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**To: Utah Public Service Commission**

From: Division of Public Utilities  
Constance B. White, Director  
Artie Powell, Manager, Energy Section  
Marlin H. Barrow, Utility Analyst

Date: August 24, 2006

Subject: Docket No. 05-057-T01, QGC GSS/EAC Task Force Report

**ISSUE:**

On May 26, 2006, The Utah Public Service Commission (“Commission”) issued an Order in Docket No. 05-057-T01 to “Create a task force to address GSS expansion area rate premiums and EACs in the company’s tariffs and develop new tariff language to address future system expansion requests.”<sup>1</sup>

A task force was formed which consisted of members Colleen Bell, Carl Galbraith, Ron Jibson, Brad Markus, Barrie McKay and Gary Robinson representing Questar Gas Company; Dan Gimble, Chris Keyser, Eric Orton and Reed Warnick representing the Committee of Consumer Services; Betsy Wolf representing the Salt Lake Community Action Program; Rob Adams (Beaver County), Delynn Fielding (Carbon County) and Mike McCandless (Emery County) representing the Utah Counties Economic Development Group; Jim Logan and Becky Wilson representing the Public Service Commission; and Marlin Barrow, Mary Cleveland, Mike Ginsberg, Sam Liu, Artie Powell, Carolyn Roll and Connie White representing the Division of Public Utilities.

**RECOMMENDATION:**

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<sup>1</sup> Docket No. 05-057-T01 PSC Order, p. 10, ¶ 5, dated May 26, 2006.



The task force members could not reach a consensus regarding how to address the current GSS/EAC rate premiums in Questar's Tariff. There was consensus regarding future expansion requests.

While the task force could not reach a consensus the members of the task force representing Questar Gas, Utah Counties Economic Development Group and the Division of Public Utilities recommends to the Commission the following:

1. The expansion area rates (GSS, IS-4 and ITS) and Extension Area Charges ("EAC") should be removed from the Questar Gas Tariff. The expansion area rates can be found in Sections 2.03, 4.03 and 5.09, and the EACs are in Section 9.02 of the tariff.
2. The revenues now being collected through the GSS, IS-4, ITS rates and EACs should be rolled into the current GS-1, I-4 and IT rate schedules, and the rates for those schedules should be adjusted so that this change is revenue neutral for the combined classes (GS-1 and GSS, I-4 and IS-4, and IT and ITS).
3. The language in Section 9.02 of Questar Gas' current tariff that discusses "Availability Of Service To New Service Extension Areas" (Pages 9-3 through 9-6) should be removed.
4. The financing of the non-refundable contribution for any future expansion of QGC's distribution system into areas currently not served by natural gas should be funded from third party sources before the expansion begins, and all other charges or required contributions in aid of construction should follow the established main and service line expansion policies included in Sections 9.03 and 9.04 of Questar Gas' current tariff.
5. Questar Gas should file a tariff change with the Commission to incorporate the above-mentioned changes, including the support for the proposed rate changes.

## **HISTORY:**

In the mid 1980s Mountain Fuel Supply Co. ("Questar Gas" or "QGC") along with three other companies' approached the Commission to extend natural gas service to several communities in Central and Southern Utah. Following hearings, Mountain Fuel was awarded the Certificate of Public Convenience and Necessity.<sup>2</sup>

In an Order dated January 5, 1987, the Commission granted QGC authority to create the GSS rate, which was designed to charge a double Distribution Non-Gas Cost (DNG) rate

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<sup>2</sup> Case No. 86-057-03.

for a 10-year period to new communities who desired natural gas service. At that time the double DNG rate, at the estimated usage levels, was thought to be sufficient enough for QGC to recover the capital required for the cost of the expansion. There were communities in seven counties that received gas service under this agreement.<sup>3</sup> At the end of the 10-year period, these areas were converted to the GS-1 rate schedule.

When Kern River Pipeline ran a line through the western part of Utah, the opportunity again presented itself for extending service to new communities that could take service off of that line. Because those communities were more remote and had smaller populations and expected growth rates, Questar Gas estimated that the GSS rates would have to be collected for 20 years to recover the capital required for the cost of the expansions. There are currently communities in five counties that are receiving service under the GSS 20-year time period.<sup>4</sup> These GSS rates are scheduled to expire between 2012 and 2013. These communities have been paying the GSS rates for about 13 years.

