- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of Questar Gas Company for a General Increase in Rates and Charges	)))	DOCKET NO. 99-057-20 ORDER GRANTING AN INTERIM RATE INCREASE

ISSUED: January 25, 2000

SHORT TITLE

Interim Rate Increase

SYNOPSIS

The Commission grants an interim rate increase of $7,065,000, to be effective January 1, 2000.

APPEARANCES

Laurie Noda Assistant Attorney General	For	Division of Public Utilities
Douglas Tingey Assistant Attorney General	"	Committee of Consumer Services
Jonathan M. Duke Gary G. Sackett Attorneys at Law	"	Questar Gas Company
Gary A. Dodge Attorney at Law	"	Large Customer Group
William J. Evans Attorney at Law	"	Utah Industrial Energy Consumers

By The Commission:

On December 17, 1999, this Commission received an Emergency Motion from Questar Gas Company (Questar Gas or the Company) in Docket No. 99-057-20, a general rate case, seeking interim rate relief in the amount of $7,065,000. On December 20, 1999, we issued a Notice of Hearing setting hearing for December 29, 1999. The Division of Public Utilities (Division) filed a Motion for Continuance on December 22, 1999, requesting delay of hearing until January 11, 2000. This request was opposed by Questar Gas in a Response filed December 23, 1999. At hearing held December 29, parties reached agreement, and we therefore ordered, that the Motion should go to hearing January 4, 1999. On that date the hearing occurred.

In its Motion, Questar Gas seeks an interim rate increase of $7,065,000. The Company alleges it is experiencing "extraordinary" financial harm and "is losing the confidence of the investment community," making an immediate rate increase a financial necessity.

The Company underearned during the 1999 test year and projects a similar outcome for 2000, but the "serious revenue

shortfall" it faces is "in large part due to the costs the Company is incurring in obtaining CO_2-removal services . . . ." Failure to recover these costs reduces net income by 20 percent, it states, and the result is "an emergency situation requiring immediate action."

The Company seeks interim rate relief "for an amount related *only* to the costs of obtaining the CO_2 treatment services . . . ." Acknowledging that recovery of these costs from ratepayers is a disputed issue in pending Docket No. 98-057-12, Questar Gas asks us to take official notice of the full record in that Docket. The Company believes the record will establish a prima facie case for inclusion of CO_2 costs in general rates, and states that if the CO_2 costs are reasonable, it is entitled to recover them. If the Commission determines otherwise, the Company believes the refund statute protects customers. Waiting 240 days until conclusion of the full rate case to recover these costs would, it opines, "inflict unnecessary and unlawful harm," contrary to "the interests of justice, equity, . . . [and] the intent of the [interim relief] statute . . . ."

The Company proposes to spread the interim increase to all rate classes on the basis of a uniform percentage increase in existing rates.

The Division recommends an interim award of $7,065,000 effective January 1, 2000, in order to "maintain a minimum level of financial health for Questar Gas during the time period between the filing of a proposed rate increase and the actual granting of any rate increase by the Commission." The recommendation is said to follow from the Division's statutory mandate "to maintain the financial integrity of the utility" and is based on its analysis of pretax-interest-coverage, net-cash-flow-to-capital-expenditures, and return-on-equity financial health indicators. In its view, an interim award of this amount is conservative and minimizes risk that a refund will be necessary.

The Division recommends a spread of any interim increase on a uniform percentage basis to all rate classes except the Municipal Transportation rate recently approved by the Commission. Within each class, the increase should be spread on a uniform percentage basis to all distribution non-gas volumetric rate components.

The Committee urges us to deny the interim rate increase request. If an increase were granted, retail customers would bear the costs of a contract between Questar Gas and Questar Transportation Services, for the operation of a CO_2 processing plant, which is the subject of dispute in pending Docket No. 98-057-12. The Committee recommends bringing that record into the present Docket and asserts it will show that the contract should not be approved and its costs should not be borne by ratepayers. If the Commission agrees, the Committee argues, the Questar Gas rationale for an interim increase is gone. Thus, in the Committee's view, any loss the Company suffers from the failure to recover CO_2 processing costs is "self inflicted" and there is no other legitimate, substantive basis for interim relief.

