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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of QUESTAR GAS COMPANY for Approval of a Natural Gas Processing Agreement	:	Docket No. 98-057-12
In the Matter of the Application of QUESTAR GAS COMPANY for a General Increase in Rates and Charges	:	Docket No. 99-057-20
In the Matter of the Application of QUESTAR GAS COMPANY to Adjust Rates for Natural Gas Service in Utah	:	Docket No. 01-057-14
In the Matter of the Application of QUESTAR GAS COMPANY to Adjust Rates for Natural Gas Service in Utah	:	Docket No 03-057-05

RESPONSE BRIEF OF QUESTAR GAS COMPANY ON PRUDENCE

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I. INTRODUCTION

Questar Gas Company ("Questar Gas" or "Company"), pursuant to the Scheduling Order issued in these dockets on March 26, 2004, submits its response to the Utah Committee of Consumer Services Marshaling of Evidence Initial Brief ("Committee Brief") and Opening Brief of the Division of Public Utilities ("Division Brief"), each filed on May 7, 2004.

The Division Brief, like Questar's opening brief on prudence ("Questar Brief"), amply marshals the evidence on the record and conclusively shows that the Company's CO_2 removal costs,[1] at least up to the amount provided in the Commission-approved CO_2 Stipulation, were within the reasonable range of expenses an unaffiliated utility could have incurred for CO_2 removal. As such, those costs were prudently incurred and rate recovery of the amount provided in the CO_2 Stipulation is appropriate.

The Committee Brief, on the other hand, does not marshal meaningful evidence in support of its conclusions. Instead, it miscasts the question of prudence—laying out a standard that ignores the real duties of regulators and utilities, and sets up straw-men arguments on affiliate influence, using speculation rather than evidence. The Committee Brief shows a continuing, stubborn refusal by the Committee to accept what the evidence on the record showed regarding the Company's prudence.

The Commission should ignore the Committee's continued attempts to divert attention from the evidence and toward inaccurate speculation about affiliate influence. The Commission should instead keep its focus on the proper standard for determining prudence. Under that standard, the key question the Commission must ask is whether, under the circumstances existing

[1] Throughout this brief, Questar Gas uses terms (such as "CO_2 removal costs") that were defined in the Questar Brief. Those definitions are adopted herein by reference, and unless otherwise noted such terms will not be defined again in this brief.

at the time and knowing what Questar Gas knew or reasonably should have known, an unaffiliated utility could reasonably have acted as Questar Gas did, in response to the increasing volumes of coal-seam gas being delivered to its system, and what level of costs that independent LDC could reasonably have incurred in taking such action.[2] Under this standard, Questar Gas has met its burden of proof to demonstrate that it acted prudently in incurring the CO_2 removal costs—certainly at least up to the amount provided in the CO_2 Stipulation—and the Commission should now so find.[3]

II. ARGUMENT

A. THE COMMISSION SHOULD ASSESS PRUDENCE UNDER THE APPROPRIATE STANDARD.

In the Questar Brief, the Company set out the proper standard for assessing prudence, citing controlling and persuasive authority, as well as public utility treatises and statements of the Committee's own witnesses in this case.[4] Under that standard, prudence is not a subjective assessment of utility intent, is not an all-or-nothing issue, does not involve hindsight or substitution of the Commission's (or the Committee's) judgment for that of the utility, and does

[2] Both the Division and Committee point out what they believe to be an additional factor in assessing prudence: that the unaffiliated utility would be acting in the interests of customers. *See, e.g.*, Division Brief at 16-17; Committee Brief at 4. Questar does not dispute the centrality of customers' interests in a prudence assessment, and believes that the concern for customers is already implicit in the assessment of prudence from the standpoint of an unaffiliated **utility** (with the obligations to customers attendant thereto). However, as will be discussed hereafter, prudent utility management (whether affiliated or unaffiliated) just like utility regulators must *balance* the interests of customers and shareholders.

[3] Questar Gas specifically requests that the Commission expressly find that $5 million per year of CO_2 removal costs have been prudently incurred through the period covered by the CO_2 Stipulation, and that the Commission again approve the rate recovery provided in the CO_2 Stipulation.

[4] *See, e.g.*, Questar Brief at 8-12.

not require an optimal result—but rather assesses utility actions based on a range of reasonableness considering circumstances existing at the time actions were taken.[5]

1. The Committee Asserts an Inappropriate Prudence Standard That Should Be Disregarded By The Commission. The Interests Of Customers And Shareholders Must Be Balanced And Questar Gas Has Achieved An Appropriate Balance.

The Committee makes various and conflicting attempts to craft a prudence standard that would deny cost recovery for Questar Gas, but never consistently describes what Questar Gas would have to do to demonstrate prudence. In the first instance, the Committee somewhat reasonably argues that: "The applicable prudence standard is whether Questar Regulated Services management, acting as the management of the public utility, acted in the best interests of the utility and its ratepaying customers in remedying the coal seam gas threat . . . in the time and manner selected."[6] But the potential reasonableness of the Committee's standard is quickly lost when it becomes clear that the Committee measures the requirement of "acting in the best interests of the utility" subjectively, rather than based on the outcome of the utility's actions, and that the Committee considers the best interests of the utility without regard for its shareholders—claiming that the utility's duty does "not tolerate conflicting management interests."[7]

Indeed, the Committee's misguided view of "conflicting management interests" would apparently require Questar Gas to go back in time and reorganize its long-standing corporate structure in order to have any chance of successfully demonstrating prudence. That is, in the Committee's view, it is apparently impossible for Questar Gas—as a subsidiary of Questar Corporation and affiliate of Questar Pipeline, sharing common management—to demonstrate

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[5] *See, e.g.*, *In re Mountain Fuel Supply Co.*, 1994 WL 570655, Nos. 91-057-11 & 91-057-17, at *5 (Utah Pub. Serv. Comm'n Sept. 10, 1993); *In re Portland Gen. Elec. Co.*, 1999 WL 719758, UP 158, Order No. 99-498, at *3 (Or. Pub. Utils. Comm'n Aug. 17, 1999); *In re San Diego Gas & Elec. Co.*, 31 C.P.U.C.2d 236 (Feb. 24, 1989); *Re W. Mass. Elec. Co.*, 80 PUR 4th at 501.

