BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF QUESTAR GAS COMPANY TO INCREASE DISTRIBUTION RATES AND CHARGES AND MAKE TARIFF MODIFICIATIONS	Docket No. 13-057-05

REBUTTAL TESTIMONY OF

DAVID M. CURTIS

FOR

QUESTAR GAS COMPANY

December 5, 2013

QGC Exhibit 2.0R

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I. INTRODUCTION

Q. Please state your name and position.

A. David M. Curtis. I am the Vice President and Controller for Questar Corporation and its subsidiaries, including Questar Gas.

Q. Are you the same David M. Curtis that filed direct testimony in this rate case?

A. Yes.

Q. What is the purpose of your testimony?

A. I will provide rebuttal testimony to the direct testimony filed by the Utah Division of Public Utilities (DPU) and the Utah Office of Consumer Services (OCS) in this case. Specifically, I will address the recommended allowed return on equity.

II. UPDATED ANALYSIS

Q. How does your recommendation of an allowed return on equity differ from those recommended by the DPU and the OCS?

A. I recommended an allowed return on equity of 10.35%, while the DPU recommended 9.45% and the OCS recommended 9.3%.

Q. Do you still believe that an allowed return on equity of 10.35% is appropriate in this case?

A. Yes, I believe an allowed return on equity in the range of 10.35% is appropriate and necessary to attract investor capital for Questar Gas' capital expenditure requirements. I will demonstrate this later in my testimony. I will also demonstrate why the allowed returns on equity proposed by the DPU and the OCS are inadequate and will have a negative impact on Questar Gas' ability to attract investor capital.

Q. Have capital markets changed since your direct testimony was filed in July 2013?

A. The value of the US stock market has increased significantly as illustrated by the S&P 500 index. On July 1, 2013, this index was 1,615. By November 26, 2013, this index increased 11.6% to 1,803.

In addition, long-term interest rates have increased significantly since my direct testimony was filed. The US 30-year treasury yield was 3.80% on November 26, 2013, up from the 3.48% yield on July 1, 2013. The increase in yields appears to be driven by expectations that the Federal Reserve will back off their accommodative monetary policy, including the bond purchase program. The expected changes in Federal Reserve policy are driven by the same improving economic conditions that appear to be changing the stock market valuations.

Q. How have the changes in capital markets impacted the discounted cash flow and capital asset pricing models used to estimate appropriate allowed returns?

A. The discounted cash flow model as described in my direct testimony is based on dividend yields and expectations of future earnings growth. Dividends increased for three of my proxy companies. Stock prices varied for each of the companies, but on average remained about the same. This resulted in a slight increase in the average dividend yield. Published analyst growth rates have not changed significantly over this time, in spite of the overall changes in economic growth. The net result is that the discounted cash flow model expectations decreased slightly for the model using analyst growth rates and increased slightly for the model using company growth rates. The updated results from the discounted cash flow model are attached as QGC Exhibit 2.1R pages 1 and 2.

Increases in interest rates have raised the results from the capital asset pricing model. Since this model is based on the capital markets line, a change in long-term interest rates would change the estimate of investor expectations for allowed returns on equity. The updated results from the capital asset pricing model are attached as QGC Exhibit 2.2R.

The following table shows the updated results from each of my models and other analysis:

	As Filed on 1-Jul-13			Updated on 25-Nov-13		
	Min.	Mean	Max.	Min.	Mean	Max.
Discounted Cash Flow Model						
Analyst Growth Estimates	7.96%	8.73%	9.50%	6.36%	8.57%	9.76%
Company Growth Estimates	6.19%	10.75%	12.59%	6.34%	10.75%	12.66%
Capital Asset Pricing Model	9.51%	9.82%	10.49%	9.85%	10.30%	10.97%
Actual Earned Returns - 2002 - 2012	8.20%	11.50%	15.30%	No Additional Data		
Recent Authorized Returns						
2009 - 2012	8.83%	10.06%	11.35%			
2009 - June 2013				8.83%	10.04%	11.35%
2012 - June 2013				9.06%	9.88%	10.50%

Q. How can the discounted cash flow model and the capital asset pricing model results move in different directions over a four-month period?

