Witness CCS – 4 RR HS

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of Questar	)	Docket No. 07-057-13
Gas Company for Authority to Increase its	)	
Utility Service Rates in Utah and for	)	PRE-FILED DIRECT
Approval of its Proposed Gas Service	)	TESTIMONY OF
Schedules and Gas Service Regulations,	)	HELMUTH W. SCHULTZ, III
Consisting of a General Rate Increase of	)	FOR THE COMMITTEE OF
Approximately $22,157,242 Per Year.	)	CONSUMER SERVICES

Confidential Information Highlighted in Gray

April 21, 2008

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INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Helmuth W. Schultz, III. I am a Certified Public Accountant, licensed in the State of Michigan, and a Senior Regulatory Analyst in the firm of Larkin & Associates, PLLC, with offices located at 15728 Farmington Road, Livonia, Michigan 48154.

Q. PLEASE DESCRIBE THE FIRM LARKIN & ASSOCIATES, PLLC.

A. Larkin & Associates, PLLC is a Certified Public Accounting and Regulatory Consulting firm that performs independent regulatory consulting primarily for public service/utility commission staffs and consumer interest groups (public counsels, public advocates, consumer counsels, attorneys general, etc.). The firm has extensive experience in over 600 regulatory proceedings involving electric, gas, water and wastewater, and telephone utilities.

Q. HAVE YOU PREPARED AN APPENDIX THAT DESCRIBES YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached Appendix I, which is a summary of my experience and qualifications.

Q. BY WHOM WERE YOU RETAINED, AND WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. Larkin & Associates, PLLC, was retained by the Committee of Consumer Services (CCS or Committee) to analyze the reasonableness of Questar Gas Company's request for an increase in rates.

OVERVIEW

Q. HOW HAS YOUR TESTIMONY BEEN ORGANIZED?

A. My testimony will begin with an overall financial summary, incorporating the adjustments that I made, as well as those resulting from the testimony of other Committee witnesses. I will then address my specific recommendations on labor costs, labor overhead, pipeline integrity costs, and various other operating and maintenance expenses.

OVERALL FINANCIAL SUMMARY

Q. HAVE YOU PREPARED ANY EXHIBITS TO PRESENT IN SUPPORT OF YOUR TESTIMONY?

A. Yes. Attached as Exhibit CCS 4.1 is the overall financial summary of recommendations in a comparable format to that submitted by the Company. The first page consists of the overall summary and reflects the Committee’s recommended change in rates. The next section consists of the adjustments made by the Company in its filing. The final section lists out each of the adjustments recommended by the Committee and are incremental to the Company's adjustments. The results in Exhibit CCS 4.1 reflect the recommendations of Committee witnesses as imputed into the Company supplied model. The Committee's recommended adjustment to reflect the impact on cash working capital associated with interest on long term debt is input on the first page of the exhibit in the cash working capital line. This adjustment, which is addressed by CCS witness Donna DeRonne and reduces cash working capital by $3,259,270, does not appear in the summary listing of Committee adjustments as the Company's model did not allow for the revision to the cash working capital section for inputting the impact of the recommendation.

The remaining attached Exhibits CCS 4.2 through CCS 4.10 reflect the various calculations and recommended adjustments that I have prepared, the results of which served as the basis for the adjustments reflected in Exhibit CCS 4.1. The Company has operations in Utah and Wyoming. The dollar amounts presented in this testimony are provided on both a total Company and on a Utah basis. Many of the adjustments in the exhibits are calculated first on a total Company basis, with the Utah amount then calculated and presented on the exhibit. The overall revenue requirement on Exhibit CCS 4.1, page 1, is on a Utah basis.

Q. BASED ON YOUR REVIEW AND THE REVIEW OF OTHER CONSULTANTS ON BEHALF OF THE COMMITTEEE, WHAT OVERALL REVENUE REQUIREMENT ARE YOU RECOMMENDING?

A. Applying the appropriate rate of return as recommended by Dr. Woolridge and reflecting the impact of the various Committee adjustments to rate base and operation and maintenance expense, an increase to rates of $97,637 is recommended. This is $22,059,905 less than the Company's requested rate increase of $22,157,542. This is shown on Exhibit CCS 4.1, page 1.

