Memorandum

TO: Public Service Commission

FROM: Division of Public Utilities
Philip Powlick, Director,
Artie Powell, Energy Manager
Charles Peterson, Technical Consultant
Doug Wheelwright, Utility Analyst

DATE: December 2, 2009

RE: Questar Gas Dividend Declaration October 27, 2009

I. ISSUE

On October 27, 2009 the Board of Directors of Questar Gas Company (QGC) declared a quarterly cash dividend of $7,200,000 on the outstanding shares of QGC common stock. The dividend is payable to the Company's sole shareholder, Questar Corporation, on December 14, 2009.

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.

II. 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.

III. ANALYSIS

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, 2008, the quarterly financial report as of September 30, 2009, Questar Corporation News Release dated October 27, 2009, and a review of the Company's bond rating from the various bond rating agencies.

In approaching this assignment, 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 it would if the dividend were not paid.

Exhibit 1 sets forth financial results for the years ended December 31, 2003 through 2008 and operating results for the nine month period ended September 30, 2009. Revenues for the year ended December 31, 2008 increased to $1,000.3 million, a 7.3% increase. Over the same 2007 to 2008 period, operating income increased 10.6%. Net income increased from $37.4 million to $40.2 million, a 7.5% increase. This is a significant improvement from the 1 percent net income gain of the previous year. Total Natural gas costs as a percent of sales remained level at 73.7 for 2007 and 2008. Natural Gas costs from affiliated companies varied in 2008 with the dramatic fluctuation in commodity prices during the year. Historically the affiliated natural gas costs have been 26.7%, however, in 2008 this increased to 43.3%.

Revenue for the first nine months of 2009 was $627.1 million, down 6.5% from the same period in 2008. Operating Income increased from $44.8 million in 2008 to $50.4 million in 2009 for a 12.5% increase. Net income increased from $19.8 million in 2008 to $21.7 million in 2009 for a 9.6% increase. The Company's net profit margin averaged 3.78 percent of revenues over the 2003 to 2008 period. The net profit margin for the first nine months of 2009 was 3.46%.

From 2000 to 2008, dividends on common stock have consistently increased by $500,000 each year, or 1.9 percent annually. The year to date dividend payment of $21.0 million represents 96.8% of the year to date net income. This is consistent with prior year to date performance and compares favorably to the 104.0% dividend payment for the first nine months of 2008.

The balance sheet information set forth on pages 2 and 6 of Exhibit 1 identifies an increase in the accounts receivable from $153.0 million in 2007 to $174.6 million in 2008. Receivables have been reduced to $55.4 million as of September 30, 2009 compared to $57.4 for the same period in 2008. Gross and net plant in service increased steadily over the 2003 to 2008 period averaging a 6.9% annual increase over the period. Total assets increased at an average rate of 7.5 percent. In 2006, the Company increased its annual capital expenditures to keep up with the growth in customers and to replace older assets. With the slowdown in new construction in 2008 and the slowing economy, the Company has dramatically decreased the amount of capital expenditures.

Long-term debt fluctuated from 2003 through 2007 and then showed a significant increase in 2008. This was due to a new debt issuance of $100 million that increased the total long term debt to $370 million.

Common equity grew at a higher average rate of 3.4 percent due, in part, to a $30 million equity contribution from the parent company in 2008. Of special note is the notes payable to Questar Corp. This account has varied widely between $95.2 million and $13.2 million for the period under review. As of September 30, 2009, the account balance was $33.4 million. It appears that

Questar Gas uses its parent company as a “bank” from which it obtains short-term loans according to its need for liquidity.

Page 4 of Exhibit 1 calculates the financial ratios and other information for the period under review. Short-term liquidity ratios for year-end 2008 are near the historical averages with the current ratio at .85 and the quick ratio at .52. The long-term solvency ratios are near the historical averages with Net Worth / Total debt at .42 and Net Worth / Fixed Assets at .39. The profitability ratios are strong and are above the historical averages with Return on Assets at 4.53% and Return on Capital of 8.2%. On an SEC financial reporting basis, the Company had a return on equity (ROE) of 11.09 percent in 2008. The company’s authorized return on equity is 10.0 percent and is calculated based on different regulatory guide lines. The Company has provided a reconciliation of the regulatory ROE which stands at the approved 10.0%.

