State of Utah
Department of Commerce
Division of Public Utilities

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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: June 16, 2010

RE: Questar Gas Dividend Declaration May 18, 2010

I. ISSUE

On May 18, 2010 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 June 21, 2010.

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.

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III. ANALYSIS

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.

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, 2009, the quarterly financial report as of March 31, 2010, Questar Corporation News Release dated May 18, 2010, and a review of the Company's bond rating from the various bond rating agencies.

Exhibit 1 sets forth financial results for the years ended December 31, 2004 through the first quarter of 2010. Total revenue for the year ended December 31, 2009 was down 8.04% from $1,000.3 million to $919.9 million in 2008. While total revenue was down, net income increased 3.4% from $40.2 million to $41.6 million. Total natural gas costs as a percent of sales showed a significant decrease from 73.7% in 2008 to 68.1% in 2009. Earnings from Operation increased 3.21% from $84.2 million in 2008 to $86.9 million in 2009. Compared to previous years, 2009 appears to have been very profitable for the Company. The average net profit margin for 2004 through 2009 was 3.96% while the margin for 2009 was 4.52%. This was higher than any other year under review.

Revenue for the first three months of 2010 was $361.0 million, down 11.0% from the same period in 2009. Operating Income increased from $57.2 million in 2009 to $58.6 million in 2010 for a 2.5% increase. Net income increased from $31.8 million in 2009 to $33.1 million in 2010 for a 4.1% increase. The temperature adjusted usage per customer decreased 2% in the first quarter of 2010 compared to the first quarter of 2009. Weather, as measured in degree days, was normal in the first quarter of 2010 compared to 1% warmer than normal in the first quarter of 2009. As of March 31, 2010, Questar Gas served 904,040 customers, up from 892,829 as of March 31, 2009.

From 2000 to 2008, dividends on common stock have consistently increased by $500,000 each year. Beginning with the dividend in the fourth quarter of 2009 this policy has changed. Instead of a constant dollar amount from Questar gas, the dividends will be based on the historical payout ratio of the various subsidiaries of Questar Corp. The Company paid $28.2 million in 2009 for an increase of $700,000 over the previous year.

The balance sheet information set forth on pages 2 and 6 of Exhibit 1 identifies a decrease in accounts receivable from $174.6 million in 2008 to $166.9 million in 2009. The net plant in service increased steadily over the 2004 to 2009 period averaging a 6.77% annual increase while total assets increased at an average rate of 5.77%. With the slowdown in the economy, capital expenditures have been reduced from a high of $135.9 million in 2007 to $88.9 million in 2009.

The Company's capital structure remains near the historical average at 48.6% debt and 51.4% equity. Long-term debt increased at an average rate of 6.27% from 2004 through 2009. Total long term debt totals $370.0 million. Common equity grew at an average rate of 4.84% for the period under review and included a $30 million equity contribution from the parent company in 2008. Of special note is the notes payable to Questar Corp. Notes payable to the parent company has varied widely from a high of $95.2 million in 2004 to a low of $13.2 million in 2006. As of March 31, 2010 the account balance was $63.4 million down from $87.0 million as for December 31, 2009. 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.

On April 21, 2010 Questar Corporation announced that it is considering a possible tax-free spin-off of the company's natural gas and oil exploration and production (E&P) business. The new E&P company would be comprised of Questar subsidiaries Questar E&P Company, Questar Gas Management and Questar Energy Trading. Subject to certain precedent conditions and board approval, the spin-off transaction may occur in the second half of 2010.

Standard & Poor's downgraded Questar Gas from A- to BBB+ on February 25, 2009. On April 22, 2010 the outlook was changed from stable to positive following the announcement of the possible spin-off of the E&P business from Questar Corporation. Moody's downgraded Questar Gas from A2 to A3 in March 2008 and affirmed the rating on April 22, 2010. 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. Standard & Poor's has indicated that they may upgrade their rating once the higher risk E&P business is a separate trading entity. Questar Gas' parent, Questar Corporation has a current bond rating of A-2.

The Company filed a general rate case in December 2009 and on April 8, 2010, the Company entered into a stipulation agreement to settle all issues in this case. The agreement sets the allowed rate of return at 10.35%, continues the Conservation Enabling Tariff (CET) and establishes a mechanism to adjust rates for a feeder-line replacement. The new rates will become effective August 1, 2010.

Page 3 of Exhibit 1 calculates the financial ratios and other information for the periods under review. Short-term liquidity ratios for year-end 2009 are near the historical averages with the current ratio at .87 and the quick ratio at .54. 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 near the historical averages with Return on Assets at 4.51% and Return on Total Capital of 7.82%. On an SEC financial reporting basis, the Company had a

[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 June 9, 2010

return on equity (ROE) of 10.62% for 2009. The company's authorized return on equity is 10.0% and is calculated based on different regulatory guide-lines. The Company has provided a reconciliation of the regulatory ROE calculated at 9.73%. 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, Retained Cash Flow / Debt and Simple ROE. All of these ratios are within the guidelines specified for year-end 2009. The financial characteristics of Questar Gas generally indicate a profitable and stable utility company.

A new report has been included as page 4 of Exhibit 1. This is detailed review of revenue by class and volume as well as temperature and customer information. Residential and commercial sales provided 95.0% of the total revenue dollars but represented 64.8% of the total volume. Natural gas cost per dekatherm (dth) was $5.01 in 2009 compared to $6.14 in 2008. Total customers increased 1.1% in 2009 to 898,558.

The growth in common equity has been slower than the growth of the Company generally and is slower than the growth of comparable natural gas companies. The dividend policy and large payout ratio is contributing to that slower growth in equity. Questar Corporation owns 100% of the stock in Questar Gas and all of the $7.2 million quarterly dividend will be paid to the Corporation. The total amount of dividends paid in 2009 was $28.2 million. The 2009 payout ratio was 67.8% which is lower than the historical average of 71.9%. While the payout is lower than the historical average, it represents a significant cash requirement for the Company and is greater than the dividend payout for comparable companies. The slower growth in the equity position can be looked at from both a positive and a negative perspective. The lower equity position allows the company to have lower net earnings in order to maintain the allowed return on equity. The cash requirement from the Company to the parent could become an issue if the total profitability were to go down. This could result in a strain on the cash and working capital positions and could result in a possible downgrade from the rating agencies. The dividend payments from the gas company to the parent company have been summarized below.

In 2009, Questar Gas provided 30.3% of Questar Corporation's revenue but only 10.6% of net income. Questar Gas paid out 67.8% of its net income to the parent company, which provided 32.1% of the Questar Corporation dividend payment. Similar percentages were paid in 2008 and 2007.

(Millions of Dollars)	2009		2008		2007	
	Questar Corp	Questar Gas	Questar Corp	Questar Gas	Questar Corp	Questar Gas
Revenue	3,038.0	919.9	3,465.1	1,000.3	2,726.6	932.5
Net Income	393.3	41.6	683.8	40.2	507.4	37.4
Dividend	87.9	28.2	85.4	27.5	83.7	27.0
Payout Ratio	22.3%	67.8%	12.5%	68.4%	16.5%	72.2%
Gas Co % of Corp Revenue		30.3%		28.9%		34.2%
Gas Co % of Corp Net Income		10.6%		5.9%		7.4%
Gas Co % of Corp Dividend		32.1%		32.2%		32.3%

On average, Questar Gas pays out approximately 71.8% of their net profit to the parent company which represents approximately 32.2% of the corporate dividend. This represents 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 each 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 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.

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