DISCUSSION, FINDINGS AND CONCLUSIONS

We consider the Motion for interim relief pursuant to 54-7-12(3)(a) which states:

On its own initiative or in response to an application by a public utility or other party, the commission, after a hearing, may allow any proposed rate increase or decrease, or a reasonable part of the rate increase or decrease, to take effect, subject to the commission's right to order a refund or surcharge, upon the filing of the utility's schedules or at any time during the pendency of its hearing proceedings. The evidence presented in the hearing held pursuant to this subsection need not encompass all issues that may be considered in a rate case hearing held pursuant to Subsection (2)(b), but shall establish an adequate prima facie showing that the interim rate increase or decrease is justified.

This statute was enacted in 1981. It was later modified to permit, among other things, interim rate decreases. Several petitions for interim rate adjustments were considered by this Commission during the first half of the 1980s, culminating in Docket No. 85-049-02, Report and Order issued June 26, 1985, wherein the Commission declined to allow an interim rate increase on grounds the utility faced no financial harm by waiting for a change in rates until the full proceeding had concluded. Because the Commission outlined the scope of its discretion and intent in the 1985 Report and Order, we briefly review it here. With the exception of an interim decrease granted in Docket No. 90-049-06 which relies on it, the Report and Order in the 1985 Docket is the last occasion on which the Commission has addressed the subject of an interim rate increase.

In the June 26, 1985 Report and Order, the Commission states that statutory provisions "contain no guiding principles for this Commission to follow in deliberating an interim rate request. Thus, the Commission is left to its own discretion and best judgment in applying the statute." The interim statute was enacted "presumably in response to . . . a period of unusually high inflation, which had the effect of exacerbating the historical problem of regulatory lag . . . . Accordingly, we have heretofore granted interim requests in the main as a response to the effects of high inflation on utilities." The "unique" financial problem rapid inflation creates for utilities having by that time abated, the Commission determined that it should reexamine the basis for granting interim awards.

Past cases reveal three problems with interim proceedings and awards. First, the Commission cannot permit the hearing process to become a "mini rate case." It must look mainly to the application, but doing so raises fairness and due process problems. In practice, an abbreviated hearing is held in which the application is considered with but cursory responses from parties. Because the process does not offer an opportunity to examine the behavior of all other costs and revenues as possible offsets, the abbreviated hearing may encourage an applicant to present a single issue as the factor motivating the interim request. As a result, the Commission concluded in 1985 that interim increases should be awarded only "in the most narrow of circumstances."

The second problem when a refund is necessary is the failure of the refund provision to adequately protect ratepayer interests. Refunds are to be made only to "present customers." Some customers who move during the period between the interim increase and the final order may not receive a refund. Moreover, the interest attached to the refund may not adequately recompense customers. Additionally, the interim award may become a floor for ultimate revenue requirement determination. For these reasons, the Commission found it must be "very circumspect in approving interim rate adjustment."

Third, because only cursory examination of an Application is permitted, the Commission set the objective to "preserve . . . the status quo among customer classes and on rate design issues, pending the full case."

Given the decline of inflation and high capital costs, and the problems these unusual conditions cause for utilities, the Commission concluded it must reexamine the basis for interim awards and apply a stricter standard to them. The Commission expressed its increasing reluctance to grant interim increases "short of a compelling showing that failure to grant such an increase would result in serious financial harm to the utility."

The Commission intended to seek in separate proceedings the specific criteria by which serious financial harm could be determined without encountering the mini-rate-case problem. In part because of the absence of further applications for interim rate increases, such a proceeding did not occur. In the present Docket, parties generally agree that the lack of specific criteria which the Commission had intended as the basis for a "compelling case for serious financial harm" makes the 1985 Docket a less than fully useful guide today. In our view, however, the record in the present Docket allows us to conclude that a number of the Commission's 1985 pronouncements provide sound guidance today.

First, we cannot permit examination of the Motion to become a mini rate case. To do so would be to prejudge the final outcome of the Docket on the basis of incomplete and in fact one-sided information. This means we must, as the Commission did previously, attempt to assess the utility's financial condition without full examination of all revenue requirement issues. As before, this leads us to rely on a set of accepted indicators of financial health. The Division's testimony is directly on point.

