GARY HERBERT
Governor
SPENCER J. COX
Lieutenant Governor

State of Utah
Department of Commerce
Division of Public Utilities

FRANCINE GIANI
Executive Director
THOMAS BRADY
Deputy Director
CHRIS PARKER
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: May 24, 2016

RE: Questar Gas Dividend Declaration April 25, 2016
Docket No. 16-999-02

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 April 25, 2016, the Board of Directors of the Company declared a quarterly cash dividend of $10.0 million. The dividend is payable to the Company's sole shareholder, Questar Corporation, on June 20, 2016. As required, the dividend declaration notice was published in the newspaper on May 3, 2016. The Division has received a copy of the affidavit of publication dated May 19, 2016.

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, 2015, quarterly financial statements as of March 31, 2016, Questar Corporation News Release dated April 25, 2016, 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, 2010 through March 31, 2016. For the 12 months ending December 31, 2015, total revenue experienced a decrease of 4.51% from $960.9 million to $917.6 million. The decrease in total revenue is primarily due to warmer than normal weather conditions and a decrease in the market price of the natural gas commodity. During calendar year 2015, the calculation of heating degree days[1] was 19% warmer than normal. From a longer term perspective, total revenue has increased slightly from 2010 through 2015 with an average annual increase of 0.32%.

Because of the seasonal nature of the business, Questar Gas typically reports income in the 1st and 4th quarters of the year. For the first quarter of 2016, total revenue was $33.1 million higher than the same period in 2015. The increase in total revenue during the first quarter is the result

[1] The number of degrees that the average temperature for the day is below 65° Fahrenheit.

of cooler temperatures in 2016 compared to the same period in 2015. While the weather was cooler, as measured in heating degree days, year-to-date 2016 has been 9% warmer than the long-term historical average. Net income was $47.6 million for the first quarter of 2016 compared to $43.8 million for the first quarter of 2015.

Natural gas supplies are provided by a combination of cost-of-service production from Wexpro and from third party market purchases. Cost-of-service natural gas provided represented approximately 59% of the natural gas supply for calendar year 2015 and approximately 30% for the requirement for the first quarter of 2016. With the high volume of cost-of-service production, market purchases are only required during the winter heating season. With the lower market price of natural gas, Wexpro's ability to drill additional wells and increase production has been limited. It is anticipated that the percentage of cost-of-service gas provided by Wexpro will decrease in future periods as the existing wells experience normal depletion.

The balance sheet information on pages 2 and 8 of Exhibit 1 identifies an increase in accounts receivable from Affiliates from $45.2 million in 2014 to $69.2 million in 2015. For the first quarter of 2016, this account increased to $71.5 million. The Company has indicated that this account is an allocation of qualified plan and postretirement benefits to the operating entities. The Division is in the process of verifying this allocation due to the pending merger of Questar Corporation with Dominion Resources.

Accounts receivable and unbilled gas accounts receivable for the first quarter of 2016 were higher than the same period in 2015 but are in line with historical averages. The net plant and equipment has increased steadily from 2010 through 2015 averaging a 9.91% annual increase compared to total assets which increased at an average rate of 9.25%. Capital expenditures have increased from $108.6 million in 2010 to $217.4 million in 2015 primarily due to the ongoing feeder line replacement program.

Long-term debt was $534.5 million as of year-end 2015 and was $527.6 million for the first quarter of 2016. Questar Corp. normally does not issue debt at the parent-company level. The parent instead issues debt at the subsidiary level, primarily to provide capital-structure clarity for regulatory purposes.[2] Of special mention is the short-term note payable to Questar Corporation of $273.3 million as of year-end 2015. This short term note payable to the parent company has been paid down to $140.5 million for the first quarter of 2016 and has varied widely during the periods under review. The note payable to Questar Corp reached the lowest point at $17.7 million as of December 2013, increased to $119.3 in 2014 and continued to increase to the historical high of $273.3 million in 2015. Questar Gas continues to use its parent company as a "bank" from which it obtains short-term loans according to its need for liquidity. The Company had indicated that it would be issuing additional long-term debt to reduce the note payable to Questar Corp, however, the additional debt issuance was postponed due to the pending merger of Questar Corp with Dominion Resources. At the present time short term intercompany loans charge an interest rate based on the method determined in Docket 85-057-09. As of December 2015, the interest rate on the intercompany loan was 0.25%. It is anticipated that short term debt issuance and intercompany lending will be part of the discussions relating to the proposed merger of Questar Corporation with Dominion Resources.

Page 4 of Exhibit 1 calculates the financial ratios for the periods under review. Short-term liquidity ratios for 2015 were slightly lower than historical averages with the current ratio at 0.82 and the quick ratio at 0.49 compared to the average of 0.86 and 0.55. The long-term solvency ratios are also slightly lower than historical averages with Net Worth / Total Debt at 0.40 and Net Worth / Fixed Assets at 0.36 compared to the average of 0.43 and 0.37.

