

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION
OF QUESTAR GAS COMPANY FOR
APPROVAL OF THE WEXPRO II
AGREEMENT

Docket No. 12-057-13

DIRECT TESTIMONY OF BARRIE L. McKAY

FOR QUESTAR GAS COMPANY

September 18, 2012

QGC Exhibit 1.0

I. INTRODUCTION

1 **Q. Please state your name and business address.**

2 A. My name is Barrie L. McKay. My business address is 333 South State Street, Salt Lake
3 City, Utah.

4 **Q. By whom are you employed and what is your position?**

5 A. I am employed by Questar Gas Company (Questar Gas or Company) as General Manager
6 of State Regulatory Affairs. I oversee and am responsible for state regulatory and energy
7 efficiency matters affecting Questar Gas Company in Utah and Wyoming.

8 **Q. What are your qualifications to testify in this proceeding?**

9 A. I have listed my qualifications in QGC Exhibit 1.1.

10 **Q. Attached to your written testimony are QGC Exhibits 1.1 through 1.4. Were these
11 prepared by you or under your direction?**

12 A. Yes.

13 **Q. What is the purpose of your testimony in this Docket?**

14 A. The purpose of my testimony is to explain 1) the benefits to customers of Wexpro cost-
15 of-service production; 2) the limitations of the Wexpro cost-of-service production; 3) the
16 unique opportunity that the Wexpro II Agreement gives to customers for future cost-of-
17 service production; 4) the meetings and discussions that led to the development of the
18 Wexpro II Agreement; and 5) an explanation of Articles IV and V of the Agreement that
19 provide the terms and conditions for acquiring a Wexpro II property and other
20 miscellaneous provisions.

21 **Q. Are there others who will provide testimony in this proceeding?**

22 A. Yes. Mr. James R. Livsey, Executive Vice President & Chief Operating Officer of
23 Wexpro Company, will also provide an overview of the 31-year history of Wexpro
24 Company and an explanation of Articles I, II and III of the Wexpro II Agreement that
25 were modeled after Articles I, II and III of the Wexpro I Agreement.

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II. BENEFITS TO QUESTAR GAS CUSTOMERS

27 **Q. Please explain how the Wexpro I Agreement has benefited Questar Gas' customers?**

28 A. Questar Gas' customers have benefitted significantly from the Wexpro I Agreement since
29 its inception in 1981. Natural gas supplies provided pursuant to the Wexpro I Agreement
30 have ranged between one-third to one-half of the annual supplies required to meet the
31 needs of Questar Gas' customers. Historically, on average, cost-of-service gas has been
32 lower-priced than market-based sources. From 1981 to the present, Questar Gas'
33 customers have saved approximately \$1.27 billion in gas costs. Additionally, this has
34 provided Questar Gas' customers with a stable source of gas supply and a long-term
35 hedge against price volatility.

36 **Q. Can you please explain how the estimated savings were determined?**

37 A. Yes. Exhibit 1.2 illustrates these savings. Page 1 is a line graph showing the costs of
38 purchased gas compared to the cost of Wexpro cost-of-service production that have been
39 included in the 191 account over the last 30 years. Page 2 is a graph illustrating the
40 cumulative savings to Questar Gas' customers over this same time period. For each year,
41 the annual Wexpro cost-of-service decatherms were multiplied by the average cost-of-
42 purchased gas that was included in the 191 account for that year. The difference between
43 this number and the total cost-of-service gas (Wexpro costs) represent the savings to
44 customers for that year. This substantial savings has been a significant factor for Questar
45 Gas in maintaining rates that are among the lowest in the nation. *See* QGC Exhibit 1.3.

46 **Q. How long can we anticipate continued Wexpro cost-of service production?**

47 A. The production from Wexpro wells comes from a defined set of properties that are clearly
48 set forth in the Wexpro I Agreement. Because of technological improvements in drilling
49 and production methods, these properties have produced longer and at greater levels than
50 the original Wexpro I Agreement parties anticipated. However, Wexpro production is
51 finite and limited to Wexpro defined areas. Although the Wexpro cost-of-service
52 production has provided a long-term hedge against price volatility for Questar Gas
53 customers in the past, it cannot be expected to last indefinitely.

54 **Q. Has Questar Corporation developed gas and oil properties other than the properties**
55 **defined in the Wexpro I Agreement?**

56 A. Yes. Questar Corporation has always been in the business of developing oil and gas
57 properties. While Wexpro has only developed cost-of-service production for Questar
58 Gas; Celsius Energy Company, and its successor in interest, Questar Exploration and
59 Production Company, acquired, explored, developed and produced oil and gas properties
60 for its own account at market rates. Today, Questar Corporation, through Wexpro, is
61 positioned to expand its exploration and production of properties outside the Wexpro I
62 Agreement.