[6] *See* Committee Brief at 5.

[7] *See id*. at 11; *see also id., passim.*

prudence. To the Committee, the "linchpin fact" in this case is that the Company's management has "conflicting affiliate interests and responsibilities."[8] Thus, "the serious conflicting interests and responsibilities of Questar Regulated Services management fatally undermine its claim of prudence with regard to incurring the utility costs at issue in these proceedings."[9] Because there allegedly was no one looking out solely for the Company's customers, as a matter of course the Committee would have the Commission conclude that Questar Gas was imprudent. If the Committee is right about this, prudence would be impossible to demonstrate and the Commission's *2003 Order*[10] requiring the parties to marshal the evidence on the Company's prudence would have been pointless. Questar Gas could never show prudence in *any* proceeding that involved actions by its affiliates. [11]

The Committee is wrong. Prudence does not require the absence of any potential management conflict of interest, and Questar Corporation's integrated management is not fatal to a finding of prudence. There is ample authority in the field of public utility regulation to demonstrate this, and to allow the Commission to appropriately find prudence even in the face of potential conflicts. The Committee does not appropriately cite any of this authority.[12] Instead it

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[8] *See id.*at 3*; see also id., passim.*

[9] *Id*. at 33-34.

[10] Order, Docket Nos. 98-057-12; 99-057-20; 01-057-14; 03-057-05 (Utah P.S.C. December 17, 2003) ("*2003 Order*").

[11] If the Committee's argument were correct, its logic would not stop at preventing utilities such as Questar Gas, with unregulated affiliates and affiliates subject to federal regulation, from demonstrating prudence. It would also prevent any utility without affiliates, but with any unregulated or federally *interests,* from demonstrating prudence, because as long as such differing interests exist there will always be potential conflict, and the utility's management will have to balance those interests appropriately.

[12] The Committee Brief does, of course, cite authority regarding the enhanced scrutiny to be given to affiliate transactions. *See, e.g*., Committee Brief at 13-14 (citing *US WEST Communications v. Public Serv. Comm'n*, 901 P.2d 270 (Utah 1995)). It fails, however, to show how such additional scrutiny undermines the evidence in support of the Company's prudence in this case. In the absence of evidence, the Committee relies on speculation and simply slings the term "affiliate interest" about like a scarlet letter, referencing such interests on practically every page of its brief.

makes irrelevant arguments about agency law and disclosure.[13] One key case the Committee does cite is *Wexpro II*,[14] but the Committee takes the wrong message from that case, claiming that the utility's duty to customers "does not tolerate conflicting management interests."[15]

Utility regulation by its very nature routinely deals with the inherent conflicts of interest between shareholders (or affiliates) and customers, without treating them as insurmountable "linchpins" against rate recovery. Indeed, the result in *Wexpro II* stands as a perfect example of balancing those interests. Specifically refuting the Committee's assertion that competing interests cannot be accommodated, the court in *Wexpro II* noted:

> This Court's references to MFS's "trust relationship to its customers," [in *Wexpro I*], have been productive of considerable confusion. The single judicial authority cited for this reference unquestionably used those words not in the technical sense of property owned in trust for another, but in the nontechnical sense of special responsibilities owed to another. Thus, in the two sentences immediately preceding its reference to "trust relationship" the cited case refers to the utility's monopoly position and to its consequent **duty "to operate in such manner as to give to the consumers the most favorable rate reasonably possible**.**" That statement, which was echoed in this Court's opinion in connection with each of its references to the "trust relationship," is simply an expression of the utility's legal responsibility to make "just and reasonable" charges for its services and to assure that those services are "in all respects adequate, efficient, just and reasonable." These and the related traditional legal duties of a utility— not a technical "trust relationship"— are the measure of the utility's relationship to its customers**.[16]

The utility obligation to provide "the most favorable rate reasonably possible" does not include an obligation to harm shareholders. Rather, as the *Wexpro II* Court stated, it refers to the

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[13] The Committee cites the Restatement of Agency and cases such as *Green v. H&R Block,* 735 A.2d 1039 (Md. 1999) about the duties of fiduciaries. But Questar Gas is neither a tax-preparation service nor its customers' agent, and such authority has no relevance whatever to the assessment of a public utility's prudence.

[14] *Utah Dept. of Administrative Services v. Public Service Comm'n*, 658 P.2d 601, 618 (Utah 1983) ("*Wexpro II*").

[15] *See* Committee Brief at 11.

[16] *See* 658 P.2d at 618 (emphasis added) (citations omitted).

obligation to make "just and reasonable" charges and provide adequate and efficient service. The just and reasonable standard balances the "conflicting"[17] interests of customers and shareholders.[18]

Taken to its logical end, the Committee's argument about "conflicts" being intolerable is an argument against the very existence of investor-owned utilities (who **must** consider shareholders, as well as customers). Protecting the interests of shareholders is neither unlawful nor improper. In fact, utility commissions and agencies such as the Division, charged with protecting the public interest, have an obligation to maintain the financial health of the utility as they do their work.[19]

In light of this, much of the Committee's argument about alleged conflicts of affiliate interests, including its supposed impact on prudence, is a straw man. The "conflict" about what to do with the coal-seam gas in this case, if any, is not much different than the conflict in any other contested utility matter. When the Committee argues that the Company's management was looking out for "affiliate interests" rather than the interests of the Company's customers, it is

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[17] The supposed conflict between customers and shareholders is not necessarily a conflict at all when the appropriate focus is placed on the long-term, sustainable health of the utility—providing both low rates and profitability. This is in the mutual interests of both customers and shareholders. *See, e.g., infra* note 19.

[18] *See, e.g.*, *Fed. Power Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 605 (1944) (fair return allows a company to maintain its financial integrity, attract capital, and compensate its investors for the risks assumed); *Jersey Cent. Power & Light Co. v. F.E.R.C.*, 810 F.2d 1168, 1189 (D.C. Cir. 1987) (a taking occurs when "an unreasonable balance has been struck in the regulation process so as unreasonably to favor ratepayer interests at the substantial expense of investor interests") (J. Starr concurring).