The payback time frame for the communities under the GSS tariff was estimated using an average after tax interest rate. With the approval of the GSS rates, the Commission did not require QGC to monitor the extra revenues collected from the GSS rates and compare them to the original extra costs of the expansions.

When Ogden Valley wanted service in 1995, the EAC was initiated.<sup>5</sup> This established a basic monthly service fee to be charged, in addition to the authorized DNG tariff rate for the GS-1 rate schedule. The monthly service fee was determined based on an analysis of the non-refundable contribution required to cover the cost to install the feeder lines to the communities. This fee assumed a specific number of signups within a two-year period and using a discount of the authorized pre-tax rate of return over 15 years. In essence, QGC created a loan for the Ogden Valley customers to pay for the required contribution in aid of construction. After Ogden Valley, nine additional areas petitioned the Commission for approval of EAC with similar provisions (Exhibit 1).

Since the EAC payments were calculated as loans from QGC to the communities to cover the extra capital required for the cost of the expansions, the Commission required QGC to monitor the payments received from each community and collect these payments until the loan was paid off. The loans were calculated with 15-year terms for most of these areas. The orders included the provision that the EACs would end before 15 years if payments

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<sup>3</sup> Case Nos. 86-2016-01, 86-057-03, 86-091-01, 86-2019-01. Counties included: Sanpete, Sevier, Piute, Iron, Washington, Cache in Utah; and Franklin County in Idaho (See Original Sheet No. 215 in Mountain Fuel Supply Company's Utah Natural Gas Tariff No. 200).

<sup>4</sup> Docket No. 93-057-03. Counties include Iron, Washington, Millard, Beaver, and Emery in Utah (See current Questar Gas Company Utah Natural Gas Tariff, page 9-5).

<sup>5</sup> Docket No. 96-057-07.

exceeded the estimates and later than 15 years if the payments were less than the estimates.

In March, 2005, a memo was sent to the Commission from Beaver County that questioned the ability of rural communities to attract new industry into the area when communities with GSS/EAC rates are compared to communities served under GS-1 rates. As a result of that memo, the Commission initiated an investigation into the GSS/EAC tariff issues. That investigation reviewed the history behind GSS rates, as well as the process to calculate the EAC charge. It also highlighted the fact that, due to a lag in the number of initial customers signing up, with the exception of Ogden Valley, the EAC term for most of the other communities would exceed 15 years.

As the process was reviewed, an inconsistency was noted in the interest rate used in the calculation of the GSS and EAC rates. In order to help bring some consistency to the analysis, the EAC interest rates were adjusted to an after tax rate in 2005.<sup>6</sup> This adjustment accelerated Ogden Valley's payoff from March 2008 to September 2005, as well as shortened the expected payoff time frame for the other EAC communities.

#### **TASK FORCE MEETINGS:**

The task force met four times during the course of this investigation. Minutes of each meeting were taken and are attached as Exhibits 2 through 5 respectively. Various handouts were prepared and are also included as attachments.

#### *FIRST MEETING*

The first meeting was held on June 13, 2006. QGC reviewed the history of the creation of the GSS and EAC tariff provisions as outlined above. In addition, material from meetings held in 2005, which detailed the status of the various communities which were using the GSS/EAC tariff provisions, was also handed out to task force members. (See Exhibit 6).

Much of the first meeting of the task force dealt with two issues. The first issue looked at inter-class subsidization and whether it is appropriate to roll into one class of service the revenue requirement of another class of service, which would be the case if the current GSS and EAC customers were rolled into the GS-1 rate schedule. QGC cited an example of how this type of inter-class subsidization has occurred in the past with the purchase of Utah Gas Service and the rolling into the GS-1 rate schedule the costs of those Utah Gas Service customers at the next rate case after the purchase occurred.

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<sup>6</sup> Docket No. 05-057-13.

The second issue discussed the problem of setting an unfavorable precedence of dealing with future expansion issues by what decisions are made as a result of this task force and the problems that are inherent in those decisions.

### *SECOND MEETING*

The second meeting of the task force was held on July 6, 2006. QGC handed out an update of the EAC payoff reflecting information as of May, 2006. Also included was information showing the payoff if the interest rate used to calculate the payments was changed from the current 9.64% to 6% and 0% respectively (Exhibit 7). A handout was also provided by QGC showing the analysis of the expected costs of extending service into some areas that currently do not have gas service (Exhibit 8). The contingent from the Rural Economic Development handed out a summary of some funding opportunities based on legislative action in 2007 (Exhibit 9). The Committee of Consumer Services (“CCS”) staff also expressed their initial ideas concerning the issues.

