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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION DOCKET CONTROL

Arizona Corporation Commission DOCKETED JUL 15 2011 DOCKETED BY

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

IN THE MATTER OF THE APPLICATION OF SOUTHWEST GAS CORPORATION FOR THE ESTABLISHMENT OF JUST AND REASONABLE RATES AND CHARGES DESIGNED TO REALIZE A REASONABLE RATE OF RETURN ON THE FAIR VALUE OF ITS PROPERTIES THROUGHOUT ARIZONA.

DOCKET NO. G-01551A-10-0458

STAFF'S NOTICE OF FILING

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby provides notice of filing the Proposed Settlement Agreement ("Agreement") in the above-referenced matter. The Exhibits to the Agreement will be filed on or before July 29, 2011.

RESPECTFULLY SUBMITTED this 15th day of July, 2011.

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Original and thirteen (13) copies of the foregoing were filed this 15th day of July, 2011, with:

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SOUTHWEST GAS CORPORATION

PROPOSED SETTLEMENT AGREEMENT

DOCKET NO. G-01551A-10-0458

JULY 15, 2011

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PROPOSED SETTLEMENT OF DOCKET NO. G-01551A-10-0458
SOUTHWEST GAS CORPORATION REQUEST FOR RATE ADJUSTMENT

The purpose of this Settlement Agreement ("Agreement") is to settle disputed issues related to Docket No. G-01551A-10-0458, Southwest Gas Corporation ("Southwest Gas" or "Company") application to increase rates. This Agreement is entered into by the following entities:

Arizona Corporation Commission Utilities Division ("Staff")
Arizona Investment Council ("AIC")
Cynthia Zwick
Southwest Energy Efficiency Project ("SWEEP")
Southwest Gas Corporation ("Southwest Gas" or "Company")
Natural Resources Defense Council ("NRDC")

These entities shall be referred to collectively as "Signatories;" a single entity shall be referred to individually as a "Signatory."

The following numbered paragraphs comprise the Signatories' Agreement.

I. RECITALS

1.1 This Agreement (with the Commission's selection of either Alternatives A or B, in each alternative's entirety) resolves all issues presented in Docket No. G-01551A-10-0458 in a manner that will promote the public interest.

1.2 On November 12, 2010, Southwest Gas filed an application requesting approval of: (i) a general rate increase for its Arizona rate jurisdiction; (ii) its proposed Energy Efficiency Enabling Provision; (iii) its proposed Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation Plan ("EE and RET Plan") and corresponding budget; (iv) its proposed pilot program for customer owned yard lines ("COYL") and a deferred accounting order; (v) a deferred accounting order for the costs associated with replacement of Aldyl HD pipe as part of the Company's 20 year plan to replace all early vintage plastic pipe ("EVPP"); and (vi) various proposed amendments to its Arizona gas tariff ("Application").

1.3 The Commission approved the applications to intervene filed by the Residential Utility Consumer Office ("RUCO"), Tucson Electric Power ("TEP"), Cynthia Zwick, AIC, SWEEP and NDRC (collectively referred to as "Parties to this Docket").

1.4 Staff, RUCO, and Cynthia Zwick filed direct testimony June 10, 2011. Staff, RUCO, NRDC, and SWEEP filed direct rate design testimony June 24, 2011.

1.5 Southwest Gas filed a Notice of Settlement Discussions June 21, 2011. The Parties to this Docket subsequently held settlement discussions beginning June 28, 2011 and continuing through July 14, 2011.

1.6 The settlement discussions were open, transparent, and inclusive of all parties to this docket who desired to participate. All Parties to this Docket were notified of the settlement discussions, were encouraged to participate in the negotiations, and were provided an opportunity to participate either in person or via teleconference.

1.7 The Signatories agree that they have reached a compromise and agreement that resolves all outstanding and contested issues that were raised during the course of this proceeding. The Signatories believe that the terms and conditions of this Agreement (inclusive of Alternatives A and B as presented) are just, reasonable, and fair, and that the Agreement promotes the public interest.

1.8 This Agreement results in a settlement package that addresses Southwest Gas' need for a rate increase and balances this need with terms and conditions that provide several specific customer benefits. The Signatories submit that many benefits of this negotiated settlement package would not otherwise have been accomplished through a litigated proceeding. Some of these customer benefits include but are not limited to:

- Commitments Benefiting Low Income Customers on the low income rate schedule(s).
    - An increased Low Income Rate Assistance discount from 20 percent to 30 percent for the low income rate schedule(s).
    - A Southwest Gas commitment to increase funding for Low Income Energy Conservation Weatherization program with non-ratepayer funds of at least $1 million over 5 years.
    - A commitment to develop enhanced communication programs to increase awareness of low-income programs.

