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SOUTHWEST GAS CORPORATION

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April 20, 2007

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

Re: **Docket No. G-01551A-04-0876; Decision No. 68487**

Pursuant to Commission Decision No. 68487, issued in Docket No. G-01551A-04-0876, Southwest Gas Corporation (Southwest) is required to submit a recapitalization plan explaining how Southwest intends to achieve a 40 percent equity ratio prior to Southwest's next rate case.

Southwest hereby submits for filing an original and thirteen (13) copies of Southwest's Recapitalization Plan.

If you have any questions or require any additional information, please contact me at (702) 876-7163.

Respectfully submitted,

Debra S. Jacobson By

Debra S. Jacobson, Director
Government & State Regulatory Affairs

c Ernest Johnson, ACC
Compliance Section, ACC
Stephen Ahearn, RUCO

Arizona Corporation Commission
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APR 23 2007
DOCKETED BY
KC nR

5241 Spring Mountain Road / Las Vegas, Nevada 89150-0002
P.O. Box 98510 / Las Vegas, Nevada 89193-8510 / (702) 876-7011
www.swgas.com

SOUTHWEST GAS CORPORATION
RECAPITALIZATION PLAN
G-01551A-04-0876
DECISION NO. 68487

Submitted: April 20, 2007

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BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF THE PROPERTIES OF SOUTHWEST GAS CORPORATION DEVOTED TO ITS OPERATIONS THROUGHOUT THE STATE OF ARIZONA.	Docket No. G-01551A-04-0876

SOUTHWEST GAS CORPORATION
RECAPITALIZATION PLAN

In Southwest Gas Corporation's ("Southwest" or "Company") last general rate case ("GRC") order, the Arizona Corporation Commission ("ACC" or "Commission") required Southwest to submit a recapitalization plan "*... explaining how it intends to achieve a 40 percent equity prior to the Company's next rate case...* "[1]. Southwest respectfully submits this Recapitalization Plan in accordance with the Commission's decision.

I. INTRODUCTION

At August 31, 2004, which was the last day of the test year of Southwest's 2004 Arizona GRC[2], the Company's common equity ratio was 34.1 percent. At December 31, 2006, the Company's common equity ratio had improved to 39.8 percent[3]. Southwest anticipates achieving a 40 percent common equity ratio in the near future, and the Company's progress in improving its equity ratio is further explained in Section III.

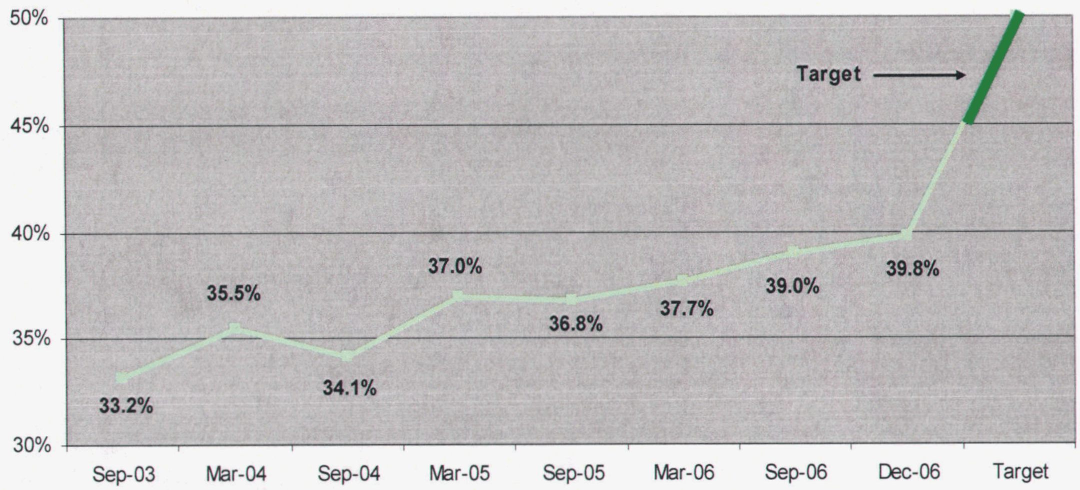
Notwithstanding the recent improvement in Southwest's equity ratio, and consistent with the Commission's directive in this regard, Southwest has developed a plan that would bring the Company's common equity ratio more in line with its peers (i.e. comparable natural gas utilities, also see Section IV), and provide it the necessary capitalization to fund the substantial capital investment necessary in the rapidly growing state of Arizona. If Southwest can achieve and sustain a higher common equity ratio in the 45 to 50 percent range, the Company will improve its credit rating, decrease its financial risk, experience lower overall capital costs, and customers would benefit from a lower cost of capital and a utility that is financially strong and healthy.

[1] Decision No. 68487, Page 25, Line Nos. 12-14, dated February 23, 2006.
[2] Southwest's 2004 Arizona general rate case was assigned Docket No. G-01551A-04-0876.
[3] See Exhibit 1.

The incremental improvement in the common equity ratio during this period has been primarily a result of additional common stock issuances. The secondary source of improvement in the common equity ratio has been the Company's actual improved financial performance (i.e., additional retained earnings).

