalation and the recovery from the market collapse in the wake of Enron's insolvency. Because of these anomalies, I do not consider additional history to be helpful in assessing company performance.

Q. What data sources did you rely on for the benchmarks you are presenting?

A. There was no single source that provided data for a consistent and sufficient group of companies. Concentric compiled data from various sources, including Securities and Exchange Commission filings, as well as LDC data filed with state regulatory Commissions (as reported by SNL Financial).[1] These data were then supplemented with additional metrics using reports from the U.S. Department of Transportation, the National Oceanic and Atmospheric Administration ("NOAA") and financial ratings information sourced from Moody's and Standard & Poor's. For data that are sourced from balance sheet entries, and hence reflect year-end values, I used an average value from the preceding year end and current year end to more closely estimate an annual value.

Q. Please describe the process you used to develop these benchmarks.

A. I developed merit order benchmarking results for both operational and economic performance of the companies in the comparables group. These generally measure the level of cost input per unit of "output," such as customer service expense per customer, or O&M expense per dekatherm (Dth). These cost diagnostics are presented individually by rank or merit order, with the lowest cost per unit of output being ranked number 1. In order to develop an "overall" assessment based on rank order, I took an average of all the rank order values and developed a merit order based on those averages. This approach shows Questar Gas' relative overall merit order. In addition, I conducted a simple "situational assessment" which used that same method to rank the level of challenges to performance that different companies face in order to put the benchmarking results in context.

Q. How did you select the specific corporate performance metrics for merit order benchmarking that are presented in your testimony?

A. The merit order metrics are designed to provide a meaningful view of economic efficiency in terms of corporate efficiency, both in terms of costs per customer

[1] www.snl.com

and cost per Dth of gas. These values offer insight into each company's performance. The specific benchmarks presented include:

- System Average Sales rate;
- Average Residential Sales rate;
- Operating and Maintenance expenses, including subcategories such as administrative and general, salaries and wages; and
- Capital Efficiency metrics, such as net plant per mile of main, capital expenditures per new customer and customers per employee.

Each of these categories of data offers an insight into the Company's relative efficiency.

Q. Does the performance merit order ranking give a complete understanding of how companies compare to each other?

A. No, almost no single benchmarking mechanism does. Even putting aside unique internal corporate drivers for performance there are a number of other factors that affect a company's costs and relative performance metrics.

Q. How did you approach looking at factors other than economic performance?

A. In a few ways. First, to gain insight into the relative challenges and opportunities different companies faced, I assessed the relative severity of various exogenous factors. This "situational assessment" provides a company's absolute value on an individual metric as well as its rank order in the comparables group. As an example, customer density (the number of customers per mile of main) is likely to affect operations and maintenance expense per customer. A system with widely dispersed customers understandably requires more miles of main to serve each customer and hence would be expected to have a higher cost associated with that increased infrastructure per customer. Similarly companies experiencing significant growth or loss of load, or more severe weather conditions might also be expected to have benchmarking results which are less favorable. The

situational assessment evaluates these types of challenges to economic performance and ranks the comparable companies on each metric.

In addition to developing the situational assessment, I interviewed Questar Gas' staff and reviewed the Company's customer service survey results to ensure that service levels have been maintained and that any improvements in costs were not achieved by reducing service. I note, however, that I was not able to make this same observation for the other companies in the comparables group and those companies are simply assumed to have maintained their historic customer service levels.

IV. BENCHMARKING RESULTS – QUESTAR GAS' PERFORMANCE

SITUATIONAL ASSESSMENT – PERFORMANCE CHALLENGES

Q. Before presenting the economic benchmarking results, would you describe the results of the situational assessment?

A. Yes. The results of this assessment are provided in QGC Exhibit 4.3; Page 2 of that exhibit shows the rank order of each of the companies for each metric, as well as an overall score in the far right column based on the average rank. These metrics generally provide insight regarding the operational challenges that the various companies face that could be expected to adversely affect cost. In this situational assessment a ranking of 1 indicates the company with the highest level of challenge related to economic efficiency for a particular measure.

Q. Would you please identify the exogenous factors you assessed and describe how each affects a distribution company's ability to keep costs low?