- Rate Stability.
    - Approval of a decoupling mechanism to improve Southwest Gas' revenue stability, which, in turn has a positive impact on its financial profile and credit ratings - benefiting customers through reductions in future debt costs.
    - Approval of decoupling mechanisms to mitigate rate increases in future rate proceedings and reduce the frequency of time consuming and expensive rate cases.
    - A moratorium on general rate case applications for over five years – reflected in Alternative B only.
- An operating Expense Reduction Commitment of $2.5 million per year.
- Continuation of a 20-Year Plan to Replace Early Vintage Plastic Pipe.
- The Establishment of a Customer Owned Yard Line Replacement Program.
- Energy Efficiency Enhancements.
    - Energy Efficiency initiatives resulting in customer annual energy savings of at least 1,250,000 therms.
- Implementation of a decoupling mechanism.
    - To align utility, customer and societal interests to pursue annual customer bill savings through the recently enacted gas energy efficiency goals – reflected in Alternatives A and B.
    - Reducing utility disincentives to support customer energy efficiency.
    - Prompt protection of customers from high winter monthly bills following extreme weather events as reflected in Alternatives A and B.
- Rate Design.
    - No increase to the monthly basic service charge to enhance customer bill savings through energy efficiency and conservation efforts.

1.9 The Signatories request an order from the Commission: (i) finding that the terms and conditions of this Agreement are just and reasonable; (ii) concluding that the Agreement is in the public interest; (iii) approving the Agreement in its entirety (including the selection of only either Alternative A or B in each alternative's entirety) and ordering that the terms and conditions therein become effective upon Commission approval; and (iv) making any and all other findings and orders in support of this Agreement that the Commission deems necessary.

1.10 Consistent with Arizona Administrative Code ("A.A.C.") R14-2-103, the Signatories request the issuance of a Commission order approving this Agreement with an effective date of new rates no later than January 1, 2012.

II. SUMMARY OF FILED REVENUE POSITIONS

2.1 The Company's application and supporting testimony requested approval, *inter alia,* of a revenue increase of $73.2 million. The requested capital structure consisted of 52.3 percent common equity and 47.7 percent long-term debt, relative to an 8.34 percent embedded cost of long-term debt and a cost of common equity capital of 11.00 percent. Southwest Gas also requested a fair value rate of return ("FVROR") of 7.50 percent using a 1.24 percent inflation-adjusted risk-free return on the fair value increment (the differential between the fair value rate base ("FVRB") and the original cost rate base ("OCRB")).

2.2 Staff made several recommendations pertaining to the Company's proposed rate base, expenses, revenues, and net operating income resulting in a recommended revenue increase of $54.9 million. Staff agreed with the Company's capital structure and embedded cost of long-term debt, but recommended a cost of common equity capital of 9.75 percent and a FVROR of 7.02 percent using a 1.25 percent inflation-adjusted risk-free return on the fair value increment (differential between FVRB and OCRB).

2.3 In its direct testimony, RUCO recommended a revenue requirement increase of approximately $29.2 million. For its cost of equity, RUCO recommended a 9.00 percent cost of equity. The recommended RUCO capital structure consists of 50.15 percent common equity and 49.85 long-term debt with a cost of long-term debt of 7.35 percent.

III. AGREEMENT ON TWO ALTERNATIVES FOR REVENUE DECOUPLING

3.1 Because of the unique circumstances presented by the revenue decoupling proposals offered in this proceeding, the Signatories have agreed to present to the Commission two alternatives (Alternative A and Alternative B), as set forth in more detail below. It is the intent of the Signatories that the Commission select one Alternative in its entirety as part of this Settlement Agreement.

3.2 Staff supports both Alternatives A and B equally, and Staff agrees to support both Alternatives equally during any subsequent hearing or other Commission proceeding involving this Agreement. Southwest Gas supports the inclusion of the two Alternatives in this Agreement, but Southwest Gas shall be permitted to express its preference for either Alternative A or B during any subsequent hearing or other Commission proceeding involving this Agreement. The remaining Signatories will support at least one Alternative (either Alternative A or B), and they shall not be precluded from expressing their respective positions on the Alternatives set forth in this Agreement during any subsequent hearing or other Commission proceeding involving this Agreement.

A. Alternative A.

3.3 Alternative A consists of a partial revenue decoupling mechanism, a monthly weather adjustor consistent with the Southwest Gas proposal, an overall revenue increase of $54,927,101, a return on common equity capital of 9.75 percent, and a FVROR of 7.02 percent on FVRB (using Staff's fair value methodology and valuation).

3.4 Should the Commission select Alternative A, the Company will implement a partial revenue decoupling mechanism comprised of two components, a Lost Fixed Cost Recovery ("LFCR") component and a weather component. The partial revenue decoupling mechanism permits Southwest Gas to recover lost base revenues attributable to achievement of the Commission's required annual energy savings and to adjust customer bills each month when actual weather during the billing cycle differs from the average weather used in the calculation of rates.

3.5 The LFCR component permits the Company to recover, through a per unit surcharge, the total amount of the anticipated lost-base revenues, assuming it achieves 100 percent of the Commission's required annual energy savings. This amount will be trued-up to actual lost base revenue due to energy efficiency during an annual reconciliation process each April.

3.6 If the Company does not meet 100 percent of the Commission's required annual energy savings, the difference between the 100 percent it was allowed to collect and the actual lost revenue would be refunded to customers during the next annual reconciliation process.

3.7 If the Company exceeds its energy efficiency goals in any reconciliation period, the Company will only be allowed to recover 100 percent of the upcoming year lost base revenues. However, the Company will be permitted to recover, through the surcharge, in the following year the difference between the 100 percent collected from customers and the actual amount of the lost-base revenues associated with attaining energy savings greater than 100 percent of the year's goal, as limited by the Commission's required annual energy savings.

