BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Questar Gas Company to Increase Distribution Non-gas Rates and Charges and Make Tariff Modifications	|	Docket No 07-057-13

TEST YEAR REBUTTAL TESTIMONY OF

ROGER J BALL

5 FEBRUARY 2008

Q Are you the same Roger J Ball who filed Test Year Testimony in this Docket on 28 January 2008?

A Yes.

Q What is the purpose of your rebuttal testimony?

A To respond to the direct test year testimony filed on behalf of the UAE Intervention Group (UAE or Energy Users), the Utah Committee of Consumer Services (CCS or Committee), and the Division of Public Utilities (DPU or Division), and to amplify my own direct testimony.

Q Have you read the direct testimony filed by UAE witness Higgins, CCS witnesses Orton and DeRonne, and DPU witness Zenger? If so, please recapitulate some of their points.

A Yes. Mr Higgins recommends calendar year 2008 as best reflecting the conditions Questar Gas Company (Questar, or QGC, or Company, or utility) is likely to encounter during the rate effective period. Mr Orton advocated an early determination of the test year by the Commission to optimize the parties' resource utilization. Ms DeRonne supported that view and recommended that the Commission adopt some measures to safeguards ratepayers if it selects any future test period. Dr Zenger writes that, subject to adjustments following audit:

> The Division has no objections to the use of the test period recommended by the Company ending June 30, 2009, subject to the conditions explained below. *On the basis of the evidence* in this particular case, we find the Company's proposed future test period is *the most defensible test period* to be used in this case, and it best reflects the conditions that the Company will encounter when the rates will be in effect.[1]

Q What evidence did Dr Zenger adduce to support her conclusion that a July 2008 – June 2009 test year is "the most defensible" period in this case?

[1] DPU's *Direct Testimony of Joni S Zenger PhD*, 28 January 2008, in this Docket, 07-057-13, lines 35-39.

A Dr Zenger wrote that she had examined the test period sought by the Company against UCA §54-4-4(3), and concluded that it complies with the statute, appeared to be based on evidence, and to best reflect conditions the utility is likely to encounter during the rate effective period. However, I was unable to find comprehensive data or analysis demonstrating that Dr Zenger had compared any other particular test period, much less all the possible test periods, with that sought by the utility to support her recommendation that "on the basis of the *evidence*" a twelve-month test period ending 30 June 2009 "is the *most defensible*" (emphases added). Without actually referring to them, she went on to address what the Commission identified in a 2004 PacifiCorp general rate case as "Some of the factors that need to be considered in selecting a test period",[2] such as inflation, costs, and efficiency. According to Dr Zenger, all these criteria endorse the adoption of the test period sought by Questar.

Q With regard to QGC's costs, what did Dr Zenger have to say?

A Dr Zenger wrote that "the primary driver of the cost increase is the need to replace feeder line".[3] In its 2004 *Order Approving Test Period Stipulation*, one of the factors the Commission identified as needing consideration was "changes in the utility's investment, revenues or expenses". It appears that Dr Zenger may have meant that the need to replace feeder line is a primary driver of new *investment*, rather than *cost* or current expense. All the expenditure associated with replacing feeder line can be expected, at the appropriate point in time, to be capitalised, added to rate base and depreciated over the appropriate life of the new plant. It

[2] *Order Approving Test Period Stipulation*, 20 October 2004, in Docket 04-035-42 *In the Matter of the Application of PacifiCorp for Approval of its Proposed Electric Rate Schedules & Electric Service Regulations*: thirds section, headed *Discussion, Findings and Conclusions*, first paragraph.

[3] DPU's *Direct Testimony of Joni S Zenger PhD*, 25 January 2008, in this Docket, 07-057-13, lines 272-273.

will serve ratepayers for decades, and Questar will have the opportunity to recover its investment, including cost of borrowing and return to corporate stockholders, over a matching period.

Q Dr Zenger wrote at length, and sympathetically to the utility, about regulatory lag. How do you respond?

A Once a utility investment has been added to ratebase, it can be expected to remain there until fully depreciated. If its addition to ratebase is advanced, as it would be if a future test period or out-of-period adjustment is used, so will be the date by which it will likely be fully written off. If rates are increased before the investment becomes used and useful, ratepayers will pay for it before receiving matching benefit. If an investment is added to ratebase after it becomes used and useful, the write-off date will be delayed, and ratepayers will continue paying for it a bit longer. Generally, though, estimates of plant lives are quite conservative, so ratepayers continue to benefit from earlier investment for some time after it has been fully depreciated. So, for customers, the better match of rates to benefits comes from the use of earlier, perhaps historic, test periods, when the numbers are more certain. For the utility, any mismatch in borrowed funds is quite eliminated by the use of other accounting conventions, such as cost-of-work-in-progress, that result in the utility accruing interest on the money they spend on capital works until it can be capitalised and added to ratebase along with other project expenditures. There is no certainty that stockholder funds will be used to finance capital projects during their construction; borrowing may finance all expenditures during that phase. And utility stockholders have always been compensated for all their risks, including any associated with regulatory lag, in the premium they receive in RoE compared with cost of borrowing.