63 **Q. Are properties available today that would be economical for acquisition by**
64 **Wexpro?**

65 A. Yes. Today's low-price gas environment makes this an advantageous time to consider
66 acquisition of new gas reserves.

67 **Q. Could Questar Corporation create another exploration and production company to**
68 **develop new gas reserves?**

69 A. Yes, however, Questar Corporation's current management recognizes that the Wexpro
70 model has been successful for both Questar Corporation and for Questar Gas' customers.
71 Questar Corporation's management desires to provide Questar Gas' customers an
72 opportunity to have access to continued cost-of-service production. This gives customers
73 an opportunity going forward to benefit from future cost-of-service development.

74 **Q. Is this what led to the development of the Wexpro II Agreement?**

75 A. Yes. Beginning in the fall of 2011, public meetings were held in both Utah and
76 Wyoming to discuss, among other issues, the Wexpro II concept. Following these
77 meetings, additional meetings were held pursuant to the Company's Integrated Resource
78 Plan (IRP) process and outside the IRP process with representatives from the Company,
79 Wexpro, the Utah Division of Public Utilities (Division), Utah Office of Consumer
80 Services (OCS), the Wyoming Office of Consumer Advocate (OCA), and the
81 hydrocarbon monitor.

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83 **Q. What was the focus of these meetings?**

84 A. Questar Gas, Wexpro and the other interested parties discussed a number of issues during
85 these meetings including: the history of the Wexpro I Agreement; customer benefits from
86 cost-of-service gas and oil revenue sharing over the last three decades; the role of the
87 accounting and hydrocarbon monitors; opportunities to acquire production and/or
88 leaseholds under the Wexpro II concept; new development drilling asset treatment;
89 regulatory right-of-first-refusal on asset acquisitions within existing Wexpro development
90 drilling areas; and coordination of Wyoming and Utah regulatory agencies.

91 **Q. What was the result of these meetings?**

92 A. With the input of these interested parties, the Wexpro II concept was further developed
93 and refined. Ultimately, the Wexpro II Agreement was the result of these parties'
94 contributions and input. The Wexpro II Agreement is attached as Exhibit 1.4.

95

96

III. WEXPRO II AGREEMENT

97 **Q. Did all of the interested parties sign the Wexpro II Agreement?**

98 A. Wexpro, Questar Gas, the Division, and the OCA have signed the Wexpro II Agreement
99 which is modeled after the terms and conditions of the Wexpro I Agreement. However,
100 the OCS, which provided significant contributions toward the development of the
101 Wexpro II Agreement, determined that it could not sign the agreement at this time.
102 Should the OCS' concerns be resolved to its satisfaction, we would welcome the OCS
103 joining the agreement going forward.

104 **Q. Please describe the Wexpro II Agreement.**

105 A. There are two key concepts underlying the Wexpro II Agreement:

106 (1) Wexpro acquires properties at its own risk.

107 (2) The Commissions have a right of first refusal on all properties acquired
108 within the Wexpro Development Drilling Areas and may determine

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109 whether to include these properties as Wexpro II properties under the
110 terms of the Wexpro II Agreement.

111 **Q. Would you describe how the proposed Wexpro II Agreement works?**

112 A. Yes. If approved, the Wexpro II Agreement would allow for Questar Gas to file an
113 application with the Wyoming and Utah Commissions to include properties acquired by
114 Wexpro as “Wexpro II Properties.” A Wexpro II Property would be developed and
115 produced under substantially the same terms and conditions set forth in the Wexpro I
116 Agreement. The Wexpro II Agreement is modeled after the Wexpro I agreement. There
117 are five major articles plus an article referencing exhibits: Article I provides the list of
118 defined terms; Article II describes the treatment for Wexpro II oil properties; Article III
119 describes the treatment for Wexpro II gas properties; Article IV describes the process for
120 a Wexpro II Property Acquisition and accounting treatment; and Article V provides
121 miscellaneous provisions including monitoring, dispute resolution, force majeure,
122 guideline letters and confidential information.

123 **Q. Were Articles I, II and III modeled after the Wexpro I Agreement?**

124 A. Yes. Article I is the definition section and is substantially the same as Article I of the
125 Wexpro I Agreement, with the exception of definitions that are not applicable to the
126 Wexpro II Agreement. Articles II and III are also substantially the same as the same
127 articles in the Wexpro I Agreement. These two articles generally address the
128 classification, accounting treatment and rate of return for the oil and gas properties. Mr.
129 Livsey provides a more thorough and complete explanation of these two articles in his
130 testimony.

131 **Q. Please describe Wexpro II Property Acquisitions.**

132 A. Article IV addresses the terms for property acquisitions; the supporting documentation
133 required for when an acquired property shall be proposed to the Utah and Wyoming
134 Commissions for approval as a Wexpro II property; the application procedure; the
135 hydrocarbon monitor’s role; withdrawal of properties; treatment of acquisition costs; title
136 to properties; management of gas volumes; and accounting and regulatory treatment.

