

1991

Mountain Fuel Supply Company v. Public Service Commission of Utah : Brief of Petitioner

Utah Supreme Court

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BRIEF

910051

IN THE SUPREME COURT OF THE STATE OF UTAH

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|---------------------------|---|------------------------|
| MOUNTAIN FUEL SUPPLY |) | |
| COMPANY, |) | |
| Petitioner, |) | |
| |) | Case No. 910051 |
| v. |) | |
| |) | (Priority Category 15) |
| PUBLIC SERVICE COMMISSION |) | |
| OF UTAH, |) | |
| Respondent. |) | |

OPENING BRIEF OF PETITIONER
MOUNTAIN FUEL SUPPLY COMPANY
[FINAL]

ON PETITION FOR REVIEW FROM THE
PUBLIC SERVICE COMMISSION OF UTAH

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UTAH

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PRELIMINARY NOTE

Mountain Fuel Supply Company's Opening Brief in this case was filed on July 25, 1991, pursuant to the Court's grant of a request for a 15-day extension after it was discovered that the Public Service Commission had not yet transmitted the entire record to the Court. The augmented record had still not been submitted by the due date for the opening brief. Accordingly, Mountain Fuel filed its opening brief on July 25 with citations to the "raw record" compiled by the PSC, with a request to file a "final opening brief" upon availability of the record citations. This final opening brief replaces the original July 25 filing with the correct record citations substituted. No textual changes have been made.

There are still two problems with the record. (1) The pagination from pages 1-205 is repeated in Volumes I and II. Therefore, to avoid ambiguity, a reference in the following brief to a page between 1 and 205 specifies Volume I and Volume II. (2) Despite repeated requests to the Secretary of the PSC, the transcript for the first day of the proceedings, November 7, 1989, has not been included in the record transmitted to the Court. Because these proceedings are important to the Court's understanding of one of the primary issues in the case, Mountain Fuel has included a copy of the certified November 7 transcript as Addendum 5 to its Final Opening Brief.

IN THE SUPREME COURT OF THE STATE OF UTAH

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| COMPANY, |) | |
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| PUBLIC SERVICE COMMISSION |) | |
| OF UTAH, |) | |
| |) | |
| Respondent. |) | |

**OPENING BRIEF OF PETITIONER
MOUNTAIN FUEL SUPPLY COMPANY
[FINAL]**

Petitioner Mountain Fuel Supply Company (Mountain Fuel) respectfully submits its initial brief in support of its petition for review of a decision of the Public Service Commission of Utah (PSC or the Commission), issued November 21, 1990, and its order on rehearing, issued December 31, 1990, in PSC Docket No. 89-057-15. (The orders are designated as Addendum 1 to this Brief.)

INTRODUCTORY MATTERS

Statement of Jurisdiction.

The Utah Supreme Court has jurisdiction in this matter pursuant to Utah Code Ann. §§ 63-46b-16 (1989) and 78-2-2(3)(e)(i) (Supp. 1990).

Statement of Issues and Standard of Review.

Mountain Fuel raises two general issues on review: (1) Whether the Public Service Commission has unlawfully set utility rates that do not reasonably reflect the conditions during the period that the rates will be in effect by basing 1991 rates exclusively on a “historic test year” 1989, and (2) whether the PSC has, in effect, imposed an unlawful penalty on Mountain Fuel by reducing its authorized rate of return below that which the PSC found otherwise to be a proper return on shareholders’ equity.

The standards for review for the issues in this case are provided by portions of the Utah Administrative Procedures Act (UAPA), Utah Code Ann. §§ 63-46b-16(4) (1989), as set forth in Addendum 2 to this Brief.

To the extent the issues that Mountain Fuel raises are mixed issues of law and fact, § 63-46b-16(4) directly addresses the standard: Relief is to be granted if an “agency has erroneously interpreted or applied the law.” The Utah Court of Appeals has indicated that this Court’s pre-UAPA analysis of the review of fact/law questions in *Utah Dept. of Administrative Services v. PSC*, 658 P.2d 601, 610 (Utah 1983), is consistent with the UAPA’s provisions. *Pro-Benefit Staffing v. Board of Review*, 775 P.2d 439, 442 (Utah App. 1989). As articulated in *Administrative Services*, the agency is to be accorded less deference than if the review involved only the agency’s findings of facts; in mixed questions, the inquiry will be to see if the agency improperly exercised its discretion in applying the law.

Id., citing Comments, Uniform Model State Administrative Procedures Act § 511(c)(4).

In addition, Mountain Fuel believes that the PSC's order does not pass the tests set forth in subsections (4)(b), (d), (g) and (h) of § 63-46b-16, as discussed in more detail in the body of the argument.

Determinative Statutes, Ordinances and Rules.

In addition to the provisions from the UAPA cited in the previous section, the PSC is required to set rates that are "just and reasonable" and for the utilities to provide proper services, as those terms are found in Utah Code Ann. § 54-3-1 (1990), and § 54-7-12(2)(b) (1990). (See Addendum 1.)

Statement of the Case.

Nature of the Case. Mountain Fuel is a natural gas public utility under Title 54 of the Utah Code, and its rates and charges are regulated by the PSC pursuant to the provisions of that title and applicable case law.

This case (PSC Docket No. 89-057-15) has arisen out of proceedings initiated by the PSC in 1989 to determine new rates for Mountain Fuel, culminating in a report and order issued by the PSC on November 21, 1990, establishing rates and charges to be effective December 1, 1990. Mountain Fuel believes the rates specified by the PSC order are based, in material part, on unlawful procedures, premises and conclusions, the result of which is the failure of the PSC to establish just and reasonable rates for Mountain Fuel in accordance with Utah law.

Course of the Proceedings and Statement of Facts. By notice of prehearing conference issued on October 31, 1989, the PSC, on its own motion, commenced an investigation into the rates and charges for the utility services Mountain Fuel renders in Utah. (R. 1434-35.) A time-line of events is depicted in Addendum 3 to this Brief.

A prehearing conference was held by the PSC on November 7, 1989. As the first order of business at the prehearing conference, prior to any discussion, the Commission declared its intent to impose a historic test year¹ on the development of Mountain Fuel's new rates. "[T]he Commission would like to have a historical test year in this case, the test year being 1989." (Addendum 5, at 5.) The PSC also requested that the parties address the relations of Mountain Fuel with that of its affiliates, including its parent company, Questar Corporation and its pipeline supplier, Questar Pipeline Company.

In response to PSC's declaration that Mountain Fuel file on the basis of a historic test year, Mountain Fuel sought to file its case using a future test year that more nearly matched the period when rates would become effective (the "rate-effective period"). (Addendum 5, at 15-17.) The Commission set the matter for

¹The "test year," as used in this proceeding, referred generally to the 12-month period over which a utility's operations, costs, revenues and investment are to be analyzed to determine new rates and charges. (R. 2423, Ex. DPU-10.1, at 1.) A historic test year is a year in which all events have concluded and books and records and other information are available.

argument on November 21.

At the November 21, 1989, oral argument of counsel on the test-year issue (R. 3-40, Vol. I), Mountain Fuel sought leave to submit comprehensive evidence with its filing concerning its operations for both the years 1990—the future test year—and the 1989 calendar year. (Addendum 5, at 6-7.) The Utah Division of Public Utilities (Division) concurred with Mountain Fuel's proposal (Addendum 5, at 17); the Committee of Consumer Services (Committee) requested that the 1989 year be used. (R. 23-24, Vol. I.)

The PSC took no evidence on the test-year issue and issued its bench order at the close of the November 21 hearing, rejecting the request of Mountain Fuel and the Division and requiring Mountain Fuel to file its case for the determination of future rates² on the basis of the calendar year 1989. No written order was issued, and no reasons were articulated at that time by the Commission. (R. 37, Vol I.)

Pursuant to the bench order limiting the test year to 1989, Mountain Fuel filed a request for rate relief under Utah Code Ann. § 54-7-12, on March 31, 1990, seeking a general annual increase of \$9,682,000 in its rates for Utah ser-

²Given the timing of the filing, the earliest that rates were likely to become effective would be about December 1, 1990, the expiration of the 240-day limit imposed on final Commission action by Utah Code Ann. § 54-7-12(3)(b) and (c) (1990). Thus, the rate-effective period was likely (and so turned out) to begin in December 1990 and run into 1991.

vice. (R. 1496-1510.) Within the constraint of a historical test year, Mountain Fuel sought to mitigate the effects of a test year nearly two years removed from the rate-effective period (1989 v. 1991) by using a 1989 year-end rate base³ and a number of post-1989 adjustments to account for known and measurable changes in the Company's operations. (R. 2287, Ex. MFS-1R, at 5; R. 2297, 2300, Ex. MFS-5, at 7, 10; R. 2346-48, Ex. MFS-5R, at 27-29.)

Following extensive discovery, several rounds of prepared, written testimony and other preliminary matters, evidentiary hearings began September 5, 1990, and concluded September 18, 1990. Oral argument was conducted on September 28, 1990, and the PSC issued a report and order on November 21, 1990 (the Order), establishing new rates for Mountain Fuel, to be effective December 1, 1990. The new rates were based on an annual revenue requirement of \$139,533,000 (exclusive of the costs of natural gas), only \$76,000 more than existing rates had been designed to produce.

To establish Mountain Fuel's rates for 1991 (and December 1990) the Order incorporated, among other things:

(a) Operations and costs for the year 1989, purportedly rejecting all post-1989 adjustments (R. 1968, 1972);

(b) A rate base (depreciated investment base) calculated by taking an average over 1989 (R. 1969-70);

³"Rate base" is the investment base on which the Company is entitled to earn a return.

(c) A rate of return on shareholders' equity of 12.1%, which incorporated a .1% reduction "adjustment" related to the existence of transactions Mountain Fuel engages in with affiliate companies (R. 1992-93).

Pursuant to Utah Code Ann. §§ 54-7-15 (1990) and 63-46b-12 (1989), Mountain Fuel sought rehearing of the November 21, 1990, order. (R. 2094-2133.) On January 10, 1991, the PSC issued its Order on Application for Rehearing, denying Mountain Fuel's requests.⁴ (R. 2161-65.)

Summary of the Argument.

The improper choice of test year and rate base. The main thrust of Mountain Fuel's position is that the PSC has not carried out its responsibilities to determine "just and reasonable rates" under applicable law, because it has improperly excluded evidence designed to exhibit the conditions that would exist when the new rates were to be effective. There is not substantial evidence nor proper findings to establish that the 1989 historical test-year data used by the PSC was properly representative of the rate-effective period. The rates imposed by the Commission are the result of improper exclusion of evidence, improper application of the Utah Public Utility Code and interpretative case law, and action that does not comport with the Utah Administrative Procedures Act.

Rate of return reduction. Having found a return of 12.20% to be a proper

⁴Section 3 of the order on rehearing gave Mountain Fuel leave to "approach the other parties with a view to having [a certain] adjustment stipulated." No such stipulation was reached.

and lawful return on Mountain Fuel's shareholders' equity, the PSC penalized Mountain Fuel by .10% (to 12.10%) because of the Commission's general displeasure with the corporate organization of Questar Corporation, the parent holding company of Mountain Fuel, and the affiliate relations that are a part of that corporate organization. The Commission's actions are unjustified on the basis of the record in this case, and they constitute an abuse of discretion and exercise of authority that is beyond its statutory grant.

DETAILED ARGUMENT

I. IMPOSITION OF THE HISTORICAL 1989 TEST YEAR, UNADJUSTED FOR ANY POST-1989 INFORMATION, WAS UNLAWFUL

A. INTRODUCTION

The primary issue in this case involves foundational principles of utility ratemaking in the United States: Whether the Public Service Commission may impose a condition on the receipt of evidence that forecloses the submission and consideration of information and data that the applicant-utility believes to be more representative of conditions expected during the rate-effective period; or, equivalently, whether the PSC can establish just and reasonable rates for a period beginning in December 1990 without any finding that a 1989 historical test year, unadjusted for post-1989 information, is properly representative of the rate-effective period.

It is undisputed that the ratemaking exercise is forward-looking and that the

role and duty of the Public Service Commission is to determine rates that are just and reasonable when they become effective. (*See* cases cited in part B of this section.) One of the primary tools in carrying out this duty is the selection of a test year, which provides a 12-month period of the utility's operations to be analyzed and adjusted, with the goal of representing the period when rates will be effective. The Commission itself stated the purpose of the test year accurately: "The purpose of a test year, or test period, is to provide revenue, expense, and investment information that reasonably approximates circumstances expected during the period rates will be in effect." (R. 1968.)

Having stated the function of a test year properly, and having recognized the new rates would not become effective until almost 1991, the PSC proceeded to frustrate attempts to reach this goal by prohibiting parties from submitting future-test-year information concerning the utility's operations beyond December 31, 1989. In addition, it made no finding that the 1989 test year it had chosen had sufficient nexus with or characteristics representative of the rate-effective period that it would produce just and reasonable rates.

Thus, the test-year question is a mixed issue of law and fact. As a legal matter, a test year must satisfy fundamental constraints of providing a proper representation of the period during which rates will be effect, as discussed in more detail below. In determining whether a given test year—whether historical, projected, adjusted or hypothetical—passes legal muster, there must be an inquiry

into the facts and circumstances.⁵

Before this brief launches into a detailed discussion of the facts, circumstances and legal underpinnings of this case, it may be helpful to state what Mountain Fuel is **not** asking this Court to do. It is **not** seeking a judicial mandate that the PSC must use a particular form of future test year or other device in order to establish just and reasonable rates.⁶ Rather, this appeal seeks the Court's finding that the PSC may not arbitrarily preclude, exclude or fail to consider relevant information that parties may wish to submit in establishing just and reasonable rates and, in so doing, limit the consideration to a particular historic period. Parties should be allowed to present evidence, in the Commission's own words, that "reasonably approximates circumstances expected during the period rates will be in effect," and the PSC must determine just and reasonable rates for the future period on the basis of such evidence.

⁵For example, it *might* be factually established that the utility's operations and the latent economic and financial conditions facing it are so stable and unlikely to change that an unadjusted historical period would serve as a lawful surrogate for the period when rates are effective. In this case, there was no such evidence or finding; the evidence was to the contrary, as will be discussed below. Conversely, materially changing conditions facing the utility—operationally, economically and financially—dictate a different approach.

⁶*See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944); *Utah Power & Light Co. v. PSC*, 107 Utah 155, 152 P.2d 542, 558 (1944). In particular, a historic test year, unadjusted for post-test-year changes is not *per se* unlawful, although the very dynamics of today's changing world suggest that the incorporation of known changes and expectations will ordinarily produce a more representative result.

Mountain Fuel believes the PSC's complete failure to incorporate considerations of the future rate-effective period is reversible error.

**B. AS A MATTER OF SUBSTANTIVE LAW,
THE PSC IS REQUIRED TO CONSIDER EVIDENCE
CONCERNING THE COMPANY'S EXPECTED OPERATIONS,
COSTS AND INVESTMENTS DURING THE RATE-EFFECTIVE PERIOD**

The applicable case law in Utah, as well as in other jurisdictions, has recognized the forward-looking nature of the ratemaking process:

[T]he basic approach in rate making is to take a test year and determine the revenues, expenses, and investment for the test year. The test period results are adjusted to allow for reasonably anticipated changes in revenues, expenses, or other conditions in order that the test-period results of operations will be *as nearly representative of future conditions as possible*.

Utah Dept. of Business Regulation, Division of Public Utilities v. PSC, 614 P.2d 1242, 1248 (Utah 1980) (emphasis added). This standard has also been stated and restated in virtually every part of the United States in which the question has arisen.

The U.S. Supreme Court addressed this issue some 65 years ago, and the principles stated then remain applicable today. In *McCardle v. Indianapolis Water Co.*, 272 U.S. 400, 408 (1926), the Court indicated that, in fixing utility rates, "there must be an honest and intelligent forecast as to probable price and wage levels during a reasonable period in the immediate future." In applying *McCardle* in 1973, the Florida Supreme Court pointed out that "a rate making body . . . cannot ignore an existing fact that admittedly will affect the future rates." *Gulf*

Power Co. v. Bevis, 289 So. 2d 401, 404 (Fla. 1973). But the PSC’s foreclosure of future-year evidence *a fortiori* “ignored” facts that the Company wished to submit that would “affect the future rates.” By limiting the period for which it considered information to December 31, 1989, the PSC could not complete its duty to determine conditions that were “as nearly representative of future conditions as possible.” *Dept. of Business Regulations*, 614 P.2d at 1248.

The U.S. Supreme Court addressed similar considerations in *West Ohio Gas Co. v. PUC*, 294 U.S. 79 (1935). In that case, there was unchallenged evidence of actual revenue and expenses for two succeeding years beyond the test year. But the PSC refused to consider this in fixing new rates, and Justice Cardozo wrote:

We think the adoption of a single year as an exclusive test or standard imposed upon the company an arbitrary restriction in contravention of the Fourteenth Amendment and of “the rudiments of fair play” made necessary thereby. [Citations omitted.] The earnings of the later years were exhibited in the record and told their own tale as to the possibilities of profit. *To shut one’s eyes to them altogether, to exclude them from the reckoning, is as much arbitrary action as to build a schedule upon guess work with evidence available.*

Id. at 81-82 (emphasis added). This principle applies directly to the case before this Court. In *West Ohio Gas*, the Commission had the information and ignored it; in Mountain Fuel’s case, the Commission didn’t allow the parties to submit data and the information in the first place—in effect, “shutting [their] eyes to them altogether.” The result is the same. Rates have not been established as just

and reasonable. *See also Southern New England Telephone Co. v. PUC*, 282 A.2d 915, 918, 29 Conn. Sup. 253 (1970).

Similar results and principles are stated in other jurisdictions. The Louisiana Supreme Court recently indicated that “[T]he historical test year rate base, expenses, and revenues *are only helpful* in the rate-making process where past operations are indicative of probable future operations.” *Central Louisiana Electric Co. v. PSC*, 508 So. 2d 1361, 1369 (La. 1987) (emphasis added). The Louisiana court went on to indicate that “test year data should not be looked at in isolation or arbitrarily applied,” finding that the utility’s operations during the test year must be examined in order to determine whether they are representative of the figures that would prevail in the future. Citing the *Gulf Power* case in Florida, the Louisiana Court concluded that the test year must “fairly represent the future period for which the rates are being fixed.” *Id.*

But the Utah Commission was having nothing to do with adjustments or any finding that the 1989 test year was reasonably representative of the future period. To the contrary, the PSC summarily rejected the Company’s proffer (R. 4-15, Vol. I) to submit evidence concerning the extent to which the year 1989 did or did not represent the period when rates would be effective—beginning late 1990 and continuing through 1991.⁷

⁷The Commission recognized that the rate-effective period would primarily be in 1991. “The rates we set in this docket will be in effect in 1991.” (R. 1968.)

As stated above, the PSC may approach the establishment of rates for the future period in more than one way, but it must do so in a way that recognizes the forward-looking nature of the exercise and in a way that it is not arbitrary, capricious nor inconsistent with the evidence in the case.

Here, of course, the Commission short-circuited the process in two different areas: (1) It precluded the parties from submitting future test-year information at the outset of the proceedings (R. 37, Vol. I), thus preventing Mountain Fuel and the Division from attempting to establish on an evidentiary basis the extent to which a projected or future test year would be more representative of conditions during the period when rates would be in effect than would a 1989 test year. (2) It adopted the 1989 test year but rejected all post-1989 adjustments of the parties, with no finding that the 1989 test year, unadjusted for any post-period expectations or occurrences, was a reasonable representation of the period during which rates would become effective. (R. 1966-68, 1971-72.)

A long line of California cases also develops the governing principle—namely, that the test period should provide information that “present[s] as nearly as possible the operating conditions of the utility which are known or expected to obtain during the future months or years for which the Commission proposes to fix rates” and that consequently yields estimates that “will be as nearly representa-

tive of future conditions as possible.” *City and County of San Francisco v. PUC*, 39 Cal. 3d 523, 703 P.2d 381, 387 (1985), *quoting Pacific Telephone & Telegraph Co. v. PUC*, 62 Cal. 2d 634, 401 P.2d 353 (1965).

Indiana cases yield the same result.

The theory underlying the use of *any* test-year and adjustment method in the rate-making process demands that the data used provide an accurate picture of the utility’s operations *during the period in which the proposed rates will be in effect*. . . . Significant changes in a utility’s operating structure, such as rapid plant expansion, may render even the most current historical data inadequate as a basis for predicting the results of future operations.

L. S. Ayres & Co. v. Indianapolis Power & Light Co., 169 Ind. App. 652, 351 N.E.2d 814, 828-29 (1976) (emphasis added; emphasis of “any” in original).

Here, the Utah PSC has precluded the parties from making such a showing, and it has itself not made any finding that there is a connection between the 1989 period and the Company’s future operations. In the *Ayres* case, the Court found that “the selection of a test year and the adoption of an adjustment method are complex issues of regulatory policy which *must be resolved in light of the special facts of each case*.” 351 N.E.2d at 830 (emphasis added). Factual showings were denied by the Utah PSC. It avoided this issue by prohibiting the parties from presenting “special facts” and compounded the problem by rejecting what information was available to make post test-year adjustments to 1989 to make it more reflective of 1991.

Not only does the overwhelming weight of judicial precedent render the

PSC's test-year actions to be unlawful, but every witness who addressed the subject of an appropriate test year reconfirmed the forward-looking nature of the exercise and indicated that the test year should reasonably reflect the conditions that will be in existence at the time that rates will become effective. Company witness Glenn H. Robinson addressed the issue in his direct and cross-examination testimony (R. 2256-57, Ex. MFS-1, at 4-5; R. 213), as did James L. Balthaser (R. 57, Vol. II). So did witnesses for the Division and Committee: Chester Sullivant (Ex. DPU-1, at 12), Carl L. Mower R. 99, Vol. II; R. 487; R. 2415-16, Ex. DPU-10, at 12-13); Michael Arndt (R. 680).

