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MEMORANDUM

To: Public Service Commission

From: Division of Public Utilities
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Energy Section
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Date: December 13, 2010

Subject: Questar Gas, Docket Nos. 10-057-17 (191 Account Pass-Through), 10-057-18 (Energy Efficiency), 10-057-19 (Conservation Enabling Tariff) and 10-057-20 (Infrastructure Rate Adjustment).

ISSUE:

On November 30, 2010, Questar Gas Company (QGC) filed four applications with the Public Service Commission (PSC).

Docket No. 10-057-17 (191 Account Pass-Through) asks for PSC approval to decrease the commodity rate components of the QGC's Utah natural gas rates by \$11,579,000 while increasing the supplier non-gas cost by \$4,943,000 which nets to a decrease of \$6,636,000.

Based on current gas cost rates in the GS Rate class, if approved, a typical GS residential customer will see a \$5.15 decrease in their annual bill.

Docket No. 10-057-18 is a request to maintain the current amortization rate set in Docket No. 10-057-15 for QGC'S Energy Efficiency (EE) programs which were established in Docket No. 05-

057-T01. If approved, a typical GS residential customer will see no change in the current amortization rate or in their annual bill.

Docket No. 10-057-19 is a request to amortize the October 2010 Conservation Enabling Tariff (CET) credit balance of \$3,346,800 (over-collection) in Account 191.9 and adjust the CET component in Block 1 and 2 of the GS class distribution non-gas (DNG) rate. If approved, based on the current CET amortization rate component in the GS Rate class DNG rate, a typical GS residential customer will see a \$0.13 increase in their annual bill.

Docket No. 10-057-20 is a request to include an Infrastructure Rate Adjustment component to the distribution non-gas cost rates of its Utah GS, FS, IS, TS, FT-1, MT and NGV natural gas schedules as approved in the Settlement Stipulation in Docket No. 09-057-16. If approved, as modified and discussed by the Division below, a typical GS residential customer will see a \$2.78 increase in their annual bill.

If all four applications are approved, a typical GS customer will see a net decrease in their annual bill of \$2.24. All four applications request an effective date of January 1, 2011.

RECOMMEND APPROVAL:

After a preliminary review of all four applications, the Division recommends that all application's rates be approved as filed for Docket Nos. 10-057-17, 18 and 19 and as modified herein for Docket No. 10-057-20 with the proposed rates becoming effective January 1, 2011. The Division recommends all rate change approvals on an interim basis.

DISCUSSION:

DOCKET NO. 10-057-17 COMMODITY AND SUPPLIER NON-GAS COSTS (191 Account)

This filing is based on projected Utah gas costs of \$539,723,061 for the test year of January 1, 2011 through December 31, 2011. The commodity portion represents a decrease of \$11,579,000

in rates while the Supplier Non-Gas (SNG) rates increase by \$4,943,000 for a total net decrease of \$6,636,000 for firm sales customers.

QGC is requesting to decrease the base commodity rate from \$4.24/Dth (rounded) to \$4.15/Dth (rounded), resulting in a \$9,001,000 decrease in the base commodity gas costs for firm sales customers as a result of the projected decrease in market prices for natural gas. This expected decrease during the 2011 calendar year is from the previous projection of gas prices in Docket No. 10-057-09. Adding to the commodity gas cost decrease is a decrease in the 191 account amortization rate. This rate is decreased from \$0.37/ Dth, which went into effect August 1, 2010¹ to \$0.34/Dth (rounded). The amortization rate decrease results in a projected decrease of \$2,578,000 for firm sales customers which, when combined with the \$9,001,000 decrease from market rates, equals the \$11,579,000 decrease in commodity gas costs. The Supplier Non-Gas (SNG) rates have increased by 4.95%, to recover \$4,943,000 in increased SNG costs.

The net effect of the decrease in gas costs to a typical GS residential customer is a decrease in their annual bill of \$5.15, or 0.73%, from gas costs in current rates.