<u>INTEGRITY MANAGEMENT COSTS</u>

Q. WHY IS AN ADJUSTMENT TO INTEGRITY MANAGEMENT EXPENSE RECOMMENDED?

A. It appears the Company duplicated its request for current expenditures for integrity management.

Q. BASED UPON WHAT EVIDENCE DO YOU SUGGEST THAT INTEGRITY MANAGEMENT COSTS HAVE BEEN DOUBLE COUNTED?

A. In Company adjustment number two, the Company reflected an adjustment to Base Year costs based on updated 2008 budgeted costs. Included in the budgeted costs in cost center 5058 were $3,588,000 for "Projected 2008 IM work" and $2,000,000 for "deferred Accounting for IM work". In adjustment number eighteen, the Company then made an additional adjustment of $3,100,000 for projected expenses for pipeline integrity work. Therefore, Test Year costs for Integrity Management in 2008 total more than $8,688,000. Based on the testimony of Company witness Kelly Mendenhall, the total annual pipeline integrity expense is $5.1 million. It is clear that the Company has duplicated the integrity cost increase requested.

Q. DID YOU ASK THE COMPANY IF THE COSTS WERE DUPLICATED?

A. Yes. The Company was asked in CCS 21.15 if the costs budgeted in cost center 5058 were the same as the costs reflected in the Integrity Maintenance adjustment on QGC Exhibit 6.2U, Page 4. The response stated that the $2,000,000 budgeted was the same as that shown as being current expenses on the exhibit. But the response also stated that the forecasted accrual is based on historical expenses and not the budget. The response then went on to say that actual pipeline integrity costs will be deferred in the pipeline integrity account. The response does not make sense when it states that the increase in integrity expense has not been budgeted. It would be fiscally inappropriate for the Company to plan on spending $3.5 million for maintenance and not budget for it.

Q. DID YOU INVESTIGATE THIS ISSUE FURTHER?

A. Yes. In my review of the budget for 2008, I verified that the $3,588,000 was in fact included in the operating and maintenance expense budget totaling $123,212,032 as shown on Company Exhibit QGC 5.5U and QGC Exhibit 6.4U, pages 15 and 16. I next verified that the budgeted amount shown on those exhibits was what was used by the Company in its adjustment to reflect forecasted expenses, or adjustment 2 on QGC Exhibit 6.2U page 2 of 4.

To verify this, it was necessary to determine how the adjustment was made. The $3,189,230 increase to total O&M expense in adjustment 2 is the difference between the $120,600,103 of budgeted dollars shown on QGC Exhibit 6.3U, page 10 and the Base Year operating and maintenance expense of $117,410,933. The $120,600,103 budgeted amount used in the adjustment is $2,611,869 less than the budget as shown on QGC Exhibit 6.4U, pages 15 and 16 because of the exclusion of the DNG and SNG uncollectibles. Thus, since the $3,588,000 for integrity management was included in the Company's budget, it was included in the Company's projection of 2008 operating and maintenance expense.

I will also point out that in response to CCS 21.13, the Company specifically states that the costs on QGC Exhibit 6.2U, page 4 (i.e. adjustment 18) are the costs associated with department 5058. The $3,500,000 requested in adjustment eighteen would duplicate the Company's requirements; therefore, as shown on Exhibit CCS 4.5, an adjustment reducing expense $3,500,000 is required.

PAYROLL

Q. HAVE YOU REVIEWED THE COMPANY'S REQUEST FOR PAYROLL FOR THE TEST YEAR ENDED DECEMBER 31, 2008?

A. Yes. The Company has requested that $47,688,351 be included in rates for labor. This request consists of $44,545,849 of general payroll costs and Questar Gas Company net incentives of $3,142,502 ($5,000,000 - $1,857,498). The average employee complement during the updated Base Year Ended December 31, 2007 was 1,189 employees. Based on the response to MDR B.22U, the average employee count included in the rate case for the Test Year is 1,206. This average is based on the assumption that in each month of the Test Year there are 1,206 employees. The same response shows the Company budget assumed an employee count for 2008 of 1,226. It is my understanding that the Company's Test Year expenses are based on the Company's 2008 budget and then adjusted for specific reasons. The Company's payroll in the filing, according to MDR A.4U, was $48,221,683 inclusive of $5,000,000 of incentive compensation. The $48,221,683 was increased $1,324,166 for annualization and then reduced $1,857,498 for the financial based incentive compensation of Questar Gas Company. According to Company witness Kelly Mendenhall, the annualization performed is consistent with the decision in Docket No. 93-057-01.

Q. ARE THERE CONCERNS WITH THE COMPANY'S REQUEST FOR LABOR IN THE TEST YEAR?

A. Yes. The request includes an unsupported increase in the number of employees, an unexplained increase in labor costs, an excessive and unsupported 4.5% merit increase, an improper annualization, and a questionable amount of incentive compensation.

Q. PLEASE DESCRIBE THE ISSUE OF UNEXPLAINED INCREASE IN LABOR COSTS.

A. My primary concern stems from the lack of justification as well as the discrepancies within the numbers presented by the Company at different times and places within this case. The unexplained increase is attributed to a change in total payroll and a change in the expense factor that occurred between the original budget and the rate case.

