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

RATE OF RETURN DIRECT TESTIMONY OF

ROGER J BALL

31 MARCH 2008

Q Are you the same Roger J Ball who filed Test Year Direct Testimony in this Docket on 26 January 2008?

A Yes. It was admitted into evidence as Exhibit RJB 1.0, together with a statement of my academic and professional qualifications and professional experience as Exhibit RJB 1.1 and my 5 February Test Year Rebuttal Testimony as Exhibit RJB 2.0. On 8 February I appeared and testified during the Test Year hearing.

Q What is the purpose of your Rate of Return Testimony?

A To comply with the requirement in the Commission's 27 December 2007 Scheduling Order in this proceeding that non-Company parties file direct testimony regarding rate of return by 31 March 2008.

Q Have you read the Application filed by Questar Gas Company (Questar, or QGC, or Company, or utility) on 19 December 2007 in this Docket?

A Yes. The Company bases its request for an increase in Distribution Non-Gas (DNG) rates upon "a 11.25% equity return" compared with the 11.2% Return on Equity (RoE) allowed by the Commission in the utility's last general rate case, Docket 02-057-02. [1]

Q What evidence has QGC provided regarding its RoE?

A The Company claims that it experienced "an annualized deficiency of $2.1 million for the 12-months ending June 30, 2007,"[2] and Questar Gas Company President, CEO, and witness Allred testifies that:

> *We must look forward to 2008 returns to determine the need for a general rate case*. As shown in QGC Exhibit 2.9, without rate relief, 2008 returns *will* fall to 7 percent.[3] (Emphasis added.)

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[1] QGC's *Application*, 19 December 2007, in this Docket, 07-057-13 (hereinafter *Application*): II C *Necessity for Relief, second paragraph,* on page 4.

[2] *Application*: II C *Necessity for Relief, second paragraph,* on page 4.

Exhibit 2.9 accompanying Mr Allred's Direct Testimony indicates that, since its last general rate increase, Questar has earned almost all the RoE authorised by the Commission. In the 12 months ended 30 June 2007, the Company appears to have earned 96.25% of its authorised return.[4] Its average earnings over the four preceding (calendar?) years appear to have been 95.27%.

Mr Allred also testifies that "(i)nvestors require a sufficient and fair return in order to provide the needed capital", and "(o)ur shareholders expect and are entitled to a sufficient and fair rate of return."[5]

Q Would you like to make any observations about that evidence?

A The Company calculates that its RoE for June 2007 was less than 1% below its 2006 number. Returns earned in 2004 and 2005 were 7.46% and 1.66% below those earned in 2006. If Questar management thought those returns sufficiently reasonable not to warrant a rate increase, why does the slightly lower June 2007 out-turn justify one? If the 10.05% RoE earned during the 2004 didn't demand a rate case in 2005, why does 2007's forecasted 10.78% demand one in 2008? The answer to both questions is the same: it doesn't. The utility's case is entirely predicated upon projected returns for future periods. As quoted above, Mr Allred writes that "(w)e must look forward to 2008 returns to determine the need for a general rate case."

But Questar Gas Company's direct contribution to the profits of Questar Corporation is only a fraction of its value to stockholders. It must not be forgotten that it began as a vertically-integrated utility some eighty years ago. Restructuring has presented numerous

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3 *Application*: *Ex 2.0 Allred Direct*, lines 326-328, on page 12.

4 Year ending 30 June 2006, 96.96%; 30 June 2005, 95.36; 30 June 2004, 89.73; and 30 June 2003, 99.02%.

5 *Application*: *Ex 2.0 Allred Direct*, lines 13-14 and 16-17, on page 1.

opportunities for corporate management to maximise returns once part of the utility's rate structure through much more recently created corporate subsidiaries and now QGC affiliates.

Q Please tell us about Wexpro.

A Wexpro was created to take ownership of the utility's drilling and production operations. The Utah Division of Public Utilities and very-recently-created Utah Committee of Consumer Services appealed the Commission's approval to the Utah Supreme Court. The result was the Wexpro Agreement, which has today's QGC trumpeting the advantages of "Company-owned gas" purchased from Wexpro at cost-of-service. Wexpro's website (www.questar.com/qmr/wexpro) boldly proclaims that it "earns a 19% unlevered after-tax return on its investment base." The reality is that Wexpro's net investment base was $300.4M at 31 December 2007 (up from $260.6M in 2006) with an average annual rate of return (after tax) of 19.9%.[6]

Q What about Questar Exploration and Production?