[19] *See, e.g.*, Utah Code Ann. § 54-4a-6(4) ("For purposes of guiding the activities of the Division of Public Utilities, **the phrase 'just, reasonable, and adequate' encompasses, but is not limited to the following criteria: (a) maintain the financial integrity of public utilities by assuring a sufficient and fair rate of return** . . . **(c) protect the long-range interest of consumers in obtaining continued quality and adequate levels of service at the lowest costs consistent with the other provisions of [this subsection].**") (emphasis added). Pursuant to this same section, the Division is also to assist the Commission in promoting "the safe, healthy, economic, efficient, and reliable operation of all public utilities . . . ." *See id.* at § 54-4a-6(1). The Committee's scorn for considering the public safety in assessing utility action is inconsistent with this statutory mandate.

essentially saying that management was allegedly looking out for corporate profits at the expense of customers, which the Commission would review regardless of the presence of affiliates. In any event, whether considered as an affiliate issue or not, Questar Gas did not act improperly in responding to the increase of coal-seam gas being delivered to its system, and Questar Corporation did not inappropriately seek to benefit other corporate interests at the expense of Questar Gas and its customers.[20] The cost resolution embodied by the Stipulation was neither improper nor imprudent.

2. The Proper Standard For Determining Prudence Is Not Subjective, And Even If It Were Questar Gas Acted Prudently.

The fundamental problem with the Committee's arguments about the prudence standard is the Committee's attempt to manufacture and rely upon a nefarious intent on the part of the Company. The Committee is wrong about the Company's intent. Even if it were right, however, if subjective intent were the issue for a prudence assessment, there would never be a need for the Commission to ask "whether a 'reasonable utility manager, under the same circumstances and acting in good faith, would not have made the same decision.'"[21] Instead, the Commission

[20] Moreover, the CO_2 Stipulation already includes a discount to customers to account for any concern that Questar Corporation might have benefited. *See, e.g.*, Tr. 6/5/00 at 56-57 (Alt) ("[T]the CO_2 stipulation, we believe, is reasonable because, in our view, it takes into account that Questar Gas may not have been entirely prudent in its actions by allowing less than full requested cost recovery, that the outcome of any FERC action that might have been pursued by Questar Gas is uncertain, that Questar Gas customers have benefited from the CO_2 removal, and that the risk to ratepayers has been mitigated by capping both the term and the annual dollar cost of CO_2 removal.").

[21] *See In re Portland Gen. Elec. Co.*, 1999 WL 719758, UP 158, Order No. 99-498, at *3 (Or. Pub. Serv. Comm'n Aug. 17, 1999) (citation omitted); for additional cases supporting an objective standard of reasonableness, *see also, e.g., Midland Cogeneration Venture Ltd. P'ship v. Pub. Serv. Comm'n*, 501 N.W.2d 573,585-90 (Mich. Ct. App. 1993) (disallowing only unreasonable portion of affiliate costs); *Re N.Y. Tel. Co.*, 121 PUR. 4th 117, 160-165 (N.Y. Pub. Serv. Comm'n 1991) (same); *Re Block Island Power Co.*, 59 PUR 4th 433 (RI Pub. Utils. Comm'n 1984) (scope of inquiry calls "only for the disallowance of profits and costs paid to affiliates and subsidiaries which are unreasonable"), *aff'd*, 505 A.2d 652 (R.I. 1986); *Re Narragansett Elec. Co.*, 17 PUR 4th 164 (RI Pub. Utils. Comm'n 1976) (duty of commission to examine utility payment to affiliate and reject "those portions" found to represent unreasonable expenses); *Northwestern Bell Tel. Co. v. State*, 216 N.W.2d 841,853-54 (Minn. 1974) (in reviewing affiliate transactions commission should disallow only excessive portion of cost paid).

would simply inquire about what the actual utility (not a hypothetical, reasonable one) intended. Under this subjective approach, it would not matter that facing the same facts, an unaffiliated, reasonable utility would have taken the **same** action and incurred the **same** costs.[22]

If the subjective standard were the rule, rate recovery for Questar Gas, at least up to the stipulated amount, would still be appropriate. The statements from Gas Quality Team members, for example, show—as did the testimony generally —that the heat-content issue regarding coal-seam gas was *subjectively* addressed from the perspective of trying to do the best job possible, to do what needed to be done to solve a serious safety issue for the lowest cost, balancing interests appropriately.[23]

The subjective standard, however, is not the rule, and to determine prudence the Commission should decide whether, under the circumstances existing at the time and knowing what Questar Gas knew or reasonably should have known, an unaffiliated utility could reasonably have responded the way Questar Gas did to the increased volumes of coal-seam gas

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[22] The situation of an unaffiliated LDC incurring at least the same, or higher costs, is easy to envision in this very case. Suppose, for example, that an unaffiliated LDC saw the increased production of coal-seam gas and went to the FERC to demand that the pipeline's tariff be amended, that the gas be kept off the pipeline's system so as not to enter the distribution system, or CO_2 removal costs be borne by coal-seam gas producers, etc. If this hypothetical utility had pursued such action, it could have incurred higher costs than the stipulated amount, because if it lost at the FERC (which would be entirely likely—*see, e.g*., Questar Brief at 37-43) it would have been saddled with 100% of the costs for CO_2 removal, rather than the 68% which Questar Gas has stipulated it will accept. Even if it had won at the FERC, the unaffiliated, reasonable utility could have incurred at least the same amount of costs that Questar Gas incurred, through increased pipeline transportation rates. *See* Division Brief at 18-19; Questar Brief at 47-48.

