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**SOUTHWEST GAS CORPORATION RECEIVED**

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AZ CORP COMMISSION  
DOCKET CONTROL

February 19, 2009

Docket Control Center  
Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, AZ 85007-2996

Subject: **Docket No. G-01551A-07-0504, Decision No. 70665**

Pursuant to Commission Decision No. 70665, dated December 24, 2008, Southwest Gas Corporation (Southwest) hereby submits an original and thirteen (13) copies of its compliance regarding two items in the above referenced decision: (1) implement ACC Staff's (Staff) Pipeline and Procurement recommendations (Ordering Paragraph No. 4, page 60 (lines 27-28) and page 61 (lines 1-2)). Please see "Attachment 1" for compliance on this item; and (2) develop in a form acceptable to Staff, a new limits and control document that would be in line with industry best practices, in accordance with Staff's recommendations (Ordering Paragraph No. 5, page 61, lines 3-6). Please see "Attachment 2" for compliance on this item.

Respectfully submitted,

Debra S. Gallo, Director  
Government & State Regulatory Affairs

c: Ernest Johnson, ACC  
Compliance Section, ACC  
Jodi Jerich, RUCO

Arizona Corporation Commission

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# Attachment 1

In Decision No. 70665, Southwest was ordered to implement Staff's Pipeline and Procurement recommendations within 60 days of the effective date of the Decision and file in this docket as a Compliance Item a copy of the revised procedures.

Staff's recommendation stated "Southwest Gas should increase the documentation and requirements for its transportation-only customers. Also, Southwest should make its Daily Forecasting Accuracy Improvement Task Force a permanent entity." Southwest is in compliance with this item as its procedures include monthly monitoring of its transportation-only customers' upstream capacity and transportation rights on El Paso Natural Gas. Further, Southwest implemented tariff changes in 2007 that established that transportation-only customers are responsible for upstream charges or penalties that are occasioned by their actions.<sup>1</sup> The combination of these two actions ensure that Southwest is able to pass-along upstream penalties or charges that are due to the actions of transportation-only customers and not due to Southwest's core residential and small commercial customers. In addition, the Daily Forecasting Accuracy Improvement Task Force is a permanent entity.

The following details the compliance actions taken by Southwest to implement Staff's recommendations:

1. Compile a listing of its gas procurement policies, practices, and strategies indicating the names, ownership, and location of documents.

#### Action taken to Comply with Recommendation

Southwest completed the compilation of a list of gas procurement policies, practices, and strategies that include each document's name, ownership, and location. All of the relevant documents are centrally located and Gas Purchases & Transportation personnel have access to those documents.

2. Clarify the APSP [Southwest Gas's Arizona Price Stabilization Program] supply element by documenting expected volumes and timing for the next one to two years forward.

#### Action taken to Comply with Recommendation

Southwest clarified the APSP. The plan documents expected volumes and timing of solicitations for the next portfolio year as well as the expected volumes and timing of solicitations for the portion of the following portfolio year that Southwest will purchase over then next 12 months. Once Southwest develops the plan for a particular portfolio year, Southwest may adjust the plan based on changes to demand forecasts, interstate capacity contracts, or if other unique market conditions arise.

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<sup>1</sup> See Surrebuttal Testimony of Stephen L. Thumb On Behalf of the Utilities Division Staff Arizona Corporation Commission, Docket No. G-01551A-07-0504, May 27, 2008, at 4 – 5.

3. Clarify the precise nature of the APSP strategy. Is it a programmatic hedge, a judgmental hedge, or a hybrid of the two? The precise strategy should be recognized and declared in company policies and procedures to guide employees and decision makers, as well as the ACC oversight.

Action taken to Comply with Recommendation

Southwest clarified the nature of the APSP strategy and modified Gas Purchasing & Transportation policies and procedures to include a declaration of the nature of the APSP so these documents can be a guide to employees, decision makers, and ACC oversight.

4. \*Revised recommendation by Staff - Require Southwest to create new limits and controls document that would be in line with the industry best practices. (Page 52, lines 9-11)

Action taken to Comply with Recommendation

Please see "Attachment 2" for compliance to this item.

5. Company policies regarding the "unbuying" of gas, as well as the reasons for the policies and the potential consequences, should be reevaluated, and then explicitly documented in official policies and procedures.

Action taken to Comply with Recommendation

Southwest reevaluated the "unbuying" policies, reasons for those policies, and the potential consequences of "unbuying" gas. Southwest updated its policies and procedures to explicitly document the policies and procedures related to the "unbuying" of gas.