To the same end, Committee witness Mattiyahu Marcus and Division witness Nile Eatmon unequivocally indicated that the determination of the cost of equity capital for the utility is a forward-looking exercise that determines the cost of capital for the *future* period.⁸ This last point is of more than passing significance. The Commission makes much of the necessity for matching (in time) investment, revenues, expenses and the other ratemaking elements (R. 1964), but

⁸This exchange took place with the Division's rate-of-return witness, Mr. Eatmon:

Q. Now, is it correct that you endeavored to determine the cost of capital for Mountain Fuel Supply Company for the period during which rates, the new rates for Mountain Fuel, would take effect?

A. Yes, sir.

(R. 725.) See also Dr. Marcus's testimony to the same effect. (R. 279.)

it never addresses the fact that its historical test-year approach provides an automatic mismatch with the cost of equity capital, which is indisputably determined for the future period.

Finally, even the Committee of Consumer Services, a state agency that has vigorously taken the position that would focus on a period that yields the smallest possible revenue requirement—the historical test year—attempted to support its position by citing a New York Public Service Commission policy statement on test-period issues that restates the fundamental principle:

[O]ur goal in setting rates would be to ascertain, *as best we could*, what the utility's revenues, operating expenses, and conditions would be *in the period for which we were setting rates: the first twelve months after the new rates became effective*.

Re: Test Periods in Rate Cases, 22 P.U.R.4th 611, 612 (N.Y.P.S.C. 1977) (emphasis added). The PSC did *not* do “the best it could” in looking to the rate-effective period. Had it done so, it would have allowed parties to submit evidence as they saw fit to establish new rates, and the Commission would then have made the judgment, with all available information, of the conditions most representative of the rate-effective period.

Notwithstanding the unanimous agreement among the parties and the PSC itself that rates are to be determined from information that characterizes the revenues, operating expenses, investment and other conditions that would be facing the utility during the rate-effective period, the Commission resolutely refused to

entertain information and evidence concerning the rate-effective period and make adjustments to 1989 data with post-1989 information that was in the record.

**C. THERE IS NO FINDING OR EVIDENCE ESTABLISHING THAT
THE 1989 TEST YEAR IMPOSED BY THE PSC REASONABLY
REPRESENTS CONDITIONS DURING THE RATE-EFFECTIVE PERIOD.**

The Utah Administrative Procedures Act requires that agency action be based on “substantial evidence when viewed in light of the whole record.” Utah Code Ann. § 63-46b-16(4)(g) (1989). This Court has defined substantial evidence as “that quantum and quality of relevant evidence that is adequate to convince a reasonable mind to support a conclusion.” *First National Bank of Boston v. County Board of Equalization*, 799 P.2d 1163, 1165 (1990), *Grace Drilling Co. v. Board of Review*, 776 P.2d 63, 68 (Utah App. 1989) elaborated somewhat:

Substantial evidence is “more than a mere ‘scintilla’ of evidence . . . though ‘something less than the weight of the evidence.’” [Citation omitted.] “Substantial evidence is ‘such relevant evidence as a reasonable mind might accept as adequate to support a conclusion.’”

There are two dimensions to the no-substantial-evidence analysis in this case: First, with *no* evidence in hand, the PSC rejected parties’ attempts to file and analyze future test-year data to determine the future rates. Second, having constrained the parties to a base test year of 1989, it rejected all proposals to make adjustments based on post-1989 data and information. In the first instance, there is an automatic failure of the substantial-evidence test; the fact-marshalling exercise called for in *Bank of Boston*, 799 P.2d at 1165, produces an empty

collection; and § 63-46b-16(4)(g)⁹ applies directly.

At the second level, the PSC still comes up short. Even after imposing a 1989 test year on the determination of 1991 rates, it further rejected all post-1989 adjustments. (R. 1971-72.) But this carries the implicit conclusion that the unadjusted 1989 test year “reasonably approximates circumstances expected during the period rates will be in effect” (the PSC’s own words). Yet the PSC made no such finding; it never “demonstrate[d] that there is a logical and legal basis for the ultimate conclusion.” *Milne Truck Lines, Inc. v. PSC*, 720 P.2d 1373, 1378 (Utah 1986). Indeed, it could not. The dynamics of today’s fast-moving energy and utility businesses dictate that, lacking an affirmative evidentiary demonstration that 1989’s conditions reasonably model or represent 1990’s, an unadjusted test year cannot be “as nearly representative of future conditions as possible.” *Dept. of Business Regulations*, 614 P.2d at 1248.

Recognizing that it “must marshal all of the evidence supporting the findings,” 799 P.2d at 1165, Mountain Fuel can find no reference in the PSC order that cites *any* evidence connecting the 1989 test year with the conditions that will exist in 1991. To put it another way, no party’s evidence addressed this key linkage, and there is, accordingly, no substantial evidence to show that the PSC

⁹Relief will be granted if “the agency action is based on a determination of fact, made or implied by the agency, that is not supported by substantial evidence when viewed in light of the whole record before the court.”

has carried out its responsibility in determining just and reasonable rates for Mountain Fuel for the rate-effective period.

The absence of evidence (much less *substantial* evidence) that would establish the connection between the 1989 test year and the rate-effective period is fundamental and crucial. It is precisely the type of situation that the UAPA and interpreting case law is designed to proscribe. The PSC has pursued an exercise that is foundationally defective: There is no substantial evidence that establishes the 1989 historical test year as a reasonable representative of the conditions that are facing Mountain Fuel and its current operations.

Indeed, the only hard evidence that attempts to connect the 1989 test year with the 1991 period during which rates are effective cuts in the other direction. Company witness Mr. Robinson sponsored an exhibit showing that there is still an inflationary trend (R. 2279, Ex. MFS-1.5) and that the future test year is a better match than the historical test year under the conditions facing Mountain Fuel at this time (R. 2256, Ex. MFS-1, at 4). Carl L. Mower testified that “If properly done, *the forecasted test year would probably be more accurate than a historical one. . . .*” (R. 492 [emphasis added].) Mountain Fuel and the Division were denied the opportunity to “properly do” such a test year.

The significance of the inflation information is that it tends to disprove any claim that, because inflation levels are less than they were five years ago (which Mountain Fuel concedes), the rate-setting exercise does not need to move forward

with more recent information. This is a tenuous argument at best if there were no inflation driving up the costs of goods and services; however, it is almost axiomatic that inflation levels of the size indicated by Mr. Robinson (and not disputed by any witness) will cause costs to increase.¹⁰ Thus, the PSC's action in refusing to allow parties to submit future-year information or other forms of evidence to show that the rate-effective period is not adequately represented by the 1989 historical test year, coupled with the rejection of all post-1989 adjustments, fails the substantial-evidence test under the UAPA. Failure of this test renders the Commission's actions unlawful.¹¹

D. THE PSC'S FORECLOSURE OF THE PARTIES'
SUBMISSION OF PROJECTED OR FUTURE TEST YEAR EVIDENCE
WAS ARBITRARY AND CAPRICIOUS UNDER THE UAPA
AND A DENIAL OF DUE PROCESS.

The Utah Administrative Procedures Act declares agency action that is arbitrary and capricious or an abuse of discretion to be unlawful. Utah Code Ann. §§ 63-46b-16(4)(h)(i) and (iv) (1989). To the extent that the PSC has some discretion in adopting methods that will produce just and reasonable rates,¹²

¹⁰Whether or not there might be offsetting effects is not the point here. If there are, then the parties would presumably submit evidence to establish the point one way or another. Here, again, the Commission foreclosed the parties from making such showings.

¹¹Mountain Fuel believes that the Commission's action would also fail the less stringent test applied to the review of agency decisions prior to the UAPA. *See, e.g., Dept. of Administrative Services v. PSC*, 658 P.2d 601, 608-09 (Utah 1984).

¹²For example, through Utah Code Ann. § 54-4-4(3) (1990).

Mountain Fuel believes it has nevertheless abused that discretion by its action in decreeing a 1989 historical test year and foreclosing the presentation of evidence by the parties concerning a projected test year.

By any standard, the Commission's decision that it intended to require a 1989 historical test year, before hearing argument and to the exclusion of any testimony or other evidence, was an arbitrary and capricious decision. It is not action that would be taken by reasonable persons with knowledge and understanding of the substantive issues. A reading of the transcripts for November 7 and November 21, 1990, indicates the PSC's predisposition toward a 1989 test year, independent of the urging of all parties that such an imposition was a factual determination that had no evidentiary support. (R. 21, 23, 29, Vol. I.)

Even during the hearings, Division witness Mr. Mower indicated that it would be better to roll the test year ahead by six months than to be restricted to using 1989 data. (R. 2413, Ex. DPU-10, at 10; R. 1967.) But the PSC opted not to adopt his suggestion.

The PSC was quick to saddle Mountain Fuel with the burden of establishing its new rates in this proceeding (Addendum 5, at 5, 22), notwithstanding that the Commission had initiated the investigation into Mountain Fuel's rates. The Company did not take issue with this burden,¹³ but then was forced to operate under

¹³By its acquiescence, Mountain Fuel does not necessarily concede that, in a case in which the PSC or other party initiates rate investigation, the utility compa-

Commission-imposed evidentiary constraints that precluded it from making its best case for a proper rate determinations for the rate-effective period. Such action is, in the first instance, a denial of due process under the section 1 of the Fourteenth Amendment of the U.S. Constitution, and the Utah Constitution, art. 1, § 7;¹⁴ and it is arbitrary or capricious, as this phase ordinarily construed. *See, e.g., Heaton v. Second Injury Fund*, 758 P.2d 957, 960 (Utah App. 1988) (“without any reasonable basis in the evidence”).

The PSC may argue that it is not required to use a particular form of future test year in the determination of just and reasonable rates. Strictly speaking, this is correct.¹⁵ But that does not give it unlimited license to preclude the utility company (or any other party) from presenting relevant evidence that would tend to show that the applicable legal standard is satisfied with appropriate projections or future-year analyses. The Commission may further argue that, in the absence of the use of a future test year, it is entitled to limit appropriate adjustments to the historical test-year information. In some factual instances, this also may be correct. But no facts were developed to establish such a result, and this, too, does

ny always has the affirmative burden of establishing or re-establishing the justness and reasonableness of its rates. In this case, however, Mountain Fuel requested a rate increase and thereby undertook a certain burden of proof.

¹⁴Additionally, this means that UAPA § 63-46b-16(4)(e) has not been satisfied (“the agency has engaged in an unlawful procedure”).

¹⁵Utah Code Ann. § 54-4-4(3) (1990) addresses the test-year choice and indicates, “The commission may adopt an appropriate future test period.”

not give the PSC authority to sweep away all post-test-period adjustments, leaving the utility's rates to be set on the basis of information that is almost two years removed from the actual rate-effective period.¹⁶

In sum, the PSC's exclusion of evidence that would allow it to determine revenues, expenses and other conditions "as nearly representative of future conditions as possible" was arbitrary and capricious¹⁷ and a denial of due process.

E. THE COMMISSION'S UNSUPPORTED REJECTION OF
A FUTURE TEST YEAR IS A DEPARTURE FROM PAST
PRACTICE THAT IS PROSCRIBED BY THE UAPA.

Since the mid-1970's, when utility rates and energy prices began to escalate rapidly for a variety of reasons, Mountain Fuel has filed seven requests for general rate relief under appropriate Public Utility Code provisions on the basis of forecasted or future test years. These applications were supported by projections of existing conditions for a future rate-effective period, with the incorporation of known changes, trends and other techniques and information. The PSC has heard these cases on that basis and has, by its orders, approved the use of these tech-

¹⁶The untenable position that the Company was put in is illustrated at page 6 of the Order, where the Commission notes that the Division agreed that "the best solution is to move the test period forward in time, nearer to the period rates will be in effect." The Commission then noted that "This cannot be done," because "we have ordered a 1989 test year." This has a distinct *Catch 22* cast to it.

¹⁷See page 27-28, *infra*, for a further discussion of the arbitrary-and-capricious standard as applied to the PSC's after-the-fact rationalization of the historic-year choice.

niques in every case.¹⁸

Mr. Robinson testified to the general development of these matters. (R. 2256, Ex. MFS-1, at 4; *see also* counsel discussion, R. 5-7, Vol. I.) Mr. Mower, testifying for the Division, indicated that the Division had experienced no major problems with past Mountain Fuel forecasting. (R. 510.) This is significant, as Mr. Mower has been with the Division of Public Utilities for many years (R. 2404, Ex. DPU-10, at 1) and has participated in many utility rate cases during that time.

The previous methods that have been used since the mid-1970's involved forecasted test years, with projections based on trending, statistical extrapolation, case-by-case analysis and consideration of known events for future periods. As discussed below, the reasons given by the PSC for abandoning a 15-year-old policy do not constitute a "fair and rational basis" for changing the policy. The PSC has articulated "reasons" that are post-facto justifications for an action that is contrary not only to past practice but to bedrock principles of utility ratemaking.

F. WHEN THE RECORD IS CONSIDERED AS A WHOLE AND
ALL THE EVIDENCE IS MARSHALLED, THE PSC'S
TEST-YEAR CHOICE VIOLATES UAPA § 63-46B-16

This Court and the Utah Court of Appeals have interpreted the UAPA to

¹⁸Addendum 4 contains a table of general rate proceedings filed by Mountain Fuel since 1975, showing docket numbers, order dates and references to adoption of the future test year.

require that a party aggrieved by an administrative action must “marshall all of the evidence supporting the findings and show that despite the supporting facts, the [agency’s] findings are not supported by substantial evidence.” *Boston First National*, 799 P.2d at 1165, citing, e.g., *Grace Drilling*, 776 P.2d at 68.

The simplest treatment of this standard is to iterate that the PSC took *no* evidence when it rendered its decision on the test-year question, and there are, accordingly, *no* facts to marshall. On an issue that has a factual foundation,¹⁹ the absence of any record evidence to support the finding and conclusion that a historic test year was a proper constraint constitutes a *per se* failure of the UAPA’s substantial-evidence test. The PSC’s action on November 7 and 21, 1989, is directly subject to this Court’s admonition in *First National Bank*:

Although it is a “universally recognized rule” that this court must “take some cognizance of the expertise of the agency in its particular field and accordingly give some deference to its determination,” the agency’s decision must rest upon some sound evidentiary basis, not a creation of fiat.

799 P.2d at 1166, citing *Hurley v. Board of Review*, 767 P.2d 524, 526-27 (Utah 1988). The PSC’s test-year choice was, in every sense of the phrase, “by fiat.”

Nevertheless, it is instructive to consider the rationale set forth in the Commission’s final order on the issue: “Our *principal reason for this choice* [historic test year] *was to avoid bogging down in debates* about the adequacy of future test

¹⁹The three major parties agreed on this. (R. 21, 23, 29, Vol. I.)

year forecasting techniques at the very time we were endeavoring to learn the actual circumstances of a utility we had not thoroughly examined for some years.”

(R. 1965 [emphasis added].)

The Utah Court of Appeals has suggested that the arbitrary-and-capricious standard of the UAPA is a sort of “catch-all” that would generally yield the right of way to one of the Act’s more substantive provisions (*e.g.*, erroneous application of the law). *Angell v. Board of Review*, 750 P.2d 611, 612 n.2 (Utah App. 1988). Yet, it strikes Mountain Fuel that the Commission’s stated primary reason for foreclosing consideration of the future test year is a classic example of unlawful arbitrariness and caprice. In addition to the implicit admission that the principal reason for foreclosing the presentation of future-year evidence was motivated by non-evidentiary considerations—a direct violation of UAPA § 63-46b-14(4)(g), *Boston First National*, and a host of case law—the PSC’s rationale directly implies that the task of determining just and reasonable rates is dependent on (1) the Commission’s convenience—its desire not to get “bogged down” in the very details that it has a duty to examine under Utah Code Ann. § 54-7-12(2)(b), and (2) the absence of a major Mountain Fuel rate proceeding since 1985.

It is not reasonable to deny parties an opportunity to present evidence designed to satisfy the legal standard of representing, as accurately as possible, the conditions that will exist when the rates are in effect. The Commission’s stated reasons are simply unrelated to its duty and responsibility to determine just and

reasonable rates. Furthermore, even if the “bog-down factor” were a proper consideration, there was no evidence on this point. There were no allegations or claims that a consideration of a future test year would produce an unmanageably burdensome proceeding.

Indeed, circumstantial evidence and representations of the Division’s counsel are to the contrary. In all Mountain Fuel rate cases since the mid-1970s, the future test year was the foundation for the determination of just and reasonable rates, and there has been no finding that the rigors of using a future test year are outweighed by the convenience of the Commission or the parties.

It is significant that the Division, which bears the lion’s share of the responsibility for a rate-case investigation, Utah Code Ann. § 54-4a-1 (1990), and might have had occasion to grouse about the burdens of a future test year, took no exception to the Company’s proposal to file on the future-year basis. To the contrary, the Division actively supported it, indicating that it would find the future test-year filing helpful in analyzing the extent historical information was indicative of the future period. (R. 17, 33-34, Vol. I.) The Commission’s conjecture that it would get “bogged down” in arguments about the future test year was, at best, irrelevant speculation and, at worst, an after-the-fact construct for an arbitrarily imposed prohibition.²⁰ Mountain Fuel believes this is the sort of action that is

²⁰It’s interesting to note that one Commissioner remarked that there would probably be as much disagreement about historic test-year adjustments as there

proscribed in § 63-46b-16(4)(h)(iv).

Another part of the PSC's rationale is "because of the unusually and undesirably long time that has passed since our last rate case examination of this utility." (R. 1966.) The PSC never explains why a five-year period of rate stability over which the Company did not need to seek general rate relief is "undesirable." To the contrary, the Commission "attribute[d] this, in part, to be a result of the quality management of the company." In effect, the PSC's message is: If the Company manages its business prudently and efficiently and avoids seeking general relief for an extended period, its absence is "undesirable," and it is denied the opportunity to bring future-test-year evidence before the Commission in an attempt to exhibit the conditions that will exist during the new rate-effective period. It's difficult to understand this Through-the-Looking-Glass reasoning.

The PSC also states that "historical data has the advantages of simplicity and accountability." (R. 1966.) A demurrer might be inserted here: Concede the fact that there is something simpler than the consideration of the expected future operations of the utility; what does this have to do with applying the legal test of establishing just and reasonable rates? The answer is: Little or nothing. Simplicity of derivation is not generally a valid criterion for setting lawful rates.

would have been about the future test year: "The historic test year is something we haven't dealt with for quite some time and I can see almost an argument about what's a known and measurable change as I can about what's a future test year" (R. 38, Vol. I.)

This irrelevant observation does not address the legal responsibility before the PSC. Particularly in the absence of any evidence that connects “simplicity and accountability” with establishing the conditions that will exist when the rates are in effect, the PSC’s rationale does not pass the tests of UAPA §§ 63-46b-16(4)(g), (h)(i) and (h)(iv).

Finally, the PSC order states that “Our analysis of the principal argument in favor of a future test year, the adverse impact of inflation, convinced us that it was not persuasive at this time.” In the first place, the PSC does not divulge its analysis. Although the agency may be accorded some deference in matters of a technical nature, it must provide “subsidiary findings in sufficient detail that the critical subordinate factual issues are highlighted and resolved in such a fashion as to demonstrate that there is a logical and legal basis for the ultimate conclusions.” *Milne*, 720 P.2d at 1378. Here, the Commission states a conclusion that is devoid of explanation.

The PSC’s inflation syllogism is nothing more than: (1) the existence of inflation is the primary reason that a future test year would be used, (2) inflation isn’t a problem for Mountain Fuel, and (3) therefore, there is no justification for using (or examining, apparently) the future test year. There are at least two major flaws to this logic.

First, the PSC’s decision at the outset of the proceedings was not accompa-

nied by any evidentiary discussion of inflation (nor “attrition”²¹) nor whether there was an inflationary effect on Mountain Fuel’s revenues and profits. The PSC cannot credibly argue that it rejected the future test year because of the absence of inflation—an evidentiary conclusion. There was no evidence one way or the other when the Commission made the decision.²²

Second, and perhaps more important, no legal principle or evidentiary chain of logic establishes the PSC’s claim that inflation is the primary reason for using a future test year. The applicable legal principle—that rates are to be established for a future period—does not depend on the existence of inflation or attrition. In the legion of cases cited earlier in this brief establishing the legal foundation for a proper test year, the existence of inflation or attrition is never cited as a necessary condition for using a future test year.²³

When the reasons for the PSC’s test-year decisions are marshalled, they do not constitute—even after the fact—the quantum of evidence that is required by UAPA § 63-46b-16(4)(g).

²¹“Attrition” was later defined in the proceedings as “a loss in the earnings of the Company due to increasing costs.” (R. 506.)

²²Subsequent evidence indicated that there is, and has been, ongoing inflation. See text pages 20-21. The Order implied (or assumed) that there was no inflation.

²³It may, however, be a *sufficient* condition. That is, the existence of an attrition of earnings due to rising costs may, by itself, establish the need for a future test year. But the Commission appears to confuse *necessary* conditions with *sufficient* conditions in its arguments.

**G. THE COMMISSION'S ORDER TO USE AN AVERAGE
RATHER THAN A YEAR-END RATE BASE
IS NOT BASED ON SUFFICIENT RECORD EVIDENCE.**

The issue of rate base is a subissue of the broader question of whether the PSC has properly applied the law to the facts of the case to produce just and reasonable rates for the rate-effective period. To the extent that the Commission's constraint confining the parties' filings to a historic 1989 test year is itself unlawful, the rate-base question is subsumed by such an infirmity. This discussion in this section, however, examines the rate-base issue's individual elements to show that, even by itself, this issue was decided wrongly by the Commission. To put it another way, the PSC's choice of rate base methodology aggravated an already unlawful ratemaking framework.