The task force discussed each of these items. The additional annual revenues from the GSS/IS4/ITS tariffs are \$1.3 million and \$546,000 from the EAC customers. Combining these rate schedules into the GS-1/I-4/IT rate classes and adjusting the rates accordingly would add on average, approximately \$0.19 cents per month to an average GS-1 customer’s bill.<sup>7</sup>

QGC noted that the estimated costs to extend gas service to communities which currently have no service was done several years ago and that today, the costs could be much higher than those presented in the handout based on increased construction costs.

One of the biggest hurdles faced by rural communities competing for development funding is the current definition of what qualifies as rural under Utah law. Many of the communities surrounding the Wasatch Front as well as the St. George area still are considered rural, which makes it more difficult for the more remote areas in Utah to compete for the available funding. The task force recognized that this issue is beyond the jurisdictional authority and scope of the Commission but also realizes that the current disparity in the current GSS/EAC rates, when compared to the GS-1 rates, creates a disincentive for economic development in those rural areas.

The CCS staff recommended rolling in the revenue requirement of the GSS/EAC rate classes into the GS-1 tariff, but was also of the opinion that QGC should bear some of the cost of this action. QGC responded that they already have incurred some revenue shortfall by adjusting the interest rate used to calculate the EAC payments to an after-tax rate of 9.64%. This action reduced Ogden Valley’s payoff from an estimated completion date of March 2008 to August 2005. Since this occurred between rate cases, QGC revenues were immediately reduced by \$565,000 per year.

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<sup>7</sup>  $(\$1,252,000 + \$546,000) / 800,000 / 12$  or \$0.13 cents for GSS and \$0.06 cents for EAC.

### *THIRD MEETING*

The third meeting was held on July 19, 2006. The focus of this meeting was formulating a preliminary policy regarding the current GSS/EAC tariffs. The CCS staff reported that the Committee had met but really hadn't had time to study the GSS/EAC situation due to the recent settlement negotiations in the Rocky Mountain Power rate case.

The Division expressed a desire to roll-in the current GSS/IS-4/ITS/EAC revenue requirement into the GS-1/I-4/IT rate schedules. The Division felt that the policy regarding future expansion of QGC's system into new communities should be made outside the current regulatory arena and is more of a statewide policy that needs legislative attention.

QGC felt that, because of the inconsistencies that have existed between the GSS and EAC tariff policies, the two should be rolled-in with the GS-1 rate and that before any future expansion takes place, the communities should have the non-refundable contribution funds available before the project is started. QGC also commented on four possible legislative proposals which the Utah Counties Economic Development group brought before the task force. Of the four, QGC felt they could support the Industrial Assistance Fund and the Rural Enterprise Fund. (See Exhibit 8, Nos 1 and 3).

### *FOURTH MEETING*

The fourth meeting was held on August 17, 2006. This meeting reviewed the preliminary recommendations of the task force regarding the current status of the GSS/EAC tariffs. The task force discussed the proposed recommendations. The CCS had several concerns with the recommendations and indicated they would not be able to support the recommendations in their present form.

CCS Staff noted that it was the Company's decisions to initiate petitions with the Commission to extend service to the new areas covered in the GSS and EAC rates with the intent to expand Questar's business. When the business expansions became problematic, Questar petitioned to have the Commission order the Company's other customers to accept the financial burden. Presently these communities are encumbered to the point that they will take decades to pay off their debt to the Company and some may never repay their obligation.

In the first order from the Commission regarding expansion of Questar's system (86-2016-01, 86-057-03, 86-091-01,86-2019-01) The initial criteria established by the

Commission included six elements. Questar provided testimony in support of the Company meeting all these six criteria. In subsequent orders these six are not mentioned. The Committee wondered if the Commission intentionally eliminated those six as being criteria. The objective in the initial order was that the expansion be 'economically feasible' and the Company provided numbers to show that the expansion was economically feasible. However, in the second order, (93-057-03) the objective was to 'allow customers in new service areas to receive natural gas where it might otherwise be economically infeasible' even with Emery County providing an up-front contribution. The Committee again wondered if this change was intentional on the Commissions part.

Finally, in the Commission's order where the EAC was established (96-057-07) the Commission established its 'going forward' policy which, the Committee proposes, is still valid and supportable.

The task force members made an effort to try and resolve any differences but soon realized that the CCS would need to make a separate filing with the Commission expressing those concerns in that filing.

