Witness OCS – 1D

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION	)	
OF QUESTAR GAS COMPANY FOR	)	
APPROVAL OF THE CANYON CREEK	)	DOCKET NO. 15-057-10
ACQUISITION AS A WEXPRO II	)	
PROPERTY	)	

REDACTED

DIRECT TESTIMONY

OF

GAVIN MANGELSON

FOR THE OFFICE OF CONSUMER SERVICES

OCTOBER 8, 2015

DIRECT TESTIMONY OF GAVIN MANGELSON

INTRODUCTION

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

A. My name is Gavin Mangelson; I am a Utility Analyst for the Office of Consumer Services (Office). My business address is 160 East 300 South, Salt Lake City, Utah 84111.

Q. PLEASE DESCRIBE YOUR EDUCATION AND EXPERIENCE.

A. I received a B.A. in Economics from the University of Utah. I previously worked as a Financial Analyst for the Department of Technology Services; where my duties involved the creation of rates that were subject to approval by a government appointed commission. I have completed a Utility Analyst training course from New Mexico State University. In my capacity with the Office I have submitted comments in over thirty dockets and testimony in dockets 14-057-19, 14-057-31 and have analyzed issues relating to cost-of-service, rate design, and gas supply.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to provide the response of the Office regarding the proposed inclusion of a newly acquired portion of the Canyon Creek property into the Wexpro II agreement and the other provisions contained in Questar Gas Company's (Questar or the Company) proposal. As part of this response, I will indicate what aspects of the Wexpro agreements have been advantageous to customers. I will also identify which portions of the Company's proposal the Office supports and which portions cause us concern.

CANYON CREEK ACQUISITION AND PROPOSED PROVISIONS

Q. WHAT IS BEING PROPOSED IN THIS DOCKET?

A. The primary proposal in this docket is to allow recently acquired portions of the Canyon Creek property to be included in the Wexpro II agreement. The application also proposes three additional provisions.

1. New wells from post 2015 development drilling would receive the Commission allowed rate of return established as part of the Wexpro II agreement, rather than the higher rate of return currently received for developmental wells. This lower rate of return would apply both to the new portions of Canyon Creek, and to any new wells developed on properties already included in the Wexpro agreements.
2. The costs associated with non-economic wells (dry holes, non-commercial) would be shared equally (i.e. 50/50) between Wexpro and ratepayers.
3. When the total cost of service price (including wells at both levels of return) is less than the market price of natural gas, the savings between the cost of Wexpro gas and what market gas would have cost would be shared equally (i.e. 50/50) between Wexpro and ratepayers.

Q. ACCORDING TO YOUR UNDERSTANDING, WHY HAVE THESE ADDITIONAL PROVISIONS BEEN PROPOSED?

A. The current agreements require that developmental drilling be anticipated to produce gas at or below the NYMEX Rockies-adjusted 5-year forward price curve. According to the testimony of Brady B. Rasmussen Wexpro cannot continue a drilling program under current market conditions (Rasmussen Direct Lines 89-94), due to the current low market prices. Reducing the rate of return on developmental drilling may reduce Wexpro's overall costs to potentially allow Wexpro to drill new wells that can meet the requirements relating to the 5-year forward curve. In summary, the reduced rate of return is being proposed to facilitate a feasible drilling program under the current conditions of low prices in the natural gas market.

The shift in who bears responsibility for dry hole costs is designed to create a lower level of risk for Wexpro in exchange for accepting a lower level of return (see generally, McKay Direct Lines 140-143).

Finally, the provisions for potential future sharing of "savings" is designed to create incentives for Wexpro to further lower its costs over time (McKay Direct lines 162-163).

WEXPRO AGREEMENTS

Q. PLEASE DESCRIBE WHAT AGREEMENTS CURRENTLY GOVERN THE PRODUCTION AND SALE OF COST-OF-SERVICE GAS PRODUCED BY WEXPRO FOR QUESTAR RATEPAYERS.