The purpose of the rate base is to establish the value of the utility's assets on which it may earn its authorized rate of return during the rate-effective period. Having imposed a historical test year on the parties, the PSC later singled out the rate base for further consideration: whether, in the context of the 1989 test year, an average or year-end rate base was appropriate. Mountain Fuel made its April 30, 1990 filing on the basis of the value of the Company's rate base on December 31, 1989 (the "year-end rate base"). (R. 2297, Ex. MFS-5, at 7.) The Division was amenable to this approach (R. 2423-25, Ex. DPU-10.1, at 1-3), but the Committee took the position that the rate base should be determined by taking an average over 1989 (the "average rate base") (R. 680). This approach has the

effect of providing the value of the investment base at mid-year, or approximately July 1, 1989—six months further in the past than a year-end value. (R. 65-66, Vol. II; R. 2424, Ex. DPU-10.1, at 2.)

If a utility's conditions are static over time, it will not matter what type of rate base is employed. However, if conditions are changing over time, then the type of rate base becomes critical, particularly where a test-year framework has already been selected which inherently provides a material mismatch between the test year and the rate-effective period. Thus, the issue of which rate base to use—as with the test-year issue itself—comprises both legal and factual components. Given the PSC's requirement of a 1989 test year, what rate-base evaluation method will best meet the legal standard of determining just-and-reasonable rates for the rate-effective period?

The Commission adopted an average rate base, stating three reasons in its order. (R. 1968-69.) First, the Commission had apparently adopted an average rate base methodology in the most recent U. S. West Communications and Utah Power & Light Company rate cases. Second, the Commission claimed that an average rate base allows matching of revenues and expenses, and that a year-end rate base creates a potentially misleading picture of the rate base at one point in time. Third, the Commission found that the use of year-end rate base requires substantial, difficult adjustments to revenues and expenses.

None of these reasons singly or in concert is sufficient to support the

conclusion that an average, historic-year rate base should have been used in this case. Other than a conclusory statement, the Commission made no finding, nor cited evidence to support a finding, that the average, historic rate base combined with an unadjusted 1989 test year would provide proper matching of rates with the rate-effective period.

The Company's circumstances are different from those of Utah Power & Light and U. S. West.

The PSC found “no compelling reason” to change from the average rate base used in recent U.S. West and Utah Power & Light Company. If the rate base issue were purely legal, then the use of those two precedents might be justified. However, as there are factual components, the holding must be based not only on applicable law, but also on substantial evidence. The difficulty with the holding is that it is not based on any factual determination. The PSC provided no discussion—evidentiary or otherwise—to explain why Mountain Fuel’s factual circumstances are governed by the PSC’s treatment of two other utility companies. Consistency for the sake of consistency is not a substitute for reasoned decision-making and evidence-based conclusions. *See generally Milne*, 720 P.2d at 1378-79.

Although it is true that the Commission regulates Mountain Fuel under the same public utility code as it does U.S. West and Utah Power & Light, it does not follow that their circumstances are similar enough to require the use of the same

rate-base analysis. In fact, Mountain Fuel witness Mr. Robinson testified that both U.S. West and Utah Power & Light have *stable* or *declining* rate bases, whereas Mountain Fuel's rate base is *increasing*; therefore, a year-end historic rate base is more appropriate than an average historic rate base.²⁴ (R. 212-13.) It is confiscatory to use average, historic rate base when actual year-end and current rate base and investment on the Company's books represent a higher value that is closer to the rate-effective period.²⁵

A year-end rate base (for a historic test-year) provides a more accurate view of conditions for the rate-effective period.

Within the constraint of the PSC-imposed 1989 test year, the appropriate question is: Under the factual circumstances facing Mountain Fuel, does the average rate base or the year-end rate base better represent the conditions the utility will face during the rate-effective period? The PSC's characterization of the year-end rate base as a "snapshot" is not inapt. But, contrary to the Commission's implication, this is not a negative consideration. In contrast to such ratemaking elements as costs, which are sums usually aggregated over a 12-month period, the rate base is inherently a "snapshot" quantity; at any moment, it represents the

²⁴This argument is made in the context of the Commission's imposition of a historic test year. An average rate base in an appropriate future or forward test year may be a proper means of evaluating the utility's investment for the rate-effective period.

²⁵Conversely, with a historic test year and declining rate base, use of average rate base will produce inappropriately high rates.

capital dedicated to the utility operation.

Thus, the “snapshot” of the rate base that is closer in time to the rate-effective period will have a better chance of matching the quantity of investor funds with the rate-effective period.²⁶ Division witness Mr. Mower hit the legal test right on the button: “The rate base and level of operations of the Company are still increasing and the end of the year levels *will better match the time period that rates will be in effect.*” (R.2425, Ex. DPU 10.1, at 3.) The PSC ignored this crucial test in favor of its claims about “difficult adjustments, fraught with policy implications.” As Mr. Mower testified, any “difficult adjustments” had been made, and there is no indication of what “policy implications” would stand in the way of updating the rate base. As indicated on page 9, line 4, of Jt. Ex. 2, dated September 26, 1990, use of an average-year calculation reduces the rate base by \$9,542,000.

Use of a year-end rate base moves the measure of investment forward by six months, as the average rate-base approach effectively uses mid-year levels. (R. 65-66, Vol. II.) Two Mountain Fuel witnesses and two Division witnesses testified that a year-end rate base would more accurately reflect actual conditions, because, among other things, the data is moved forward six months. (Mr. Robinson, R. 212-13; Mr. Balthaser, R. 69, Vol. II; Mr. Mower, R. 85-86,

²⁶See note 8 and accompanying text concerning the forward-looking nature of the rate-of-return determination.

Vol. II; R. 507; R. 2419, Ex. DPU-10, at 16; and Mr. Sullivant, R. 527.) *No one* testified that the average rate base was more representative than the year-end rate base for the rate-effective period.

The necessary calculations were made to support a year-end rate base.

Even if a year-end rate base “requires that substantial, difficult adjustments, fraught with policy implications, be made to revenues and expenses” (R. 1969), this is not sufficient to reject a year-end rate base unless it is apparent from the record that such calculations cannot or have not been made. The record in this case establishes the contrary. Most notably, in response to questions from the Commission, Mr. Mower clearly stated that the Division had made the necessary calculations for this case. (R. 86, Vol. II.)

More to the point, the Commission’s implication that a historic year-end rate base “requires that substantial, difficult adjustment, fraught with policy implications, be made” is not consistent with the evidence in this case. Mr. Mower’s grudging “comfort level” for an average historic rate base²⁷ is not the relevant consideration. In this case, the calculations had been made; the year-end information was available and a part of the record; and year-end rate base moved closer to satisfying the fundamental requirement of matching rates with rate-effective period conditions.

²⁷R. 1969; R. 86-87.

The Committee offered no evidentiary support for the use of an average rate base.

The Committee's evidentiary support for an average rate base was virtually non-existent. The Committee withdrew its initial submittal on average rate base (Tr. 101-03, Vol. II), leaving only Committee witness Michael L. Arndt's testimony. Mr. Arndt summarized his position on average test-year approach (R. 654):

The average test year approach is consistent with prior Commission rulings and produces the desired matching of investment, revenues and expenses. The year end test period approach, on the other hand, focuses on a single point in time and requires numerous year end adjustments to achieve the necessary and proper matching of investment, revenues and expenses.

Such adjustments are complex, speculative and contrary to the Commission's intent to simplify the ratemaking process.

These are conclusory statements without any factual support in the record. It is significant that nowhere in the record did Mr. Arndt or any other witness indicate that the year-end rate base was not calculable. Indeed, as indicated by Mr. Mower, those calculations were made by the Company and the Division. The simple assertion that calculations need to be made is not by itself sufficient to support the rejection of a year-end rate base. To the extent that the calculations employ more recent data, they should be made as a matter of course if it results in a better matching of rates with the conditions in the rate-effective period.

II. THE REDUCTION OF THE RATE OF RETURN ON EQUITY FROM 12.2% TO 12.1% ON THE BASIS OF MOUNTAIN FUEL'S AFFILIATE RELATIONSHIPS IS UNLAWFUL.

A. INTRODUCTION

On pages 23-30 of the Order (R. 1985-92), The PSC discusses the appropriate rate of return on common shareholders' equity and concludes: "[W]e find the cost of equity to be 12.2%." (R. 1991.) Although Mountain Fuel may not necessarily agree that this level is satisfactory, it has not taken legal issue with this determination. However, the PSC did not permit Mountain Fuel to file and charge rates on the basis of the 12.2% that the Commission found to represent the cost of equity in the ratemaking equation.

Instead, it "impose[d] an adjustment in the form of a reduction in the allowed rate of return of 10 basis points"—from 12.2% to 12.1%.²⁸ (R. 1993.) The reason given for this "adjustment" is that "we [the PSC] take issue with the management of the company's parent, Questar Corporation." (R. 1992.) On rehearing, the PSC partially justified its return adjustment on the basis that "setting rates . . . is not a precise science" and that, in any event, 12.1% is within the "zone of reasonable rates" established for rate of return. (R. 2163-64.)

²⁸One basis point = .01%.

B. IMPOSITION OF A PENALTY REDUCTION OF THE ALLOWED
RATE OF RETURN IS, AS A MATTER OF LAW, BEYOND
THE STATUTORY GRANT OF AUTHORITY TO THE PSC.

The Public Service Commission has no inherent regulatory powers. *Kearns-Tribune Corp. v. PSC*, 682 P.2d 858, 859 (Utah 1984). Although it has the authority to determine rates Mountain Fuel may charge, it has limited powers to impose penalties and other punitive measures. In this case, the PSC has explicit statutory authority to determine just and reasonable rates for the utility companies for which it has statutorily granted jurisdiction. Utah Code Ann. § 54-3-1 (1990). But the Commission has partially founded rates on the basis of a reduction in the allowed rate of return for Mountain Fuel because of its general dissatisfaction with “the management of the Company’s parent, Questar Corporation.” (R. 1992.) Although the text of the Commission’s order characterizes the reduction as an “adjustment,” it is a *penalty* in every sense of the word. Indeed, the Commission’s order, in what might be a Freudian slip, addressed the general issue of affiliate transactions in terms of “penalties” in the table of contents of its November 21 Order. (R. 1960.)²⁹

Quite apart from the absence of any finding that the affiliate relationships of

²⁹This characterization was apparently changed in the text of the order to refer to “disallowances,” but it seems a fair inference that the mindset of the Commission was to consider penalizing Mountain Fuel and its parent, Questar Corporation, for their particular corporate structure and relationship. *See also* R. 2011-13.

Mountain Fuel adversely affected the rates charged to its customers (see discussion in § C below), the PSC's authority to impose sanctions, penalties and reparations on a utility is limited to those provided for by statute. Title 54 of the Utah Code provides a variety of methods and actions that the Commission can take, including injunction, penalties, fines, and reparations for *certain specified situations*. *E.g.*, Utah Code Ann. §§ 54-7-24 through -29 (1990). There is, however, no statute that provides the authority—and the Commission has cited none—for dispensing punishment to Mountain Fuel by lowering its authorized rate of return.

This issue is a matter of law, and the Court must apply a correction-of-error standard. *Kearns-Tribune*, 628 P.2d at 859. There is no clearly defined statutory grant of authority authorizing the imposition of penalties for a fabric of corporate affiliations that the Commission cannot identify as being the cause of any rate detriment to Mountain Fuel's customers. To the extent that the Commission would have found imprudently incurred or other unjustified costs, it has the authority to deny cost coverage.³⁰ But it does not have the authority to penalize Mountain Fuel because of the holding-company framework in which the

³⁰The Commission did adjust cost coverage in this docket from one relatively small affiliated-related transaction, the "Brewery property" issue. (R. 1979-81.) To the extent that the action taken on this issue is otherwise lawful and sustainable, the Commission's cost-recovery-adjustment "remedy" is appropriate because it is specifically oriented around the facts and circumstances of identifiable costs and rate effects. Further, the PSC appears not to have relied on the Brewery-property issue in reducing Mountain Fuel's return on equity.

Company operates its utility business.³¹

The courts have been called upon to review a variety of adjustments and penalties related to the rate of return and have produced a spectrum of results as a function of the underlying statutory scheme and the precedential state law. There have been a number of cases in which a public utility commission has penalized a utility for providing substandard service or for exhibiting mismanagement. No such factual finding has been made in this case.

But even in cases of a demonstrated potential negative effect on rates, many courts have found that regulators' rate-of-return penalties are not lawful. For example, the Texas Court of Appeals has examined this question in a context that allows even wider agency discretion and authority to make rate-of-return adjustments than in Utah. In *PUC v. Houston Lighting and Power Co.*, 715 S.W.2d 98, 103-04 (Tex. App. 1986), the Texas court found that the statutory framework provided "no implied authorization . . . for imposing a rate penalty," and:

[T]he Commission's reduction of a rate of return found by it to be reasonable, as a penalty for mismanagement, exceeds the Commission's authority under [Texas law] and substantially prejudices the rights of [the utility] by depriving it of revenues . . . beyond the general findings of poor management and unreasonable expenses, there is no stated basis for lowering the rate of return

In Mountain Fuel's case, the Commission's rate-of-return reduction is an

³¹Mountain Fuel is a wholly owned subsidiary of Questar Corporation, a nonoperating holding company that is a Utah corporation. See R. 2280, Ex. MFS-1.6, which gives the Questar Corporation structure.

even more obvious excursion outside the boundaries of its legal authority. It found no evidence of mismanagement, and it made no finding that rates of Mountain Fuel's customers were adversely affected by what it perceived as an undesirable corporate structure.³² (R. 1208-13, 1991-92, 1998-99, 2011-13.) Some courts have sustained rate-of-return adjustments on the basis of poor service, but the *Houston Lighting* case distinguishes these from cases like Mountain Fuel's because "there are no findings of poor service to ratepayers." 715 S.W.2d at 103.

The Supreme Court of Kentucky has reached similar conclusions in observing that "the legislative grant of power to regulate rates will be strictly construed," so that "granting the Commission the authority, in a rate case, to penalize the utility for poor service would be an improper extension of the statutory procedure." *South Central Bell Telephone Co. v. Utility Regulatory Commission*, 637 S.W.2d 649, 653 (Ky. 1982). This Kentucky case is, once again, all the stronger relative to the Mountain Fuel situation because it involves a finding of poor ser-

³²The Commission's apparent displeasure with the current corporate structure (which it approved in 1984) is not reasonable. Private investors in the United States are entitled to form corporations and subcorporate structures as they see fit, so long as the businesses they operate are willing to meet the standards of the law and regulatory constraints as they find them. The Commission's general malaise over the choice made by the investors and managers of Questar Corporation cannot lawfully be translated into penalties against one of that corporation's subsidiary entities. See, e.g., *Missouri ex rel. Southwestern Bell Telephone Co. v. PSC*, 262 U.S. 276, 288-89 (1923).

vice. Even where the utility has been found to provide something less than the expected standard of service, the Commission has no power to penalize the company through rate-of-return adjustments. According to the Kentucky court,

It seems to us that there is an inherent danger in permitting poor service as a basis for setting rates, particularly in the imposition of a penalty which results in a *reduction of a rate which the Commission has already found to be fair and reasonable*. There are no objective, definable standards upon which to base a penalty. It is, at best, arbitrary and subjective. Punitive actions should not be subject to the possible whims of individuals, including those serving on a responsible administrative body. In the present case, it appears that the Commission was upset or frustrated by what it deemed Bell's failure to improve its service in a previous case. . . . This case is a classic example of arbitrary and subjective judgment.

Id. at 653. The New Mexico Supreme Court reached the same result:

The [State Corporation Commission] may not demand rate forfeitures on service deficiencies from a regulated company for noncompliance with its after-the-fact determination of a fair and reasonable rate of return. To the contrary, the SCC had a constitutional duty in a rate case to adopt rates that "will allow [the utility] to operate successfully, maintain its financial integrity, attract capital, and compensate investors for the risk assumed."

In re: General Telephone Company of the Southwest, 98 N.M. 749, 652 P.2d 1200, 1207 (1982). On the facts in Mountain Fuel's case, the Utah Commission's action is even less justifiable than that of the New Mexico Commission. *See also General Telephone Co. v. Michigan PSC*, 341 Mich. 620, 67 N.W.2d 882 (1954); *Askew v. Bevis*, 37 Fla. Supp. 63, 283 So. 2d 337 (1973).

The Commission may argue that its action is not a "penalty." The context in which it was imposed and the "slip of the pen" in the table of contents of the

report and order demonstrate the contrary. The Utah Commission has sought to reduce the otherwise just and reasonable compensation to Mountain Fuel's share-owners because of its general dissatisfaction with the corporate family within which Mountain Fuel resides. This is not within the statutory powers granted to the Public Service Commission.

**C. THE REDUCTION FROM 12.2% TO 12.1%
IS NOT SUPPORTED BY SUBSTANTIAL EVIDENCE**

Utah Code Ann. § 63-46b-16(4)(g) requires that agency action based on a determination of fact must be "supported by substantial evidence when viewed in light of the whole record." The only foundation for the reduction of the equity rate of return from that otherwise found to be just and reasonable is the general existence of the Company's current affiliate relationships. The Commission has cited no justification for the reduction outside of its general dissatisfaction with the corporate structure in which Mountain Fuel operates. There has been no finding of Mountain Fuel management imprudence, nor has there been any disallowance of costs that would signal malfeasance or mismanagement of the utility operations that serve Utah customers. In the course of the proceedings, several witnesses addressed the affiliate relations of Mountain Fuel. With one minor exception,³³ the PSC did not adopt any contested, material adjustment to Mountain Fuel's cost

³³ An adjustment was made to revalue portions of a multiple-party real estate transaction that involved, among others, an affiliate of Mountain Fuel. (R. 1979-81.)

of service or other ratemaking elements in connection with its affiliate relationships. (*See, e.g.*, R. 1981-82, 2003-05; R. 1979-80, 1999-2001.)

To the contrary, the Commission found that the Company's long absence from the rate-making arena is attributed "in part, to . . . the quality management of the Company" (R. 1965) and that "without the benefit of systematic examination, [] Company management has performed very well in most respects." (R. 1992.) Although the Commission "take[s] issue with the management of the Company's parent, Questar Corporation," there is no finding that *Mountain Fuel* has conducted its affairs in any way that is prejudicial to its carrying out its responsibilities under Utah Code Ann. § 54-3-1 to provide quality natural gas service to its Utah customers. The Commission cited, with apparent concurrence, the Division's conclusions that "there was not evidence that [affiliate] transaction charges were inappropriate" and that "the Company had readily provided requested information about its affiliate transactions." (R. 1980.)

The Commission's implication that it might organize the Company differently were it to be managers of the Company is not sufficient reason to penalize Mountain Fuel for its place in the corporate organization of Questar Corporation—an organization which, as the Commission has noted (R. 1992), it approved in 1984 in Docket No. 84-057-10.³⁴ Short of a divestiture of the distribution

³⁴Order issued October 1, 1984.

company, there will of necessity be intracorporate transactions between Mountain Fuel and the parent and other affiliates. Thus, the Commission's reduction of Mountain Fuel's rate of return appears to be based on its general displeasure with the organization itself, not on any substantial evidence of an abuse of the corporate framework.

An independent failure of the PSC's rate-of-return penalty is the absolute absence of evidence on the quantification of any penalty or adjustment to the rate of return. The rate-of-return issue was the subject of extensive evidence—written testimony, exhibits, analyses, cross-examination—and not a word was uttered or written by any witness on what would be an appropriate measure of a decrement to the cost of capital under the PSC's theory of adjustment.

The *Houston Lighting* court identified this as a fundamental evidentiary problem:

[W]e observe that no objective standard exists for imposing a rate penalty. The Commission concedes that the .5% penalty is without support in the record. Beyond the general findings of poor management and unreasonable expenses, there is no stated basis for lowering the rate of return by .5%, as opposed to .3% or .7%

715 S.W.2d at 104. A similar situation exists in the Mountain Fuel case—with even less justification to impose penalties. Not only was there a complete void of evidence linking the ensemble of interaffiliate matters with the rate of return or on the quantification of penalty for any PSC-perceived transgressions of Mountain Fuel, there was no finding of “poor management and unreasonable expenses.”

The Texas court's reasons for rejecting penalties for the absence of evidentiary support are all the stronger when applied to Mountain Fuel.

Quite simply, the PSC's rate of return reduction does not satisfy the substantial-evidence test of § 63-46b-16(4)(g), nor the provisions proscribing arbitrary and capricious action in subsection (4)(h)(iv).

CONCLUSION

For the reasons set forth above, Mountain Fuel believes the PSC's November 21, 1990, Report and Order does not comply with applicable standards of statutory and case law.

Mountain Fuel seeks relief from this honorable Court as follows: (1) An order voiding the PSC's .1% penalty to rate of return and permitting Mountain Fuel to file new tariff sheets incorporating a 12.2% equity rate of return. (2) An order remanding the issue of the test year to the Commission with instructions to permit Mountain Fuel to seek the establishment of rates to be based on the legal principles set forth in this Brief—in particular, to permit the Company and other parties to submit evidence that it believes will establish as nearly as possible the conditions that will exist when the rates are effective. (3) An order requiring the PSC, in the absence of the development of a full new record for a future period, to allow Mountain Fuel to refile tariffs based on the use of the 1989 year-end rate base as the lawful measure of the level of investment entitled to earn a return, as a

matter of law on the record established in the proceeding.

Respectfully submitted,

MOUNTAIN FUEL SUPPLY COMPANY

A handwritten signature in black ink, appearing to read "Gary G. Sackett", written in a cursive style.