6. Ensure all confirmations with gas suppliers, also known as Exhibit A, include deal transaction dates.

Action taken to Comply with Recommendation

Southwest modified the "Exhibit A" to include deal transaction dates. Southwest interprets the deal transaction date and the deal accepted date as being the same date for a specific transaction confirmation "Exhibit A."

7. Ensure all confirmations with suppliers, also know as Exhibit A, include dates of the internal approval next to the authorized signature.

Action taken to Comply with Recommendation

Southwest has modified the "Exhibit A" to include the accepted date. Southwest interprets the deal transaction date and the deal accepted date as being the same date for a specific transaction confirmation "Exhibit A."

8. Considerably shorten the time lapsed between deal execution and deal confirmation with gas suppliers.

Action taken to Comply with Recommendation

Southwest has modified its procedures in an effort to shorten the time lapsed between deal execution and deal confirmation with gas suppliers.

9. Include a list of attendees present during the solicitation and purchase of the APSP fixed price gas supply element (as well as during selection and approval of the index gas supply element) to ensure independence, proper monitoring, and to improve the quality of the audit trail.

Action taken to Comply with Recommendation

Southwest has modified its procedures to require that Southwest keep a list of attendees for both fixed-price APSP solicitation and for the meetings where firm term portfolio index gas supplies are selected and approved for inclusion in the portfolio.

10. Update old master supply agreements that limit the buyers' liquidated damages at 50 cents per mmBtu into supply agreements that are based on true-up to actual market during non-performance.

Action taken to Comply with Recommendation

Southwest reviewed the firm gas supply master agreements that are in effect with its suppliers and the buyer's liquidated damages provisions found in those agreements do not limit a buyer's liquidated damages to a maximum of \$0.50/MMBtu, but specify that the maximum amount the buyer is permitted to recover as liquidated damages is calculated on a true-up of the contract price to the market price during periods of supplier non-performance or under-performance.

## **Attachment 2**

In Decision No. 70665, Southwest was ordered to develop, in a form acceptable to Staff, a new limits and control document that would be in line with industry best practices, in accordance with Staff's recommendations. This document was to be filed within 60 days of the effective date of the Decision as a Compliance Item. Southwest revised its Gas Purchases & Transportation Portfolio Selection Procedures to set forth specific personnel authorized by senior management to execute gas purchase transactions and the limits on that authority. A copy of the revised procedures are attached.

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

**Limits and Controls**

Southwest's Gas Purchases & Transportation (GP&T) personnel (Specialist, Sr. Specialist, and Manager) are authorized to enter into specific gas supply transactions based upon the authority outlined in this document. With regard to one month or less spot purchases, each of the GP&T personnel are assigned a specific service territory(ies) and are only authorized to purchase gas supplies for the assigned service territory(ies). GP&T personnel shall forward any questions concerning the authority to enter into a specific transaction to management or senior management prior to entering into such transaction to ensure GP&T personnel do not exceed authority levels. GP&T personnel are not authorized to enter into gas supply transactions that are not authorized by this document without the approval of management or senior management.

**Solicitation of Firm Term Bids**

1. GP&T consults with Gas Resources Planning (GRP) to identify the input variables required by the computer model or other analyses GRP will use in the upcoming portfolio evaluation process.
2. In consideration of GRP modeling and other analytical needs, requisite non-modeled contractual details, and concerns for respondent understandability, GP&T fashions a solicitation designed to maximize the quantity, quality, and diversity of proposals received and Southwest's ability to evaluate such proposals effectively.
3. The firm term solicitation requests index-based supply pricing.
4. GRP attempts to evaluate all responsive term proposals received. The primary tool used for evaluating the proposals is a computer-based optimization modeling program. If GRP cannot model a proposal as submitted, GRP will use other available tools to evaluate such proposals. In cases where a supplier submits a proposal with attributes that GRP cannot enter into the model, a surrogate may be used that conforms to the parameters outlined in the bid solicitation guidelines, subject to any model design limitations.
5. If proposals that appear incomplete, unclear, internally inconsistent, or not within the scope of the solicitation, GP&T will seek supplier clarification. Southwest removes proposals that suppliers cannot sufficiently clarify for evaluation from further consideration. GRP and GP&T will maintain appropriate documentation as to the reason(s) when a proposal is removed from evaluation.

