ORIGINAL

OPEN MEETING

MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: June 28, 2011

RE: SOUTHWEST GAS CORPORATION – APPLICATION FOR APPROVAL OF A SPECIAL GAS PROCUREMENT AGREEMENT WITH YUMA COGENERATION ASSOCIATES (DOCKET NO. G-01551A-11-0202)

Background

On May 19, 2011, Southwest Gas Corporation ("Southwest" or "the Company") filed an application with the Commission for approval of a new special gas procurement agreement ("SGPA") with Yuma Cogeneration Associates ("Yuma Cogen"). Southwest has provided natural gas to the Yuma Cogen facility through SGPAs for approximately 17 years, since the facility opened in 1994. The most recent SGPA was approved on July 3, 2008 (in Decision No. 70404), and will expire on July 31, 2011.

SPGA Requirements

Schedule G-30 provides that an SPGA shall be submitted for Commission approval if: (i) the customer qualifies for G-30 service due to its ability to bypass Southwest; and (ii) the customer can not be served utilizing the Company's floor cost of gas.[1] Southwest states that: (i) Yuma Cogen satisfies bypass criteria (as discussed further herein); and (ii) can not be served using the Company's floor cost of gas because of the difference between the floor cost of gas and the price Yuma Cogen is paid for electricity, which is partly based on first-of-month index supplies. Due to this difference, Southwest believes that Yuma Cogen would be exposed to an unacceptable financial risk if serviced using the floor cost of gas and, to address this, the Company has submitted an SGPA which provides for gas cost pricing based on a Permian first-of-month index.

If approved, the proposed SGPA would become effective August 1, 2011, remain effective for four years, and continue on a month-to-month basis for a period not to exceed 12 months.

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[1] The "floor cost of gas" is the weighted average commodity cost of gas and amounts to reflect upstream pipeline capacity charges and shrinkage (Schedule No. G-30).

The Yuma Cogen Facility

Yuma Cogen is a 56.8 MW cogeneration facility located in Yuma. It began commercial operations in 1994 and is operated by Falcon Power Operating Company ("Falcon"), which employs 12 employees at the facility. Yuma Cogen is an Arizona general partnership, consisting of California Energy Development Corporation ("CEDC") and California Energy Yuma Corporation ("CEYC").[2] Yuma Cogen has a 30-year power purchase agreement with San Diego Gas & Electric, and a 30-year agreement with a nearby industrial company, Shaw Diversified Services, for process and chilling steam. The primary term for both 30-year agreements ends in May 2024.

Eligibility for Service Under Schedule G-30

Southwest's SGPA service to Yuma Cogen is pursuant to Schedule G-30, which permits service at a lower rate than would be available under the G-60 rate usually applicable to electric generation facilities. Schedule G-30 is available to customers who qualify for transportation service under Schedule T-1, and who can demonstrate that bypassing Southwest is "economically, operationally and physically feasible and imminent."

The G-60 delivery charge rate would be higher than the negotiated rate proposed under the proposed SGPA.[3] Southwest has indicated its belief "that Yuma Cogen would terminate the Master Agreement with Southwest and bypass Southwest's system before considering a move to full margin G-60 transportation service." Southwest has also indicated that Yuma Cogen satisfies Schedule G-30 requirements for bypass, including qualifying for transportation service. Yuma Cogen's eligibility for Schedule G-30 service is discussed in more detail below.

Feasibility of Bypass

Under the terms of a June 30, 1993 Master Agreement between Yuma Cogen and Southwest, (i) Yuma Cogen has the right to terminate its agreements with Southwest; (ii) the right to purchase the on-site distribution system constructed by Southwest for $300,000, and (iii) the right to acquire Southwest's access to the El Paso Natural Gas Company ("El Paso") tap.

Southwest states that Yuma Cogen is an affiliate of MidAmerican Energy Holdings, which has ample resources to exercise the Master Agreement's termination option, and that Yuma Cogen would achieve simple payback for acquiring the on-site distribution system in less than eight months, based on the facility's therm usage.