A. The inconsistent movement in the discounted cash flow model and the capital asset pricing model illustrates the inherent weaknesses in the two models. Using these models to estimate investor expectations of appropriate allowed returns is not a simple mathematical exercise. The results of these models must be used with other information, including actual earned returns and recent authorized returns.

Q. Did you update your summary of recently authorized returns for other natural gas distribution companies?

A. Yes, I updated the summary of recently authorized returns as reported by the AGA through June 2013. The mean result did not change significantly from my earlier analysis.

In addition to this analysis, on November 5, 2013 the Alabama Public Service Commission issued its order authorizing a return on equity range of 10.50% to 10.95% with an adjusting point of 10.80% for Alabama Gas Corporation.

Q. Do the results of your updated models continue to support your recommendation of a 10.35% allowed return on equity?

A. Yes, a continuation of the currently authorized 10.35% return on equity is still appropriate.

III. IMPACT OF ALLOWED RETURNS LESS THAN 10.35%

Q. What are Questar Gas's capital requirements over the next few years?

A. Questar Gas forecasts that it will have capital expenditures of about $985 million for the years 2014 through 2018. In addition to the annual capital expenditures required for the high-pressure and intermediate high-pressure feeder line replacement projects described by Mr. McKay, these expenditures are also necessary to accommodate projected customer growth and major plant upgrades or installations. In order to fund these capital expenditures, Questar Gas estimates that it will need to raise $400 million of long-term debt (including $134.5 million to repay maturing debt) and raise $210 million of common equity from its parent company. The balance of capital requirements will come from retained earnings.

Q. The DPU and OCS recommend allowed returns on equity of 9.45% and 9.3% respectively. How would allowed returns at these levels impact Questar Gas' ability to raise capital?

A. Attached is QGC Exhibit 2.3R. This exhibit shows Questar Gas's forecast of 2014 and 2015 financial results from its Fall 2013 Five-Year Plan as presented to the Questar Board of Directors in October 2013. The forecast assumed rates based on an allowed return on equity of 10.35% as requested by the Company in this rate case. Pro forma adjustments are made to the plan results to show the impact of receiving a 9.45% allowed return on equity as proposed by the DPU and a 9.3% allowed return on equity as proposed by the OCS. The pro forma revenue adjustment was based on the difference

between the proposed returns applied to the revised rate base in this case. Because the new rates are scheduled to go into effect on March 1, 2014, only 80% of the difference in rates was applied to 2014 results.

Q. What does this analysis show?

A. First, even if Questar Gas' rates are based on a 10.35% return on equity in this rate case, the financial metrics are much worse than they have been in the last few years. In the past, Questar Gas' financial return on equity (measured by dividing net income by the average of beginning and ending common equity) has been approximately equal to its Utah allowed return. This is not expected to hold true going forward. Capital expenditure requirements to fund customer growth and pipeline replacements and plant expansions are very significant. The regulatory lag between incurring these costs and recovering the costs through increases in customer rates is significant. Only about one-third of capital expenditures are included in the infrastructure tracker.

Q. Doesn't the use of a forecast test year resolve the problem with regulatory lag?

A. Although a forecast test year is better than an historical test year, Questar Gas still faces significant regulatory lag. In this case, Questar Gas was allowed to use an average 2014 test year. Since rates do not go into effect until March 1, 2014, there are only a few months of non-heating season revenues before forecasted capital expenditures exceed the amount recoverable in rates and are no longer included in rate base. Since the rate-effective period will most likely extend past 2014, capital expenditures during that period outside of the infrastructure replacement tracker will not be included in rate base until the next general rate case. Any increases in costs, due to inflation or otherwise, beyond mid-2014 are not recovered from customers.