Q. HOW DID YOU DETERMINE THAT DISCREPENCIES EXISTED WITH THE TOTAL PAYROLL AND EXPENSE FACTOR?

A. During the on-site visit to the Company's offices, the Company provided the 2008 budget information. After reviewing the budget information by department, the Company was asked to reconcile the total budget to the operating and maintenance expense budget dollars on MDR A.4U. The explanation provided by the Company identified the amount of labor, labor overhead and other cost that were charged to other accounts or companies. The labor difference was $36,517,526 charged to accounts other than expense or other companies. A comparison of the labor expense from the two different budgets identified a $1,498,700 difference between the original budget and the 2008 budget dollars reflected in the rate case. Using the 2008 original budget expense amounts and adding in the $36,517,526 of labor charged elsewhere, it was determined that the total labor dollars was $83,240,509.

The original budgeted expense of $46,722,983 is 56.13% of $83,240,509. The budgeted expense of $46,722,983 provided during the on-site visit can be confirmed by referring to the responses to DPU 8.01 that shows 2008 O&M budgeted labor expense of $46,723,000. The original budget expense factor of 56.13% is less than the 56.91% expense factor reflected in the filing.

As indicated previously, the budgeted expense amount included in the Company's rate request is $48,221,683 before the annualization adjustment, compared to the actual original budgeted expense of $46,722,983. This is another discrepancy.

To further confuse this situation, a special 2008 budget report generated by the Company at my request by transaction code produced yet another dollar figure for labor.

Q. HOW DID YOU DETERMINE THERE WAS AN UNEXPLAINED INCREASE IN EMPLOYEE COSTS?

A. Company Exhibit QGC 5.5U shows budgeted labor expense of $48,221,683. According to Company testimony, this is for 1,206 employees. The actual 2008 budget, according to MDR B.22U, included 1,226 employees and had a budgeted expense of $46,722,983. The actual budget has 20 more employees but $1,498,700 less in payroll expense for 2008.

The reason for this difference is that the total payroll budgeted for 2008 was less than what is reflected in the filing for 2008, and the calculated expense factor is less than what is reflected in the filing. However, the filing does not present any supporting evidence justifying the increase in these costs.

Q. WHAT HAVE YOU CONCLUDED ABOUT THE ISSUE OF LABOR EXPENSE?

A. I am concerned about the fact that the original budget had more employees but lower dollars projected than the rate case budget numbers. The Company's use of a moving budget puts those of us evaluating the projections at a severe disadvantage. The use of budgeted numbers (i.e. a projection) as a starting point, as opposed to using a known factor like the Base Year, can be acceptable if the budget doesn't keep moving and is fully supported. However, the Company established a budget and then adjusted the budget while the rate case filing was put together. The change between the original budgeted labor and the rate case budgeted labor has not been explained like the historic budget-to-actual variances were explained in the MDRs.

The Committee's recommendation is that a known and fixed period cost, like the Base Year, should be the starting point for determining Test Year labor and then adjustments for changes in compensation levels and employees could be made. We are not proposing specific adjustments relative to this issue in the current case, but recommend that the Commission provide additional guidance to the Company to fix the issue going forward.

Q. DO YOU HAVE OTHER PAYROLL CONCERNS TO ADDRESS?

A. Yes, I describe my additional concerns and propose appropriate adjustments in "merit increase and annualization" and "incentive compensation" sections that follow.

MERIT ADJUSTMENT AND ANNUALIZATION

Q. WHAT IS THE CONCERN WITH THE MERIT INCREASE?

A. The Company's average merit increases were 3.35% in 2005, 4.03% in 2006 and 4.57% in 2007. The Company has stated that the 2008 budgeted dollars used a 4.5% merit increase in developing labor costs. In evaluating the Company's compensation levels and practices, we found the Company prepares a comprehensive analysis for comparing compensation from various studies to employee compensation. After reviewing the information supplied by the Company and based on my experience, I find the increases for 2006 and 2007, as well as the projected increase for 2008, to be unsupported.

Q. HOW DID YOU DETERMINE THAT THESE INCREASES WERE UNSUPPORTED?

A. Following the Company's practice of identifying with a specific study as the primary study and focusing on the "all" category as opposed to regional or local compensation levels, I found that the Company's employees appear near or better than average for the most part. As shown on CCS Exhibit 4.2, Page 3 the Company would have been above average if compared to regional or local compensation levels instead of the "all" category. With respect to the 2008 projection, I relied on the most recent selected primary study for guidance as to the projected increase. That study indicated that the overall increase for 2008 for distribution and combined gas operations is projected to be 3.5%. That is different from the 4.5% identified by Company witness David Curtis. The same study indicated that 2007 overall increases were about 3.6% and actual 2005 increase were 3.5%. That suggests that the Company's increases of 4.03% and 4.57% for 2006 and 2007, respectively, were high.