Figure 1 shows the Company's common equity ratio bi-annually for the last three years, at December 2006, and the Company's long-term equity ratio target.

Figure 1 – COMMON EQUITY RATIO



There were three significant events during the last three years that have contributed to the Company's improved financial performance:

1) The California Public Utilities Commission ("CPUC") approved a full margin decoupling mechanism in Southwest's 2003 GRC and Southwest began collecting $10.1 million in annual rate relief in May 2003. Southwest has also received annual revenue increases of approximately $2.5 million per year in its California jurisdiction since its 2003 GRC.

2) In September 2004, Southwest began to collect $13.7 million in annual rate relief in its Nevada jurisdictions. The Public Utilities Commission of Nevada ("PUCN") authorized a declining block rate structure, reducing the second tier commodity margin rate to just 15.387 cents per therm, compared to 34.486 cents per therm for the first tier, significantly increasing Southwest's probability of recovering its fixed costs.

3) In March 2006, the ACC authorized Southwest to begin collecting $49.3 million in annual rate relief. As part of this rate relief, the ACC increased the residential BSC by $1.70 per month.

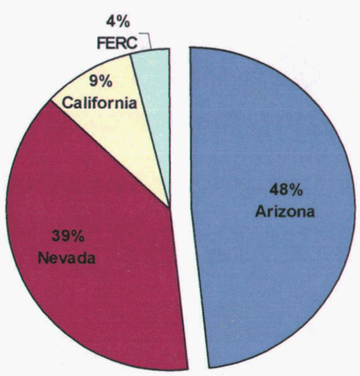
As a result of these and other contributing factors, Southwest has nearly achieved the hypothetical common equity ratio used to set rates in the 2004 Arizona GRC within ten months of the effective date of the Commission's decision.

Despite the recent improvement in its common equity ratio, Southwest believes that it is reasonable to target a common equity ratio that is in line with its peers as the level to achieve and sustain in the long run. In order to achieve and sustain this higher common equity ratio, the Company will request regulatory support from the Commission in future proceedings. This Recapitalization Plan will explain the steps Southwest feels are necessary to give it the opportunity to meet this goal.

II. DESCRIPTION OF THE COMPANY AND ITS RISKS

Southwest is a diversified company with natural gas distribution operations in the states of Arizona, Nevada, and California, a federally-regulated natural gas pipeline, and a wholly-owned pipeline construction subsidiary. As such, the ability of the Company to obtain a certain equity ratio is largely dependent on the Company's level of earnings and cash flows in each of the Company's regulatory jurisdictions.

Figure 2 – RATE BASE BY JURISDICTION



The size of each regulatory jurisdiction compared to the overall size of the Company can be measured by rate base. Figure 2 shows the rate base percentage of each jurisdiction, as a percentage of total Company rate base, at December 31, 2006.

Arizona comprises approximately 48 percent of the Company as measured by rate base. Therefore, any actions taken by this Commission that support Company initiatives to improve its capital structure would have a significant impact.

Southwest recognizes that while Arizona makes up a significant portion of its natural gas distribution operations, it does not depend solely on this Commission to improve its capital structure. Southwest has been proactive in seeking needed regulatory assistance from all of its jurisdictions to help the Company remove the obstacles it faces in improving its capital structure. As a result of these regulatory initiatives, Southwest has improved its earned rates of return in its California, Nevada, and FERC-regulated jurisdictions. Throughout this document Southwest will discuss several regulatory mechanisms approved in other states that have assisted the Company in improving its capital structure over the last few years.

There are numerous risk factors that may cause the Company's realized common equity ratio to differ materially from the target outlined in this Recapitalization Plan. These risks include, but are not limited to: the impact of variations in customer usage and growth rates, changes in natural gas prices, weather, the Company's ability to recover gas costs through its PGA mechanisms on a timely basis, the timing and amount of rate relief, changes in rate design, changes in capital requirements and funding, capital market conditions, and changes in costs.

III. SOUTHWEST'S PROGRESS IN IMPROVING ITS CAPITAL STRUCTURE

The Company's actual ratemaking capital structure at August 31, 2004 and December 31, 2006[4] are shown below in Table 1:

Table 1 – SOUTHWEST'S ACTUAL RATEMAKING CAPITAL STRUCTURE ($ IN MILLIONS)

Ratemaking Capital	8/31/04	12/31/06	$ Increase	% of New Cap.
Long-Term Debt	60.8%	55.9%	$103	29%
Preferred Equity	5.1%	4.3%	0	0%
Common Equity	34.1%	39.8%	251	71%
Total	100.0%	100.0%	$354	100%

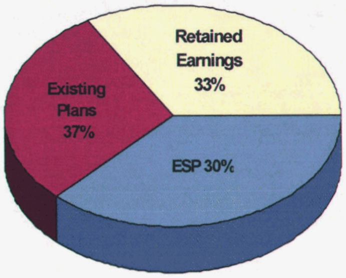
During this 28-month period, total ratemaking capital increased by approximately $354 million. This total consists of a $251 million increase in common equity and a $103 million increase in long-term debt. Since Southwest was able to finance most of the incremental capital with common equity, the common equity ratio has improved by over five percentage points.

