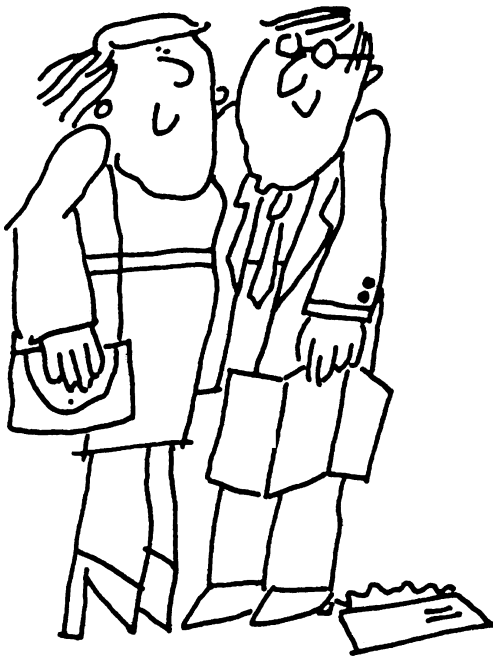

A Guide To Utility Ratemaking

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QUESTAR
Gas

Introduction

This booklet explains how natural gas rates are determined and describes the process Questar Gas Company goes through in Utah and Wyoming in seeking rate adjustments.

In Utah and Wyoming, utility rates are set by public service commissions (PSCs). These commissions are responsible for ensuring that consumers receive adequate and reliable utility services at reasonable rates. At the same time, the PSCs must allow utilities an opportunity to earn a profit that will fairly compensate the utilities' investors and enable the utilities to maintain their financial stability and to attract the capital necessary to provide satisfactory future service.

There are three sections in this booklet:

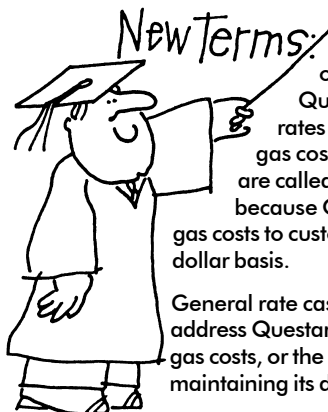
- A description of Questar Gas' regulatory environment;
- A description of the two types of rate cases Questar Gas files;
- An explanation of how rate cases are processed.

Terms

Following are explanations of some terms used in this booklet:

Gas Costs – The amount Questar Gas pays for the gas it resells to its customers.

Distribution non-gas – The costs of operating and maintaining Questar Gas' distribution system.



Purchased-gas adjustment – A type of rate filing that allows Questar Gas to adjust its rates to reflect changes in gas costs. These filings also are called "pass-on" filings because Questar Gas passes its gas costs to customers on a dollar-for-dollar basis.

General rate case – These rate filings address Questar Gas' distribution non-gas costs, or the cost of operating and maintaining its distribution system.

They have two functions: 1) to review Questar Gas' distribution non-gas costs and establish rates that fairly reflect them, and 2) to approve the method by which these costs are divided among various kinds of customers.

191 account – Also called the "balancing" account, the 191 account is used to balance actual gas costs against revenue collected from customers to cover these costs. The balance of this account shows whether revenues from current rates are more or less than actual costs. If the balance shows a surplus, it reduces rates the following year; if it shows a deficit, it increases rates the following year.

Allowed return on investment – Commonly called "allowed rate of return," it is the return or profit a utility is allowed an opportunity to earn. It is calculated as a percentage of the utility's rate base.

Rate base – The utility's investment in its facilities and the cash, or "working capital," necessary to operate on a day-to-day basis.

Test year – a 12-month period used to calculate the revenue required to cover the company's distribution non-gas costs. The test year should reflect as closely as possible the conditions the utility will face when the rates being established will be in effect.

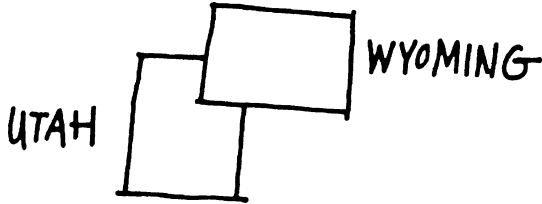
Rate design – The process that determines how Questar Gas' distribution non-gas costs are divided among various types of customers and how revenue will be collected (through customer charges, minimum bills, charges per therm used or a combination of these methods).

Therm – A measure of heat content that is equal to 100,000 British thermal units or Btus. Questar Gas bills its customers for the heat content of the gas they use, measured in therms. A decatherm is 10 therms.

Interim relief – Rates allowed by the PSC to be put into effect on a temporary basis, usually subject to refund, while a rate case is being settled.

QUESTAR GAS' REGULATORY ENVIRONMENT

Questar Gas provides natural gas service to residential, commercial and industrial customers in northern, central and southwestern Utah, southwestern Wyoming and southeastern Idaho. The Utah and Wyoming public service commissions (PSCs) approve appropriate rates for their respective states. Questar Gas' Idaho customers pay the same rate as Utah customers.