[23] *See, e.g.*, DeBernardi 98 Rebut. at 2 ("Q. Mr. Hanson implies that the make-up of the team affected the selection of the CO_2 . . . plant option. Is this accurate? A. Yes, but not in the manner alleged by Mr. Hanson. The fact that both operating companies (QPC and QGC) and QRS were represented did influence the recommendations and decisions made concerning gas quality issues. That was the intent when the team was formed. Questar's management recognized that gas quality issues (not just CO_2), [a]ffecting QPC would also affect QGC and QPC's largest customer. By bringing together representatives from these companies, all aspects of the issues were discussed and evaluated."); Tr 6/22/99 at 116 (Allred) ("We certainly looked at and said what could Questar Pipeline do to solve this problem. We did not see a way to do that at any lower cost or any better solution than the one we chose. If we had, we would have pursued it.").

being transported on its distribution system, and what level of costs an independent LDC could reasonably have incurred in making that response.[24]

B. The Evidence Demonstrates That Questar Gas Acted Prudently.

At one point amid the Committee's attempts to cloud the issues in this case, it—perhaps inadvertently—correctly identifies the real issue the Commission must address. That issue is what "a utility management—surrogate or otherwise" should have done "to properly and timely respond to business activities of other parties—affiliates of the utility or otherwise."[25]

The Questar Brief demonstrated that an unaffiliated utility would in all likelihood have reacted the same way that Questar Gas did, or that even if it attempted to react differently (such as by filing a complaint at the FERC) the end result would likely have been the same with costs at least as great as those provided in the Stipulation.[26]

1. The Division Brief Reinforces The Company's View That The Stipulated Amount Of CO_2 Removal Costs Was Within The Range An Unaffiliated Utility Could Have Prudently Incurred.

The Division Brief buttresses the Company's demonstration of prudence by noting several key points.[27] First, the Division aptly notes that "[b]ased on the evidence . . . and because of immediate safety problems, a reasonable person could have decided, like Questar Gas did, to build the CO_2 plant. While not every utility manager would have reached this decision, complete agreement among all similarly situated decision makers is not required for an action to

[24] *See, e.g., Re Foothills Water Company*, Docket No. 91-2010-01,1992 WL 501201, *7 (Utah Pub. Srvc. Comm'n Nov. 30, 1992) (showing again that the Commission looks to the reasonableness of the costs incurred, rather than whether the costs were intended to benefit closely-related entities or individuals).

[25] *See* Committee Brief at 25.

[26] *See, e.g.*, Questar Brief at 14-46.

[27] These points are in addition to noting that the costs of the CO_2 plant were entirely reasonable.

be declared prudent."[28] This statement evidences the Division's substantive agreement with at least the results of the objective prudence standard,[29] and is, under that standard and considering the evidence on the record, sufficient alone to support a finding of prudence for the stipulated amount of CO_2 removal costs.

Second, the Division Brief cites Mr. Townsend for the proposition that if an unaffiliated utility had successfully requested the FERC to reduce Questar Pipeline's total inert standard, the reduction would at most have been from 3% to 2%.[30] Mr. Townsend assumed that "Questar Gas [would have] saved about 1/2 of the $7.3 million cost recovery" had it received a FERC ruling that the pipeline tariff standard should be lowered to 2% total inerts.[31] The Division Brief also notes, however, that Mr. Snider, who actually performed a cost analysis, "provided an estimate . . . that it would cost about 75%" of the cost of a 3%-to-1% plant for an unaffiliated utility to process from 2%-to-1% (the inert level actually needed by Questar Gas to safely operate its

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[28] Division Brief at 16.

[29] The Division states the prudence standard somewhat differently than the Company, but the result in this case is the same. The Division asserts that "even in affiliated transactions, the investment or expense should rarely be completely disallowed where no one disputes the need for some kind of action and that the cost for the investment or expense was reasonable. Where there were other alternatives, the question should be whether they were adequately reviewed without the decisionmaker being inappropriately influenced by its affiliate. If inappropriate influence is found, some disallowance could be appropriate. However, if there is some benefit, even with affiliate influence, complete disallowance could be inappropriate." *See* Division Brief at 8.

While Questar Gas would state the prudence standard regarding affiliate transactions differently—that subjective intent is not the issue and that partial or total disallowance is appropriate only to the extent actions were taken and costs incurred beyond those of a prudent, unaffiliated utility; but that increased scrutiny is applied to ensure that affiliate costs do not exceed those an unaffiliated utility would have incurred (*see, e.g., Re US West Communications, Inc.*, 1995 WL 798880, at *12 (Utah Pub. Serv. Comm'n Nov. 27, 1995)—the result is the same in this case under either the Division's or the Company's view of the standard. The bottom line is that rate allowance should not exceed the amount of benefit to customers that a prudent, unaffiliated utility would have provided. The CO_2 Stipulation accomplishes that result.

[30] Division Brief at 18.

[31] *Id*.

system) after receiving the favorable FERC decision.[32] The costs recovered pursuant to the Commission-approved CO_2 Stipulation were 68%, somewhere between the assumption of Mr. Townsend and the estimate of Mr. Snider, and certainly within the range of reasonable results one could have expected had an unaffiliated LDC (or Questar Gas, for that matter) gone to the FERC and received some relief. Again, under the proper standard, this supports a Commission finding that the stipulated amount of CO_2 removal costs were prudently incurred.

Third, the Division Brief cites the evidence presented by Dr. Compton that had the FERC required the pipeline to bear the costs of CO_2 removal "65% of the costs to remove the CO_2 would be expected to flow through [to] Questar Gas."[33] As the Division Brief correctly notes, "[t]hat amount is well within the range of the CO_2 Stipulation."[34] It therefore supports a Commission finding of prudence for the stipulated amount of CO_2 removal costs. It also refutes the Committee's argument that "Questar Pipeline could have just as easily and quickly not only built and operated the CO_2 plant – which it did – but also paid for its operation – which it isn't. Such a remedy would have put the costs on a much more appropriate party than the utility and its ratepayers . . .."[35] The Committee's argument ignores the fact that even if Questar Pipeline had obtained FERC approval to build the CO_2 plant, the FERC would have still been required to determine cost apportionment for the plant. The testimony on FERC cost-apportionment principles indicated that the Company would likely have borne **all** of the costs of CO_2 removal had the FERC approved Questar Pipeline building the plant or a change to Questar Pipeline's

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[32] *Id*. Of course, the Questar Brief also demonstrated that victory at the FERC would have been very unlikely. *See* Questar Brief at 37-44.

[33] Division Brief at 19.

