Witness OCS – 1D

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION	)	
OF QUESTAR GAS COMPANY FOR	)	
APPROVAL OF THE VERMILLION	)	DOCKET NO. 17-057-01
ACQUISITION AS A WEXPRO II	)	
PROPERTY	)	

REDACTED

DIRECT TESTIMONY

OF

GAVIN MANGELSON

FOR THE OFFICE OF CONSUMER SERVICES

FEBRUARY 21, 2017

DIRECT TESTIMONY OF GAVIN MANGELSON

INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Gavin Mangelson; I am a Utility Analyst for the Office of Consumer Services (Office). My business address is 160 East 300 South, Salt Lake City, Utah 84111.

Q. PLEASE DESCRIBE YOUR EDUCATION AND EXPERIENCE.

A. I received a B.A. in Economics from the University of Utah. I previously worked as a Financial Analyst for the Department of Technology Services where my duties involved the creation of rates that were subject to approval by a government appointed commission. I have completed a Utility Analyst training course from New Mexico State University. I have worked for the Office for three and a half years. I have submitted Comments in numerous dockets and testimony in five dockets including Docket No. 15-057-10, the application for inclusion of the Canyon Creek Acquisition as a Wexpro II property, and participated in the settlement discussions of that docket. (In addition to including a new property, the settlement in that docket provided for material changes to the way that new properties are treated under the Wexpro II Agreement.)

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to present the position of the Office regarding the proposal of Questar Gas Company (Questar) to include several newly acquired properties, collectively referred to as the Vermillion Acquisition, into the Wexpro II Agreement. I will address how the Vermillion Acquisition may affect gas costs and gas supply for ratepayers, and I will present the position of the Office for each individual property.

VERMILLION ACQUISITION

Q. WHAT IS BEING REQUESTED IN THIS DOCKET?

A. Questar is requesting that the four new properties of the Vermillion Acquisition be included in the Wexpro II Agreement. Inclusion would allow Wexpro to sell the gas attained from these properties to Questar at a price determined by the combination of costs and a regulated rate of return. This is referred to as Cost of Service (COS) gas.

Q. PLEASE IDENTIFY THE INDIVIDUAL PROPERTIES OF THE VERMILLION ACQUISTION.

A. The current proposal includes four separate properties. These properties are located within the Kinney, Trail, Whiskey Canyon and Canyon Creek Units. (The Canyon Creek acquisition is composed of property outside the current participating area (OPA) and the Over Riding Royalty Interest (ORRI) of certain wells within the participating area).

Q. PLEASE EXPLAIN HOW THIS REQUEST IS GOVERNED BY THE WEXPRO AGREEMENTS.

A. According to Section IV-1(a) & (b) of the Wexpro II Agreement:

(a) Questar Gas shall apply to the Utah and Wyoming Commissions for approval to include under this agreement any oil and gas property that Wexpro acquires within the Wexpro I development drilling areas.

(b) Wexpro may also acquire additional oil and gas properties or undeveloped leases outside the Wexpro I development drilling areas. Questar Gas may apply for Commission approval to include these properties under this agreement.

Questar has determined that the Kinney and Trail properties are located in the Wexpro I Development Drilling Area as defined in the Wexpro Agreement, Section I-26 (Development Drilling Area), and therefore Questar is required to apply for the inclusion of these properties.

The Whiskey Canyon and Canyon Creek properties are being included in this application in accordance with the option granted in Section IV-1 (b) of the Wexpro II Agreement.

Q. PLEASE CLARIFY THE DIFFERENT WAYS THAT THE TERM "COST OF SERVICE" MAY BE USED.

A. The Wexpro Agreements allow for Questar to purchase natural gas from Wexpro at prices that are based on the actual costs of extracting, refining and delivering the gas plus a regulated rate of return. This is referred to as Cost of Service gas. Individual natural gas wells have different levels of output and other factors that affect the price of gas from that well, this is the COS price calculated for that specific well. The total COS price charged to Questar and passed on to ratepayers is an aggregate of the COS of each producing well within the Wexpro Agreements. Gas from more expensive wells is combined with gas from less expensive wells to determine the combined COS. For informational purposes COS calculations may also be provided that group the COS prices by wells with some type of commonality, such as Proved Developed Producing (PDP) wells in a common property, proposed development wells in a common property, a combination of PDP and proposed development wells, and in the case of this filing, a COS calculation that is an aggregate of PDP wells and proposed development wells within the Vermillion Acquisition.

