State of Utah
Department of Commerce
Division of Public Utilities

FRANCINE GIANI
Executive Director

THAD LEVAR
Deputy Director

CHRIS PARKER
Director, Division of Public Utilities

GARY HERBERT
Governor

GREG BELL
Lieutenant Governor

Memorandum

TO: Public Service Commission

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

DATE: March 10, 2011

RE: Questar Gas Dividend Declaration February 18, 2011

I. 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.

II. ISSUE

On February 18, 2011 the Board of Directors of Questar Gas Company (QGC) declared a quarterly cash dividend of $7,575,000 on the outstanding shares of QGC common stock. The dividend is payable to the Company's sole shareholder, Questar Corporation, on March 24, 2011.

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. Based on the filing date, it

160 East 300 South, Box 146751, Salt Lake City, UT 84114-6751 Telephone (801) 530-7622 • Facsimile (801) 530-6512 •
www.publicutilities.utah.gov

appears that the Company is in violation of this requirement. The Company declared the dividend on February 18, 2011 but did not notify the Commission until February 28, 2011. While it is in violation of this requirement, on this occasion the Division does not recommend any action.

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 as 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, 2010, Questar Corporation News Release dated February 18, 2011, 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, 2005 through December 31, 2010. Total revenue for the year ended December 31, 2010 was down 1.85% from $919.9 million to $902.9 million. While total revenue was down, net income increased 5.53% from $41.6 million to $43.9 million. Total natural gas costs as a percent of sales showed a decrease from 68.12% in 2009 to 65.59% in 2010. Earnings from Operation increased 1.96% from $86.9 million in 2009 to $88.6 million in 2010. Compared to previous years, 2010 was the most profitable of all the years under review. The average net profit margin for 2005 through 2010 was 4.08% compared to the 2010 margin of 4.86%.

For the year 2010, the Company experienced a 1.22% increase in the number of customers from 898,600 to 909,600. While temperatures were 1.00% colder than normal, the temperature adjusted usage per customer was down 1.93% from 109.0 dth in 2009 to 106.9 dth in 2010. The usage per customer has been moving down each year from the peak in 2006 of 113.6. The usage reduction is due in part, to consumer conservation efforts which are encouraged by the current Demand Side Management program (DSM). While usage per customer has decreased, the company has been able to remain profitable in part due to the Conservation Enabling Tariff (CET).

From 2000 to 2008, the dividend on common stock consistently increased by $500,000 each year but this policy changed in the fourth quarter of 2009. Instead of a constant dollar amount increase, the dividend is now 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. In 2010, the Company paid $28.8 million in dividends for an increase of $600,000 over the previous year.

The balance sheet information set forth on pages 2 and 7 of Exhibit 1 identifies an increase in accounts receivable from $166.9 million in 2009 to $171.3 million in 2010. The net plant in service has increased steadily from 2005 through 2010 averaging a 7.39% annual increase while total assets increased at an average rate of 4.98%. Capital expenditures increased from $82.6 million in 2009 to $108.6 million in 2010 partially due to the current feeder line replacement program.

The Company's regulatory capital structure stands at 47.10% debt and 52.90% equity and remains close to the historical average with of 48.67% debt and 51.33% equity. Long-term debt increased at an average rate of 2.64% from 2005 through 2010 and is currently $368.0 million. Of special note is the note payable to Questar Corporation. Short term notes payable to the parent company have varied widely from the current high of $153.6 million to a low of $13.2 million in 2006. This note to Questar Corporation is up significantly from the December 2009 balance of $87.0 million. It appears that Questar Gas continues to use its parent company as a "bank" from which it obtains short-term loans according to its need for liquidity. Common equity grew at an average rate of 5.5% for the period under review and included a $30 million equity contribution from the parent company in 2008.

Effective July 1, 2010, Questar Corporation completed a spin-off of the company's natural gas and oil exploration and production (E&P) business into QEP Resources, Inc. (QEP). QEP is comprised the former Questar Exploration & Production, Questar Gas Management and Questar Energy Trading. Shareholders of record as of June 18, 2010 were issued 1 share of QEP for each share of Questar Corp. As a result of the spin-off, Standard & Poor's upgraded Questar Gas from BBB+ to A as of July 8, 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] Questar Gas' parent, Questar Corporation was also upgraded from A-2 to A-1.

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 program. The new rates became effective August 1, 2010 and were in place for the last quarter 2010.

Page 4 of Exhibit 1 calculates the financial ratios for the periods under review. Short-term liquidity ratios for year-end 2010 are near the historical averages with the current ratio at 0.84 and the quick ratio at 0.51. The long-term solvency ratios are near the historical averages with Net Worth / Total Debt at 0.42 and Net Worth / Fixed Assets at 0.38. The profitability ratios are strong and are near the historical averages with Return on Assets at 4.46% and Return on Total Capital of 7.87%. On an SEC financial reporting basis, the Company had a return on equity (ROE) of 10.97% for 2010. The company's authorized return on equity is 10.35% and is calculated based on different regulatory guide-lines. The Company is currently working on 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

reconciliation of the financial and regulatory ROE. 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 Capitalization, Retained Cash Flow / Debt and a Simple ROE calculation. All of these ratios are within the guidelines specified for year-end 2010. The financial characteristics of Questar Gas generally indicate a profitable and stable utility company.

A new report has been included as page 5 of Exhibit 1. This report looks at the revenue by customer class and the natural gas costs per dekatherm (dth) for each year under review. Residential and commercial sales provided 92.26% of the total revenue dollars but represented 62.38% of the total volume. Natural gas cost per dth shows a slight increase from $5.01 in 2009 to $5.34 in 2010. Total customers increased 1.22% in 2010 to 909,600.

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 $7.575 million quarterly dividend will be paid to Questar Corporation. The total amount of dividends paid in 2010 was $28.8 million. The 2010 payout ratio was 65.6%, which is lower than the historical average of 69.5%. 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. 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 maintain the high level of capital expenditures in 2011 and beyond as part of a feeder line replacement program and the dividend on common stock is 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 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 $7,575,000 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 and the services rendered by the Company.

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