Utah Gas Supply

QGC expects a total Utah system requirement of 115.4 million decatherms. Of this, 105.5 million decatherms will meet the projected sales requirement; 5.0 million decatherms is required for gas volume reimbursement for gathering, transportation and distribution fuel use; 4.9 million decatherms is planned to increase gas storage inventory levels. To supply the Utah system requirement, QGC plans on utilizing 65.7 million decatherms of WEXPRO production, 56.9% of total requirements, at a net projected cost of \$280,244,000² while purchasing from third party producers another 49.7 million decatherms, 43.1 % of total requirements, for \$193,514,000.³

¹ Docket No. 10-057-05.

² QGC Application, Docket No. 10-057-17, Exhibit 1.5, Line 5 Column E.

³ Ibid, Line 6, Column E.

Transportation and storage costs are projected to be \$65,966,000 for an estimated total cost to Utah customers of \$539,723,000.⁴

As noted in the filing, and as provided for in QGC's Tariff for Natural Gas Service in Utah, PSCU 400, §2.10, pp. 2-11 through 2-13, these gas costs represent a direct pass through of costs. These costs do not impact the operating profit or rate of return of QGC except for \$3,712,000,⁵ which is the Utah allocation of the pre-tax return on the working storage gas inventory approved by the PSC in Docket No. 93-057-01 and based on the pre-tax rate of return from the weighted cost of capital approved in the Settlement Stipulation in QGC's most recent rate case, Docket No. 09-057-16.

Natural Gas Spot Prices

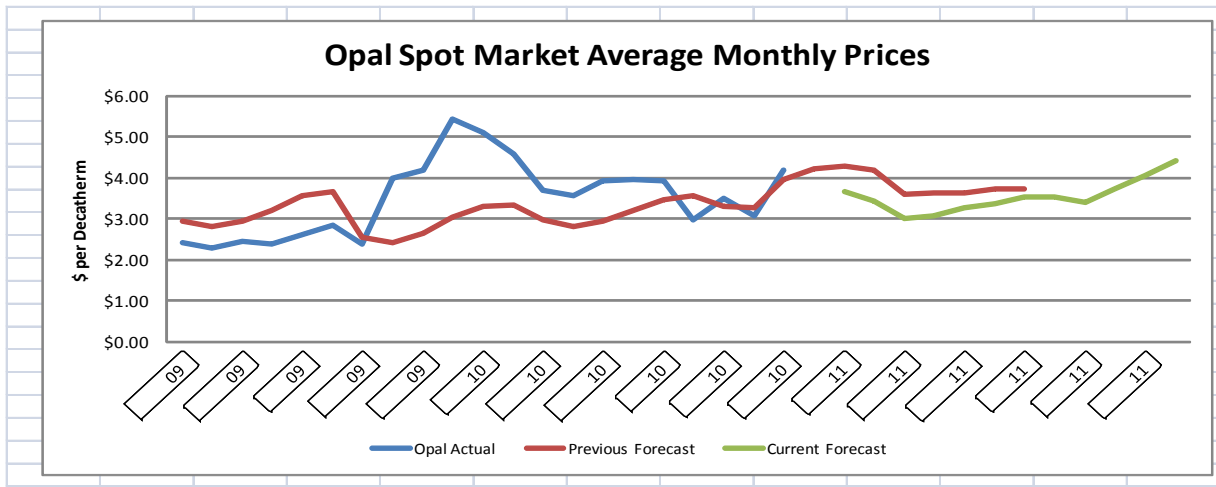
Since the time the PSC approved the last pass-through request, effective August 1, 2010 (Docket No. 10-057-09), actual prices have trended downward from the previously forecasted prices. In this filing, QGC utilizes an average forward looking twelve month forecast spot price of \$3.54/Dth⁶ compared to \$3.76/Dth in the previous filing. Figure 1 shows the actual first of month spot prices for natural gas at Opal, Wyoming from March 2009 through November 2010 compared to the forecasted prices used in the previous pass-through application in Docket No. 10-057-09, as well as the forecast prices for the 2011 calendar year used in this application. As shown in Figure 1, from October 2009 through July 2010, actual prices have been higher when compared to the forecast prices that form the basis for setting the rates QGC charges its customers. However, since August 2010, when the forecast was last updated in Docket No. 10-057-09, actual prices have tracked close to the forecasted price.