Q. DO THE PROPERTIES OF THE VERMILLION ACQUISITION ALREADY CONTAIN PDP WELLS?

A. Yes, each property contains interest in existing wells, the production of which would be integrated into the combined COS gas acquired from Wexpro. According to the Direct Testimony of Mr. Barrie L. McKay the number of existing wellbores in each area are as follows: 7 in Kinney, 73 in Trail, 7 in the Canyon Creek OPA, interest in 105 wellbores in the Canyon Creek ORRI, and 4 in Whiskey Canyon (McKay Direct Lines 31-43). Specific information about each wellbore and flow stream is presented in Questar's Confidential Exhibits C, D and E.

Q. HOW DOES THE ESTIMATED COS FROM THESE PDP WELLS COMPARE TO CURRENT MARKET PRICES?

A. Market prices fluctuate seasonally, from day to day, and are affected by a variety of factors including location and unforeseen supply issues, but for general comparison I will use a market price derived from the five-year Henry Hub Rockies adjusted prices found in Questar's Exhibit A-1 columns B & C. This calculation results in an average market price of $2.89/dth. Averaging the first five-year price estimates for existing PDP wells found in Questar's Confidential Exhibits L1-L4 (Annual COS Incremental G&A) demonstrates that COS prices on existing PDP wells of the Vermillion Acquisition are above the average market price calculated from Exhibit A-1 for all four properties. ****BEGIN CONFIDENTIAL**** [redacted]

[redacted]

****END CONFIDENTIAL****

Q. PLEASE EXPLAIN THE IMPLICATIONS OF INCLUDING THE GAS DERIVED FROM THE EXISTING PDP WELLS OF THE VERMILLION ACQUISTION INTO THE WEXPRO II AGREEMENT.

While the addition of natural gas production interests, as proposed in the Vermillion Acquisition, can be reviewed in the context of COS implications for the overall price of COS gas being secured by Questar from Wexpro under the Wexpro Agreements, it is important to acknowledge that the COS gas from the PDP wells of the Vermillion Acquisition, standing alone, is higher than current market prices, and that inclusion of those volumes into the Wexpro II Agreement will require ratepayers to purchase volumes of natural gas from wells whose COS price is greater than market prices. This is particularly true for the period of time before any potentially less expensive development wells become productive.

Q. DOES WEXPRO PLAN TO DRILL DEVELOPMENT WELLS IN THE NEW AREAS?

A. Yes, the application identifies 117 possible development wells, 1 in Kinney, 73 in Trail, 15 in Whiskey Canyon, 27 in the Canyon Creek ORRI and 1 in the Canyon Creek OPA (McKay Direct Lines 31-43). The intended schedule for these wells is found in Questar’s Confidential Exhibit O.

During the Technical Conference held on February 2, 2017 representatives from Wexpro and Questar stated that there may be additional sites for viable exploration, but that they have not been included in the calculations for this application.

Q. HOW WOULD THE ESTIMATED COST OF SERVICE FOR THESE NEW WELLS COMPARE TO MARKET PRICES FOR NATURAL GAS?

A. According to the Trail Settlement Stipulation new drilling can only be undertaken if the estimated COS will be at or below the NYMEX Rockies-adjusted 5-year forward price curve. The estimated COS derived from the proposed properties is presented individually in Questar's Confidential Exhibits L1 –L4 and collectively in L5. These exhibits forecast that COS gas can be attained from new wells at prices that are below market in most cases. Since this application has been made in 2017 and has not yet been approved I have chosen to use a 5-year average for new development wells starting in 2018. ****BEGIN CONFIDENTIAL**** [redacted] ****END CONFIDENTIAL****

Q. WHAT WOULD BE THE RESULTING COST OF SERVICE FROM THE VERMILLION ACQUISITION WHEN COMBINING THE PDP AND FUTURE WELL FORECASTS?