Gary G. Sackett,

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July 25, 1991

D89-011A \SUPCT.BFI

ADDENDUM 1

DOCKETED

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Investigation)
of the Reasonableness of the Rates)
and Tariffs of MOUNTAIN FUEL SUPPLY)
COMPANY)

DOCKET NO. 89-057-15

REPORT AND ORDER

ISSUED: November 21, 1990

1989 TEST PERIOD RATE CASE

SYNOPSIS

By this Order the Commission has established a revenue requirement for the Company of \$139,533,000 and an allowed overall rate of return of 11.03 percent.

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I. PROCEDURAL HISTORY

The Commission on its own motion and pursuant to Section 54-4-2 and other applicable statutory provisions determined to commence a formal investigation into the reasonableness of the rates and charges of Mountain Fuel Supply Company ("Mountain Fuel" or "Company"). A notice of prehearing was issued on October 31, 1989, in which the Commission indicated that the issues of (1) whether the

of return, (2) affiliate relationships, and (3) cost of service were to be addressed. The prehearing was held on November 7, 1989.

On November 21, 1989, the Commission bench-ordered that a 1989 historical test year would be employed. In response to a Mountain Fuel motion, and following a hearing on the subject, the Commission issued a Protective Order on January 31, 1990.

On January 22, 1990, the Division filed a motion to consolidate Dockets 90-057-02 (gas cost proceeding) and 89-057-15 (general rate case). The motion was granted.

Mountain Fuel filed an application for a general rate increase in the amount of \$9,682,000, on March 30, 1990. The Commission set the application for prehearing on April 10, 1990, and, at the prehearing, determined a schedule for the proceedings. This schedule was subsequently amended owing to motions filed by the Division of Public Utilities ("Division") and the Committee of Consumer Services ("Committee"). In one instance the Committee requested clarification about a Commission-directed inquiry of the Wexpro Agreement. In another, the Division alleged failure of the Company to comply with the timetable for response to discovery requests. Sanctions were demanded by the Division.

On June 27, 1990, the Commission issued a formal order denying the Division's request that the Company be sanctioned for failure to meet discovery requirements and granting a request of the parties that a new schedule be set for the case.

On August 27, 1990, the Commission sent a memorandum to the parties notifying them that the issue of the appropriate test-year rate base would be the first item addressed in the hearings.

In addition, the Commission directed the parties to prepare a joint exhibit of their respective positions on the rate case issues.

Hearings began on September 5, 1990. The Committee, on September 17, 1990, filed a motion to compel the Company to respond to a data request and to impose sanctions. The Commission again declined to impose sanctions but directed Mountain Fuel to respond to the data request. On September 27, 1990, following the conclusion of the hearings, the parties filed the required joint exhibit. Thereafter, the parties filed briefs explaining and defending their respective positions.

II. DISCUSSION AND FINDINGS WITH RESPECT TO
DETERMINATION OF REVENUE REQUIREMENT

Early in this docket formulation of the test period emerged as a key issue. We had ordered the use of a 1989 historic test year after having considered the parties' arguments, pro and con. Our principal reason for this choice was to avoid bogging down in debates about the adequacy of future test year forecasting techniques at the very time we were endeavoring to learn the actual circumstances of a utility we had not thoroughly examined for some years.

The last Mountain Fuel rate case was concluded in 1985. Since then, several rate decreases have occurred as a result of decreases in gas costs. In addition, the Company found no reason to seek rate relief. We attribute this, in part, to be a result of the quality management of the Company. Our analysis of the principal argument in favor of a test year

inflation, convinced us that it was not persuasive at this time. Implicitly, therefore, we did not recognize the need for attrition adjustments.

Thus, use of a historic test year in this proceeding is important in part because of the unusually and undesirably long time that has passed since our last rate case examination of this utility. Actual, historical data has the advantages of simplicity and accountability. In general, such data can be used for rate case analysis, thereby minimizing the use of forecasted data derived by technical and debatable methods.

Prior to this rate case we adopted a rule prescribing test year annualization guidelines. It did not contemplate historic test years and, as the evidence on this record shows, is not readily applicable to them. A future test year embodies forecasted revenues, expenses, and investment; that is, forecasts of changes in both prices and quantities of inputs and outputs. The annualization rule attempts to confine ad hoc test year adjustments to those that are not linked, logically and economically, with other revenues, expenses, or investments; those, in the words of the rule, where interdependencies are minimal. This generally means that price, as distinct from volume or quantity, changes may be acceptable. An increase in the price of postage stamps occurring during the test year is one example: in the short term, it may affect nothing else, such as the volume of mailings. However, the price increase is beyond management's control, and failure to account for it may unfairly decrease the opportunity to earn a fair return. Yet, revenues, expenses, and investments must be matched in the test period or in other words revenues and expenses must be

correspond to investments and accounting information must reflect the underlying economic relationships between inputs and outputs. One ad hoc change which affects other things, without compensating adjustments, will upset the necessary balance. In the interest of proper matching, it should be done as little as possible.

Post-test-year adjustments are not the subject of the annualization guidelines. The Company, and to a limited extent the Division, attempted to apply them to such adjustments in this docket nonetheless. We reject this because the greater the time between the test year and a proposed single item adjustment, the more likely it will necessitate other deliberate changes if test year revenues, expenses, and investment are to remain matched. Even more importantly, with the passage of time prudent management will have adapted operations to any such change in ways not embodied in test-year information and not on this record.

The accounting information presented in this docket generally does not permit us to draw inferences about the utility's economic relationships, that is, how it organizes, in cost minimizing fashion, productive inputs in order to deliver its services. We do not know, for example, what prudent management would do in reaction to or in anticipation of a change in the price of a key input such as labor wage rates. Certainly there is no justification for an assumption that there are no consequences, yet this is what it means to say that a future price level change has minimal interdependencies.

In our opinion, to permit out-of-period adjustments is almost certainly to upset the test-year match of revenues

may impose a risk of under-recovery. When the period between rate cases is short this risk is lessened, as is the potential for mismatch when, as is the case here, accounting data is used to approximate complex economic interrelationships. But when this period is as long as it has been, out-of-period adjustments should be based upon an economic model of the firm. Without the understanding of economic relationships such a model provides, the use of accounting data will tend to support selective adjustments to the test year that are one-sided, and generally proposed by those having information and expertise. This will lead to an undesirable mismatch of investment, revenue, and expenses, generally increasing revenue requirement. Selective adjustments, in short, may yield a less representative test period for ratemaking purposes than no adjustments at all.

The purpose of a test year, or test period, is to provide revenue, expense, and investment information that reasonably approximates circumstances expected during the period rates will be in effect. The rates we set in this docket will be in effect in 1991. Are post-test-period adjustments required to approximate future circumstances? The Company, and in part the Division, say yes; the Committee, no. The Company argued that post-test-year adjustments must be made; the Division, that such adjustments can, with difficulty, be made; and the Committee, that such adjustments create more problems than they solve. According to the Division, the best solution is to move the test period forward in time, nearer to the period rates will be in effect. This cannot be done in this docket. First, we have ordered a 1989 test year, parties

has not audited 1990 data and no party other than the Company is in a position to present a case based on it.

There are three options. First, we can reopen the record and redo the case based on a test period nearer in time. This is completely impractical and we reject it. Second, we can permit selective out-of-period adjustments loosely corresponding to the guidelines contained in an inapplicable rule. For reasons discussed at length above, we also reject this approach. Third, we can stay with the 1989 test year, permitting in-period adjustments only. We find that this is the most practical and least complex alternative. Upon issuance of this order, the Company or any other party is immediately free, as is always the case, to petition for a change in rates should a party claim a change is necessary.

Confusion and unnecessary work have resulted because the Commission did not decide all of the test-year issues at the outset of this docket. In future proceedings, the Commission will decide issues concerning test year, rate base, out-of-period adjustments, and related matters, prior to the onset of hearings and based on the then existing conditions of the utility and the economy in which it is operating.

A. Average-of-Year Versus End-of-Year Adjustments

1. Average Rate Base

Certain annualization adjustments depend on the choice of average or year-end rate base. The Company argued that, for a historic test year, an end-of-year rate base more accurately reflects conditions expected when new rates will be in effect than

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base is six months nearer in time. The Division agreed, though under questioning from the Commission, its witness, citing the complexity of adjustments to test-year revenues and expenses necessitated by end-of-year rate base, stated a preference for using average-of-year rate base. The Committee recommended use of average-of-year rate base based upon consistency with prior Commission rulings and more accurate matching of known test-year investment, revenues, and expenses. According to the Committee, end-of-year rate base, a single point in time, requires that numerous complicated adjustments be made to revenues and expenses to restore a proper matching.

The Commission finds an average rate base appropriate for the following reasons. First, the Commission has relied on average rate base in recent U S WEST Communications and Utah Power and Light dockets. The present docket has produced no compelling reason to depart from that practice. Second, an average-of-year rate base provides an appropriate basis for matching the annual flows of revenues and expenses to the average annual stock of plant and equipment employed by the utility and to the manner in which the utility has been operated. An end-of-year rate base is a mere snapshot, a potentially misleading picture of rate base at one point in time. Third, an end-of-year rate base requires that substantial, difficult adjustments, fraught with policy implications, be made to revenues and expenses. Because the Company's application reflects end-of-year rate base, our acceptance of the

Committee's recommendations for average-of-year rate base decreases rate base by \$9,542,000.¹

2. End-of-Year Depreciation

The Company proposed to increase 1989 depreciation expense to reflect end-of-year rate base. Our decision to employ average-of-year rate base in this docket makes this proposed adjustment moot. We find that no expense adjustment is necessary.

3. GS Customer and Use Per Customer Annualization

The Company based its test year on year-end rate base figures, but did not annualize either the number of GS-1 and GSS customers or the customer use based on its position that the product of total customers times customer use or total gas volume delivered has remained relatively constant over the last decade.

The Division recommended that the number of customers should be annualized to match the year-end rate base, but that the usage per customer, which has declined over the last decade, should not be annualized because it had leveled out over the last two heating seasons. The Division annualization adjustment would increase revenue by \$2,097,000.

The Company countered that if the Division's annualization of the number of customers was adopted, it would be necessary to annualize the customer usage which the Company views as continu-

¹ The dollar value of this adjustment is the change in rate base our decision requires. Likewise, our following revenue and expense decisions are expressed as the dollar adjustments required. None of the adjustments are stated in revenue requirement terms until summarized as such in section III.

ing the declining trend exhibited over the last decade. The combined effect of the annualization of the number of customers and the usage per customer would be a decrease in revenue of \$1,057,000 according to the Company.

The Committee took the position that the average test year approach produces the desired matching of investment, revenues, and expenses and therefore recommended against both adjustments.

The Commission, having adopted the average test year approach, finds the Committee's position appropriate, and rejects both adjustments.

B. Post-Test Period Adjustments

Eight post-test-year adjustments were proposed, all but one of them by the Company. Two of these, the "ET-2" and "customer X" adjustments, though partially offsetting, would increase revenues. Six of them would increase expenses: 1990 labor adjustment, pension plan adjustment, Questar Service 1990 adjustment, production-related depreciation, FICA tax, and gross receipts tax. The effect of accepting them all would be a small increase in test period revenues and a much larger increase in test period expenses. With one minor exception the Committee recommended rejecting the adjustments.

The Division proposed and supported one revenue adjustment and recommended rejecting the one proposed by the Company. The six expense adjustments were proposed by the Company. The Division recommended rejecting two of them and supported, but disputed the dollar amounts of the remaining four. We will not

repeat here the details of party positions any further, having previously discussed our position on post-test-year adjustments under the circumstances of this docket. For the reasons stated in that discussion, we find that the adjustments must be rejected.

The Company included revenues from deferred main extension payments made by a customer added to its system in 1990. The payments are part of a five-year contract. The Company maintained that these deferred payments are a known and measurable benefit to the customers, have no interdependency and should not be eliminated. The Division took no position. The Committee, however, argued that such revenues should not be considered since they occur beyond the test year and recommended an adjustment removing such revenues. The Commission agrees with the Committee and finds that the Company's Utah non-gas revenues should be decreased by \$312,000.

C. Test Period Adjustments

1. Adjustments to Industrial Revenues

The Company proposed 75 adjustments to the revenues received from industrial customers, 69 of which primarily involved rate schedule changes and occurred within the test year. The remainder were post-test year. The Company and the Division testified that these are appropriate. The Committee opposed them. There is little basis on this record by which in-period annualization adjustments can be clearly distinguished from post-test year ones. Therefore, the Commission finds that the annualization adjustments are acceptable, and will permit a \$72,000 increase in revenues.

2. Promotional Advertising

The Company testified that \$309,000 in test-year promotional advertising expense should be recovered in rates because, it was asserted, the advertising had resulted in increased revenues well in excess of the expense. In the Company's view, this was a ratepayer benefit. The Division and the Committee both argued that the Company had asserted but failed to demonstrate a causal connection between promotional advertising and additional revenues, and in no other way had suggested a benefit sufficient to permit recovery of the expenses in rates. The Commission notes that R750-406-1 prohibits recovery of promotional advertising expenses from ratepayers, unless, under subsection C of that rule, it finds such advertising to be in the public interest. In this instance, the Company has sought to equate what it characterizes as the ratepayer benefit of speculative increased revenues with the public interest. This is not sufficient.

The Commission finds that the Company has failed to demonstrate that its promotional advertising is in the public interest sufficiently to qualify for a subsection C exemption from the R750-406 prohibition and will therefore reduce the Company's expenses by \$309,000.

We further find that the Company did not demonstrate that its promotional advertising produced the additional revenues it alleged. Disallowance of these expenses, therefore, necessitates no change in revenues.

3. 1989 Labor Annualization

Mountain Fuel sought an adjustment in the amount of \$1,027,000 to bring labor and labor overhead costs to year-end 1989 levels. The Company argued that this adjustment is known and measurable, clearly meets annualization criteria, and is necessary to accurately reflect conditions expected during the period new rates will be in effect. The Division agreed with this adjustment. While not opposed to the adjustment per se, the Committee recommended that the adjustment should be \$799,000. The Company argued that the Committee failed to consider the effect annualizing wages to December levels has on overtime pay, on-call pay, and stock plan benefits, among other things. **The Commission finds that this Company-proposed adjustment is appropriate and that it results in an increase of test year expenses of \$1,027,000.**

4. Questar Corporation/Massachusetts Formula

The Company allocated unassigned general corporate costs to Questar Corporation subsidiaries using a three-factor "Massachusetts formula" which assigns equal weight to relative levels of gross plant, labor and gross revenues. The Division recommended that the net revenue version of the Massachusetts formula, established by the FERC in Order 291, be employed in this docket in order to remove gas costs from the revenues of Mountain Fuel and other subsidiaries, thus eliminating a duplication arising from the pass-through of gas costs. The Division argued that Order 291 was not case specific, but was applicable generally. The Committee recommended use of a general allocation factor of 40.46

prevent general corporate overhead costs from being overallocated to the Company. The Commission finds that the gross revenues formula over-allocates general corporate costs to the Company, that the net revenue formula is a better means of allocating such costs, and, accordingly, will adopt the Division's position, resulting in a \$575,000 decrease in expenses.

5. Questar Services 1989 True-Up

Mountain Fuel sought an adjustment of \$40,000 to reflect the January, 1990 adjustment of test-year Questar Service Corporation charges. The Company argued that the adjustment is necessary to correct a mistake in the December, 1989 billing. The Division did not oppose the adjustment. The Committee argued that the adjustment should be treated consistently with past January true-ups for Mountain Fuel and disallowed. The Commission finds the adjustment acceptable and will allow the \$40,000 increase in expenses.

6. Interest Synchronization

The Committee proposed an interest synchronization adjustment to provide equal treatment to customers of Option 1 and Option 2 utilities. The Committee alleged that failure to adopt the adjustment for Option 1 utilities (such as Mountain Fuel) would result in a higher revenue requirement for the Company and rate discrimination against Option 1 ratepayers.

The Company argued that it will violate federal law if it applies interest synchronization and will thereby risk tax penalties. In addition, the ratepayers will risk having the amount of

the forfeited tax credits added to rate base. The Division likewise rejected the adoption of the interest synchronization method arguing that it applies only to IRS Code Section 46(f)(2) companies while Mountain Fuel is a 46(f)(1) company. Adoption of the adjustment would penalize the Company at the same time its revenue requirement is already lower than a 46(f)(2) counterpart entity.

The Commission finds that the interest synchronization method proposed by the Committee is not applicable to Mountain Fuel and, therefore, rejects the proposed adjustment.

7. South Georgia Amortization

Mountain Fuel proposed to use the South Georgia method to reflect flow-back of underdeferred tax expenses. The Company argued that this method is consistent with IRS regulations and results in the lowest impact on rates. The Division agreed that this method is appropriate and testified that the Company could lose a \$45,000,000 adjustment to rate base if it is not allowed to use this method. The Committee testified that the South Georgia adjustment increases revenue requirement, is not required by the Internal Revenue Code, is merely one method used by FERC for certain utilities, and should be rejected because the Company has not demonstrated that it is required.

The Commission finds that the South Georgia method is appropriate and will allow the resulting \$921,000 increase in expenses.

8. Environmental Clean-Up

The Company sought to include in this case certain environmental cleanup expenses incurred at its Salt Lake North Operation Center. The Company argued that such cleanup expenses are appropriately recovered in rates because they are normal, ongoing expenses of the Company. The Division agreed with the position of the Company. The Committee, however, argued that such costs are extraordinary, non-recurring and not a normal part of utility operations. The Committee pointed out that these cleanup costs relate to contamination caused from 1908 to 1929 by Utah Gas & Coke Company's coal gasification activities, and, therefore, relate to prior service periods and prior customers. The Committee suggested that to allow such costs today would be a violation of the rule against retroactive ratemaking.

In our Order in Case No. 84-057-07, we said that the failure of the Company to recover certain expenses in the cost of service constitutes a risk of conducting utility business for which the utility is compensated when a rate of return is established for invested capital. However, we are cognizant of the fact that this cleanup was necessitated by government regulation enacted long after the events causing the contamination. We consider that such burdens may be placed upon the Company by government's changing environmental views from time to time and believe that in this instance it is an unavoidable expense for an energy utility. Therefore, the recommendation of the Committee to disallow these expenses is rejected.

9. Brewery Property

The Division proposed a rate base and depreciation expense adjustment for that portion of an acquired piece of property, called the Brewery property, which was in excess of what the Division testified was its fair and reasonable value. The Committee supported the Division's proposed adjustment, modified to reflect an average rather than year-end rate base.

The Company obtained this property through an exchange of other properties involving a Questar Corporation affiliate company, Interstate Land Corporation ("ILC"). Mountain Fuel received the Brewery property along with a garage facility which had been constructed by ILC for the Company. ILC received five pieces of property which were either owned or purchased by Mountain Fuel. The Company proposed that the transaction be evaluated by considering the land priced at market value and the garage and related facilities at depreciated book value. The Company argued that the latter was justified owing to the specific purpose of the facilities and their construction for the Company's utility operation. In addition, the Company proposed that the valuation of its Sunnyside property, one of the five exchanged in payment for the Brewery property, should reflect the Company appraiser's revised assumption of 30 condominium units per acre, decreasing its value in the transaction.

Both the Division and the Committee argued that the valuation of the Brewery property was too high, while that of the Company's Sunnyside property, given an exchange for the Brewery property, was too low. According to them, the key to the exchange

length. The Division offered an adjustment that valued the transaction at the average of the original appraisals performed by the Company and ILC. It further justified the Brewery property and improvements average appraisal by calculating the depreciated book value of this asset transferred from the affiliate to the utility and arriving at essentially the same value.

The Commission is of the view that transactions involving affiliates place ratepayers at a disadvantage that can never be entirely controlled or offset. For that reason it is generally appropriate to allow transfers of property from affiliates to the utility at the lesser of book or market and transfers going the other way at the greater of book or market. We find that Mountain Fuel's property transferred to an affiliate should be valued at the greater of market or book, while that transferred from an affiliate to Mountain Fuel should be valued at the lesser of market or book. We further find reasonable the Company's proposed valuation of the Sunnyside property on the basis of 30 condominium units per acre. Therefore we will accept the Division's adjustment as modified by the Sunnyside changes. These decisions result in two adjustments, a decrease in depreciation expenses of \$23,000 and a decrease in rate base of \$923,000. We would note that if the Company had sought Commission approval of these affiliate transactions at the time they took place, which approval is required under our 1984 Order approving the reorganization of Questar Corporation, Docket No. 84-057-10, it would have been in a better position to justify its actions and/or provide additional data where its position was inadequately supported.

10. Affiliate Rate of Return

All parties agreed that affiliate transactions involving Mountain Fuel should be based on this Commission's authorized rate of return on equity. Having determined in this docket that the rate of return on equity allowed is 12.1 percent, the Commission therefore finds that an adjustment to expenses of \$42,000 is appropriate.

11. Affiliate Transaction Disallowances

The Committee recommended that the Commission impose a disallowance of not less than 10 percent of the 1989 test-year affiliated transaction charges billed by Questar Corporation and Questar Services Corporation to Mountain Fuel. The Committee based this recommendation on the Commission's Order in the U S WEST Communications, Inc. case, Docket No. 88-049-07, in which it was determined that the Company has the burden to justify its affiliate transactions. The Committee argued that Mountain Fuel had failed to meet this burden. The Division opposed the penalty and testified that, based upon its extensive audit review, there was not evidence that the transaction charges were inappropriate. The Division also stated that the Company had readily provided requested information about its affiliate transactions.

Were it not for the testimony of the Division, we would conclude that the Company's affiliate transactions had not been justified on this record. Regulatory oversight, however well performed by the Division, will not displace utility management's responsibility to meet its burden in future proceedings. We find

the disallowance recommended by the Committee. We also find that the burden to justify affiliate transactions is, and must always be, the utility's.