A. Wexpro Company (Wexpro) is a subsidiary of Questar Corporation that develops and produces natural gas for Questar Gas Company's ratepayers at a "cost of service" price, rather than a market price. The initial governing agreements are The Wexpro Stipulation and Agreement, executed on October 14, 1981 (Wexpro I.) In 2012, Questar submitted its Wexpro II Agreement between Wexpro, Questar Gas Company, the Utah Division of Public Utilities (Division) and the Wyoming Office of Consumer Advocate. This agreement expanded the properties that could be governed by the same general terms that are included in the Wexpro I agreement. Wexpro II was approved by the Public Service Commission of Utah (Commission) in docket no. 12-057-13 in an order dated March 28, 2013. In addition, guideline letters are developed as necessary to clarify specific aspects of Wexpro operations.

Finally, in docket 13-057-13, Questar, the Division and the Office submitted a settlement stipulation (Trail II Stipulation) agreeing to the inclusion of the first property, the Trail Unit Acquisition, under the Wexpro II agreement. The Trail II stipulation contained additional commitments related to the overall operations of Wexpro and provision of cost-of-service gas.

Q. HOW HAS THE COST-OF-SERVICE GAS AFFECTED RATEPAYERS?

A. Utah ratepayers have generally benefited by having the reliable source of natural gas provided in the Wexpro Agreements. Historically the cost of service gas has been on average below the market price of natural gas, and therefore Utah rate payers have saved money on the cost of their natural gas. However, recent years have seen low market prices for natural gas resulting in ratepayers purchasing cost of service gas at prices higher than those available on the market.

Q. HAVE THE TERMS OF THE TRAIL II STIPULATION BEEN SHOWN TO BE ADVANTAGEOUS TO RATEPAYERS?

A. Yes. The Trail II stipulation within the Wexpro II agreement specifies that new wells may be drilled only when the price of gas produced from those wells will be less than or equal to the prices reflected in the published NYMEX Rockies-adjusted 5-year forward curve for natural gas prices. This provision protects ratepayers by restricting new production of cost of service gas that would likely be above market prices. Under the Trail II stipulation, Wexpro also agrees to manage the supply of cost of service gas so that it does not exceed 65% of total gas supply. This provision alleviated concerns raised by the Office and others that total cost-of-service gas was reaching a level that could not be cost effectively managed. An additional benefit was that it lowered the total amount of cost-of-service gas that currently has a cost above current market prices.

OFFICE'S RESPONSE TO CURRENT PROPOSAL

Q. WHAT IS THE OFFICE'S ASSESSMENT OF THE NEW PROPERTY PROPOSED FOR INCLUSION UNDER THE WEXPRO II AGREEMENT?

A. The application explains that Wexpro had previously held a 70% interest in the Canyon Creek property and has now purchased the remaining 30% interest. This acquisition includes 100 existing wells with locations planned for 30 additional development wells. Analysis of confidential exhibits L and L-1 demonstrate that the gas produced from existing wells on the property cost less than the current average cost of service gas; however, these existing wells produce gas at costs that are above current market prices. Therefore, inclusion of this property in to the Wexpro II agreement will result in additional wells that produce cost of service gas at costs above current market prices. These exhibits also provide forecasted prices for gas from new wells within the property, under the proposed reduced rate of return these development wells are anticipated to provide gas at costs that are near or below market prices.

Q. THE OFFICE HAS RAISED CONCERNS IN THE PAST ABOUT THE TOTAL LEVEL OF COST OF SERVICE GAS. HOW DOES THE CURRENT

REQUEST TO INCLUDE A NEW PROPERTY AFFECT THE OFFICE'S CONCERNS?

A. Wexpro is currently forecasting an ongoing reduction to percentage of gas supply from cost of service gas. Confidential Exhibits M and M-1 demonstrate that this new property will not substantially change the percentage of gas supply from cost of service gas, ****BEGIN CONFIDENTIAL****[redacted]. ****END CONFIDENTIAL**** Exhibit M-1 further demonstrates that these levels decrease (by a lesser amount) even with the adoption of the additional provisions proposed in this filing that are designed to allow for an increase in production, ****BEGIN CONFIDENTIAL****[redacted] ****END CONFIDENTIAL**** Due to these forecasts the Office is comfortable that the inclusion of this property will not result in an increase of cost of service gas to its former elevated levels. The anticipated low cost of gas from development wells under the new provisions also serves to alleviate some of the concerns relating to cost of service gas. If circumstances change, the agreement not to exceed 65% remains in place and will serve as a protection to ratepayers.