⁴ QGC Application, Docket No. 10-057-17, Exhibit 1.5, Line 14, Column E.

⁵ Ibid, Exhibit 1.5, Line 13, Column E.

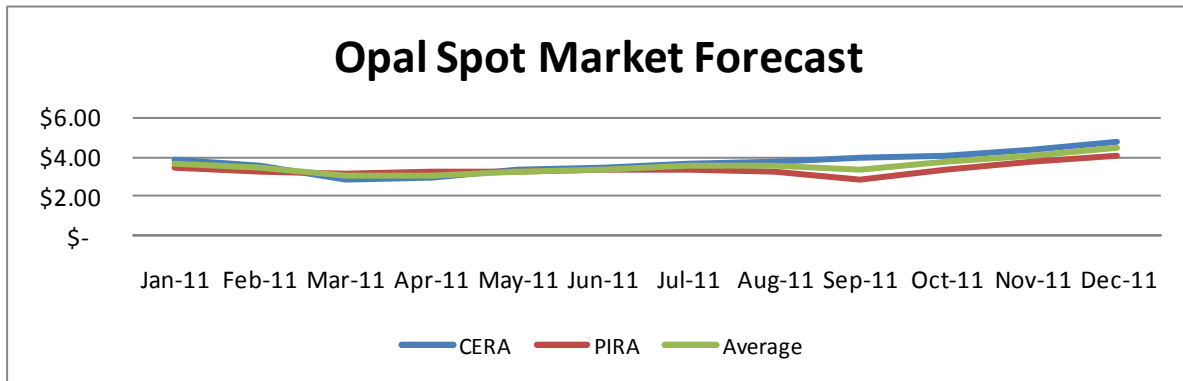
⁶ Arithmetic average of PIRA and CERA forecast from January 2011 to December 2011 used in pass-through application Docket No. 10-057-17.

Figure 1



The price forecast in this filing is based on an average of future price projections by two different forecasting entities. Those two entities are Cambridge Energy Research Associates, Inc. (CERA) and PIRA Energy Group (PIRA). The two price forecasts for CERA and PIRA are displayed in Figure 2. Figure 2 reveals what appears to be a relative consensus on prediction of natural gas price stability through August of 2011.

Figure 2



Pricing Hedges

The WEXPRO production and QGC's gas storage practices play an important role in QGC's plan to "hedge" against natural gas price volatility while meeting their overall supply plan. These practices generally allow QGC to keep WEXPRO production flowing during the summer months to meet summer demand and to inject into storage for later use during the winter months. The use of storage gas minimizes the need to purchase gas in the winter. As previously mentioned, the Utah allocated WEXPRO production is 65.7 million decatherms or 56.9% of the gas supply mix. The weighted cost of this production is \$3.89/Dth⁷ which is an increase of \$0.11/Dth since the last filing in Docket No. 10-057-9. Currently, with lower projected spot market prices, the average net cost of the WEXPRO production is equal (rounded) with the projected average cost of \$3.89/Dth⁸ for purchased gas. When gathering costs for the WEXPRO production are added, the total cost of the WEXPRO production is \$4.26/Dth⁹, \$0.37/Dth higher than the purchase cost per decatherm.

