State of Utah
Department of Commerce
Division of Public Utilities

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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: August 25, 2016

RE: Questar Gas Dividend Declaration August 1, 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 August 1, 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 September 12, 2016. As required, the dividend declaration notice was published in the newspaper on August 9, 2016 and the Division has received a copy of the affidavit of publication dated August 16, 2016. In addition to the quarterly dividend, the Board of Directors also approved a contingent cash dividend of $0.00242 per share for each day elapsed from August 9, 2016 to the closing date of the merger with Dominion Resources Inc. The contingent dividend will not be paid if the merger agreement is terminated of if the merger does not close before the record date of the next quarterly dividend declaration.

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 June 30, 2016, Questar Corporation News Release dated August 1, 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 annual financial results for the periods ending December 31, 2010 through 2015 and quarterly financial information through June 30, 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

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

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 and losses in the 2nd and 3rd quarters. For the first six months of 2016, total revenue was $19.6 million higher than the same period in 2015. The increase in total revenue during the first six months is the result 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 14% warmer than the long-term historical average. Net income was $46.0 million for the first six months of 2016 compared to $41.0 million for the first half 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 by Wexpro represented approximately 59% of the natural gas supply for calendar year 2015 and approximately 47% for the requirement for the first half 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 six months of 2016, accounts receivable from affiliates increased to $72.1 million. The Company has indicated that this account is an allocation of the qualified retirement plan and post-retirement benefits to the operating entities. Accounts receivable and unbilled gas accounts receivable were $6.4 million higher for the first half of 2016 compared to the same period in 2015.

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. Year-to-date capital expenditures for 2016 total $124.3 million.

Long-term debt totaled $534.5 million as of year-end 2015 and remained stable at $531.4 million as of June 30, 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 $129.0 million as of June 30, 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 and 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 is anticipating issuing additional long-term debt following the proposed 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 short-term intercompany loans was 0.25%. It is anticipated that the lending arrangements for short-term lending will change following the merger of Dominion and Questar.

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 is 9.85% and is calculated based on slightly different regulatory guidelines and,

[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.

therefore, is not directly comparable to the SEC results. The Company does, however, provide a calculation of its earned ROE on a regulatory basis with its semi-annual Results of Operations (ROO). For year-end 2015 ROO, the Company calculates its regulatory ROE as 9.6%. Based on the calculations, the Company does not appear to be 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 Division will continue to monitor the debt ratings from the reporting agencies and will note any changes that occur as a result of the Dominion merger.

The Company's regulatory capital structure as of year-end 2015 was 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 six months of 2016, residential, commercial and sales customers provided 95.9% of the total revenue dollars but represented only 57.4% of the total volume. The volume of gas used by 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 compared to the Wexpro cost-of-service gas. The price difference has created an incentive for larger volume customers to move to transportation service. An additional 138 customers moving to the TS rate as of July 2016.

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. The Division is currently reviewing the individual charges included in the OSF in prior years and has provided the Overland Audit Report findings to the Commission. The Division is continuing to review the results of this audit and may make recommendations to the Commission. 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%.

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 but did impact the 191 account balance.

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 the Commission approved the negotiated stipulation agreement. Parties in Wyoming have also signed a stipulation agreement for the approval of the merger with a hearing scheduled on September 15, 2016. It is anticipated that the Wyoming Commissions will also approve the merger since there has been no opposition to the stipulation.

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. Additional transaction and transition costs associated with the Dominion merger will likely have an impact on earnings as these expenses begin to flow through the financial statements. The proposed contingent dividend of $0.00242 per share of common stock for each day elapsed from August 19, 2016 to the closing date of the merger calculates to the same $10.0 million dividend amount for the next quarter and is in line with the current dividend rate.

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. The proposed contingent dividend is in line with the current dividend rate.

[4] Questar 2015 Form 10-K, Note 10 – Contingencies, p. 87

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