Q. Is there downward pressure on Questar Gas' bond ratings?

A. Yes, even if Questar Gas is allowed rates based on a 10.35% on equity in this case, bond ratings will be on the border between an A rating and a Baa rating as shown in QGC Exhibit 2.3R. This will occur despite Questar Corporation's significant $90 million equity contribution to Questar Gas in the fourth quarter of 2013. Questar Gas will need to manage its financial affairs very tightly to avoid a down grade in its bond ratings.

As shown in this exhibit, the downward pressure on Questar Gas' bond ratings gets much stronger if the DPU's or OCS's recommended allowed return on equity is awarded in this rate case. Financial returns on equity drop below 9%. All other credit metrics used by the bond rating agencies get worse.

Q. Do the bond rating agencies also include the regulatory environment in assigning a bond rating?

Yes. A recent report[1] by Standard & Poor's titled "Key Credit Factors for the Regulated Utilities Industry" outlines the criteria used to evaluate regulated utilities. One of these criteria is the regulatory framework. The report states, "The regulatory framework/regimes's influence is of critical importance when assessing regulated utilities' credit risk because it defines the environment in which a utility operates and has a significant bearing on a utility's financial performance." Standard & Poor's evaluates the regulatory environment for factors that are "key for a utility to recover all its costs, on time and in full, and earn a return on capital employed."

I believe Standard & Poor's and Moody's bond ratings for Questar Gas will be negatively impacted if the Utah Commission only allows a return that is in the bottom quartile of allowed returns throughout the nation as recommended by the DPU and OCS. For example, in a Moody's Investor Service article dated June 10, 2013, entitled "Rating Action: Moody's downgrades American Transmission Systems, Inc. and Trans-Allegheny Interstate Line Company; outlook is stable" it states "Longer-term, unexpected increase in credit metrics or a more lucrative ROE and rate structure from the FERC could be a trigger for rating upgrades. Conversely, ATSI and/or TrAILCo could experience downward rate pressure if the FERC negatively changes the rate structure or if there is a serious deterioration of credit metrics." Please see QGC Exhibit 2.4R.

[1] S&P Capital IQ Global Credit Portal "Key Credit Factors for the Regulated Utilities Industry", November 19, 2013.

Q. What would be the impact of a decrease in bond ratings on Questar Gas' interest cost and access to capital?

A. The difference in spread between corporate bonds with an A rating and those with a Baa rating will vary over time and is different depending upon maturities. On average, a 10-year Baa-rated bond will likely cost at least 50 basis points more than a 10-year A-rated bond. During times of financial uncertainty, such as the economic downturn that occurred in 2008 and 2009, the spread was over 200 basis points. As I indicated earlier, Questar Gas expects to issue about $400 million of long-term debt within the next five years. A 50 basis point difference in the cost of this debt would cost the customer $2 million per year for the life of the debt. At certain times of financial stress, similar to what occurred during the economic downturn, lower rated debt may not be available to fund Questar Gas' ongoing capital needs.

IV. PROXY GROUP

Q. Witnesses for the DPU and the OCS raised some issues with your direct testimony and recommendation of 10.35% allowed return on equity. Can you address those issues?

A. Yes. To understand my recommendation it is important to first understand my selection of the proxy group. I selected eight companies, primarily engaged in the natural gas distribution business based on certain criteria outlined in my direct testimony. The universe of natural gas distribution utilities with publicly traded stock is not very large. I included all companies that were comparable to Questar Gas' distribution operations, except for Laclede Group, which is involved in acquisitions of Missouri Gas and New England Gas. The reason I excluded companies involved in acquisitions is because the market price may be distorted due to the transactions and may not be reflective of an appropriate value of ongoing operations. More importantly to the discounted cash flow model, it is uncertain whether or not analyst earnings growth expectations include only the current operations or if the growth rate includes the acquisitions. Because of this uncertainty, I excluded Laclede Group. Once Laclede Group either completes or

terminates the acquisitions, I would again include the company in a proxy group assuming it continues to meet the other criteria.