Second, the refund provision does not fully protect ratepayers from the adverse effects of an unwarranted interim increase. We consider but reject Questar Gas' position that the refund provision balances the interests of the Company and its customers by protecting the interests of ratepayers. The reasons why this is not so were advanced in the 1985 Report and Order and are summarized above. They remain valid and persuasive today. This means an interim increase must be conservative, a conclusion also supported by our concern that an interim award must not set a floor for the final rate case outcome.

Third, any interim rate increase that is granted must be spread to classes of service and rate elements on a basis that does not upset existing relationships. Again, the reasons given in the 1985 Report and Order remain valid.

It is of course true, as parties state, that the Commission did not develop specific criteria by which to implement a *serious* financial harm interim award standard. This leaves the matter of criteria open to debate, and serious financial harm as the proper standard merely an expression of Commission intent at the time. As we conclude herein, however, record evidence that financial harm is likely in the absence of an interim award remains the proper basis for our decision.

Questar Gas' argument for interim rate relief primarily turns on a continuing inability to earn the allowed rate of return. From the Company's point of view, the problem is exacerbated by our decision in Docket No. 98-057-12 not to allow recovery of certain CO_2 plant gas processing costs in semiannual pass-through, or 191 Account, proceedings. The Company's most recent regulatory semiannual filing of operations information shows, the Company states, earnings on equity for the 12 months ended June 30, 1999, excluding CO_2 processing costs, of 9.44 percent. Non-recovery of these costs reduces return on equity to 7.66 percent, and the Company expects final data to show earnings of but 6.41 percent at year-end 1999.

Though the question of the prudence of the contract by which Questar Gas obtains gas processing service is pending in that Docket, the Company urges us to take official notice of the record there because it believes it will establish that the costs are prudently incurred, and that substantial financial harm, in an amount equal to about 20 percent of annual net income, results from the inability to recover these costs. Coupled with the failure to earn at authorized levels during the 12 months ending September 1999, earned return, in the Company's words, is driven "critically lower - to confiscatory levels." It asserts that CO_2 processing costs have been incurred since mid-1999, are therefore accurately determinable, and are not offset by revenues or changes in other costs of providing service. In the Company's view, the situation is one of serious financial harm.

Two fundamental points arise when we consider this argument. First, should interim relief turn on a claim of underearning? Second, is it wise to award an interim increase on a single item like CO_2 processing costs, even when, as the Company asserts, the costs are extraordinary?

In past dockets, we have declined to grant interim rate increases on an underearning argument. Underearning is the usual trigger for a general rate case, and it is not until all evidence has been considered at the end of proceedings that the Commission judges whether underearning, if it is occurring, is a problem requiring a regulatory response. To base an interim increase on that argument is therefore to prejudge the entire case and to do so on evidence presented almost solely by the utility itself. Clearly, both fairness and due process would suffer. This realization has led the Commission to rely on an analysis of financial indicators instead.

But is underearning, when caused or exacerbated by something "extraordinary" a different matter? In the present Docket, the Company argues the CO_2 processing costs are extraordinary, meaning that the costs result from extraordinary actions the Company believes it was forced to take to counter declining BTU content in the gas stream and to protect the safety of its customers. The term is not used in a legal sense.

Though the CO_2 processing costs may be extraordinary in that sense, the question pending is whether they have been prudently incurred and are reasonable and recoverable in rates. Questar Gas believes the record in Docket No. 98-057-12 proves the Company entered the gas processing contract prudently and the costs are being incurred reasonably; thus, the interim increase should be granted to prevent further deterioration in financial position. The Committee disagrees, though it does advise the Commission to incorporate the record from that Docket into the present one. Indeed, the Committee's entire response to the Motion centers on this issue. It urges us to decide the CO_2 prudence issue and if we conclude imprudence, the interim request must, the Committee asserts, be rejected. The Division does not take a position on this matter, but bases its recommendation for an interim increase on its analysis of the Company's financial condition, excluding CO_2 costs.

