- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of MOUNTAIN FUEL SUPPLY COMPANY to Adjust Rates for Natural Gas Service in Utah	))))	DOCKET NOS. 95-057-30 96-057-12 AND 97-057-11 ORDER on Gathering Issues and Storage Capacity Release Revenues

---

ISSUED: December 31, 1998

SYNOPSIS

The Commission resolves issues relating to the charges paid by Mountain Fuel Supply Company (now Questar Gas Company) to an affiliate, Questar Gas Management Company, for gathering services performed during the period March 1, 1996, through August 31, 1997. The Commission also resolves a dispute relating to the accounting of revenues received by Mountain Fuel Supply for its release of natural gas storage capacity in the Clay Basin Storage Area.

Appearances:

Jonathan M. Duke	for	Mountain Fuel Supply Company
Charles Greenhawt	"	Questar Gas Company
Laurie Noda Assistant Attorney General	"	Division of Public Utilities
Doug Tingey Assistant Attorney General	"	Committee of Consumer Services

BY THE COMMISSION:

PROCEDURAL HISTORY

These cases were consolidated to resolve continuing issues which had been reserved and deferred as each pass-through filing, or 191 Account proceeding, was previously reviewed by the Commission. What remains at issue in these dockets are three matters:

1. The appropriateness of Mountain Fuel Supply's acceptance of gas supplies from Union Pacific Resources, associated with the resolution of a processing plant gas BTU reimbursement obligation of Union Pacific Resources, arising over a number of years from the operations of the Emigrant Trails and Yellow Creek plants;

2. The appropriateness of Mountain Fuel Supply's accounting of revenues associated with its release of storage capacity in the Clay Basin Storage area, relative to Stipulation No. 1, approved in Docket No. 95-057-02; and

3. The appropriateness of the gathering charges Mountain Fuel Supply (MFS or Company) has paid to its affiliate Questar Gas Management during the period of March 1, 1996 to August 31, 1997. In this Order, we resolve issues associated with items 2 and 3.

On the issues we address herein, direct testimony was filed by Dan Gimble, on behalf of the Committee of Consumer Services (Committee) on December 3, 1997. Direct testimony of Darrell Hanson, on behalf of the Division of Public Utilities (DPU or Division), was filed on November 21, 1997. The Company's direct testimony had previously been filed at the time of each original 191 ("pass through") Account application and supplemental direct testimony was filed by Alan Allred on December 19, 1997. Rebuttal testimony was filed by the Committee and the Division on December 31, 1997. A hearing was held January 9, 1998, where the Committee, DPU and MFS witnesses testified. MFS and the DPU filed post-hearing briefs on February 6, 1998, and reply briefs February 27, 1998. Due to the issues raised by the parties and the evidence presented on the record to that point in time, the Commission submitted a briefing request to the parties on May 6, 1998. The briefing request directed the parties to respond to specific questions raised by the Commission in the request. In response, MFS and the DPU filed supplemental briefs on May 29, 1998. MFS also filed the direct testimony of Brice Bergquist on June 2, 1998. The DPU filed supplemental testimony of Mr. Hanson on July 17, 1998, with MFS filing reply testimony of Mr. Allred and Mr. Bergquist on August 28, 1998. An additional hearing was held September 2, 1998, where MFS and the DPU presented their witnesses.

POSITIONS OF THE PARTIES, DISCUSSION, AND CONCLUSIONS

Storage Capacity Releases:

In April 1996, MFS sold 1.3 million decatherms of its contracted storage capacity in the Clay Basin Storage area for $4,457,526. One million decatherms were released for a one year period and .3 million decatherms for a two year period. Storage capacity allows MFS to meet its peak demand and provides the opportunity for the Company to purchase natural gas supplies during periods when prices are low, typically during the off-peak season, for use in peak periods when prices are generally higher. However, if seasonal price differentials are small, the entire storage capacity might not be needed. Under such circumstances, the costs associated with retaining excess storage capacity could increase overall costs of delivering natural gas. When MFS sold the 1.3 million decatherms of its storage capacity, it recorded 80 percent of the revenues as a credit to the 191 account, or gas pass through account, with the remaining 20 percent recorded as general revenue. The Committee proposes an adjustment to the Company's accounting and records 100 percent of the revenues from the sale of its storage capacity as a credit to the 191 account. This adjustment increases the 191 account credit by $77,321. The Committee argues that MFS has historically charged all of the expenses associated with the storage capacity to ratepayers. The Committee maintains that fairness and symmetry require that the ratepayers who bear all costs for storage capacity should receive all benefits when any excess is released. The Committee points out that the decision to sell storage capacity resulted in a fuel cost increase of $1,599,445 as compared to keeping all its storage capacity. This resulted from MFS's inaccurate forecast of the seasonal price differentials, that is, had MFS retained the storage capacity and stored natural gas for later use, it would not have had to purchase 1.3 million decatherms of natural gas at the higher prices. The Committee maintains that MFS should not benefit from a decision which ultimately increased the customers' costs of natural gas. Alternatively, the Committee argues that should MFS be permitted to retain 20 percent of the storage capacity release revenues, the 191 account should be credited $1,599,455 to shield customers from the results of the storage capacity release decision.