3.8 The initial LFCR surcharge will be set at $0.00213 per therm, beginning when rates under this Agreement become effective. This surcharge amount is based on the Commission's 2011 energy efficiency savings goal.

3.9 Southwest Gas shall make a filing annually, starting April 2013, to permit the Commission and all Parties to this Docket an opportunity to review the performance of the LFCR mechanism and to allow the Company an opportunity to reset the surcharge to recover the lost-base revenues attributable to its achievement of the Commission's required annual energy savings. Under or over collections should be trued up as part of the surcharge reset.

3.10 The weather-related component will be incorporated through a monthly true-up to winter (November through April) bills. When actual weather during the billing cycle differs from the average weather used in the calculation of rates there will be either an upward or downward adjustment to the customers' bill. In the event of an extreme cold weather event, customers will receive an immediate real-time benefit as there will be a downward adjustment to their bill.

Special Terms and Conditions for Alternative A

3.11 Staff will perform an annual review to determine compliance with the Commission's required annual energy savings and the Company agrees to pay up to $50,000 for an independent consultant selected by Staff for this review.

3.12 No Signatory will petition, nor join in a petition, to suspend, terminate, or modify the LFCR mechanism prior to the Company's next general rate case, unless for two consecutive years the results of the annual review process conclude the Company did not comply with the Commission's required annual energy savings. Paragraph 3.12 applies to the LFCR mechanism only.

3.13 Prior to the granting of any request to suspend, terminate, or modify the LFCR mechanism, a hearing will be conducted to permit the Signatories due process and an opportunity to be heard prior to any suspension, termination, or modification of the decoupling mechanism.

3.14 Southwest Gas will not be subject to a rate case application moratorium under Alternative A.

3.15 Southwest Gas will submit a proposed customer outreach/education plan to Staff for review and approval, with service to the Parties to this Docket. The plan shall outline how the Company intends to explain decoupling to customers.

3.16 Alternative A in its entirety, as described herein, consisting of a partial revenue decoupling mechanism, a revenue increase of $54,927,101, a return on common equity of 9.75 percent, a FVROR of 7.02 percent, as well as the special terms and conditions stated herein, is a carefully negotiated, integrated package representing compromises in the positions of the Signatories that results in a package that is just, reasonable, and in the public interest.

B. Alternative B.

3.17 Alternative B consists of a full revenue decoupling mechanism, a monthly weather adjustor consistent with the Southwest Gas proposal, an overall revenue increase of $52,607,414, a return on common equity capital of 9.50 percent, and a fair value rate of return of 6.92 percent on FVRB (using Staff's fair value methodology and valuation).

3.18 Should the Commission select Alternative B, the Company will implement a full revenue decoupling mechanism whereby rates will adjust to reflect any differences between authorized revenues per customer and actual revenues per customer – as proposed by the Company in its Application. This full revenue decoupling mechanism shall also include a monthly weather component and an annual non-weather component.

3.19 The weather-related component will be incorporated through a monthly true-up to winter (November through April) bills. When actual weather during the billing cycle differs from the average weather used in the calculation of rates there will be either an upward or downward adjustment to the customers' bill. In the event of an extreme cold weather event, customers will receive an immediate real-time benefit as there will be a downward adjustment to their bill.

3.20 There will also be an annual true-up reflecting the difference between the non-gas revenues authorized by the Commission and the actual non-gas revenues experienced by Southwest Gas. The phrase "revenues authorized by the Commission" is defined as the Commission authorized monthly revenue per customer multiplied by the total number of customers billed for service during the month. "Experienced revenue" is defined as the billed revenue for the month. At the end of each year, a per-therm rate adjustment will be computed by dividing the balance in the deferred account by the previous 12 months sales volume. The resulting rate will remain in effect for a 12-month period to refund or collect the deferred account balance.

Special Terms and Conditions for Alternative B

3.21 Southwest Gas shall file quarterly reports each April, July, October and January with the Commission on the performance of the decoupling mechanism. The first quarterly report will be filed no later than April 30, 2012.

3.22 The quarterly reports will address at a minimum: (i) monthly bill impacts for the Residential and Non-residential customer sectors, based on average sector therm usage, with comparisons of pre- and post-decoupling bills over two years, with a year-to-year comparison going forward; and (ii) monthly bill impacts by individual tariff, based on average tariff therm usage, with comparisons of pre- and post-decoupling bills over two years, with a year-to-year comparison going forward.

3.23 Commencing April 2013, Southwest Gas will file annual reports, each April, to permit the Commission and all Parties to this Docket an opportunity to review the performance of the decoupling mechanism. The annual filing shall include, but not be limited to: (1) listing of customer complaints resulting from or associated with revenue decoupling; (2) a showing that disincentives to energy efficiency have been removed by December 31, 2012; (3) compliance with the Commission's required annual energy savings and as contemplated in Section V.C. of this Agreement; (4) an analysis of usage differences between new and existing customers; (5) a comparison of the differences between new and existing customer usage per customer ("UPC"); (6) an analysis of overall customer usage, UPC, and customer growth per class on a pre- and post-decoupling basis; (7) an analysis of customer migration to tariffs not subject to decoupling or converting to non-gas energy usage; and (8) an analysis of Company activities in supporting new customer growth including the encouragement of new and economic uses of natural gas. These items are types of information that should provide meaningful information regarding the full revenue decoupling mechanism. The presence or absence of information responsive to any one of these items shall not, in and of itself, be indicative of whether to continue, suspend, terminate or modify the full revenue decoupling mechanism.