D. Cash Working Capital

1. Lead/Lag Study Results

The basis of the cash working capital requirement is the Company's lead/lag study. The study contains ten broad categories of revenues and expenses, and each category is associated with lead/lag day. The study calculates a net composite lead/lag day as an average of the individual lead/lag days weighted by the dollar amount in each respective category. An average daily cash working capital requirement is obtained as the product of the net composite lead/lag day and cost-of-service, divided by 365 days. There are two disputed issues concerning the lead/lag study. The first is the revenue lag day associated with delinquent accounts and the second is the expense lead day associated with income tax payments.

a. Delinquent Accounts

The Company testified that the delinquent account balance was an average for the entire year and therefore a revenue lag of 365 days should be employed. The Division took issue with the Company's use of a 365 revenue lag day. The Division testified that due to the lack of quantifiable information caused by the Company's exclusion of delinquent accounts from its statistical sampling method, it is appropriate to use a revenue lag day determined as an average of the number of days the accounts were delin-

The Committee recommended that delinquent accounts be removed from the lead/lag study. The Committee argued that Mountain Fuel's proposal is inconsistent with the treatment requested in its recent Wyoming rate case. In addition, the proposal is deficient in that it fails to accurately measure the impact of delinquent accounts by overlooking offsets such as the customer-contributed capital available from the accumulated provision for uncollectible accounts.

The Commission finds that the analyses of this issue by the Company and the Committee are not satisfactory and that the proposal of the Division is the most reasonable. Therefore a revenue lag of 125.39 days associated with delinquent accounts should be applied in this case.

b. Income Tax Payments

Mountain Fuel proposed an expense lead day associated with income tax payments, computed from actual 1989 historic test year payments. The Division based its factor on statutory due dates and a June 30th test year mid-point. According to the Division, the expense lead day associated with income tax expenses should not be based on actual results which are the product of Company estimates but should be based on a fixed payment schedule throughout the year. The Division argued that the Company's estimates unnecessarily increase cash working capital. The Committee supported the Division's proposal. The Commission finds, consistent with its decisions in prior cases, that it is appropriate to use statutory due dates to determine the expense lead day

and therefore an expense lead of 59.32 days should be applied in this case.

c. Adjusted Lead/Lag Study Results

The Company adjusted its lead/lag study to incorporate Commission findings concerning revenue and expense adjustments and findings with respect to the lead/lag days associated with delinquent accounts and income tax payments. The Commission finds reasonable the adjusted lead/lag study which results in a cash working capital requirement of \$2,824,000.

2. Compensating Balances

The Company proposed to include in cash working capital the cash balances required to maintain lines of short-term credit and cash funds for other administrative purposes. The Company argued that these cash balances are assets necessary to the operation of the Company and therefore a return on such balances should be allowed. The Division argued that there should be no addition to rate base for compensating balances because investors know that funds are required for administrative purposes and their return on equity expectations already reflect this understanding. The Committee agreed with the Division that compensating cash balances should not be allowed as a component of cash working capital. The Commission finds, consistent with its decisions in prior cases, that it is not appropriate to include compensating cash balances in the determination of cash working capital and therefore rejects the Company's proposal.

3. Require Payment in 23 Days

The Division proposed to reduce the Company's cash working capital requirement as a result of its proposal to modify the Company's billing practices by requiring customer payment within 23 days after the billing date. According to the Division this reduction in payment period would produce an annual savings in revenue requirement. The Company argued that the proposed adjustment is not known and measurable and the modification to its billing practices would require the addition of employees and equipment, and would not be favorably perceived by its customers. The Committee testified that the Division's proposal would be appropriate only if the 23-day period was fully reflected throughout the determination of cash working capital. The Commission finds that the proposal is insufficiently developed in this case and will not adopt it at this time. We may revisit this issue after the task force currently addressing these issues submits its report.

E. Rate of Return

1. Rate of Return on Equity

The position the Company took in this docket is that a return on common equity above 13 percent is required by investors. This was the conclusion of its witness, Dr. Williamson, who analyzed a sample of comparable companies primarily by application of a discounted cash flow (DCF) model to a sample of representative gas distribution utilities. He supported this analysis with capital asset pricing model and risk premium tests, and a study of

Williamson's sample consisted of eight companies which he determined had operational and risk characteristics similar to the Company's. Size, service territory degree-days, proportion of distribution operations, and availability of information were the factors used to select the sample. To estimate expected growth, a key component of the DCF analysis, Dr. Williamson relied on security analysts' estimates of earnings growth rates. Forecasted growth, added to estimated dividend yield, which he based on next year's dividend, and applied to the sample companies, then checked by the Hope and Bluefield and risk premium analyses, yielded the recommendation. In prefiled testimony, Dr. Williamson's estimate of the required return was 13.5 percent. At hearing's end, the Company advocated a return above 13 percent.

Division witness Eatmon recommended a 12.0 percent required return on equity. Mr. Eatmon relied on the DCF method, applying it to several different samples of comparable companies. His estimate of the DCF growth component was based on forecasts of earnings and dividend growth rates, equally weighted. For dividend yield, he selected 12-month average stock prices, after reviewing market prices for periods of one, three, six, and twelve months, and employed an estimate of the next period's expected annual dividend. Application of the DCF model to the comparable companies resulted in an 11.6 to 12.4 percent range of reasonable estimates of investor required returns. Mr. Eatmon recommended 12.0 percent.

The Committee and Nucor Steel jointly sponsored the testimony of Dr. Marcus on these issues. Dr. Marcus's DCF analysis of comparable companies led to his recommendation of 12.2 percent as the cost of equity capital

These witnesses were in agreement that Mountain Fuel Supply's actual capital structure should be used in this proceeding. Though the Company is a subsidiary of a holding company, each testified that the actual capital structure could be measured in an acceptable manner and would be appropriate to derive the overall cost of capital.

We can only determine the cost of capital indirectly, by assessing expert opinion about the rate of return investors can be expected to require if they are to purchase equity shares. This required market rate of return is hypothetical and is estimable only through a conscientious, fair-minded exercise of judgment.

Our decisions must afford the utility the opportunity to earn a fair rate of return. This is a return which will maintain the utility's credit standing and allow it to attract additional capital, thus assuring its financial integrity. Also, this return would allow it to achieve earnings comparable to companies of similar risk. Such standards guide our decisions and are well known. At the heart of our considerations, however, is the presumption of an efficient, effective management.

The rate of return must not be set so high as to exploit consumers, however. Thus, the concept of a fair rate of return suggests a range or a zone of reasonableness. A return permitted within this range will be just and reasonable; earnings within the range will not be insufficient for the Company or harmful to consumers. We must balance the interests of owners and customers.

On this record, expert witness testimony places the fair rate of return at 12.0, 12.2, or 13.5 percent, estimates drawn from

somewhat broader. One hundred-fifty basis points separate the three point estimates. Each basis point amounts to \$23,000 of revenue requirement.

The evidence shows, and the parties themselves agree, that each witness testified credibly. Widely accepted techniques, though primarily the DCF model, frame their analyses.

The principal value of the DCF or other models presented on the record is the delimitation and organization of relevant information. Sophisticated extension and elaboration of the models is of doubtful value since it can only obscure the subjectivity, the careful Commission judgment, that is the deciding factor. In this case, the presentation of the models has been straightforward, without suggestion of an unrealistic precision.

Our orders in recent rate cases reveal growing reliance on the DCF method. It is acceptable because it is understandable, its basis in theory reasonable, its components estimable in our proceedings, and perhaps above all, its results reliable under a variety of circumstances. The same cannot be said of the capital asset pricing model, which in our proceedings seems immersed in doubt. The technique is of questionable reliability and more often than not has been employed to support a rate of return recommendation much higher than indicated by DCF results. As with the risk premium approach, measuring the components is problematical. While the DCF method is not free of problems, including circularity--regulation authorizes earnings, which influence dividends per share, from which yield is determined and the growth rate is estimated, all then resulting in calculated equity cost--the

view typically fall within a narrow range and we have been able to assess their disagreements. We therefore reaffirm a previously stated determination to place little reliance on other methods. (See Report and Order, Docket Number 88-049-07, October 18, 1989, pp. 65-67.)

Our first concern is the estimation by the witnesses of the DCF variables and the samples of comparable firms to which the method is applied. Secondly, we will consider other influential factors.

The discounted cash flow method estimates the investor's capitalization or discount rate, the cost of capital, as the sum of the dividend yield and the expected dividend growth rate. Current dividend per share is divided by current market price to obtain dividend yield. There is some disagreement concerning the proper dividend and price to use, but the more significant disputes arise over the estimation of the dividend growth rate.

In theory, the DCF model requires a dividend yield calculated for the point in time that cost of capital is determined, that is, current annual dividend divided by current market price. Short-term fluctuations in market price can affect the cost of capital determination unduly, however, so each witness used a price averaged over a period of time determined to be representative. The dividend used was adjusted to reflect the next period's expected annual dividend by each witness, but the Committee and the Division witnesses both criticized Dr. Williamson's next period yield adjustment as unsupportably high.

The estimation of a dividend growth rate is problematical

used earnings growth rate forecasts as the basis for his dividend growth rate estimate. He described DCF as working best "when both earnings and dividends are in a smooth upward trend and when forecasts of growth are consistent," and asserted this was true for his sample of eight companies. Both Committee and Division witnesses criticized his approach. Dr. Marcus analyzed historic growth patterns, growth in retained earnings, and reviewed analysts' opinions in his effort to estimate expected dividend growth rates. He asserted that Dr. Williamson had been unduly influenced by analysts' opinions and had not analyzed historic growth behavior. Moreover, two firms in the Williamson sample of eight show unrealistically high growth rates, 22 percent for one and 15 percent for the other. Division witness Eatmon estimated a dividend growth rate based on both earnings and dividend growth forecasts. He testified that the Company used unrealistic earnings growth projections as the basis for its DCF dividend growth rate. Both Division and Committee witnesses recommended rejecting this aspect of Williamson's DCF analysis, and stated this would bring the Company's DCF result down from 13-14 percent to near 12 percent, virtually the same as they had obtained.

Each witness applied the DCF model to sample companies, but differed as to the correct sample. According to Dr. Marcus, comparable firms are few in number and the use of reasonable measures of risk resulted in a sample that was too small to be useful. He therefore used the Moody's gas distribution group of firms, abandoning a risk analysis. Dr. Williamson employed several measures of risk and comparability to select his eight-company sample. All but one of these measures gave the same result, the

Moody's group, according to Dr. Marcus, and use of the size measure results in a different sample. Dr. Marcus criticized the use of size as a measure and asserted that no systematic relationship between size and risk exists. He also questioned Dr. Williamson's use of degree-days as a risk factor, stating that whether fewer degree-days correlates with lower risk depends upon volatility of weather and a utility's ability to deal with it. Such an analysis was not presented. Division witness Eatmon examined several samples, including one consisting of 'A' rated companies. The Division argued Dr. Williamson's sample did not yield reasonable results, whereas the Division's more encompassing analysis did. The main problem identified with the Williamson sample, according to the Committee, is the inclusion of one company with a DCF cost of capital estimate of 25 percent. It was asserted that a company having a market-required return of 25 percent bears no relation to Mountain Fuel Supply and does not belong in a sample.

We can only accept Dr. Williamson's DCF results in part. The critique offered by the Division and the Committee witnesses is persuasive in three important respects. First, the adjustment to bring the dividend to the next period is excessive. Second, the sample of firms contains at least one company that, arguably, is not comparable, producing an upward bias in the dividend growth rate estimate. And third, reliance upon earnings growth rate forecasts to estimate the dividend growth rate also imparts an upward bias. A cost of equity estimate near those of the other two witnesses is obtained when corresponding adjustments are made. On this basis, we find the cost of equity to be 12.2 percent.

There are reasons why the cost of equity obtained from a model may differ from a fair rate of return allowance. Where we wish to compensate for outstanding management performance, or to provide an incentive for efficiency, or to compensate for extraordinary risk, we can do so by setting a return greater than the minimum cost of equity. The converse of this is also true. We can adjust where we have reason to believe management has not adequately met its public service obligations.

The record contains no evidence suggesting that Mountain Fuel Supply Company is either more or less risky than comparable gas distribution companies, and Dr. Williamson so testified. Nor is there any evidence suggesting that the Company suffers from attrition; i.e., the adverse effects of inflation to which management is unable to adjust. The record suggests, though without benefit of systematic examination, that Company management has performed very well in most respects. In two areas, however, affiliate relationships and gas supply planning, we take issue with the management of the Company's parent, Questar Corporation.

The record shows that this company has organized and reorganized during the 1970s and 1980s in order to capitalize on market opportunities, to simplify its relationship with federal and state regulatory entities, to clarify its activities for shareholders, and for other reasons best known to management. In 1984, docket number 84-057-10, we permitted the formation of a holding company structure, with the utility we regulate as a subsidiary. This approval was conditional, however, and the conditions were to ensure that we could continue to regulate the utility in the public interest. Evidence on this record, however, strongly suggests a

deliberate shift of risk from Questar Corporation operations generally to the distribution utility and thence to its core customers. Affiliate relationships have constrained and inhibited the pursuit of least-cost gas supply by the distribution utility. Though Questar Pipeline Company's rates and rate structure can adversely affect the distribution utility and its core customers, the utility has never intervened to represent these interests at FERC cases where such rates are determined. We find no convincing evidence of an attempt to simulate an arms-length relationship with Questar Corporation subsidiaries, or better, to deliberately overcome the inherent lack of such a relationship. The chief case in point is the assumption by an affiliated company having interests demonstrably different from the utility's of the utility's gas supply planning, acquisition, and dispatch functions. These issues are all discussed at greater length in Section III, pages 34-43. In our judgment these actions do not protect the interests of the utility's customers. We determine, therefore, to impose an adjustment in the form of a reduction in the allowed rate of return of 10 basis points.

In summary, we find that the utility's cost of equity capital as determined, in the main, by various discounted cast flow analyses, is 12.2 percent. The equity rate of return which we find to be just and reasonable, is 12.1 percent.

2. Capital Structure and Rate of Return on Rate Base

The cost of capital may vary with the debt-equity ratio. For this reason and others, we have at times adopted a hypothetical

suggested by sample companies. This capital structure would insulate utility customers from the potentially adverse effects of subsidiary operations, from management financial decisions that might increase the cost of obtaining capital, and from the problem of measuring an actual capital structure for a utility that is a subsidiary of a holding company. Adoption of a hypothetical capital structure is an adjustment similar to the disallowance of any unreasonable expense. There are, however, arguments to be considered why a hypothetical capital structure should not be adopted.

In the present docket no witness has opened the door to these difficult matters. Each testified that the utility's actual capital structure should be used to determine the overall rate of return. It was also clear on the record that the Company's actual capital structure was within the range of hypothetical capital structures calculated from a reasonable sample of companies. All parties used the same capital structure component weights and costs, with the exception of the cost of equity capital, to derive the overall rate of return recommended. Substituting the cost of equity we have determined to be reasonable, 12.1 percent, produces an overall rate of return of 11.03 percent. We find this rate to be fair, just and reasonable. We will note, however, a concern with the costs of debt and preferred stock in this capital structure, and request the Division to conduct an examination to determine if these costs might be reduced.

F. Revenue Requirement Summary

The following table summarizes the revenue requirement determinations reached in this proceeding. It presents the derivation of a revenue requirement deficiency of \$76,000.

**SYSTEM COST BY FUNCTION
ADJUSTED TEST YEAR ENDED DECEMBER 1989
MOUNTAIN FUEL SUPPLY COMPANY
(\$000)**

| <u>OPERATING EXPENSES</u> (1) | <u>TOTAL RATE BASE</u> (2) | <u>TOTAL COSTS</u> (3) | <u>PRODUCTION</u> (4) | <u>WYOMING</u> (5) | <u>UTAH</u> (6) |
|---|---------------------------------------|-------------------------------|--------------------------|-----------------------|--------------------|
| 1. Operation & Maintenance Expenses | | 76,297 | 2,308 | 3,708 | 70,281 |
| 2. Depreciation, Depletion & Amortization | | 17,215 | 3,716 | 765 | 12,734 |
| 3. Taxes (Excluding Income Taxes) | | 7,801 | 113 | 462 | 7,226 |
| 4. Colorado Credits | | (353) | (353) | | |
| 5. TOTAL OPERATING EXPENSES | | 100,960 | 5,784 | 4,935 | 90,241 |
| 6. FEDERAL INCOME TAX (Distributed on Rate Base Basis) | | 13,204 | 2,295 | 708 | 10,201 |
| RETURN (Distributed on Rate Base Basis) | | | | | |
| 7. Production | 52,745 | 5,818 | 5,818 | | |
| 8. Distribution - Wyoming | 16,279 | 1,796 | | 1,796 | |
| 9. - Utah | 234,462 | 25,860 | | | 25,860 |
| 10. TOTAL RETURN @ 11.03% | 303,586 | 33,474 | 5,818 | 1,796 | 25,860 |
| 11. System Non-Gas Costs | | 147,638 | 13,897 | 7,439 | 126,302 |
| 12. Utah percent = > | | | 95 21% | 0 | 1 |
| 13. Utah costs = > | | 139,533 | 13,231 | 0 | 126,302 |
| 14. TOTAL UTAH REV | | 139,457 | | | |
| 15. UTAH DEFICIENCY | | 76 | | | |

III. DISCUSSION, FINDINGS, AND CONCLUSIONS
WITH RESPECT TO GAS SUPPLY

A. The Gas Supply Function

The Division's consultants, Theodore Barry and Associates ("Barry"), performed a qualitative examination of the management and technical aspects of the gas supply planning and related activities of Mountain Fuel Supply and its affiliates. The Committee's consultants, Exeter Associates ("Exeter"), reviewed the gas supply procurement arrangements of Mountain Fuel for consistency with a least-cost acquisition strategy.

The gas supply function can be segmented into four inter-related areas: load forecasting, design day analysis, gas supply planning, and gas supply dispatch. Mountain Fuel's Forecasting and Load Research Department develops both load forecasts and design day estimates. Beginning with the 1990 planning cycle, Mountain Fuel has stated these forecasts will normally be for ten years.

According to Barry, the management process involved in load forecasting and in formulating the design day estimate appear to be reasonable and consistent with industry practice. Further, Mountain Fuel does do a reasonably good technical job of forecasting the loads of the residential sector. Because the residential sector is its most important load, Barry concluded that it is likely that Mountain Fuel's cost of service is not substantially higher than it would be with better gas load forecasting. In addition, the technical considerations of design day for Mountain Fuel as a distribution utility are rather straightforward such that either the design day issue does not really exist at the Mountain

Fuel level or it is significantly less of a technical issue than it is at Questar Pipeline Company.

Questar Pipeline develops and prepares a gas supply plan for all gas to be delivered to Mountain Fuel under the terms of the Gas Supply, Odorization and Operating Services Agreement between Mountain Fuel and Questar Pipeline. The written policy of Questar Pipeline filed at the Federal Energy Regulatory Commission ("FERC") essentially says that Questar Pipeline will use its best efforts in consideration of all its operating and contractual requirements to provide its jurisdictional customer, Mountain Fuel, with reliable supplies at the lowest achievable cost.

Mountain Fuel has two sources of gas supply, its own production and contract purchases from Questar Pipeline at rates established by the FERC. Mountain Fuel is Questar Pipeline's only sales customer and Questar Pipeline is the only source of contract purchases for Mountain Fuel. Mountain Fuel's own production is operated by WEXPRO, a Questar affiliate, under the terms of the WEXPRO Agreement. For planning purposes, WEXPRO supplies Mountain Fuel with reserve and deliverability estimates of Mountain Fuel's own production. Mountain Fuel determines the quantity of such reserves expected to be produced by WEXPRO during the planning period.

Mountain Fuel supplies its gas load and design day forecasts, along with the desired production from Mountain Fuel's own sources to Questar Pipeline. Questar Pipeline incorporates the Mountain Fuel information with Questar Pipeline data relating to reserves, deliverability, and contractual requirements of purchase gas sources. The latter includes Colstrip, Bannock, and...

("Celsius"), an exploration and production subsidiary all of whose production is purchased by Questar Pipeline for resale to Mountain Fuel.

Questar Pipeline determines a gas supply plan using an economic optimization model, the Gas Contract Analyzer ("GCA") model. The gas supply plan is returned to Mountain Fuel for review, further modification, and ultimate agreement with Questar Pipeline. Questar Pipeline then implements the plan by means of a non-optimization model, the Gas Dispatch and Cost (GDC) model. Mountain Fuel monitors the implementation of the plan through monthly written reports and review meetings and daily dispatch review meetings.

According to Mountain Fuel, the GCA model is used to develop strategy to deal with uncertainty by undertaking sensitivity studies and analyzing contingencies. Mountain Fuel claimed the model is not well suited for the development of an annual gas supply plan and there is not a focus on one specific GCA result as an optimized solution to be replicated by the GDC model.

Both Barry and Exeter claimed that Questar Pipeline's use of the GCA model did not provide a least-cost gas supply plan, that Mountain Fuel personnel did not possess a technical understanding of the GCA model and its use by Questar Pipeline, and that Mountain Fuel management lacked oversight and control of Questar Pipeline. They also stated that Mountain Fuel's lack of oversight of its pipeline supplier and the fact that it does not purchase either spot or other market gas is relatively unique in the industry.

According to Barry, the gas dispatch performed by Questar Pipeline for Mountain Fuel is quite good in that the dispatch

instructions developed by the GDC implement well what the GCA calculates to be the gas supply plan.

