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MEMORANDUM

To: Public Service Commission

From: Division of Public Utilities
Philip J. Powlick, Director
Energy Section
Marlin H. Barrow, Technical Consultant
Doug Wheelwright, Utility Analyst
Artie Powell, Manager

Date: October 16, 2008

Subject: Questar Gas, Account 191 Pass Through, Docket No. 08-057-23.

ISSUE:

On October 2, 2008, Questar Gas Company (QGC) filed an application to adjust rates for natural gas with the Public Service Commission (PSC). This filing in Docket No. 08-057-23 asks for approval to increase the supplier non gas cost and decrease the commodity portion of the Company's Utah natural gas rates in order to pass-through an expected total decrease in gas costs of \$68,809,033. This is based on projected Utah gas costs of \$672,480,619. The commodity portion represents a decrease of \$93,377,626 while the supplier non-gas rate increase is \$24,568,594. A typical residential customer, assuming a usage of 80 decatherms per year, will see an average decrease in their annual bill of \$47.96 or a decrease of 5.87% below the current rates.



RECOMMEND APPROVAL:

After a preliminary review of this application, the Division recommends that the decrease be approved as filed with the proposed rates becoming effective November 1, 2008. The Division also recommends that in future applications, the Company either augment Exhibit 6.1 to include details for the test year commodity cost change or include a similar exhibit detailing the test year commodity cost.

DISCUSSION:

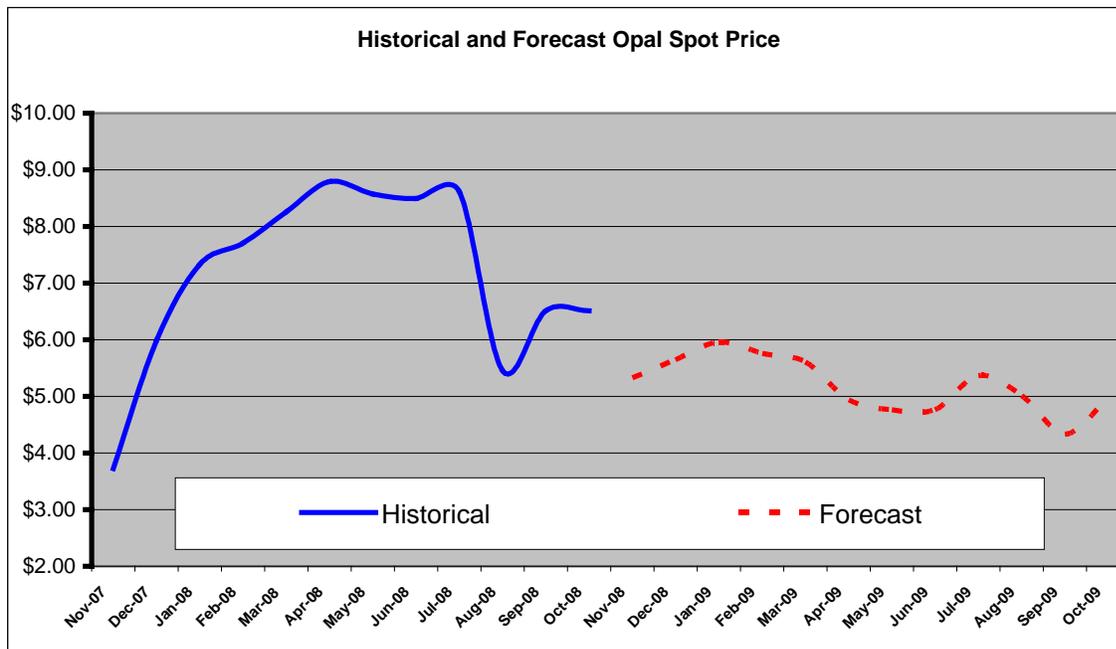
This filing (Docket No. 08-057-23) uses a base period of November 1, 2008 through October 30, 2009. QGC expects total system requirements of 118.1 million decatherms. Of this total system requirement, 89.5% or 105.7 million decatherms is required to meet firm system sales expectations with 96% of the total firm system sales requirements or 101.6 million decatherms Utah's firm sales volumes. The remaining 12.4 million decatherms of the total system requirement is for the Company's restoration of Btu value after gas processing and fuel use (9.3 million Dth) and to meet planned storage levels (3.8 million decatherms).