## **CONCLUSIONS:**

In reviewing the work of the task force during the past few months, the Division must consider the implications of the age old battle between the concepts of "fairness and functional efficiency."<sup>8</sup>

The question of fairness arose often when the topic of discussion dealt with rolling the current GSS/IS-4/ITS/EAC revenue requirements into the GS-1/I-4/IT rate schedules. The central question in that discussion was, "Is it fair to excuse the obligations of some (the GSS/EAC customers) when they knowingly committed to that obligation?" The counter argument to that question was, "Is it fair that those individuals that did sign up, (referring to the EAC customers) when they said they were going to sign up, be punished with an extended payment schedule because others that said they were going to sign up but didn't, causing the entire community's payout schedule to be extended?"

When looking at these questions, the Division is reminded of the "Good-Faith Standard" of fairness.<sup>9</sup> The first eight communities which signed up under the GSS rate schedule paid under that schedule for ten years as agreed and then went to the GS-1 schedule. The next five communities signed up for a period of 20 years and have been paying under that schedule for 13 to 14 years. However, the Division cannot ascertain whether or not those communities under the GSS schedules have actually paid for the cost of the line

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<sup>8</sup> James C. Bonbright, *Principles of Public Utility Rates*, Chapter VIII (New York: Columbia University Press, 1961), republished on the web (July 2005): <http://www.terry.uga.edu/bonbright/publications>.

<sup>9</sup> *Ibid*, p127.

extension, because no records have been kept by QGC pertaining to the collection of revenues from that class of customer.

The EAC customers agreed to a definite monthly surcharge in addition to the regular DNG rate that is charged to the GS-1 customer. The original terms established for the various EAC monthly charges were done in good faith based on the estimates at the time. However, due to lags in customer sign ups, many, if not most, EAC customers face payback periods greater than what was first negotiated. It seems an injustice to have EAC customers who signed up on time, should have to pay longer than originally negotiated, and it is also administratively impractical to monitor each individual customer's payback period.

The following tables illustrate the average differences in payments between GS-1 customers, GSS customers and EAC customers for a year( Table 1) and for the remaining duration of the GSS and the EAC estimated payback periods (Table 2) per Exhibit 6:

Table 1

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Table 2

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With the understanding that the above tables uses averages, it can be seen that a GSS customer, assuming usage is the same irrespective of physical location, will pay an average of \$94/ year (rounded) compared to a GS-1 customer. This equates to approximately \$561 more that a GSS customer will pay when compared to a GS-1 customer over the remaining six year GSS contract life.

The EAC customer will pay \$289 more per year than a GS-1 customer and \$195 more than a GSS customer. Using an average estimate of 9 years of remaining EAC contract life, the EAC customer will pay an average of \$2,600 more than a GS-1 customer and \$2038 more than a GSS customer.

Most task force members, in reviewing this type of disparity in the rates of residential customers, feels the past experiences of QGC in extending service to new areas has been inconsistent and resulted in the unintended consequence of economic disparity between rural and urban areas for economic growth potential.

Rather than continue along this path, the Division along with QGC and the Utah Counties Economic Development recommends to the Commission that QGC opt for a path of "functional efficiency" by revising their current tariff to remove the expansion area rates



and EACs so that residential customers statewide pay the same rate as currently provided by Rocky Mountain Power in their Schedule No.1 for Residential Service, and require those areas that desire new gas service to acquire the necessary funding for the non-refundable contribution from third party resources and not from QGC.

GSS/EAC TASK FORCE REPORT  
Docket No. 05-057-T01

## EXHIBITS

1. Exhibit No. 1..... Extension Area Charge and Expiration Date.
2. Exhibit No. 2..... Minutes of GSS/EAC Task Force Meeting of June 13, 2006.
3. Exhibit No. 3..... Minutes of GSS/EAC Task Force Meeting of July 6, 2006.
4. Exhibit No. 4 .....Minutes of GSS/EAC Task Force Meeting of July 19, 2006.
5. Exhibit No. 5..... Minutes of GSS/EAC Task Force Meeting of August 17, 2006.
6. Exhibit No. 6 .....Material provided in initial meetings on GSS/EAC during 2005.
7. Exhibit No. 7 .....Update of EAC Payoff Scenarios at Various Interest Rates.
8. Exhibit No. 8 .....Summary of Potential Future Expansion Areas.
9. Exhibit No. 9 .....Alternative Funding Mechanisms.

