ORIGINAL

SOUTHWEST GAS CORPORATION

April 16, 2009

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

Subject: Docket Nos. E-00000J-08-0314 and G-00000C-08-0314

Southwest Gas Corporation (Southwest) herewith submits for filing an original and fifteen (15) copies of its responses to the Arizona Corporation Commission Utilities Division Staff questions issued in a letter to the docket dated April 1, 2009.

Respectfully submitted,

Debra S. Gallo, Director
Government and State Regulatory Affairs

Enclosure

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

KRISTIN K. MAYES, Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

IN THE MATTER OF THE ARIZONA CORPORATION COMMISSION'S INVESTIGATION OF REGULATORY AND RATE INCENTIVES FOR GAS AND ELECTRIC UTILITIES	DOCKET NO. E-00000J-08-0314 G-00000C-08-0314

NOTICE OF FILING WRITTEN COMMENTS

Southwest Gas Corporation hereby provides notice of its filing written comments in response to the Arizona Corporation Commission Staff's question filed in the above-captioned docket. A copy of Southwest's written comments are enclosed herewith.

DATED this 16th day of April 2009

SOUTHWEST GAS CORPORATION

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INVESTIGATION OF REGULATORY AND RATE INCENTIVES FOR GAS AND ELECTRIC UTILITIES
Docket Nos. E-00000J-08-0314 and G-00000C-08-0314

Southwest Gas Corporation Response to Commission Staff Questions for Technical Working Group Meetings April 17, 2009

The Arizona Corporation Commission's decision to actively pursue greater energy efficiency for the state of Arizona will require implementation of a new regulatory model – one that permits utility cost recovery even if customers conserve, and a new approach in the way utilities interact and work together in furthering the statewide energy efficiency goals. The effective promotion of energy efficiency requires cooperation among stakeholders rather than competition. This cannot be fully accomplished unless the utilities are financially indifferent, in total, to the choice between increased energy efficiency or increased energy usage. In this regard, and as discussed further in these responses, Southwest supports full revenue decoupling for all of Arizona's regulated utilities because it serves to remove the utilities' energy efficiency-related financial interest from the decision process. With decoupling, there is nothing to gain by increasing sales beyond each company's least cost planning level. Likewise, there is nothing to lose by implementing maximum cost-effective energy efficiency and conservation measures. This will make it easier for each company to balance customer and investor interests while working to maximize energy efficiency. Southwest trusts Arizona's regulated utilities will follow the Commission's lead in bringing the benefits of greater energy efficiency to customers. Southwest's specific responses to Staff's questions are set forth below.

Assuming an energy efficiency goal of at least 20 percent of the total energy resources needed to meet retail load in 2020:

1. What should the annual percentage be and on what schedule?

Southwest is willing to support any proposed energy efficiency standard and goal that is sufficiently tailored to address Southwest's unique operating conditions and challenges, that is realistically attainable, and that is established in conjunction with the removal of the financial disincentives that currently serve as a barrier to achieving energy efficiency goals. In addition, Southwest recognizes that each utility has its own unique operating conditions and challenges with respect to obtaining greater energy efficiency. Accordingly, prior to selecting a target efficiency rate and schedule, consideration should be given to how energy efficiency progress will be measured for each utility. For example, if the Commission establishes a statewide energy efficiency goal of 20 percent of total energy resources needed to meet retail load by 2020, is each utility (gas and electric) expected to achieve that reduction, or will we measure efficiency gains on a statewide and total energy basis. Furthermore, how will individual utility performance be measured?

Southwest submits that establishing a statewide energy efficiency goal, similar to what other regional states and the Western Governor's Association ("WGA") have already established, is the most logical way to ensure movement toward greater "total" energy efficiency for Arizona, as this model lends itself to consideration of the full energy cycle when analyzing energy efficiency. The most effective energy efficiency programs should take into account the full or complete energy cycle, which measures the energy efficiency of the resource from the source to the site. Such consideration will ultimately require the encouragement of consumers to use certain energy resources as an end-use whenever possible – i.e. gas appliances and not electric appliances whenever possible, as well as utilizing renewable energy resources as an end-use whenever possible – i.e. solar-thermal appliances and not gas or electric appliances.

Southwest has experienced a 40 percent decline in average use per customer during the last 20 years. Whether, and at what level, this trend will continue cannot be known with absolute certainty. Consideration must be given to these unique circumstances when establishing an energy efficiency goal and standard. For instance, the possible increase in the end-use of natural gas where it is the most efficient resource and a continuing downward trend in use per customer, do not lend themselves to setting a strict percentage efficiency goal for Southwest. Rather than applying an energy efficiency goal, such as 1.5 percent per year or 20 percent by 2020, it would be more practical to require Southwest to deliver an aggressive, cost effective menu of conservation and energy efficiency programs to its customers. Southwest's performance should then be evaluated based on how well it delivers each program. This is similar to the policy recommendations in both the WGA's Clean and Diversified Energy Advisory Committee's Energy Efficiency Task Force Report[1] and the Arizona Climate Change Action Group's Climate Change Action Plan[2].

