BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF QUESTAR GAS COMPANY TO INCREASE DISTRIBUTION RATES AND CHARGES AND MAKE TARIFF MODIFICATIONS	)))))))))	**DOCKET NO. 13-057-05** **DPU Exhibit 1.0 SR** **Testimony** **Douglas D. Wheelwright**

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

Testimony of

Douglas D. Wheelwright

January 7, 2014

INTRODUCTION AND SUMMARY

Q: Please state your name, business address and title.

A: My name is Douglas D. Wheelwright; my business address is 160 East 300 South, Salt Lake City, Utah 84114. I am a Technical Consultant with the Division of Public Utilities (Division).

Q: On whose behalf are you testifying?

A: I am testifying on the Division's behalf.

Q: Are you the same Doug Wheelwright that filed direct testimony in this proceeding?

A: Yes I am.

Q: What is the purpose of your surrebuttal testimony?

A: I will respond to the rebuttal testimony of Ross Ford from the Utah Home Builders Association (Utah Home Builders) regarding main and service line extension cost allocations and to the rebuttal testimony and calculations provided by David M. Curtis for Questar Gas Company (Questar Gas or the Company) regarding cost of equity/return on equity.

Q: Can you summarize your final conclusion and recommendation?

A: Although I have revised my analysis slightly, my final conclusions have not changed. I continue to maintain that the appropriate return on equity (ROE) for Questar Gas is 9.45% with an overall weighted average cost of capital of 7.44%. I believe that my cost of capital estimate and overall weighted average cost of capital estimate are just and reasonable and in the public interest.

RESPONSE TO THE UTAH HOME BUILDERS

Q: Do you agree that Questar Gas' proposed changes to the service line and main extension cost allocations will place a greater burden on lower income customers living in lower-end homes?

A: The proposed change appears to be based on the costs associated with the line extension and the Division supports the allocation of costs to the appropriate users. I would agree that new

homes that require a short line extension will be paying more under the new program than would be required under the current program. I would not agree that new homes that require a short service line extension will create a burden on low income customers.

I am not exactly sure which customers Utah Home Builders witness Mr. Ross Ford is considering low income customers when he states, "However, the Home Builders Association is concerned that lower-income customers who generally live in lower-end homes will be adversely affected by the proposed changes to the cost allocation."[1] I do not believe that, for his purposes in this docket, he is discussing the individuals who qualify for the HEAT or other assistance programs but instead he is discussing customers purchasing smaller new homes. Based on the information provided, the average service line extension in 2011 was 46 feet, and application of the new method would result in an increased cost to the customer of $275.54.[2] This amount does not appear to create an overwhelming burden on a new home buyer. The impact of the line extension policy on urban and rural areas should be considered as well since rural locations may require a longer service line extension than a more urban area.

Q: Do you agree that the cost of the meters should be capitalized by Questar Gas instead of being paid for by the customer?

A: No, I disagree with Mr. Ross' statement.[3] The installation of a service meter is a cost that should be paid by the user of the service, not shared by all rate payers. The recovery of these costs over an extended period of time will create additional costs to rate payers if Questar Gas were allowed to earn the allowed rate of return on additional rate base items.

RESPONSE TO QUESTAR GAS

Q: Do you feel that the rebuttal testimony and exhibits of Mr. Curtis support the 10.35% requested ROE?

[1] Rebuttal Testimony of Ross Ford, lines 116-118.
[2] Rebuttal Testimony of Ross Ford, Exhibit C.
[3] Rebuttal Testimony of Ross Ford, lines 271-273.

A: No. I have reviewed the information provided in Mr. Curtis' rebuttal testimony and I do not believe that his original or revised calculations support the recommended 10.35% return on equity. DPU Exhibit 1.1 SR provides a summary of Mr. Curtis' calculations provided in his rebuttal testimony compared with the revised calculations provided by the Division. Averaging the various methods used by Mr. Curtis to calculate the cost of equity results in a 9.82% estimate.[4] Additionally, as will be discussed later in this testimony, I disagree with some of the assumptions used in Mr. Curtis' analysis.

Q: Do you still believe that the appropriate cost of equity for Questar Gas is 9.45% as filed in your direct testimony?