To supply these system requirements, QGC plans on utilizing 52.0 million decatherms of WEXPRO production at a cost of \$255.3 million (44.0% of total requirements at an average cost of \$4.63/Dth) and purchasing from third party producers, during the winter heating season, another 66.1 million decatherms for \$386.9 million (56.0 % of total requirements at an average cost of \$5.85/Dth). As noted in the filing, and as provided in QGC's Tariff for Natural Gas Service in Utah, PSCU 400, §2.10, pp. 2-11-2-17, these gas costs represent a direct pass through of costs. These costs do not impact the operating profit or rate of return of QGC except for \$4.1 million as noted on line 13, column (E) of Exhibit 1.5, which is the Utah allocation of the pre-tax return on the working storage gas inventory approved by the PSC in Docket No. 93-057-01 and using the cost of capital approved in QGC's current rate case in Docket No 07-057-13.

Natural Gas Spot Prices

Since the Commission approved the last rate request there has been a significant reduction in the commodity price. In the June 2008 filing the forecast spot price was \$8.55. The current filing indicates a forecast spot price of \$4.95. Figure 1 shows the actual first of month spot prices of gas at Opal, Wyoming from November 2007 through October 2008 along with the forecast prices for November 2008 through October 2009¹. This chart shows the significant reduction in commodity prices since July 2008. The projections indicate a return to lower and possibly more stable prices in the future.

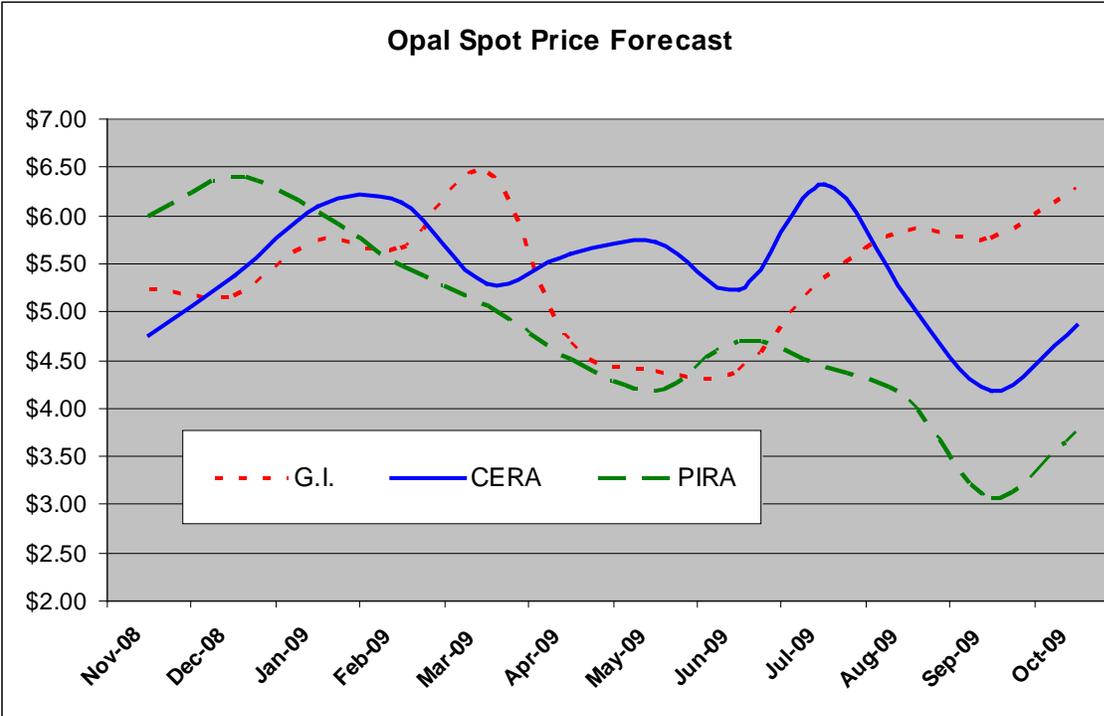
Figure 1



Like the previous pass-through filing, the forecast is based on an average of future price projections by three different forecasting entities. Those three entities are Global Insight (GI), Cambridge Energy Research Associates, Inc. (CERA) and the PIRA Energy Group (PIRA). There is a divergence of opinions within the three forecasting services used by QGC as to the prediction of the future spot prices. This is displayed in Figure 2.

¹ Arithmetic average of GI, CERA and PIRA forecast from July 2008 to June 2009 used in pass-through application Docket No. 08-057-15.

Figure 2



Because of the disparity between these projections, the use of an average of the three has been recommended and used by QGC in their price forecasts.

Pricing Hedges

The WEXPRO production and QGC's storage practices play an important role in QGC's plan to "hedge" against natural gas price volatility while meeting their overall supply plan. These practices allow QGC to keep WEXPRO production flowing during the summer months to meet summer demand and to inject into storage. The Company can then withdraw the lower cost company production in the winter months, which minimizes the need to purchase gas in the winter.

