

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

<p>IN THE MATTER OF THE APPLICATION OF QUESTAR GAS COMPANY FOR APPROVAL OF THE CANYON CREEK ACQUISITION AS A WEXPRO II PROPERTY</p>	<p>Docket No. 15-057-10 REDACTED</p>
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DIRECT TESTIMONY OF BARRIE L. McKAY

FOR QUESTAR GAS COMPANY

QGC Exhibit 1.0

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I. INTRODUCTION

1 **Q. Please state your name and business address.**

2 A. My name is Barrie L. McKay. My business address is 333 South State Street, Salt Lake
3 City, Utah.

4 **Q. By whom are you employed and what is your position?**

5 A. I am employed by Questar Gas Company (Questar Gas or Company) as Vice President of
6 State Regulatory Affairs. I am responsible for state regulatory and energy-efficiency
7 matters in Utah and Wyoming.

8 **Q. What are your qualifications to testify in this proceeding?**

9 A. I have listed my qualifications in QGC Exhibit 1.1.

10 **Q. Attached to your written testimony are QGC Exhibits 1.1 through 1.3. Were these**
11 **prepared by you or under your direction?**

12 A. Yes.

13 **Q. What is the purpose of your testimony in this Docket?**

14 A. The purpose of my testimony is to: 1) describe Wexpro's recent acquisition of natural gas
15 producing properties within the Wexpro I Development Drilling area known as the
16 Canyon Creek Acquisition Area and explain why Questar Gas is required to bring this
17 property to the Utah and Wyoming Commissions for approval as a Wexpro II property;
18 2) describe changes that Questar Gas and Wexpro are proposing to make in conjunction
19 with the Canyon Creek Application and 3) explain why including the Canyon Creek
20 Acquisition as a Wexpro II property in conjunction with the proposed changes are in the
21 public interest and should be approved by this Commission.

22 **Q. Are there others who will provide testimony in this proceeding?**

23 A. Yes, Mr. Brady B. Rasmussen, Executive Vice President and Chief Operating Officer of
24 Wexpro Company, will also provide an overview of the Canyon Creek Acquisition and

25 explain how the proposed changes would allow Wexpro to continue drilling at or below
26 the 5-Year Forward Curve.

27 **II. CANYON CREEK ACQUISITION**

28 **Q. Please describe the recent purchase by Wexpro of natural-gas producing properties**
29 **in the Canyon Creek Acquisition Area.**

30 A. On December 19, 2014, Wexpro closed on its purchase of the Canyon Creek Acquisition
31 for approximately \$52.7 million. (Note: If approved as a Wexpro II property, this
32 amount would be adjusted to reflect the volumes Wexpro has sold since acquiring the
33 property. See QGC Exhibit 2.2.) This purchase consists of a 30% interest in 100
34 producing wells and approximately 30 future wells. This acquisition increased Wexpro’s
35 ownership interest from 70% to 100% in the Canyon Creek Acquisition Area.

36 **Q. Is this a Wexpro property acquisition that the Company must bring to the Utah and**
37 **Wyoming Public Service Commissions for approval?**

38 A. Yes, under the terms of the Wexpro II Agreement, the Company is required to apply for
39 Utah and Wyoming Commission approval of Wexpro property acquisitions in the
40 Wexpro I Development Drilling areas. The Canyon Creek Acquisition is a property
41 within a Wexpro I Development Drilling area.

42 **Q. Does Questar Gas support the Canyon Creek Acquisition?**

43 A. Yes. As explained in Mr. Rasmussen’s testimony, the Canyon Creek Acquisition is in an
44 area where Wexpro operates and already has significant experience. Wexpro had a 70%
45 interest in these wells in this area. These wells were drilled by Mountain Fuel and
46 Wexpro over the last 60 years. Wexpro understands the geology, engineering and
47 production of these wells. These properties are currently some of the higher-producing
48 and the lowest-cost properties in the Wexpro I Development Drilling areas. The Wexpro
49 II concept was conceived to accommodate adding these types of acquisitions to Questar
50 Gas’ supply portfolio.