Mr. Wheelwright, as witness for the DPU would have me include Laclede Group in the proxy companies. I disagree with Mr. Wheelwright because of the possible distortion in the results as described above. Mr. Wheelwright supports his inclusion of Laclede on the basis that its current financial indicators do not differ significantly from its historic indicators. I think this justification misses the point. The fact that the indicators do not differ significantly from historic indicators may be attributable to the fact that Laclede is involved in pending acquisitions. The issue is what Laclede's indicators would be if it were not involved in pending acquisitions. It is uncertain whether current metrics for Laclede are affected by pending acquisitions. Therefore, Laclede should be excluded from the proxy group.

The DPU witness would exclude New Jersey Resources and WGL Holdings from the proxy group. Both of these companies have energy services segments that market natural gas to customers under customer choice programs. Mr. Wheelwright excludes these companies because more than half of the operating revenues are generated from these energy services segments. I disagree with Mr. Wheelwright's analysis. The energy services revenues do not significantly change operating risks for these companies since the revenues are merely a pass-through of gas costs to distribution customers. As I showed in my testimony, 65% of New Jersey Resources operating income and 82% of WGL Holdings operating income are generated by regulated natural gas distribution operations. Only a small percentage of assets are associated with energy services operations. I believe my criteria of "more than half of operating income derived from natural gas distribution operations" is more appropriate than looking at operating revenues. Investment analysts clearly consider New Jersey Resources and WGL Holdings to be natural gas distribution companies.

Q. What is Mr. Lawton's position regarding Questar's risks relative to the proxy group?

A. On lines 343 and 344 of Mr. Lawton's testimony he states "I would note that many gas companies and some electric utilities have similar mechanisms, thus Questar's risks relative to the proxy gas companies are similar in terms of regulatory mechanisms that enhance cash flow and reduce regulatory lag."

Q. Do you agree with his statement?

A. Yes, I agree that all of the companies in the proxy group have a form of regulatory and revenue stabilization mechanisms in at least some of their jurisdictions.

Q. Do you also agree that Questar Gas' return on equity should be reduced by 5 basis points because it has an infrastructure recovery mechanism?

A. No. Because the other companies in the proxy group have similar revenue stabilization mechanisms and similar risks which are already included in the return on equity calculations. Please see the table below.

	Balancing Account	Weather Normalization	Rate Stabilization	Infrastructure Replacement
AGL	Yes	Yes	Straight Fixed Variable	Yes
Atmos	Yes	Yes	Straight Fixed Variable	Yes
NJR	Yes	Yes	Decoupling	Yes
NWN	Yes	Yes	Decoupling	Yes
PNY	Yes	Yes	Decoupling	Yes
SJI	Yes	No	Decoupling	No
SWX	Yes	Yes	Decoupling	No
WGL	Yes	Yes	Decoupling	Yes

V. DISCOUNTED CASH FLOW MODEL

Q. Both the DPU witness Mr. Wheelwright and the OCS witness Mr. Lawton take issue with your version of the discounted cash flow model that uses a combination of historical growth rates and company provided growth rates. Do you still believe that this is a valid model that should be used in setting the allowed return on equity in this case?

A. As I stated in my direct testimony, the discounted cash flow model relies heavily on understanding investor expectations of future earnings or dividend growth. Unfortunately, it is impossible to survey investors and obtain a reliable understanding of their actual growth assumptions. I believe that there are four possible ways to estimate these investor expectations. The first way is to look for published earnings or dividend growth rates from investment analysts. Second, one could look at actual historical earnings growth rates. Third, information provided by the company to investors on earnings growth expectations can be used. And finally, an earnings retention growth rate can be calculated. I will address each of these methods to estimate investor expectations.