Other factors support the feasibility of bypass. One is that Yuma Cogen's facilities are only approximately 100 feet from El Paso's lateral, limiting the additional work that would be required to effect a bypass. Another factor is that, although El Paso's Yuma Lateral is fully

[2]CEYC is indirectly owned 100% by CE Generation LLC ("CEG"). CEG is owned equally by MidAmerican Energy Holding Company ("MidAmerican") and TransAlta (CE GEN) Investment USA Inc.
[3]Southwest considers the financial terms of the proposed SPA proprietary and commercially sensitive.

subscribed by Southwest and Arizona Public Service Company, capacity is likely to become available if Southwest were no longer serving Yuma Cogen.

Eligibility for Transportation Service Under Schedule T-1

According to the Company, Yuma Cogen meets the Schedule G-30 requirement that customers qualify for transportation service under Schedule T-1. The application indicates that: (i) Southwest has available capacity to render service without constructing additional facilities, and (ii) Yuma Cogen's average monthly requirements are no less than 15,000 therms, including May through September.

Alternate Fuel Capability

In addition to eligibility arising from the ability to bypass, customers using 11,000 therms or more per month can qualify for Schedule G-30 if they "have installed facilities capable of burning alternate fuels or energy." Yuma Cogen uses more than 11,000 therms, has installed alternate fuel facilities and would be able to switch to No. 2 fuel oil, if natural gas were not available. Although Yuma Cogen does not keep onsite fuel oil supplies, its 525,000 gallon fuel oil storage tank and the pumps related to using alternative fuel remain in place and operational, and its permit to use fuel oil for electric generation is current.

SGPA Provision Allowing Southwest to Divert Yuma Cogen's Gas Supplies and Capacity

The Company has stated that it has sufficient pipeline capacity and other rights to serve its core customers and Yuma Cogen on non-peak days. Under the terms of the SGPA, Southwest has the right to divert gas supplies and capacity from Yuma Cogen for up to ten days from October through April, thereby allowing the Company more flexibility in meeting core customer service needs.

Southwest states that it "diverted Yuma Cogen's supplies and capacity February 2, 2011 through February 6, 2011 when portions of Arizona were experiencing design-day cold weather." There were no supply or pressure problems in Yuma during the February event, but the diversion of Yuma Cogen's supplies and capacity allowed Southwest to reduce the Critical Operating Condition imbalance penalties charged to its core customers. (In addition to the interruption cited above, Southwest has interrupted Yuma Cogen's service "on rare occasions" due to an El Paso pipeline integrity project.) Such a diversion of supplies and capacity would not be available under Schedule G-60.

Contributions to Capacity and to Operations and Maintenance ("O&M") Costs

Payments by Yuma Cogen under the proposed SGPA would contribute to the cost of capacity for all of Southwest's customers. Under the proposed SGPA, Yuma Cogen would pay the full FT-1 rate for capacity on the El Paso pipeline, equal to the greater of the customer nomination or actual use, to deliver supplies each day. This capacity payment is then credited back to ratepayers. In addition, payments by Yuma Cogen would help to cover Southwest's incremental O&M costs. These contributions to capacity and O&M costs would be lost, should Yuma Cogen cease to be a Southwest customer.

Pass-Through of El Paso Penalties/Charges; Pass-Through of Negative Margin to Core Customers Prohibited

Southwest currently passes through charges and penalties from El Paso that are attributable to Yuma Cogen. Under the proposed SGPA, Southwest would continue to pass through these charges and penalties to Yuma Cogen.

Because core customers should not bear the risks of this agreement, Staff recommends that Southwest be prohibited from passing through any negative margin that may result from this agreement to Southwest's core customers in any future proceeding.

Summary and Analysis

Based on the application and communications with Southwest, Staff believes that bypass is feasible as required by the G-30 tariff. Staff also believes that service to Yuma Cogen under the G-30 tariff is reasonable: (i) due to the potential for bypass and to Yuma Cogen's ability to burn alternative fuels; (ii) because Southwest's ability to divert Yuma Cogen's supplies and capacity provides a benefit to core customers; and (iii) because Yuma Cogen makes contributions to capacity and O&M costs. The benefits to core customers cited under (ii) and (iii) would be lost should Yuma Cogen start taking service directly from El Paso.