A Since the Wexpro Agreement, Questar Corporation's strategy was to create another new subsidiary, Questar Exploration and Production (QE&P), to explore and produce additional natural gas supplies through it, and sell them in the unregulated market. That subsidiary has been very active, contributing much of the Corporation's enormous revenue and profits increases.

Subsequently, Wexpro sat on the properties previously owned by the utility and did little to find or develop additional supplies. Whereas the utility had previously produced all the gas required to serve its customers (after all, at the time, it served a market effectively

[6] Questar Market Resources' Form 10-K, filed with the US Securities and Exchange Commission on 27 February 2008 for the period ending 31 December 2007: Note 11, table on page 50.

isolated from other supplies and consumers by a very limited interstate pipeline network), in 2007 Wexpro managed to deliver only 34%.

The utility has an obligation to serve all who require natural gas service in its monopoly territory and to meet all their demands. Questar Corporation's strategy has resulted in very little exploration and production, to meet increasing ratepayer demand or offset diminishing production from existing Wexpro wells, at cost-of-service. Instead, it has concentrated its efforts on those activities through QE&P on selling into the much more profitable unregulated market, and steered QGC towards buying its increasing requirements in that same market. As QE&P's revenues and profits have escalated, increasingly rapidly in recent years, so have QGC's commodity costs, and consequently ratepayers' bills.

Questar would have Utah believe that, since QGC doesn't buy from QE&P, there is no connection and no way for the Gas Company to mitigate the impact of market price rises on ratepayers. Nonsense! This is directly the result of Questar Corporation's strategy.

> Wexpro develops and produces gas and oil on certain properties for affiliate Questar Gas … (and) satisfied 34% of Questar Gas supply requirements during 2007 … Wexpro has identified over $1 billion of additional drilling opportunities …[7]

Done differently, Wexpro would have continued drilling and delivered increased supplies in step with QGC's demand growth, so that ratepayers would have both continued to underwrite the risks of exploration and benefit from cost-of-service gas. Why haven't the more than $1B of additional Wexpro drilling opportunities already been exploited?

Under the Wexpro Agreement, two monitors oversee the operations and books of Wexpro and report to Utah and Wyoming regulators. The process is shrouded in secrecy, and it is

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[7] Idem: Exploration and Production – Questar E&P and Wexpro; third, fourth and fifth paragraphs on pages 8 and 9.

past time that it was exposed to the daylight of public scrutiny. How are we to know, for instance, that none of QE&P's revenues have been or are being derived from Wexpro properties?

There is a tendency to assume that affiliate transactions consist only of the supply of goods and services between subsidiaries, including their holding companies, neglecting the withholding of such supply. Questar Corporation has been much more sophisticated than that for several decades, and Utah ratepayers are bleeding through their wallets while dividends and the stock price climb, and climb, and climb.

Q Are there other examples?

A The Corporation hived the interstate pipeline assets of the vertically-integrated utility off into Questar Pipeline Company (QPC). Originally, pipelines were built for the sole purpose of bringing natural gas from wells in Colorado and Wyoming to Utah. Pipeline investment and expenses were recovered from utility ratepayers just like gas and distribution costs. When the new subsidiary was first created, jurisdiction passed from the Commission to FERC, which created new rates that allowed QPC to recover those investments and expenses from its customers, principally the remaining utility. After all, the chief use of the pipes continued to be bringing gas from the same wells to Utah.

However, as time passed, the interstate pipeline network grew. Non-Questar Corporation (NQC) companies' pipes intersected QPC's, NQC parties began to ship gas on QPC's pipes, QE&P began to ship its gas to NQC parties on QPC pipes, and so forth. It even reached a point where QPC contracted to ship coal-seam gas from NQC producers to NQC purchasers on its pipelines, causing safety concerns for QGC's customers.