In this filing, WEXPRO production accounts for 44.0% of the gas supply mix at a weighted cost of \$4.63/Dth (\$4.26/Dth for net QGC production costs and \$0.37/Dth for costs associated with gathering the WEXPRO production). The weighted cost of the WEXPRO production has decreased 7.2% since the last filing. This decrease is the result

of decreased royalties, which are based on the decrease in current market prices, and a decrease in the WEXPRO operator fee. The decrease in operator fee is attributed to the moderation in drilling costs necessary to find gas to maintain production levels as older wells begin to decline in production rates. The value that WEXPRO production brings to the customers of QGC cannot be overlooked. If these volumes were purchased using the current prices forecasted in this filing, a typical residential customer, assuming a usage of 80 decatherms per year would see a decrease of \$10 a year over current rates instead of a decrease in their annual bill of \$48. This equates to a savings of \$38 per year.

QGC further attempts to manage gas price volatility, and thereby “hedge” or mitigate customers’ exposure to that volatility, by continuing its planned purchase program. For this filing, QGC has developed a gas supply portfolio of 66 million decatherms of purchased gas and 52 million decatherms of company owned production. The Company currently has hedged 17% of the purchased winter gas supply with fixed price contracts. The goal is to reach a level of 25% to 30% of fixed priced contracts which will depend on future movements in the price of natural gas. An additional \$2,000,000 is included in this filing to allow QGC to purchase price-capped supply contracts. However, the price of such caps is currently too high to be cost-effective. The extra \$2,000,000 provides the company with the option to act if and when capped contracts prices move downward. These approaches were developed through continued meetings with regulators to provide updated information regarding this planned “hedging” program and current expectations in the gas market.

Amortization of existing 191 Account Balance

Experience has shown that the natural gas commodity price forecast used by QGC will not exactly match the actual prices as they unfold with time, especially with the market volatility in energy prices that currently exists. This fact is demonstrated by following the monthly commodity balances of the 191 account. At the time of QGC’s last filing in June 2008, the commodity balance was forecasted to be under collected by \$29.6 million

and \$0.40194/Dth amortization rate was applied to the commodity rate to begin collecting this balance. By August 2008 the actual balance was \$9.3 under collected. By November 2008 the Company anticipates this balance will be approaching a zero balance. Therefore the Company has reduced the commodity 191 amortization rate to zero, a reduction of \$0.4194/Dth.

In contrast, the SNG costs are relatively stable and predictable since those costs are set by contractual rate agreements. During the summer months when sales volumes are low, an under collection in the SNG cost balance is likely to occur, as reflected in this application with a request to increase the SNG amortization rate. During the winter months when sales volumes are high, an over collection is likely to occur which may require a subsequent reduction to the SNG amortization rate in the following pass-through application in the spring time. The Division believes there maybe some merit in setting the SNG amortization rate on an annual basis in order for more overall rate stability. This is something that the Division will discuss with the Company for future filings. The SNG amortization rate increase requested in this application does provide a small hedge against the price volatility in the natural gas markets should those prices increase more during the coming winter months than what is anticipated in this forecast.

The Division also notes that, unlike the supplier non-gas cost change (Exhibit 1.6, p.2), the detail for the commodity cost change is not detailed out in exhibit format. This is inconvenient for the reader. Therefore, the Division recommends that the Company either augment Exhibit 1.6 to include this detail or include an additional exhibit similar to Exhibit 1.6 in future pass-through applications detailing the commodity cost change.

SUMMARY AND CONCLUSION:

The recent volatility and dramatic increases in the commodities seen during the summer months appears to be easing with significant reduction in the price of natural gas. While the commodity prices have come down in recent months, the total proposed rates

beginning November 1, are higher by \$1.54/Dth than they were one year ago (total GS-1 Block 1 winter rate). This has not been a concern to customers during the summer months but will be more apparent during the winter heating period. This is a concern to the Division and emphasizes the need for customers to become even more energy efficient. The current DSM programs offered by QGC through the ThermWise campaign provide an excellent opportunity for customers to become more aware of ways they can become more energy efficient. The Division urges Questar to use its customer education and DSM funds to educate consumers on how they can reduce their gas usage on an ongoing basis in order to reduce consumption and mitigate the impact of possible future price increases.

The Division recommends that the pass-through application and the requested rate decrease as proposed by the Company be approved. Exhibit 1 attached to this memo show a summary of the rate changes contained in this application. The Division is currently in the process of auditing the 191 account for 2007. As always, the Division will continue to monitor the published monthly index prices² and compare them to the prices used in this pass-through filing to see if any trend develops which may warrant an out-of-period filing by QGC.

Cc: Barrie McKay, Questar Gas Company
 Michele Beck, Committee of Consumer Services
 Rea Petersen, Division of Public Utilities
 Francine Giani, Department of Commerce

² Published monthly in Platts "Inside FERC's Gas Market Report."