Drawing from its review of best practice policies and programs the WGA Energy Efficiency Task Force did not recommend savings requirements or targets for natural gas utilities, unlike its recommendation to establish minimum energy savings requirements or targets for electric utilities. Instead, it focused more on investing in energy efficiency programs and their expected resulting savings. The task force made the following recommendations for gas utility demand-side management programs:

- Encourage or require gas utilities to integrate efficiency resources into their resource planning and procurement decisions and pursue energy efficiency whenever it is the lowest cost option.
- Establish ratepayer-funded natural gas energy efficiency programs.
- Invest at least 1.5-2% of gas utility revenues in energy efficiency programs and strive to save the equivalent 0.5-1.0% of gas consumption per year, as long as doing so is cost effective.
- Decouple gas utility sales and revenues and create performance incentives that reward utilities for implementing effective DSM programs.

[1] Western Governor's Association' Clean and Diversified Energy Advisory Committee, Energy Efficiency Task Force Report, January 2006.
[2] Arizona Climate Change Advisory Group, Climate Change Action Plan, August 2006.

Similarly, the CCAG's recommendations for demand-side efficiency goals established energy savings targets for electricity of 5 percent savings by 2010 and 15 percent savings by 2020. However, with respect to natural gas, the CCAG recommended a spending target and not a savings target. The CCAG recommended ramping up to "spending 1.5 percent of gas utility revenues on energy efficiency programs by 2015 pursuant to Arizona Corporation Commission (ACC) decoupling of gas sales and revenue." The recommendation also noted that "decisions by the ACC to decouple gas sales and revenues are viewed as central to achieving this target."

As noted above, Southwest is willing to support any proposed energy efficiency standard and goal that is sufficiently tailored to address Southwest's unique operating conditions and challenges, that is realistically attainable, and that is established in conjunction with the removal of the financial disincentives that currently serve as a barrier to achieving energy efficiency goals. In establishing a standard or goal, consideration must be given to the unique operating conditions and experiences of each utility to determine how that particular utility can best contribute to whatever statewide energy efficiency goal is ultimately established.

2. What are the estimated annual costs of achieving this goal?

Until there is more direction on how Southwest will be contributing to a statewide energy efficiency goal of 20 percent by 2020, it is difficult to calculate the annual costs of achieving such a goal. However, Southwest has experienced annual reductions in use per customer of 2.55 percent over the last 20 plus years without significant investment in conservation and energy efficiency programs. Given Southwest's unique operating conditions and experiences, Southwest submits that its current program budget of approximately $4 million increasing by $1 million annually is reasonable at this time.

3. Estimated annual savings of achieving goal.

Using its currently effective residential rates, Southwest estimates that a 1.5 percent reduction in annual use per residential customer from 2010 thru 2020 would result in average annual savings of approximately $3.8 million. This $3.8 million savings is a net customer savings, assuming the current regulatory model of providing for cost recovery only if customers do not conserve is modified so that the existing financial disincentives are removed and Southwest is able to recovery its cost of service regardless of customer conservation.

4. How and to what extent can energy efficiency help to relieve system constraints?

Increasing statewide energy efficiency will likely not provide significant relief from system constraints on Southwest's system. First, there may be offsetting effects. While its customers will become more efficient, to the extent increasing statewide energy efficiency involves making greater use of natural gas as an end-use fuel, there will be some offsetting upward pressure on Southwest's customers' usage. An additional

consideration is that for natural gas utilities the cost of incremental capacity is relatively inexpensive, i.e. less than average capacity cost. This is because capacity increases exponentially. For example, 4-inch distribution system pipe costs only marginally more per foot than 2-inch distribution system pipe but carries 4 times the volume of gas.

5. What is an adequate level of funding?

As noted in response to question number 2, Southwest submits that its current program budget of approximately $4 million increasing by $1 million annually is reasonable at this time. Southwest also believes that achieving optimal funding and program performance requires regular ongoing dialog among the stakeholders, including flexibility to easily and quickly modify programs and spending as conditions change. Southwest's program effectiveness should be monitored by Southwest, affected Stakeholders and the Commission, and funding levels modified prospectively as appropriate.

6. What are the best methods for cost recovery?

Southwest's existing DSM program surcharge methodology is appropriate for its current program funding levels. However, alternative forms of cost recovery may be more appropriate depending upon the unique conditions of the utility. For instance, a rate base and equity adder approach to cost recovery may be more appropriate for some utilities. Also, it is critical to address the erosion of utility revenues associated with increased energy efficiency, which is discussed in greater detail in response to questions 9 and 10.