Q Does regulatory lag affect ratepayers, too?

A It does. When a utility is over earning, ratepayers must wait for reduced rates while the process operates, and there is no limit – no 240 days or any other period – specified to protect them.

Q Are ratepayers exposed to other risks when a projected test period, or out-of-period adjustments, are used in ratemaking?

A In its 2004 *Order Approving Test Period Stipulation*, the Commission wrote that:

> For many years our general practice has been to rely on historical test periods without out-of-period adjustments. A major concern with out-of-period adjustments is the possible bias and lack of complete information about offsetting adjustments. Additional concerns discussed in the order in Docket No. 92-049-05 include the Company's unequalled access to financial and accounting information and the shifting of risks to ratepayers of the uncertain future as management action may offset the effects of regulatory adjustments. Our concerns with future test periods include the diminished economic examination and accountability, replacement of actual results of operations data with difficult-to-analyze projections, ability of parties to effectively analyze the Company's forecasts, dampening of the efficiency incentive of regulatory lag, playing to the Company's strength from control of critical information and shifting of the risks of the future to ratepayers.

As the Commission recognised in those earlier orders, the regulatory and rate-setting process relies entirely upon a utility's books and records. History is replete with failures of controls over those with the money in their hands. What if additional expenses, including ones that will be capitalised, are not incurred, and the associated benefits to ratepayers delivered, as forecast by a utility when a future test period is adopted? The utility could receive a windfall in revenues, may apply the proceeds to activities that are not beneficial to ratepayers, including over-earning, and the regulatory lag that ratepayers will be subject to before rates can be adjusted downward may be far longer than the utility would have experienced.

Q What did Dr Zenger have to say about the Commission's role in selecting the Test Year in this proceeding?

A After quoting UCA §54-4-4(3) in full, a sub-section in which the word "commission" appears 9 times and the term "public utility" just once, she asserts that "the Company can select a test period". That is patently not the intent of the statute.

Q What do you mean by "all the possible test periods" (line 31, above) in this case?

A Questar Gas Company's application offered historic data for one, July 2006 to June 2007, and projected numbers for another, July 2008 to June 2009. There is no statutory reason in UCA §54-4-4(3) why a test year must run either July to June, or January to December. Indeed the use of the "period" rather than "year" in the statute doesn't preclude the use of something other than 12 months, or mandate that it must commence on the first of a month or end on the last. Within the bounds of time used by the Company alone, there are 24 possible 12-month test periods that start on the first and end on the last of the month.

Q Is the Commission limited to considering only test periods mentioned in a utility's application, or for which the utility has offered data sets?

A No. UCA §54-4-4(3)(a) requires the Commission to "select a test period that, on the basis of evidence, the commission finds best reflects" conditions the utility will encounter during the rate effective period. It doesn't empower the Commission just to pick one from a limited range of options offered by a utility. It *shall* select the *best*, and it *shall* do so *on the basis of evidence*. The Division is statutorily required to "provide the commission with objective and *comprehensive* information, evidence, and recommendations" (emphasis added). It earlier proposed a later determination of test year after adequate time to study the issue, and Dr Zenger explained that she had done what she could prior to filing her direct testimony. Questar Gas Company chose to offer data sets for just 2 of at least 24 possible test periods. Dr Zenger examined just one of them. The information, analysis and recommendations before the Commission are inadequate to meet the statutory requirement that the Commission base its selection on *evidence*, and without a much more wide-ranging comparison of alternatives it cannot reasonably find that July 2008 to June 2009 is the period that *best* reflects conditions during the rate effective period.

Q What evidence did Mr Higgins offer in support of his recommendation that the Commission select calendar 2008?

A In addition to the statute mentioned by Dr Zenger, and the Commission's factors she addressed, he referenced a number of concerns about the use of out-of-period adjustments that the Commission recorded in its 2004 *Order Approving Test Period Stipulation* (third section, second paragraph). Mr Higgins recommended the selection of calendar 2008 as the test year in this Docket, explaining that, while this was a fully-forecasted test period, it did not reach so far as the utility's into the future beyond the likely date of a Commission order in this Docket. He noted that no data set had yet been compiled for this third option. Mr Higgins cautioned that embedding forecasts of rising inflation in rates would make it more likely, and addressed others of the Commission's criteria that he concluded made his recommended calendar 2008 test period superior to the one the Company sought. He advanced several other arguments in favour of the test period he recommended.

Q Do you agree with Mr Higgins' assertions that "there is no presumption either for or against an historical, a mixed, or a future test period" and that future test periods do not necessarily best reflect rate effective periods, which are necessarily in the future?