Although disputed issues remain among the parties concerning the gas supply planning function, the Commission finds that possible improvements in the load forecasting, the design day estimate, and the gas dispatch functions, while desirable, are unlikely to substantially reduce the annual costs of gas supply.

B. Corporate Organization and Affiliate Relations

The current form of corporate organization reflects the corporate objective of reducing what it views as duplicative regulation, with Mountain Fuel subject to regulation by this Commission, its sister affiliate Questar Pipeline subject to regulation by the FERC, and WEXPRO, unregulated.

Mountain Fuel contracts with Questar Pipeline and WEXPRO are effectively cost-plus contracts. The only oversight Mountain Fuel has of Questar Pipeline is through FERC regulation and two independent monitors provide oversight of WEXPRO.

Mountain Fuel stated that decisions regarding gas supply often involve conflicts between the interests of Mountain Fuel and Questar Pipeline. When such conflicts of interest do arise, they are resolved within Questar Corporation. Since disputes are effectively resolved by the corporate parent, independent arms-length transactions and adversarial relationships cannot be expected to occur among affiliated economic entities.

Mountain Fuel further stated that any major proposal that Questar Pipeline makes at the FERC is the result of internal

only one of which is Mountain Fuel. The proposals it makes at the FERC are the result of internal consensus and attempt to balance the interests of the various entities involved, including the shareholders of Questar Corporation.

Recent Questar Pipeline cost-of-service and rate design issues at the FERC have resulted in a shift of costs from other customers of Questar Pipeline to Mountain Fuel. Mountain Fuel has never participated at FERC in a Questar Pipeline rate proceeding. The Division, not Mountain Fuel, intervenes at FERC on behalf of Mountain Fuel's ratepayers.

Based on the foregoing, the Commission finds that the current organizational structure of Questar Corporation and pattern of regulation provide an opportunity for Mountain Fuel to bear a disproportionate share of the risks facing Questar Corporation and, in particular, for Questar Pipeline to subsidize its activities in other markets by shifting costs to Mountain Fuel. Further, inter-affiliate agreements and regulatory oversight of affiliates are not a substitute for utility management oversight and control.

C. The GCA Gas Planning Model and its Use by Questar Pipeline

The objective of the gas supply plan provided by the GCA model is to minimize the net present value of gas acquisition costs consistent with supply reliability over the planning horizon. The model is limited by a number of operational requirements and constraints, and the forecast information available to the company at the time the plan was prepared. Operational requirements and constraints include the use of Mountain Fuel's own production,

must-take purchase contracts with Questar Pipeline, and the use of Questar Pipeline storage.

Mountain Fuel's own production is not subject to optimization within the model but is exogenous to the model. Mountain Fuel stated what it has done is consistent with the stipulation reached with the Division. Mountain Fuel stated that in the future it would like to investigate the modeling of economic optimization of its own production.

Exeter agreed with the testimony of Division witness Darrell Hanson concluding that prices of gas obtained under the WEXPRO Agreement compare favorably with alternative sources. However, Exeter expressed concern that Mountain Fuel has little control over when WEXPRO decides to develop new wells and the supply of gas forthcoming from such wells in relation to Mountain Fuel's demand needs and other supply options.

The GCA models all gas supplies as contracts requiring the aggregation of data describing approximately 1,700 individual wells into 30 contract or well groups for use by the GCA. The data provided to Barry by Questar Pipeline segmented wells on the basis of load factor thus preventing the GCA model from optimizing across well groups with respect to price. Mountain Fuel claimed the data provided to Barry was in the process of being updated for use by a new version of the GCA. No party disputed the need for segmenting well groups on the basis of price as well as load factor.

Originally the GCA model did not treat take-or-pay issues. Mountain Fuel designed a method for modeling take-or-pay in which the objective is to reduce Questar Pipeline's exposure to

take-or-pay penalty rates in order to constrain the model to deal with must-take sources of gas supply, thus passing take-or-pay liabilities of Questar Pipeline on to Mountain Fuel. There is no provision in the GCA model which allows a buy-out or buy-down of take-or-pay liabilities.

Spot market purchases were effectively eliminated as a feasible alternative since, if a unit of spot gas is taken, the full amount of the the take-or-pay liability on the gas that is not taken must be paid in full.

The model constrains the use of storage consistent with FERC-imposed dates that permit Questar Pipeline to take and replace gas from storage. Questar Pipeline provides storage as a part of firm sales or transportation service. Questar Pipeline's storage costs are recovered in FERC firm sales (CD-1) and transportation (T-1) rates. Questar Pipeline does not provide unbundled storage service.

Since Questar Pipeline does not offer unbundled storage, the model does not contain as a feasible alternative Mountain Fuel purchases from independent third parties with Questar Pipeline providing transportation and storage service. The sole source of gas supply to Mountain Fuel beyond its own production is Questar Pipeline. The Kern River and WyCal pipeline proposals are not considered feasible sources of supply due to the low load factor of Mountain Fuel's demand and the need for storage to serve such a low load factor customer. Although FERC determines the timing of storage use and the method by which storage costs are recovered in rates, such determinations can be changed in future FERC

Actual historical data was not available to Barry thus preventing Barry from quantifying the effect on gas costs of operating in a manner different from that modeled by Questar Pipeline. Further, no party recommended an adjustment to revenue requirement as a result of analyzing the GCA model and its use by Questar Pipeline.

The Commission finds that the use of the GCA model by Questar Pipeline may not provide a long term least-cost integrated resource plan. The Mountain Fuel contracts with Questar Pipeline and WEXPRO are cost-plus contracts, and are not the result of arms-length transactions but result from a single economic interest. Mountain Fuel's own production and contract purchases from Questar Pipeline are the only sources of gas supply treated in the GCA model. Economic optimization of Mountain Fuel's own production is lacking. The GCA model excludes FERC reconsideration of take-or-pay liabilities or use of storage over the planning horizon. Finally, spot market and independent third party sources are not supply options, and demand side considerations are absent.

D. Conclusions

The Commission finds that the current practice of the gas supply planning and purchase functions residing within Questar Pipeline is not in the public interest.

We recognize that there may be problems with implementing these functions within Mountain Fuel. The current unavailability of unbundled storage and transportation in the tariffs set by FERC for Questar Pipeline is one such problem which comes immediately to

implementing changes in the gas supply planning and purchasing functions.

The Commission has two primary goals in consideration of the gas supply planning function. The first goal is to create a method which duplicates arms-length transactions between Mountain Fuel and the Questar family of companies. The second goal is to design a method, for the long term, to provide the lowest priced gas supply to Mountain Fuel ratepayers without any regard to corporate structure or the needs of the corporate parent or affiliates. In light of these goals, the Commission finds that the gas planning function of Mountain Fuel should be moved from Questar Pipeline to Mountain Fuel.

Two events present an opportunity for Mountain Fuel to be considering what its future options are: 1) take-or-pay liabilities or take requirements that present take-or-pay liabilities come to an end in the 1993-94 timeframe; and 2) complete deregulation of gas occurs in 1993. A review of a long-term least-cost integrated resource plan for Mountain Fuel cannot be made in 1993 when Questar Pipeline has already made commitments to continue to fulfill its function and responsibilities to Mountain Fuel. Therefore the Commission finds that Mountain Fuel is to provide a long-term least-cost integrated resource plan within six months for review by the Commission and other interested parties. Mountain Fuel is to provide the funding necessary, as pre-approved by the Commission, to allow the Division and the Committee to contract with consultants for a management audit follow-up. The Commission will allow inclusion of such funding as an expense in the 191 Account.

The Commission further finds that a task force is to be established to consider the various issues that have arisen in this case. Issues to be considered shall include but need not be limited to the following:

1. How the gas planning function is to be returned to Mountain Fuel;
2. Recommendations of Barry concerning load forecasting, design day estimation, and gas supply dispatch;
3. Recommendations of Barry and Exeter concerning the use of the GCA model;
4. Cost/benefit analyses of relaxing model constraints;
5. Possible changes in FERC regulation necessary to increase the feasible options of Mountain Fuel and/or reduce the limitations of constraints including, among other issues, the availability of transportation service, the use of storage, the unbundling of storage service, the possible buy-down of take-or-pay liabilities, and the availability of spot market sources;
6. The investment incentives facing WEXPRO and the resulting economic impact on Mountain Fuel;
7. The maintenance of a historical data base and recommendations for annual review of gas supply decisions; and
8. The relevance and applicability of planning and dispatch models to the development of an annual gas supply plan for ratemaking purposes.

IV. DISCUSSION AND FINDINGS WITH RESPECT TO
RATE SPREAD AND RATE DESIGN

A. Stipulated Cost of Service and Rate Design

Cost of service and most rate design issues in this docket were resolved by a stipulation of the parties that we tentatively accepted on September 5, 1990, and finally approve with this order. A copy is appended.

B. Disputed Issues

1. General Service (GS) Rate Design

Three general service rate design proposals were presented which if accepted would alter customer charge and block elements of the rate. Currently, the rate consists of a \$5 customer charge and two declining blocks. Division witness Compton proposed to replace the two blocks with three in order to better track intra-class cost-of-service differences tending to harm larger customers. He also proposed a summer/winter differential in GS-1 rates based on seasonal gas cost differences. The Company proposed increasing the customer service charge to \$6. The Committee opposed both the Company's \$6 customer charge and, testifying on the importance of price signals for conservation, the Division's three-block recommendation, suggesting a flattened two-block structure instead. The Committee also opposed the summer/ winter differential, in part, on grounds that low-income households would be harmed by it.

Our rate design decisions are guided by a number of objectives including efficiency, conservation, equity, stability, and simplicity. We have described these at length in the past and

wish to say here only that the objectives may be in conflict at times. Cost-of-service based rates are an important means of attaining equity and efficiency, and, some would argue, conservation as well.

We have no desire to change rates just for the sake of having done it. In this docket, we must change them as to amount; structure is another matter. Rates for general service customers will go up for three reasons: increased commodity costs in the pass-through part of this proceeding (see Report and Order, Docket Nos. 90-057-02, 90-057-07, October 31, 1990); the stipulation redresses an inequity which shifts costs from interruptible transportation customers to general service customers; and a small increase in revenue requirement.

General service rate structure changes have been presented to us as proposals to make rates more closely conform to the costs of providing service, thereby addressing intraclass inequity and sending the proper price signals about seasonal variation in gas costs. These are small changes and not the only way to address the problem. They are also controversial proposals, and have in fact been opposed in this proceeding, including substantial opposition by public witnesses. They raise questions about which rate-making objectives might be attained and which not. For instance, not all parties define conservation in the same way and, given this, oppose a declining block rate, however much it may be cost-based. Rate stability is also a concern. Simplicity and understandability are also rate design objectives, and both would be confounded by the introduction of an increased customer charge, a

In our judgment, now is not the time to implement these changes. By accepting the stipulation on cost of service and rate design, we have resolved some matters and opened the door to others. We require a dispassionate examination of rate structure, which permits alternatives to be identified and analyzed. We find that the increase in customer charge, the change from a two-block declining rate, and the summer/winter differential should not be implemented at this time.

2. Utah Energy Office Proposal

The Utah Energy Office ("UEO") has proposed what it calls an "Energy Efficiency Tariff" for interruptible transportation ("IT") customers of Mountain Fuel Supply. In order to qualify for service under this tariff, IT customers would have to submit a brief plan committing three cents per decatherm of expected usage toward direct natural gas efficiency improvements. The UEO provided only general guidelines of how the proposal would be implemented, and this lack of specificity raised concerns among the various industrial intervenors who stated that the record was insufficient to support the need for and merit of the proposal.

The UEO based its proposal on two major premises. First, the current relatively low cost for transported gas does not provide sufficient incentives for energy efficiency measures or proper market signals as to the risk of significantly higher future gas prices. Second, since the IT customers may retain the option of returning to the system as interruptible sales customers at average cost pricing, they are not fully exposed to the risk of a sharp gas price increase. Both of these factors will lead the IT

customers to under-invest in energy efficiency/conservation to the potential future detriment of other customers and society in general.

The Commission recognizes the problem that existing market signals may not be sufficient to adequately provide long-term incentives for cost-effective investment in energy efficiency. They may also not promote global competitiveness of United States (or Utah) companies. This is a problem which must be addressed, both nationally and locally.

It is not clear, however, that the IT customers, with their relatively high load factors, will ever wish to return to interruptible sales customer status given the impact on average gas costs of the lower load factor GS-1 customers. The parties have agreed, and the Commission concurs, that this issue should be analyzed in a future proceeding.

The Commission has the statutory authority to encourage the conservation of resources and energy in determining just and reasonable rates under Utah Code Ann. § 54-3-1. Notwithstanding the sketchy nature of the Energy Office proposal, the Commission would perhaps have considered implementing it, or a similar proposal in this case were it not for the fact that we are adopting a cost-of-service stipulation in this case, signed by all parties including the Utah Energy Office. This proposal would alter the result of that stipulation which we have adopted. As we have indicated in Docket No. 90-2035-01, the least-cost planning proceeding for PacifiCorp, it is appropriate to address future capacity and energy needs during a period of relative excess supply

Similarly it is appropriate for the Commission to address future supply and demand issues, including efficient utilization of natural gas supplied or transmitted by Mountain Fuel Supply, during the current period of relative demand and supply balance in natural gas markets.

We commend the Utah Energy Office for bringing energy efficiency issues forward at this time. In the rate design portion of this order, we rejected GS-1 tariff concepts which would, perhaps, send a better signal to customers to invest in energy efficiency. This, not because the Commission rejects consideration of such concepts, but rather that a more comprehensive look at rates and energy efficiency is appropriate before the changes are made. We have elsewhere in this order determined that we will initiate an integrated resource planning effort for Mountain Fuel Supply. We hereby find that the Utah Energy Office proposal will not be adopted in this docket, but will request that the Utah Energy Office consider its proposal in the integrated resource plan context and participate in that process. The potential may exist for additional "windows of opportunity" for a program, such as the one proposed by the Utah Energy Office, in future cases. The Commission will require that it be analyzed within the broader implications of efficiency incentives for all ratepayers prior to implementation.

ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED that:

1. The Company file revised schedules and tariffs reflecting

calculated to result in annual revenues of \$139,533,000 and yield an overall annual return of 11.03 percent beginning December 1, 1990.

2. The stipulation proposed by the parties on cost-of-service and the rate design issues in this case is approved and adopted as appended hereto.

3. The Company henceforth assume and carry the burden of justifying all interaffiliate transactions that bear on rates and services in all future proceedings.

4. The Company's actual capital structure is adopted, but we order that the Division shall conduct an examination of that capital structure to determine whether or not the costs of debt and preferred stock can be reduced.

5. The gas-planning function presently performed for the Company by Questar Pipeline shall be transferred to the Company.

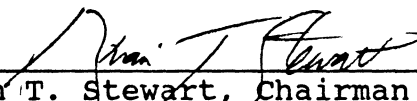
6. The Company shall provide the Commission, Division and interested parties with a long-term, least-cost integrated resource plan within six months of this Order.

7. The Division shall establish a task force hereafter to consider various issues arising in this case which shall include but not be limited to the issues set forth on page 43.

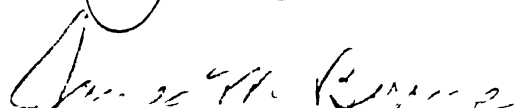
8. To the extent that the Commission has inadvertently omitted from the ordering provisions of this Order any duty or obligation intended to be imposed upon the Company or Division, which duty or obligation is otherwise clear from the language of the the preceding portions of this Order, it is hereby incorporated herein by this reference and made a part hereof.

9. Any party, or any stockholder, bondholder, or other person pecuniarily interested in the Company may apply for rehearing of any matter determined herein. The application for rehearing must be filed within 30 days after the issue date of this Order. An application for rehearing not granted by the Commission within 20 days after filing is denied. If the application for rehearing is denied, a petition seeking judicial review of any matter determined in the Order must be filed within 30 days of the date the application is denied.

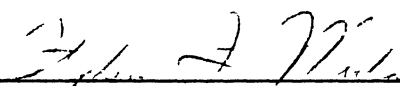
DATED in Salt Lake City, Utah this 21st day of November, 1990.



Brian T. Stewart, Chairman



James M. Byrne, Commissioner



Stephen F. Mecham, Commissioner

Attest:



Stephen C. Hewlett, Commission Secretary

CONCURRENCE OF CHAIRMAN BRIAN T. STEWART AND DISSENT IN PART

I cannot concur with the decision of my fellow commissioners rejecting the 10 percent disallowance for affiliate transactions proposed by the Committee. In the last U.S. West rate case, docket number 88-049-07, the Commission expressed its con-

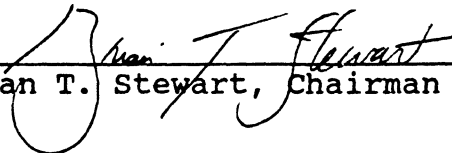
... about affiliate transactions

affiliated transactions falls squarely upon the utility. We further stated that we would look at the reasonableness with which the utility responded to efforts by regulators to obtain information about affiliate transactions (referred to in this case as the attitude test). In my view, the Company failed both tests.

The first test was clearly not met by the Company inasmuch as it made practically no effort to substantiate the reasonableness of its affiliate transactions. Fortunately for the Company, the Division undertook a comprehensive look at such transactions, sufficient to satisfy my fellow commissioners. I believe that the utilities that we regulate must be on notice that inasmuch as they control the corporate structure which they choose to use, as well as the inter-affiliate transactions made, that the burden must fall totally upon them to justify each and every affiliate transaction--which transactions are encumbered by a presumption of suspicion and self-serving. Utilization of already stretched regulatory resources to seek-and-find-something-wrong is unacceptable to me. Regulators should only be required to review the affirmative case made by the utility.

It has been asserted that the Company passed the attitude test because it willingly made available whatever the Division requested. I believe that this assertion failed to take into account the Motion to Compel that the Division was forced to file in May of this year, and the effort of the Company to use the affiliate shield as justification for not making the appropriate gas supply models and necessary data available to the Division and the Committee. Though this was an isolated incident, in my mind it

I believe my fellow commissioners have been unduly patient with the Company on this issue, and I believe the Company should be grateful for their tolerance.



Brian T. Stewart, Chairman

APPENDIX

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

| | |
|--------------------------------------|----------------------------|
| IN THE MATTER OF THE INVESTIGATION) | CASE NO. 89-057-15 |
| OF THE REASONABLENESS OF THE RATES) | |
| AND TARIFFS OF MOUNTAIN FUEL) | STIPULATION REGARDING RATE |
| SUPPLY COMPANY) | DESIGN AND COST ALLOCATION |
|) | ISSUES |
|) | |
|) | |

The undersigned parties hereby enter into the following Stipulation regarding Rate Design and Cost Allocation Issues in this case. The undersigned parties jointly move the Commission to approve and adopt this Settlement in its entirety.

This Stipulation, if accepted by the Commission, will resolve most of the rate design and cost allocation issues raised by the parties in this case. It employs the company's cost of service and rate design proposals, with stated modifications. Attached as Exhibit "A" is a cost of service allocation reflecting the parties' agreement. As soon as practicable, Mountain Fuel Supply Company will prepare and supply to all parties and the Commission the tariff modifications that will be required as a result of this Stipulation.

The only rate design and tariff issues not resolved by this Stipulation are the GS-1 rate design, a winter/summer commodity rate differential and an Energy Efficiency Transportation Tariff. This Stipulation does not address issues relating to revenue requirement, rate of return, affiliated interests or gas procurement.

I. ISSUES ON WHICH AGREEMENT HAS BEEN REACHED

The parties have reached agreement on, and request Commission approval of, the following issues:

A. Rate Design.

1. The functionalization, classification, allocation and rate design principles embodied in the Application and testimony of Mountain Fuel Supply Company (the "Company") have been utilized, except as indicated herein. Among other things, the Company's treatment of distribution mains has been retained. Changes from current tariffs and practices which are included in the Company's filing, and adopted in this Stipulation, include a consolidated interruptible sales class (Rate Schedule I), a consolidated interruptible transportation class (Rate Schedule IT), and the apportionment of production costs on a volumetric basis to sales customers only.

2. Feeder main costs are classified 45% demand and 55% commodity. The demand component has been allocated on allocation base 1 (peak day) and the commodity component has been allocated on allocation base 2 (volume).

3. The distribution system related non-gas costs and pipeline related non-gas costs have been eliminated from the F-3 commodity charge, and the commodity charge has been calculated using cost of service principles.

4. The definition of "winter" season for all allocation and pricing purposes has been changed to November 1 - March 31.

5. Administrative and General Expenses are allocated to each customer class on a pro rata basis, by using a weighted class allocator which is based on the allocation of the sum of the five distribution cost sub-functions (e.g. Feeders, Large Diameter Mains, Network Costs, Meter Reading, and On-Premise Service).

B. Tariff Issues.

1. The 2,000 Dth/day contract maximum has been eliminated from the F-3 tariff (§ 2.05, F-3(c)).

2. The qualifying period for waiver of the five cent surcharge in the IT tariff (§ 3.17(1)(3)) has been changed to November 1 - March 31.

3. Issues raised by certain industrial intervenors regarding the minimum load factor charge in the IT tariff (§ 3.17(j); §3.15(f)) will not be considered in this case.

4. The 100 Dth/day minimum in Mountain Fuel Supply Company's proposed IT tariff (§2.10-IT(a)) has been eliminated.

5. The parties agree that issues relating to whether, and at what cost, transportation customers can convert back to interruptible sales customers should not be resolved in this case and may be reserved for a future docket.