7. What would be the bill impact to customers of achieving this goal?

Using its currently effective residential rates, Southwest estimates that a 1.5 percent reduction in annual use per residential customer from 2010 thru 2020 would result in an average annual reduction in residential bills of $3.92. This $3.92 represents a net customer savings, assuming the current regulatory model of providing for cost recovery only if customers do not conserve is modified so that the existing financial disincentives are removed and Southwest is able to recovery its cost of service regardless of customer conservation.

8. What waivers may be necessary for unexpected circumstances?

Recognizing that there may be a need for waivers or modifications to address unexpected and unintended circumstances is the most vital part to administering energy efficiency programs as well as rate and regulatory incentive mechanisms that better enable utilities to promote energy efficiency. There needs to be ongoing dialog among the stakeholders regarding performance and effectiveness of DSM measures and spending and the ability to change course if needed. The willingness to be flexible in the design and administration of energy efficiency programs and rate and regulatory incentive mechanisms, and to tailor them to the specific operating conditions and challenges of the utilities will allow the parties to identify and implement specific waivers that may

become necessary. For instance, to avoid any unexpected or unintended consequences attributed to implementing full revenue decoupling, Southwest is willing to exclude customers served on its low-income rate schedules form part, or all of the affects of the revenue decoupling mechanism(s).

9. What would be the revenue concerns, quantified, for utilities?

For Southwest, based on its currently effective residential rates, and assuming a 1.5 percent reduction in annual use per residential customer from 2010 thru 2020, lost margin is estimated to total from $7.5 million to more than $8.0 million per three-year rate case cycle over the period. However, as noted in responses to question 3, customers receive a net benefit of $3.8 million in savings, even if the current regulatory model of providing for cost recovery only if customers do not conserve is modified so that the existing financial disincentives are removed and utility lost margin concerns are mitigated.

10. Methods to address utility revenue concern?

Southwest continues to strongly support revenue per customer decoupling for its system because this approach: 1) removes the utility's energy efficiency-related financial interest from the decision process; 2) adjusts revenue based on the number of customers served, which is beneficial in a growing state like Arizona; 3) improves (rather than dilutes) the commodity price signal, as consumers who conserve more, pay less and consumers who conserve less, pay more; 4) allows freedom in designing rates that help promote conservation; 5) provides strong incentive for the utility to operate efficiently; 6) is easily adaptable to customer impact considerations; and 7) is simple and easy to administer.

Absent revenue decoupling, Southwest's revenue concerns can only be addressed thru rate design by significantly increasing the basic service charge and/or implementing declining block rate designs. Historically, many stakeholders have been opposed to these rate designs. The result of shifting cost recovery to the basic service charge and the mitigating affect on Southwest's cost recovery is reflected in Table I below.

Table I

Three-Year Rate Case Cycle Beginning Losses					
Basic Charge	$10.70	$12.00	$15.00	$20.00	$26.98
Loss in Millions	$7.5	$6.9	$5.6	$3.4	$0.0

* Losses based on 1.5% annual reductions in residential use per customer.

Unlike higher fixed charge rate designs, revenue decoupling, to the extent we are successful in reducing customers' natural gas usage, improves the effectiveness of rate design in promoting conservation by: 1) allowing greater freedom in rate design; 2) increasing the value of each therm actually conserved; and 3) sending a stronger commodity price signal to customers who do not conserve.

For example, given Southwest's currently effective $10.70 basic service charge and commodity charge, with revenue decoupling, if an average customer reduces usage by

1.5 percent per year, the customer will save $34.75 over a three-year rate case cycle. However, an average customer who does not reduce gas usage will pay $8.72 more than would be the case without decoupling. Decoupling actually improves Southwest's rate design price signal by causing customers who do not conserve to pay more than they otherwise would; it is these customers who need to be influenced the most.

Also, decoupling allows implementation of rate design changes that result in an average customer paying approximately the same amount in total with decoupling as they would pay if basic service charges are increased to address Southwest's financial concern. For example, if Southwest's basic service charge were increased to $12.00 per month with a corresponding reduction to its per therm commodity charge, an average customer who reduces usage by 1.5 percent per year would pay approximately $1,786 in total for natural gas service over a three-year rate case cycle. With decoupling, and retaining Southwest's currently effective $10.70 basic service charge and commodity charge, the customer would pay $1,790 over a three-year rate case cycle.

These rate design effects are summarized in Tables II and III below.

Table II – Price Signal With Decoupling

Basic Charge	- 1.5% Change in Use	No Change in Use
$9.00	($35.65)	$9.61
$10.70	($34.75)	$8.72
$12.00	($34.07)	$8.05

Table III – Rate Design Total Bill Impacts

Basic Charge	With Decoupling	W/O Decoupling
$9.00	$1,786	$1,777
$10.70	$1,790	$1,782
$12.00	$1,794	$1,786