Staff has reviewed the rates and terms of service under the SGPA and believes that they are consistent with the G-30 tariff. Charges under the SGPA would include a monthly basic service charge, applicable upstream pipeline costs, and volumetric charges, including the gas cost. (Interstate pipeline fuel shrinkage is included in the gas cost, but distribution shrinkage is not, due to the close proximity of Yuma Cogen to the El Paso pipeline.) The proposed agreement also contains provisions for cashing out daily imbalances experienced by Yuma Cogen.

The proposed SGPA would set a primary term of four years for the agreement, and would continue on a month-to-month basis thereafter. The month-to-month extensions would be limited to twelve months and subject to termination by either party upon ninety days notice. Staff recommends that the Commission approve Southwest's new SGPA with Yuma Cogen for the requested four-year term, with extensions, effective on the first of the month following approval.

Summary of Recommendations

- Staff recommends that the Special Gas Procurement Agreement between Southwest and Yuma Cogen be and hereby is approved, for a period of four years, effective on the first of the month following approval and extending for four years, with month-to-month extensions not to exceed twelve additional months, and with the modifications indicated below.

- Staff recommends that the capacity costs credited to the Purchased Gas Adjustor bank balance continue to be equivalent to El Paso's FT-1 reservation rate.

- Staff recommends that Southwest be prohibited from passing any negative margin that may result from this agreement to Southwest's core customers in any future proceeding.

for Steven M. Olea
Director
Utilities Division

SMO:JMK:lhm\RM

ORIGINATOR: Julie McNeely-Kirwan

BEFORE THE ARIZONA CORPORATION COMMISSION

GARY PIERCE
Chairman
BOB STUMP
Commissioner
SANDRA D. KENNEDY
Commissioner
PAUL NEWMAN
Commissioner
BRENDA BURNS
Commissioner

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR APPROVAL OF A SPECIAL GAS PROCUREMENT AGREEMENT WITH YUMA COGENERATION ASSOCIATES	DOCKET NO.G-01551A-11-0202 DECISION NO. ________ ORDER

Open Meeting
July 12 and 13, 2011
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Southwest Gas Corporation ("Southwest" or "the Company") is engaged in providing natural gas within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

Background

2. On May 19, 2011, Southwest filed an application with the Commission for approval of a new special gas procurement agreement ("SGPA") with Yuma Cogeneration Associates ("Yuma Cogen"). Southwest has provided natural gas to the Yuma Cogen facility through SGPAs for approximately 17 years, since the facility opened in 1994. The most recent SGPA was approved on July 3, 2008 (in Decision No. 70404), and will expire on July 31, 2011.

SPGA Requirements

3. Schedule G-30 provides that an SPGA shall be submitted for Commission approval if: (i) the customer qualifies for G-30 service due to its ability to bypass Southwest; and (ii) the

customer can not be served utilizing the Company's floor cost of gas.[1] Southwest states that: (i) Yuma Cogen satisfies bypass criteria (as discussed further herein); and (ii) can not be served using the Company's floor cost of gas because of the difference between the floor cost of gas and the price Yuma Cogen is paid for electricity, which is partly based on first-of-month index supplies. Due to this difference, Southwest believes that Yuma Cogen would be exposed to an unacceptable financial risk if serviced using the floor cost of gas and, to address this, the Company has submitted an SGPA which provides for gas cost pricing based on a Permian first-of-month index.

4. If approved, the proposed SGPA would become effective August 1, 2011, remain effective for four years, and continue on a month-to-month basis for a period not to exceed 12 months.

The Yuma Cogen Facility

5. Yuma Cogen is a 56.8 MW cogeneration facility located in Yuma. It began commercial operations in 1994 and is operated by Falcon Power Operating Company ("Falcon"), which employs 12 employees at the facility. Yuma Cogen is an Arizona general partnership, consisting of California Energy Development Corporation ("CEDC") and California Energy Yuma Corporation ("CEYC").[2] Yuma Cogen has a 30-year power purchase agreement with San Diego Gas & Electric, and a 30-year agreement with a nearby industrial company, Shaw Diversified Services, for process and chilling steam. The primary term for both 30-year agreements ends in May 2024.

