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State of Utah
Department of Commerce
Division of Public Utilities

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Executive Director

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Deputy Director

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Director, Division of Public Utilities

Memorandum

TO: Public Service Commission

FROM: Division of Public Utilities
Chris Parker, Director,
Artie Powell, Energy Manager
Charles Peterson, Technical Consultant
Doug Wheelwright, Technical Consultant

DATE: November 18, 2015

RE: Questar Gas Dividend Declaration October 28, 2014
Docket No. 15-999-02

I. RECOMMENDATION – No Action

Based upon the following analysis, the Division of Public Utilities (Division) finds no indication that the capital and operations of Questar Gas Company (Company or Questar Gas) will be impaired pursuant to UCA §54-4-27. Therefore, the Division recommends that the Commission take no action.

II. ISSUE

On November 2, 2015, the Board of Directors of the Company declared a quarterly cash dividend of $9.5 million. The dividend is payable to the Company's sole shareholder, Questar Corporation, on December 14, 2015. On November 4, 2015, the Commission issued an Action Request to the Division to review and make recommendations. This memo is the Division's response to the Action Request.

Pursuant to Utah Code Annotated §54-4-27, the Company must notify the Commission of the dividend within five days of its declaration. The Commission has 30 days from the dividend declaration date to investigate whether the payment of such dividend would result in impairment of the capital or to the utility's service to the public, and if it finds that such impairment will or may occur, the Commission may order that the dividend not be paid.

III. ANALYSIS

The Division understands the terms "impaired" and "impairment" in the statute to mean that (1) the payment of the dividend will result in actions being taken against the Company by creditors, rating agencies, or others due to a reduction in the value of the capital, the violation of loan covenants, or other agreements; (2) the payment of the dividend would result in a reduced ability of the Company to provide service through a lack of working capital or other financial capacity to continue its operations in the same manner as it would if the dividend were not paid.

The Division investigated the effects of the dividend on the capital and cash flows of the Company using the latest financial information available. This included the annual financial statements through December 31, 2014, quarterly financial statements as of September 30, 2015, Questar Corporation News Release dated November 2, 2015, and a review of the Company's bond rating from the various bond rating agencies. The financial characteristics of Questar Gas generally indicate a profitable and stable utility company.

Exhibit 1 is a summary of the financial results for the periods ending December 31, 2009 through September 30, 2015. Because of the seasonal nature of the business, Questar Gas typically reports income in the 1st and 4th quarters of the year and losses in the 2nd and 3rd quarters. For the 12 months ending December 31, 2014, total revenue saw a slight decrease of 2.53% from $985.8 million to $960.9 million. The decrease in total revenue is primarily driven by a decrease in the total volume and the price of the natural gas commodity due to warmer than normal weather conditions. During the calendar year 2014, weather was 17% warmer than normal. From a longer term perspective, total revenue has increased slightly from 2009 through 2014 with an average annual increase of 0.88%.

For the first nine months of 2015, total revenue was $36.2 million lower and the cost of natural gas sold was $36.6 million lower than the same period in 2014. The decrease in total revenue was due primarily to lower gas prices and warmer than normal temperatures at the beginning of the year. Weather, as measured in degree days has been 23% warmer than normal for year-to-date 2015.

Natural gas provided by Wexpro represented 62% of the natural gas supply in 2014. For the first 9 months of 2015, Wexpro has produced 72% of the total gas requirement. Additional gas purchases from third parties will be required during the last three months of the year and should reduce the total percentage of cost of service gas for calendar year 2015. It is anticipated that Wexpro will provide approximately two-thirds of the Questar Gas annual supply requirement.

The balance sheet information is included on pages 2 and 8 of Exhibit 1. The net plant and equipment category has increased steadily from 2009 through 2014 averaging an 8.79% annual increase. Capital expenditures increased from $82.6 million in 2009 to $174.7 million in 2014 primarily due to the ongoing feeder-line replacement program. For the first 9 months of 2015, the Company has reported capital expenditures of $153.2 million. The feeder-line replacement program and customer growth are projected to support 6% – 8% annual net income growth through 2019.[1]

Questar Corporation manages cash at the corporate level and loans between Questar Gas and Questar Corporation occur on a regular basis. For short term cash needs, Questar Gas has historically borrowed money from its parent company Questar Corporation and the short term notes payable have varied widely during the periods under review. The note to Questar Corporation as of December 2014 was $119.3 million and has increased to $180.0 million as of September 30, 2015. The Company follows an established intercompany loan procedure for lending and interest calculations. Long Term Debt totals $534.5 million and has been unchanged since 2013.