[34] *Id*.

[35] Committee Brief at 21-22.

tariff.[36] Even if it were not required to pay all costs, Dr. Compton's testimony supports the view that Questar Gas would have at least had to bear 65% of the costs.

Finally, the Division Brief cites the testimony of Mr. Hanson, calculating "an estimate of the financial benefits that an affiliated pipeline may have obtained from the transportation of the increased flow of coal seam gas."[37] This estimate of "benefits" to Questar Pipeline led Mr. Hanson to support a reduction in rate recovery of $3.4 million. "This proposed reduction is within a range of the CO_2 Stipulation." It therefore supports a Commission finding that the stipulated amount of CO_2 removal costs were prudently incurred.

As the Division Brief shows in many ways, the actions of Questar Gas in response to the increased presence of coal-seam gas being delivered to its system were within the range of reasonable responses that an unaffiliated, prudent utility could reasonably have taken, and the resulting recovery provided in the Commission-approved CO_2 Stipulation is well within the range of reasonable costs that an unaffiliated, prudent utility could have expected to incur **even if** it could have successfully implemented an alternative course of action in response to the heat-content problem.

2. The Committee's Arguments That Questar Gas Should Have Reacted Sooner And That The Problem Was Caused By Questar Pipeline's Expansions Are Not Supported By The Evidence, Are Misplaced And Irrelevant.

The Questar Brief preemptively refutes the unsupported allegations about timeliness in the Committee Brief.[38] Indeed, the Committee cites no substantial evidence to suggest that Questar Gas was untimely in responding to the safety threat posed by the incompatibility of the Company's historically high appliance set point with the volumes of coal-seam gas that

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[36] *See, e.g.*, Questar Brief at 39-41.

[37] Division Brief at 19.

[38] *See, e.g.*, Questar Brief at 15-16.

unexpectedly surged beginning in 1997. Instead, the Committee merely reiterates the speculation provided by Mr. Hanson and Mr. McFadden about what the Company "might" or "could" have done "if" it had identified the problem sooner,[39] and then resorts to non-record "public statements" made in Questar Corporation annual reports.[40]

The first indication cited in a "public statement" that coal-seam gas production could significantly increase is from Questar Corporation's 1996 Annual Report. That report was published in the spring of 1997, mere months ahead of the time Questar Gas has testified that it fully appreciated the heat-content problem due to increased coal-seam gas production. Even at the time of publishing the 1996 Annual Report, Questar Corporation only stated that production **could** increase from the then-current level of 50,000 dth per day to 250,000 dth per day in 2002, not that it would (or likely would) increase to that amount (or that it would exceed blending capacity by spring of 1999 on the Company's system). [41] To alert the Company of the need to undertake expensive capital projects or pursue litigation at the FERC in response to an as-yet-unknown heat-content problem, there needed to be more than projections of what **could** happen by 2002.[42] Indeed, what **could** happen would likely not even present a live case or controversy

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[39] *See* Committee Brief at 18-20.

[40] *See id.* at 27-28. The Committee's forays outside the record are inappropriate deviations from general principles of administrative procedure and from the Commission's *2003 Order(see, e.g., 2003 Order* at 6, directing the parties to "marshal the evidence from the existing records in Dockets 98-057-12 and 99-057-20 relating to the prudence of Questar's actions and decisions") and Questar Gas objects to the introduction of such extra-record information. Had such information been appropriately presented during the hearings, Questar Gas would have had an opportunity to respond with evidence and explanation. In the event the Commission determines to consider the extra record submitted by the Committee, it should also consider the extra-record "public information" submitted herein by Questar Gas, to correct the false impressions the Committee has sought to create.

[41] *See* Questar Corporation 1996 Annual Report at 24.

[42] *See, e.g.*, Tr. 6/22/99 at 185 (DeBernardi) ("[S]everal such [coal-seam] projects . . . have been attempted near Questar Pipeline's system, [but] the River Gas project is the only one that has shown more than limited success. It was only the production success and forecast in the winter of '97 and '98, and the subsequent fact that the Ferron Fairway production is exceeding those forecasts, that it became apparent

at the FERC if an LDC sought to do something in response to projected production increases (assuming it should have known of the problems that would attend such possible increases).[43] A potential increase in coal-seam gas production also had benefits; it was a new gas supply source necessary for meeting growing customer demand, [44] and this close, convenient source of gas would be a factor contributing to lower Questar Pipeline index pricing. The Questar Pipeline price index has consistently been significantly lower than other pipeline pricing points. These lower prices have benefited Questar Gas customers on all gas purchased across Questar Pipeline's system.[45]

The Committee's claim that the increased presence of coal-seam gas on the Company's system was caused by the intentional expansion of Questar Pipeline's system to accommodate

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that there could be a unique and urgent problem with the ability to blend Btus to the Payson gate."); *id.* ("[I]t would not have been prudent to reorifice customers [in] the mid nineties or take other actions based on the speculation of the volume of coal seam gas raising to the level of current concern.").

[43] In early 1997 when the 1996 Annual Report was prepared, not only was Questar Corporation citing additional volumes of coal-seam gas that **might** be produced, it was citing transport business that Questar Pipeline **might** get. Questar Pipeline did not yet have contracts in place to transport the increased volumes, and it was public knowledge that several other pipelines were interested in pursuing the coal-seam gas transportation business. For example, the Ruby Gas Pipeline proposed by Colorado Interstate Gas and the Timberline Pipeline proposed by Kern River both sought to obtain the transportation business from the coal-seam fields. Had Questar Gas gone to the FERC at the time the 1996 Annual Report was issued, complaining about gas that **might** be produced and might be transported by **someone**, it is not clear which pipeline Questar Gas would have complained against. Nor would the FERC have been able to react to such a speculative situation.

[44] *See, e.g.,* Tr. 6/5/00 at 169-70 (Allred) ("[T]here would be safety implications to customers [from refusing to take the gas], because in the wintertime, at high demand levels, we would not be able to keep all customers served from our Indianola and our Payson City gate on gas service. In other words, residential customers would . . . be in a situation of having to shut off and not receive gas. Then you've got all the safety associations, or safety concerns associated with after the system's been shut down, massive costs going around, checking house by house as you bring the system back up to ensure that as you turn the gas back on that there are no explosions or problems with pilot lights in houses.").

