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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 15, 2009

RE: Questar Gas Dividend Declaration May 19, 2009 **Docket # 09-999-02**

I. ISSUE

On May 19, 2009 the Board of Directors of Questar Gas Company declared a quarterly cash dividend of $7,000,000 on the outstanding shares of Questar Gas common stock. The dividend is payable to the Company's sole shareholder on June 22, 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 March 31, 2009, Questar News Release dated February 11, 2009, and reviewed 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 three months ended March 31, 2009. Revenues for the year ended December 31, 2008 increased to $1,000.3 million from 932.5 million in 2007, a 7.3 percent increase. Over the same 2007 to 2008 period, operational income increased 10 percent and net income increased from $37.4 million to 40.2 million, for a 7.5 percent 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% but in 2008 this amount increase to 43.3%.

From 2000 to 2008, dividends on common stock have consistently increased by $500,000 each year, or 1.9 percent annually. The Company's net profit margin averaged 3.78 percent of revenues over the 2003 to 2008 period. Results for the first quarter of 2009 indicate a net profit of $31.8 million compared to $30.6 million for the first quarter 2008.

The balance sheet information set forth on pages 2 and 6 of Exhibit 1 indicates some fluctuations in the current asset and current liability accounts over the time period examined. Primary increases were noted in the accounts receivable and materials and supplies with decreases in accounts payable.

As might be expected, gross and net plant in service increased fairly steadily over the 2003 to 2008 period. Net plant averaged a 6.9 percent annual increase over the period. Total assets increased at an average rate of 7.5 percent. In 2006 the Company has increased its annual capital expenditures to keep up with the growth in customers and to replace older plant at a faster rate. 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 indicated some fluctuation from 2003 through 2007 with 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. 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 the first quarter of 2009 the account balance was $0. 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 sets forth financial ratios and other information for the period under consideration. Short-term liquidity ratios are near the historical averages while the long-term solvency ratios are below their historical averages. The profitability ratios are all strong and are above the historical averages. On an SEC financial reporting basis the Company had a return on equity (ROE) of 11.09 percent in 2008. ROE is expected to decrease due to the 2006 CET

Amortization case and the rate order in Docket No. 07-057-13, where the company's authorized return on equity was reduced to 10.0 percent.

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 has remained near 48 percent debt and 52 percent equity for all years under review.

The financial characteristics of Questar Gas generally indicate a profitable and stable utility company. The return on equity calculated on an SEC reporting basis indicates a return of 11.09 percent for the twelve months ended December 31, 2008. This compares with the Company's authorized return—on a regulatory adjusted basis—of 10.0 percent. As mentioned above, the recent reduction in rates ordered by the Commission will likely reduce to 10 percent going forward. The recent volatility in natural gas prices and the likely consumer response may have some long-term negative impact. 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.

[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

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 a decrease in capital expenditures relative to the historical period, but assumes that other expenses and accounts are kept in line with the historical period. In 2008, the Company obtained new long term debt, and is forecasted to increase their debt as needed up through 2012. Dividends on common stock are assumed to increase by $500,000 per year. While this analysis is based upon a number of assumptions that appear reasonable at this time, actual results will undoubtedly vary, perhaps widely. 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. CURRENT CREDIT ENVIRONMENT

The Division is concerned with the current and ongoing changes in the financial market. The current availability of credit and the ability of Questar Gas to obtain adequate financing for operations has been addressed with the Company. As noted above, Questar Corporation does not issue long term debt at the parent-company level. The company issues debt at the subsidiary level, primarily to provide capital-structure clarity for regulatory purposes. With the recent tightening in the credit markets it is even more important to maintain adequate cash balances to fund current and future operational needs.

The dividend payment of Questar Gas to the Questar Corporation in prior years has been reviewed in relationship to the other affiliated companies. In 2008, Questar Gas provided 28.9% of total revenue and 5.9% of net income. Questar Gas paid out 68.4% 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 as illustrated below.

	2008 Questar Corporation	2008 Questar Gas	2007 Questar Corporation	2007 Questar Gas	2006 Questar Corporation	2006 Questar Gas
Revenue	3,465.1	1,000.3	2,726.6	932.5	2,835.6	1,059.1
Net Income	683.8	40.2	507.4	37.4	444.1	37.0
Dividend	85.4	27.5	83.7	27.0	79.7	26.5
Payout Ratio	12.49%	68.41%	16.50%	72.19%	17.95%	71.62%

This is a large cash requirement from one entity and is a concern in the current credit environment. Taking into account current market conditions and Questar Gas Company's financial strength, current circumstances indicate that Questar Gas Company should have adequate cash flows to maintain its service obligations and meet its financial needs.

V. CONCLUSION

The Division concludes that the payment of a $7,000,000 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.