Eligibility for Service Under Schedule G-30

6. Southwest's SGPA service to Yuma Cogen is pursuant to Schedule G-30, which permits service at a lower rate than would be available under the G-60 rate usually applicable to electric generation facilities. Schedule G-30 is available to customers who qualify for transportation service under Schedule T-1, and who can demonstrate that bypassing Southwest is "economically, operationally and physically feasible and imminent."

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[2] CEYC is indirectly owned 100% by CE Generation LLC ("CEG"). CEG is owned equally by MidAmerican Energy Holding Company ("MidAmerican") and TransAlta (CE GEN) Investment USA Inc.

7. The G-60 delivery charge rate would be higher than the negotiated rate proposed under the proposed SGPA.[3] Southwest has indicated its belief "that Yuma Cogen would terminate the Master Agreement with Southwest and bypass Southwest's system before considering a move to full margin G-60 transportation service." Southwest has also indicated that Yuma Cogen satisfies Schedule G-30 requirements for bypass, including qualifying for transportation service. Yuma Cogen's eligibility for Schedule G-30 service is discussed in more detail below.

Feasibility of Bypass

8. Under the terms of a June 30, 1993 Master Agreement between Yuma Cogen and Southwest, (i) Yuma Cogen has the right to terminate its agreements with Southwest; (ii) the right to purchase the on-site distribution system constructed by Southwest for $300,000, and (iii) the right to acquire Southwest's access to the El Paso Natural Gas Company ("El Paso") tap.

9. Southwest states that Yuma Cogen is an affiliate of MidAmerican Energy Holdings, which has ample resources to exercise the Master Agreement's termination option, and that Yuma Cogen would achieve simple payback for acquiring the on-site distribution system in less than eight months, based on the facility's therm usage.

10. Other factors support the feasibility of bypass. One is that Yuma Cogen's facilities are only approximately 100 feet from El Paso's lateral, limiting the additional work that would be required to effect a bypass. Another factor is that, although El Paso's Yuma Lateral is fully subscribed by Southwest and Arizona Public Service Company, capacity is likely to become available if Southwest were no longer serving Yuma Cogen.

Eligibility for Transportation Service Under Schedule T-1

11. According to the Company, Yuma Cogen meets the Schedule G-30 requirement that customers qualify for transportation service under Schedule T-1. The application indicates that: (i) Southwest has available capacity to render service without constructing additional facilities, and (ii) Yuma Cogen's average monthly requirements are no less than 15,000 therms, including May through September.

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[3] Southwest considers the financial terms of the proposed SPA proprietary and commercially sensitive.

Alternate Fuel Capability

12. In addition to eligibility arising from the ability to bypass, customers using 11,000 therms or more per month can qualify for Schedule G-30 if they "have installed facilities capable of burning alternate fuels or energy." Yuma Cogen uses more than 11,000 therms, has installed alternate fuel facilities and would be able to switch to No. 2 fuel oil, if natural gas were not available. Although Yuma Cogen does not keep onsite fuel oil supplies, its 525,000 gallon fuel oil storage tank and the pumps related to using alternative fuel remain in place and operational, and its permit to use fuel oil for electric generation is current.

SGPA Provision Allowing Southwest to Divert Yuma Cogen's Gas Supplies and Capacity

13. The Company has stated that it has sufficient pipeline capacity and other rights to serve its core customers and Yuma Cogen on non-peak days. Under the terms of the SGPA, Southwest has the right to divert gas supplies and capacity from Yuma Cogen for up to ten days from October through April, thereby allowing the Company more flexibility in meeting core customer service needs.

14. Southwest states that it "diverted Yuma Cogen's supplies and capacity February 2, 2011 through February 6, 2011 when portions of Arizona were experiencing design-day cold weather." There were no supply or pressure problems in Yuma during the February event, but the diversion of Yuma Cogen's supplies and capacity allowed Southwest to reduce the Critical Operating Condition imbalance penalties charged to its core customers. (In addition to the interruption cited above, Southwest has interrupted Yuma Cogen's service "on rare occasions" due to an El Paso pipeline integrity project.) Such a diversion of supplies and capacity would not be available under Schedule G-60.

