



GARY HEBERT

Governor

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Lieutenant Governor

State of Utah
Department of Commerce
Division of Public Utilities

MEMORANDUM

To: Utah Public Service Commission

From: Utah Division of Public Utilities

Chris Parker, Director

Artie Powell, Energy Section Manager

Brenda Salter, Technical Consultant

Douglas Wheelwright, Technical Consultant

Charles E. Peterson, Technical Consultant

Date: February 24, 2015

Re: Request for Agency Action to Review the Carrying Charges Applied to Various Questar Gas Company Account Balances, Docket No. 14-057-32

Recommendation (Reset Carrying Charges Annually)

The Division of Public Utilities (Division) recommends that the Public Service Commission of Utah (Commission) order that the carrying charges paid on identified accounts of Questar Gas Company (Questar or Company) be updated annually initially changing on July 1, 2015 and then on March 1 of succeeding years. The Division proposes to use the average of the annual Aaa and Baa Corporate interest rates for the preceding calendar year as published by the Federal Reserve Board of Governors. The Division believes that periodically revising the carrying charges will keep these charges more in-line with current market rates and reduce the possibility, or the

perception of the possibility, that Questar or its parent company or affiliates may take advantage of carry charges that are disparate from interest rates available in the marketplace.¹

Issue

On December 31, 2014 the Division made a request for Agency Action to review the carrying charges applied to various Questar Gas Company account balances. On January 13, 2015 the Commission held a scheduling conference setting February 24, 2015 as the date for the Division's initial recommendation in this docket. The Commission also scheduled a technical conference that was held on January 26, 2015. At the technical conference the Company made a presentation discussing the history of each account's carrying charge. The Division notes that the current carrying charge for all accounts, 6.0 percent, was first set in the mid-1990s from previous rate of 9.0 percent. The Division believes that the carrying charge rate for more recent accounts, such as DSM in 2006, was set to be merely consistent with the rates in other accounts and not based upon reflection of interest rate levels at the time.

Analysis and Discussion

The Division examined the following six accounts that it believes are the only ones that have Commission-approved carrying charges associated with them.

Account	Description
182.3	Demand Side Management
182.4	Pipeline & Distribution Integrity
191	Pass Through Costs
235.1	Customer Deposits
191	CET
191.8	Energy Assistance Balancing Account
	Extension Area Charge (EAC)

¹ The Division mentions the possibility of the Company "gaming" the interest rates only as theoretical possibility. The Division has no evidence that the Company has done this.

As described above, annual carrying charges in each of these accounts is currently set at 6.0 percent. Depending on whether the balance in a particular account is a debit balance (i.e. the Company has under-collected on the account) or a credit balance (i.e. the Company has over-collected on the account) the carrying charge interest can either accrue to the Company or to customers. The only exception is the Customer Deposit account where the carrying charge accrues to the customer.

The possible incentives for the Company to “game” the carrying charge rate depends on the current interest rate, the debit or a credit balance, and the anticipated duration of the account balance. The following are hypothetical scenarios.

- If the Company has the opportunity to invest at an interest rate that is higher than the carrying charge rate, then there is an incentive for the Company to try to create and maintain a credit balance (over-collection). The Company collects the money from customers and invests it at the higher rate and earns the difference between the high rate and the carrying charge the customers receive for lending their money to the Company.
- If the Company can borrow money at a rate that is lower than the carrying charge, the incentive is for the Company to create and maintain, if it can, a debit balance (under-collection). The Company earns the difference between the higher carrying charge and the lower rate that it can borrow to cover the under-collection.
- The anticipated duration of the credit or debit balance situations described above, will provide an incentive for the Company to act. If the credit or debit balance can persist for months or years, then it would only be prudent money management practice for the Company to maximize interest income or minimize interest expense. Similarly if the debit or credit balance durations were short and of highly unpredictable duration, then the Company would likely find it impractical to actively pursue a few dollars of interest income or expense.

As stated in the last bullet point a regulated utility would generally be expected to act prudently in all of its operations including its money management. In the long run prudent money management would benefit ratepayers with lower rates than otherwise. However, the situation is complicated when the utility is part of a holding company structure, which Questar is. There may be situations where the parent holding company can extract the benefit of the debit or credit balances to the detriment of ratepayers. For example, if the utility has a large cash balance that might be the result of over-collection on the accounts under consideration, then the parent company might take out a loan from the subsidiary and invest the proceeds at a (expected) higher return than the carrying charges the subsidiary utility has to pay. Without strict regulatory oversight of such a transaction between the parent and the subsidiary utility, utility ratepayers would see no benefit from the interest rate arbitrage engaged in by the parent company.