Q. WHAT ARE YOUR CONCERNS WITH THE ANNUALIZATION DONE BY THE COMPANY?

A. The Company has effectively projected labor costs beyond the 2008 Test Year. The annualization takes the average of the adjusted budgeted labor for the months of September 2008 through December 2008 and multiplied it by 12 to get labor costs that effectively represent labor for the twelve months ended August 2009.

Q. HAS THE COMPANY EXPLAINED ITS BASIS FOR THIS ADJUSTMENT?

A. Yes. Kelly Mendenhall stated that this is in accordance with the methodology adopted in Docket No. 93-057-01. I do not agree with Mr. Mendenhall’s statement. First, there is a significant difference in the fact that the Test Year in Docket No. 93-057-01 was an actual year ended September 30, 1993. This docket is using a projected Test Year not a historical year as was done in Docket No. 93-057-01. Second, the annualization that was done in Docket No. 93-057-01 was based on an average year employment. If the decision was being followed, the Company would be using the average employee complement for the most recent actual year completed. That would mean the average employee complement as of March 31, 2008 would be used and the labor would be annualized based on March compensation levels, not September 2008 compensation levels. The annualization proposed by the Company is not appropriate. I am recommending that the annualization be based on the average employee complement of 1,189 positions in the Base Year.

Q. WHAT ADJUSTMENTS HAVE YOU PROPOSED TO REMEDY THE MERIT INCREASE AND ANNUALIZATION PROBLEMS?

A. On Exhibit CCS 4.2, Page 2, I have annualized the Base Year compensation by increasing the base labor compensation for January through August by the excessive 4.57% and then increased September through December by the primary compensation study projection of 3.5%. I used the 4.57% incorporated by the Company for the months through August, despite the unsupported high level, since this increase has already been granted to employees. However, I used the more appropriate 3.5% for the remainder of the year. My proposed changes to the annualization reduces the Company's request $1,310,432.

Q. WHY DID YOU REDUCE THE $1,310,432 ADJUSTMENT ON CCS EXHIBIT 4.2, PAGE1?

A. On Exhibit CCS 4.2, Page 1, I adjusted the annualized Base Year to reflect the addition of an average of 17 positions to be consistent with the Company's request for an employee complement of 1,206 positions. This adjustment reduces the annualization adjustment of $1,310,432 by $663,099 for a net payroll expense adjustment of $647,333, or $626,882 on a Utah basis.

As indicated earlier I did not recommend a specific adjustment for the Company's failure to justify the increase in employees, but have requested that the Commission provide guidance to the Company as to what will be expected in the future when an increase in employees is being requested.

<u>INCENTIVE COMPENSATION</u>

Q. WHAT CONCERN IS THERE WITH THE COMPANY'S INCENTIVE COMPENSATION?

A. The Company's request includes $5,000,000 of incentive compensation to be paid on the assumption that the Company will achieve its Target Goals and that the goals are reasonable. I do not totally agree with the reasonableness of the Company's goals.

Q. WHAT ARE YOU QUESTIONING ABOUT THE GOALS SET BY THE COMPANY?

A. Incentive compensation is compensation that is supposedly at risk. To be at risk, incentive compensation must be tied to goals of increasing levels of performance, not just maintaining current levels of achievement. In response to CCS 12.22, the Company stated that maintaining superior performance is the appropriate target. To be eligible for rate recovery, superior performance must be defined as producing results that will benefit not only the Company but also the ratepayers. If superior performance is defined as maintaining current levels of achievement, incentive compensation will not be pay that is at risk. It will, instead, be expected compensation.

Q. ARE YOU PROPOSING AN ADJUSTMENT TO INCENTIVE COMPENSATION IN THIS CASE?

A. Not in this case. However, the Company should be put on notice that if goals are not set at a level that requires improved performance, then the risk will be that incentive compensation will not be allowed in rates. The Committee will closely monitor this issue in any future rate cases.

<u>LABOR OVERHEAD</u>

Q. ARE THERE CONCERNS WITH THE COMPANY'S REQUESTED LABOR OVERHEAD COST?

A. Yes. The Company has not supported its requested increase for Medical costs, Pension costs or other Salary Overhead.

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO THE COMPANY'S REQUESTED LABOR OVERHEAD COST?

A. As shown on Exhibit CCS 4.3, Page 1, the Company's request should be reduced $1,120,221, or $1,086,614 on a Utah basis.