[45] *See, e.g.,* Terzic 99 Rebut. at 5 ("[T]he FERC has taken the position that increasing the supply of gas from the largest number of sources and locations does benefit the consumer. **Increasing the number of supply basins has the effect of both making greater supply available and of providing price competition not only for commodity gas but for pipeline transmission services.** This has benefited all customers, including those supplied by Questar Gas.").

A "linchpin" of the Committee's argument is that the Company did not want the coal-seam gas. In fact, the Company's customers benefit from the presence of the gas.

coal-seam production is misplaced and irrelevant. It is misplaced because all of Questar Pipeline's facilities—including each of the southern system expansions cited in the Committee Brief (the vast bulk of which were not to accommodate coal-seam gas)—were approved by the FERC under Section 7 of the Natural Gas Act. The FERC considered all factors potentially relevant to the public interest and issued certificates authorizing such projects based on findings that the facilities were required by the public convenience and necessity.

The Committee's claim is irrelevant for several reasons. First, as discussed at length in the Questar Brief, in determining the prudence of Questar Gas the actions of Questar Pipeline are irrelevant.[46] Second, whether or not Questar Pipeline "sought" business opportunities, it was required to accept gas that conformed to its FERC-approved tariff.[47] Even if it wanted to, Questar Pipeline **could not** serve as a dedicated gatherer and transporter for Questar Gas. Third, if Questar Pipeline had not constructed facilities to gather the coal-seam gas, the producers could have chosen to build their own facilities to connect to Questar Pipeline, and Questar Pipeline could not refuse to transport their gas.[48] Fourth, even if Questar Pipeline had not contractually

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[46] Questar Brief at 8-14.

[47] *See, e.g., United Distribution Cos. v. FERC,* 888 F.3d 1105, 1123-24 (D.C. Cir. 1996), *cert. denied,* 520 U.S. 1224 (1997) (blanket transportation certificates conditioned on pipelines' acceptance of non-discrimination requirements guaranteeing equal access to service for all customers, effectively imposing common carrier duties on pipelines). FERC rules require Questar Pipeling to "provide transportation services without undue discrimination, or preference, including undue discrimination or preference in the quality of service provided, the duration of service, the categories, prices, or volumes of natural gas to be transported, customer classification, or undue discrimination or preference of any kind." Further, Questar Pipeline must provide service "on a basis that is equal in quality for all gas supplies transported under that service, whether purchased from the pipeline or another seller" and it cannot "include in its tariff any provision that inhibits the development of market centers." *See* 18 C.F.R. § 284.7(b)(1)-(3) (2003).

[48] *See, e.g.*, Snider 99 Rebut. at 5-6 ("Q. Mr. Hanson states that QPC could have said 'We don't have room for your gas' or they could have said 'We will build facilities to take your gas if you will help us with the gas quality needs of our major customer.' Do you agree with Mr. Hanson that such courses of action would have been fruitful? A. No. It should be remembered that **coal-seam production is located just a short distance from QPC's Mainline #40, where more than sufficient capacity is available to accommodate this production.** The producers of the coal-seam gas were in the process of investing

obtained the business for transporting the increased volumes of coal-seam gas, significant volumes of the gas were likely to come onto the system. Producers and shippers on Questar Pipeline's system (other than Questar Gas) could purchase and nominate the gas (which they had every right under FERC policy to do and would have had strong incentive to do, given the coal-seam gas's low cost and the fact that its heat-content was not problematic to them).[49] If the volumes of coal-seam gas reached Questar Pipeline's system for **any** of the foregoing reasons, the coal-seam gas would still be physically delivered to the Questar Gas system, whether contractually bound for the Company's system or not.[50]

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millions of dollars to drill the wells and install significant facilities to deliver the gas to QPC. **Had QPC attempted to exclude the coal-seam gas on the basis of limited capacity in the lateral pipelines serving the production area, the producers could have easily laid their own lateral pipelines and requested capacity on QPC's main pipeline. This would be a minor investment when compared with the estimated $180 million annual revenues the coal-seam production was expected to generate. Based on my experience with open-access pipelines, QPC, having no capacity constraints in the main pipeline, would then be required to allow the producer to deliver its gas into QPC's system.** Q. Isn't it true that QPC could have tied the producers' hands while it pursued a FERC resolution of this issue? No. This ignores the fact that the producers were already in the process of spending significant funds to develop the coal-seam production and were not going to be deterred by an attempt by an interstate pipeline to prevent the progress of the coal-seam development. **The fact is that when a producer tenders gas supply (which complies with pipeline tariff specifications) to an open-access pipeline with an end-user some place on the interconnecting system, it must be accepted. That is what open-access means.**") (emphasis added).

[49] *See, e.g.,* Tr. 6/22/99 at 13 (Allred) ("[T]he coal seam gas, without the CO_2 removal, is merchantable, complies with industry standards, and is gas that can be used in nearly all other distribution systems."); Tr. 6/5/00 at 154-55 (Allred) ("[E]very other customer [with the possible exception of Nephi Municipal System, with an inconsequential load] that I'm aware of on Questar Pipeline had no need for gas to be processed below the 3 percent tariff standard to get it onto the pipeline."); Under its FERC-approved tariff, Questar Pipeline is required to provide transportation service to any shipper according to Part 284, Subparts B and G of the FERC's regulations provided the shipper meets the criteria set forth in the tariff. See, Questar Pipeline Company's FERC Gas Tariff, First Revised Vol. No. 1, Second Revised Sheet No. 10, Third Revised Sheet No. 20, and Second Revised Sheet No. 30, effective March 23, 2001. See also, Questar Pipeline Company's FERC Gas Tariff, First Revised Vol. No. 1, Section 10 "Use of Receipt and Delivery Points" beginning on Fourth Revised Sheet No. 72, effective May 1, 2001, (discussing Shippers' rights to access receipt and delivery points).