A: Yes I do. I have made modifications to my original analysis and have included updated exhibits identified as DPU Exhibits 1.1 – 1.6 SR. The revised exhibits support the DPU's proposed 9.45% return on equity.

Q: Can you provide additional information concerning why you feel the Company's ROE analysis is not correct?

A: Yes. There are several items in the Company's analysis that I will discuss in this testimony and which I discussed in my direct testimony that are inconsistent with Questar Gas' prior filings and are not supported by the evidence or analysis provided by Mr. Curtis.

Q: Do you agree that the Commission should consider the recent Alabama Gas Corporation allowed return of 10.8% as a comparable to Questar Gas?

A: Not at all. Alabama Gas does not follow the formal rate case process like other gas utilities across the country and the recent award is actually a reduction of the stabilization rate allowed for this utility. As SNL Finance reports,

> The PSC's rate stabilization and equalization, or RSE, mechanism, does not provide for regular formal rate cases and allowed Alabama Gas, an Energen Corp. subsidiary commonly known as Alagasco, to earn an ROE between 13.15% and 13.65% - a range well above the 2012 full-year average ROE of 9.94% for gas utilities nationwide. Commissioner Terry Dunn had expressed concern that the lack of formal rate cases and transparency had allowed the RSE mechanism to become detached from the current economy, but PSC President Twinkle

[4] DPU Exhibit 1.1 SR.

> Cavanaugh and Commissioner Jeremy Oden have not supported instituting formal rate cases. But even without a formal rate case, the commission decided Nov. 5 to lower Alagasco's authorized ROE range to 10.5% to 10.95%, with a 10.8% adjusting point. [5]

DPU Exhibit 1.2 SR provides a summary of the authorized returns for natural gas companies through December 27, 2013. This information updates the information provided in my direct testimony as DPU Exhibit 1.4 DIR. It appears that Mr. Curtis updated his authorized returns for comparable companies through June 2013 but then selectively included only the Alabama decision from November. Including only the November Alabama stabilization decision provides an incorrect comparison to other general rate case decisions. Because the rate setting process in Alabama is different, SNL Financial does not include the Alabama decision in its summary of the 2013 rate case decisions.

In addition, the Company's update does not mention other rate cases that were concluded between June and November with allowed returns of 9.60%, 10.20%, 9.84%, 10.25 and 9.5%.[6] Since June 2013 there have been 17 natural gas rate case decisions. The Company continues to fails to note the downward trend in the allowed rate of return in recent years. As identified in DPU Exhibit 1.2 SR, the average allowed return for 2013 was 9.66%, with a high of 10.25% and a low of 9.08%. The 2013 average is down from the 9.94% average in 2012, and 9.92% in 2011.

The last column of DPU 1.2 SR provides a comparison of the requested ROE and the authorized ROE for natural gas companies from January 2011 through December 2013. A comparison of the requested ROE and the authorized ROE indicates an average reduction of 81 basis points in 2013 and 83 Basis points in 2011 and 2012.[7] If the average 81 basis point difference between the requested and allowed ROE were applied to this Questar Gas case, the authorized ROE would be reduced from 10.35 to 9.54%. This calculation compares favorably to the Division's recommended 9.45%.

[5] SNL Financial, Alabama PSC finds common ground, drops Alagasco ROE closer to national average, November 5, 2013.
[6] DPU Exhibit 1.2 SR.
[7] DPU Exhibit 1.2 SR.

Q: Do you agree that a lower allowed rate of return will cause a downgrade in the bond rating?

A: No. In the rebuttal testimony provided as QGC Exhibit 2.3R, Mr. Curtis provided an estimate of the impact to net income under the Company's proposed 10.35%, the Division's recommended 9.45%, and the Office of Consumer Service's (Office) recommended 9.30%. Mr. Curtis states, "Questar Gas will need to manage its financial affairs very tightly to avoid a down grade in its bond ratings."[8] While the different allowed returns do slightly change the key ratio calculations, the lower ROE amounts do not change the indicated ratings when compared to those calculated under the Company's higher ROE amount. Standard & Poor's Research issued a credit rating of A / Stable for Questar Gas in January 23, 2013, noting "supportive regulation, a growing service area with a mostly residential customer base, low operating risks and lack of competition characterize the utility's excellent business risk profile."[9]