A. I looked at seven different factors that create challenges to operational and corporate performance. The following is a summary of each of them:

- Heating Degree Days ("HDD"), which measures the variance from 65ºF in ambient temperature for a distribution company, is an indicator of the weather-related challenges a company may face. This has a particular impact on load factor and peaking supply needs. Companies with higher

HDD values are more challenged than others. The HDD values presented for all companies other than Questar Gas, are load-weighted estimates based on state-wide HDD NOAA data for the states in which the LDCs operate. For Questar Gas, its actual HDD value for 2006 is used. This is based on NOAA data for the specific weather stations closest to Questar Gas' load centers.[2] In this category, Wisconsin Gas LLC ranks 1st, with an HDD value of 6,861, whereas Questar Gas ranks 5th out of the 20 comparable companies.

- Customer Growth from 2005 to 2006 reflects the change in the total number of customers on each company's system. While growth is generally positive, a high level of change in the number of customers (either positive or negative) presents challenges for managing system infrastructure as well as commodity contracting. The ranks in QGC Exhibit 4.3 are based on the absolute value of the level of change. In this category Puget Sound Energy ranks 1st, having experienced 4.4% growth. Questar Gas' is 2nd with 4.05% growth in that same period. I note that Questar's growth has been relatively constant throughout the study period and in the 2002 through 2006 period the Company has had 13.6% total growth in customers.

- Accumulated provision for depreciation as a percentage of gross plant gives a general sense of system age. These data were not reported for all companies in the comparables group. Questar Gas was in the middle of the pack. It ranked 7th out of 16 and was one of five companies that were within one percentage point of each other. Higher proportionate depreciation, or older systems, are viewed as more challenged.

- Commercial and Industrial ("C&I") throughput as a percentage of total throughput indicates the risk of loss that a company faces if a large

[2] http://www.cpc.ncep.noaa.gov/products/analysis_monitoring/cdus/degree_days/

percentage of its customers are of sufficient size that they may leave or bypass the system. In this case, Questar Gas' relatively modest level of C&I load is an advantage. The Company is ranked 16th with 54% of its throughput to C&I customers. I note that there are three other companies within 3% of Questar Gas.

- Customer density, measured in terms of number of customers per mile of main, can also be a means of assessing economic challenges to a system. Less dense systems require more infrastructure per customer and, as such, can be more expensive to operate. That being said, I acknowledge very dense urban systems may also face operational issues, but in general a higher level of density is viewed as an advantage. Questar Gas is in the upper half of the comparables group, ranking 7th out of 20, which indicates a relatively less dense system and a relatively greater cost challenge.

- Change in residential sales use per customer over the study period 2002-2006 shows the declining use challenges that the comparables group face. These data were only available for 15 of the companies in the comparables group. Questar Gas ranked 1st, having experienced a 32% decline in residential use per customer on average. The second ranked company experienced a 23% decline and Consolidated Edison, which ranked as least challenged, has actually seen an increase in use per customer over that same period.

- Credit rating is also included as a means of capturing access to capital for various companies. Concentric used the ratings for corporate bonds from Standard and Poor's for the distribution companies in the comparables group to measure credit rating at the operating company level. Since multiple companies can have the same rating, the rankings have duplicate stepped values. Questar Gas ranks 9th on this metric, indicating that eight companies are more challenged, e.g. have a lower bond rating, than

Questar Gas. There are six companies in the comparables group that have superior bond ratings and Questar is one of six companies that hold an A-rating. While Questar Gas enjoys strong credit, it is not particularly advantaged relative to the comparables group, and in fact less than half of the comparables group have more challenging credit issues.

Q. How would you summarize the situational assessment?

A. First, it is important to keep this assessment in context. I offer these metrics as a means of "getting the lay of the land" in understanding the financial performance metrics. This is not a perfect means of capturing all the challenges or advantages of the companies in the comparables group. For example, San Diego Gas and Electric has a similar number of customers to Questar Gas and passed the credit screen. It is, however, part of Sempra, which through its various affiliates including, Southern California Gas, serves over 4 million distribution customers. While only a high-level snapshot, these data indicate that Questar Gas is one of the three most "challenged" companies within the comparables group, as shown on QGC Exhibit 4.3, Page 2 of 2. Questar Gas' weather intensity, customer growth, system age, and population density all contribute to this conclusion and suggest that it may have a valid reason for having some cost metrics that are more expensive than its peers.

FINANCIAL BENCHMARKING RESULTS

Q. What is your assessment of Questar Gas relative to its peers?

A. Questar Gas is a top performer among the comparables group. Across almost all economic performance-based metrics Questar Gas is in the most efficient half of the comparables group, and, in most, the Company ranks in the top quartile. While Questar Gas ranks in the first spot only in a couple of instances, the combined effect of being a top performer across so many variables results in Questar Gas ranking first, on an aggregate basis, among these 20 companies in 2006. (See QGC Exhibit 4.5, Page 1.) The fact that Questar Gas faces greater

operational challenges than most of these other companies heightens this achievement.