Page 4 of Exhibit 1 calculates the financial ratios for the periods under review. Ratio calculations for the first 9 months of 2015 have been calculated but may not accurately reflect the current conditions due to the seasonality of the operation. Short-term liquidity ratios for

[1] Questar Corporation Investor Presentation, September 2015, p. 16

year-end 2014 were higher than historical averages with the current ratio at 1.00 and the quick ratio at 0.61 compared to the average of 0.86 and 0.56. The long-term solvency ratios are near the historical averages with Net Worth / Total Debt at 0.44 and Net Worth / Fixed Assets at 0.38.

The profitability ratios are changing with the increase in capital expenditures in recent years. Return on Total Assets was 3.88% for 2014 compared to the 5 year average of 4.12%. Return on Total Capital went down to 6.52% in 2014 compared to the 5 year average of 7.45%. On an SEC financial reporting basis, the Company had a Return on Equity (ROE) of 9.41% for year-end 2014 compared to the 5 year average of 10.23%. The Company's authorized return on equity at the end of 2014 was 9.85% and is calculated based on different regulatory guidelines. The regulatory ROE is provided by the Company in the year-end Results of Operation and were calculated to be 9.53% for 2014. Based on the calculations, the Company does not appear to be earning more than the authorized rate of return.

On January 31, 2014, Moody's Investor Services upgraded Questar Gas and Questar Corporation from A3 to A2.[2] Included in the Other Financial Indicators section on page 4 are calculations used by Moody's as part of its bond rating guidelines. These include the EBIT / Interest, Debt / Book Capitalization, Retained Cash Flow / Debt and a Simple ROE calculation. All of these ratios are within the guidelines specified by the rating agency as of year-end 2014.

The Company's regulatory capital structure for 2014 was 47.2% debt and 52.8% equity which is close to the historical average of 47.0% debt and 53.0% equity. In the most recent general rate case, the Commission approved a capital structure of 47.93% debt and 52.07% equity.[3] The Division is currently reviewing the capital structure of Questar Gas and Questar Corporation and will report any findings to the Commission.

Page 5 of Exhibit 1 includes the operating statistics and looks at the revenue by customer class along with the natural gas costs per dekatherm (Dth) for each year under review. In 2014,

[2] Moody's Investor Service, US utility sector upgrades driven by stable and transparent regulatory frameworks, February 3, 2014.
[3] Questar Gas Docket No. 13-057-05, Report & Order, p. 17.

residential and commercial sales provided 91.1% of the total revenue dollars but represented only 53.4% of the total volume. The volume of gas delivered to transportation and industrial customers represented 46.6% of the total volume in 2014 compared to the average of 39.3%. This change is primarily due to the increase in the number of customers that have moved from sales to transportation customers. The system natural gas cost has increased to $5.98 per Dth in 2014 compared to $5.00 per Dth in 2013 and was higher than the 5 year average of $5.03. The migration from sales to transportation service could continue as long as the price for the cost-of-service gas is higher than the current market price.

On May 1, 2012, Questar Gas Company filed a legal action against QEP Field Services Company, a subsidiary of QEP Resources, Inc. The case, entitled *Questar Gas Company v. QEP Field Services Company*, was filed in the Third District Court in Salt Lake County, Utah. Questar Gas believes certain charges of QEP Field Services Company for gathering services exceed the amounts contemplated under a Gas Gathering Agreement, effective September 1, 1993, pertaining to certain gas produced by Wexpro Company under the Wexpro Agreement.

On October 19, 2014, QEP Field Service and Tesoro Logistics LP (Tesoro) entered into a purchase agreement to transfer the related assets and liabilities of QEP Field Services to Tesoro. The purchase transaction was closed on December 2, 2014. On December 2, 2014, the court issued a memorandum decision granting two motions for partial summary judgement for breach of contract filed by Questar Gas. The court found that QEP breached the Gas Gathering Agreement by overcharging Questar Gas in its gathering rates. The court also denied two motions for partial summary judgement filed by QEP and denied cross-motions related to another claim. Due to the extended court proceeding, these issues may not be resolved for some time. Since this issue has not been resolved, management cannot determine whether this litigation may have an adverse material effect on its financial position, results of operations or cash flows. There has been no change in the pending litigation during the last quarter.

Questar Corporation owns 100% of the stock in Questar Gas; therefore, the entire dividend payment of $9.5 million will be paid to Questar Corporation. The dividend payment represents a significant cash requirement for the Company and could become an issue if there is a downward trend in the overall profitability. At the present time, Questar Gas has adequate cash flow to maintain its debt service obligations and meet its financial needs. The Company is projected to maintain profitability levels similar to historical results and the Division will continue to monitor the actual results and the regulated return on equity.

IV. CONCLUSION

The Division concludes that the payment of a $9.5 million common stock dividend declared by Questar Gas's Board of Directors is within the discretion of the Company and it appears that there will be no impairment of the capital or the services rendered by the Company.

cc: Barrie McKay – Questar Gas
Michele Beck – Office of Consumer Services