At December 31, 2006, the Company had a Purchased Gas Adjustment ("PGA") receivable balance of approximately $77 million Company-wide and no short-term debt outstanding. Adjusting the balance sheet for the after-tax effects of the PGA balances, the Company's common equity ratio would have improved to approximately 40.6 percent.

[4] The ratemaking capital structure is the Company's gas segment permanent capital structure, which includes common equity, preferred securities and long-term debt. Short-term debt is excluded as short-term debt is used primarily to finance working capital and PGA receivable balances, and not long-term rate base assets. See Exhibit 1 for details.

The $251 million increase in common equity was primarily from three sources: the issuance of additional common equity shares from the Company's existing equity plans (Dividend Reinvestment and Stock Purchase Plan, Employee Investment Plan, Management Incentive Plan, and Stock Incentive Plan); the Equity Shelf Program ("ESP"); and an increase in retained earnings. As Figure 3 illustrates, 67 percent of the growth of common equity during this period was a result of issuing additional shares of common stock, while just 33 percent of the growth was from increased retained earnings.

Figure 3 –NEW COMMON EQUITY, BY SOURCE



a. Common Equity Issued Through Existing Plans

From August 2004 through December 2006, the Company issued approximately 3.4 million shares of common stock through its existing plans, with net proceeds of $93.6 million.

b. Common Equity Issued Through the ESP

An ESP is a service offered by institutional bankers that provides for the issuance of relatively small amounts of new common equity continuously and discreetly as part of regular daily trading flows. All aspects of the ESP are under the Company's control including the number of shares, trading period, and minimum sales price. The sales of common stock are made in "at the market" offerings in sales made directly on the New York Stock Exchange or sales made to or through a market maker or an electronic communications network. In addition, shares of common stock may be offered and sold by other methods, including privately-placed negotiated transactions. The ESP is a very cost-effective method of issuing new shares. While a traditional equity placement may incur administrative costs of approximately 3 to 5 percent, the referenced ESP used by Southwest incurs administrative costs of just 1 percent.

From August 2004 through December 2006, the Company issued approximately 2.8 million common shares through the ESP with net proceeds of $74.6 million. The Company originally established a three-year, $60 million ESP in May 2004. The Company began issuing shares through the ESP in June 2004 and had completely issued the $60 million ESP by the end of September 2005. In March 2006, the Company established a three-year, $45 million ESP. At December 30, 2006, the Company had approximately $16.7 million of remaining capacity under its existing $45 million ESP.

c. Increase in Retained Earnings

From August 2004 through December 2006, Southwest's retained earnings increased by $83.9 million. Contributing to this improvement were increased earnings from timely rate relief granted in Southwest's Nevada jurisdictions, rate relief and annual margin adjustments in Southwest's California jurisdictions, and ten months of realized rate relief from Southwest's 2004 Arizona GRC.

The increase in retained earnings is also attributable to the Company's prudent management of its costs. One measure the Company uses to evaluate productivity is its customer-to-employee ratio. From August 2004 through December 2006, Southwest added nearly 88,000 new customers in its Arizona jurisdiction, an increase of over 10 percent. During this same time period, the customer-to-employee ratio (a measure of employee productivity) improved from 754 to 871 in Southwest's Arizona jurisdiction, an improvement of roughly 15 percent during this 28-month period. The more productive the Company's work force, the lower costs will be to serve customers.

IV. SOUTHWEST'S PLAN TO ACHIEVE A CAPITAL STRUCTURE THAT IS IN LINE WITH ITS PEERS

The recent improvement in capital structure has been achieved primarily from common stock issuances. However, there is a limit to the number of shares the Company can prudently issue. Simply issuing additional common stock in an attempt to build equity, without regard for the dilution effect on existing shares, can result in realizing less than the maximum possible proceeds from future common stock issuances. Achieving and then maintaining a common equity ratio that is near the industry average will only be accomplished if the Company can consistently realize a fair opportunity to earn its authorized rate of return.

Southwest will continue to follow its ongoing balance sheet management strategy. An essential part of that strategy is to improve the Company's opportunity to earn its authorized rate of return and increase common equity through retained earnings. The Company bears much of the responsibility to ensure it can realize a sufficient level of net income in order to build retained earnings. The Company will continue to make efforts to control costs, improve productivity, make prudent investments in technology, operate in a safe and efficient manner, add new customers without burdening existing customers (in accordance with its tariffs), file for rate relief when revenues become deficient, and ask the Commission to act favorably on rate design changes and other regulatory mechanisms to address shortcomings in Southwest's ability to recover its cost of service and earn its authorized rate of return.

To expand on the last point in the proceeding paragraph, Southwest will describe various regulatory mechanisms that, if adopted by the Commission, will assist the Company in improving its capital structure. These regulatory mechanisms are discussed in the following section.