3.24 The Company's annual filing shall be the subject of an Open Meeting for the Commissioners to deliberate the performance of the full revenue decoupling mechanism. If the Commission determines that good cause exists to suspend, terminate, or modify the full revenue decoupling mechanism, then the matter shall be set for hearing to permit the

Parties to this Docket due process and an opportunity to be heard prior to any suspension, termination, or modification of the decoupling mechanism. In the event the Commission decides to suspend or terminate the full revenue decoupling mechanism prior to the Company's next general rate case, the moratorium for filing general rate case applications shall terminate. If the Commission decides to modify the full revenue decoupling mechanism, the Commission shall also determine if the modification is material enough that the moratorium for the filing a general rate application should be eliminated.

3.25 With the implementation of the full revenue decoupling mechanism, Southwest Gas will be subject to an annual earnings test whereby the Company will be prohibited from recovering any decoupling deferral amounts, to the extent that recovery would increase earnings such that the Company would be earning more than its authorized return on common equity.

3.26 Commencing April 2013, Southwest Gas shall include in its annual report, the results of its annual earnings test in a format consistent with the report attached hereto as Exhibit A.

3.27 The data points and assumptions to be utilized in the earnings test report will include the following:

- Reporting period shall consist of the 12 months ending December 31;
- FVRB held constant at $1,452,933,391;
- FVROR held constant at 6.92 percent, and all related cost of capital components held constant, including capital structure (52.30 percent equity and 47.70 percent debt), cost of debt (8.34 percent), cost of equity (9.50 percent), and return on fair value increment (1.25 percent);
- Experienced non-gas revenue for the reporting period;
- Recorded operating expenses for the reporting period, adjusted for certain ratemaking adjustments. The ratemaking adjustments will consist of recorded dollars less the Staff-specified disallowance percentage for the following Staff adjustments:

- C-3, Management Incentive Program ("MIP") expense will be limited to fifty percent of the recorded and allocated cost, however Staff may make a further adjustment if Staff believes the MIP expense has increased unreasonably;
- C-4, the cost of all stock-based compensation (other than MIP) shall be excluded;
- C-5, all Supplemental Executive Retirement Expense charged or allocated to Arizona operation shall be excluded. (Arizona);
- C-6, forty percent of American Gas Association dues shall be excluded;
- C-7, all losses related to the sale of employee homes for relocation shall be excluded;
- C-9, all Gas Heat Pump Development Expenses shall be excluded;
- C-11, fifty percent (50%) of all Directors' and Officers' Liability Insurance expense shall be excluded;
- C-13, leased aircraft expense shall be limited to the lesser of (1) the actual recorded amount or (2) Staff's proposed allowance of $472,000;
- Staff's Schedule B adjustments and Staff's Schedule C adjustments C-1 (Completed Construction Not Classified Correction), C-2 (Yuma Manors Pipe Replacement), and C-10 (Interest Synchronization) will remain constant because rate base and FVROR remain constant for the purposes of the earnings test;
- Staff's Schedule C adjustment C-8 (Rent Charged to Affiliate IntelliChoice Energy LLC) and C-14 (COYL Leak Detection Survey) will be recorded in Southwest Gas' operating expenses going forward, so no further adjustment will be necessary for the earnings test;
- Staff's Schedule C adjustments C-12 Reserve for Self Insurance, is a normalizing adjustment and Southwest Gas will use its recorded amounts for purposes of the earnings test;
- For purposes of calculating income taxes, interest expense will be held constant since the FVROR will be held constant;
- Any surcharge revenues and expenses will not be included in the earnings test.

3.28 Staff will perform an annual review to analyze the information submitted by Southwest Gas and the Company agrees to pay up to $75,000 for an independent consultant selected by Staff for this review.

3.29 Any surcharge through the decoupling mechanism that will result in an annual increase in non-gas revenue of greater than 5 percent from the test-year non-gas base revenue per customer will be capped at 5 percent. Southwest Gas will carry the deferral account balance forward for recovery in the next year and subsequent years with no carrying charges. There will be no cap on annual surcharge decreases.

3.30 Southwest Gas will not file a general rate case application prior to April 30, 2016 with a test year no earlier than November 30, 2015 and none of the Signatories will request any change, nor join in a request for any change, to the Company's base rates that would take effect prior to May 1, 2017. This moratorium is not intended to preclude the Company from filing other interim applications as may be necessary or required, including without limitation, proposals to reset its demand side management surcharge mechanism, or requests to establish deferred accounts for costs incurred by the Company to comply with new or revised pipeline safety requirements, or other unfunded state or federal mandates.

3.31 Southwest Gas will submit a proposed customer outreach/education plan to Staff for review and approval, with service to the parties of record. The plan shall outline how the Company intends to explain decoupling to customers.

3.32 Alternative B in its entirety - consisting of a full revenue decoupling mechanism, a revenue increase of $52,607,414, a return on common equity capital of 9.50 percent, a fair value rate of return of 6.92 percent, as well as the special terms and conditions stated herein - is a carefully negotiated package representing compromises in the positions of the Signatories that results in a package that is just, reasonable, and in the public interest.