Contributions to Capacity and to Operations and Maintenance ("O&M") Costs

15. Payments by Yuma Cogen under the proposed SGPA would contribute to the cost of capacity for all of Southwest's customers. Under the proposed SGPA, Yuma Cogen would pay the full FT-1 rate for capacity on the El Paso pipeline, equal to the greater of the customer nomination or actual use, to deliver supplies each day. This capacity payment is then credited back to ratepayers. In addition, payments by Yuma Cogen would help to cover Southwest's

incremental O&M costs. These contributions to capacity and O&M costs would be lost, should Yuma Cogen cease to be a Southwest customer.

Pass-Through of El Paso Penalties/Charges to Yuma Cogen; Pass-Through of Negative Margin to Core Customers Prohibited

16. Southwest currently passes through charges and penalties from El Paso that are attributable to Yuma Cogen. Under the proposed SGPA, Southwest would continue to pass through these charges and penalties to Yuma Cogen.

17. Because core customers should not bear the risks of this agreement, Staff has recommended that Southwest be prohibited from passing through any negative margin that may result from this agreement to Southwest's core customers in any future proceeding.

Summary and Analysis

18. Based on the application and communications with Southwest, Staff believes that bypass is feasible as required by the G-30 tariff. Staff also believes that service to Yuma Cogen under the G-30 tariff is reasonable: (i) due to the potential for bypass and to Yuma Cogen's ability to burn alternative fuels; (ii) because Southwest's ability to divert Yuma Cogen's supplies and capacity provides a benefit to core customers; and (iii) because Yuma Cogen makes contributions to capacity and O&M costs. The benefits to core customers cited under (ii) and (iii) would be lost should Yuma Cogen start taking service directly from El Paso.

19. Staff has reviewed the rates and terms of service under the SGPA and believes that they are consistent with the G-30 tariff. Charges under the SGPA would include a monthly basic service charge, applicable upstream pipeline costs, and volumetric charges, including the gas cost. (Interstate pipeline fuel shrinkage is included in the gas cost, but distribution shrinkage is not, due to the close proximity of Yuma Cogen to the El Paso pipeline.) The proposed agreement also contains provisions for cashing out daily imbalances experienced by Yuma Cogen.

20. The proposed SGPA would set a primary term of four years for the agreement, and would continue on a month-to-month basis thereafter. The month-to-month extensions would be limited to twelve months and subject to termination by either party upon ninety days notice. Staff

. . .

has recommended that the Commission approve Southwest's new SGPA with Yuma Cogen for the requested four-year term, with extensions, effective on the first of the month following approval.

CONCLUSIONS OF LAW

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

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

3. The Commission, having reviewed the application and Staff's Memorandum dated June 28, 2011, concludes that it is in the public interest to approve Southwest's application for approval of its SPGA with Yuma Cogeneration Associates as discussed herein.

ORDER

IT IS THEREFORE ORDERED that the Special Gas Procurement Agreement between Southwest Gas Corporation and Yuma Cogen Associates be and hereby is approved, for a period of four years, effective on the first of the month following approval and extending for four years, with month-to-month extensions not to exceed twelve additional months, and with the modifications indicated below.

IT IS FURTHER ORDERED that the capacity costs credited to the Purchased Gas Adjustor bank balance continue to be equivalent to El Paso Natural Gas Company's FT-1 reservation rate.

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IT IS FURTHER ORDERED that Southwest Gas Corporation be prohibited from passing any negative margin that may result from this agreement to Southwest Gas Corporation's core customers in any future proceeding.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, 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 __________________ , 2011.

____
ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT: __________________________

DISSENT: __________________________

SMO:JMK:lhm\RM

SERVICE LIST FOR: Southwest Gas Corporation
DOCKET NO. G-01551A-11-0202

Mr. Justin Lee Brown, Esq.
Associate General Counsel
Southwest Gas Corporation
Post Office Box 98510
Las Vegas, Nevada 89193-8510

Ms. Debra Gallo
Director/Government and State Regulatory Affairs
Southwest Gas Corporation
Post Office Box 98510
Las Vegas, Nevada 89193-8510

Mr. Steven M. Olea
Director, Utilities Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Janice M. Alward
Chief Counsel, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007