[50] Given the fact that gas molecules do not flow according to contract provisions (but, rather, according to the laws of physics), to ensure that such gas did **not** physically affect the Company's distribution system would have been cost prohibitive for the very reasons that pipeline alternatives, as opposed to the CO_2 plant, would be too expensive. *See* Questar Brief at 24-27; Tr. 6/22/99 at 70 (Allred) (The nature of all pipelines is that you do not actually get the same physical molecules of gas that you

Thus, as the Committee admits[51] and since the coal-seam gas would have had a physical impact on Questar Gas regardless of Questar Pipeline's contractual participation in the transportation of that gas, the relevant question is not whether Questar Pipeline took advantage of business opportunities by transporting coal-seam gas, as any unaffiliated pipeline would have done. Rather, the relevant question is whether an unaffiliated LDC should have identified the problem ultimately caused by the increased coal-seam gas production and acted sooner than Questar Gas did. The answer, based on the record and on reality, is no.[52]

The undisputed evidence on the record also refutes the unstated logical conclusion of the Committee's argument. The benefit of earlier discovery of the problem—if such discovery were possible—would have been more time to reorifice or to go to the FERC before the safety issue arose. With regard to earlier reorificing, both Messrs. Allred and DeBernardi testified without rebuttal that even if Questar Gas had known in the mid-1990s that its customers would be facing a low heat-content safety problem by the spring or early summer of 1999, it could **not** have prudently started the multi-year process of reorificing then. Changing the tariff-specified heat content in the mid-1990s, when coal-seam production was minor, but nonetheless the **latest** time the Company could have begun reorificing if it was to have enough time prior to the mid-1999 safety deadline to rely exclusively on reorificing, would likely have led to gas being delivered to the system with a heat content too **high** for the customers' reorificed appliances.[53] Such action

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contracted for. Rather, "We get gas of the pipeline's quality standards. We are obligated to put the gas onto the pipeline that meets quality standards, and we get gas off the pipeline that meets quality standards.").

[51] *See* Committee Brief at 25.

[52] *See, e.g.*, Questar Brief at 14-17.

[53] *See, e.g.*, Allred 98 Rebut. at 11 ("Q. Both the Division and the Committee argue that Questar Gas should have changed the recommended set point for customers' appliances earlier. Are they correct? A. No. They are both relying on the benefit of hindsight. In the early to mid 1990's, Questar Gas did know that the Btu level of gas was trending downward, but it was still well within the safe operating

would have substituted one interchangeability problem for the other. Alternatively, if the Company could have identified the problem sooner and gone to the FERC to pursue its allegedly "natural interest" in "see[ing] the flow of that coal seam gas diminished,"[54] it would very likely still not have eliminated the timing problem with pursuing FERC action, as complaint proceedings at the FERC are more likely to last years, rather than months.[55]

Further, any increase in the available time to pursue a FERC action would not have eliminated the substantive weaknesses of the unaffiliated LDC's coal-seam gas case because the LDC would have still been attempting to restrict the flow of gas in interstate commerce, and the LDC likely still would have been stuck with 100% of the costs of solving the heat-content problem.[56] If it had been "lucky" enough to actually minimize the presence of coal-seam gas through a victory at the FERC, it would have cost itself a convenient source of supply, which

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range of the 1080 set point. **Based on the information available at that time, it was not clear that a change in set point was called for. At that time, coal seam production from the Emery County area was well below the levels that would cause any concern.** While gas on other portions of the system was subject to processing, Questar Pipeline was successfully blending its gas stream and monitoring gas supplies well within the safe operating range. A customer set point adjustment at that time would have served to only change concerns about managing gas supplies to stay above the low end of the range into concerns about managing the gas supply to stay below the upper end of the range. **It must be remembered that the Company has a long history of taking action to manage the gas supply and ensure that the Btu content was not too high. In the mid 1990's there was simply no sound reason to implement a set point change.**") (emphasis added); Tr. 6/22/99 at 185 (DeBernardi) ("[I]t would not have been prudent to reorifice customers [in] the mid nineties or take other actions based on the speculation of the volume of coal seam gas raising to the level of current concern.").

[54] Committee Brief at 4.

[55] By citing Questar Corporation's 1996 Annual Report that merely indicates the possibility of increased coal-seam gas production, the Committee only potentially brings a few more months into play (spring of 1997, if the possible increased volumes of coal-seam gas cited in the Annual Report should have triggered a response, versus the fall of 1997 when the Company actually fully appreciated and began working to resolve the problem). Further, that complaint proceedings at the FERC typically take years does not account for the additional time associated with any appeals of those proceedings. In short, for the same reasons identified in the Questar Brief (*see, e.g.*, Questar Brief at 33-37), a FERC complaint, even if it could have been brought in early 1997, would likely not have been completed in time to eliminate the need for CO_2 removal.

[56] *See* Questar Brief at 37-43.

was necessary to meet its gas-supply needs and which by its mere presence increased gas volumes on the pipeline and therefore would ultimately lower pipeline transportation rates.[57]

C. THE COMMITTEE'S REMAINING ARGUMENTS ABOUT IMPROPER AFFILIATE INFLUENCE ARE SPECULATIVE, IRRELEVANT, AND ERRONEOUS.

The bulk of the remainder of the Committee Brief is merely a continuation of the Committee's attempts to use claims of "improper affiliate influence" without citing any substantial evidence of such, and without offering a persuasive argument about why any alleged influence should cause the Commission to disallow rate recovery. Throughout this case when competent evidence runs against the Committee's position, the claim of "improper affiliate influence" has been used to divert attention from the record support for the Company's and Division's position. But the very witnesses upon whom the Committee relies to assert improper influence use speculative language, such as "I can only guess" and "actions . . . appear to be influenced" when addressing this alleged influence.[58]

As noted above, what matters is whether Questar Gas properly responded to the presence of the coal-seam gas on the system. Even if the actions of Questar Corporation or Questar Pipeline *were* relevant, and even if they were wrong in viewing the coal-seam gas issue as one of FERC-mandated open access due to the fact that the gas satisfies the pipeline tariff (i.e., even if accepting the gas were simply the voluntary "business decision" that the Committee alleges), the Company's actions in response were nevertheless reasonable. The Committee's assertions, such as that the Questar decision-makers "failed to confront the growing threat [from coal-seam gas] to the utility's gas supply, not because the safety crisis was unforeseeable, but rather because earlier effective utility action would have jeopardized Questar Pipeline and Questar Corporation

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[57] *See supra* note 44.