The Company's assessment of a pending down grade does not match the recent decision by Moody's to possibly upgrade many of the regulated utilities in the United States including Questar Gas and Questar Corp. Moody's reported:

> New York, November 08, 2013 -- Moody's Investors Service placed the ratings of most regulated utilities and utility holding companies in the United States on review for upgrade, affecting approximately $400 billion of debt. These companies have been placed on review because Moody's has adopted a generally more favorable view of the relative credit supportiveness of the US regulatory environment, as detailed in our September 23, 2013 Request for Comment: "Proposed Refinements to the Regulated Utilities Rating Methodology and our Evolving View of US Utility Regulation."
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> RATINGS RATIONALE
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> "Our placement of these issuers on review considers improving regulatory trends in the US, including better cost recovery provisions, reduced regulatory lag, and generally fair and open relationships between utilities and regulators, " said Moody's Managing Director Larry Hess. We believe that many US regulatory jurisdictions have become more credit supportive of utilities over time and that

[8] Rebuttal Testimony of David M. Curtis, page 5, line 124.
[9] Standard & Poor's Research, Questar Gas Co., January 23, 2013.

> our assessment of the regulatory environment that has been incorporated into ratings may now be overly conservative.
>
> The US utility sector's low number of defaults, high recovery levels, and generally strong financial metrics from a global perspective provide additional corroboration for our view that ratings should generally be higher.
>
> We expect that most upgrades will be limited to one notch, and that the reviews of the affected companies will be completed within approximately 90 days. Although we anticipate that most of the utilities placed under review will be upgraded, there may be selected instances where ratings will not be upgraded following the completion of our review.
>
> We note that several regulated utilities and utility holding companies were not placed on review due to issuer specific circumstances that would preclude an upgrade at this time. These exclusions include utilities that are engaged in substantial construction programs for new generation or other large capital projects, currently have a Negative Outlook or are under potential downward rating pressure, are characterized by material concentration or event risk, face market or regulatory risks specific to their particular jurisdictions, or are part of a corporate family that has significant non-utility operations.[10]

Within the past six months, Questar Gas has issued new long term bonds at interest rates of 4.78% and 4.83%. This recent bond activity indicates that Questar Gas is able to obtain financing and issue debt at favorable interest rates. The Division agrees with the Company that lower rated debt will have a higher interest rate, however no information has been presented to indicate that the 9.45% recommended ROE will result in a lower bond rating.

Q: Do you agree with Mr. Curtis that Questar Gas has a higher level of risk than the proxy group and should require a higher rate of return?

A: No. As noted above, the Company has access to debt offering at favorable rates and has access to equity infusion from Questar Corporation. Due to the current regulatory requirements, most if not all of the natural gas distribution companies are completing infrastructure upgrades requiring capital expenditures. In response to the suggested five basis point reduction due to the infrastructure recovery mechanism, Mr. Curtis stated: "The other Companies in the proxy group have similar revenue stabilization mechanisms and

[10] Moody's Investors Service, Rating Action: Moody's places rating of most US regulated utilities on review for upgrade, November 8, 2013.

similar risks which are already included in the return on equity calculation."[11] This statement would indicate that the other comparable companies have similar risk, not lower risk, and therefore should have a similarly rate of return.

Another measurement of risk for investors is the stability and predictability of future earnings. DPU Exhibit 1.6 SR provides a summary of the return on equity for the comparable companies and for Questar Gas from 2004 through 2012. With the exception of 2004, Questar Gas has had more stable earnings than the industry average and significantly more stable earnings than Northwest Natural and Piedmont Natural Gas. The more stable earnings pattern suggests a lower risk of volatile future earnings for investors. There has been no information presented that would indicate that Questar Gas has a higher level of risk than the proxy group.

Q: Do you still believe that New Jersey Resources and WGL Holdings should be excluded from the selected proxy group?