C. Rates and Charges are Just, Reasonable, and in the Public Interest.

3.33 The Signatories agree that the overall rate increases associated with Alternatives A and B are just, reasonable, and in the public interest based upon the unique circumstances of each alternative, but only if either Alternative A or B is implemented in its entirety, as intended by the Signatories herein. The Signatories further agree that if any of the components of Alternative A or B are changed, including any other remaining components of this Agreement, then the rates and charges associated with the changed alternative may not be considered just and reasonable by the Signatories.

3.34 A comparison of the various revenue requirement increases and returns on equity ("ROE") proposed by certain Signatories, as compared to those contained in each of the settlement alternatives, is set forth in the following table:

	Company Direct	Staff Direct	Settlement Alternative A	Settlement Alternative B
Proposed Revenue Increases	**$73.2M**	**$54.9M**	**$54.9M**	**$52.6M**
Requested ROE	**11.00%**	**9.75%**	**9.75%**	**9.50%**
Overall Average Rate Increase %	**9.26%**	**6.95%**	**6.95%**	**6.66%**

IV. LOW INCOME PROGRAMS

4.1 Southwest Gas will enhance and increase the funding level of the Low Income Energy Conservation ("LIEC") weatherization program by committing to make non-ratepayer funded contributions to the LIEC weatherization program each year for the next 5 years. This commitment shall result in a total contribution of at least $1 million.

4.2 The demand-side management adjustor rate for the low-income residential rate schedule(s) will not be increased above the rate currently collected, which is $0.00200 per therm.

4.3 The Customer Owned Yard Line cost recovery mechanism ("CCRM") will consist of a per therm charge, and the CCRM will not apply to the low-income rate schedule(s).

4.4 The proposed increase to the low-income residential rate schedule(s) shall be mitigated by increasing the Low-Income Rate Assistance discount to 30 percent, from the current 20 percent for the first 150 therms in the winter months (November through April). This will result in an average monthly bill increase of either $0.70 (Alternative A) or $0.59 (Alternative B) depending upon the alternative selected by the Commission.

4.5 Southwest Gas will meet with the Parties to this Docket within 45 days of the effective date of any order approving this Agreement to develop a plan to enhance customer education and outreach for its LIEC weatherization programs.

V. AGREEMENTS REGARDING OTHER SPECIFIC ISSUES

5.1 Upon the Commission's selection of either Alternative A or B in each alternative's entirety, the Signatories agree to the following remaining issues regarding the Company's general rate application. The Commission's selection of either Alternative A or B in their entirety does not materially impact the compromises reached by the Signatories on these remaining issues.

A. Cost of Capital.

5.2 The Signatories agree that a capital structure comprised of 47.70 percent long-term debt and 52.30 percent common equity is appropriate and shall be adopted for ratemaking purposes, and for the purposes of this Agreement.

5.3 The Signatories agree that an embedded cost of debt of 8.34 percent is appropriate and shall be adopted for ratemaking purposes, and for the purposes of this Agreement.

B. Rate Base.

5.4 For ratemaking purposes and for the purposes of this Agreement, the Signatories agree that the Company's jurisdictional OCRB for the test year ending June 30, 2010 is $1,070,115,558.

5.5 For ratemaking purposes and for purposes of this Agreement, the Signatories agree that the Company's jurisdictional Reconstruction Cost New Depreciated ("RCND") rate base for the test year ending June 30, 2010 is $1,835,749,225.

5.6 For ratemaking purposes and for purposes of this Agreement, the Signatories agree that the fair value of Southwest Gas' jurisdictional rate base for the test year ending June 30, 2010 is $1,452,932,391.

C. Energy Efficiency and Renewable Energy Resource Technology.

5.7 Southwest Gas included in its Application a request for approval of its EE and RET Plan pursuant to A.A.C. R14-2-2501 *et seq*.

5.8 Southwest Gas agrees to provide supplemental EE information to support a modified EE and RET Plan for EE measures that are cost-effective at the measure level as part of this Agreement. This modified EE and RET Plan shall result in an incremental improvement of EE that exceeds the current Southwest Gas approved portfolio budget of $4.4 million, and that results in customer annual energy savings of at least 1,250,000 therms within nine months of Commission approval of the modified Plan.

5.9 Staff will provide recommendations on as many measures of the modified EE and RET Plan as possible in a report filed prior to the Open Meeting where the Commission intends to vote on the Recommended Opinion and Order approving this Agreement. In an effort to achieve timely approval of the modified EE and RET Plan, the Signatories urge the Commission to vote on the measures in Staff's report on the date the Commission votes on this Agreement.

5.10 The Signatories acknowledge that the energy savings proposed in the modified EE and RET Plan may not be sufficient to meet the 2011 energy savings goals set forth in A.A.C. R14-2-2501 *et seq*. In order to increase the customer annual energy savings that are being agreed to as part of this Agreement, Southwest Gas shall file in a new docket within 60 days of filing this Agreement a new and revised EE and RET Implementation Plan pursuant to A.A.C. R14-2-2501 *et seq* setting forth a plan for how it proposes to comply with the energy savings goals set forth therein. The new and revised EE and RET Implementation Plan will be incremental to the modified EE and RET Plan measures that are being committed to by Southwest Gas as part of this Agreement.