A. For this comparison I will use the COS calculations presented in the Confidential Portion of the Technical Conference held on February 2, 2017. Slide number 53 demonstrates the 5-year Cumulative COS for the Vermillion Acquisition. ****BEGIN CONFIDENTIAL**** [redacted]

[redacted] ****END CONFIDENTIAL****

<u>VERMILLION ACQUISITION EFFECT ON GAS SUPPLY</u>

Q. PLEASE DESCRIBE HOW THE PERCENTAGE OF GAS SUPPLY FROM COS GAS HAS BEEN ADDRESSED IN PREVIOUS STIPULATIONS.

A. The Trail Stipulation imposed a new requirement that COS gas not exceed 65% of total gas supply. This was followed by the Canyon Creek Stipulation that capped COS gas at 55% of total gas supply (by the year 2020). Previous historic levels of COS gas had been nearer to 40% of total gas supply, whereas prior to the Trail Stipulation COS gas had risen to around 70% of total gas supply. The Office was a signatory to both stipulations which established ceilings in order to drive the levels of reliance on COS gas downward.

Q. HOW WILL THE CURRENT REQUEST TO INCLUDE NEW PROPERTIES AFFECT THE LEVEL OF COS GAS?

A. According to Questar's Confidential Exhibit M, the Vermillion Acquisition, including the results of new developmental drilling, would not result in levels of COS gas that violate the terms of the Canyon Creek Stipulation. Although the Vermillion Acquisition will not necessarily cause COS gas levels to exceed 55% of total gas supply, the Office asserts that the cap established in the Canyon Creek Stipulation is a ceiling for COS gas levels, and not a floor or minimum. Therefore, drilling programs should be prudent in avoiding a development schedule that attempts to constantly hover at or near the maximum allowed level of COS gas.

Q. WHAT OTHER RISKS ARE INHERENT IN THE INCLUSION OF NEW PROPERTIES IN THE WEXPRO II AGREEMENT?

A. Once a property has been accepted into the Wexpro II Agreement, ratepayers are obliged to purchase the COS gas produced from those properties (up to the supply ceiling previously discussed) regardless of market prices for natural gas. Therefore, ratepayers will still be required to purchase the COS gas even if some of the price projections turn out to be inaccurate. Furthermore, regarding development drilling, the terms of the Canyon Creek Stipulation require ratepayers to absorb a certain amount of risk for both non-commercial wells (dry holes) and commercial wells that do not produce as much as was originally anticipated.

Q. WHAT IS THE OFFICE’S RESPONSE TO MR. RASMUSSEN’S ASSESSMENT OF THE BENEFITS OF A DRILLING PROGRAM?

A. In the Direct Testimony of Mr. Brady B. Rasmussen he asserts that if volumes of retired wells are not replaced with volumes from new wells, then fixed costs will be distributed over fewer decatherms (Brady Direct Lines 176-182). The Office agrees with Mr. Rasmussen in his assessment that declining dths can result in an increasing allocation of certain fixed costs per dth. However, this could be construed as an argument in favor of acquiring new properties merely to mitigate an increase in the COS price regardless as to whether or not the new gas supplies themselves exceed market prices. In certain cases, it could be more cost effective to pay a higher price per dth due to declining volumes when the declining volumes of COS gas would likely be supplemented with gas purchased at market rates, which are currently lower than the price of COS gas. The Office asserts that consideration of any new property must be well supported by the stand-alone merits of the property being considered, and the long-term implications of adopting it into the Wexpro II Agreement.

OFFICE'S POSITION ON THE VERMILLION ACQUISITION

Q. DOES THE OFFICE SUPPORT INCLUSION OF THE VERMILLION ACQUISITION AS A WEXPRO II PROPERTY?

A. Based on the price forecasts provided in Questar's application the Office supports the inclusion of the Trail and Whiskey Canyon properties as they appear to provide the most cost effective gas when combining their respective PDP wells and planned development wells. Both of these properties contain a proportionately high number of low risk future well sites that will aid in producing COS gas from these properties below market prices.

Q. WHAT IS THE POSITION OF THE OFFICE REGARDING THE KINNEY PROPERTY?

A. The position of the Office is that the evidence presented in this application is insufficient to justify inclusion of the Kinney property into the Wexpro II Agreement. Calculations available in Confidential Exhibit L4 and in slide 53 of the confidential portion of the Technical Conference show that the COS gas from the Kinney property will likely be above market prices.

Q. WHAT IS THE POSITION OF THE OFFICE REGARDING THE CANYON CREEK PROPERTY?

A. Although the forecasted prices for this property are lower than those for the Kinney property, the projections are still sufficiently near market prices that any variations manifested in the actual costs could potentially drive the price of COS gas from the

Canyon Creek property above market prices. The Office therefore does not recommend inclusion of the Canyon Creek property based on the current price projections.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.