The CO_2 case was filed November 25, 1998, and the general rate case December 17, 1999. For reasons stated in its Procedural History, the Report and Order in the CO_2 case was not issued until December 3, 1999. It is true that the juxtaposition of the general rate case and the CO_2 case are unusual in the sense that the CO_2 issue not only predates the

rate case but that one of its two principal issues remains pending. Although the Commission declined to rule on the prudence of the CO_2 contract, believing the record incomplete, it ruled against the Company on the pass-through treatment of gas processing costs. The result blocks recovery of a large, ongoing expenditure, a situation that will remain until an order can be issued which resolves the prudence issue. Clearly, the timing of these matters has placed the Company in difficulty. We therefore find reason to set aside the Commission's stated reluctance to consider a single issue as the basis for interim relief, and will give the matter of CO_2 cost recovery, though in the context of the Division's financial harm analysis, some weight in the decision we reach herein.

The Company supplements the CO_2 argument by reference to the ratings financial firms now give the debt of Questar Gas. Both Moody's and Standard and Poor's report a "negative outlook" for Company debt. According to the Company, this suggests that, without improvement, bond rating may be downgraded. Although Moody's has rated Company debt "A-1" for a number of years, it issued its negative outlook on November 12, 1999, due to concern over the Company's "high capital spending plan." Likewise, Standard and Poor's has given Company debt an "A-plus" rating for years and its negative outlook had been in effect for some 16 or more months. The consequence of a downgrade is higher capital costs. At a time of rapid customer growth, higher cost financing may produce higher service rates for customers.

We find record support for interim relief in the Division's analysis of financial indicators. As it had done in interim award cases during the early 1980s, the Division develops a set of financial harm indicators by which to analyze the requested interim rate increase. The Division's "minimum financial health" target is maintenance of a "single-'A'" bond rating. Of several indicators, or financial ratios, the Division relies most on pretax interest coverage, which shows that an interim increase of at least $5 million is required to place the ratio in the range needed for single-A rating. The Division also relies on the ratio of net cash flow to capital expenditures, showing by its analysis that an interim increase of some $2 million could be required to bring that ratio to the level experienced by comparable companies.

To ensure an interim increase recommendation that will not engender a refund, the Division examines rate of return. Excluding CO_2 costs, the Division determines that the requested interim increase of $7,065,000 would bring the Company's rate of return to only 10 percent, which in its estimation is a conservative minimum equity return. On this basis, the Division recommends an interim increase of $7,065,000.

The Committee argues that the Division's approach is improper. To the extent the Division arrives at its recommendation by a different route than that of the Company's Motion, it has not responded to Applicant's case, avers the Committee, but has created a new one. This, the Committee argues, is not proper because the case was officially noticed as an interim increase request justified by an asserted need to recover CO_2 costs. Adequate notice to respond has not been given, it asserts.

This argument is tantamount to an assertion that the Commission is unable to take the full record, not simply the Applicant's case, into consideration. The law does not restrict us in this way. Indeed, as Questar Gas responds, the interim relief statute pins the case for interim relief merely on a prima facie showing that such relief is necessary. We conclude that the Company and Division evidence is sufficient, and believe it represents the prima facie case needed.

We find record support in the testimony and evidence of the Company and the Division for an interim rate increase in the amount requested by the Company, and on that basis conclude that the increase should be permitted.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED, that:

- An interim rate increase of $7,065,000 is granted, effective January 1, 2000.
- The interim rate increase will be spread on an equal percentage basis to all rate classes except the Municipal Transportation rate, and within each class on a uniform percentage basis to all distribution non-gas volumetric rate components.

DATED at Salt Lake City, Utah, this 25th day of January, 2000.

/s/ Constance B. White, Commissioner

/s/ Clark D. Jones, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary

Chairman Mecham dissents and a written dissent will issue.

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Application of Questar Gas Company for a General Increase in Rates and Charges	)))	DOCKET NO. 99-057-20 DISSENT OF STEPHEN F. MECHAM

I respectfully dissent from the decision of my colleagues. Questar Gas bases its petition for interim relief principally on two assertions: "earnings are too low to sustain the Company's financial standing," and "current rates are not sufficient to cover the costs of providing utility service."[(1)] In Questar's application, both points are dependent on the expenses of the CO_2 gas processing plant, a disputed issue squarely before the Commission in this case.