MEDICAL COSTS

Q. WHAT ADJUSTMENT ARE YOU PROPOSING TO THE COMPANY'S REQUESTED MEDICAL COST?

A. As shown on Exhibit CCS 4.3, Page 2, the Company's request should be reduced $486,066. The Company's forecast for 2008 was developed based on the August 2007 costs being annualized and then inflated by 7% for the medical portion and 3.1% for the dental portion. This methodology was explained in response to CCS 7.19. Based on history and taking into consideration other discovery, the methodology lacks merit.

Q. WHAT HISTORY AND OTHER INFORMATION HAS CAUSED YOU TO CONCLUDE THAT THE METHODOLGY USED LACKS MERIT?

A. As shown on Exhibit CCS 4.3 Page 2, the Company's projection results in an astounding increase of 27.14% in total cost and 17.6% in expense over the 2007 Base Year costs. Initially the Company was asked in CCS 7.19 why the costs for the initial proposed Test Year ending June 2009 increased so significantly over the initial Base Year ended June 2007. Part of the explanation was the year end adjustments made in 2006. In a follow up request, CCS 10.14, a further explanation was sought regarding the 2006 adjustments. The response simply stated that "Health and Dental costs were lower than expected in 2006, so November and December costs are lower." Apparently there was an over estimate earlier in the year and the cost were being adjusted accordingly. Further review of MDR A.4U revealed that in 2005, 2006 and 2007 that the costs for medical were typically adjusted at year end. Had the Company annualized the September of 2007 expense, the cost would have been at least $600,000 less. By choosing August 2007 on which to annualize, the projected costs are artificially high.

Q. DID YOU DETERMINE WHETHER OTHER FACTORS COULD BE DRIVING UP COSTS?

A. The Company was also requested in MDR B.25 to provide detailed information about the various benefits and identify changes subsequent to the Base Year. In that response, the Company did not identify any major cost increase factors for medical. Subsequently in response to CCS 10.04, which sought information on changes to the benefits, the Company indicated that costs savings were reflected in the budgeted medical costs for changes in the mail order prescription co-pay. Based on the information received in this docket, there are changes that result in cost savings but there are no changes that would cause the costs to increase significantly. There is no evidence in the record to justify the medical expense increase requested by the Company.

Q. HOW DID YOU DETERMINE YOUR ADJUSTMENT FOR MEDICAL EXPENSE?

A. As shown on Exhibit CCS 4.3, Page 2, I took the expense for the Base Year 2007 and increased it by 7%. The result is a reduction to expense of $486,066. The 7% was the inflation rate for the health care costs and is from the Company response to CCS 7.19. This adjustment does not separately inflate the dental portion of the costs at the lower rate of 3.1%, which would have resulted in an even larger proposed adjustment.

<u>PENSION</u>

Q. DO YOU HAVE CONCERNS WITH THE COSTS FOR PENSIONS?

A. Yes. The Company failed to justify the cost requested. MDRs B.26, B.27 and B.28 asked the Company to provide information regarding pension and other post employment benefit assumptions used in the filing and the most recent actuarial reports for each. The responses stated the information was confidential and would be provided during the on-site visit. The information was not provided during the on-site visit, but the Company indicated that the information would be sent to our offices in Michigan. The information was not received. No explanation was given.

Q. DID YOU ATTEMPT TO INVESTIGATE THE ISSUE FURTHER, DESPITE THE LACK OF RESPONSE FROM THE COMPANY?

A. Yes. We reviewed the Company's 2007 annual report or Form 10(K) and noted that the typical footnote included in the financial statements for the pension and other post employment benefit costs did not include disclosures regarding the actuarial assumptions utilized. Given the lack of support in the Company's filing and in response to discovery, the Commission should require the Company to provide full and complete information on the derivation of its test year pension and other post employment expense determination including, but not limited to, the actuarial assumptions utilized as well as the most recent completed actuarial reports. They should also provide all information provided by the external actuarial firm in estimating the test year expense included in the filing. Absent such information and support being provided, the Commission should consider disallowing the costs entirely. Although we have not proposed this adjustment in our summary, it would constitute an additional $7,451,463 reduction to expenses on a total Company basis ($7,227,919 Utah basis).

OTHER SALARY OVERHEAD

Q. WHAT IS THE BASIS FOR YOUR ADJUSTMENT TO OTHER BENEFITS?

A. The Company has requested a significant increase in costs for this miscellaneous benefit. According to MDR A.4U the expense in the Base Year was $59,416 and the cost requested for the Teat Year is forecasted to be $1,532,116. The Company provides no support for increasing this amount by almost twenty-five times the base year. To put it in context, we reviewed several years' history. As shown Exhibit CCS 4.3, Page 3, the amount expensed has fluctuated from year to year.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING?

A. As shown Exhibit CCS 4.3, Page 3, the Company's expense request is being reduced $634,154 to reflect an amount that is more representative of historical costs on the assumption that all the costs included in this benefit classification are necessary and provide a benefit to customers.