V. REGULATORY MECHANISMS OR ACTIONS THAT WOULD IMPROVE SOUTHWEST'S CAPITAL STRUCTURE

Due to its current residential rate design in Arizona, Southwest depends to a large extent on the volumes of gas delivered to residential customers to recover its cost of service. This dependency has historically caused the Company to earn less than its authorized rate of return due to margin shortfalls from two distinct causes: (1) a decline in average use per customer; and (2) weather variations.

The variability in customer consumption of natural gas is a risk that is recognized by the capital markets. If this risk is reduced, the markets may react favorably and the Company may experience lower overall capital costs, which benefit customers. In fact, when Moody's downgraded Southwest's senior unsecured debt to Baa3 from Baa2 on May 30, 2006, roughly 3 months after Southwest implemented an increase in revenues pursuant to its 2004 rate case application in Arizona, it noted that one of the factors in the downgrade was: "... the absence of revenue decoupling in Arizona ... that would serve to protect this company from weather variation and customer conservation."[5] Also, in a recent industry outlook, Moody's stated that it: "... believes that having a rate design that compensates the LDCs for margin losses caused by variations in gas consumption due to conservation as well as those due to weather would serve to stabilize the utility's credit metrics and credit ratings..." and that the rate design proposals "... generally involve "de-coupling" or other rate mechanisms that would de-couple the LDC's margins from its volumes."[6] In addition, Standard and Poor's ("S&P") recently affirmed its "BBB-" rating on Southwest and revised the outlook from stable to positive, citing progress in cash flow and declining debt leverage, but noting that "...supportive rate treatment will continue to be an important consideration with respect to ratings improvement, particularly as the company's customer growth rate slows to a more moderate pace and declining customer usage effects possibly become more

[5] See Exhibit 2 for the full text of Moody's downgrade announcement.

[6] Moody's Industry Outlook, North American Natural Gas Transmission & Distribution, October 2006.

pronounced in the absence of decoupling or weather normalization mechanisms in Arizona and Nevada."[7]

There are several rate and regulatory mechanisms that Southwest can propose in future regulatory filings that can assist Southwest in stabilizing its earned margin, and reduce its dependency on recovering a disproportionate percentage of its fixed cost of service based on customer consumption.

a. Decoupling Mechanism

In its 2004 Arizona GRC Application, Southwest proposed a decoupling mechanism to address the Company's ongoing inability to achieve its authorized rate of return due, in part, to declining per customer use on its system. This mechanism was proposed to "... accomplish Southwest's rate design objective of stabilizing margin recovery for the residential classes and allow a more gradual movement towards cost based rates for the residential classes."[8] The mechanism, as designed by Southwest, would have decoupled Southwest's residential margin recovery from the volume of gas delivered in a given month and re-couple residential margin recovery to the number of customers served for that month. In other words, Southwest would recover the authorized margin per customer. Such mechanisms do not guarantee that the utility will earn its authorized rate of return, since general inflationary cost trends can cause earnings shortfalls even when revenues have been stabilized.

While the Commission did not adopt the mechanism as proposed, it did order Southwest to coordinate its efforts with other interested parties to pursue implementation of a decoupling mechanism[9]. Southwest formed a collaborative working group, consisting of the Company, ACC Staff, the Residential Utility Consumer Office ("RUCO"), and the Southwest Energy Efficiency Project ("SWEEP"). Several meetings of the collaborative working group have been held to date, and additional meetings are anticipated during 2007. Southwest hopes that this process will result in the identification of one or more margin stability mechanisms that can be supported by all parties, and can be presented to the Commission for review and approval in a future general rate case proceeding.

There is increasing momentum throughout the country, led by various organizations, to encourage state commissions to support natural gas LDC efforts to

[7] See Exhibit 3 for full press release, dated March 14, 2007.
[8] Docket No. G-01551A-04-0876, direct testimony of Southwest witness Edward Gieseking, page 4, Ins 20-23.
[9] Decision No. 68487, Page 68, Line Nos. 3-7.

manage volatility in gas prices and reduce volatility risks for customers. In July 2004, the American Gas Association ("AGA") and the Natural Resources Defense Council ("NRDC") issued a joint statement, which was later adopted by the National Association of Regulatory Utility Commissioners' ("NARUC") Board of Directors, which encourages state commissions to eliminate a utility's dependence on sales to recover its authorized margin. These organizations agree that "...traditional rate structures often act as disincentives for natural gas utilities to aggressively encourage their customers to use less gas. Among the mechanisms supported ... are the use of automatic rate true-ups to ensure that a utility's opportunity to recover authorized fixed costs is not held hostage to fluctuations in retail gas sales."[10]

In addition, in July 2006 the National Action Plan for Energy Efficiency (NAPEE)[11] presented policy recommendations for creating a sustainable, aggressive national commitment to energy efficiency. NAPEE observed that traditional ratemaking encourages utilities to increase throughput in order to earn their authorized rate of return, since growth in sales can offset cost increases that may occur between rate cases. NAPEE recommends policy changes that can remove this impediment to greater investment in energy efficiency, such as the implementation of a decoupling mechanism that allows utilities to recover their revenue requirement with less dependency on sales volume. On August 2, 2006, NARUC adopted a resolution endorsing the principal objectives and recommendations of the NAPEE. Finally, the Energy Policy Act of 2005 (Section 139) has provided similar policy direction insofar as it has required that a study of state and regional policies that promote cost-effective programs to reduce energy consumption be conducted and submitted to Congress within one year of the date of enactment, and that methods of reducing disincentives for utilities to implement energy efficiency programs be considered.