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137 **Q. Would you briefly describe each provision of Article IV?**

138 A. Yes. The first provision, Property Acquisition, provides that Wexpro will acquire an oil
139 or gas property or undeveloped lease at its own risk. Wexpro understands that if the
140 property is not approved for inclusion as a Wexpro II property, it will develop the
141 property at its own risk. This alleviates the concern that Wexpro may only acquire
142 marginal properties. There are certain properties that must be brought to the Utah and
143 Wyoming Commissions for approval. Section IV-1 (a) provides that any property
144 acquired by Wexpro within the development drilling areas of the Wexpro I Agreement
145 must be brought to the Utah and Wyoming Commissions. This right-of-first refusal
146 alleviates the concern that Wexpro would not offer the best performing properties. If
147 both Commissions approve these properties for inclusion as Wexpro II properties,
148 Wexpro will develop these properties for the benefit of Questar Gas' customers as
149 provided in the Wexpro II agreement.

150 **Q. What about properties outside the Development Drilling Areas as defined by**
151 **Wexpro I?**

152 A. Section IV-1 (b) provides that if Wexpro acquires additional oil and gas properties or
153 undeveloped leases outside these Development Drilling Areas, Questar Gas may apply
154 for Commission approval to include these properties as Wexpro II properties. If
155 approved, Wexpro would develop and produce these properties under the terms of the
156 Wexpro II Agreement.

157 **Q. Would you please describe the application and supporting information referenced**
158 **in Section IV-2?**

159 A. Yes. The Company worked with interested parties and the hydrocarbon monitor to
160 develop a list of the documentation and analysis that the Company will file with each
161 application. To the extent that a particular property requires additional information, the
162 Company will file such supporting information as requested or needed.

163 **Q. Please describe the application procedure and the role of independent hydrocarbon**
164 **monitor in Sections IV-3, 4, and 5.**

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165 A. Following the acquisition of a property by Wexpro, the Company will file an application
166 requesting approval of the property as a Wexpro II property. Within seven business days
167 following receipt of the application by the Division and the OCA, the hydrocarbon
168 monitor/evaluator will file an independent review of the assumptions, data and analysis
169 used by Wexpro in the purchase of the proposed property, but will not provide a
170 recommendation regarding approving the property for inclusion as a Wexpro II property.
171 The Division and OCA will file responses either recommending approval or rejection of
172 the proposed property based on their own analysis and on the independent hydrocarbon
173 monitor's evaluation. If the proposed property is not approved by both Commissions
174 within 60 days, Questar Gas may withdraw the property from consideration. This time
175 limitation allows Wexpro to assess and manage the risk of carrying properties it
176 purchased at its own risk for an indefinite amount of time.

177 **Q. Will the capital costs used to acquire these properties earn a return similar to**
178 **property identified as "prior company wells" in the Wexpro I Agreement?**

179 A. Yes. Section IV-6 defines the return Wexpro will earn on the acquired property. This
180 return is calculated using the Commission-allowed return which is defined as the
181 weighted average of the then current Utah and Wyoming rates of return approved for
182 Questar Gas and determined as of July 31 of each year using the previous calendar year's
183 volumetric firm sales. Additionally, this provision describes how the properties will be
184 depreciated.

185 **Q. What about the return on the development drilling area?**

186 A. Development drilling wells will earn the same return as in the Wexpro I Agreement,
187 Articles II and III.

188 **Q. Who will retain title to these Wexpro II properties and how will the production of**
189 **gas volumes be managed?**

190 A. Wexpro will retain title and associated operating rights to all Wexpro II properties.
191 Additionally, just as with Wexpro I properties, Questar Gas will manage the rate of
192 production of gas volumes on a daily basis.

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193 **Q. Finally, would you please explain the accounting and regulatory treatment as**
194 **described in Section IV-9.**

195 A. Yes. This section requires Wexpro to separately account for Wexpro II properties. All
196 royalties, income and costs associated with Wexpro II properties will be accounted for
197 under the 191 balancing account tariff provisions. If a proposed property is not approved
198 for inclusion as a Wexpro II property then all direct costs associated with that property
199 must be assigned to that property and all common or general and administrative costs will
200 be allocated using the distri-gas formula.

201 **Q. Have you prepared an exhibit that illustrates the Wexpro II property approval**
202 **process described in Section IV and Wexpro well-determination process?**

203 A. Yes. Attached as Exhibit F to the Wexpro II Agreement (Exhibit 1.4) is a flow chart that
204 depicts these processes. Page 1 depicts the Wexpro II property approval process and
205 page 2 depicts the Wexpro II well-classification process.