Q. HOW DID YOU DETERMINE THE RECOMMENDED AMOUNT?

A. A three year average of $876,060 was used based on the costs from the years 2005 through 2007. That average was increased by $21,902 to $897,962 to account for inflation.

<u>PAYROLL TAXES</u>

Q. DOES THE ADJUSTMENT TO PAYROLL REQUIRE AN ADJUSTMENT BE MADE TO PAYROLL TAXES?

A. Yes. Payroll taxes should be reduced based on the various payroll adjustments recommended using an estimate of the Company's effective payroll tax rate. As shown on Exhibit CCS 4.4, we propose an adjustment of $42,724 ($41,442 on a Utah basis) to the Company's payroll taxes to reflect the impact of other adjustments previously made.

LEGAL LIABILITY ACCRUAL

Q. DO YOU HAVE CONCERNS WITH THE LEGAL LIABILITY ACCRUAL EXPENSE?

A. Yes. The Company's request for $714,930 in expense ($695,361 on a Utah basis) for what has been classified as legal liabilities is not supported by the evidence presented. Further, even if the Commission considers the expense to be appropriate, the Company has treated it improperly by not recognizing this is an accrual, in which case the reserve should be reflected as an offset to rate base.

Q. WHAT IS THE PROPER TREATMENT OF LEGAL LIABILITY?

A. The legal liability should be based on actual claims and not the result of adjustments to the reserve. The Company's request is based on accruals in the Base Year and is high when compared to the previous five historical periods. In reviewing the detail in the reserve for legal liabilities, it was noted that the driving force for the increase in Base Year expense was essentially the accrual to the reserve account for amounts that the Company, in response to CCS 21.19, states "a written legal assessment is not available". Under Generally Accepted Accounting Principles (GAAP), for the recording of a contingency the Company must be able to show there is a probability of loss and be able to reasonably estimate the loss. {BEGIN

CONFIDENTIAL** ** ************** {END CONFIDENTIAL} The accruals have not been substantiated.

Q. ARE THERE OTHER CONCERNS WITH THE COMPANY'S LEGAL LIABILITY ACCRUAL REQUEST?

A. Yes. On QGC Exhibit 6.3U at page 37, the Company shows how the requested average was developed. In Company witness Kelly Mendenhall's testimony, he states that the adjustment is based on the last five years of legal liabilities. I do not agree with that characterization. {BEGIN CONFIDENTIAL} ** ** ** ****************** {END CONFIDENTIAL}

Another concern is that part of the accrued amount that the Company is requesting appears to be provided for in the General Counsel's budget in cost center 1070 in which the outside consultants fees were increased by approximately $600,000. The justification provided is "Added expenses due to upcoming trials." Since this is included in the budget, this amount would typically be applied toward the self insurance costs. An average of actual claims paid is the proper method for reflecting an estimate in rates for future periods, not the use of accrued estimates that have not been sufficiently supported with evidence.

Q. WHAT ADJUSTMENT ARE YOU RECOMMENDING FOR THE COMPANY'S LEGAL LIABILITY ACCRUAL REQUEST?

A. The Company's request on QGC Exhibit 6.3U at page 37 should be reduced by $564,930 ($549,467 on a Utah basis) to $150,000 based on five years of actual historical costs. In the Company's next rate case, the actual amount paid for the claims will be included in the average and the Company will then be allowed recovery for the costs that are unknown at this time.

<u>DIRECTORS & OFFICERS LIABILITY INSURANCE</u>

Q. ARE YOU RECOMMENDING AN ADJUSTMENT TO THE COMPANY'S DIRECTORS & OFFICERS LIABILITY INSURANCE EXPENSE?

A. Yes. The Company's request for the Test Year includes $319,303 in direct expense and $95,834 from shared services for a total of $415,137. As shown Exhibit CCS 4.7, the Company's insurance expense should be reduced $207,569 ($201,341 on a Utah basis), removing 50% of the projected costs.

Q. HOW HAVE THESE COSTS BEEN CHANGING RECENTLY?

A. The cost for this insurance has skyrocketed since 2002 because of various corporate misdeeds such as those conducted by Enron Corporation, WorldCom Inc., etc. According to the response to CCS 7.37, the cost for Questar Gas Company increased from $89,782 in 2002 to $363,725 in 2007.