The financial and operating performance benchmark metrics for 2006 are presented individually in QGC Exhibit 4.4. This exhibit provides the value for that metric for each company in the comparables group, shows the merit order rank (ranking 1 is the best result) and depicts those results in a chart. Also presented, and depicted in QGC Exhibit 4.5, is Questar Gas' performance on each metric during the study period of 2002-2006. In each of the time series charts in QGC Exhibit 4.6, Questar Gas' specific performance is plotted against the mean value for the balance of the comparables group.

Q. How would you summarize Questar Gas' performance on the financial and operating metrics?

A. The following table, shows the summarized results of the merit order rankings for each metric presented in QGC Exhibit 4.4. The table is organized with 12 financial efficiency metrics listed first, and eight (8) operational metrics listed on the lower portion of the table. Questar Gas is a top quartile performer in 12 of the 20 metrics; eight (8) out of 12 of those are financial and four (4) of eight (8) reflect operations. Questar Gas is in the top half of the comparables group on all metrics.

Table 1

	2006 Performance Metrics	Questar Rank	Quartile	No. of Companies
Financial	System Average Rate	4	1st	20
	Residential Average Rate	1	1st	19
	Purchased Gas Cost / Dth	2	1st	18
	Gross Margin / Dth	4	1st	18
	Distribution O&M / Customer	8	2nd	20
	Distribution O&M / Dth	7	2nd	20
	A&G Expense / Customer	4	1st	20
	A&G Expense / Dth	6	2nd	20
	Customer Expense* / Customer	2	1st	20
	Customer Expense* / Dth	4	1st	20
	Net Income / Customer	5	1st	20
	Net Income / Dth	7	2nd	20
Operating	Uncollectible Accounts Expense / Customer	7	2nd	18
	Uncollectible Accounts Expense / Dth	7	2nd	20
	Salaries, Wages, Pensions, and Benefits / Employee	3	1st	14
	Customers / Employee	7	2nd	17
	Employee / Mile of Main	4	1st	17
	Capital Expenditure / New Customer	1	1st	12
	Net Plant / Mile of Main	6	2nd	16
	Distribution O&M / Mile of Main	5	1st	20

Note: Customer Expense includes Sales, Customer Accounts and Customer Service Expenses

Q. Are there specific results you would like to highlight?

A. Yes. While all of the measures are important in terms of assessing company performance, at the end of the day the focus is often on the end result, generally considered to be reflected in price per unit of service. In this case, the results of the Company's efforts are clear in both the system average rate and the average residential rate. Virtually every other measure of performance in this benchmarking study helps to identify particular areas of strength which explain how the Company is able to achieve its strong results. It is notable that Questar Gas ranks in first place on residential average rate, and the next closest company in the comparable group has an average residential rate that was $1.38/Dth higher than Questar Gas in 2006. This is a significant achievement.

Q. Have you developed an overall assessment of the financial and operational performance benchmarks?

A. I have. Exhibit 4.5 summarizes the merit order rankings for each year from 2002 to 2006. As with the situational assessment, these tables reflect the ranking for each company by individual performance metric. In addition, in the right hand columns, these tables provide for each company an average of the ranks it achieved across the various metrics and a merit order rank of those averages across all of the companies.[3] For example, QGC Exhibit 4.5, Page 5 indicates that Questar Gas' average rank across all metrics in 2002 was 4.5 and on that basis it was third in overall merit order in the comparables group. QGC Exhibit 4.5, Page 1 indicates that for 2006, Questar Gas' average score across all metrics was 4.7, and it ranks first in overall merit order among the comparables group in 2006.

Q. Which metrics provide the best indication of Questar Gas' overall economic performance relative to the comparables group?

A. The Company's overall performance is reflected in the low rates it charges its customers, its low purchased gas costs, and its low gross margin per Dth.