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51 **Q. If the Canyon Creek Acquisition is approved as a Wexpro II Property, would**
52 **Wexpro be able to develop the property in today’s gas market?**

53 A. No, as more fully explained by Mr. Rasmussen, if today’s natural gas prices continue as
54 forecasted and the rate of return on development gas drilling remains unchanged, then
55 based on Wexpro’s current model, Wexpro would need to wait until gas prices increase
56 to develop the property at or below the current 5-Year Forward Curve.

57 **Q. Does Questar Gas want Wexpro to develop gas reserves at or below today’s current**
58 **5-Year Forward Curve?**

59 A. Yes, for at least two reasons. Recognizing that the long-term history of natural gas prices
60 is volatile and given the likelihood of some future inflation, anytime Wexpro can develop
61 natural gas that will produce for 20 to 30 years at today’s low prices, that is good for
62 customers. Second, as more fully explained by Mr. Rasmussen, an ongoing drilling
63 program helps lower the per-unit cost/Dth of cost-of-service production and preserves
64 Wexpro’s expertise and efficiencies in developing these properties.

65 **III. PROPOSED CHANGES**

66 **Q. To take advantage of developing natural gas reserves at today’s low gas prices,**
67 **would changes need to be made to the Wexpro I and II programs going forward?**

68 A. Yes.

69 **Q. Realizing that natural gas prices may remain low for the foreseeable future and that**
70 **the current required returns on new wells drilled under Wexpro I and II produce**
71 **natural gas above the 5-Year Forward Curve, how did Questar Gas and Wexpro**
72 **develop the proposed changes?**

73 A. Following the purchase of the Canyon Creek Acquisition and the significant change in
74 the natural gas market, the answer to that question became the focus of discussions
75 between Wexpro and Questar Gas. We studied and analyzed various alternatives.
76 Finally, when we believed we had a proposal that would benefit customers and Wexpro

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77 and provide incentives, checks and balances going forward, we presented those ideas to
78 parties that would be part of this proceeding. After getting feedback, we further refined
79 the proposal.

80 **Q. What are the changes that are being proposed with this Application?**

81 A. In conjunction with the Canyon Creek Acquisition as a Wexpro II property, the following
82 changes are being proposed:

- 83 1) The rate of return on post-2015 Development Drilling will be lowered to the
84 Commission-Allowed Rate of Return as defined in Section I-31 of the Wexpro II
85 Agreement (currently 7.64%).
- 86 2) Dry-hole and non-commercial well costs will be expensed and shared on a 50/50
87 basis between customers and Wexpro; and
- 88 3) When the actual annual weighted average price from all cost-of-service wells is
89 less than the current market price, then annual savings will be shared between
90 customers and Wexpro on a 50/50 basis.

91 **Q. Are Questar Gas and Wexpro proposing any changes to the 65% percentage of total
92 gas supply, the requirement that future Wexpro Development Drilling must be
93 generally at or below the current 5-Year Forward Curve, the allowed return on
94 Proven-Developed-Producing (PDP) properties or the return on pre-2016
95 development gas drilling?**

96 A. No. These requirements were agreed to by the Parties and approved by the Utah and
97 Wyoming Commissions as part of either the Wexpro II Agreement or the Trail Unit
98 Stipulation and are proposed to continue.

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99 **Q. Have you prepared an exhibit that summarizes some of the key criteria of the**
100 **Wexpro Agreements and how they were handled under the original Wexpro I and II**
101 **Agreements, the Wexpro II Trail Stipulation and the proposed changes?**

102 A. Yes, attached as QGC Exhibit 1.2 is a table that compares how a property was treated in
103 the past and how it will be treated if the Commission approves the proposed changes in
104 this Application.