Q. WHY ARE YOU RECOMMENDING AN ADJUSTMENT TO THE COMPANY'S DIRECTORS & OFFICERS LIABILITY INSURANCE EXPENSE?

A. This expense is primarily for the benefit of shareholders. Directors' & Officers' liability insurance protects shareholders from themselves. It is shareholders who appoint directors and the directors are responsible for appointing officers. Ratepayers do not benefit from any claims that are made against this insurance and should not be required to pay the entire cost of this insurance. Typically a Company will argue that the cost is necessary because it is required to attract and retain competent management. Ratepayers should not be held entirely responsible for a cost that has no direct benefit to them. A proper adjustment would be for the ratepayers to pay for none of these costs that do not directly benefit ratepayers. My proposed 50% adjustment to this cost is a more than fair compromise.

SOFTWARE EXPENSE ADJUSTMENT

Q. WHY ARE YOU RECOMMENDING AN ADJUSTMENT TO THE COMPANY'S SOFTWARE EXPENSE?

A. The Company's request is overstated based on historical trends and should be reduced accordingly. The Company's request for the Test Year includes $2,889,867 in expense for software, which is significantly higher than its recent average annual actual expense. As shown on Exhibit CCS 4.8, the Company has expensed $2,436,301 on average for software over the last three years.

Q. WHAT DOES YOUR ANALYSIS SHOW REGARDING THE RELATIONSHIP TO BUDGET AND ACTUAL EXPENSE FOR SOFTWARE?

A. The notable characteristic about the budget and actuals for software is that while the budget levels vary, the actual spending has been relatively level, ranging from a low of $2.2 million in 2006 to a high of $2.7 million in 2005. In general, my analysis shows that the higher the budget, the greater was the variance. In 2005 and 2006 the Company expense was well below the higher budgeted levels. The 2007 actual expense was almost at budget, but the budgeted amount was significantly less than the 2005 and 2006 budgets. The 2008 forecast is almost as high as the 2005 budget. Based on past performance, it would be expected that with such a high budget, the variance with actual would also be higher and actual spending levels would be close to the average.

Q. WHAT ARE YOU RECOMMENDING FOR AN ADJUSTMENT TO THE COMPANY'S SOFTWARE EXPENSE REQUEST?

A. The Company's request for the Test Year expense should be reduced $455,660 ($441,990 on a Utah basis). As shown on Exhibit CCS 4.8, the reduction is the difference between the $2,889,867 requested and the three year average of $2,436,207.

<u>DONATION AND MEMBERSHIPS</u>

Q. ARE THERE CONCERNS WITH THE COMPANY'S ADJUSTMENT FOR DONATIONS AND MEMBERSHIPS EXPENSE?

A. Yes. The Company's adjustment for the Test Year does not include a sufficient level of adjustments. The adjustment for allocated costs did not reflect the removal of all the lobbying related costs and it includes cost that are considered to be image building and not beneficial to ratepayers. The Company's adjustments for Questar Gas costs also failed to remove all of the donations and image building memberships.

Q. WHAT ARE THE ALLOCATED COSTS THAT THE COMPANY'S ADJUSTMENT FAILED TO REMOVE?

A. The Company's adjustment did not remove the 3% for lobbying included in the membership costs for the National Petroleum Council and the Salt Lake Chamber of Commerce dues. In addition, the Company failed to remove the 35% of lobbying costs included in the United States Chamber of Commerce dues. The remaining portion of the Salt lake Chamber of Commerce dues and the United States Chamber of Commerce dues should also be removed. The membership in the Chamber of Commerce provides no direct benefit to ratepayers and is basically an image enhancement for the Company to claim it is a member of the Chamber of Commerce.

Q. WHAT ADJUSTMENT TO THE ALLOCATED COSTS ARE YOU RECOMMENDING?

A. The Company's allocated adjustment for donations and memberships should be increased $26,256 ($25,427 on a Utah basis) from $127,728 to $153,534. This adjustment is calculated on Exhibit CCS 4.9, Page 3. This adjustment removes the 3% of the membership costs for the National Petroleum Council associated with lobbying and 100% of the Salt Lake Chamber of Commerce dues and the United States Chamber of Commerce dues.

Q. WHAT ARE THE QUESTAR GAS COSTS THAT THE COMPANY'S ADJUSTMENT FAILED TO REMOVE?

A. The additional necessary adjustments that were not made by the Company have not all been identified. At this time, I am recommending the following adjustments:

- Based on the response to CCS 10.06, the Company's adjustment did not remove a $62,000 donation to the American Red Cross and various other donations totaling $4,550.
- The Company also had recorded its payment of dues to Energy Solutions for both 2007 and 2008 in the Base Year. Removing the duplicated payment of dues from expense increases the Donations and Memberships adjustment by another $19,000.
- Next the Company has included a payment for $15,000 to the Utah Foundation in costs cleared from account 146 in the Base Year. The Utah Foundation invoice specifically identifies the foundation as a 501(c) 3, meaning that this is a donation.
- Finally, I have identified at least $13,158 of payments to various Chambers of Commerce that, as explained above, are considered image building expense that is not beneficial to ratepayers.