At this time, decoupling mechanisms are in place for natural gas utilities in California, Georgia, Indiana, Maryland, Missouri, New Jersey, North Carolina, North Dakota, Ohio, Oregon, Utah, and Washington. Southwest is subject to a decoupling mechanism in its California jurisdiction. Utilities in other states, including Arkansas, Colorado, Delaware, Illinois, Michigan, Minnesota, New Mexico, New York, and Virginia,

[10] Resolution on Gas and Electric Energy Efficiency adopted by NARUC, July 14, 2004.

[11] More than 50 organizations collaborated in developing the NAPEE, including investor-owned and municipal utilities, regulators, large corporations, and organizations dedicated to energy efficiency. The U.S. Department of Energy and the U.S. Environmental Protection Agency facilitated the work of the NAPEE.

have pending requests for their respective commissions to approve decoupling mechanisms.[12]

b. Weather Normalization Mechanism

Similar to a decoupling mechanism, a weather normalization mechanism would reduce the weather-related volatility the Company faces in recovering its authorized margin. Once again, such a mechanism would not guarantee that a utility will earn its authorized rate of return. Generally, the purpose of such a mechanism is to allow the Company to realize the authorized weather-normalized margin on a per customer basis; increases in overall expenses and/or rate base may still cause earning shortfalls. The margin variance due to weather would be calculated based on the extent that weather varies from normal. If weather is colder-than-normal, the utility would overcollect its authorized revenue per customer and seek Commission approval for a rate credit to return the overcollection to customers. If weather is warmer-than-normal, there would be an undercollection on the utility's authorized revenue per customer, and a surcharge would be sought. Under such a mechanism, customers are protected from higher winter bills resulting from colder-than-normal weather, yet the utility recovers its authorized revenues during warmer-than-normal weather. Over 20 states have approved weather normalization mechanisms providing this symmetric margin stabilization for consumers and utilities from weather fluctuations[13]

c. Increased Basic Service Charge

Excluding gas costs (which are recovered through the PGA mechanism), Southwest's costs of providing distribution service are primarily fixed. The Company can reduce its dependency on volumetric recovery of its cost of service by seeking Commission approval of higher residential monthly basic service charges ("BSC"). Higher residential basic service charges are supported by the cost of service studies included in general rate case applications. In the Company's 2004 GRC, the Commission approved increasing the Company's residential BSC from $8.00 to $9.70 per month. Further increases in the residential BSC move residential customers closer to cost-based rates, and help alleviate high winter bills.

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[12] "Aligning Utility Interests with Energy Efficiency Objectives: A Review of Recent Efforts at Decoupling and Performance Incentives, American Council for an Energy-Efficient Economy, October 2006, Page iii.
[13] Ibid.

d. Enhance Declining Block Rate Structure

Another way Southwest can reduce its dependency on volumetric cost recovery is to seek a declining block rate structure that recovers a greater portion of fixed costs in the less variable (first) consumption block. In other words, to the extent that the first rate block is higher than subsequent rate blocks, a higher percentage of Southwest's costs are recovered in the therms most likely to be consumed. If weather or conservation cause actual consumption to decrease, the Company is somewhat shielded from a portion of the otherwise anticipated revenue loss. This would also protect customers from higher bills in periods of increased consumption due to cold weather.

A variation of the declining block rate structure rate design was recently approved by the Missouri Public Service Commission for Laclede Gas Company ("Laclede").[14] The rate design approved for Laclede shifts, for accounting purposes, more margin (and less gas cost) to the first block rate of residential usage per month, without any change to the total commodity rate. As a result of this rate design, Laclede's dependency on volumetric cost recovery is reduced, while, at the same time, the total bills that customers pay remain unchanged.

e. Reduce the Impact of Regulatory Lag and Attrition

Regulatory lag is the amount of time between the date a utility measures its cost of service and the date the Commission responds by authorizing increases or decreases in the utility's rates. Historically, regulatory lag has been detrimental to a utility's earnings and its ability to maintain its capital structure due to costs increasing faster than revenue. The adverse impact of regulatory lag on utility earnings may hamper a utility's ability to raise capital for infrastructure at desirable rates, which is detrimental to customers. Thus, the Commission may have an incentive to reduce regulatory lag, so neither the utility nor its customers are harmed.

The Commission itself has expressed some concern regarding the impact of regulatory lag on regulated utilities in Arizona. Recently, during the processing of the Arizona Public Service ("APS") GRC, then Chairman Hatch-Miller wrote a letter to APS, referencing a report published by S&P, which explained the advantages that public power utilities have over investor-owned utilities in terms of weathering significant increases in natural gas prices and purchased power costs, as well as preserving credit ratings and financial margins. He requested APS to "...provide testimony on what

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[14] Case No. GR-2002-356.

measures the Commission could take in helping APS gradually improve its creditworthiness."[15] APS presented several proposals in its testimony[16], under the heading "Regulatory Lag and Attrition", in response to the Chairman's request. The heading highlights the fact that regulatory lag and attrition, and its impact on a utility's credit ratings, earnings, and capitalization are all interrelated.