QGC further attempts to manage gas price volatility, and thereby "hedge" or mitigate customers' exposure to that volatility, by continuing its planned purchase program. For this filing, as previously mentioned, in addition to the 65.7 million decatherms of company owned production, QGC has developed a Utah gas supply portfolio of 49.7 million decatherms. This filing includes planned gas purchases for January through March of 2011, which are the last three months of the 2010-2011 winter heating season and November-December 2011, the first two months of the 2011-2012 winter heating season. Because of this, QGC has yet to fully develop a hedging strategy for the 2011-2012 heating season but already has in place some fixed price contracts for January-February of the 2010-11 heating season. Typically, QGC targets 20% to 30% of the winter purchase requirement as a target for fixed price contracts. These approaches are developed through continued meetings with regulators to provide updated information regarding this planned "hedging" program and current expectations in the gas market.

⁷ QGC Application, Docket No. 10-057-17, Exhibit 1.4, Line 3, Column D.

⁸ Ibid, Line 6, Column D.

⁹ Ibid, Line 5, Column D.

Supplier Non-Gas Costs (SNG)

In contrast to the volatility seen in the price of natural gas, the SNG costs are relatively stable and predictable since those costs are set by contractual rate agreements. Therefore, in Docket No. 09-057-03, QGC proposed and the Division supported, setting the SNG amortization rate annually. QGC projects total SNG costs, in this filing, to be \$102,834,000.¹⁰ The October 2010 SNG portion of the 191 account balance is \$2,310,000.¹¹ At current rates, SNG revenues that will be collected are projected to be \$100,200,000¹² leaving a balance \$4,943,000 for an adjustment to current rates. Therefore, QGC is requesting a 4.95%¹³ increase to the SNG summer and winter rates.

191 Account Rate Details

DPU Exhibit 1.1 shows a summary of the SNG and commodity rate changes proposed in this application for the GS Rate Schedule. Netting the changes requested from the current rates results in a decrease in the GS commodity rates of \$0.11¹⁴/Dth (rounded) for both the summer and winter. The GS SNG rates increase by \$0.03/Dth (rounded) in the summer and \$0.06/Dth in the winter.¹⁵ Based on these new rates, a typical GS residential customer will realize a decrease in their annual bill of \$5.15 which is a 0.73% decrease in annual gas costs.

DOCKET NO. 10-057-18 ENERGY EFFICIENCY(EE) AMORTIZATION

This application requests the current EE amortization rate set in Docket No. 10-057-11 remain unchanged. That rate was set to amortize an estimate of \$36,000,000 in EE costs. The actual October 2010 EE balance in Account 182.4 is \$43,673,000. However, the 2011 Energy

¹⁰ QGC Application, Docket No. 10-057-17, Exhibit 1.6, page 2 of 3, Line 1. This represents an increase of \$2.7 million from the SNG costs in Docket No. 10-057-09. This increase is mainly due to the increase in gathering expenses associated with the WEXPRO production.

¹¹ Ibid, line 2.

¹² Ibid, line 4.

¹³ Ibid, line 7.

¹⁴ DPU Exhibit 1.1, line 56.

¹⁵ Ibid, line 52.

Efficiency budget request pending before the Commission in Docket No. 10-057-15 is for \$32,241,000. Because of changes in the market place and changes requested in the 2011 EE budget, the Company and the Division both feel that the level of expenditures in the EE programs will begin to reduce and stabilize resulting in a more predictable level of spending that is lower than the current balance in the EE 182.4 account. Therefore, the Division supports keeping the current \$0.38/Dth amortization rate set in Docket No. 10-057-11 for the GS rate schedule. The Division also feels, for reasons stated above, that the DSM amortization rate may best be suited for annual adjustments due to the relative stability of costs. This will help promote rate stability by allowing the amortization to occur through a full summer and winter heating season where the majority of GS sales volumes occur. The Division will discuss going to an annual EE amortization with the Company.