206 **Q. How was Article V developed?**

207 A. Article V is a combination of applicable provisions from the Wexpro I Stipulation and
208 Article VIII of the Wexpro I Agreement.

209 **Q. Are there any provisions that changed through the course of discussion with**
210 **interested parties that you would like to highlight?**

211 A. Yes. Starting with Section V-2, "Integrated Provisions," this provision now reads that if
212 any part of this Agreement is stricken down by a court or agency with proper jurisdiction
213 it will not cause the entire Agreement to fail. This is a departure from the Wexpro I
214 Agreement where parties agreed that failure of one provision would cause failure of the
215 entire Agreement.

216 Section V-6, "Force Majure" was written to include Wexpro only. If Wexpro is rendered
217 incapable of carrying out its obligations due to a force majeure event, then it will notify
218 the parties and try to remedy the situation as soon as possible. Questar Gas must
219 nevertheless do everything possible to ensure that its customers receive uninterrupted

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220 service. If Questar Gas is impacted by a force majeure event, it will rely on its tariff just
221 as it would with any service interruption that is outside its control.

222 Section V-12 “Monitoring of Performance Under Agreement,” was changed to allow that
223 the monitors will be paid actual and reasonable fees and expenses incurred in evaluating
224 properties for both Wexpro I and Wexpro II by Wexpro without a cap.

225 Section V-13 “Dispute Resolution” was changed to limit the arbitration to a default by
226 Wexpro of its obligations under the agreement. A default by the Company is anticipated
227 to be adjudicated before the Utah and Wyoming Commissions. Otherwise, the arbitration
228 provision mirrors the original language in the Wexpro I Agreement. While this dispute
229 resolution provision has never been used in the 30 years of Wexpro I Agreement
230 operations, it is a consistent process of resolving disputes between the Parties over well
231 classifications or monitoring issues that the Parties agreed to continue under Wexpro II.

232 Section V-15 “Guideline Letters” addresses the guideline letters that were developed
233 during the last 30 years that provide guidance to the independent monitors, Wexpro
234 Company, Division and Wyoming Staff regarding issues that have arisen. The Parties
235 agreed that the guideline letters applicable to Wexpro II properties would be incorporated
236 by reference in the Wexpro II Agreement. The Parties also understand that future
237 guideline letters may be required. The Parties agreed that future guideline letters would
238 be developed with the Parties, and Wyoming Commission Staff, and in consultation with
239 the independent monitors as necessary. In an effort to ensure that both the Wexpro I
240 Agreement and the Wexpro II Agreement are interpreted and applied consistently, it is
241 anticipated that any future guideline letters would apply to both agreements.

242 And finally, Section V-18 “Amendment” provides that the Wexpro II Agreement may be
243 amended with the consent of the Parties and subject to the Commissions’ approvals.

244 **IV. BENEFITS OF THE WEXPRO II AGREEMENT**

245 **Q. Please summarize why you believe the Wexpro II Agreement is beneficial for**
246 **Questar Gas’ customers?**

247 A. First, Wexpro will acquire these properties at its own risk prior to seeking Commission
248 approval to include them as Wexpro II properties. The Commissions of Utah and
249 Wyoming will always have a choice as to whether the properties should be developed for
250 the benefit of Questar Gas' customers. The viability of each property and the potential
251 hedge that it provides will be fully vetted by the Company, the hydrocarbon monitor and
252 any other interested parties before the Commissions decide whether to include the
253 properties as Wexpro II properties. Once approved and developed, Questar Gas'
254 customers will continue to enjoy the risk-mitigation that is built into the terms and
255 conditions of the existing Wexpro I Agreement. Having long-term access to cost-of-
256 service supplies will lessen the impact of the volatility of the natural gas market on
257 Questar Gas and its customers. Questar Gas' customers will not experience sharp spikes
258 that market-based gas costs have seen. And if history is any indication, Questar Gas'
259 customers should continue to enjoy significant cost savings over time.

260 **Q. Is the Wexpro II Agreement in the public interest?**

261 A. Yes. The Wexpro II Agreement provides a unique opportunity for Questar Gas' Utah
262 and Wyoming customers to receive the substantial benefits of a long-term physical hedge
263 against price volatility in the natural gas market.

264 **Q. Does this conclude your testimony?**

265 A. Yes.

State of Utah)
) ss.
County of Salt Lake)

I, Barrie L. McKay, being first duly sworn on oath, state that the answers in the foregoing written testimony are true and correct to the best of my knowledge, information and belief. Except as stated in the testimony, the exhibits attached to the testimony were prepared by me or under my direction and supervision, and they are true and correct to the best of my knowledge, information and belief. Any exhibits not prepared by me or under my direction and supervision are true and correct copies of the documents they purport to be.

Barrie L. McKay

SUBSCRIBED AND SWORN TO this ____ day of September, 2012.

Notary Public