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, Utility Analyst

DATE: June 7, 2012

RE: Questar Gas Dividend Declaration May 10, 2012—No Action

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 May 10, 2012 the Board of Directors of Questar Gas Company (QGC) declared a quarterly cash dividend of $8,250,000. The dividend is payable to the Company's sole shareholder, Questar Corporation, on June 11, 2012.

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 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, 2011, quarterly financial statements as of March 31, 2012, Questar Corporation News Release dated May 10, 2012, 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, 2007 through March 31, 2012. For the 12 months ending December 31, 2011, total revenue increased 7.3% from $902.9 million to $968.8 million. Natural gas costs as a percent of total sales showed a slight increase from 65.59% in 2010 to 66.65% in 2011. Earnings from Operations increased 6.2% from $88.6 million in 2010 to $94.1 million in 2011. During the same period, net income increased 5.0% from $43.9 million to $46.1 million. Net Income as a percentage of total revenue was 4.76% in 2011 compared to the historical average of 4.43%. Wexpro provided 52% of the natural gas supply in 2011 compared to 51% in 2010. For the calendar year 2011 the Company experienced a 1.03% increase in the number of customers from 909,600 to 919,000.

For the first quarter of 2012, total revenue was $47.9 million lower compared to the same period in 2011. Along with the reduced revenue, total operating expense was $50.9 million lower while net income increased from $33.4 million to $34.9 million.

Weather, as measured in degree days, was 7% colder than normal in 2011. During this same period, the temperature adjusted usage per customer increased 3.9% from 106.9 Dth in 2010 to 111.1 Dth in 2011. This is the first increase in the usage per customer since 2006 and may be due in part to change in the Dth computation that was implemented in August 2010. The new calculation compensates for the ambient temperature and elevation at the meter. When the new calculations were approved by the Commission, it was anticipated that the new measurements would provide more accurate customer billing and reduce the lost and unaccounted for gas volumes. Additionally, the Company's current 10-Q report states that the recent increase in the usage per residential customer may be due to low natural gas prices.

Despite the increase in usage, the first quarter of 2012 the Company's revenues were down by approximately 11.6% from the first quarter of 2011. Weather again may be the primary reason for this decline: the first quarter of 2012 was 13% warmer than normal.

The balance sheet information on pages 2 and 7 of Exhibit 1 identifies a steady increase in the Net Plant & Equipment $908.9 million in 2007 to $1.177 billion in 2011 for a 7.5% average annual increase. Capital expenditures increased from $82.6 million in 2009 to $121.5 million in 2011 partially due to the current feeder line replacement program. Capital expenditures for the first quarter of 2012 were $44.8 million compared to $25.9 million for the first quarter of 2011.

Page 4 of Exhibit 1 calculates the financial ratios for the periods under review. Short-term liquidity ratios for year-end 2011 are lower than historical averages with the current ratio at 0.58 and the quick ratio at 0.37 compared to the average of 0.75 and 0.47. The long-term solvency ratios are near the historical averages with Net Worth / Total Debt at 0.45 and Net Worth / Fixed Assets at 0.38. The profitability ratios are close to the historical averages with Return on Assets at 4.36% and Return on Total Capital of 8.24%. On an SEC financial reporting basis, the Company had a return on equity (ROE) of 10.62% for 2011. The company's authorized return on equity is 10.35% and is calculated based on different regulatory guidelines. The adjusted return on equity for regulatory purposes was calculated to be 10.23% for year-end 2011.

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 as of year-end 2011. The financial characteristics of Questar Gas generally indicate a profitable and stable utility company.

The Company's regulatory capital structure at the end of 2011 was 44.86% debt and 55.14% equity and is slightly different than the historical average of 47.40% debt and 52.60% equity. Long-term debt totaled $276.5 million as of year-end 2011 and has been reduced to $236.5 million at the end of the first quarter of 2012. Included in the current liabilities is a note payable to Questar Corporation. The short term note payable to the parent company has varied widely from the low of $13.2 million in 2006 to a high of $153.6 million in 2010. The note to Questar Corporation was $142.7 million at the end of 2011 and has been paid down to $66.4 million 3 months later in March 2012. 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.

Similar to how the parent company provides debt financing, Questar Corporation has provided equity contributions to maintain the capital structure. Common equity grew at an average rate of 6.94% for the periods under review and included equity contributions from the parent company of $30 million in 2008 and $20 million in 2011. It appears that the equity contribution in these two years may have been completed in order to increase the equity position to keep the calculated return on equity below the approved limit and to modify the percentage of debt to equity.

Page 5 of Exhibit 1 includes the operating statistics and looks at the revenue by customer class and the natural gas costs per Dth for each year under review. Residential and commercial sales provided 92.18% of the total revenue dollars but represented 66.33% of the total volume in 2011. Natural gas cost per Dth shows a slight decrease from $5.34 in 2010 to $5.05 in 2011 and is lower than the historical average of $5.49. Natural gas cost per Dth for the 1st quarter of 2012 is reported as $6.07.

On July 8, 2010, Standard & Poor's upgraded Questar Gas from BBB+ to A following the spin-off of QEP Resources (QEP) which was the natural gas and oil exploration portion of the business. Questar Gas' parent, Questar Corporation was also upgraded from A-2 to A-1.

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]

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. Also, on May 1, 2012, QEP Field Services Company filed a legal action against Questar Gas entitled *QEP Field Services Company v. Questar Gas Company*, in the Second District Court in Denver County, Colorado seeking declaratory judgment relating to its gathering service and charges under the same agreement. The charges under the Gas Gathering Agreement are included in Questar Gas's rates as part of its purchased gas costs. Depending on the outcome of the litigation, Questar Gas may seek approval to pay a refund to its customers. While Questar Gas intends to vigorously pursue its legal rights, the claims involve complex legal issues and uncertainties that make it difficult to predict the outcome of the cases and therefore management cannot determine at this time whether this litigation may have an adverse material effect on its financial position, results of operations or cash flows.

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.

IV. CONCLUSION

The Division concludes that the payment of an $8,250,000 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.

[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

cc: Barrie McKay – Questar Gas

Michele Beck – Office of Consumer Services