Southwest faces financial challenges that are similar to those faced by APS, and believes that it could be very productive for the Commission, Arizona utilities, and other interested parties to work together to develop regulatory mechanisms to address these issues. In addition to the issues raised by S&P, Moody's noted in its recent "Industry Outlook" for North American Natural Gas Transmission and Distribution companies that: "Ratings may be negatively affected if new rates do not adequately address regulatory lag..."[17] Any measures the Commission adopts that help reduce the impact of regulatory lag may help Southwest improve its credit ratings and ability to raise capital.

f. Improve Return on Common Equity

Southwest is currently authorized a 9.5 percent return on common equity in Arizona. At the present time, the hypothetical common equity percentage and authorized return on common equity ("ROE") are lower than those authorized for Southwest by the CPUC, the PUCN, and FERC[18].

The AGA's Gas Utility Rate Case Database ("Database") shows that commission-authorized ROE percentages in 2005 and 2006 averaged 10.5 percent, and commission-authorized common equity ratios averaged 47.6 percent.[19] A survey conducted by ValueLine of the earned results of natural gas LDCs for the twelve months ended June 30, 2006 shows similar percentages.

[15] ACC Chairman Hatch-Miller letter to APS, re: Arizona Public Service Company General Rate Case (Docket No. E-01345A-05-0816) dated July 21, 2006.

[16] Rebuttal testimony of APS witness Stephen Wheeler, pp 13-20.

[17] Moody's industry Outlook, October 2006.

[18] The docket number and effective dates by jurisdiction are as follows: Arizona, Docket No. G-01551A-04-0876, March 31, 2006; Paiute, Docket No. RP05-163, August 1, 2005; Nevada, Docket No. 04-3011, September 1, 2004; and California: Docket No. 02-02-012, January 1, 2005 (authorized return on common equity updated per mechanism adopted by CPUC to 10.38%).

[19] AGA maintains a database of ROE and common equity percentages requested and authorized for natural gas utilities. For details, see Exhibit 4.

Table 2 shows the authorized common equity ratios and authorized returns on common equity authorized by each Commission that regulates the natural gas operations of Southwest, along with industry averages from AGA (authorized):

Table 2 - COMMON EQUITY PERCENTAGE AND RETURN ON COMMON EQUITY

Southwest Authorized Percentages					Industry Averages
Description	Arizona	Nevada	California	FERC[20]	Authorized
Common Equity	40%	40%	42%	45%	47.6%
ROE	9.5%	10.5%	10.9%	11.8%	**10.5%**

Despite the progress Southwest has made in improving its earned rates of return, more progress needs to be made to approach the ROE and common equity ratios achieved by the peers with which it competes in the capital markets. This observation has been noted by the investment community: in a recent research summary for Southwest, S&P notes that "Ratings improvement hinges on achieving better rates of return and rate design improvements in Arizona..."[21] Future potential improvements in Southwest's authorized return on equity can be expected to be favorably received by the credit rating agencies and strengthen Southwest's ability to raise investment capital to fund Arizona infrastructure.

g. Timely Recovery of Purchased Gas Costs

While a large cumulative difference between the actual cost of gas and the cost of gas in Southwest's tariff does not impact the Company's earnings, it can have a significant impact on the Company's cash flows and its common equity ratio, to the extent that short-term under-recoveries are funded with short-term debt. This impact can be magnified during periods of rapidly increasing or decreasing gas prices.

Currently, Southwest's monthly gas cost can change by a maximum of thirteen cents per therm in any twelve-month period in Arizona. This thirteen-cent cap on the annual change in gas cost rates results in greater under-recovery of actual gas costs when market prices have quickly increased beyond the cap and, conversely, greater over-recovery of costs as market prices decrease rapidly below the cap. If the thirteen-cent cap is eliminated or significantly expanded to more closely mirror today's natural

[20] Authorized common equity and return on common equity percentages estimated by Southwest (based on stipulation).
[21] RatingsDirect, Publication date: September 15, 2006. S&P provides independent credit ratings, investment research, and other data for investors.

gas marketplace, large over- or under-recovered purchased gas cost balances are less likely to build up. Southwest believes that an expansion, or elimination, of the thirteen cent cap is warranted, and will look to propose such in future rate proceedings.

VI. CONCLUSION

Southwest's Recapitalization Plan outlines several potential rate and regulatory mechanisms that Southwest may propose in future regulatory filings that can help it achieve a common equity percentage that is more in line with its peers. If Southwest is able to continue to build on the substantial progress it has made in the last two years to improve earnings and increase its common equity ratio, the Company will be able to finance a higher percentage of its significant annual capital expenditures from internally-generated funds, reduce its net debt balances, and eventually improve its credit rating, all of which will benefit Southwest's customers in the long run by reducing the capital costs embedded in customers' rates.

