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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Questar Gas Company to File a General Rate Case	**Docket No. 07-057-13**

PREFILED DIRECT TESTIMONY OF KEVIN C. HIGGINS

[RATE OF RETURN]

The UAE Intervention Group hereby submits the Prefiled Direct Testimony of Kevin C. Higgins on rate of return issues.

DATED this 31st day of March, 2008.

/s/______________________________
Gary A. Dodge,
Attorneys for UAE

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was served by email this 28th day of January, 2008, to the following

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BEFORE

THE PUBLIC SERVICE COMMISSION OF UTAH

Direct Testimony of Kevin C. Higgins

on behalf of

UAE

Docket No. 07-057-13

[Rate of Return]

March 31, 2008

DIRECT TESTIMONY OF KEVIN C. HIGGINS

Introduction

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

Q. By whom are you employed and in what capacity?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

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

A. My testimony is being sponsored by the Utah Association of Energy Users Intervention Group (UAE).

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously testified before this Commission?

A. Yes. Since 1984, I have testified at least fifteen times before the Utah Public Service Commission on electricity and natural gas matters.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes. I have testified in at least seventy other proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arkansas, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Missouri, Montana, Nevada, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, Virginia, Washington, West Virginia, and Wyoming.

A more detailed description of my qualifications is contained in Attachment A, attached to my direct testimony on test year, UAE TP 1.

Overview and conclusions

Q. What is the purpose of your testimony in this proceeding?

A. My testimony addresses the implications of revenue decoupling for Questar Gas Company (QGC) with respect to rate of return in this proceeding.

Q. What are your conclusions and recommendations?

A. In its Order in Docket No. 05-057-T01, the Commission found that QGC's Conservation Enabling Tariff ("CET") reduces QGC's risk. At the same time, the Commission determined that the record in that docket was insufficient to determine the effect of these changes on the Company's cost of capital and consequently on DNG rates.

In his direct testimony, UAE witness Robert H. McKenna addresses this unresolved question from Docket No. 05-057-T01 by analyzing the risk reduction benefit to QGC from the CET. Mr. McKenna's analysis measures the exposure QGC would have to fluctuations in its operating income absent the CET, based on the historical variability in QGC's usage-per-customer. One of Mr. McKenna's findings is that absent the CET, the expected value of the change in QGC's operating income in any given year is approximately $1.45 million. This is equivalent to about 37 basis points on QGC's return on equity, and represents the upper end of what a party would reasonably pay to remove this risk.

I recommend that the Commission use the information in Mr. McKenna's analysis to help guide its decision on QGC's allowed return on equity. Specifically, this information should be factored into the Commission's decision on where within the range of reasonable returns QGC's return on equity should be set. All things equal, the CET should cause QGC's allowed return to be reduced within the reasonable range.

<u>Revenue Decoupling and QGC's Return on Equity</u>

Q. Has the Commission addressed the issue of the implications for QGC's return on equity ("ROE") of adopting revenue decoupling?

A. Yes. QGC's Conservation Enabling Tariff ("CET") provides for revenue decoupling. In its Order in Docket No. 05-057-T01, issued November 5, 2007, in which the Commission approved the retention of the CET on a pilot basis, the Commission stated as follows:

> There is substantial disagreement among parties regarding whether the CET shifts economic and commodity price risk from shareholders to customers without compensation. The Company and the Division agree with the Committee and UAE the CET shifts these risks in theory, but argue the magnitude of the risk shift in practice is unclear. The Division presents a study it believes shows the theory does not apply in Questar Gas' case. This study evaluates whether commodity price risks are shifted from shareholders to customers and is contested by the Committee and UAE on technical grounds. However, no party contends this study resolves whether there is a reduction in risk regardless of any shift in risk from shareholders to customers. We do not resolve the debate regarding a shift in economic and commodity price risk from shareholders to customers. <u>We do find the CET reduces Company risk</u>.
>
> Risk to Company earnings are changed in at least two ways with the CET. First, the CET either reduces or removes the risk associated with the deterioration of earnings caused by declining use per customer, depending on whether an accrual cap is included. For example, to the extent an accrual cap is in place and shown to have a constraining affect, this risk is reduced rather than removed. Second, the variation in revenues is reduced because the number of customers is less variable and more predictable than customer usage. However, this record is insufficient to determine the effect of these changes on the Company's cost of capital and consequently on DNG rates. [Order at pp. 11-12] [Emphasis added].

Q. Is evidence provided in this proceeding that addresses the insufficiency in the record of Docket No. 05-057-T01 with respect to the risk reduction benefit to QGC from the CET?

A. Yes. In his direct testimony, UAE witness Rob McKenna addresses this question by analyzing the risk reduction benefit to QGC from the CET. Mr. McKenna's analysis measures QGC's exposure to fluctuations in its operating income absent the CET, based on the historical variability in QGC's usage-per-customer. One of Mr. McKenna's findings is that absent the CET, the expected value of the change in QGC's operating income in any given year is approximately $1.45 million. This is equivalent to about 37 basis points on QGC's return on equity. It represents the upper end of what a party would reasonably pay to remove this risk.

Q. Are you familiar with the recommendation of QGC witness Robert B. Hevert that no adjustment to QGC's return on equity is warranted as a result of the continuation of the CET?

A. Yes, I am. Mr. Hevert's recommendation is based on his assessment of investors' perceptions of QGC risk with the CET relative to the proxy group in his study. In contrast, Mr. McKenna's analysis is *specific to QGC*, and looks at the Company's situation with and without the CET. I believe the Commission should consider both types of analysis in making its decision in this proceeding with respect to allowed return.

Q. Are you recommending the QGC's ROE be reduced by 37 basis points to account for the reduction in its risk from the adoption of the CET?

A. No. I am not recommending an ROE adjustment based on the upper end of what a party would pay to remove the risk QGC faces from changes in usage-per-customer.

Q. What is your recommendation to the Commission on this matter?

A. I recommend that the Commission use the information in Mr. McKenna's analysis to help guide its decision on QGC's allowed return on equity. Specifically, this information should be factored into the Commission's decision on where within the range of reasonable returns QGC's return on equity should be set. All things equal, the CET should cause QGC's allowed return to be reduced within the reasonable range.

Q. Does this conclude your direct testimony with respect to rate of return?

A. Yes, it does.