II. UNRESOLVED ISSUES

The only rate design and tariff issues not resolved by this Stipulation are as follows:

A. The customer service charge and rate design for the GS-1 class.

B. A winter/summer commodity rate differential.

C. An Energy Efficiency Transportation Tariff.

III. OTHER ISSUES

A. This Stipulation is intended by the parties to be an integrated settlement for purposes of this case of all of the rate design and cost allocation issues addressed herein. If the Commission does not approve all or any part of the issues resolved in Section I of this Settlement, no party shall be bound by this Settlement, each party shall be free to support any position on rate design and cost allocation issues, and this Settlement Agreement, and all documents, discussions and negotiations relating to the same, shall be privileged and not admissible for any purpose.

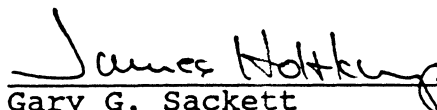
B. The parties agree to support this Stipulation in good faith and to urge Commission approval of the same. The parties shall submit testimony to explain and support this Stipulation and the unresolved issues.

C. Execution of this Stipulation by any party shall not constitute an acknowledgement or acceptance of the validity or invalidity of any particular method, theory, or principle of ratemaking or allocation in any other or future case.

D. This Stipulation may be executed in one or more counterparts and, upon execution, each executed counterpart shall be part of the same agreement as though all parties had executed

the same document. Any signature page may be detached from any counterpart without impairing the legal effect of any signatures and may be attached to another counterpart of this Stipulation.

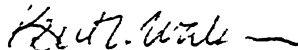
DATED this 22nd day of August, 1990.



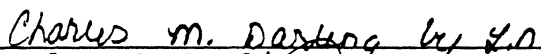
Gary G. Sackett
Patricia S. Drawe
James A. Holtkamp
Mountain Fuel Supply Company



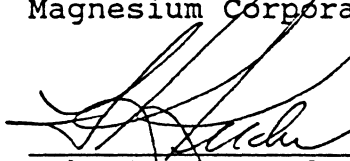
Laurie L. Noda
Division of Public Utilities



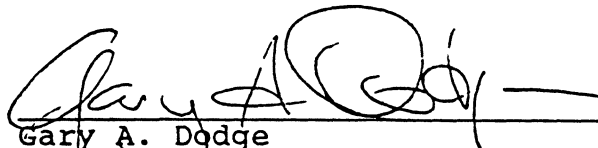
Kent L. Walgren
Committee of Consumer Services



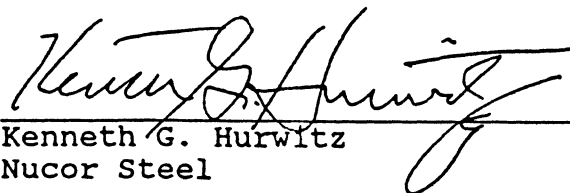
Charles M. Darling, IV
Magnesium Corporation of America



Robert F. Reeder
Kennecott Corporation and Hercules,
Inc. et al.



Gary A. Dodge
Geneva Steel



Kenneth G. Hurwitz
Nucor Steel

James A. Simpson
Phillips Petroleum

Bruce J. Barnard
Hill Air Force Base



David S. Christensen
Utah Energy Office

Brian W. Burnett
Central Valley Water Reclamation
Facility

Scott Gutting
ESI Group

Olof Zundel
Utility Shareholders Association of
Utah

Exhibit a

MOUNTAIN FUEL SUPPLY COST OF SERVICE ALLOCATION *

| | (A) | (B) | (C) | (D) | (E) | (F) | |
|--|--------------|--------|--------|--------|---------|---------|-----|
| | GS1 | F1 | F4 | I | IT | TOTAL | |
| | ----- | ---- | ---- | ---- | ---- | ----- | |
| 1. ON PREMISE SERVICE | | | | | | | |
| 2. COST/CUSTOMER 1/ | 17.84 | 666.6 | 61.26 | 478.89 | 478.89 | | |
| 3. CUSTOMERS 2/ | 460,008 | 315 | 3 | 125 | 62 | | |
| 4. TOTAL (000) 3/ | 8,207 | 210 | 0 | 60 | 30 | 8,506 | 15/ |
| 5. METER READ EXPENSE | | | | | | | |
| 6. COST/CUSTOMER 4/ | 36.91 | 143.92 | 309.64 | 393.42 | 8497.64 | | |
| 7. CUSTOMERS 2/ | 460,008 | 315 | 3 | 125 | 62 | | |
| 8. TOTAL (000) 5/ | 16,979 | 45 | 1 | 49 | 939 | 17,614 | 16/ |
| 9. NETWORK COST (#6) 6/ | 76,047 | 230 | 13 | 102 | 117 | 76,508 | 17/ |
| 10. LARGE DIA MAIN (#4) 7/ | 1,941 | 102 | 2 | 41 | 96 | 2,143 | 18/ |
| 11. FEEDERS (#1) 8/ | 45.00% 7,568 | 245 | 43 | 0 | 0 | 7,856 | |
| 12. (#2) 9/ | 55.00% 6,187 | 395 | 106 | 265 | 2,649 | 9,402 | |
| | ----- | ----- | ----- | ----- | ----- | ----- | |
| 13. | 13,756 | 640 | 148 | 265 | 2,649 | 17,459 | 19/ |
| 14. TOTAL DIST EXCEPT A & G 22/ | 116,929 | 1,228 | 164 | 516 | 3,392 | 122,229 | 24/ |
| 15. ADMIN & GENERAL 23/ | 11,990 | 126 | 17 | 53 | 348 | 12,534 | 25/ |
| 16. PRODUCTION (#3) 10/ | 12,775 | 816 | 218 | 947 | 0 | 14,356 | 20/ |
| 17. F-3 & CONCURRENT SALE REVENUE CREDIT (#3) 11/ | (999) | (64) | (17) | (43) | 0 | (1,123) | 21/ |
| 18. 487 & 488 CREDIT | (4,233) | | | | | (4,233) | 21/ |
| 19. TOTAL 12/ | 136,462 | 2,106 | 382 | 1,073 | 3,740 | 143,763 | |
| | ===== | ===== | ===== | ===== | ===== | ===== | |
| 20. PERCENT 13/ | 94.92% | 1.46% | 0.27% | 0.75% | 2.60% | 100.00% | |
| 21. 9/DTM 14/ | 2.0765 | 0.5018 | 0.3403 | 0.3816 | 0.1329 | 1.4096 | |

* For footnotes - see Exhibit No. 6.17, page 2.

KLM
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27.

Footnotes for Exhibit 6.17, page 1

- 1/ Source: Exhibit 6.3, page 4, line 20.
- 2/ Output of computer program Revrun.exe.
- 3/ Line 2 * line 3 divided by 1000.
- 4/ Source: Exhibit 6.3, page 4, line 21.
- 5/ Line 6 * line 7 divided by 1000.
- 6/ Exhibit 6.3, line 11, column 6 less Exhibit 6.17, page 1, column F, lines 4, 8 and 15 times Exhibit 6.5, page 4, columns B through F, line 18.
- 7/ Exhibit 6.5, page 4, line 13 times Exhibit 6.17, page 1, column F, line 10.
- 8/ Exhibit 6.5, page 4, line 1 times 49% of Exhibit 6.17, page 1, line 13, column F.
- 9/ Exhibit 6.5, page 4, line 3 times 55% of Exhibit 6.17, page 1, line 13, column F.
- 10/ Exhibit 6.5, page 4, line 9 times Exhibit 6.17, page 1, line 16, column F.
- 11/ Exhibit 6.5, page 4, line 9 times Exhibit 6.17, page 1, line 17, column F.
- 12/ Sum of lines 4, 8, 9, 10, 13, 15, 16, 17, and 18.
- 13/ Line 19, columns A through E divided by column F * 100.
- 14/ Line 19 divided by Exhibit 6.5, page 4, line 4.
- 15/ Exhibit 6.17, page 1, line 4, sum of columns A through E.
- 16/ Exhibit 6.17, page 1, line 8, sum of columns A through E.
- 17/ Sum of line 9, columns A through E.
- 18/ Exhibit 6.3, line 11, column 6 less Exhibit 6.17, page 1, column F, lines 4, 8 and 15 times Exhibit 6.5, page 4, column I, line 18.
- 19/ Exhibit 6.3, line 11, column 6 less Exhibit 6.17, page 1, column F, lines 4, 8 and 15 times Exhibit 6.5, page 4, column J, line 18.
- 20/ Exhibit 6.3, line 13, column 4.
- 21/ See Exhibit 6.3, page 2, footnote 6.
- 22/ Sum of lines 4, 8, 9, 10 and 13.
- 23/ Line 15 column F spread by line 14.
- 24/ Sum of line 14 columns A through E.
- 25/ Exhibit 6.3, page 2, footnote 1.

DOCKETED

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

| | |
|--------------------------------------|-----------------------------|
| In the Matter of the Investigation) | <u>DOCKET NO. 89-057-15</u> |
| of the Reasonableness of the Rates) | |
| and Tariffs of MOUNTAIN FUEL) | <u>ORDER ON APPLICATION</u> |
| SUPPLY COMPANY.) | <u>FOR REHEARING</u> |

ISSUED: January 10, 1991

BY THE COMMISSION:

Mountain Fuel Supply Company ("Mountain Fuel" or "Company") filed with the Commission an Application for Rehearing ("Application") of our Order of November 21, 1990 in the above-entitled and numbered matter on December 21, 1990. The Committee of Consumer Services and the Division of Public Utilities have filed responsive memoranda.

The Company's Application raises numerous issues most of which we are persuaded have been adequately dealt with in our Order of November 21, 1990. However, with respect to three issues we feel constrained to supplement our Order.

1. Post-test year adjustments.

The Company argues that because the Commission allowed post-test year adjustments in U.S. West Docket No. 88-049-07, issued October 18, 1989, it must find them appropriate in this Docket or provide some rationale for a departure from its prior "practice". 63-46b-16(4)(h)(iii). At this point in time we consider the historic test year without post-test year adjustments to be

appropriate and reasonable and the allowance of post-test year adjustments or future test years to be exceptional. The choice of test years lies within the discretion of the Commission based upon a clear showing by the utility that its case merits special treatment. If that were not so, the existence of Section 54-4-4 (3) would be superfluous.

In retrospect, we allowed U.S. West to make post-test year adjustments without having adequately justified them. If we were making that decision today, there is little doubt that those adjustments would not be granted in the absence of additional factual justification from U.S. West. As was indicated by the Supreme Court in Utah Department of Business Regulation v. the Public Service Commission, 614 P2d 1242 (1980) at 1249,

"In evaluating an application, the fundamental principle involved is that post-test year adjustments to expenses must be matched with post-test-year revenue increases which might offset additional expenditures.. ..To be entitled to an adjustment for increased wage and salary expense the applicant must sustain its evidentiary burden to establish these payroll increases will not be offset by productivity and increased sales."

In our judgment, Mountain Fuel has not on this record justified the employment of post-test year adjustments.

Furthermore, we do not agree with the argument that our granting of the post-test year adjustments in the U.S. West case constitutes a Commission "practice" that now needs to be explained and justified in this case.

Having so stated our current preference on test year, we will also reiterate our statement on page 7 of our November 21, 1990 Order.

"In future proceedings, the Commission will decide issues concerning test year, rate base, out-of-period adjustments, and related matters prior to the onset of hearings and based on the then existing conditions of the utility and the economy in which it is operating."

The historic test year, which is our current preference, is no more "set in concrete" than was our previous use of future test years when the conditions required it.

2. The reduction of the rate of return on equity from 12.2% to 12.1%.

The Company complains that our reduction of return on equity from 12.2% to 12.1% is not supported by substantial evidence in the record, that it is arbitrary, capricious and an abuse of Commission discretion, that it circumvents federal preemption of rate regulation and that it constitutes a penalty or reparation outside our statutory authority.

It is safe to say that setting rates, a part of which is the establishment of the return on equity, is not a precise science. The statute allows us to consider a number of factors in reaching rate determinations considered "just and reasonable". Preeminent among these factors is the judgment of expert witnesses subjected to cross-examination on the record. However, the importance of that one factor does not preclude the Commission's taking other factors

into consideration, including such things as the utility's affiliate relationships, once we have established a zone or range of reasonable rates of return on equity. In this Docket, we infer from the expert testimony a range from around 11.6% to something less than 13%. While the extremes of this range are subject to debate and judgment, the rate we have allowed the Company, 12.1%, is squarely within the range, even though it is based at least in part on our perception of the Company's behavior with its affiliates.

3. Inconsistent treatment of certain other test year adjustments.

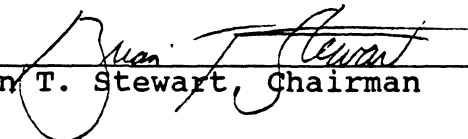
Among other adjustments argued to have been given inconsistent is one involving five industrial customers with increased purchases. The claim is that among these five industrial customers is one who made a deferred main extension payment excluded by the Commission. The net effect the Company asserts would be \$266,000 in additional revenues. We have examined the Company's exhibits on which this claimed discrepancy is based and find them inconclusive, which is another way of saying that the information is not there. Nevertheless, we will allow the Company to clarify the exhibits and anticipate that the Company will approach the other parties with a view to having this adjustment stipulated and included in the Order by way of an addendum.

ORDER

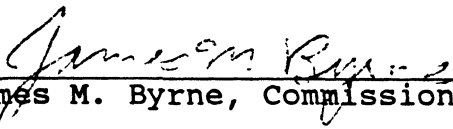
NOW, THEREFORE, IT IS HEREBY ORDERED that Mountain Fuel's Application for Rehearing be and is hereby denied save for the matter set forth in Section 3 hereof.

Notice is hereby given that a petition seeking judicial review of the Commission's Order must be filed within 30 days of the date of the denial of the application for rehearing.


DATED in Salt Lake City, Utah this 10th day of January, 1991.



Brian T. Stewart, Chairman



James M. Byrne, Commissioner



Stephen F. Mecham, Commissioner

Attest:



Stephen C. Hewlett, Commission Secretary

ADDENDUM 2

ADDENDUM 2

Utah Code Ann. § 63-46b-14(4) (1990) (in relevant part):

(4) The appellate court shall grant relief only if, on the basis of the agency's record, it determines that a person seeking judicial review has been substantially prejudiced by any of the following:
. . . .

(b) the agency has acted beyond the jurisdiction conferred by any statute; . . .

(d) the agency has erroneously interpreted or applied the law;

(e) the agency has engaged in an unlawful procedure or decision-making process, or has failed to follow prescribed procedures; . . .

(g) the agency action is based upon a determination of fact, made or implied by the agency, that is not supported by substantial evidence when viewed in light of the whole record before the court;

(h) the agency action is:

(i) an abuse of the discretion delegated to the agency by statute; (ii) contrary to a rule of the agency; (iii) contrary to the agency's prior practice, unless the agency justifies inconsistency by giving facts and reasons that demonstrate a fair and rational basis for the inconsistency; or (iv) otherwise arbitrary or capricious.

Utah Code Ann. § 54-3-1 (1990).

All charges made, demanded or received by any public utility . . . for any product or commodity furnished or to be furnished, or for any service rendered or to be rendered, shall be just and reasonable. Every unjust or unreasonable charge made, demanded or received for such product or commodity or service is hereby prohibited and declared unlawful. Every public utility shall furnish, provide and maintain such service, instrumentalities, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respect adequate, efficient, just and reasonable.

Utah Code Ann. § 54-7-12(2)(b) (1990):

The commission shall, after reasonable notice, hold a hearing to determine whether the proposed rate increase or decrease, or some other rate increase or decrease, is just and reasonable.

Utah Constitution, art 1, § 7.

No person shall be deprived of life, liberty or property, without due process of law.

U. S. Constitution, Fourteenth Amendment, § 1.

. . . [N]or shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

ADDENDUM 3

UTAH PSC PROCEEDINGS IN DOCKET NO. 89-057-15

| 1989 | | 1990 | | | 1991 |
|----------------------------|--|------|--|--|--|
| PSC-imposed test year 1989 | | | | | First rate-effective 12 months |
| | | | | | 12-1-90 New rates become effective |
| | | | | | 11-21-90 PSC issues final order |
| | | | | | 9-5-90 Hearings commence (end 9-28-90) |
| | | | | | 3-31-90 MFS files rate request |
| | | | | | 11-7-89 PSC sets historic test year (reconfirmed 11-21-89) |

ADDENDUM 3

ADDENDUM 4

ADDENDUM 4

PREVIOUS MOUNTAIN FUEL SUPPLY COMPANY RATE PROCEEDINGS

| Docket No. | Case Filed | Final Order | Future Test Year Approved |
|-------------------|-------------------|--------------------|---|
| 7113-II | Mar. 27, 1975 | Dec. 1, 1975 | Report and Order at 5, ¶ 9 |
| 77-057-03 | Apr. 4, 1977 | Dec. 29, 1985 | Report and Order at 5, ¶ 5 |
| 79-057-03 | Mar. 30, 1979 | Aug. 17, 1979 | Report and Order, Stipulation, Ex. 1. |
| 80-057-01 | Oct. 16, 1979 | Aug. 10, 1981 | Motion to Adopt Stipulation, Joint Ex. 1. |
| 82-057-15 | Sept. 3, 1982 | May 2, 1983 | Preliminary Order at 2, ¶ (a) |
| 83-057-12 | July 1, 1983 | Sept. 2, 1983 | Stipulation at 2, ¶ 1 |
| 84-057-07 | Aug. 8, 1984 | Apr. 30, 1985 | Final Report and Order at 5, ¶ 3; at 8, ¶ 6-7; at 13, ¶ 12. |
| 89-057-15 | Mar. 30, 1990 | Nov. 21, 1990 | Order at 7 |

ADDENDUM 5

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

--oOo--

| | |
|-----------------------------|--------------------------------|
| -----) | |
| In the Matter of the |) Case No. 89-057-15 |
| Investigation of the |) |
| Reasonableness of the Rates |) <u>REPORTER'S TRANSCRIPT</u> |
| and Tariffs of Mountain |) <u>OF PROCEEDINGS</u> |
| Fuel Supply Company. |) |
| -----) | |

Salt Lake City, Utah

Tuesday, November 7, 1989

10:00 a.m.

BEFORE:

BRIAN T. (TED) STEWART, Chairman, Public
Service Commission of Utah;

JAMES M. BYRNE, Commissioner, Public
Service Commission of Utah;

STEPHEN MECHAM, Commissioner, Public
Service Commission of Utah.

--oOo--

COPY

WENDY K. RANDALL, CSR, RPR
160 E. 300 S. 4th Floor
Salt Lake City, UT 84111
(801) 530-6693

A P P E A R A N C E S

FOR MOUNTAIN FUEL PATRICIA S. DRAWE, ESQ.
SUPPLY: GARY G. SACKETT, ESQ.
 180 East 100 South
 Salt Lake City, Utah 84139

FOR THE DIVISION OF MICHAEL GINSBERG, ESQ.
PUBLIC UTILITIES: LAURIE NODA, ESQ.
 130 State Capitol
 Salt Lake City, Utah 84144

FOR THE COMMITTEE KENT WALGREN, ESQ.
OF CONSUMER 130 State Capitol
SERVICES: Salt Lake City, Utah 84144

FOR CENTRAL VALLEY BRIAN W. BURNETT, ESQ.
WATER RECLAMATION Callister, Duncan & Nebeker
FACILITY: Kennecott Building, Suite 800
 Salt Lake City, Utah 84133

FOR BASIC MANUFAC- GARY A. DODGE, ESQ.
TURING AND TECH- Kimball, Parr, Crockett &
NOLOGIES: Waddoups
 185 S. State Street, #1300
 Salt Lake City, Utah 84111

FOR KENNECOTT, F. ROBERT REEDER, ESQ.
AMOCO OIL COMPANY, Parsons, Behle & Latimer
HERCULES, AND WEST- 185 S. State
ERN ZIRCONIUM A Salt Lake City, Utah 84111
DIVISION OF WESTING-
HOUSE:

1 Date: November 7, 1989
2 Time: 10:00 a.m.

3 P R O C E E D I N G S

4 COM. STEWART: Let's go on the record in
5 docket number 89-057-15 in the matter of the
6 investigation of the reasonableness of the rates and
7 tariffs of Mountain Fuel Supply Company. This
8 matter is before the Commission pursuant to a notice
9 of prehearing which was filed by the Commission on
10 October 31st indicating the Company's intent to
11 undertake an investigation of the reasonableness of
12 the rates of Mountain Fuel Supply and setting today
13 as a prehearing to set dates for that rate case. If
14 we could first take appearances for the record.

15 MS. DRAWE: Patricia S. Drawe and Gary
16 Sackett for Mountain Fuel Supply Company.

17 MR. WALGREN: Kent Walgren for the
18 Committee of Consumer Services.

19 MS. NODA: Laurie Noda appearing on
20 behalf of the Division of Public Utilities.

21 MR. DODGE: Gary Dodge appearing on
22 behalf of Basic Manufacturing and Technologies of
23 Utah.

24 MR. REEDER: F. Robert Reeder of the firm
25 of Parsons, Behle and Latimer. We appear this

morning for Kennecott, Amoco Oil Company, Western Zirconium a Division of Westinghouse and Hercules, Inc.

MR. BURNETT: Brian W. Burnett appearing on behalf of Central Valley Water Reclamation Facility.

MR. GINSBERG: Michael Ginsberg will also be appearing for the Division of Public Utilities.

COM. STEWART: Any other appearances? The Commission has spent considerable amount of time discussing, debating, considering this matter before we initiated this rate case and we think that it would be helpful if we were to commence this matter by giving the parties some of our thoughts on it.

Afterwards, we will go ahead and respond to any questions that you may have and then go ahead and set a schedule for this matter.

First of all, we need to note that this rate case will be the first Mountain Fuel rate case since 1984. The Commission feels that a period of five, five and a half years between rate cases is probably too long. We have considered for a long time the possibility of requiring all utilities in the state to make annual filings with the Commission that would give us information that would help us to

1 understand whether or not a rate case was needed.