A: No. I believe that they both should be included. While both companies generate a significant portion of their total income from non-regulated operations, they do generate over 50% of their operating income from regulated natural gas distribution. I have included updates to the DCF, CAPM, and comparable earnings models as DPU Exhibits 1.3 SR through DPU Exhibits 1.6 SR to include New Jersey Resources and WGL Holdings. I have included both companies in the revised exhibits, however it does not materially change the calculations or the outcome of the analysis from my original calculations. The revised DPU exhibits also include the updated stock price through December 26, 2013. A summary of the revised DPU analysis has been included as DPU 1.1 SR. This summary includes the revised calculations provided in the QGC rebuttal exhibits.

Q: Do you still believe that Laclede should be included in the comparable group?

A: Yes. As I stated in my direct testimony, much of the peer group analysis is based on the historical earnings growth and dividend payments. The historical information has been compared to the projected earnings and dividend growth rates. The merger of Missouri Gas

[11] Rebuttal Testimony of David M. Curtis, page 9, line 218.

with Laclede was announced in December 2012 and was approved by the Missouri Public Service Commission on July 17, 2013. As analysts prepare forecast growth rates, they will consider known facts and circumstances that may impact future earnings. It is likely that analysts and investors have already included the merger in forecast growth rates and therefore should be included in the analysis.

Q: Do you believe that the Company has used the correct growth rates in its revised DCF analysis?

A: No. Two of the three principal components in the DCF model are directly observable in the market: the dividend payment and the current stock price. The third component or future growth rate is necessarily an estimate, and is the key component of the analysis. Mr. Curtis' states in his rebuttal testimony that "Traditionally, the most common source of earning growth rate expectations has been from published analyst reports".[12] While acknowledging the use of published growth rates, the Company analysis uses a growth rate that is significantly higher than the published rates. The growth rate is the key component of the DCF analysis and by using a higher growth rate the Company model overstates the expected rate of return. The differences between the published growth rates and the growth rates used in the Company analysis are summarized below.

	Average	Midpoint
Yahoo, Reuters and Zacks	4.61%	4.60%
Value Line	6.00%	5.50%
Questar Analysis Growth Estimate	6.94%	

The Company model uses a 6.94% growth rate derived by averaging the historical five year earnings growth for each company, the historical 10 year earnings growth for each company and a calculated industry midpoint based on the forecast of six companies. No explanation has been provided as to why the industry midpoint is used or why the industry calculation is different from the comparables used in the other analysis. One of the six companies selected to calculate the industry earning growth estimate is Questar Gas. It is inappropriate to include an internal growth forecast for Questar Gas to calculate an industry comparable ROE

[12] Rebuttal Testimony of David M. Curtis, page 10, line 239.

for Questar Gas. The Company has not provided any explanation as to why company growth estimates for only five of the comparable companies have been used to calculate an industry average and why the higher midpoint was used instead of the average.

The updated DCF model included as DPU Exhibit 1.3a SR uses the published growth rates from Reuters, Zacks and Yahoo and results in an estimated cost of equity of 8.21%. DPU Exhibit 1.3b SR uses the published growth rates from Value Line and results in an estimated cost of equity of 9.26%. The difference of 1.05% between the two models demonstrates the importance of selecting an appropriate growth rate. The revised exhibits indicate a reduction from the estimated cost of equity calculated in my direct testimony. The Value Line growth rates have been used in the summary report to estimate the appropriate rate for Questar Gas.

Updated two-state DCF models have been included as DPU Exhibit 1.4a SR and 1.4b SR. The updated models include New Jersey Resources and WGL Holdings and include updated stock prices through December 26, 2013. The revised exhibits indicate a reduction from the estimated cost of equity calculated in my direct testimony.

Q: Have you modified your calculation of the CAPM model from your rebuttal testimony?

A: Yes. I have reviewed the Ibbotson calculation model and have removed the industry adjustment that was included in my direct testimony. In addition, the revised model includes New Jersey Resources and WGL Holdings in the comparable list and uses the current 30 year US Treasury rate of 3.94%. The key assumptions used in calculating the CAPM model are the beta value and the risk premium. The risk premium is calculated as the difference between the market returns and the risk free returns over various time periods. DPU Exhibit 1.5a SR uses the average of the Yahoo, Reuters and Zacks beta values and DPU Exhibit 1.5b SR uses the Value Line beta values. DPU Exhibit 1.5a SR calculates an investor expected return of 8.53% and DPU Exhibit 1.5b calculates the investor expected return of 10.04%. The only difference between the two models is the published beta value since Value Line uses a different method to calculate the beta value.