(Provision for Questar Gas to extend natural gas service to these Idaho customers on the same basis as similar customers in Utah was authorized in 1990 by a bill passed in the Idaho legislature and implemented through a contract between the Idaho Public Utilities Commission and the Utah PSC.)

The PSCs were organized because utilities don't always have direct competition from other providers of the same service. Since Questar Gas is the only natural gas distribution company in its service area, rate regulation is provided by the PSCs as a substitute for direct competition.

While Questar Gas does not compete with another natural gas distribution company in its service area, it does compete with providers of other energy sources, such as electricity, propane, fuel oil and coal. It also faces competition for industrial customers from interstate natural gas pipelines.

Regulators, by law, cannot assume management's role in running utilities. They can only ensure that rates are just, reasonable and in the public interest.

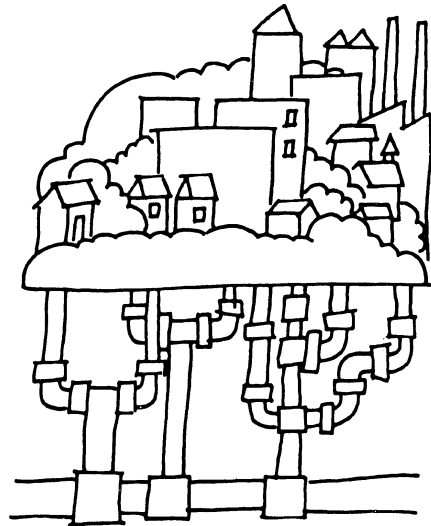
The PSCs also do not guarantee utilities' earnings. They simply set rates that provide a utility a reasonable opportunity to achieve its allowed rate of return.

In Utah, the PSC has three members who are appointed by the governor and confirmed by the Senate. It has a staff that assists in evaluating utility requests. Utah law established the Utah Division of Public Utilities to represent the general public interest before the PSC and the Committee of Consumer Services to represent small businesses and residential customers. The Utah Attorney General's office provides attorneys to represent these groups before the PSC.

The Wyoming PSC also has three members who are appointed by the governor. It has an independent staff of attorneys, auditors and other employees.

In both states, industry representatives and other special interest groups often participate in PSC proceedings.

In addition, the PSCs sometimes conduct "public witness days" during rate-case hearings to allow individuals an opportunity to express their opinions and provide information concerning utility rates.



Types of Rate Cases

Questar Gas' rates have two components that reflect different types of costs:

- gas costs, or the amount Questar Gas pays for the gas it resells to its customers; and
- distribution non-gas costs, or the costs of operating and maintaining the company's distribution system.

While the equation may vary depending upon changes in various costs, in recent years, gas costs have accounted for about 60 percent of rates for residential customers, while distribution non-gas costs have accounted for about 40 percent.

These costs are considered in different types of rate cases:

- Purchased-gas adjustment cases (also called "pass-through" or "pass-on" cases), which allow Questar Gas to adjust its rates to reflect changes in gas costs; and
- General rate cases, which cover the company's distribution non-gas costs and the way in which these costs are divided among various types of customers.

Matters such as the company's terms and conditions of service expansion into new service areas are also submitted for PSC consideration. These types of filings generally are independent of rate cases.



Purchased-Gas Adjustments

Purchased-gas adjustments reflecting changes in Questar Gas' costs are filed twice each year in both Utah and Wyoming.

Gas costs are passed through to customers on a dollar-for-dollar basis, so purchased-gas adjustment filings have no impact on Questar Gas' earnings. These rate cases are commonly referred to as "pass-through" cases in Utah and "pass-on" cases in Wyoming to reflect that any changes in gas costs are simply passed through to customers.

Gas costs also are collected from all customers using the same rate per therm used.

In both Utah and Wyoming, Questar Gas uses "balancing" accounts, called 191 accounts, to balance its actual gas costs against the revenues collected from customers to cover these costs. The balance of this account shows whether revenues from current rates are more or less than actual costs. If the balance shows a surplus, the surplus is returned to customers over a 12-month period through a rate reduction. If the balance shows a deficit, it is recovered over a 12-month period through a rate increase.

General Rate Cases

General Rate cases reflect changes in distribution non-gas costs, or the costs of operating and maintaining Questar Gas' distribution non-gas costs, or the costs of operating and maintaining Questar Gas' distribution system. These costs include such things as employee wages, the cost of maintaining the pipeline system required to provide service to customers, the cost of vehicles and other equipment the company uses, taxes the company pays, and the cost of capital needed to finance the company.

General rate cases require significantly more time to complete than purchased-gas adjustment cases – often many months. The proceedings typically include several weeks of hearings, preceded by months of research and thorough audit of the company's books.

A typical general rate case considers five areas:

- Size of the utility's rate base,
- Amount and treatment of expenses,

- Sales levels and revenues for the test year under consideration,
- Return on investment to be allowed, and
- Rate design.

Rate Base

Questar Gas' rate base includes its investment in facilities (pipelines, vehicles, buildings, etc.) and the operating funds, or "working capital," necessary to operate on a day-to-day basis.