Traditionally, the most common source of earnings growth rate expectations has been from published analyst reports. I included this model in my direct testimony as did both the DPU and OCS witnesses. However, as stated in my direct testimony, I believe that these published analyst reports may not truly reflect investor expectations. The reason for my skepticism over these reports has to do with the nature of the natural gas distribution business. The vast majority of natural gas customers in the United States are served by companies that are either combination gas and electric distribution companies or are part of integrated natural gas companies (such as Questar Corporation). There are only a handful of small and medium sized "pure" natural gas distribution companies that earn the majority of their income from natural gas distribution operations. This small group of companies is the only universe from which we can select our proxy group. My proxy group only serves 13 million gas distribution customers out of a total of an estimated 70 million gas distribution customers served by investor owned companies throughout the United States. The largest providers of natural gas distribution services are not included in the proxy group. Because of the size of their operations, my proxy companies are not widely followed or traded. The following table compares trading activity and analyst coverage for my proxy group with other energy companies as reported by Yahoo! Finance on November 15, 2013:

Symbol	Company	Daily Volume	Analysts with Price Opinions
Proxy Group			
GAS	AGL Resources	632,000	N/A
ATO	Atmos Energy	408,000	6
NJR	New Jersey Resources	177,000	5
NWN	Northwest Natural Gas	117,000	2
PNY	Piedmont Natural Gas	256,000	5
SJI	South Jersey Industries	89,000	4
SWX	Southwest Gas	153,000	5
WGL	WGL Holdings	250,000	7
Other Energy Companies			
STR	Questar	1,306,000	8
NI	NiSource	2,052,000	9
SRE	Sempra	997,000	15
OKE	ONEOK	1,274,000	11
NFG	National Fuel Gas	376,000	10
EGN	Energen	805,000	14
EQT	Equitable Resources	1,175,000	18
QEP	QEP Resources	1,887,000	20

As can be seen in the above table, the proxy companies are not as widely traded or followed as other energy companies. For this reason, I don't believe that published analyst growth expectations should be the only source of growth estimates in the discounted cash flow model.

Investors have access to historical earnings growth rates. I calculated 5-year and 10-year earnings growth rates for the proxy group and included them in one of my models. I believe one good indication of future earnings growth for investors is a look-back to historical growth rates.

Many companies provide some guidance to investors on expected earnings growth rates. I believe that this is a valuable source of information for setting investor expectations. In fact, some analysts that follow Questar Corporation use company forecasts of earnings growth as a starting point for their valuation models. Companies like Questar are typically restrained from overstating their expected earnings growth rate by the potential decline in value in a company's stock that can be significant if actual results do not meet investor expectations.

I combined the 5-year historical earnings growth rate, the 10-year historical earnings growth rate and an average of company-provided earnings growth rates in the second version of my discounted cash flow model. I believe this model is a fair representation of investor expectations of return on equity requirements.

The final way to estimate earnings growth rates is the earnings retention model. OCS witness Mr. Lawton provides a version of this model. The assumption under this model is that earnings will grow by a factor of retaining earnings (net income less dividends) times the historical return on equity. A significant problem with this model is that income can grow from other factors besides retained earnings, included the issuance of equity and other changes in capital structure. Although Mr. Lawton adjusts for equity issuance, I do not believe his model is a reasonable estimation of investor growth expectations.

Mr. Wheelwright uses a discounted cash flow model with a growth rate based on 75 percent of analysts' earnings growth estimates and 25 percent based on analysts' dividend growth estimates. I believe this model is less reflective of investor expectations than the model using only analysts' earnings growth expectations because very few analysts publish dividend growth rates.

VI. CAPITAL ASSET PRICING MODEL

Q. You include a factor in your capital asset pricing model for company size. Neither the DPU nor the OCS witnesses include this factor. Why is this factor important to the capital asset pricing model?