5.11 Southwest Gas shall achieve customer annual energy savings equivalent to the 2011 requirement of the gas energy savings goals within 12 months of Commission approval of the new and revised EE and RET Implementation Plan. Staff agrees to make its best efforts to review the Company's new and revised EE and RET Implementation Plan and file recommendations for Commission approval on a schedule that contributes to timely implementation of the energy savings programs that are necessary to achieve the 2011 energy savings target. In 2012 and beyond, Southwest Gas will comply with the cumulative annual energy savings requirements set forth in A.A.C. R14-2-2501 *et seq.* At least 75 percent of the cumulative annual energy savings shall be achieved through EE programs. In this regard, Southwest Gas agrees to file its implementation plans consistent with the requirements of A.A.C. R14-2-2501 *et seq*, on schedule, at the energy savings targets identified therein, and commits to work with SWEEP and Staff to avoid the need to file a request for waiver during any plan year from 2011-2015 in lieu of submitting an implementation plan designed to achieve the energy savings targets set forth in A.A.C. R14-2-2504. Staff agrees to make their best efforts to review the Company's implementation plans and file recommendations for Commission votes on a schedule that contributes to timely implementation of the energy savings programs that are necessary to achieve the energy savings targets set forth in A.A.C. R14-2-2501 *et seq.*

D. Customer Owned Yard Line Replacement Program.

5.13 Southwest Gas shall be permitted to establish a program for replacing customer owned yard lines ("COYL") consistent with the terms of this Agreement.

5.14 Southwest Gas will purchase four (4) Remote Methane Leak Detection ("RMLD") units, field test and validate the effectiveness of the RMLD equipment, and work with Staff to obtain approval for the use of the RMLD equipment. Following approval of the RMLD equipment, Southwest Gas will begin to leak survey COYLs utilizing the RMLD equipment and other conventional equipment as necessary. Prior to leak surveying the COYLs, Southwest Gas will notify customers with COYLs and obtain permission, where necessary, to perform leak surveying of the COYL. The Company estimates that it has approximately 102,000 COYLs in its service territory. Southwest Gas commits to leak survey approximately one-third of the COYLs every year.

5.15 So as to not unduly financially burden its customers, Southwest Gas will replace all COYLs that are found to be leaking, either as a result of the COYL leak survey process or from a leak survey following an odor call complaint. Southwest Gas will be allowed to recover the capital investment associated with the COYL replacement program through a COYL cost recovery mechanism ("CCRM") that will be reset annually. The CCRM shall not result in a surcharge amount greater than $0.01 per therm in any single year.

5.16 The CCRM is based solely on actual costs and costs eligible for recovery, which are depreciation and pre-tax return. The original cost pre-tax rate of return authorized by the Commission is applied to gross plant, less accumulated depreciation and less all credit-balance Accumulated Deferred Income Taxes related to the plant cost incurred under this program. Depreciation expense includes actual recorded depreciation expense at the currently-authorized depreciation rate of 5.30 percent per year for services, applied on a monthly basis to COYL replacement plant as of the previous month-end, plus amortization of deferred depreciation expenses.

5.17 Recovery of costs through a CCRM surcharge terminates upon inclusion of the COYL replacement cost in rate base. A surcharge schedule, showing a detailed calculation of the COYL revenue requirement and the surcharge will be included in the Company's annual application for cost recovery. A sample calculation illustrating the mechanics of the CCRM is attached hereto as Exhibit B.

5.18 Upon completion of the first six months of leak surveying, Southwest Gas will file a report with the Commission, with service to the Parties to this Docket, informing them of its findings and any recommendations regarding the program. Southwest Gas will then report on its findings and recommendations on an annual basis thereafter. The annual report shall include the following: (1) location by address of each leak detected; (2) indication of how the leak was discovered, i.e. leak detection or odor complaint; (3) itemization of the cost and the plant installed at each location; (4) the surcharge calculation; and (5) a schedule describing the survey rotation provided to Staff. Southwest Gas will file its annual report and CCRM application in February of each year with data from the previous calendar year, with the initial filing to be made in February

2013. Staff will review the filing and within 45 days make a recommendation to the Commission regarding the report and the request to reset the surcharge amount.

5.19 The Company shall make modifications to its operations and maintenance manuals as may be required by the Commission's Office of Pipeline Safety for the Company's COYL replacement program.

E. Expense Reduction Plan.

5.20 The Company will identify cost reduction initiatives to reduce its expenses on an annual basis by an average of $2.5 million per year beginning in 2012. Southwest Gas agrees the $2.5 million average annual expense reduction commitment will continue through the end of the test year in the Company's next general rate case. The $2.5 million annual expense reduction by Southwest Gas represents an average annual reduction - in some years, it may exceed $2.5 million.

F. Customer Communication Improvements.

5.21 The Company shall file a report in this docket every six months, beginning March 31, 2012, detailing developments in its efforts to improve communications with customers. The Company will include in its initial report to the Commission a section on whether the Company can use texting to communicate with its customers, or if it cannot, provide an explanation as to why not.