All this NQC activity increased QPC's revenues and profits. Of course, new facilities requiring additional investment were built, capacity grew, and FERC approved revised rates to reflect it all. But what is missing from the equation is any recognition of the many years during which Utah ratepayers underwrote the investments in pipeline assets, either during vertically-integrated utility days or during the early years of QPC when all, or almost all, of its revenues came from QGC's predecessor, and thus from ratepayers.

Q How does all this relate to your earlier contention that Questar Gas Company's direct contribution to the profits of Questar Corporation is only a fraction of its value to stockholders?

A The excess of Wexpro's returns over QGC's authorised rate of return are a significant value to the owners and managers of Questar Corporation. The money comes from ratepayers and has been effectively concealed, albeit in plain sight, from the Commission for years. It represents but one of the many ways in which the Corporation has not merely diminished the risks of operating a utility but, but turning it into merely a local distribution company, has increased the profitability of previously vertically-integrated activities at ratepayer expense.

The failure of QGC and Wexpro to find and produce additional company-owned gas in step with load growth, at the same time QE&P has been expanding its activities, has resulted in both huge rate increases for customers and enormous profits for Questar Corporation's owners and managers. This piece of legerdemain has saddled ratepayers with all the risks of price volatility in an unregulated market that simply didn't exist for them previously. Meantime, the Corporation has benefited greatly from that same market. There is no balance between cost and benefit for ratepayers here.

The creation of QPC stripped assets from the utility without recompense. The theory was that Questar Corporation owned those assets and was merely moving them from one room into another. But ratepayers had underwritten the risks associated with pipeline construction and operation for decades. That began to matter as QPC increasingly exploited the assets to grow its revenues and earnings. It became poignant when Questar Regulated Services – then Questar Corporation's subholding company for QGC and QPC, all three sharing common top managers – took advantage of them to increase QPC's profit at the expense of QGC's ratepayers by transporting gas that would enter their homes and perhaps endanger their families.

Q Do you have any recommendations for the Commission?

A I recommend that Wexpro's profits be imputed to QGC so that its excess returns over the utility's authorised rate help offset ratepayers' bills, after the pattern of Yellow Pages imputation.

I recommend that the Commission impute to QGC a share of QE&P's profits equivalent to the portion of its production that equates to QGC's market purchases of natural gas.

I recommend that the Commission impute an appropriate share of QPC's revenues to QGC to recognise ratepayer's interest in QPC's assets, and additionally to entirely offset all costs associated with coal-seam gas processing and the green sticker programme, including reimbursing ratepayers who have paid for appliance inspections and adjustments.

I further recommend that the Commission direct a comprehensive investigation of the interplay within Questar Corporation of its strategies, results, and subsidiaries, and their strategies and results, and the impact of those elements on QGC's ratepayers.

Q How does this bear on the Rate of Return segment of this proceeding?

A QGC's authorised rate of return on equity is only a fraction of the local distribution company's value to its parent corporation. Ratepayers are also paying for a much higher rate of return at Wexpro, for the failure of QGC or Wexpro to find and produce additional gas supplies while QE&P has rapidly increased its contribution to the corporate treasury, for an unrecognized interest in QPC, and have paid costs associated with coal-seam gas transportation profits.

The Commission should offset all these elements when setting a new authorised RoE for QGC.

Q Are there other existing elements in QGC's rates that the Commission should consider in setting a new authorised RoE?

A Some of the elements that have already transferred considerable risk from the stockholders and managers of its parent corporation and QGC include weather normalisation and the conservation enabling tariff.

Every dollar that QGC collects as a result of the CET that it would not otherwise collect is a direct cost to ratepayers and benefit to owners and managers.

QGC has worked assiduously to expand its monopoly service territory across Utah. It has used the threat of possible FERC regulation to fend off those who wished to transport gas on its (not QPC's) intra-state pipelines to serve portions of the state. It has been most effective; apart from one or two municipalities, nobody but QGC retails natural gas in Utah, and some propane retailers and suppliers of other fuels have lost a great deal of business. The Company arranged for its ratepayers at large to subsidise its entry into many smaller communities, and then wanted them to subsidise the few in those areas even more by eliminating its GSS and EAC rates. Questar is always alert to opportunities to milk the cash cow that is its utility customer-base to provide sustenance for its managers and owners, and cream for those who might be politically useful to them.