A. The capital markets line as illustrated on QGC Exhibit 2.4 of my direct testimony shows that the risks and returns on small and mid-sized companies are clearly greater than large company stocks. The size factor is necessary since the market risk premium was calculated from the difference between large company stocks and long-term government bonds. The increased return requirements for smaller companies because of increased risk are well documented in the Ibbotson data of historic returns. The size premia as reported in the Ibbotson SBBI 2013 Valuation Yearbook measure additional risks not accounted for in the capital asset pricing model. The size premia is included in the examples and clarification in this report.

Q. The DPU witness, Mr. Wheelwright, suggested that you should include an industry premium in your capital asset pricing model. Do you agree?

A. No, there are several models that use the capital markets line to estimate cost of capital. Mr. Wheelwright appears to be combining two of these models. The capital asset pricing model uses a company's Beta as a measure of the company's risk relative to the overall market. I included the capital asset pricing model in my direct testimony. Another model, described in the Ibbotson book as the "buildup method" uses industry specific premia to adjust for an industry's risk relative to the market. The industry premia adjustment in the buildup method makes a similar adjustment to the costs of equity as the Beta adjustment does in the capital asset pricing model. Both of these models make use of the size premia to adjust for the added risk associated with smaller companies. While I did not include the buildup method in my direct testimony, I believe its results support my recommendation. The calculation of Questar Gas' cost of equity under the buildup method is as follows:

Risk free rate of return – 30-year Treasury Bond yield forecast for 2014	3.91%
Market risk premium	
Large company common stock, total return 1926 – 2012 average	11.80%
Long-term government bonds, total yield 1926 – 2012 average	5.10%
Market risk premium	6.70%
Natural gas distribution industry premium	(2.44)%
Questar Gas size premium – decile 7	1.73%
Estimated Questar Gas cost of equity	9.90%

VII. QUESTAR GAS RISKS

Q. In your direct testimony you make a risk comparison between Questar Gas and the proxy companies and conclude that Questar Gas has a higher level of risk. Neither the DPU witness nor the OCS witness accepts this conclusion. Do you still believe that Questar Gas is riskier than the proxy group?

A. Yes, as I explained earlier in this rebuttal testimony, the outlook for Questar Gas' financial results has changed significantly from prior years because of significant capital expenditure requirements. Questar Gas has similar bond ratings as the proxy group, although, as I showed earlier in this testimony, these bond ratings are at risk especially if the allowed rate of return is reduced. Questar Gas has lower interest coverage than the proxy group. Questar Gas' actual financial return on equity is lower than the proxy group and is expected to go lower, even with a continuation of a 10.35% allowed return on equity. Questar Gas' capital expenditures relative to its current size are larger than the proxy group and are expected to go higher. Finally, Questar Gas is smaller in size than the average proxy company. The impact of size on relative risk has been discussed earlier.

The report from Standard & Poor's referred to earlier uses most of these same risk factors to assess financial risk for bond holders. The interest coverage ratio is a key financial measure used by bond rating agencies to measure the ability to withstand financial

uncertainty. Standard & Poor's considers return on equity to be a key measure of profitability used to assess risk. As stated in this report, "We generally believe a larger service territory with a diverse customer base and average to above-average economic growth prospects provides a utility with cushion and flexibility in the recovery of operating costs and ongoing investment (including replacement and growth capital spending), as well as lessening the effect of external shocks (i.e., extreme local weather) since the incremental effect of each customer declines as the scale increases."

I believe that equity investors view the risks shown on QGC Exhibit 2.7 of my direct testimony in a similar way that bond investors view these risks. Taken all together, I believe these factors make Questar Gas riskier than the proxy group. I believe this higher risk should be taken into account in setting an appropriate allowed rate of return on equity.

Q. Does this conclude your rebuttal testimony?

A. Yes.

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

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

_____
David M. Curtis

SUBSCRIBED AND SWORN TO this ___ day of _____ 2013.

_____
Notary Public