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

**Evaluation of Firm Term Supplies**

1. Preparation for Evaluation
  - a) Evaluation Engineers from GRP create a new model set-up for each rate jurisdiction that requires modeling. Space is set-aside in the model for existing and future fixed-price contract commitments procured through the VMP or APSP programs. The minimum daily quantities are dependent on each rate jurisdiction's needs. However, the minimum daily quantities are subject to revision at anytime during the analysis to reflect changing market conditions and experienced management judgment.
  - b) Southwest's interactive bid program creates a database that contains the electronic bid forms submitted by suppliers.
  - c) Evaluation Engineers review bids for clarity and convert price statements into modeling equation coefficients. GRP returns any bids that appear incomplete, unclear, or internally inconsistent to GP&T for clarification, as noted above. Any proposal that GP&T cannot sufficiently clarify for evaluation will be removed from further consideration.
  - d) All bids accepted for consideration will be sorted by rate jurisdiction, term, and type to facilitate modeling.
  - e) Special cases will receive appropriate treatment.
2. At this point, GP&T and GPT present all offers or surrogates for management and senior management review and an iterative selection and negotiation process begins to identify and secure the best cost portfolio considering price, reliability, and resource mix.
3. Modeling identifies the lowest cost portfolio components from the available bids, based upon portfolio requirements.
  - a) GRP uses demand forecasts developed by the Demand Planning department in the modeling, with minor exceptions as deemed necessary to meet supply reliability goals.
  - b) GRP bases monthly price levels for modeling on forward market conditions with adjustments necessary for specific location or seasonal decision support.

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

4. The Vice President/Gas Resources is authorized to accept offers for inclusion in the portfolio based upon model results and qualitative considerations with and without negotiated improvement.
5. Southwest shall keep a list of attendees that are present during meetings where the Vice President/Gas Resources selects and approves Firm Term Supplies for inclusion in the portfolio.
6. GRP converts supplies already contracted and bids authorized during the evaluation process to "existing" status in its models. The iterative selection process then continues until Southwest contracts for sufficient gas supplies to meet requirements for each jurisdiction.

**VMP and APSP Solicitation Overview**

Apart from the Firm Term Supplies, Southwest requests fixed-price proposals for inclusion in the portfolio as part of the Nevada Volatility Mitigation Program (VMP) and Arizona Price Stability Program (APSP), collectively "Volatility Mitigation Purchases." Similar programs may be conducted for Southwest's other rate jurisdictions as management deems appropriate. Volatility Mitigation Purchases are programmatic hedges designed to mitigate the volatility in gas supply prices that Southwest's customers experience when Southwest passes prudently incurred gas costs along to its customers.

Volatility Mitigation Purchases involve periodic solicitations and purchases for various future purchase periods. GP&T and GRP, with Senior Management input, jointly determine the dates for issuing the solicitations and the Volatility Mitigation Purchases plan outlines expected volumes for the next two portfolio years. The scope of the fixed-price Volatility Mitigation Purchase solicitations is limited when compared to the general firm term bid solicitation. Southwest narrowly tailored the structure of Volatility Mitigation Purchase solicitations to minimize evaluation and acceptance response times and permit respondent suppliers to minimize risk, therefore encouraging participation. Further, Southwest designs the Volatility Mitigation Purchase solicitations to allow direct competition between fixed-price physical gas supplies and financial fixed-for-floating index swaps that provide the same level of volatility mitigation.

GP&T creates solicitations for fixed-price physical gas supplies and financial fixed-for-floating index swaps specific to each jurisdiction and delivery period, and distributes such to physical gas and financial product suppliers. These solicitations identify market areas, receipt locations, purchase periods, and applicable indexes for financial fixed-for-floating index swaps, as well as setting forth the response date and time deadlines. Southwest shall keep a list of attendees that are present

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

during the solicitation process meetings where the Vice President/Gas Resources selects and approves Volatility Mitigation supplies for inclusion in the portfolio. Upon receipt of offers, Southwest ranks those offers by price and contracts for the best price supplies to meet the Volatility Mitigation Purchase requirements. The Vice President/Gas Resources is authorized to accept the lowest priced supply option for inclusion in the portfolio.