2 It's something we have not yet accomplished.
3 We may yet, but in the absence of that, we think
4 that rate cases, again, with four or five years
5 interceding is too long and that is one of the
6 reasons why this matter has been initiated by the
7 Commission.

8 We would also like to point out that it will be
9 the first rate case since the corporate
10 reorganization which took place in the fall of 1984.
11 For those two reasons, the Commission has ordered
12 this rate case and we would like to make it clear
13 from this point on that it is our intention that the
14 burden of establishing rates will be on Mountain
15 Fuel Supply.

16 This will be unlike the rate case that we
17 undertook last year with US West Communications
18 wherein the burden was carried by the Division. It
19 is our intention that Mountain Fuel Supply will make
20 a filing with the Commission establishing the
21 appropriate rates for 1990.

22 Secondly, the Commission would like to have a
23 historical test year in this case, the test year
24 being 1989. We realize that that is a significant
25 issue and that there may be some who would disagree.

Accordingly, if a party wishes to request a test year other than 1989, we would ask that they quickly motion up a hearing on that specific issue.

We would point out, however, that it is the Company's strong preference that we go with the 1989 test year and we believe that the precedence that we established with the US West case which had a historical test year as well as the Utah Power & Light rate case that we are currently engaged in and the Utah Power & Light rate case that we will have in 1990 will both use historical test years also.

So we believe the precedence has been set. We would like to point out that as was noted in the notice of prehearing that one of the significant issues that we want all parties to be concerned with is that of the affiliated relations of Mountain Fuel Supply.

We would specifically ask that the Division undertake an analysis of whether the Wexpro agreement is helping or hurting the ratepayers of this state. We would note that the Questar order, the order dated October 1st, 1984 in docket number 84-057-10 which was the request of the Company to reorganize itself into its current structure, in that order, the Commission listed a number of

1 conditions for approval of that corporate
2 restructuring.

3 In item number 3, in particular, addresses the
4 questions of affiliates and it says "Goods and
5 services provided to the utility corporation by the
6 holding company Questar or its subsidiaries shall be
7 either on a preferential basis or at a minimum on an
8 'arm's length' basis and shall not exceed the market
9 rate for comparable goods and services except as
10 otherwise governed by the Wexpro stipulation and
11 agreement or approved by the Commission."

12 We would ask that all of the parties including
13 Mountain Fuel Supply be prepared to respond to
14 whether or not that condition has been met. I would
15 also, if I may, point out to the Company that this
16 Commission in its recently completed US West case
17 took great exception to the Company in that case
18 making it difficult for the Division and the
19 Committee to investigate the affiliated relations.

20 We would hope that you would review that part
21 of our order and that we will not have that problem
22 reoccur in this case.

23 On the question of cost of capital, another
24 item that was mentioned in our prehearing order, I
25 think the question that we would like to have

addressed is, does the current corporate structure affect the business risk of Questar, therefore, increasing the cost of capital to the ratepayers of Mountain Fuel Supply.

Again, I would note that this is the first rate case since the corporate restructuring. This will be the first opportunity for that issue to be addressed.

Finally, in the area of cost of service, it is the intention of the Commission that all of the ad hoc decisions that we have made over the last few years; for example, the approval of the transportation rate, the approval of an environmental rate and so on, will be examined in this rate case under the cost of service category, that everything is open; everything shall should be addressed.

If a party wishes to argue that the five cent surcharge on transportation is inappropriate, they have the right to do so though they will be met with others who will disagree, we are assuming, but in any event, we would hope that you would understand that all cost of service issues are wide open in this case.

I believe either Commissioner Byrne or

1 Commissioner Mecham may have something they want to
2 add to what I just went through.

3 COM. MECHAM: Mr. Ginsberg or Ms. Noda, I
4 was told by Doug Kirk of our staff that at some
5 point George Compton from the Division had worked on
6 a gas optimization model. I'm wondering if that can
7 or ought to be part of this rate case as we review
8 affiliate relationships.

9 MR. GINSBERG: Do you want me to answer
10 or respond?

11 COM. MECHAM: Yes, please.

12 MR. GINSBERG: There is a gas
13 optimization model that was developed by Dr. Compton
14 and was used in the transportation case and I
15 believe other cases. If I could, maybe I can answer
16 the question really throwing it back to you.

17 This is a non-gas cost rate case and the gas
18 mix or the optimization of the Mountain Fuel Supply
19 gas versus Questar gas is and has been an issue in
20 pass-through cases where we have addressed a
21 number of pass-through cases, the optimization of
22 the use of D24 gas or Mountain Fuel Supply's own
23 gas in relationship to the pipeline gas that they
24 take under their FERC tariffs.

25 The question I guess is, does the Commission

desire that we would address that in a non-gas cost case or in a pass-through case where the gas costs of Mountain Fuel Supply are at issue?

In this case the affiliated relationship or the gas cost transactions are not directly before the Commission, but would be directly before the Commission for purposes of setting rates in a pass-through case.

COM. MECHAM: My response to that would be that I think it would be more appropriate in this case because as we are reviewing the various relationships between and among the affiliate interests of this company, it would have at least indirect application, even in a non-gas cost case.

In a pass-through case, grant it, my experience with the pass-through case is minimal, but it seems that there's not enough time to really address the issue and it seems that there's more time to do it here.

MR. GINSBERG: I don't know how long it would take to do that kind of study, but it certainly could be done.

COM. STEWART: Let's presume it will be done then.

COM. BYRNE: I think probably the

1 emphasis, Mr. Ginsberg, ought to be on the structure
2 of how gas is acquired rather than the specifics
3 that we would see in a pass-through case.

4 I also think that one of the problems in
5 regulating this company is that we deal with the
6 issues in a piece meal fashion. As Commissioner
7 Stewart indicated, we haven't had a rate case for
8 five years and we have had numerous pass-through
9 cases dealing with specifically the issues of gas at
10 that time.

11 We also attempt to follow the proceedings at
12 FERC with Questar pipeline, but in terms of a
13 comprehensive analysis of how this gas delivery
14 system is working for the ratepayer, we just haven't
15 had a chance to really do that.

16 So it may be that the Division will have to sit
17 back and think about this for a little while and
18 then come back to us if you really think it's -- and
19 perhaps explain to us how you think this ought to be
20 approached. I think the reference specifically to
21 the gas acquisition model, I'm not sure myself how
22 to utilize that in this case.

23 MR. GINSBERG: The kind of studies that
24 we used that for were I believe with respect to like
25 whether or not the amount of D24 gas was being

1 taken, should be increased and whether or not the
2 mix between Mountain Fuel Supply's own gas, the
3 amount that they take and the amount that they take
4 under their FERC contract as through Questar
5 pipeline, what is the best mix for that. Those are
6 the kinds of studies I think we have done in the
7 past.

8 COM. BYRNE: I think what we are asking
9 for here in terms of the affiliate relationships is
0 to step back from that a bit and take a look at the
1 entire picture of how gas is acquired for the
2 ratepayer and if it's being acquired in the best
3 interest of the ratepayer. Whether we need to
4 specifically address that model or not, I'm not
5 sure.

6 MR. BURNETT: The model was utilized to
7 analyze whether or not gas transportation was
8 appropriate and to the degree the gas transportation
9 is a five percent per decatherm charge, perhaps the
0 model would be of some assistance.

1 COM. BYRNE: I guess the only other
2 things that I recall from previous cases that were
3 addressed that we haven't mentioned so far were in
4 terms of the services provided to Mountain Fuel
5 Supply by its subsidiaries, by its corporate family

1 members, real estate services, computer services,
2 the various legal services, I believe the various
3 services that are provided to the utility arm by
4 other affiliates within the Questar family and how
5 the Division has reviewed those and whether those
6 are appropriate.

7 MR. GINSBERG: All of those type of
8 affiliate relationships that you have talked about
9 were the type that we would be reviewing in this
10 case with respect to corporate overheads, computers
11 and other services that are provided by the parent
12 company.

13 COM. STEWART: Do any of the parties have
14 any questions of the Commission at this time? Mr.
15 Walgren?

16 MR. WALGREN: Yes, a couple of questions.
17 One issue that's just been raised is and I haven't
18 had a chance to look carefully at the statute, but
19 does the 240 days start to run from the date that
20 the Commission's order was issued in this or the
21 date that the filing was actually made by Mountain
22 Fuel? Does anyone know that offhand?

23 COM. STEWART: I believe it's from the
24 date of filing by Mountain Fuel.

25 MR. GINSBERG: I think it depends also

what the filing requests if anything. The 240 days only applies to rate increases and does not apply to rate decreases or status quo, so it really depends on that if there's a statutory time period applied.

MR. WALGREN: The other issue that the Committee would like raised is in the UP&L case that's set for next year, there are some filing, uniform filing requirements that are being proposed based on Carl Mowers study. The Committee would like the filing of Mountain Fuel to also comply with those requirements.

COM. STEWART: Those uniform filing requirements probably will not be known for months by the Commission and I don't think we want to delay this matter. I think we have just got to have the Company make a filing, as I indicated at the beginning, to justify its rates for 1990 and we will go from there.

Hopefully, as I indicated today also, we will have those uniform filing requirements for all utilities in the state some day, but they are still some distance away from us.

Are there any other questions? If not then, Ms. Drawe, can you give us an idea of when the Company can make its filing?

MS. DRAWE: Based on the Company's long term commitment to a future test year for rate cases, we had discussed the filing of an application on or before March 1st.

I think we need to explore the correct test year and maybe we would need some additional time if ultimately the historical year is the filing that we are required to make.

COM. STEWART: But you cannot make a filing before March 1st?

MS. DRAWE: We could. It's our understanding that you do want a full investigation of all of the normal rate case issues and we feel in order to do a thorough job and to put together an application that meets the requirements that you have set up that that's a reasonable time for us to do it.

We are coming into a holiday period. We could do it sooner if you felt there was some benefit to speeding up the process.

COM. BYRNE: Ms. Drawe, one of the problems with that is that we have scheduled already a rate case for PacifiCorp next year which will be getting a filing in the March timeframe. I at least had hoped we could move at a much more rapid

schedule than that.

It may be that some of the things that have been said here today affect how the parties would approach this case and it may be that we need to have a technical conference or discussion among the parties about various issues before we can look at setting the schedule. I'm not sure.

COM. STEWART: I would anticipate that even if we were to push you, you couldn't move it up any more than what, a month or so, so we are going to be, regardless, on almost an identical track with Utah Power & Light in any event.

MS. DRAWE: That's likely.

MR. WALGREN: For the Committee also, to participate in this case we are going to have to get a supplemental appropriation and I'm told that the soonest that we can let a contract would be March 15th to do that, so we are also looking if we participate in this at about the same schedule.

COM. STEWART: Let's go off the record for just a minute.

(Discussion off the record)

COM. STEWART: Let's go back on the record. First of all, Ms. Drawe, are you confident that the Company is going to be arguing for a future

test year?

MS. DRAWE: Ninety nine percent confident, yes.

COM. STEWART: Then let's go ahead and set a hearing date for that so that we can hear that issue as soon as we can. Will you be prepared to argue that on the 21st?

MS. DRAWE: Yes.

COM. STEWART: Okay. Let's set that matter for law and motion on the 21st.

MR. GINSBERG: Isn't it more in the light of an evidentiary issue than a legal issue?

COM. STEWART: Not really. The question is whether or not the Commission is going to order them to file a historical test year or a future test year. That to me is a legal issue.

COM. BYRNE: I don't interpret it as a legal issue. I mean, clearly within the statute we can have historical test years or future test years. I think the argument in a practical sense what --

COM. STEWART: Policy issue.

COM. BYRNE: Policy issue. Which one makes more sense. The Chairman has just indicated that had we had -- well, in the past the precedent has been future test year. We have with the other

fixed utilities right now historic test year cases and we have a period where we are seeing lesser inflation, less pressure on rates and those kinds of things that were the argument for future test years in the past.

So I don't see it as a legal issue if the Company can convince us that the future test year is the way to go as a practical matter, that's what they need to do.

MS. DRAWE: Could I ask if you are basically putting forth a new policy that the historic test year is what you want in any case or are you basing it on the facts at the present time? You mentioned that inflation is not rampant at this time.

COM. BYRNE: I would hate to think we got tied up in the rulemaking argument here about whether we are making a rule for historic test year. I think that in the case of the other two fixed utilities, we decided it was appropriate to deal with a historic test year. The companies agreed and we went ahead with it.

If Mountain Fuel Supply feels strongly that a future test year is the way we ought to go, let's reevaluate that. We haven't done it for five years

or more and obviously the conditions in 1984 were quite different than they are now.

COM. MECHAM: I would characterize it as an exercise of Commission discretion. I mean it's discretionary whether we go with a future year or not.

MS. DRAWE: Would it be subject to review in future cases?

COM. STEWART: Yes.

MR. REEDER: Does the Commission anticipate making a record for the exercise of its discretion or does it prefer to do it in the comment rulemaking process to exercise its discretion?

COM. MECHAM: I believe we are setting a hearing to do that for the 21st.

MR. REEDER: Evidentiary hearing to make a record upon which to make a decision and a judiciary process?

COM. MECHAM: That appears to me to be exactly what we are doing, Mr. Reeder.

COM. BYRNE: We have made a decision, Mr. Reeder, and we are giving the parties an opportunity to tell us why we are mistaken in doing that. We do believe this is a discretionary matter.

MR. WALGREN: Wouldn't that require the

presentation of some evidence, though, on what's likely to be the most useful way in determining rates and in setting rates? Isn't there an evidentiary issue there? The question of whether or not the Commission is abusing its discretion or not in basing the test year on --

COM. STEWART: I think the statute clearly gives us the discretion as to whether we go with a future test year or historical test year. We have decided we want a historical test year.

We will, however, allow any party to come in and argue that a future test year is more appropriate. We will set a hearing for November 21st to hear that on the law and motion calendar. We will set it at 10:00 on October 21st -- November 21st.

Ms. Drawe, if the Commission was to hold that we were going to stick with a historical test year, can the Company still make its filing by March 1st?

MS. DRAWE: It's my understanding that no, we could not, that we would need an additional month to take the year end figures that were final and audited and made available which would be early February and that then an April 1st filing would be more reasonable.

COM. STEWART: Well, we may end up getting off the track with Utah Power & Light in the direction opposite from what we considered possible.

I think the question of when you should file will have to await a decision by the Commission on a historical versus future test year. So we will probably discuss that matter again on the 21st so that those of you who are interested in that issue should be here.

I'm talking about the schedule, regardless of whether you intend to argue for or against the historical test year. With that in mind then, are there any other questions at this time?

MR. GINSBERG: Would we use the 21st as a time where we can more define the type of -- come back to you with what you have given us today with a more specific approach on the type of studies that we would be doing?

COM. STEWART: That would be helpful.

MR. GINSBERG: With a more detailed schedule?

COM. STEWART: Yes and again, if there are any other questions that you may have in terms of what the Commission intends this case to include, you could raise them on the 21st.

COM. BYRNE: We have got sort of a split burden I think in this case in terms of the determination of rates, we have indicated the Company has the burden to come forward with the information on which to base rates going forward.

The Division's burden is probably in the area of the other things that we have asked for and that's the analysis of affiliate relations and those kinds of issues. So I think perhaps it would be very helpful if the Division could come back.

MR. GINSBERG: You are not going to require the Company to put forth any affirmative filing on their affiliated relations?

COM. BYRNE: Well, I'm not sure what an affirmative filing from the Company on those affiliate relations would be. My personal view is that it's the Division that's going to do an investigation and the Company will provide the information as requested by the Division, but the Company has made its affirmative case. It has its company organized the way it deems is appropriate and it seems to me that's a given.

COM. STEWART: Mr. Ginsberg, I would, however, take the view that in light of the paragraph 3 from the order in the paragraph of the

1984 case that I read to you earlier that the Company has the affirmative responsibility to establish that the goods and services provided to the utility by the holding company or its subsidiaries are either on a preferential basis or on an arm's length basis, so I think they have the burden of justifying those relationships pursuant to that order.

MR. GINSBERG: I have two other comments. First, maybe the Company could provide use of historical information with certain forecasts for the rest of 1989 and then provide actual data as it becomes available. I don't know if that would hinder the process or speed up the process, but it certainly is I think something that should be considered.

We do have certain amounts of actual data available and we don't -- we have obviously a forecast for the rest of 1989. Whether or not you could provide actuals with forecasts for the rest of this year and update those to actual results when they are available.

COM. STEWART: Again, Mr. Ginsberg, that's going to await our decision on the test year.

MR. GINSBERG: I guess my question was to

Mountain Fuel whether they could provide that sooner in that format rather than waiting until their books are closed for 1989 --

COM. STEWART: You mean if we were to decide to go with a historical test year and tell them to file it February 1st, for example, with certain number of months of actuals and a certain number of months of forecasting?

MR. GINSBERG: I don't know whether that would speed up the -- the actuals have to be converted into a test year. Second, I was wondering if the Commission could provide any additional comments of the type of analysis that you wanted us to do with respect to the Wexpro agreement?

COM. STEWART: Well, again, I think the standard was stated by me when I read it to you, Mr. Ginsberg, and that is we want you to tell us whether or not the Wexpro agreement is helping or hurting the ratepayer of the state. That's pretty open ended, I realize, but I can't be any more specific.

MR. GINSBERG: Okay.

COM. STEWART: The Wexpro agreement has been in effect eight years. It has had substantial impact on the ratepayers of this state one way or the other; perhaps it's neutral.

The only people who can tell us that would be the Division and it will come under close scrutiny by the other parties in this proceeding and at the end of the case, we hopefully will be able to say, "Yes, the Wexpro agreement is good, bad or indifferent." I'm sorry I can't be more specific. Are there any additional questions?

MR. DODGE: Commissioner Stewart, could we request that those appearing today be deemed intervenors without filing formal pleadings?

COM. STEWART: Yes.

MR. DODGE: Thank you.

MR. REEDER: Thank you.

COM. BYRNE: Could we ask the Company then to also respond on November 21st relative to the question Mr. Ginsberg asked about whether if we do go forward with a historic test year, the Company could make a filing of so many months of actuals as normalized and so many projected because that will affect the schedule.

The Division would be able to move forward more rapidly after the Company's filing if they had information prior to the Company's filing that they could be working with. Otherwise, we will see a longer timeframe requested by the Division between

the Company's filing and when we can actually have a case.

MR. GINSBERG: It was our intention to begin requesting information immediately and we would provide those to the Company as we have those requested. Many of them will relate to 1989, normalizing that as a test year.

COM. STEWART: Are there any other questions at this time?

MR. GINSBERG: I had one other comment. Should some mechanism be provided in order to provide a public notice of this proceeding? Should it be published or should that wait until there's an actual filing by the Company?

COM. STEWART: I think it can wait until the actual filing, Mr. Ginsberg. I don't know that a public notice at this time is going to do anybody any good and we are not going to see an actual filing until March 1st, maybe even later.

I mean, again, we are here today, but the actual commencement of this proceeding does not commence until the filing by the Company, so there will be plenty of time for any party who may be interested in this case to examine the filing and determine whether or not their interests are

affected.

COM. BYRNE: I think notice has already gone out to all of the parties that we know of that have an interest in this proceeding.

MS. DRAWE: Could I respond to Mr. Ginsberg? He's suggested that he'd like to start data requests coming to Mountain Fuel right away. I think if there's interest in our having a timely filing, there will be a lot of work going into the preparation of that filing and to be having numerous data requests during the same period will make it more difficult to tend to the task at hand of getting the filing in, so I would suggest that those may be delayed somewhat although certainly for their initial reports there may be some information that they would need.

MR. GINSBERG: I think there's a number of benefits of us providing them data requests as soon as possible. Some information they could incorporate that into their filing, information that they know that we are interested in receiving or if it's -- I don't think we are suggesting that we would cause any delay at all in them making the filing whenever they felt it was required to be made and I think we are just saying if we started our

process now, it would speed up the entire proceeding rather than us waiting until April to even begin.

COM. STEWART: Let me ask this. Let me request that the parties who desire to do so meet informally after we are through here and set a date where you can get together and discuss those types of issues between now and the 21st.

I don't want the Division to be on a fishing expedition requesting information that's speculative or even forecasted if we are going to have a completely actual historical test year, for example, but on the other hand, I think your points are legitimate, Mr. Ginsberg. I think you ought to meet together and try to discuss that and then if you have any problems, bring them up again on the 21st, if you would, Ms. Drawe.

MR. GINSBERG: When you were referring to a historical test year, were you including known and measurable changes that would have occurred outside of the test year?

COM. STEWART: Mr. Ginsberg, we have a policy on known and measurable changes that we refer to quite consistently in the US West order and we will abide by that. Does that answer your question?

MR. GINSBERG: That's fine.

COM. STEWART: Are there any other questions at this time? If not, we will be in recess until November 21st at 10:00 a.m.

(Whereupon the preceedings were concluded)

* * * *

STATE OF UTAH)
) ss.
COUNTY OF SALT LAKE)

I, WENDY K. RANDALL, CSR, RPR, hereby certify that I am a Certified Shorthand Reporter of the State of Utah and that on the date herein noted I was present before the Public Service Commission of Utah at the hearing of the above-entitled matter and thereat I reported the proceedings in shorthand and thereafter I transcribed my said shorthand notes into typewriting and the foregoing pages numbered from 1 to 29, inclusive, contain a full, true, and correct transcript of the proceedings had at said time.

Wendy K. Randall
WENDY K. RANDALL, CSR-----

My Commission Expires:

January 3, 1990

CERTIFICATE OF SERVICE

I, certify that on August 14, 1991, I served four copies of the "Opening Brief of Petitioner, Mountain Fuel Supply Company [Final]" by first class mail upon counsel for respondent and intervenors in this matter to the following addresses:

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