In reviewing the parties' evidence, it appears the essence of the argument for interim relief is that Questar Gas is underearning. U.C.A. 54-7-12 (3) (a) requires a party to present evidence that establishes an adequate prima facie showing that an interim rate increase is necessary. After considering the meaning of that statute, I conclude below that underearning, even a prima facie demonstration of underearning, does not by itself justify an interim increase.

QGC 1.1 shows that Questar earned 9.4% on rate base as recently as 1998, a return the Company agreed was acceptable. By June 1999, that return declined slightly to 9% without considering the effects of the CO_2 plant contract expenses on earnings, and to 8% if those expenses are included. Based on ten months of actual 1999 data and two months that Questar projected, the rate of return declined somewhat further.

Although I am very concerned about the trend in the Company's performance, I do not agree that Questar's or the Division's submissions, together or separately, make the required statutory showing. Normally, a utility only files a rate case when it believes it is underearning. The legislature established a process that allows the Commission 240 days to thoroughly analyze evidence and determine if an increase is necessary to maintain the financial viability of the utility and adequate utility service. Underearning is always the ultimate issue in any rate case, but that alone is not enough to demonstrate immediate financial harm. If it were, we would have to grant interim relief in virtually every case, defeating the other important parts of the law to ensure that the rates we set are just and reasonable. The utility's incentive to manage its operations efficiently would be diminished.

In my judgment, the underearnings claimed in this case and the potential for financial harm do not reach the levels required to justify interim relief. In Questar's view, earnings have been satisfactory until just recently. In addition, the Company's bond rating remains A1 by Moody's and A+ by Standard and Poors' (S&P). Though both rating agencies have Questar Gas on negative credit watch,[(2)] it is unlikely that it will affect the regulated gas company or its customers before we issue an order in the pending rate case this August. In Cross Examination Exhibit Interim 1, an S&P analyst wrote that "the state's eight-month rate case period is shorter than most and allows the company to implement rate increases quickly." I concur with that assessment and believe the normal rate case procedure would address Questar Gas'

difficulties.

Though the Division's analysis is used to support interim relief, it appears to give substance to my position. Of the four S&P financial indicators[3] to maintain an A bond rating that the Division analyzes, only one, the pretax interest coverage, suggests granting relief of $5 million. The other three indicators affirm my position of not awarding interim relief. A fifth indicator that does not have a published target, net cash flow to capital expenditures, may justify an interim increase of between $0 and $2 million, but I do not find that outcome at all persuasive either. Immediate serious financial harm is a legitimate standard to pursue in an interim relief petition, but the indicators before us in this case do not point convincingly to granting interim relief.

In my opinion, interim relief generally should be reserved for times when inflation, interest rates, or extreme capital costs overwhelm the regulatory process and threaten to outpace a utility's ability to provide utility service. Relief may also be necessary in the event of a natural or man-made disaster. The Commission articulated some of those points in U.S. West's 1985 interim relief order and referred to them again in an order issued June 22, 1990 in Docket No. 90-049-06. None of those conditions apply today. Inflation and interest have been very low for several years, particularly when compared to the early1980s. Utility cost of capital awards have been at their lowest levels in years. Finally, we have been fortunate not to have any disasters that have had widespread impact on utility service.

Simply stated in summary, I do not believe there is a justification for interim relief in this case based on a financial harm standard. Given that position, the effect on earnings the CO_2 expenses have is not relevant at this point in the proceeding. That issue, along with the Company's under earnings, should be addressed in the rate case hearings scheduled to begin June 5, 2000.

DATED at Salt Lake City, Utah, this 25th day of January, 2000.

/s/ Stephen F. Mecham, Chairman

1. QGC Interim Exhibit 1, p.1.

2. S&P established its negative credit watch 16 months ago. Moody's just issued its analysis on November 12, 1999.

3. The four S&P indicators are: Pretax interest coverage, Total debt to total capital, Funds from operations interest coverage, Funds from operations to total debt.