- Questar Gas' system average sales rate in 2006 was $9.55/Dth, which ranks 4th in the comparables group. (QGC Exhibit 4.4, Page 1)
- Looking at 2006 residential average sales rates (QGC Exhibit 4.4, Page 2), Questar Gas ranks 1st by a margin of $1.38/Dth.
- For purchased gas costs (QGC Exhibit 4.4, Page 3), the Company ranks 2nd, with San Diego Gas and Electric, an affiliate of Sempra Energy, coming in 1st. Questar Gas' purchased gas cost is $0.62/Dth lower then Texas Gas Service which ranks 3rd. This metric for Questar Gas includes both purchases from third parties as well as the Company-owned production it has available under its contract with Wexpro Company, an exploration and development affiliate of Questar Gas.
- Gross margin (QGC Exhibit 4.4, Page 4), measured as the system average rate net of purchased gas cost, is also an indicator of the relatively low unit

[3] An average of the various ranks is used, rather than a sum, to accommodate the fact that some companies do not have an individual metric available in particular years.

costs at which Questar Gas serves its customers. Questar Gas ranks 4th in this metric.

Q. Have you looked at how significantly the Wexpro contract affected Questar Gas' overall performance?

A. I have. In an effort to isolate and remove its influence on the results of the benchmarking, I reviewed overall the merit order rankings excluding those values that are influenced by Wexpro. Specifically, I excluded:

- System Average Rate,
- Residential Average Rate,
- Purchased Gas Cost, and
- Gross Margin.

With the effect of those metrics excluded from all companies, Questar Gas' average rank is 5.2, and it still ranks first in the comparables group across all the remaining categories. This indicates that the beneficial impact of Wexpro, while material, is not a defining element of Questar Gas' benchmarking results. Rather the Company's competitive position is the result of broad operational and financial efficiencies.

Q. Is Questar Gas' number 1 ranking with and without consideration of Wexpro's benefits the product of any single achievement by Questar Gas?

A. No. Questar Gas' No. 1 position stems from strong performance in nearly all of the areas I have studied. Questar Gas is a top performer in several categories of controllable expense, including customer expenses, uncollectible expenses, and distribution O&M costs, and displays significant efficiency in staffing levels, employee compensation, and the cost of new customer connections. Questar Gas' average rank for 2006 is far ahead of the second and third best performers, and has shown sustained improvement since Questar Gas' last rate case in 2002.

As discussed earlier, Questar Gas' performance is especially impressive when viewed in light of the situational assessment, which showed that it faces some of

the most challenging market conditions of any of the companies in the comparables group.

Q. Are there other specific metrics that warrant particular attention and discussion?

A. Yes, some of the data elements underlying various metrics appeared to have anomalies. For example, distribution operations and distributions maintenance expenses when looked at separately, clearly indicated differences in the practices of companies in reporting these data. Accordingly, these metrics are presented on a combined basis. The same situation exists with regard to how companies classify customer service, customer accounting and sales expenses. We have also combined these expenses into one metric. Finally, it should be noted that some metrics have incomplete data, which reduces our number of valid observations. However, these anomalies affect all of the companies in the group, and do not provide any advantage for Questar Gas.

Q. Do the combined results of the merit order ranking and the situational assessment provide a complete profile of how the comparable companies "stack-up" to each other?

A. Not fully. In addition to these benchmarking results, there are some customer benefits that may not be reflected in the benchmarking results.

Q. Please describe the economic benefits which you feel were not captured or quantified in the benchmarking results.

A. One such example is associated with the gas supply agreement Questar Gas has with its exploration and development affiliate, Wexpro Company.

This significant supply resource dampens the price volatility for ratepayers because it is priced at cost, instead of the market price, and the level of deliveries is flexible so that it can be exercised more fully when market prices are high. While some measure of its value is reflected in benchmarked commodity prices, the option value of the contract and the value of reduced volatility are not. It is

extremely rare in the current market for customers to have cost-based gas supplies available and the option value cannot be readily determined or benchmarked, but it is worth noting.

Q. Have you quantified the financial benefit to Questar Gas' customers of its low-cost supply resources?

A. Yes. I have looked at customer benefits from commodity costs in a couple of ways. First, I note that the Company's customers have saved approximately $1.5 billion as a result of its Wexpro contract since its inception, as noted by Mr. Allred. The table in QGC Exhibit 4.4, Page 3 depicts Questar Gas' overall purchase gas cost with that of the comparables group. These values reflect the purchased gas costs for all LDC's in the comparables group, and for Questar Gas it also includes the gas costs and associated royalties for Wexpro. In 2006 alone, Questar Gas' gas costs averaged $6.58/Dth, compared to an average price of $8.44/Dth for the balance of the comparables group. On that basis Questar Gas customers "saved" $1.86/Dth or $200 million compared to the average gas cost of the comparables group.[4]

Q. Did you consider whether Questar Gas' relative advantage could be a function of its geographic location?

A. I did. While the data available were limited, the following table depicts Questar Gas' average cost of gas in 2006 as compared to a few regionally proximate local distribution companies.