105 Line 1 shows that “Future drilling criteria” was governed by standard industry practice as
106 provided in the Wexpro I and II Agreements. Under the terms of the Trail Unit
107 Stipulation the future drilling criteria was changed to be less than or equal to the 5-Year
108 Forward Curve and is proposed to continue with the proposed changes.

109 Line 2 shows that cost-of-service production was limited to 65% in the Trail Stipulation
110 and is proposed to continue with the proposed changes.

111 Line 3 shows that pre-1981 wells and PDP wells, that may be added as a Wexpro II
112 Property, have been billed at the Commission-Allowed Rate of Return under the Wexpro
113 I and II Agreements and the Trail Stipulation and will continue to be billed at the
114 Commission-Allowed Rate of Return under the proposed changes.

115 Line 4 shows that “Developmental Gas Wells” drilled prior to 2016 were billed at the
116 Base Rate of Return plus 8% for a gas well (5% for oil) and will continue to be billed
117 using that rate over the remaining life of the well.

118 Line 5 shows that all “Developmental Gas and Oil Wells” drilled post 2015 will be billed
119 at the Commission-Allowed Rate of Return for the life of the wells.

120 Line 6 shows that “Dry Hole/Non-Commercial Costs” were 100% the responsibility of
121 Wexpro under the Wexpro I and II Agreements and the Trail Stipulation. Going forward,
122 under the proposed changes these costs will be shared 50/50 between customers and
123 Wexpro.

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124 Line 7, shows that the “Incentive to reduce costs and share savings,” is proposed to be
125 part of the proposed changes. This shows that when the total annual cost-of-service price
126 is below the annual market gas price, then savings will be shared with customers 50/50.

127 **Q. Are any other changes being proposed?**

128 A. No, all other provisions, terms and conditions of the Wexpro I, Wexpro II and Trail
129 Stipulation and all guideline letters remain unchanged.

130 **IV. PUBLIC INTEREST**

131 **Q. In the development of this proposal you mentioned checks, balances and incentives.
132 Please explain how these are accomplished with the approval of this application.**

133 A. First, Wexpro may only develop wells that are generally at or below the current 5-Year
134 Forward Curve. This assures that Wexpro will not be developing properties that are
135 currently “out of the market.” Additionally, with the rate of return being lowered to the
136 Commission-Allowed Rate of Return on post-2015 development wells, Questar Gas’
137 customers reap the benefit of adding long-term reserves at low gas price.

138 Second, Wexpro manages production at or below 65% of Questar Gas’ total gas supply.

139 **Q. Are there other checks included within this proposal?**

140 A. Yes. The proposed changes also address dry-hole and non-commercial well costs.
141 Rather than proposing that all the dry-hole and non-commercial well costs should be
142 borne by customers, which may be warranted given the proposal to lower the return to the
143 Commission-Allowed Rate of Return on future development wells, Wexpro will be
144 sharing in that potential expense 50 cents on every dollar. This equal sharing assures
145 that Wexpro has “skin in the game” and will be cautious as they continue to drill wells in
146 the future. Additionally, this check is “balanced” with the proposal to share savings in
147 the future.

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148 **Q. Please summarize how the incentives for Wexpro and benefits for customers worked**
149 **in the past?**

150 In the past, the Wexpro I and II Agreements were set up to provide Wexpro with an
151 incentive to find and develop natural gas reserves for Questar Gas customers. This is
152 illustrated by the larger risk premium of 8% being allowed on natural gas wells versus a
153 risk premium of 5% for oil wells. Questar Gas customers in return received a physical
154 hedge at a cost-of-service price for the life of the well. Although not required by the
155 Agreements, the cumulative result for Questar Gas customers was over a billion dollars
156 of savings, when compared to the purchased price of natural gas. This can be seen in the
157 attached QGC Exhibit 1.3. This is a two-page exhibit. The first page shows the average
158 purchase price by year compared to the average cost-of-service price for that year. The
159 second page shows the cumulative savings since 1981.