Rate base is computed on the basis of a 12-month period called a test year. The company is allowed to include in its test year expenses a "return on rate base," which is determined by multiplying the calculated rate base by the allowed return on investment.

Expenses

Expenses include what Questar Gas' spends to operate and maintain its distribution system; to pay employee wages and benefits; to purchase materials and supplies; to pay interest on the company's debt; to pay federal, state and local taxes; and the costs of other direct business expenses.

The PSCs are required to allow appropriate operating expenses to be recovered in rates. However, a commission can disallow recovery of an expense if it feels the expense is not necessary to carry out utility service. When that happens, the utility must absorb the disallowed expense out of what otherwise would be profit, or shareholders' return on investment.



Sales Levels and Revenues

Revenue generated from test-year sales is compared to the total cost of providing natural gas service for the test year. The difference is the rate deficiency. While rates are based on the sales levels included in the test-year information, many factors affect actual sales levels. These factors include weather, general economic conditions, and customer growth. For example, the test-year sales levels are based on "normal" weather. When actual weather condition vary from what is considered normal, there is a significant impact on what Questar Gas actually earns.



Return on Investment

In order to maintain the quality of its service and to provide for the needs of a growing service area, a utility must raise money for new facilities. This money is obtained by the utility through the sale of stock or the issuance of long-term debt.

Attracting this capital depends on the utility's ability to earn a return on investment (commonly called rate of return) that is sufficient to cover the cost of this capital – to pay interest on debt, dividends to shareholders and provide retained earnings. Retained earnings are reinvested in the company. In addition to receiving dividends, shareholders also realize gains or losses depending on whether the value of their stock increases or decreases as a reflection of the company's performance.



In Utah and Wyoming, utilities are allowed an opportunity to earn a return on their investment in their facilities through the rates they charge their customers. The PSCs determine a utility's "allowed return on investment." This allowed return on investment is just that – an *allowed* not *guaranteed* return. The utility must effectively manage its operations in order to achieve its allowed return on investment.

Questar Gas periodically files financial statements with the PSCs. If Questar Gas expects to earn less than its allowed rate of return, it can file a rate increase with the PSC. Questar Gas realizes, however, that an increase in rates can hinder the company's ability to compete with other energy sources. In addition, when rates increase, customers generally use less gas, so a rate increase doesn't necessarily increase earnings.

If Questar Gas' financial statements show earnings above the allowed rate of return, or if the PSC believes earnings may exceed the allowed return in the future, it may ask the company to justify its rates. If the PSC believes the utility's earnings will continue to exceed its allowed rate of return, it can reduce the utility's rates.

Rate Design

Once Questar Gas' rate base, operating expenses and other costs, and a reasonable allowed return on investment are established, the company's total cost of providing service is calculated.

The process of dividing this total cost of providing service among various types of customers is called rate design. Customers fall into one of several rate classes including general service (residential and small commercial customers), firm industrial, interruptible industrial and transportation customers.

Questar Gas presents recommendations to the PSC on how costs should be divided among rate classes. These recommendations are based on the cost of providing service to each rate class. Other parties also present their opinions based on their special interests. Then the PSC approves the rate design that will be used.



How Rate Cases are Processed

General rate cases and purchased-gas adjustment cases are handled in generally the same manner:

- 1) Questar Gas files its request with the PSC, including information needed to support the request.



- 2) The request is studied by the Division of Public Utilities in Utah or the PSC staff in Wyoming.

Other interested parties that file with the PSC as intervenors in the case, such as industrial customers or private consumer organizations, also may study the request. This typically includes requesting additional information from Questar Gas.

These groups then file testimony with the PSC in response to Questar Gas' request. Filing testimony and evidence prior to the hearing process allows all parties to prepare adequately so the PSC's time can be spent productively during the hearing(s) and review of evidence.

- 3) Individuals can provide information and express their opinions during public witness days. Public witnesses are not required to file testimony in advance.
- 4) In a typical hearing, witnesses for each party testify and are cross-examined by attorneys representing the other parties. Then all parties have an opportunity to present rebuttal witnesses and evidence. This information is presented during public hearings, after which briefs are filed by the involved parties, and the PSC considers its ruling in the case.

Questar Gas has the option in general rate cases to seek interim relief. This means Questar Gas may ask the PSC to allow the company to implement all or part of the requested increase on an interim basis while the case is being settled, a process that may take many months. Interim relief is designed to prevent the company from suffering unfair losses due to inflation and other factors that may affect it during the rate case proceedings. Interim rates



are general subject to refund, pending the PSC's final order in the case.

Purchased-gas adjustment cases, which are filed twice each year in both Utah and Wyoming, generally are processed more quickly than general rate cases.

Conclusion

Judgements about the quality of regulation can be made on the basis of the answers to three questions:

1. Are the rates customers pay just and reasonable for the level of service they receive?
2. Is the quality of the service adequate?



3. Is the allowed return on investment adequate to fairly compensate shareholders for committing their capital to the utility?

When these three questions can be answered "yes," utility regulators and utilities are meeting their responsibilities to the public they serve.