G. Gas Procurement.

5.22 The Company agrees that it will create a new section in its Annual Gas Procurement Plan to document the use of financial instruments – including providing an explanation.

5.23 The Company agrees that it will provide an explanation in any future purchased gas adjustor ("PGA") reports when it begins to recover compressed natural gas costs through the PGA mechanism, including an indication of the reasons for such service, the expected length of time such service will be necessary, and the estimated cost and volume of such service.

H. Purchased Gas Adjustor.

5.24 Southwest Gas will file, within 60 days of the effective date of an order approving this Agreement, a document defining all current line items in the monthly PGA report. The Company will include in its cover letters for future monthly PGA reports an explanation of any additions, deletions, or changes in the line item terms used in the report.

I. Yuma Manors.

5.25 Southwest Gas will not be permitted to recover in base rates the remaining $225,445 associated with the Yuma Manors pipe replacement project that occurred in 2006 and that was the subject of Decision No.70665.

J. 20 Year Plan To Replace Early Vintage Plastic Pipe.

5.26 Southwest Gas shall continue with its 20-year plan for replacing EVPP, and provide documentation of progress and money spent in future rate case proceedings.

5.27 Southwest Gas shall not establish a deferral account in conjunction with the replacement of EVPP.

5.28 Southwest Gas shall not modify or discontinue the write-off requirements associated with Aldyl HD pipe.

K. Development of Gas Heat Pump Technology.

5.29 The Signatories agree that for ratemaking purposes all gas heat pump technology development costs shall be removed from operating expenses.

5.30 Southwest Gas agrees that no new gas heat pump projects shall be funded through the Commission-approved research and development surcharge.

5.31 Southwest Gas will prepare an accounting for all gas heat pump technology development costs that have been funded by Arizona ratepayers through base rates and the research and development surcharge through the date of the Commission's final order in this case. Southwest Gas will track the Arizona ratepayer funding for gas heat pump technology development as a potential regulatory liability, to be returned to ratepayers, only to the extent commercial development occurs and revenues and royalties are received by

Southwest Gas and profits and royalties are received by any other entities that are affiliated with Southwest Gas including but not limited to IntelliChoice Energy LLC.

5.32 Southwest Gas will prepare a plan to reimburse Arizona ratepayers for their proportionate level of funding of gas heat pump technology development costs. This plan will include a methodology for how the benefits of any commercialization revenues and royalties associated with the gas engine driven air conditioning units are to be shared with Southwest Gas' Arizona ratepayers to ensure that customers receive credit for any investment that contributed to the development of this technology. Southwest Gas will file its above-referenced plan and related information with the Commission, with service to the Parties to this Docket within 90 days of the effective date of an order approving this Agreement. Within 120 days of Southwest Gas' submittal of this plan and related information, Staff will submit its recommendation to the Commission for its consideration.

L. Incremental Contribution Method.

5.33 In compliance with Decision No. 70665, Southwest Gas provided, in its application, an explanation, including sample calculations and documentation, of how it has been implementing the Incremental Contribution Method ("ICM") and Rule 6 of its Arizona Gas Tariff. The Signatories agree to the Company's continued use of its ICM and ICM model.

5.34 Within 30 days of the effective date of an order approving this Agreement, Southwest Gas will submit to the Commission a revised ICM model that prevents the Company from collecting contributions in aid of construction ("CIAC") that result in an expected ROE, as generated through the ICM model, that is more than 50 basis points above the authorized return on common equity. Within 90 days of the Company's filing of the revised ICM model, Staff will submit a recommendation to the Commission for the Commission's consideration.

M. Depreciation Study.

5.35 Southwest Gas will file a comprehensive depreciation study as part of its next general rate case application that addresses depreciation and amortization rates for all of Southwest's Arizona Direct and System Allocable depreciable and amortizable plant accounts. Southwest Gas shall not omit any such accounts from such studies.

N. Rate Design and Revenue Allocation.

5.36 The Signatories agree to a base rate revenue allocation resulting in an equal percentage increase among all customer classes, with the exception of the low income rate schedules.

5.37 A comparison of the overall average rate increase, the average residential and low-income rate increase, and the average monthly bill impact for residential and low-income customers associated with certain Signatories' filed positions and the results of Alternatives A and B of this Agreement is contained in the following table (which includes gas costs but not surcharges):

	Company Direct	Staff Direct	Settlement Alternative A	Settlement Alternative B
Overall Average Rate Increase (%)	9.26%	6.95%	6.95%	6.66%
Average Rate Increase (%) - RESIDENTIAL	13.55%	10.31%	8.11%	7.77%
Average Monthly Bill Impact – RESIDENTIAL	$5.81	$4.42	$3.48	$3.33
Average Rate Increase LOW INCOME	16.08%	11.61%	2.16%	1.81%
Average Monthly Bill Impact - LOW INCOME	$5.20	$4.04	$0.70	$0.59

5.38 A comparison of the proposed increases associated with Alternative A for each rate schedule is contained in Exhibit C and a comparison of the proposed increases associated with Alternative B for each rate schedule is contained in Exhibit D.

5.39 As part of Southwest Gas' next general rate application, Southwest Gas will include as one of its rate design proposals an inclining block rate design.

O. Miscellaneous Tariff Changes.

5.40 The miscellaneous housekeeping and other proposed changes to its Arizona Gas Tariff that were proposed in the Company's Application shall be accepted, except as otherwise specifically addressed in this Agreement.