160 **Q. How will the proposed changes provide incentives for Wexpro and benefits for**
161 **customers in the future?**

162 A. Under the proposed changes, Wexpro will be incentivized to reduce costs on current
163 reserves and develop lower-cost reserves in the future. I should point out, as explained in
164 Mr. Rasmussen’s testimony, Wexpro has already been actively working to bring the
165 current cost-per-unit of cost-of-service gas down. Wexpro will now be incentivized to
166 continue these cost saving measures.

167 **Q. When and how will savings be calculated?**

168 A. Savings will be determined when the all-in cost-of-service price is below market. This
169 means that the weighted average price of 1) the pre-2016 wells that will continue to be
170 produced at the rate of return allowed at the time they were drilled and 2) the post-2015
171 wells that will be produced at the Commission-Allowed Rate of Return must be below
172 the current market price before savings begin to be shared.

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173 Savings will be calculated on an annual basis. If annual savings have not occurred
 174 because market prices have dropped or cost-of-service prices have increased, or for some
 175 other reason, then no sharing will occur.

176 **Q. Why should the Company secure this supply at a time when market prices are low**
 177 **and the forward curves indicate that those prices may remain low for the next few**
 178 **years?**

179 A. There are several important reasons. The Canyon Creek Acquisition is one of the best
 180 performing properties in our cost-of-service portfolio due to the low finding costs and
 181 Wexpro-owned gathering, processing, and compression. To be able to add to the best
 182 producing area is a great opportunity. It is not only competitive with market prices over a
 183 20- to 30-year period but also competitive with today's low market prices. [REDACTED]

184 [REDACTED]
 185 [REDACTED]

186 Second, a low-price asset is rarely available in a high-price market. To assume a
 187 property could be purchased at a price below the current market price seldom occurs
 188 without unique circumstances as explained by Mr. Rasmussen. This was the type of
 189 opportunity that the Parties anticipated when they developed the Wexpro II Agreement.

190 Third, the approval of the Canyon Creek Acquisition as a Wexpro II property in
 191 conjunction with the proposed changes in allowed return, expense assignment and
 192 potential shared savings with customers would provide an opportunity for Questar Gas'
 193 customers to receive cost-of-service natural gas that is estimated to be lower than market
 194 prices over a 20- to 30-year period. Additionally, the proposed changes will set up long-
 195 lasting checks and balances that will provide benefits for customers and incentives for
 196 Wexpro into the foreseeable future.

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197 **Q. Should this property be approved as a Wexpro II property in conjunction with the**
198 **proposed changes as described above?**

199 . Yes, both the Utah and Wyoming Commissions should approve the Canyon Creek
200 Acquisition as a Wexpro II property and find that it is in the public interest. The
201 production from Wexpro I wells comes from a defined set of properties that are clearly
202 set forth in the Wexpro I Agreement. Because of technological improvements in drilling,
203 completion, and production methods, these properties have produced longer and at
204 greater levels than the original parties to the Wexpro I Agreement anticipated. However,
205 Wexpro production is finite and limited to defined areas. The Company and Wexpro
206 believe that the proposed changes will allow cost-of-service production to be managed
207 within a range that will benefit Questar Gas' customers and Wexpro.

208 **Q. Does this conclude your testimony?**

209 A. Yes.

State of Utah)
) ss.
County of Salt Lake)

I, Barrie L. McKay, being first duly sworn on oath, state that the answers in the foregoing written testimony are true and correct to the best of my knowledge, information and belief. Except as stated in the testimony, the exhibits attached to the testimony were prepared by me or under my direction and supervision, and they are true and correct to the best of my knowledge, information and belief. Any exhibits not prepared by me or under my direction and supervision are true and correct copies of the documents they purport to be.

Barrie L. McKay

SUBSCRIBED AND SWORN TO this 31st day of August, 2015.

Notary Public