The profitability ratios remain close to historical averages with Return on Total Capital of 7.2% in 2015 compared to the 5 year average of 7.3%. On an SEC financial reporting basis, the Company had a Return on Equity (ROE) of 10.5% for 2015. The Company's authorized return on equity at the end is 9.85% and is calculated based on slightly different regulatory guidelines. The regulatory ROE is provided by the Company in the year-end Results of Operation and were calculated to be 9.6% for 2015. Based on the calculations, the Company does not appear to be

---

[2] Questar Comments on Moody's Rating,, http://prnwire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/11-12-2002/0001839749&EDATE= > < Accessed June 9, 2010.

earning more than the authorized rate of return. The Division will continue to monitor the regulatory ROE calculations and will report any findings to the Commission.

Included in the Other Financial Indicators section are four calculations used by Moody's as part of their 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 agencies as of year-end 2015. On February 1, 2016, Moody's placed Questar Corporation on review for possible downgrade but affirmed the outlook for Questar Gas and Questar Pipeline as stable. The review for downgrade was prompted by the announced merger of Questar Corporation with Dominion Resources.

The Company's regulatory capital structure is currently 46.1% debt and 53.9% equity, which is close to the five year average of 46.8% debt and 53.2% equity. Total Common Equity grew at an average rate of 8.5% for the periods under review and included a $20 million equity contribution from the parent company in 2011 and a $90 million equity contribution from the parent company in 2013.

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 period under review. Residential, commercial and industrial sales customers provided 94.9% of the total revenue dollars but represented 55.8% of the total volume in 2015. For the first quarter of 2016, residential, commercial and sales customers provided 97.2% of the total revenue dollars but represented 67.8% of the total volume. The volume of gas for transportation customers has increased from 30.7% in 2011 to 44.2% in 2015. The increase in the volume for transportation customers is likely due to the low commodity price which has created an incentive for large volume customers to move to the transportation class.

Page 6 of Exhibit 1 includes a breakdown of the cost of sales for Questar Gas. The majority of this information is taken from Note 1-F included in the SEC 10-K report. Of particular note is the Operator Service Fee (OSF) paid to Wexpro. While the total cost of gas sold has decreased at an annual average rate of 1.18% for the periods under review, the OSF has increased at an average annual rate of 5.86% and represents the largest individual line item in the total cost of gas. The OSF grew from $240.0 million in 2010, increased to $349.7 million in 2014 and has decreased to $319.0 million in 2015. In contrast to the growth in the cost of the OSF, the volume (Bcf) of the cost of service gas production from Wexpro has increased at an average annual rate of 2.82%. During the same time period, the volume of purchased gas decreased at an average annual rate of 8.01% and the cost decreased at an average annual rate of 19.59%. The Division is currently reviewing the individual charges included in the OSF in prior years and will provide any findings to the Commission.

Questar Corporation owns 100% of the stock in Questar Gas; therefore, the entire dividend payment of $10.0 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.

On May 1, 2012, Questar Gas Company filed a legal action against QEP Field Services Company, a subsidiary of QEP Resources, Inc. concerning certain charges for gathering services. On March 22, 2016, a settlement was reached in this case and the disputed issues were resolved. The settlement agreement did not result in a material impact on the Questar Gas results of operation, financial position or cash flows.

In a separate legal issue, in February 2015, a trial was held in the case of Rocky Mountain Resources and Robert N. Floyd v. QEP Energy Company and Wexpro Company.[3] Plaintiffs allege they are entitled to a 4% overriding royalty interest (ORRI) in a state oil and gas lease assigned to Wexpro and QEP in the Pinedale Field. On February 13, 2015, a jury decision was reached that awarded the Plaintiffs $14.1 million from Wexpro and $16.2 million from QEP. Wexpro and QEP have filed an appeal of the case to the Wyoming Supreme Court. Wexpro has

[3] Ninth Judicial District, County of Sublette, State of Wyoming, Case No. 2011-7816.

accrued its estimate of additional royalties in the case. Any additional payments from this case could potentially be expected to be recovered from Questar Gas customers.[4]

On January 31, 2016, Questar Corporation, the parent company of Questar Gas, entered into a merger agreement with Dominion Resources, Inc. a Virginia corporation. The merger was approved by Questar Corporation shareholders on May 12, 2016 and regulatory agencies have scheduled hearings in August and September of 2016. The Merger Agreement includes certain termination rights for both companies. If the merger is not completed, Questar could be required to pay termination fee of $99.0 million. In addition, upon termination in certain specified circumstances, Questar would be required to reimburse certain expenses in an amount not to exceed $5.0 million. Dominion may also be required to pay a termination fee of $154.0 million to Questar under certain circumstances.[5] The Division is currently reviewing the proposed merger and a hearing date for the Utah Commission has been scheduled for August 18, 2016.

IV. CONCLUSION

The Division concludes that the payment of a $10.0 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
Kelly Mendenhall – Questar Gas
Michele Beck – Office of Consumer Services

[4] Questar 2015 Form 10-K, Note 10 – Contingencies, p. 87
[5] Questar 2015 Form 10-K, Note 2 – Proposed Merger with Dominion Resources, p. 75