[4] The mean purchased gas cost for the comparables group in 2005 was $8.61/Dth compared to $5.96/Dth for Questar Gas. The product of the cost difference and Questar Gas' purchased gas volume of 106,015,755 Dth is $280.9 million.

Table 2

Company	2006 Purchased Gas Cost ($/Dth)
Intermountain Gas Company	$9.14
MDU Resources Group, Inc.	$7.09
Public Service Company of Colorado	$6.61
Questar Gas Company	**$6.58**
Southwest Gas Corporation	$9.14
Wyoming Gas Company	$11.10

These data indicate that Questar Gas' cost per Dth of gas was at the low end of the group and also that the range of prices paid by this group of companies is similar to the range paid by the comparables group in that same period. I do not believe that Questar Gas' relative competitiveness with the comparables group on purchased gas costs is simply the result of its geographic location.

Q. Are there other examples of quantifiable benefits resulting from Questar Gas' superior performance?

A. Yes. In general one can consider the degree to which Questar Gas charges less than the average of its comparables group to be a reflection of the value to those customers of the Company's superior performance. Since there can be variations in the way elements of O&M and A&G are calculated, for purposes of illustrating the quantifiable benefits I have simply relied on these broad categories of expense on a per dekatherm basis.

Table 3[5]

2006 Operating Expenses per Dekatherm of Throughput			
	Average of Comps Group	**Questar Gas Company**	**Savings Based on Questar Volume (millions)**
Distribution O&M	$ 0.36 / Dth	$ 0.32 / Dth	$5.0
Administrative and General	$ 0.48 / Dth	$ 0.29 / Dth	$26.6
Sales, Cust. Accts, Cust. Service	$ 0.31 / Dth	$ 0.21 / Dth	$14.3
Total	$ 1.15 / Dth	$ 0.82 / Dth	$45.9

[5] These values are from the Distribution Expenses portion of the various LDCs' filings. A&G is not included as part of O&M in those filings.

This $45.9 million represents a portion of the savings to customers in 2006 compared to average performance among similarly sized LDC's.

Q. Is there any way of calculating the overall savings to customers of Questar Gas' superior performance across the various economic metrics?

A. On a macro level, yes. Ultimately, the all-in effect of Questar Gas' various efficiencies is reflected across the board in its system average sales cost per Dth. As indicated in QGC Exhibit 4.4, Page 1 for 2006 Questar Gas system average sales rate was $9.55/Dth compared with a mean value for the comparables group of $12.36/Dth. The product of that price differential and the total sales volume for Questar Gas, yields a "savings" to Questar Gas customers compared to the comparables group of approximately $301 million[6] in 2006 alone.

Q. Are there any sensitivities associated with the benchmarking analysis you wish to point out?

A. There are some points which the Public Service Commission of Utah (Commission) should be aware of in judging these results. In looking at economic efficiencies it is easy to assume that the companies represented in the data set are all equivalent in terms of safety, customer satisfaction and other important operational standards, but that is not always the case. It is important to note that Questar Gas has achieved this top economic performance without sacrificing, and in fact while improving reliability and customer satisfaction. Productivity metrics assume a constant level of service quality is achieved. If service levels are improving they may well have appropriate attendant costs associated with those improvements but the data illustrates only the cost impact not the off-setting service improvement.

I have provided, in QGC Exhibit 4.6 a series of graphs depicting Questar Gas' performance for the study period on each of the metrics as compared with the

[6] The commodity savings of $199 million and operating expense savings of $45.9 million do not capture all operating savings for the Company's customers. For example, savings from lower levels of depreciation, rate base and taxes are not captured in the individual cost categories.

comparables group. Generally these depict a trend of improving performance for Questar Gas relative to the rest of the group.

V. CORPORATE PERFORMANCE

Q. Why are you looking beyond the metrics presented in your benchmarking study?

A. Quite simply because low cost is not the only, or even perhaps most important, objective of utility service. Critically important aspects of utility performance are not ascertainable when reviewed with the type of benchmarking provided above. Generally these other measures fall into two categories: public benefits and responsiveness to policy objectives. In terms of public benefits, key performance indicators include safety and customer satisfaction as reflected in Utah Code 54-3-1 where it calls for utility service to "promote safety, health, comfort and convenience" of its customers. In addition, resource stewardship is called for in that same statute insofar as it includes "reducing periodic demands" and "encouraging conservation of resources and energy."