Analysis of the Company's balances versus interest rates.

The Division investigated the relationship between certain interest rates, the current carrying charge, and certain major accounts of Questar where carrying charges are applied. The Division notes that historically there was a problem with the DSM account which was under-collected due apparently to an unexpected rush for customers to install home insulation. At its peak the account ballooned to \$33 million in 2011. In docket no. 11-057-04 the Commission ordered the Company to reduce the balance to near zero over a three year period.

The Division also collected information from the Company regarding the monthly Account 191 balances. DPU Exhibit 1 sets forth a chart of the Account 191 monthly balances between January 2000 and December 2014. DPU Exhibit 2 sets forth a chart of various interest rates obtained from the Federal Reserve Board of Governors.²

² See <http://www.federalreserve.gov/releases/h15/data.htm> last accessed February 23, 2015.

DPU Exhibit 3 sets forth the results of a correlation analysis between the Company's balances, estimated carrying charge interest, and the interest rates found on DPU Exhibits 1 and 2. The Correlation Analysis indicates that there is no correlation between interest rates and the 191 Account balances. There is however some correlation between the various interest rates and the cumulative estimated interest on the 191 Account balances. This correlation effect appears to be due to the combination of the decline in interest rates over the period and the cumulative interest rate balance generally trending from a positive (i.e. a debit balance implying under-collection) to a negative (i.e. a credit balance implying over-collection). In other words, in terms of debits and credits it declines as well.

The overall conclusion is that there is no evidence of the Company trying to manipulate these balances in order to achieve some internal corporate goal. Indeed the data suggests that overall, the Company has had to pay interest to ratepayers, on average, during a time when all of the interest rates examined were declining to below six percent values.

Analysis and Recommendation of Changes Going Forward.

In the mid-1990s when the Commission adjusted the carrying charges from typically 9.0 percent to the current 6.0 percent level, DPU Exhibit 2 shows that the 90-day commercial paper rate was about 5.5 percent and the long-term bond rates and the bank prime lending rates were about 1.5 to 2.0 percent above the 6.0 percent rate. Currently the bank prime lending rate is 3.25 percent, where it has been since 2009; the long-term average Baa and Aaa bond rates are about 4.50 percent; and the 90-day commercial paper rate is around 0.10 percent.

The Wyoming Public Service Commission sets rates annually and recently set the carrying charge rate for calendar year 2015 for all gas companies at 1.68 percent.³

In selecting a carrying charge rate, the Division is aware that there is no perfect, one-size-fits-all rate. If purely incentivizing the Company to keep balances at zero were the only motivation, one could richly reward ratepayers with a high interest rate paid on over-collections and “reward” the Company with little or no interest paid on under-collections.

The Division believes that it is unreasonable to expect the Company to be able to meaningfully control funds flowing into or out of these accounts, it appears to the Division that a single interest rate balancing the interests of rate payers and the Company that has been employed to date combined with continued regulatory monitoring of the account balances appears to be the most reasonable. Since longer-term interest rates are typically more stable, and because the short-term rates are much more subject to manipulation by federal monetary policy, the Division believes that a readily available longer-term rate is appropriate. If the Commission believes that a move to lower, shorter-term rates is more appropriate, then it would likely be best to do that in steps in keeping with the general principle of gradualism.

The Division recommends that the Commission adopt the average of the annual Aaa and Baa Corporate interest rates for the preceding calendar year as published by the Federal Reserve Board of Governors. The Division believes that periodically revising the carrying charges will keep these charges more in-line with current market rates. The Division proposes that the annual updated rates first go into effect on July 1, 2015 for the period through February 29, 2016, and then on March 1 of succeeding

³ See <http://psc.state.wy.us/pscdocs/gas.html> last accessed February 23, 2015.

years. The March to February fiscal year allows for the collection of annual data from the preceding year to be collected and evaluated. The rate that would go into effect on July 1, 2015 is 4.51 percent based upon the annual average of the Baa and Aaa corporate bond yields as published by the Federal Reserve Board of Governors.

CC Barrie McKay, Questar Gas Company
 Michele Beck, Office of Consumer Services
 Service List