[58] *See, e.g.*, Committee Brief at 32-33 (quoting Mr. McFadden and Mr. Hanson).

efforts to secure the business opportunity of gathering and transporting the coal seam gas,"[59] are simply unsupported by anything beyond speculation.

The Committee no doubt realizes the difficulty any utility would have in affirmatively proving its proper motives, and so it throws out its speculation about bad intent, realizing that Questar Gas can only respond with statements such as those the Committee quotes from Mr. Allred: "We certainly looked at and said what could Questar Pipeline do to solve this problem. We did not see a way to do that at any lower cost or any better solution than the one we chose. If we had, we would have pursued it."[60] Beyond such averments on its intent, Questar Gas can only point to the objective reasonableness of its actions, and the benefits to customers of those actions. Those demonstrations of objective reasonableness are exactly what the proper prudence standard requires a utility to do in order to meet its burden of proof.

The final "affiliate" issue in this case is not really an issue either. That issue involves the decision to use Questar Transportation Services to build and operate the CO_2 plant. The Committee senses the kernel of an argument here and complains about the decision "that awarded the asset and revenue stream benefit of a new CO_2 processing plant to an unregulated Questar Pipeline subsidiary while assigning its costs to utility ratepayers."[61] Had the Committee completed its review of this issue it would have seen that there is there is essentially no additional revenue stream because the processed gas goes to Questar Gas,[62] and the use of

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[59] Committee Brief at 17-18.

[60] *See id.* at 30 (quoting Tr. 6/22/99 at 116).

[61] *Id.*

[62] *See, e.g.,* Tr. 6/5/00 at 155 (Allred) ("Every decatherm of gas that's been processed to 1 percent has physically come to Questar Gas. It hasn't gone anyplace else.").

Moreover, it is ironic that the Committee would complain that Questar Gas did not get the regulatory asset of the CO_2 plant, when had it done so a finding of prudence would mean that the Company was entitled to full rate recovery for the used and useful life of the plant. As it stands, recovery

Questar Transportation Services resulted in lower-costs than (a) would have attended the Committee's proffered alternatives to CO_2 removal, (b) would have been passed-on to customers if Questar Gas owned the plant as a regulatory asset itself, or (c) could have reasonably been expected had Questar Gas had the plant built by, or obtained CO_2 removal services from, an unrelated party. [63] Simply put, all of the record evidence shows that the way the plant was built, owned and operated resulted in the lowest cost to the Company's customers.[64] Thus, yet another of the Committee's ill-conceived "affiliate interest" arguments is completely erroneous. The record demonstrates that the Company's affiliate relationships were actually helpful to customers in this case, rather than harming their interests.[65]

III. CONCLUSION

The Committee's misstating of the prudence standard and assertion of unsupported affiliate-influence allegations demonstrate an unjustified, dogged refusal to accept the result that the facts, the law, and simple fairness dictate in this case. That result is a Commission finding of prudence. The reality with which the Committee refuses to come to grips is that Questar Gas did

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is capped at 68%, and the Company has to come back and ask the Commission anew if it wants to obtain rate recovery beyond the 5-year term of the CO_2 Stipulation (even though CO_2 removal at the plant will need to go on into the foreseeable future). Such an arrangement can hardly be considered disadvantageous to customers.

[63] *See* Questar Brief at 29-32.

[64] *See, e.g.*, Division 99 Brief at 27 ("Although the DPU has testified that QGC did not bid the CO_2 plant but instead went to a subsidiary to have CO_2 removal done for it[,] [n]o one, other than that, has seriously challenged the cost of the CO_2 plant. Both in 98-057-12 and in this docket [99-057-20] neither the DPU or the CCS challenged the cost to build the CO_2 plant or the expenses to operate it.") It is simply inexplicable that the Committee could now argue that the Company's customers are harmed by the arrangement with Questar Transportation Services to own and operate the plant; yet at least a dozen times in the Committee Brief it attempts to draw unfavorable inferences from this affiliate arrangement.

[65] As the Questar Brief demonstrated, affiliate actions helpful to the Company and its customers in this case include the actions of the Gas Quality Team in identifying and working to solve the heat-content problem, the steps taken by Questar Pipeline to assist the Company in managing the heat-content of the gas on its system, and the low-cost construction and operation of the CO_2 plant by Questar Transportation Services.

not seek to inappropriately burden its customers with CO_2 removal costs. Nor did the Company seek to inappropriately benefit its shareholders or affiliates. Rather, as the evidence shows, Questar Gas took timely and appropriate actions to remedy a serious safety problem that resulted from the incompatibility of the Company's unique appliance set point with the increased volumes of lower-Btu coal-seam gas being delivered to Questar Gas. The Company's customers are the beneficiaries of those actions, just as they are beneficiaries of having the additional gas supplies. A prudent, unaffiliated utility certainly could, and probably would, have taken the same steps and incurred the same costs; therefore, the Company continues to believe that the CO_2 removal costs were prudently incurred. However, even if a prudent, unaffiliated utility might have successfully taken other steps, the CO_2 Stipulation, as supported by the Questar and Division Briefs, demonstrates that the 68% cost recovery previously approved by the Commission falls within the range of costs a prudent utility could reasonably have been expected to incur. Under the proper prudence standard, therefore, costs of at least up to the 68% amount provided in the CO_2 Stipulation should be found to have been prudently incurred. Questar Gas again requests that the Commission so find.

The Commission should objectively weigh the competent evidence marshaled by the Company and the Division, and contrast this evidence against the unsubstantiated claims made by the Committee. The weight of the evidence justifies the $5 million per year of rate recovery provided in the CO_2 Stipulation.

RESPECTFULLY SUBMITTED: May 21, 2004.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing **RESPONSE BRIEF OF QUESTAR GAS COMPANY ON PRUDENCE** was served by electronic mail on the following on May 21, 2004:

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