The Company opposes the Committee's proposals. MFS maintains that it is entitled to a 20 percent sharing of the revenues from the released storage because it conforms to Stipulation No. 1, submitted and approved in Docket No 95-057-02. The Company interprets that stipulation to include all capacity release revenues as subject to the 80/20 percent sharing formula, both pipeline and storage capacity. The Company asserts that it signed the stipulation based on the FERC's definition of transportation capacity, which includes storage. MFS argues that the Committee's adjustment is based upon subsequent natural gas prices and therefore is flawed. The decision to release the 1.3 million decatherms of storage capacity was based on the best information available at the time the decision was made and therefore is reasonable.

The Committee rebuts the Company's interpretation of the meaning of transportation capacity and points to MFS's own tariff as support. Tariff Sheet No. 10 defines 'released capacity' as "Firm capacity on an upstream pipeline which is released by Mountain Fuel." The Committee testifies that during the negotiations over Stipulation No. 1, there was no discussion of storage or anything else other than pipeline transportation capacity as being eligible for the 80/20 sharing. As additional support for its position, the Committee quotes the Stipulation itself which states that... "The 80%/20% sharing mechanism is meant to apply to capacity release mechanisms that have a positive effect to firm sales

customers."

During the hearing the Company did not cross examine the Committee's witness nor did it address the issue in either of its final briefs to the Commission.

The Commission finds that the Committee's interpretation of Stipulation No. 1 and its definition of released capacity is correct. Therefore, all revenues from the sale of storage capacity should be credited to the 191 account. This adjustment results in an additional $77, 321 credit to the 191 account.

Gathering Rates:

In addition to purchasing natural gas supplies from third parties, MFS operates its own natural gas wells or properties. The natural gas produced from these wells is included in MFS's gas portfolio from which it supplies its retail customers. Natural gas produced from MFS wells needs to be gathered, processed and delivered to a transportation pipeline for delivery to a receiving point in MFS's distribution system. The physical facilities which accumulate and transport the gas from a well to an acceptance point of a natural gas transportation pipeline are called a gathering system. Historically, MFS had a completely integrated system which was capable of delivering natural gas from the well to the ultimate retail consumer of the gas. However, in 1984, MFS undertook a reorganization which broke up this system into discrete parts and assigned them to affiliated companies. The facilities, functions and services required for gathering, processing and transportation were placed in affiliated companies while MFS retained the local distribution facilities and functions. This reorganization also caused a change in the jurisdictional entity regulating the various facilities and services. Whereas this Commission had regulated the integrated system, after the reorganization, the Federal Energy Regulatory Commission (FERC) became the regulating entity for the interstate pipeline transportation and processing facilities and services while this Commission became the regulating entity for the distribution system. The gathering facilities and services fell into a regulatory limbo.

Apparently, the FERC staff expounded differing positions on FERC's jurisdictional reach over the gathering facilities. The MFS affiliate controlling those facilities consistently maintained that gathering facilities were not under FERC jurisdiction. However, the gathering affiliate (while different names were used, for ease of reference we will use Questar Pipeline Company) always included gathering rates as part of its FERC tariffs. Thus, Questar Pipeline's charges for gathering services to its affiliate, MFS, were included in MFS's 191 account as part of the costs associated with the natural gas consumed by MFS's retail customers, pursuant to U.C.A. §54-7-12(3)(d). Because of the reorganization, jurisdictional changes and the ostensible FERC regulation of Questar Pipeline's rates, this Commission no longer reviewed the rate levels for the gathering services.

In 1992, the FERC issued Order 636 which made fundamental changes in its approach to regulating natural gas entities. Order 636 unbundled all natural gas pipeline services and discouraged pipelines from being in the natural gas merchant business. Order 636 also represented a significant change in how FERC would design pipeline transportation rates, placing a greater burden on the gas distribution company and its low-load, i.e. residential customers. As a result of Order 636, Questar Pipeline transferred its gas procurement operations and contracts to MFS in 1993. This change, once again, placed MFS's gas supply decisions and operations under this Commission's review. Questar Pipeline, however, retained the gathering facilities and operations and continued to provide gathering services for MFS's own natural gas production areas and for third parties, some of whom sold natural gas to MFS.