Q. What evidence have you seen, outside of the benchmarked results, to indicate Questar Gas is meeting these goals?

A. There are a number of indicators of on-going commitment to meeting the array of responsibilities placed on Questar Gas. As the benchmarking results show, the Company is a top-performer in terms of economic value and efficiency and has been improving its performance over the past five years. This has been achieved through attention to operational improvement, while maintaining customer service and implementing various efficiency programs.

Q. What specific operational improvement programs has the Company undertaken?

A. The following is a summary of recent operational improvement programs that Questar Gas has undertaken that reflect its focus and commitment to service and meeting customer needs:

- Operations Classifications: Beginning in 2002, Questar Gas combined the areas of construction and technical service. This effort enabled Questar Gas employees to perform multiple tasks during peak times. This program has resulted in improved ability to meet the peak demands of the construction and technical service areas, while maintaining a favorable customer/employee ratio.

- Ask-A-Tech: This on-going program allows customers to contact a service technician who can assist them over the phone with minor natural gas issues. This reduces the number of service calls, minimizes waiting time for customers, and reduces costs. This service is one of the highest rated services from customers.

- Meter Turn-Ons: Rolled-out in 2002, this Questar Gas program offers its customers the option of contracting with an HVAC contractor or turning on their appliances themselves. Customers can then, at their convenience, turn the gas on to their home.

- Automated Meter Reading: Completed in 2006, Questar Gas successfully implemented an automated meter reading system that has significantly reduced the use of estimated bills, the number of billing and meter reading employees, and increased safety and customer satisfaction.

- Customer Account Issue Management: Over the past several years, Questar Gas has implemented a series of programs to improve management of customer account and billing issues. These programs include, 1) outsourced credit card payments that result in a reduction of needed staff and increased customer satisfaction by allowing a more flexible bill paying option; 2) interactive voice response system that allows for a self-help call-in system for customers with account questions and has resulted in reduced call volume and improved

customer satisfaction; 3) automated collection process that automatically notifies customers of payment delinquencies, resulting in time savings for Questar Gas staff and improved response rates from delinquent customers; and 4) improved collection procedures, using an incentive-based collection system that has reduced the number of write-offs of unpaid bills.

While it is difficult to specify the benefits of each of these programs, the overall cost effectiveness of the Company and its customer satisfaction ratings reflect the value of Questar Gas' efforts.

Q. What specific conservation and energy efficiency programs has the Company undertaken?

A. Subsequent to the approval of the Conservation Enabling Tariff (CET), the Company launched and implemented a comprehensive and cost effective energy efficiency initiative, including: a suite of rebate programs targeting residential and commercial GS customers, a detailed residential home energy audit program, increased funding for low-income weatherization and a multi-media market transformation campaign directed at changing customer and market behavior through energy efficiency and conservation education and awareness. This initiative has seen tremendous success since its launch in March 2007. Based on just the customer participation to date alone, the cost effective long-term natural gas savings attributed to these efforts will be substantial. From every perspective, the Company's efforts to date have exceeded expectations. Moreover, the Company is continuing to expand its efforts with the recently approved 2008 demand side management (DSM) budget that includes a projected annual increase in natural gas savings of 55% over 2007 levels. During the 2002-2006 study period, Questar Gas' use per residential customer has declined by 32%, almost twice as much as the 12.4% experienced by the rest of the comparables group. Questar Gas' energy efficiency programs have the potential to drive further reductions in usage-per-customer.

VI. REGULATORY CONSTRUCT AND POLICY REVIEW

Q. What options does the Utah Public Service Commission have for recognizing superior utility performance?

A. Rate regulation generally does not allow a regulated utility to recover more than its costs, including a reasonable return. Therefore, where utility performance has been highly successful in keeping costs low, it is generally not considered appropriate to set rates that include recovery of any more than the actual costs. However, it is widely recognized that regulators have significant latitude in establishing the appropriate level of return to be included in rates. As discussed later in this testimony, the allowed level of return often reflects the regulator's judgment on how efficient and effective the utility has been in producing customer benefits and meeting regulatory objectives. This is appropriate and should be the means by which the Commission addresses the performance of Questar Gas.