Standard and Poor’s downgraded Questar Gas on February 25, 2009 from A- to BBB+ with a stable outlook. Moody’s downgraded Questar Gas from A2 to A3 in March 2008. Questar Corp. 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.[1] Both Standard & Poor’s and Moody’s ratings of Questar Gas are investment grade ratings. There is no apparent indication from the rating agencies that they have particular concern for Questar Gas that would have an effect on the debt rating in the short term. Questar Gas’ parent, Questar Corporation has a current bond rating of A-2. The Company’s capital structure remains near the historical average of 49% debt and 51% equity.

The financial characteristics of Questar Gas generally indicate a profitable and stable utility company. A change in general rates went into effect in mid-August 2008 and increased the margin by $6.7 million in the first nine months of 2009. Temperature-adjusted usage per customer decreased 1.0% in the first nine months of 2009 compared to the first nine months of

[1] Questar Comments on Moody’s Rating,, http://prnwire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/11-12-2002/0001839749&EDATE= > < Accessed December 4, 2007

2008. The impact on the Company margin from changes in usage per customer has been mitigated by a pilot conservation-enabling tariff (CET) that was approved by the Commission. The CET resulted in a margin increase of $0.7 million in the first nine months of 2009, partially offsetting the $1.4 million decrease in margin resulting from lower usage per customer. Operating and maintenance expenses increased 14.0% in the first nine months of 2009 compared to the first nine months of 2008. Demand-side management costs (DSM) increased $9.1 million in the first nine months of 2009 compared to the first nine months of 2008. These costs are for the Company's energy-efficiency program and are recovered from customers through periodic pass-through rate changes. Operating, maintenance, general and administrative expenses per customer were $114 in the first nine months of 2009 compared to $103 in the first nine months of 2008 due to an increase in demand-side management cost of $10 per customer.

The growth in common equity has been slower than the growth of the Company generally. The dividend policy of the Company is, of course, contributing to that slower growth in equity. If this trend continues, at some point the capital structure of the Company would be negatively impacted, which could result in a rating downgrade. However, the Company would be expected to act long before such an eventuality resulted in a negative impact. The dividend payment of Questar Gas is paid to Questar Corporation. The regular dividend payments from the gas company to the parent company have been summarized below. In 2008, Questar Gas provided 28.9% of Questar Corporation's revenue but only 5.9% of net income. Questar Gas paid out 67.9% of its net income to the parent company, which provided 32.2% of the Questar Corporation dividend payment. Similar percentages were paid in 2007 and 2006.

(Millions of Dollars)	YTD 2009		2008		2007	
	Questar Corp	Questar Gas	Questar Corp	Questar Gas	Questar Corp	Questar Gas
Revenue	2,132.0	627.1	3,465.1	1,000.3	2,726.6	932.5
Net Income	243.3	21.7	683.8	40.2	507.4	37.4
Dividend	65.3	21.0	85.4	27.3	83.7	27.0
Payout Ratio	26.8%	96.8%	12.5%	67.9%	16.5%	72.2%
Gas Co % of Corp Revenue		29.4%		28.9%		34.2%
Gas Co % of Corp Net Income		8.9%		5.9%		7.4%
Gas Co % of Corp Dividend		32.2%		32.0%		32.3%

On average, Questar Gas pays out approximately 71.0% of their net profit to the parent company which represents approximately 32.8% of the corporate dividend. This is a large cash requirement from one entity but is consistent with the activity in prior years. Questar Gas Company should have adequate cash flows to maintain its service obligations and meet its financial needs.

The Division has made its own *pro forma* analysis and forecast of the financial results of Questar Gas. The analysis assumes a level of profitability consistent with past performance. The forecast has also attempted to account for forecasted capital expenditures, but assumes that other expenses and accounts are kept in line with the historical results. It is anticipated that the Company will increase the capital expenditures in 2010 and beyond as part of a feeder line replacement program and dividends on common stock are assumed to increase by $500,000 per year. While the forecast is based upon a number of assumptions that appear reasonable at this time, actual results will vary. With this caveat in mind, the Division concludes that there is no indication that the assumed level of dividends, capital expenditures and additional debt will materially and negatively impact the financial health of Questar Gas. The Company is projected to maintain profitability levels similar to historical results. 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 $7,200,000 common dividend as 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 and the services rendered by the Company because of this dividend payment.