Not long ago, QGC wanted its ratepayers to pay for the gas burned in the 2002 Olympic flame, a piece of corporate PR that would be seen around the world but conferred no apparent benefit on consumers. Most recently, it has “messed up”, its spokesman’s words, to the tune of $½M with regard to meter transponders, and wants all its ratepayers to reimburse it together if 500 of them won’t pay it separately. Why should ratepayers pay for management incompetence?

This Questar Gas Company, this Questar Corporation, is highly risk-averse. It has taken step, after step, after step to minimize its risks, and it was able to persuade the Commission to raise its RoE in its last general rate case. Now here it comes again, asking for more. Time for the Commission to play the beadle.

Q You have often referred to “owners and managers” as beneficiaries of risk shifting. How do managers benefit?

A Through incentive schemes, such as bonuses and stock awards, that are conditioned on company financial performance. Such arrangements give managers a direct inducement not only to increase profits in the short run, but to structure companies and tariffs to transfer risk from owners to ratepayers, all the while making managers stockholders, so blurring any distinction, and ensuring that managers work to benefit stockholders at the expense of ratepayers.

Q The Commission has determined that a calendar 2008 test period shall be used in this case. How does that impact your RoE recommendations?

A The provision in §54-7-12(3)(c) effectively requiring the Commission to decide a rate case within 240 days of its filing has significantly limited a utility’s regulatory lag risk for many years. There is no balancing protection for ratepayers. Nevertheless, the utilities were not satisfied.

HB320, passed by the Legislature during its 2000 General Session and widely known as "the Questar Bill", but repealed in its entirety in 2001, was an omnibus bill containing a shopping list of the utilities' wishes to tilt the regulatory playing field dramatically in their favour. Despite the eventual failure of the 2000 Bill, those provisions remained on the utilities' wish list, and those that have not been passed since are still on their agenda. Then-Senate Majority Leader Valentine sponsored SB61, resurrecting two provisions of HB320, in 2003: the end of purely historic test years and their replacement with aggressive future test years going out up to 20 months from the date of filing a rate increase request; and a mandate for the Commission, Division and Committee to favour private negotiation over public litigation of utility cases.

Utilities have been compensated for their limited risk from regulatory lag and the use of an historic test year in the rates of return on equity they have been granted an opportunity to earn. The Commission has repeatedly over many years in many cases found that rates resulting from historic test years were just and reasonable and QGC has generally accepted that its rates set in accordance with that theory were just and reasonable at the time.

The adoption of a 19-month projected test year will transfer further risk from stockholders to ratepayers, as I demonstrated in my uncontroverted testimony in the Test Year portion of this proceeding.

As then Commission chairman Campbell observed during a hearing in a previous proceeding concerning this Company, "if I were an employee of the Company, I guarantee you I could give you a forecast every time that shows I'm not over earning."[8]

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8 *Transcript of Proceedings*, 17 May 2006, in Docket 05-057-T01 *Joint Application of Questar Gas Company, the Division of Public Utilities and Utah Clean Energy for the Approval of the Conservation Enabling Tariff Adjustment Option and Accounting Orders*: page 146, lines 21-23.

Q Has this Commission previously set rates for Questar on the basis of a projected test year?

A No, this will be the first time that the Commission has tackled the transition from historical to projected test period. In previous Questar Gas Company general rate cases, the Commission determined RoE based upon the risk to which stockholders were exposed when future rates were based upon historic test periods. The evenhanded balancing of the utility's interest in increasing its earnings with the ratepayers' interest in paying no more than just and reasonable rates suggests that If the Commission, in selecting a test year in this proceeding in accordance with revised UCA 54-4-4(3), chooses to adopt anything other than an historic test year, it should balance this shift of risk by commensurately reducing RoE.

Q Does the move from an historic to a projected test year carry any monetary value?

A In its Application, Questar Gas Company apparently valued a 24 month forward projection at almost $27M. It has calculated a reduced figure of about $22 since the Commission ordered a calendar 2008 test period.

Q Do you have a recommendation for the Commission?

A Yes. The Commission should adjust RoE downwards by about $22M to restore the balance of risk.

That concludes my pre-filed written direct test year testimony, thank you.

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing Rate of Return Testimony of Roger J Ball in Docket 07-057-13 was served upon the following by electronic mail on 31 March 2008:

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