Q. Is it consistent with the public interest to authorize an ROE that is at the upper portion of the range of a "reasonable" rate of return?

A. Yes. First, a reasonable rate of return is almost never a single number or mathematically precise result. It is best thought of as being a range of reasonable values, with many judgmental elements that go into determining the final value to be incorporated into rates. The public interest is achieved as long as the allowed rate does not either, 1) put the allowable rate of return outside of a reasonable range, or 2) increase or decrease the total revenue requirement by more than the cost consequences of the utility's actions.

Q. Have you considered the regulatory policy implications of this Commission reflecting Questar Gas' management performance in the return on equity it establishes?

A. Yes. I believe there are a number of bases on which to establish such a finding, which include historic precedent, consistency with current policy and consistency with the public interest.

Q. What precedent did you discover?

A. The judicial underpinnings of such an adjustment extend back at least to 1923 in the Supreme Court's decision in Bluefield Water Works (262 U.S. 679). Many public utility commission orders reference that case in the context of setting rates of return giving due consideration to a company's efficiency. In a number of cases from the late 1970's to the mid – 1990's, commissions reviewed utility efficiency and either explicitly or implicitly reflected that in setting an allowed rate of return.

Q. Did you find similar cases in other jurisdictions?

A. Yes, I did. These included Iowa, New Mexico, Rhode Island and Utah.

Q. Please describe the regulatory context of the Iowa precedent.

A. The specific order I reviewed was from 1992, deciding a MidWest Gas rate case. In that case, the board explicitly awarded the company 50 basis points in its allowed return on equity in recognition of superior management efficiency and benefit to ratepayers. The board noted in its order the Iowa statutory provision (Iowa Code §476.52 (1991)), which allows the board if it "determines in the course of a proceeding … that a utility is operating in such an extraordinarily efficient manner that tangible financial benefits result to the ratepayer, the board may increase the level of profit or adjust the revenue requirement for the utility."

The order goes on to note some of the factors the board considers when making adjustments to a utility's return of equity.

In its final determination, the board did adjust the Midwest Gas ROE:

> Board adjusts the cost of common equity upward by 50 basis points, finding that consistently superior service, beneficial corporate restructuring, and investment in a pipeline interconnection stemmed from extraordinary management efficiency and resulted in tangible financial benefit to ratepayers.[7]

[7] Iowa Utilities Board, May 15, 1992. Re Midwest Gas, a Division of Iowa Public Service Company, Docket No. RPU-91-5.

Q. Please describe the New Mexico cases you mentioned.

A. In the context of a general rate case, the New Mexico Public Service Commission, in 1978, awarded Southwestern Public Service Company "an extra" 50 basis points in setting its ROE in part as a means of recognizing "the efficiency and prudence" of company actions while keeping its costs competitive. The order stated:

> The Commission believes that regulatory incentives should be provided for efficient management. Such incentives need not always be punitive. In an instance where a utility management's activities have resulted in the development of farsighted utility planning at minimal costs to the ratepayers, positive incentives are warranted and will ultimately accrue to the benefit of the ratepayer.[8]

Q. What was the context for the Rhode Island decision that you reviewed?

A. In the case of Rhode Island, that Commission, as part of a general rate case for Narragansett Electric Company, took note of corporate performance in setting ROE. The Commission noted, "In establishing a reasonable return from within a range, the commission has in the past given consideration to the service record of the company and the general attitude of management in meeting its public service obligations." [9] On that basis, the Commission set the ROE at the higher end of the reasonable range.

> In recognition of the company's performance the Commission finds the fair rate of return to be 13.75 which is the upper end of the range proposed …[10]

Q. Did you find any similar cases in Utah?

A. My research turned up two particular cases in which the Utah Commission noted that various elements of utility performance warranted recognition in setting the ROE for a company. Specifically, a 1990 order, in a Utah Power and Light general rate case, the Utah Commission noted:

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[8] New Mexico Public Service Commission, December 5, 1978. Re Southwestern Public Service Company, Case No. 1435.

[9] Rhode Island Public Utilities Commission, November 8, 1980. Re Narragansett Electric Company, Docket No. 1499.

[10] IBID.

> We recognize that management performance is an appropriate factor for the Commission to consider in setting the return on equity within a reasonable range"[11]

Later, in a 1995 case for Mountain Fuel Supply Company, the Commission echoed that perspective:

> The Commission agrees that the Company's gas procurement performance merits recognition and is a factor contributing to the stipulated return-on-rate base.[12]

Q. In a number of these cases commissions provided a defined award of incremental basis points to reflect specific actions. Are you suggesting a similar approach?

