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 26, 2014

RE: Questar Gas Dividend Declaration July 29, 2014
Docket No. 14-999-02

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 July 29, 2014, the Board of Directors of the Company declared a quarterly cash dividend of $9.0 million. The dividend is payable to the Company's sole shareholder, Questar Corporation, on September 8, 2014. On July 30, 2014, 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, 2013, quarterly financial statements as of June 30, 2014, Questar Corporation News Release dated July 29, 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 June 30, 2014. 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, 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 the first 6 months of 2014 which have been 16% warmer than normal. From a longer term perspective, total revenue has decreased slightly from 2008 through 2013 with an average annual decrease of 0.29%.

For the first 6 months of 2014, total revenue was down $17.5 million compared to the cost of natural gas which was down $32.3 million for the same period last year. While total revenue and gas costs were down, net income was $0.5 million higher than the same period in 2013. Effective March 1, 2014, Questar Gas received approval to increase rates as a result of a general rate case.

Natural gas provided by Wexpro represented 59% of the natural gas supply in 2013 compared to 68% in 2012. For the first half of 2014, Wexpro produced 36.2 Bcf of cost of service gas compared to 30.2 Bcf in the first half of 2013.[1]

The balance sheet information is included on pages 2 and 7 of Exhibit 1. The net plant and equipment has increased steadily from 2008 through 2013 averaging an 8.06% annual increase. The growth in the net plant compares to a 6.55% annual increase in total assets. Capital expenditures increased from $82.6 million in 2009 to $166.2 million in 2013 primarily due to the ongoing feeder line replacement program.

Long-term debt has increased at an average rate of 7.63% and is currently at $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.[2]

Questar Corporation manages cash at the corporate level and loans between Questar Gas and Questar Corporation have been occurring 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

[1] Questar 2014 Form 10-Q, For the quarterly period ending June 30, 2014, p 30.
[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

Corporation as of December 2013 was $17.7 million compared to the high of $166.1 million just 12 months earlier in 2012. Due to new long term funding arrangements in 2013, during the first 6 months of 2014, Questar Gas has been in an excess cash position and has been lending cash to Questar Corporation. As of June 30, 2014, Questar Gas has a note receivable from its parent Corporation for $4.8 million. The Company follows the established intercompany loan procedures for lending and interest calculations. It is anticipated that by the third quarter of 2014, Questar Gas will return to borrowing funds from the Corporation.

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 Commission authorized return on equity at the end of 2013 was 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 is calculated to be 9.59% for 2013. As part of the recent general rate case, the authorized ROE has been reduced from 10.35% to 9.85%. Based on these 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.[3] 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

[3] Moody's Investor Service, US utility sector upgrades driven by stable and transparent regulatory frameworks, February 3, 2014.

> 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. [4]

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 2013. Due to the seasonal nature of the business, some of the ratio calculations may be misleading on a quarterly basis.

The Company's regulatory capital structure for 2013 was 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 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.

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 2013, residential and commercial sales provided 92.3% of the total revenue dollars but represented 62.5% of the total volume. 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.

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[4] Moody's Investor Service, Rating Action: Questar Corporation and Questar Gas, January 31, 2014

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