**Monthly/Daily Spot Purchases (One month or less)**

1. GP&T determines monthly spot gas (baseload for no more than one month) purchase requirements for each service territory prior to the first of each month. The forecasted minimum day for the month for which GP&T is purchasing monthly supplies is the starting point to determine the monthly spot gas purchase requirement for each service territory. GP&T subtracts the total available baseload supplies (Volatility Mitigation Purchases and Firm Term Portfolio Purchases) from the forecasted minimum day to determine the gross monthly spot purchase requirement. With the exception of the Southern California service territory, the gross monthly spot purchase requirement for each service territory will be zero for the winter months (November through March) because available baseload supplies should equal the forecasted minimum day. After considering economic, contractual, and operational considerations, GP&T then adjusts the gross monthly spot purchase requirement to determine the monthly spot purchase requirement. GP&T personnel are authorized to contract for supplies selected to meet the monthly spot purchase requirement for each service territory.
2. GP&T issues a solicitation outlining monthly spot purchase requirements to suppliers. This solicitation identifies the market areas, receipt locations, and purchase periods, as well as setting forth the response date and time deadlines. When GP&T receives the offers from suppliers, GP&T sorts those offers by jurisdiction and ranks the offers by price. GP&T compares the best prices to those prices available on internet trading platform(s). GP&T contracts for the best price supply available to meet the projected purchase requirements. GRP personnel act as an independent observer/participant for the monthly spot gas purchase process.
3. GP&T determines, on a daily basis, the daily spot gas purchase requirements for each jurisdiction based on economic, contractual, and operational considerations. GP&T then gathers market intelligence through communications with prospective suppliers, monitoring internet trading platform(s), and reviewing other industry pricing information to determine daily marketplace price parameters. GP&T continues to monitor market price fluctuations throughout the daily trading period and modifies offer acceptance threshold levels based on these market fluctuations. GP&T reviews available firm term contract supplies/prices and

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

determines what, if any, opportunities are available to flex firm term contract volumes up or down based on prevailing spot market prices. GP&T continues this iterative process until daily spot purchase requirements for each service territory are met. GP&T personnel are authorized to contract for daily spot market supplies to meet the daily spot market requirement, as determined below through the Daily Purchase and Nomination Procedures.

**Daily Purchase and Nomination Procedures**

The following constitutes a general procedure for acquiring and nominating daily supplies. GP&T follows these steps after the previously detailed Firm Term Supplies, firm fixed-price Volatility Mitigation Purchases, and monthly spot supplies have been contracted and are available for nomination.

1. Survey current spot market prices.
2. Review daily system demand forecast for the assigned service territory, as available, from Central Gas Dispatch. The daily forecast is the starting point for determining GP&T personnel's authority to purchase daily supplies. Central Gas Dispatch provides this forecast to GP&T personnel at least twice daily (at about 5:00 AM and about 2:00 PM).
3. Review the available firm term and baseload supplies Southwest currently has contracted for each service territory.
4. Review pipeline imbalance activity to determine if a deviation from Central Gas Dispatch's daily system demand forecast is necessary or desired to counteract any imbalance trends.
5. Determine if any further deviation from Central Gas Dispatch's daily system demand forecast is necessary to accommodate any requests or demands for action communicated from upstream pipelines or to comply with pipeline balancing tariffs.
6. Review available upstream pipeline capacity availability for the flow day for which supplies are being purchased.
7. Review past nomination activity and results.
  - a) Review most recent pipeline scheduling reports to identify any instances of nonperformance on nominated supplies.
  - b) In cases of nonperformance, identify the cause of the nonperformance.

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

- c) Determine if it is necessary or desirable to have the involved supplier re-nominate the shortfall.
  - d) If re-nomination is desirable, contact supplier to make re-nomination arrangements.
  - e) Enter re-nominations into internal nomination systems.
  - f) Review pipeline reports for results of any prior re-nomination attempts.
  - g) If re-nomination efforts were partially unsuccessful, repeat Steps 6(c) through 6(f), as appropriate.
8. Determine estimated daily spot gas requirements in light of the preceding steps. GP&T personnel are authorized to contract for daily spot market supplies to meet the requirements so determined for each assigned service territory.
9. Gather market intelligence by receiving calls from and making calls to prospective suppliers and monitoring electronic messaging, internet trading platform(s), and other industry pricing information to determine daily price parameters available in the marketplace.
10. Monitor market price fluctuations throughout the daily trading period and modify offer acceptance threshold based on these market fluctuations.
11. Review available firm term contract supplies/prices and determine what, if any, nomination changes from prior day should be made in consideration of opportunities to flex firm term contract volumes up or down based on prevailing spot market prices. GP&T personnel are authorized to activate firm term supplies, up to the maximum available contract quantity, to meet the daily requirements of each service territory that is in excess of the baseload supplies.
12. Modify daily spot purchase requirement arrived at in Step 7 based on price observations made in Steps 8, 9, and 10.
13. Enter daily nomination information in internal systems and advise respective system Central Gas Dispatch scheduler of its availability.
14. Print daily spot gas confirmation letters, review for accuracy, and sign them.

**SOUTHWEST GAS CORPORATION**  
**GAS PURCHASES & TRANSPORTATION**  
**PORTFOLIO SELECTION PROCEDURES**  
**AND**  
**GAS PURCHASING LIMITS AND CONTROLS**

1/28/2009

15. Provide signed daily spot gas confirmation letters to administrator for faxing to respective suppliers.
16. Review any confirmation letters independently sent by supply representatives for accuracy, and follow up with supplier on any perceived errors.