A. No. It is difficult to ascribe a specific basis point value to particular company actions. However the benchmarking analysis demonstrates that in many areas of controllable expenses Questar Gas is a top performer. This improvement in performance over time is depicted in QGC Exhibit 4.6, Pages 1 through 10. A historical review shows those metrics have improved in recent years and my discussions with the Company confirm that that improvement is the result of specific actions by Questar Gas, some of which are listed above.

Q. Are there more recent examples of regulators recognizing management performance?

A. Yes. At both the state and federal level, regulators offer various mechanisms to financially reward utilities for meeting various performance, efficiency and policy objectives. These include the FERC's incentive return on equity to entice critical electric transmission investment, and numerous state level programs.

Q. Do these programs offer only upward adjustments to return on equity?

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[11] Public Service Commission of Utah, Februrary 9, 1990. Re Utah Power and Light Company, Docket No. 89-035-10.

[12] Public Service Commission of Utah, October 17, 1995. Re Mountain Fuel Supply Company, Docket No. 95-057-02.

A. No. While some programs, such as the FERC transmission adder, are simply that, an adder, at the state level many commissions have adopted symmetrical mechanisms to provide a financial incentive to companies to meet specific targets.

Q. How do those programs compare with Questar Gas' request in this proceeding?

A. Generally, they are more complex. The Company has not proposed an incentive ratemaking process, such as a revenue-sharing mechanism, but rather it is merely requesting that its past strong economic efficiency performance and strong customer satisfaction indices be recognized by the Commission in setting a ROE at the top end of the reasonable range defined by the proxy group.

Q. Do you consider it to be the job of a utility to provide efficient and cost effective service while maintaining customer satisfaction and providing reliable service?

A. Yes, that is part of each utility's public service obligation.

Q. Why then should any regulated utility company receive "recognition" for meeting its public service obligation?

A. Just as there are a range of acceptable values to set ROE for a particular company, there is a range of acceptable utility performance. As long as a utility operates within that range of reasonable results, it has discharged its public service obligation. Utility commissions have the latitude to recognize and reward better than average performance, although such rewards should not exceed the value of this performance to customers. In particular, in this instance the benefits to customers, measured in the hundreds of millions of dollars, far exceed the cost impact of setting the allowed return on equity at the high end of the reasonable range. While I am not suggesting any particular incremental adjustment to ROE, the following table indicates the annual cost to customers of various increments in ROE, assuming a rate base of $616 million and an equity ratio of 52.3%.

765 **Table 4**

ROE Increment	Annual Cost (millions)
15 basis points	$0.78
25 basis points	$1.30
50 basis points	$2.60
60 basis points	$3.12

766

767 Clearly the economic effect of establishing an authorized ROE at the higher end
768 of the range is a mere fraction of the benefits that customers enjoy as a result of
769 Questar Gas' success in achieving economic efficiency.

770 It is the challenge of each regulator to find the right balance between customers'
771 needs for reliable service at just and reasonable rates and the financial needs of
772 the utilities that provide that service. One element of that challenge is
773 appropriately considering a utility's performance, the benefits that performance
774 provides to customers and recognizing the value of that superior service.

775 **Q. Does it skew the balance between customers and investors to reward strong**
776 **performance?**
777 A. Absolutely not, particularly when the "reward" is merely within the range of
778 reasonable rate setting options. Questar Gas is not requesting treatment outside
779 the norm, as described by Mr. Hevert.

780 **VII. CONCLUSION**

781 **Q. Would you please summarize your testimony?**
782 A. Yes. Questar Gas has demonstrably superior performance in many areas of
783 economic efficiency, which provide customers significant savings as compared
784 with average performance. These benefits are the result of focused efforts by the
785 Company and are enhanced by Questar Gas' strong customer service record.

The trend in improvement can be seen in the Company moving up in the efficiency benchmarking results from 2002 to 2006; it now ranks as the best overall performer in my benchmarking group.

It is well within the purview of this Commission, on the basis of the quantifiable benefits the Company has already achieved and provided to customers, to support a ROE at the top end of the reasonable range established by Mr. Hevert. It is consistent with both cost-based regulations and the long-standing latitude of regulators to recognize low-cost efficient service in setting a compensatory return.

Q. Does this conclude your direct testimony?

A. Yes, it does.