Respectfully submitted,
SOUTHWEST GAS CORPORATION

Roger C. Montgomery

Roger C. Montgomery
Vice President/Pricing
Southwest Gas Corporation
5241 Spring Mountain Road
P.O. Box 98510
Las Vegas, Nevada 89193-8510
702.876.7321

SOUTHWEST GAS CORPORATION
RATEMAKING CAPITAL STRUCTURE
AT AUGUST 31, 2004 AND AT DECEMBER 31, 2006
($000,000s)

Line No.	Description		August 31, 2004		December 31, 2006		Change	% New Capital	Line No.
	(a)		(b)		(c)		(d)	(e)	
							(c) - (b)	(d) / Ln 8(d)	
	Common Equity								
1	Common Stock, $1 par	$	37	$	43	$	6		1
2	Capital Surplus		546		709		163		2
3	Capital Stock Expense		(9)		(11)		(1)		3
4	Retained Earnings		90		173		83		4
5	Total Common Equity[1]	$	664	$	915	$	251	71%	5
6	Preferred Securities		100		100		-	0%	6
7	Long-Term Debt[2]		1,181		1,284		103	29%	7
8	Total Capital	$	1,945	$	2,299	$	354	100%	8
	Capital Ratios								
9	Common Equity		34.1%		39.8%		5.7%		9
10	Preferred Securities		5.1%		4.3%		-0.8%		10
11	Long-Term Debt		60.7%		55.9%		-4.9%		11
12	Total		100.0%		100.0%				12
13	Shares Outstanding[3]		36		42		6		13
14	PGA Balance	$	54	$	77	$	23		14
15	Short-Term Debt		27		-		(27)		15

[1] Does not include accumulated other comprehensive income(loss)
[2] Includes current maturities of long-term debt
[3] In millions

MOODY'S DNG SR UNSEC DEBT OF SOUTHWEST GAS CORPORATION TO Baa3
2006-05-30 16:48 (New York)

New York
John Diaz
Managing Director

Corporate Finance Group
Moody's Investors Service
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SUBSCRIBERS: 212-553-1653

New York
Edward Tan
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MOODY'S DOWNGRADES SENIOR UNSECURED DEBT OF SOUTHWEST GAS CORPORATION TO Baa3 FROM Baa2; OUTLOOK IS STABLE

Approximately $ 1.2 Billion of Debt Securities Affected.

New York, May 30, 2006 -- Moody's Investors Service downgraded the senior unsecured long-term debt ratings of Southwest Gas Corporation (SWX) to Baa3 from Baa2 with stable outlook. This action concludes the rating review initiated on March 10, 2006. The downgrade reflects the view that the credit measures of SWX remain weak when compared with its gas utility peers in light of its continued rapid growth and sensitivity to decline in earnings on account of warmer than normal weather and the absence of revenue decoupling in Arizona (54% of gross margins) and Nevada (37% of gross margins) that would serve to protect this company from weather variation and customer conservation. The company's heightened sensitivity to warmer than normal weather is exacerbated by the fact that in 2005 it experienced one of the 10 warmest years on record with 2003 being one of the warmest years in over 100 years. The cumulative effects of this warmer than normal weather has continued into the recent quarter ending March 31, 2006 which was mostly responsible for the company's loss of $9 million in operating margin.

While the company was able to obtain some rate relief in recent years, the fact that it is among the fastest growing gas utilities in the country (5% p.a. growth) continues to expose it to regulatory lag as rate cases in its key state of Arizona take at least a year to resolve and even then, typically deliver only part of the rate improvement necessary for it to earn its allowed rate of return. While the company has been encouraged in certain jurisdictions to further pursue discussions with interested parties as to the possibilities of adopting some form of weather normalization clause protection or conservation tracker, these efforts will take more time before they could be implemented even if agreed upon by all the stakeholders concerned.

KEY RATING DRIVERS

For a few years the company has been performing at the lower end of its peers in terms of the financial rating indicators employed by Moody's which include, as example, fiscal 2005 return on equity of 6.0%, EBIT/Interest Expense coverage of 1.7, Retained Cash Flow to Adjusted Debt of 10.0% and Adjusted Debt to Adjusted Cap. of 62.5%. The comparable ratios for Baa2 peers averaged 8.9% ROE, 2.8 EBIT/Interest Exp. coverage, 13% RCF to Adj. Debt and 55% Adj. Debt to Cap. In addition, cash flow from operations after dividend payments has been insufficient to cover the active level of capital expenditures, a trend that has existed for several years and which is likely to continue into the foreseeable future given the company's very rapid growth rate. In addition, operating expenditures rose 14% in fiscal 2005 and 6% in the first quarter of 2006, reflecting the impact of general cost increases and incremental costs associated with providing service to a growing customer base, pressures that are expected to continue in the foreseeable future.

The challenges for this company which bear directly on the aforementioned financial indicators are the ability to obtain the most comprehensive rate design possible to protect against warmer than normal weather, the reduction of regulatory lag by incorporating forward period test data along with pursuing more profitable growth alternatives, the correction for margin losses on account of customer conservation, and exercising strong control over operating expenses.