Q. IN WHAT WAYS CAN THE OTHER PROPOSAL TERMS POTENTIALLY BENEFIT UTAH RATEPAYERS?

A. The primary potential benefit of the proposed provisions is to reduce the average price of cost of service gas. This reduction can result initially from the lower rate of return. Additionally, the provision to share savings when average cost of service gas is below the market price will provide an incentive for Wexpro to look for additional ways to lower costs.

Mr. Rasmussen also asserts additional benefits of a drilling program on lines 95-110 of his Direct Testimony, such as reliable supply through more consistent production over time.

Q. DOES THE OFFICE AGREE WITH WEPRO'S ASSESSMENT OF THE BENEFITS OF A DRILLING PROGRAM?

A. Not entirely. It is likely that Wexpro values having a drilling program more highly than does the Office. However, the Office doesn't oppose a proposal that allows a drilling program to resume as long as the terms and conditions provide net benefits to ratepayers in comparison to market alternatives.

Q. IS THE OFFICE SATISFIED WITH THIS CURRENT PROPOSAL?

A. No. The Office is concerned that this application and supporting testimony may not provide adequate controls to certain portions of the agreement. The Office's concerns include the following:

- The proposal for ratepayers to pay 50% of the costs of future dry holes and non-economic wells.
- The lack of specificity regarding how the market price will be defined for determination of drilling and for determination of potential shared savings.
- Some of the details regarding the proposal for shared savings.

Q. WHAT IS THE OFFICE'S RESPONSE TO THE COMPANY'S PROPOSAL TO HAVE RATEPAYERS PAY 50% OF THE COSTS OF FUTURE DRY HOLE AND NON ECONOMIC WELLS?

These new expenses for ratepayers introduce a liability that may be difficult to predict or anticipate. The Office does not question Wexpro's shared incentive to keep these costs low. However, we recognize that some years may see a more aggressive drilling program while others a more conservative one. Therefore, this provision introduces a certain amount of potential volatility into the expenses covered by ratepayers. The Office is not convinced that equally sharing these expenses provides an adequate incentive to appropriately mange them. An annual cap on dry hole expenses would be an acceptable means to mitigate the potential volatility.

Q. PLEASE EXPLAIN THE OFFICE'S CONCERNS ABOUT THE DEFINITION OF MARKET PRICES.

A. The Office notes that the application and supporting testimony do not currently establish a specific method for determining the "current market price" that will be the benchmark for determining future shared savings. Before taking a final position on the proposals in this docket, the Office would need to evaluate a specific method of calculation. Specifying this calculation is essential in order to ensure that this determination of current market price is fair and consistent.

A related concern is that the Trail II Stipulation never precisely defined the calculation of the five-year forward price curve, which is a key element defining future drilling. Before the Office supports any expansion of the Wexpro II agreement, we assert that this term also needs to be more specifically defined.

Q. WHAT ADDITIONAL CONCERNS DOES THE OFFICE HAVE REGARDING THE PROPOSED SHARING OF SAVINGS?

In the testimony of Barrie L. McKay he proposes that savings will be shared 50/50 when the average price of cost of service gas is less than the market price (McKay Direct lines 88-90). Such "savings" are not anticipated for the near future.

First, the Office notes that the use of the term "savings" is a bit of a misnomer. In practice this "sharing" would result in ratepayers paying for cost of service gas, and then paying an additional sum commensurate with 50% of the difference in market price.

Second, the Office notes that if the market price of gas were to become extremely high, then this sharing provision could result in Wexpro earning returns in excess of previous limits set by Wexpro's governing documents. The Office's view is that this agreement should not result in a windfall for Wexpro, no matter how unlikely or how far into the future it might occur. Therefore, the Office asserts that this proposed provision must also be refined by providing that shared savings be capped at amounts commensurate with the previous returns for development wells.

Finally, the Office has concerns regarding some of the details of the calculations. If any proven developed and producing wells (PDP) are later acquired and included in The Wexpro II Agreement under these new provisions, then the volumes from those wells should not be allowed in the calculation of shared savings. All PDP wells should be limited to the Commission allowed rate of return regardless of when they are acquired. This is consistent with the longstanding rate of return applied to PDP wells and should not be modified by the current proposal.

Q. DOES THE OFFICE SUPPORT THIS PROPOSAL WITHOUT THESE CONCERNS BEING FURTHER ADDRESSED?

A. No.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.