The DPU notified MFS that, as a result of the gas procurement transfer, the DPU believed that MFS's gas supply decisions should place greater weight on the delivered price of natural gas, rather than the commodity cost. By this, if gathering and transportation costs for a certain gas supply with a low commodity cost were higher than another gas supply with a higher commodity cost, but lower gathering and transportation costs, the prudence of selecting the net higher delivered cost supplier would be raised. In this context, participants in MFS's pass-through proceedings subsequent to the 1993 transfer, reviewed MFS's efforts to modify gas supply agreements to achieve a low cost, relative to delivered price, gas supply portfolio. During these proceedings, the DPU also expressed dissatisfaction with the rates and terms of the gathering agreement between Questar Pipeline and MFS. The DPU believed that the agreement placed an unreasonable portion of Questar Pipeline's gathering system's cost recovery on MFS.

The Company asserts that in response to the DPU's dissatisfaction with the gathering rates, it renegotiated and modified

the gathering agreement with Questar Pipeline. The DPU believed that the renegotiated agreement continued to place a disproportionate share of the gathering system's costs on MFS. The DPU expressed its continued dissatisfaction with the gathering agreement, e.g., see testimony of Mr. Hanson, made in MFS's 1993 general rate case proceeding, Docket No. 93-057-01. The DPU contends, however, that because the gathering agreement rates and terms were included as part of Questar Pipeline's FERC tariffs, they would have to seek redress before FERC to have them modified. The Division had two options before FERC, the first was to argue that the gathering rates were not under FERC's jurisdiction and therefore should be reviewed by this Commission, the other option was to argue for lower gathering rates before FERC to be included in its tariff. However, given the uncertainty about a favorable ruling on the jurisdictional issue and FERC's preference for a straight fixed variable rate design (one which would have led to even higher gathering charges), the DPU did not "waste its time" seeking modifications before this Commission or the FERC.

In the current dockets, the DPU argues that whatever conundrum was posed by the FERC jurisdictional claims over Questar Pipeline's gathering services and rates, it was removed by Questar Pipeline's transfer of the gathering facilities and operations to another affiliate in 1996. On February 28, 1996, the FERC approved an application of Questar Pipeline to 'spinoff' all of Questar Pipeline's gathering facilities to an unregulated affiliate, Questar Gas Management Company. On March 15, 1996, the DPU filed a memorandum with this Commission informing us of the transfer and recommending that a procedure be set up to investigate the proper treatment and allowed amounts of gathering costs to be included in MFS's rates. The DPU argues that, due to the DPU's continued insistence that the 1993 renegotiated agreement still did not produce what it considers reasonable gathering rates and the DPU's March 15, 1996, memorandum, MFS and its affiliates were on notice that the DPU could, and would, contest the reasonableness of the gathering rates for modification by this Commission, effective on a date where there was no question as to the FERC's jurisdiction over the gathering rates. In these proceedings, the DPU argues that, if this Commission determines that the gathering rates charged by Questar Gas Management Company to MFS are unreasonable, this Commission may make an adjustment back to March 1, 1996.

As noted above, MFS and Questar Pipeline renegotiated the gathering agreement in 1993 to assuage the concerns raised by the DPU. In 1993, the original agreement would have continued in force for a period of six years. MFS portrays the terms of the renegotiated gathering agreement as providing a four year transition period until September 1997, after which the gathering rates charged to MFS would be altered. MFS contends that this four year transition was reasonable and agreed to in order to avoid Questar Pipeline from making possible 'stranded cost' claims before the FERC. MFS argues that under Order 636, had the gathering agreement's terms been more stringent (following more closely the rates or rate design which the DPU believed would be reasonable), the difference would have been characterized as a stranded cost of Questar Pipeline resulting from Order 636. MFS also argues that, as Order 636 had provisions which permitted natural gas pipelines to recover stranded costs resulting from implementation of the order, Questar's reduced gathering revenues could have resulted in a FERC conclusion that there were stranded costs associated with the gathering system. MFS's position is that whatever may have been gained in hard bargaining to reduce gathering rates would have been lost in Questar Pipeline's recovery of stranded cost from MFS. MFS further argues that the 1993 renegotiated gathering agreement was filed with the FERC without rejection; therefore the rates and terms of the renegotiated gathering agreement were deemed just and reasonable by the FERC. MFS argues the terms of the renegotiated agreement did not change in 1996; the only change was the assignment or transfer of the gathering service responsibilities to another affiliate, therefore, the DPU's position is in error. That is, the rates and terms of the 1993 renegotiated gathering agreement were either just and reasonable or not when the agreement was reached in 1993. FERC's acceptance of the tariff incorporating the renegotiated gathering agreement terms constitutes a determination that the gathering rates and terms were just and reasonable. The 1996 spinoff did not change the rates and terms and does not provide an opportunity to rejudge the prudence or reasonableness of the gathering agreement rates and terms. MFS argues that the DPU's position essentially renegotiates the agreement again, shortening the transition period by eighteen months. MFS contends that this significantly alters the bargain which MFS and Questar Pipeline struck in 1993 and removes part of the consideration which Questar Pipeline derived from the agreement.

