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: March 3, 2014

RE: Questar Gas Dividend Declaration February 11, 2014

I. RECOMMENDATION – No Action

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

II. ISSUE

On February 11, 2014, the Board of Directors of Questar Gas Company (QGC) declared a quarterly cash dividend of $9.0 million. The dividend is payable to the Company's sole shareholder, Questar Corporation, on March 10, 2014. On February 12, 2014, the Commission issued an Action Request to the Division to review and make recommendations. This memo is the Division 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 of Public Utilities 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, 2013, Questar Corporation News Release dated February 11, 2014, 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, 2008 through December 31, 2013.

For the 12 months ending December 31, 2013, total revenue increased 14.3% from $862.2 million to $985.8 million. The increase in total revenue is primarily driven by a 12.8% increase in the volume of natural gas sold due to cold weather conditions. In 2013, the weather was 8% colder than normal compared to 2012, which was 16% warmer than normal. From a longer term perspective, total revenue has decreased slightly from 2008 through 2013 with an annual change of -.29%.

Earnings from Operations increased 9.7% from $92.9 million in 2012 to $101.9 million in 2013. During the same period, net income increased 12.1% from $47.1 million to $52.8 million. Net Income as a percentage of total revenue was 5.36% in 2013 compared to the five year average of 4.99%. As mentioned above, weather, as measured in degree days, was 8% colder than normal in 2013. During this same period, the temperature adjusted usage per customer decreased slightly from 108.4 Dth in 2012 to 108.0 Dth in 2013. In 2013, the Company experienced a 1.6% increase in the number of customers from 931,000 to 946,000.

Natural gas provided by Wexpro represented 59% of the natural gas supply in 2013 compared to 68% in 2012 and 52% in 2011. The higher percentage in 2012 was due to increased production and lower Questar Gas sales volumes driven by warmer than normal weather conditions.

The balance sheet information on pages 2 and 7 of Exhibit 1 identifies an increase in accounts receivable from $177.0 million in 2012 to $209.9 million in 2013. The net plant and equipment has increased steadily from 2008 through 2013 averaging a 8.06% annual increase compared to total assets which increased at an average rate of 6.55%. Capital expenditures increased from $82.6 million in 2009 to $166.2 million in 2013 primarily due to the ongoing feeder line replacement program.

Page 4 of Exhibit 1 calculates the financial ratios for the periods under review. Short-term liquidity ratios for 2013 were higher than historical averages with the current ratio at 1.21 and the quick ratio at 0.86 compared to the average of 0.84 and 0.54. The long-term solvency ratios are near the historical averages with Net Worth / Total Debt at 0.47 and Net Worth / Fixed Assets at 0.40. The profitability ratios are changing with the increase in capital expenditures. Return on Total Assets shows a slight decrease in 2013 to 3.90% compared to the historical average of 4.25%. Return on Total Capital was 6.80% in 2013, down from average of 7.71%. On an SEC financial reporting basis, the Company had a Return on Equity (ROE) of 10.12% for 2013. The company's authorized return on equity is 10.35% and is calculated based on different regulatory guidelines. The calculation for the regulatory ROE has historically been lower than the SEC amount and will be provided with the Results of Operation filed in March. Based on the preliminary calculations, the Company does not appear to be earning more than the authorized rate of return.

The $9.0 million dividend for the fourth quarter brings the total dividend payment for 2013 to $35.5 million. This amount represents a 7.6% increase from the $33.0 million in dividends paid in 2012. The dividend payment represents a 67.2% payout ratio which is consistent with the historical 67.3% payout ratio. The payout ratio is calculated as the dividend payment divided by the net income.

In November 2013, Moody's placed many of the US investor owned utilities on review for possible upgrade. On January 31, 2014, Moody's Investor Services upgraded Questar Gas and Questar Corporation from A3 to A2.[1] The upgrade was due to the following rationale:

> The primary driver of today's rating action was Moody's more favorable view of the relative credit supportiveness of the US regulatory environment, as detailed in our September 2013 Request for Comment titled "Proposed Refinements to the Regulated Utilities Rating Methodology and our Evolving View of US Utility Regulation."
>
> The regulatory environment has been constructive for Questar Gas. The company has obtained rate mechanisms that stabilize its credit metrics and accelerate the recovery of its investments. For example, its recent rate order indefinitely extended an existing decoupling mechanism and implemented an infrastructure cost-tracking mechanism that allows Questar Gas to place into rate base almost immediately upon project completion capital expenditures associated with a multi-year high-pressure natural gas feeder-line replacement program. We expect this replacement program to continue to keep Questar Gas' capital expenditures elevated for several years, so this cost tracking mechanism will help accelerate the recovery of this investment. The company has also had a weather normalization adjustment mechanism for some time. [2]

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 2013.

The Company's regulatory capital structure is currently 48.12% debt and 51.88% equity which is slightly different than the historical average of 47.18% debt and 52.82% equity. Common equity

[1] Moody's Investor Service, US utility sector upgrades driven by stable and transparent regulatory frameworks, February 3, 2014.
[2] Moody's Investor Service, Rating Action: Questar Corporation and Questar Gas, January 31, 2014

grew at an average rate of 8.42% for the periods under review and included a $30 million equity contribution from the parent company in 2008 and a $20 million equity contribution in 2011.

Long-term debt is currently $534.5 million. In December 2012 the Company issued $150.0 million in private placement notes and an additional $150.0 million was issued in December 2013. The 2012 debt was issued as 12 and 15 year notes at an average rate of 3.2%. Proceeds from these issues replaced $133.5 million in maturing debt with an average rate of 6.06%. The 2013 debt was issued as 30 and 35 year notes at an average rate of 4.8%. Proceeds from these issues were used to repay existing indebtedness and general corporate purposes. 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.[3]

Of special mention is the note payable to Questar Corporation. Short term notes payable to the parent company have varied widely during the periods under review. The note to Questar Corp as of December 2013 reached the lowest point at $17.7 million compared to the high of $166.1 million just 12 months earlier in 2012. It appears that Questar Gas continues to use its parent company as a "bank" from which it obtains short-term loans according to its need for liquidity. Short term Intercompany loans charge an interest rate based on the method determined in Docket 85-057-09. As of year-end 2013 the weighted average interest rate for intercompany loans was .27%. [4]

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. Residential and commercial sales provided 92.3% of the total revenue dollars but represented 62.5% of the total volume in 2013. The volume of gas for transportation and industrial customers decreased 7.9% from the previous year and represents 35.1% of the total volume. System natural gas cost increased 4.82% to $5.00 per Dth in 2013 compared to $4.77 per Dth in 2012.

[3] 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
[4] Questar 2013 Form 10-K, Page 78.

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. Questar Gas is alleging breach of contract by QEP Field Services Company and is seeking an accounting and a declaratory judgment relating to the charges under the Gas Gathering Agreement. 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.

Questar Corporation owns 100% of the stock in Questar Gas; therefore, the entire dividend payment of $9.0 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.

IV. CONCLUSION

The Division concludes that the payment of a $9.0 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
Michele Beck – Office of Consumer Services