As mentioned in my direct testimony, the use of size and industry adjustments can be

controversial. DPU Exhibit 1.1 SR includes the Ibbotson Risk Premium calculation without adjustments which calculates an expected market return of 8.48% using the current risk free rate, the Value Line beta and the 87 year average risk premium. Calculations for the expected returns using the 15, 20, 30, 40 and 50 year average risk premiums have been include at the bottom of Exhibits 1.5a SR and 1.5b SR.

Q: Do you agree with the Company's calculation of the buildup method identified in Mr. Curtis' rebuttal testimony?

A: Yes. As mentioned in Mr. Curtis rebuttal testimony, an additional calculation model or buildup method can be used to estimate the expected return. The key to this model is also the equity risk premium that is used in the calculation. Consistent with the other models, the Company uses the 87 year average risk premium from 1926 – 2012.

Using a 30 year Treasury bond rate of 3.94% and the 87 year average risk premium of 6.70%, the estimated cost of equity would be 9.93%. I have included the calculation using the 50 year average risk premium below for comparison.

Risk Free Rate	3.94%
Equity Risk Premium (50 Yr Avg) [13]	4.50%
Industry Discount or Premium[14]	-2.44%
Firm Size Premium	1.73%
Estimated Questar Gas Cost of Equity	7.73%

If the 50 year average risk premium of 4.50% is used instead of the 87 year average, the expected return drops to 7.73%. Changing only one variable can have a significant change in the calculation so the selection of the appropriate risk premium is very important to the analysis. As I stated in my direct testimony, I am more comfortable with the 50 year average but have used the higher 87 year average to compensate for the current low interest rate environment.

Q: With the addition of New Jersey Resources and WGL Holdings, have you provided an update to the comparable earnings model?

[13] 2013 Ibbotson SBBI Valuation Yearbook, Table A-1, page 147.
[14] 2013 Ibbotson SBBI Valuation Yearbook, Table 3-5, page 37, SIC Code 4924.

A: Yes. DPU Exhibit 1.6 SR provides a summary of the historical return on equity from 2004 through 2012 for all of the comparable companies and for Questar Gas. The last three columns calculate the three and five year average returns and the nine year standard deviation. Including the two additional companies increases the three year average return from 10.34% in my direct testimony to 10.71% primarily due to the high return attributed to New Jersey Resources of 13.87%. The revised analysis indicates that Questar Gas has earned a 0.16% lower return over the past three years than the comparable companies.

The last column on DPU Exhibit 1.6 SR calculates the standard deviation of the returns on equity over the 2004-2012 time period. Standard deviation is a common statistical measure of variability; the higher the standard deviation, the more risk there is to the expected return, and vice versa. Questar Gas has a standard deviation that is one-third of the average. Only Atmos Energy had a lower standard deviation than Questar Gas. This analysis further supports the idea that Questar Gas has less risk than a typical company in the proxy group.

Q: Is there any recent information that you want the Commission to be aware of as it considers the authorized return on equity for Questar Gas?

A: Yes. On January 3, 2014 PacifiCorp filed a new rate case application with the Commission (see Docket No. 13-035-184). In its application PacifiCorp requested a return on equity of 10.0 percent, or 35 basis points (0.35 percent) below what Questar Gas is requesting.

Q: Will you summarize the Return on Equity amount the Division is recommending for this case?

A: Yes. I have completed and included the revised calculations for the various models and maintain that the appropriate cost of equity for Questar Gas is 9.45%. The Division's recommendation is near the mid-point of the calculated range of 7.93% to 11.47% and is based on an average of the Ibbotson Risk Premium model, Discounted Cash Flow model and the Comparable Earnings model.[15] The recommended rate is fair to the ratepayers and to the Company and is slightly lower than the 9.66% average authorized return for natural gas

[15] DPU Exhibit 1.1 SR.

302 companies in 2013[16] but higher than the 9.16% allowed return for Questar Gas by the
303 Wyoming Commission. The results of the Division's calculations are summarized in DPU
304 Exhibit 1.1 SR.

305 **Q: Does this conclude your testimony?**

306 A: Yes.

[16] DPU Exhibit 1.2 SR.