I would note that while I am proposing the removal the Chamber of Commerce dues, I am not proposing the removal of some similar costs that may also be image building such as civic dues for Rotary Clubs, the Lions Club, the Kiwanis Club, etc.

Q. WHAT ADJUSTMENT TO THE QUESTAR GAS DONATIONS AND MEMBERSHIP COSTS ARE YOU RECOMMENDING?

A. After inflating each of the respective adjustments by 2.5%, as the Company did, the Company's adjustment should be increased $116,551 ($112,869 on a Utah basis), from $40,450 to $157,001. This adjustment is calculated on Exhibit CCS 4.9, Page 2. The adjustment removes the costs I identified above including American Red Cross donation, various other donations, the duplicated Energy Solutions dues, and the various Chamber of Commerce dues.

<u>**BOARD OF DIRECTORS FEES AND EXPENSES**</u>

Q. WHAT ARE YOUR CONCERNS WITH THE BOARD OF DIRECTORS FEES AND EXPENSES?

A. The Board of Directors for Questar Corporation is nearly the same as the Board of Directors for Questar Gas Company (Questar Gas Company's Board is a subset of the parent company's board). The Company must justify that the costs for directors directly benefit ratepayers. Typically, the Board of Directors is responsible to its shareholders, so the ratepayer benefits are not obvious. In this case, it is particularly troubling that ratepayers are asked to bear the costs of two Boards. The Questar Corporation Board of Directors oversees parts of the company that does not benefit ratepayers in any way. All of the Questar Gas Company board members also sit on the corporate board. Therefore, it is difficult to make a case that these Board members are representing ratepayer interests and not simply Questar Corporation interests.

Q. DID YOU DO ANY ANALYSIS TO TRY AND DETERMINE TO WHAT EXTENT BOTH BOARDS DIRECTLY BENEFITED RATEPAYERS?

A. Yes. One means of substantiating the costs is to review the Board of Directors minutes to determine the extent to which the subject matter related to and benefited ratepayers. The minutes identify the decisions made by the Board and the minutes can help determine whether the duties performed are providing a level of service to ratepayers. The Committee reviewed the minutes of Questar Gas Company and the Questar Corporation minutes from February 8, 2005 through October 23, 2007. The vast majority of the Questar Corporation minutes were redacted, therefore providing little, if any, evidence that the board work in any way related to ratepayer interests. In fact, less than ten percent of the total material contained any printed material to review. I estimated that the printed section of the pages for each meeting in relation to the redacted pages to be less than ten percent of the total pages made available for review. The Questar Gas minutes consisted primarily of a generic introduction, a brief recap of results of operations, dividend approval and compensation approval. The Questar Corporation minutes that were available for review included basically the introduction and on a rare occasion Questar Gas Company was mentioned.

None of the minutes showed business decisions related to the ratepayers being made. The content of the meetings showed very little support for the directors' fees and expenses to be included in rates.

Q. HOW MUCH IS INCLUDED IN THE TEST YEAR FOR DIRECTORS FEES AND WHAT IS YOUR RECOMMENDATION WITH REGARDS TO THESE FEES?

A. The Directors fees in the filing for Questar Gas Company and Questar Corporation are $638,148. Given the lack of justification for Directors fees and expenses, there is no real justification for ratepayers to pay this expense I recommend that the Commission put the Company on notice that failure to justify directors fees in future rate cases will result in a disallowance of Directors fees.

<u>MISCELLANEOUS ADJUSTMENTS</u>

Q. WHAT MISCELLANEOUS ADJUSTMENTS ARE YOU RECOMMENDING?

A. The Company during the Base Year recorded a golf outing at a cost of $7,528 in account 908, a payment of $15,000 to the Utah State Fairpark for sponsorship, a $1,000 for sponsorship of the Utah Science Center, a $10,000 sponsorship for the Utah Manufacturers Association, and last but not least $44,200 for a blimp at a Utah Jazz game. These sponsorship costs are image building that are not costs that the ratepayers of Utah should have to pay. Finally, the Company charged $15,683 to account 921 for MREs (dried foods) for emergency purposes. I am not questioning the appropriateness of the cost but the fact that the costs are not recurring and the MREs are expected to be stored for emergency purposes for a period of maybe five years, based on a discussion with the Company. This cost is being recommended for allowance as if it were being amortized over a five year period.

Q. WHAT IS THE MISCELLANEOUS ADJUSTMENT YOU ARE RECOMMENDING?

A. The Company's Test Year costs should be reduced $90,274 for these items. On Exhibit CCS 4.10 I reduced miscellaneous expenses by $90,274 ($87,416 on a Utah basis).

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.