MFS argues that even if the rates and terms of the gathering agreement are reviewed as of 1996, the rates are cost based and the agreement is reasonable. The testimony of Mr. Bergquist and Mr. Allred contends that the differences in rates charged to MFS and others under the agreement are due to the differences in the nature and quality of the services rendered to MFS. The DPU argues that affiliate transactions are usually determined to be reasonable if they are at the lower of cost or market. The DPU contends that as an affiliate transaction, the gathering agreement has no presumption

of reasonableness and the evidence MFS presents is insufficient to conclude that the rates are the lower of cost or market. The DPU argues that the reasonableness of the rates and terms can be judged by comparison to the rates and terms which were negotiated in 1997. The DPU consulted with MFS in 1997 in order to reach renegotiated gathering rates and terms which the DPU could support. Those efforts were successful, as MFS and Questar Gas Management Company reached agreement on new rates and terms for gathering services in 1997. Thereafter in 1997, MFS and the DPU presented a joint memorandum recommending that the Commission approve the new rates and terms. The 1997 negotiations significantly reduced the charges for gathering services provided to MFS by Questar Gas Management Company. In the absence of a clear market price for gathering, the DPU believes that the 1997 agreement's gathering charges for services to MFS can be used as a surrogate for 1996 rates. The DPU has calculated that if this reduction were related back to March 1, 1996, a credit of $7.8 million should be made to the 191 account.

To judge whether rates are reasonable, we believe that the rates and terms of the 1993 gathering agreement should be judged on the circumstances prevailing at the time the agreement was reached. The Division maintains that the rates charged to MFS were four times that charged to other customers and this can be taken as prima facia evidence that the rates were unreasonable. However, MFS has presented evidence that there is a difference in the gathering services rendered to MFS that accounts for the difference in the rates charged to MFS and to other customers. We, therefore, conclude that the absolute difference in the rates charged to the different gathering customers may be explained in the variances in the gathering services. There is no evidence of the market price for an identical level of service for gathering in 1996. Lacking a market price for gathering services, we must therefore use costs to judge the reasonableness of the agreement.

We believe that it is appropriate to rely upon the fact that the 1993 gathering agreement's rates and terms were determined using cost-based principles and accepted by the FERC. We recognize that different rate designs and methods may be used by different jurisdictions to determine just and reasonable rates. That different rate designs or methods are permissible, even though there is a difference in the actual rate calculation, is reflective that the 'just and reasonable' conclusion is reached on a continuum of possible outcomes rather than solely one point within a range. We cannot say that one, and only one, rate design and the charges resulting therefrom must be followed to obtain just and reasonable rates. While we may not choose the rate design employed by the FERC, in 1993, in making our review of the reasonableness of the rates, we also cannot conclude that there was an error in FERC's acceptance of the 1993 gathering agreement terms.

Additional support for accepting the reasonableness of the gathering agreement is found in the possible recovery of stranded costs by Questar Pipeline. It is still unclear, on this record, whether Questar Pipeline could have recovered as stranded costs the lost revenue resulting from a transition period shorter than the four year period to which Questar Pipeline and MFS agreed. However, that ambiguity existed in 1993 as well. We will not say that MFS was imprudent in agreeing to the four year transition while the stranded cost potential loomed to consume any further gathering service concessions. We, therefore, reject the adjustment proposed by the DPU.

ORDER

NOW, THEREFORE IT IS HEREBY ORDERED that:

1. The 191 account be credited $77,321 to reflect the Committee's adjustment.

2. The gathering charges paid to Questar Gas Management need not be adjusted.

DATED at Salt Lake City, Utah, this 31st day of December, 1998.

/s/ Stephen F. Mecham, Chairman

(SEAL) /s/ Constance B. White, Commissioner

/s/ Clark D. Jones, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary