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OPEN MEETING

AZ CORP COMMISSION
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MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: January 11, 2006

RE: IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS FOR APPROVAL OF A PURCHASED GAS ADJUSTOR SURCHARGE INCREASE (DOCKET NO. G-01551A-05-0823)

On November 8, 2005, Southwest Gas Corporation ("Southwest") filed for Commission approval of an increase in its temporary purchased gas adjustor ("PGA") surcharge from the current level of \$0.02 per therm to \$0.11 per therm due to increasing natural gas prices. Previously, in Decision No. 67458 (January 4, 2005), the Commission approved a \$0.02 per therm PGA surcharge for Southwest, effective in January 2005 and terminating upon a change in Southwest's rates resulting from a general rate proceeding, unless otherwise ordered by the Commission.

Southwest's application indicates that it projects that its PGA bank balance will be undercollected by approximately \$60 million by the end of 2005. As of the end of October 2005, Southwest's PGA bank balance was undercollected by \$33,894,523 according to the most recently available monthly PGA report.

In December 2005, the total cost of gas reflected in Southwest's rates was \$0.65407 per therm, consisting of a base cost of gas of \$0.37034 per therm, a monthly PGA rate of \$0.26373 per therm, and a temporary PGA surcharge of \$0.02 per therm. By comparison, the total cost of gas reflected in Southwest's rates in December 2004 was \$0.53407 per therm. Nevertheless, the current cost of gas reflected in Southwest's rates is substantially below the actual incurred cost of natural gas, including both the commodity cost and the interstate transportation cost, for Southwest in recent months, as spot market natural gas prices have soared. Southwest has indicated that approximately half of its winter 2005/2006 natural gas supplies are hedged at between \$6.00 and \$7.00 per dth, with the remainder of supplies subject to monthly or daily market indices.

In recent months, natural gas prices soared in late summer due to high temperatures and then the hurricanes which swept through the Gulf of Mexico, disrupting natural gas production, processing and deliveries. Natural gas prices dipped during November as weather was mild. However, in December prices have risen to their highest levels yet, as cold weather across the nation has driven early winter demand for natural gas and other heating fuels. As of December 22, 2005, the Gas Daily El Paso-Permian index was \$11.35 per dth and the El Paso-San Juan index was \$11.325 per dth. The United States Energy Information Administration projects El

Paso-San Juan prices to average \$8.21 per thousand cubic feet (approximately equivalent to a decatherm) in 2006. A variety of factors could move natural gas prices significantly upward or downward during the current heating season and further into the future.

Staff has reviewed Southwest's projected natural gas prices and believes they are reasonable for the purpose of evaluating Southwest's application for an increase in its PGA surcharge. Southwest projects an average commodity cost in 2006 of approximately \$0.77 per therm. Additionally, Southwest projects a substantial increase in its interstate transportation costs, due to the on-going El Paso Natural Gas Company rate proceeding before the Federal Energy Regulatory Commission. Southwest's projections show that even with implementation of the proposed PGA surcharge, Southwest's PGA bank balance will continue to grow through 2006, exceeding \$100 million in the second half of 2006.

Southwest's application requests implementation of the PGA surcharge increase in the first billing cycle for January 2006 or as soon as practicable thereafter. Giving the timing of the process for reviewing this matter, a February 2006 implementation would likely be the earliest possible. Southwest's application does not specify when the Company wishes the proposed surcharge to end. In discussions with Southwest, the Company indicated to Staff that its intent is for the \$0.11 per therm PGA surcharge to be in effect until the bank balance reaches zero.

While certainly substantial, Southwest's requested PGA surcharge of \$0.11 per therm is relatively small in comparison to the PGA surcharges the Commission has recently granted to other Arizona LDCs. At least part of the reason for this is likely that Southwest is only requesting a PGA surcharge to address the undercollected PGA bank balance as of the end of December 2005, whereas other PGA surcharge requests have, to at least some extent, addressed anticipated undercollections that are projected to occur through 2006. Staff believes that, given the high level of natural gas prices and the real possibility that Southwest's PGA bank balance will increase even if Southwest's application is granted, the Commission should grant the full \$0.11 per therm PGA surcharge requested by Southwest. If Southwest's projections are accurate, the Company may need to seek additional relief at a later point in 2006. Beginning November 28, 2005, Southwest began inserting customer notices in its bills to inform customers of its request to increase the PGA surcharge, in addition to other educational efforts. Attached are several tables showing possible options if the Commission wishes to approve a surcharge in some form other than the \$0.11 level requested by the Company. Additionally, it should be noted that Southwest has an on-going general rate case proceeding (Docket No. G-01551A-04-0876) before the Commission that likely will result in some level of additional rate increase.

In the Commission's recent decision on a UNS Gas PGA surcharge application, the Commission exempted customers taking service on the low income discount tariff from paying the PGA surcharge. Staff recommends that customers taking service on Southwest's G-10, Low Income Residential Gas Service (Southwest's LIRA program), be exempted from paying the PGA surcharge in effect for Southwest after this proceeding.

THE COMMISSION

January 11, 2006

Page 3

For an average residential customer in February 2006, using 55 therms, the bill is estimated to be \$71.57 with only the \$0.02 per therm surcharge in effect, and \$76.52 with the additional \$0.09 per therm surcharge. By comparison, an average residential customer in February 2005, using 55 therms, would have had a bill of \$65.68 (only \$0.02 surcharge in effect). The increases from 2005 reflect both the surcharge(s) that would be in effect in February 2006 and the gradual increase in the monthly PGA rate. The table below shows estimated customer bills in February 2006 at a variety of usage levels, with either the existing \$0.02 per therm surcharge or the proposed \$0.11 per therm surcharge.

Therms	February 2006 bill with a \$0.02 per therm surcharge	February 2006 bill with a \$0.11 per therm surcharge	Percentage Difference
30	\$43.36	\$46.06	+6.23%
55	\$71.57	\$76.52	+6.92%
75	\$93.46	\$100.21	+7.22%
100	\$120.82	\$129.82	+7.45%
150	\$175.54	\$189.04	+7.69%

Given current conditions, Staff recommends approval of Southwest's application to increase the PGA surcharge from \$0.02 per therm to \$0.11 per therm, effective the first billing cycle in February 2006. Staff further recommends that the \$0.11 per therm PGA surcharge remain in effect until the PGA bank balance reaches zero or the Commission orders otherwise. Staff further recommends that customers enrolled in the LIRA program be exempted from paying the PGA surcharge approved in this proceeding. Staff further recommends that Southwest engage in an immediate, highly visible and meaningful public relations campaign, in consultation with Staff, to inform its customers of (1) the specific details of the PGA surcharge level(s) approved in this proceeding and how it benefits customers to recover natural gas costs now rather than later; (2) the impact of the PGA surcharge level(s) on customer bills; (3) general natural gas price circumstances leading to the PGA surcharge; and (4) ways in which Southwest's customers can try to manage the higher rates they are facing. Heavy emphasis should be placed on promoting programs such as budget billing (especially during the time of year that it would be most beneficial to customers to apply), the LIRA program, and ways to reduce consumption.



Ernest G. Johnson
 Director
 Utilities Division

EGJ:RGG:lhv\JG

ORIGINATOR: Robert G. Gray

PGA Surcharge Scenarios

1. Company Proposed - \$0.11 per therm total surcharge
2. Retain Current \$0.02 per therm surcharge
3. Half of Proposed Surcharge - \$0.055 per therm total surcharge
4. Recover Greater Amount of Surcharge in Summer Months - recovers roughly the same amount annually as Company proposed
5. Total Surcharge of \$0.15 per therm
6. Total Surcharge of \$0.25 per therm
7. Total Surcharge of \$0.30 per therm

End of Month PGA Bank Balance Under Each Scenario

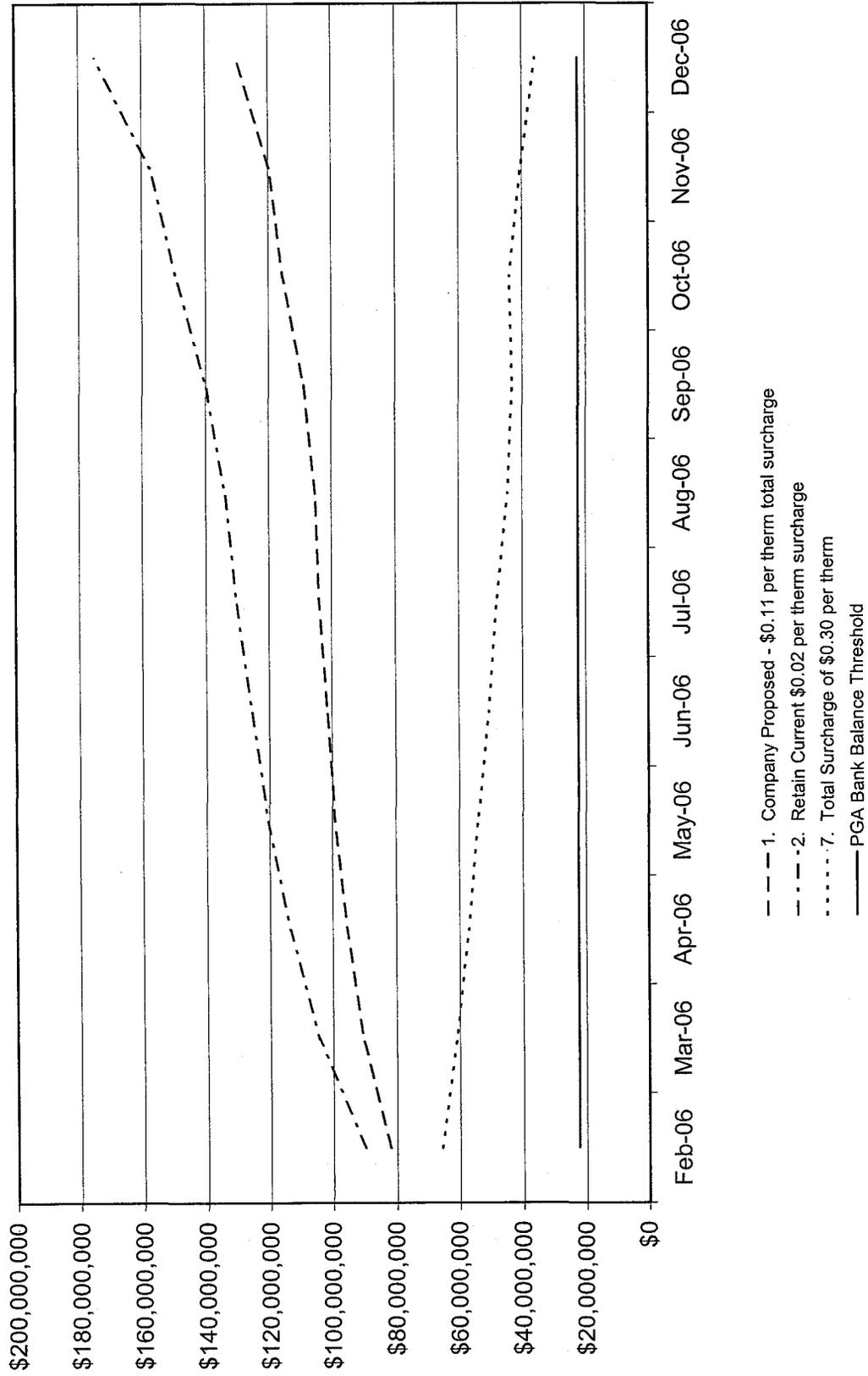
Scenario	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06
1	\$81,977,629	\$90,399,546	\$95,302,550	\$99,067,715	\$101,336,365	\$103,894,946	\$105,128,526	\$108,829,082	\$115,354,250	\$119,673,207	\$130,105,721
2	\$89,679,089	\$104,357,958	\$113,432,207	\$120,430,005	\$125,399,053	\$130,371,864	\$133,880,491	\$140,002,139	\$149,222,827	\$157,276,844	\$174,817,540
3	\$86,684,077	\$98,929,686	\$106,381,784	\$112,122,447	\$116,041,348	\$120,075,285	\$122,699,171	\$127,879,284	\$136,051,713	\$142,653,208	\$157,429,611
4	\$86,256,218	\$96,769,091	\$102,150,504	\$104,525,152	\$102,713,163	\$101,636,529	\$99,451,823	\$99,507,289	\$104,848,499	\$110,344,912	\$124,632,737
5	\$78,554,759	\$84,195,808	\$87,244,924	\$89,573,365	\$90,641,866	\$92,127,427	\$92,349,875	\$94,974,392	\$100,301,550	\$102,960,480	\$110,233,804
6	\$69,997,582	\$68,686,463	\$67,100,860	\$65,837,488	\$63,905,568	\$62,708,629	\$60,403,247	\$60,337,663	\$62,669,798	\$61,178,663	\$60,554,006
7	\$65,718,993	\$60,931,790	\$57,028,829	\$53,969,551	\$50,537,420	\$47,999,232	\$44,429,934	\$43,019,300	\$43,853,924	\$40,287,756	\$35,714,111

Note: These bank balance projections do not reflect the revenue reduction which would occur if Staff proposal to exempt G-10 customers from the surcharge is approved.

Bill Impact of PGA Surcharge Each Month Under Each Scenario

Scenario	Feb-06	Mar-06	Apr-06	May-06	Jun-06	Jul-06	Aug-06	Sep-06	Oct-06	Nov-06	Dec-06
1	\$4.95	\$4.05	\$2.52	\$1.55	\$1.23	\$0.99	\$0.88	\$0.96	\$1.06	\$1.71	\$4.50
2	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00	\$0.00
3	\$1.93	\$1.58	\$0.98	\$0.60	\$0.48	\$0.39	\$0.34	\$0.37	\$0.41	\$0.67	\$1.75
4	\$2.20	\$2.70	\$2.24	\$2.23	\$3.15	\$2.54	\$2.26	\$2.45	\$1.53	\$1.14	\$2.00
5	\$7.15	\$5.85	\$3.64	\$2.23	\$1.78	\$1.44	\$1.28	\$1.38	\$1.53	\$2.47	\$6.50
6	\$12.65	\$10.35	\$6.44	\$3.95	\$3.15	\$2.54	\$2.26	\$2.45	\$2.72	\$4.37	\$11.50
7	\$15.40	\$12.60	\$7.84	\$4.81	\$3.83	\$3.09	\$2.75	\$2.98	\$3.31	\$5.32	\$14.00

Projected PGA Bank Balance Under Scenarios 1, 2, and 7



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BEFORE THE ARIZONA CORPORATION COMMISSION

- JEFF HATCH-MILLER
Chairman
- WILLIAM A. MUNDELL
Commissioner
- MARC SPITZER
Commissioner
- MIKE GLEASON
Commissioner
- KRISTIN K. MAYES
Commissioner

IN THE MATTER OF THE APPLICATION
OF SOUTHWEST GAS CORPORATION
FOR APPROVAL OF A PURCHASED GAS
ADJUSTOR SURCHARGE INCREASE

DOCKET NO. G-01551A-05-0823
DECISION NO. _____
ORDER

Open Meeting
January 24 and 25, 2006
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Southwest Gas Corporation ("Southwest") is engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.
2. On November 8, 2005, Southwest filed for Commission approval of an increase in its temporary purchased gas adjustor ("PGA") surcharge from the current level of \$0.02 per therm to \$0.11 per therm due to increasing natural gas prices.
3. Previously, in Decision No. 67458 (January 4, 2005), the Commission approved a \$0.02 per therm PGA surcharge for Southwest, effective in January 2005 and terminating upon a change in Southwest's rates resulting from a general rate proceeding, unless otherwise ordered by the Commission.
4. Southwest's application indicates that it projects that its PGA bank balance will be undercollected by approximately \$60 million by the end of 2005. As of the end of October 2005, ...

1 Southwest's PGA bank balance was undercollected by \$33,894,523 according to the most recently
2 available monthly PGA report.

3 5. In December 2005, the total cost of gas reflected in Southwest's rates was \$0.65407
4 per therm, consisting of a base cost of gas of \$0.37034 per therm, a monthly PGA rate of \$0.26373
5 per therm, and a temporary PGA surcharge of \$0.02 per therm. By comparison, the total cost of
6 gas reflected in Southwest's rates in December 2004 was \$0.53407 per therm. Nevertheless, the
7 current cost of gas reflected in Southwest's rates is substantially below the actual incurred cost of
8 natural gas, including both the commodity cost and the interstate transportation cost, for Southwest
9 in recent months, as spot market natural gas prices have soared.

10 6. Southwest has indicated that approximately half of its winter 2005/2006 natural gas
11 supplies are hedged at between \$6.00 and \$7.00 per dth, with the remainder of supplies subject to
12 monthly or daily market indices.

13 7. In recent months, natural gas prices soared in late summer due to high temperatures
14 and then the hurricanes which swept through the Gulf of Mexico, disrupting natural gas
15 production, processing and deliveries. Natural gas prices dipped during November as weather was
16 mild. However, in December prices have risen to their highest levels yet, as cold weather across
17 the nation has driven early winter demand for natural gas and other heating fuels.

18 8. As of December 22, 2005, the Gas Daily El Paso-Permian index was \$11.35 per dth
19 and the El Paso-San Juan index was \$11.325 per dth. The United States Energy Information
20 Administration projects El Paso-San Juan prices to average \$8.21 per thousand cubic feet
21 (approximately equivalent to a decatherm) in 2006. A variety of factors could move natural gas
22 prices significantly upward or downward during the current heating season and further into the
23 future.

24 9. Staff has reviewed Southwest's projected natural gas prices and believes they are
25 reasonable for the purpose of evaluating Southwest's application for an increase in its PGA
26 surcharge. Southwest projects an average commodity cost in 2006 of approximately \$0.77 per
27 therm.

28 ...

1 10. Additionally, Southwest projects a substantial increase in its interstate
2 transportation costs, due to the on-going El Paso Natural Gas Company rate proceeding before the
3 Federal Energy Regulatory Commission.

4 11. Southwest's projections show that even with implementation of the proposed PGA
5 surcharge, Southwest's PGA bank balance will continue to grow through 2006, exceeding \$100
6 million in the second half of 2006.

7 12. Southwest's application requests implementation of the PGA surcharge increase in
8 the first billing cycle for January 2006 or as soon as practicable thereafter. Giving the timing of
9 the process for reviewing this matter, a February 2006 implementation would likely be the earliest
10 possible. Southwest's application does not specify when the Company wishes the proposed
11 surcharge to end. In discussions with Southwest, the Company indicated to Staff that its intent is
12 for the \$0.11 per therm PGA surcharge to be in effect until the bank balance reaches zero.

13 13. While certainly substantial, Southwest's requested PGA surcharge of \$0.11 per
14 therm is relatively small in comparison to the PGA surcharges the Commission has recently
15 granted to other Arizona LDCs. At least part of the reason for this is likely that Southwest is only
16 requesting a PGA surcharge to address the undercollected PGA bank balance as of the end of
17 December 2005, whereas other PGA surcharge requests have, to at least some extent, addressed
18 anticipated undercollections that are projected to occur through 2006.

19 14. Staff believes that, given the high level of natural gas prices and the real possibility
20 that Southwest's PGA bank balance will increase even if Southwest's application is granted, the
21 Commission should grant the full \$0.11 per therm PGA surcharge requested by Southwest. If
22 Southwest's projections are accurate, the Company may need to seek additional relief at a later
23 point in 2006.

24 15. Beginning November 28, 2005, Southwest began inserting customer notices in its
25 bills to inform customers of its request to increase the PGA surcharge, in addition to other
26 educational efforts.

27 16. Attached are several tables showing possible options if the Commission wishes to
28 approve a surcharge in some form other than the \$0.11 level requested by the Company.

1 Additionally, it should be noted that Southwest has an on-going general rate case proceeding
 2 (Docket No. G-01551A-04-0876) before the Commission that likely will result in some level of
 3 additional rate increase.

4 17. In the Commission's recent decision on a UNS Gas PGA surcharge application, the
 5 Commission exempted customers taking service on the low income discount tariff from paying the
 6 PGA surcharge. Staff recommends that customers taking service on Southwest's G-10, Low
 7 Income Residential Gas Service (Southwest's LIRA program), be exempted from paying the PGA
 8 surcharge in effect for Southwest after this proceeding.

9 18. For an average residential customer in February 2006, using 55 therms, the bill is
 10 estimated to be \$71.57 with only the \$0.02 per therm surcharge in effect, and \$76.52 with the
 11 additional \$0.09 per therm surcharge. By comparison, an average residential customer in February
 12 2005, using 55 therms, would have had a bill of \$65.68 (only \$0.02 surcharge in effect). The
 13 increases from 2005 reflect both the surcharge(s) that would be in effect in February 2006 and the
 14 gradual increase in the monthly PGA rate.

15 19. The table below shows estimated customer bills in February 2006 at a variety of
 16 usage levels, with either the existing \$0.02 per therm surcharge or the proposed \$0.11 per therm
 17 surcharge.

Therms	February 2006 bill with a \$0.02 per therm surcharge	February 2006 bill with a \$0.11 per therm surcharge	Percentage Difference
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55 (Average)	\$71.57	\$76.52	+6.92%
75	\$93.46	\$100.21	+7.22%
100	\$120.82	\$129.82	+7.45%
150	\$175.54	\$189.04	+7.69%

26
 27 20. Given current conditions, Staff has recommended approval of Southwest's
 28 application to increase the PGA surcharge from \$0.02 per therm to \$0.11 per therm, effective the

1 first billing cycle in February 2006. Staff further recommends that the \$0.11 per therm PGA
2 surcharge remain in effect until the PGA bank balance reaches zero or the Commission orders
3 otherwise.

4 21. Staff has further recommended that customers enrolled in the LIRA program be
5 exempted from paying the PGA surcharge approved in this proceeding.

6 22. Staff has further recommended that Southwest engage in an immediate, highly
7 visible and meaningful public relations campaign, in consultation with Staff, to inform its
8 customers of (1) the specific details of the PGA surcharge level(s) approved in this proceeding and
9 how it benefits customers to recover natural gas costs now rather than later; (2) the impact of the
10 PGA surcharge level(s) on customer bills; (3) general natural gas price circumstances leading to
11 the PGA surcharge; and (4) ways in which Southwest's customers can try to manage the higher
12 rates they are facing. Heavy emphasis should be placed on promoting programs such as budget
13 billing (especially during the time of year that it would be most beneficial to customers to apply),
14 the LIRA program, and ways to reduce consumption.

15 CONCLUSIONS OF LAW

16 1. Southwest is an Arizona public service corporation within the meaning of Article
17 XV, Section 2, of the Arizona Constitution.

18 2. The Commission has jurisdiction over Southwest and over the subject matter of the
19 application.

20 3. The Commission, having reviewed the application and Staff's Memorandum dated
21 January 11, 2006, concludes that it is in the public interest to approve the PGA surcharge discussed
22 herein.

23 ORDER

24 IT IS THEREFORE ORDERED that the purchased gas adjustor surcharge, as discussed
25 herein, be in effect until the PGA bank balance reaches zero or the Commission orders otherwise,
26 is approved.

27 IT IS FURTHER ORDERED that customers served under the LIRA program are exempted
28 from paying the PGA surcharge approved in this order.

1 IT IS FURTHER ORDERED that Southwest engage in an immediate, highly visible and
 2 meaningful public relations campaign, in consultation with Staff, to inform its customers of (1) the
 3 specific details of the PGA surcharge level(s) approved in this proceeding and how it benefits
 4 customers now to recover natural gas costs now rather than later; (2) the impact of the PGA
 5 surcharge level(s) on customer bills; (3) general natural gas price circumstances leading to the
 6 PGA surcharge; and (4) ways in which Southwest's customers can try to manage the higher rates
 7 they are facing. Heavy emphasis should be placed on promoting programs such as budget billing
 8 (especially during the time of year that it would be most beneficial to customers to apply), the
 9 LIRA program, and ways to reduce consumption.

10 IT IS FURTHER ORDERED that this Order shall become effective immediately.

11 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

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CHAIRMAN

COMMISSIONER

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COMMISSIONER

COMMISSIONER

COMMISSIONER

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IN WITNESS WHEREOF, I BRIAN C. McNEIL, Executive
 Director of the Arizona Corporation Commission, have
 hereunto, set my hand and caused the official seal of this
 Commission to be affixed at the Capitol, in the City of
 Phoenix, this _____ day of _____, 2006.

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 BRIAN C. McNEIL
 Executive Director

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DISSENT: _____

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DISSENT: _____

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EGJ:RGG:lhmvJG

1 SERVICE LIST FOR: Southwest Gas Corporation
2 DOCKET NO. G-04204A-05-0823

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