DOCKET 10-057-19 CONSERVATION ENABLING TARIFF (CET)

Unlike the SNG and commodity rate changes in Docket No. 10-057-17 that affect the rates for all firm sales customers, but like the EE amortization rate, the rate changes requested in Docket No. 10-057-19 affect only a component of the distribution natural gas (DNG) rates of the GS rate class. In this docket, the Company requests to begin amortizing an over-collected balance of \$3,347,000 in the CET deferral account, which is the balance in Account 191.9 as of October 31, 2010. This over collected balance is lower than the balance approved in Docket No. 10-057-10 by \$124,000 resulting in a net increase to the amortization rates as shown in DPU Exhibit 1.2, line 58. If approved by the PSC, a typical GS rate class customer will see a increase in their annual bill of \$0.13 or a 0.02% change due to a lower CET amortization credit rate.

Rate Details

The CET amortization rates reflected in the GS tariff sheets filed with this application have changed for both blocks 1 and 2 of the summer and winter rates. The incremental increase in the

GS DNG Block 1 rate is \$0.001/Dth (rounded) for the summer rate and \$0.002/Dth rounded for the winter rate as shown in DPU Exhibit 1.2.¹⁶

DOCKET 10-057-20 INFRASTRUTURE RATE ADJUSTMENT

This is the first application filed by QGC since the approval by the PSC of an infrastructure tracking mechanism pilot program as part of the Settlement Stipulation in Docket No. 09-057-16.¹⁷ In this application filed by QGC, the Company requests PSC approval for a surcharge to be applied to all rate schedules to allow QGC to begin earning on \$25,335,000 of replacement costs for sections of feeder lines now in service. The cost details are provided in Exhibit 1.1 of the application. In reviewing the application, the Division believes there are four modifications that should be made to Questar's calculation of the revenue requirement associated with the tracker in this filing. The Division believes it is important to establish the correct procedures at the beginning to avoid the accumulated effects that may carry over time. The Division has met with QGC and discussed these modifications. These four modifications increase the revenue requirement requested by QGC from \$3,123,623¹⁸ to \$3,179,618,¹⁹ an increase of \$55,995.²⁰ The four modifications are as follows:

- 1) The current filing assumes that the tax basis (for which tax depreciation is calculated) is the same as the book basis (for which accumulated depreciation is calculated). Due to tax laws regarding allowance for funds used during construction (AFUDC), the book and tax basis amounts should technically be different. The tax basis used by the Division was based on estimates²¹ obtained from Questar. This distinction should be made so that accumulated deferred income taxes (ADIT) are calculated accurately.

¹⁶ DPU Exhibit 1.2, Line 58, Columns B,D.

¹⁷ Settlement Stipulation, Docket No. 09-057-16, paragraph 15, page 20.

¹⁸ QGC Application, Docket No. 10-057-20, Exhibit 1.1, Page 2 of 2, line 11.

¹⁹ DPU Exhibit 1.3, line 34.

²⁰ Ibid, line 35.

²¹ The Division added back the retirement costs to the Company's estimated tax basis. Tax basis = $[(25,042,918+25,192,158)/2] + 651,869$.

- 2) The amount of accumulated depreciation included in Questar's filing is based on an assumption that all the assets are placed into service January 1, 2011 and that depreciation begins on that same date and is accumulated through December 31, 2011. Although these dates are consistent with the proposed 2011 test year, the actual assets came into service over a six month period between July 2010 and December 2010. This means that depreciation started accumulating in July of 2010 and not January 1, 2011. By starting the accumulated depreciation in July 2010, the 2011 test period would have a beginning accumulated depreciation debit²² balance of \$568,074 rather than a zero credit or debit balance. The Division proposes that depreciation should start accumulating in July 2010 and that a 13 month average balance of accumulated depreciation be used for the test year. This averaging is consistent with the averaging methods used for accumulated depreciation in previous Questar general rate case filings.
- 3) The third modification is similar to the second modification above, but involves ADIT as opposed to accumulated depreciation. The current filing includes 2010 bonus depreciation but does not accurately take into consideration the beginning and ending ADIT balances for the test year. ADIT balances begin accumulating in 2010 and carry through to the end of 2011. The complicated tax calculations are not conducive to a 13 month average and so the Division proposes a beginning/ending average to calculate the ADIT balance for the 2011 test year.
- 4) Questar's filing did not take into consideration the effect of the November 2010 retirements on accumulated depreciation. Retirements have the opposite effect that depreciation expense has on accumulated depreciation. As a result, accumulated depreciation should have a debit balance at the beginning of the test year. After meeting with Questar personnel, the retirement numbers themselves were also modified slightly to match the actual accounting records.