A Yes. The first of those is what the plain language of UCA §54-4-4(3) and the legislative intent statement he quoted says. I entirely agree with Mr Higgins that, since rate-effective periods have been and are always in the future, the Legislature clearly and certainly did not intend to *mandate* test periods that were even partially projected. Nor did it limit the Commission's freedom to consider adjustments sought on the basis of plans and forecasts on their individual merits. If it is permissible to adjust historic data for "known and measurable changes" that will likely post-date a test period, it must surely be permissible to adjust projected data for differences that most certainly occurred prior to it. The concerns expressed by the Commission in 2004 (quoted at lines 77-90, above), effectively summarise why future test periods and out-of-period adjustments do not necessarily best reflect rate effective periods.

Q Has Questar Gas Company proposed in this Application to include in rates expenditures associated with capital projects that it may bring into service during the forecast test year it seeks in this docket?

A Yes. "By June 2009, Questar Gas' total rate base will have increased by approximately $211million since December 31, 2002, the end of the test year in the Company's last general rate case."[4] Professionals in the field are familiar with the concept of three project management variables: cost, time and quality. If one has to be reduced or constrained, one or both of the others will inevitably increase. Many people are familiar with Murphy's Law: anything that can go wrong, will; and some with its extension, O'Reilly's Law: Murphy was an optimist. Should some delaying factor interpose, the decision must be made whether to increase expenditure, or sacrifice quality, or defer

[4] QGC's *Application*, 19 December 2007, in this Docket, 07-057-13 (hereinafter *Application*): II E 1 *Major Factors Contributing to the Revenue Deficiency, Increased Rate Base,* on page 5.

project completion. Often, neither the first or second options are as acceptable as an extension of time. No one can be certain that the infrastructure promised in this Application will be timely brought into service, and the Commission should not expose ratepayers to risks over which they (ratepayers) have no control. QGC, on the other hand, is receiving a risk premium in its Return on Equity. In seeking certainty of recovery before bringing the promised facilities on-line, the Company is looking to transfer the risks of that not happening on time to ratepayers. Mr Higgins has asked for a less aggressive future test period; Ms DeRonne has asked that ratepayers be safeguarded if the Commission adopts a future test year; I have proposed that RoE be reduced commensurate with the quantified risk transferred from stockholders to ratepayers. These are reasonable proposals that conform with UCA §54-4-4(3), and both the factors and the concerns identified by the Commission in its 2004 *Order Approving Test Period Stipulation*.

Q Do you wish to respond to Mr Orton's recommendation that the Commission select the test period in this proceeding very early?

A I agree that the sooner everyone knows what the test period is to be, the more efficiently we can all focus our efforts. However, it is more important that the selection be right than that it be quick. A test year ending 30 June 2009 may be *good*, in that it more closely matches a rate effective period commencing on 13 August 2008 – if indeed that turns out to be the rate effective period – than QGC's other data set or calendar 2008. Mr Higgins has argued persuasively that this last is *better*. But the Commission is required to select the *best*, and it cannot know what that is based upon just 2 of at least twenty-four data sets. It will take longer to generate and examine a fuller range of options.

Q What did you mean when, on lines 10-12 on page 4 of your direct Testimony, you wrote: "However, it also seems to lie within the Commission's UCA §54-7-12(3)(c) authority to revise Questar Gas Company's proposed increase to go into effect well after that date"?

A UCA §54-7-12(3)(c) provides only that "(i)f the commission fails to enter the commission's order granting or *revising* a revenue increase within 240 days after the utility's schedules are filed". There appears to be nothing in the statute to prevent the Commission revising a proposed revenue increase so that any rate increase would take effect more than 240 days after filing. If the Commission needs more time to adequately examine this Application, it could therefore issue an interim order at any point before 15 August 2008, ie within the 240 days, revising the proposed increase for later implementation.

Q Do you have any corrections to your direct Testimony, filed on 28 January?

A Yes. The sentence that begins on line 17 and ends on line 19 of page 5 should be extended to read:

> However, regulatory lag affects ratepayers, too: when a utility is over earning, ratepayers must wait for reduced rates while the "administrative process" operates, and there is no limit – no 240 days or any other period – specified to protect them.

Further, the sentences on lines 22 through 26 on page 5 should be amended to read:

> For some reason, regulators seem to have decided that the Bill requires the determination whether a utility is over or under earning to be based upon projected rather than actual numbers. Although §UCA 54-4-4 doesn't require that, the perception that it does has apparently already deflected regulators from initiating at least one case seeking a decrease in QGC's rates.

There is nothing anywhere in that Section, not just sub-section (3)(a) that requires the assessment of over- or under-earning to be based upon forecast, rather than actual, expenses and revenues.

Q Does that conclude your Test Year Rebuttal Testimony?

A Yes, thank you.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Test Year Rebuttal Testimony of Roger J Ball in Docket 07-057-13 was served upon the following by electronic mail on 5 February 2008:

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