



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: November 12, 2014

RE: Questar Gas Dividend Declaration October 28, 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 October 28, 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 December 8, 2014. On October 29, 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 September 30, 2014, Questar Corporation News Release dated October 28, 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 September 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 in the previous year was primarily driven by a 12.8% increase in the volume of natural gas sold due to weather conditions. In 2013, the weather was 8% colder than normal. From a longer term perspective, total revenue has decreased slightly from 2008 through 2013 with an average annual decrease of 0.29%.

Effective March 1, 2014, Questar Gas received approval to increase rates as a result of a general rate case. For the first 9 months of 2014, total revenue was \$6.4 million lower than the same period in 2013. During the same period, the cost of natural gas was \$32.3 million lower and

Operating and Maintenance costs were \$10.7 million higher. While total revenue and gas costs were different, net income was \$0.4 million higher than the same period in 2013. For the first 9 months of 2014, the weather conditions have been 17% warmer than normal.

Natural gas provided by Wexpro represented 59% of the natural gas supply in 2013. For the first 9 months of 2014, Wexpro has produced 51.6 Bcf of cost of service gas compared to 43.5 Bcf during the first 9 months of 2013.¹ The Wexpro production represents approximately 75% of the total requirement for the first 9 months of 2014. 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. 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 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. For the first 9 months of 2014, the Company has reported capital expenditures of \$138.2 million. The feeder-line replacement program and customer growth are projected to support 6% – 8% annual net income growth through 2018.²

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

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

² Questar Corporation Investor Presentation, November 2014, p. 16

level. The parent instead issues debt at the subsidiary level, primarily to provide capital-structure clarity for regulatory purposes.³

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 Corporation as of December 2013 was \$17.7 million compared to the high of \$166.1 million just 12 months earlier in 2012. As of September 30, 2014, Questar Gas has a note payable to its parent Corporation for \$90.8 million. The Company follows the established intercompany loan procedures for lending and interest calculations. The guidelines for intercompany lending were established in 1985 are currently being reviewed by the Division.

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. Ratio calculations for the first 9 months of 2014 may not accurately reflect the current conditions due to the seasonality of the operation.

The profitability ratios have changed 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. During the most recent general rate case, the authorized ROE was been reduced from 10.35% to 9.85%.

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

On January 31, 2014, Moody's Investor Services upgraded Questar Gas and Questar Corporation from A3 to A2.⁴ 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.⁵

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 not be accurate 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

⁴ Moody's Investor Service, US utility sector upgrades driven by stable and transparent regulatory frameworks, February 3, 2014.

⁵ Moody's Investor Service, Rating Action: Questar Corporation and Questar Gas, January 31, 2014

2011. In the most recent general rate case, the Commission approved a capital structure of 47.93% debt and 52.07% equity with a 7.64% return on capital.⁶

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.

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 and return on capital.

⁶ Questar Gas Docket No. 13-057-05, Report & Order, p. 17.

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