²² The beginning test year balance is a debit balance because of the retirements that occur in November 2010. See DPU Exhibit 1.4, line 12.

DPU Exhibit 1.5 shows the impact of each of the recommended modification to the revenue requirement filed in the application. The sequence shown in the exhibit reflects the order in which they were implemented.

These modifications are also consistent with the methodologies used by Rocky Mountain Power in their second major plant addition filing. For example, Rocky Mountain Power's Dunlap Wind plant and associated interconnect project were anticipated to be placed in service over the course of August 2010 through October 2010. The test year used for Dunlap was 2011. The accumulated depreciation and ADIT balances included in the Company's revenue requirement started accumulating in August 2010 and carried forward to December 2011. Therefore, Rocky Mountain Power's test year began with an ADIT balance and an accumulated depreciation balance. Rocky Mountain Power also used a 13 month average for the accumulated depreciation balance and a beginning/ending average for the ADIT balance.

Incorporating these modifications into the rate calculations does modify the rates from those filed in Exhibit 1.3 of the application as shown in DPU Exhibit 1.6, Column J. If the modified rates in DPU Exhibit 1.6 are approved by the PSC, a typical GS residential customer will see an increase in their annual bill of \$2.78 or a 0.40% change rather than the \$2.75 noted in the filing.

SUMMARY AND CONCLUSION

DPU Exhibit 1.7, Line 58 , Columns B,C,D and E shows the net decrease of all four applications on the rates of the GS class's summer and winter rates. DPU Exhibit 1.8 combines the effect of all four applications and shows that a typical GS rate class residential customer whose annual usage is 80/Dth will see a net decrease in their annual bill of \$2.24 or 0.32%. This is the net result of the \$2.91 increase to a customer's annual bill as a result of the changes to the DNG rates off-set by the decrease of \$5.15 from the changes to the SNG and commodity rates.

With the current state of the overall economy, it is difficult to predict exactly what effect the current economic conditions will have on the volatility of natural gas prices. It is hoped that prices will remain stable, but, as history has shown, that hope can diminish very rapidly. The Division wishes to emphasize the need for customers to become even more energy efficient. The current Energy Efficiency programs offered by QGC through the ThermWise campaign provide an excellent opportunity for customers to become more aware of ways they can become more energy efficient. Those GS customers that do take advantage of the EE programs will be able to mitigate, to some degree, the effects of price spikes in natural gas. The Division continues to urge QGC to use its customer education and EE funds to educate consumers on how they can reduce their gas usage on an ongoing basis in order to reduce consumption and mitigate the impact of possible future price increases.

As always, the Division will continue to monitor the published monthly index prices²³ and compare them to the prices used in this pass-through filing to see if any trend develops that may warrant an out-of-period filing by QGC.

The Division supports and recommends that the rate changes requested in Docket Nos. 10-057-17, 18 and 19 be approved by the Commission as filed and the revised rates in column J of the DPU's Exhibit 1.6 be approved for Docket No. 10-057-20. The Division recommends that all rate changes be approved on an interim basis until the Division can complete an audit of the entries into the respective accounts associated with these applications. After the completion of those audits, the Division will issue memos to the Commission with its recommendations on making the revised rates permanent.

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²³ Published monthly in Platts "Inside FERC's Gas Market Report."

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