RATING OUTLOOK

The stable outlook anticipates a gradual improvement on the key rating drivers mentioned above that have negatively impacted the company's credit metrics and have prompted this rating adjustment.

Downgraded Ratings of SWX are as follows:

Southwest Gas Corporation -- to Baa3 from Baa2 senior unsecured;

Southwest Gas Capital II -- to Ba1 from Baa3 preferred trust securities;

Southwest Gas Corporation --to (P) Ba2 from (P) Ba1 preferred shelf.

Southwest Gas Corporation is headquartered in Las Vegas, Nevada, and provides natural gas service to over 1.7 million customers in Arizona, Nevada and California.

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Provider ID: 00328511
-0- May/30/2006 20:48 GMT

SWX US: S&P: Outlook On Southwest Gas Corp's Rating Revised
2007-03-14 10:52 (New York)

MCGRAW-HILL COS INC ("MHP-BHDNPX3")
SOUTHWEST GAS CORP ("SWX-BHDNPX3")
- S&P: Outlook On Southwest Gas Corp's Rating Revised To
- Positive On Strengthening Financial Measures

Standard & Poor's Ratings Services affirmed its 'BBB-' rating on Southwest Gas and revised the outlook to positive from stable due to consistently strong cash flow measures and declining debt leverage.

"Southwest Gas has made significant progress toward reducing its historically high debt leverage and will likely make further progress as a result of strong internal cash flows, minimal debt financing, and regular equity infusions," said Standard & Poor's credit analyst Leo Carrillo.

"Supportive rate treatment will continue to be an important consideration with respect to ratings improvement, particularly as the company's customer growth rate slows to a more moderate pace and declining customer usage effects possibly become more pronounced in the absence of decoupling or weather normalization mechanisms in Arizona and Nevada."

Las Vegas, Nev.-based Southwest Gas, the largest distributor of natural gas in Arizona and Nevada, provides service to such high growth cities as Phoenix, Las Vegas, and Tucson. At Dec. 30, 2006, the company had approximately $1.4 billion of debt.

Complete ratings information is available to subscribers of RatingsDirect, the real-time Web-based source for Standard & Poor's credit ratings, research, and risk analysis, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Credit Ratings in the left navigation bar, select Find a Rating, then Credit Ratings Search.

Analyst Contact:

Leo Carrillo, San Francisco (1) 415-371-5077

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Key Contacts:

Americas Media Relations: (1) 212-438-6667
media_ relations@standardandpoors.com

Americas Customer Service: (1) 212-438-7280
research_request@standardandpoors.com

TEL: 212-438-6634 Edward Sweeney, Media, S&P
EMAIL: edward_sweeney@standardandpoors.com

Provider ID: 00000460
-0- Mar/14/2007 14:52 GMT

SOUTHWEST GAS CORPORATION
AMERICAN GAS ASSOCIATION UTILITY RATE CASE DATABASE
UTILITY DECISIONS IN UNITED STATES
2005 AND 2006

Decision Year	Utility	ROE Granted	CE % Granted
2006	Aquila, Inc. d/b/a Aquila Networks	Black Box	51.40%
2005	Wisconsin Public Service	12.05%	59.73%
2005	Superior Water, Light and Power Company	11.70%	
2005	Wisconsin Power & Light	11.50%	31.75%
2006	Wisconsin Energy	11.20%	
2006	Wisconsin Gas	11.20%	
2005	Semco	11.00%	
2005	Michigan Consolidated	11.00%	39.31%
2005	MGE - Gas Utility	11.00%	56.65%
2005	Baltimore Gas & Electric	11.00%	48.40%
2005	Xcel - Northern States Power	11.00%	53.63%
2005	Atlanta Gas Light	10.90%	
2005	Vectren Energy Delivery of Ohio	10.60%	51.90%
2006	Sierra Pacific Power	10.60%	40.76%
2006	Central Hudson Gas & Electric	10.60%	45.00%
2005	Northern Illinois Gas dba Nicor Gas	10.51%	56.37%
2005	Entergy Gulf States	10.50%	47.52%
2006	Xcel - Pub. Service CO	10.50%	55.49%
2005	Xcel Energy	10.40%	50.24%
2005	Interstate Power and Light Company	10.40%	49.35%
2005	Avista Utilities	10.40%	40.00%
2006	Atmos Energy Louisiana Gas	10.40%	48.00%
2005	Puget Sound Energy	10.30%	43.00%
2005	South Carolina Electric & Gas	10.25%	50.75%
2005	Union Light Heat & Power	10.20%	54.45%
2005	CenterPoint Minnegasco	10.18%	50.27%
2005	AmerenIP	10.00%	53.09%
2005	Bay State Gas	10.00%	53.95%
2005	Southern Connecticut Gas	10.00%	51.28%
2006	Roanoke Gas	10.00%	
2005	Oklahoma Natural Gas	9.90%	46.73%
2005	Arkansas Western Gas Company	9.70%	33.23%
2006	Southwest Gas	9.50%	40.00%
2005	Centerpoint Arkla	9.45%	31.80%
	Average Authorized Percentages	**10.54%**	**47.64%**