5.41 Southwest Gas agrees that it shall modify its Arizona Gas Tariff consistent with Staff witness Bryan Frye's testimony supporting metering configurations where a sub-meter is installed by Southwest Gas downstream of the primary meter.

VI. FORCE MAJEURE PROVISION

6.1 Notwithstanding anything contained herein to the contrary, Southwest Gas shall not be prevented from requesting a change to its base rates in the event of conditions or circumstances that constitute an emergency. For the purposes of this Agreement, the term "emergency" is limited to an extraordinary event that is beyond Southwest Gas' control and that, in the Commission's judgment, requires base rate relief in order to protect the public interest. This provision is not intended to preclude any Settlement Party from opposing an application for rate relief filed by Southwest Gas pursuant to this paragraph.

VII. COMMISSION EVALUATION OF PROPOSED SETTLEMENT

7.1 The Signatories agree that all currently filed testimony and exhibits shall be offered into the Commission's record as evidence. The Signatories waive the filing and submission of rebuttal testimony and exhibits from Southwest Gas, the filing and submission of surrebuttal testimony and exhibits from Staff and Intervenors, and the filing and submission of rejoinder testimony and exhibits by Southwest Gas.

7.2 The Signatories recognize that Staff does not have the power to bind the Commission. For purposes of proposing a settlement agreement, Staff acts in the same manner as any party to a Commission proceeding.

7.3 This Agreement shall serve as a procedural device by which the Signatories will submit their proposed settlement of Southwest Gas' pending rate case, Docket No. G-01551A-

10-0458 to the Commission.

7.4 The Signatories recognize that the Commission will independently consider and evaluate the terms of this Agreement. If the Commission issues an order adopting all material terms of this Agreement, such action shall constitute Commission approval of the Agreement. Thereafter, the Signatories shall abide by the terms as approved by the Commission.

7.5 The Signatories agree that each Signatory, with the exception of Staff, retains the right to express its respective positions on Alternatives A and/or B during any hearings held by the Commission on this Agreement and at any subsequent Commission proceeding where the Commission votes on this Agreement. However, the selection of either Alternative A or B in each alternative's entirety by the Commission at Open Meeting does not relieve any of the Signatories from their respective obligations to support and defend this Agreement from that point forward.

7.6 The Signatories agree that if the Commission, in selecting between Alternative A and Alternative B, selects the alternative in its entirety that was not supported by a Signatory, such Signatory will nonetheless continue to be bound by the terms of this Agreement and the Commission order. With respect to this paragraph only, each of the Signatories waives its right to request a rehearing under Arizona Revised Statutes ("A.R.S.") § 40-253 or an amendment or modification under A.R.S. § 40-252 solely on the basis that the Commission selected an Alternative (either Alternative A or B) that was not supported by such Signatory.

7.7 If the Commission fails to issue an order adopting all material terms of this Agreement, or makes material modifications to either Alternative A or B as part of the acceptance, or imposes any additional material conditions on approval of this Agreement any or all of the Signatories may withdraw from this Agreement, and such Signatory or Signatories may pursue without prejudice their respective remedies at law, subject to Paragraph 7.6. For the purposes of this Agreement, whether a term is material (except for Alternative A or B) shall be left to the discretion of the Signatory choosing to withdraw from the Agreement. If a Signatory withdraws from the Agreement pursuant to this paragraph and files an application for rehearing (except as set forth in Paragraph 7.6), the other Signatories, except for Staff, shall support the application for rehearing by filing a document to that effect with the Commission that supports approval of the Agreement in its entirety. Staff shall not be obligated to file any document or take any position regarding the withdrawing Signatory's application for rehearing.

7.8 Within ten days after the Commission issues an order pertaining to this Agreement, if not sooner, Southwest Gas shall file compliance schedules for Staff's review.

VIII. MISCELLANEOUS PROVISIONS

8.1 This Agreement represents the Signatories' mutual desire to compromise and settle disputed issues in a manner consistent with the public interest. The terms and provisions of this Agreement apply solely to and are binding only in the context of the purposes and results of this Agreement.

8.2 This case has attracted a number of participants with widely diverse interests. To achieve consensus for settlement, many participants are accepting positions that, in any other circumstances, they would be unwilling to accept. They are doing so because this Agreement, as a whole, with its various provisions for settling the issues presented by this case, is consistent with their long-term interests and with the broad public interest. The acceptance by any Signatory of a specific element of this Agreement shall not be considered as precedent for acceptance of that element in any other context.

8.3 Nothing in this Agreement shall be construed as an admission by any Signatory as to the reasonableness or unreasonableness or lawfulness or unlawfulness of any position previously taken by any other Signatory in this proceeding.

8.4 No Signatory is bound by any position asserted in negotiations, except as expressly stated in this Agreement. No Signatory shall offer evidence of conduct or statements made in the course of negotiating this Agreement before this Commission, any other regulatory agency, or any court.

8.5 Neither this Agreement nor any of the positions taken in this Agreement by any of the Signatories may be referred to, cited, or relied upon as precedent in any proceeding before the Commission, any other regulatory agency, or any court for any purpose except in furtherance of securing the approval and enforcement of this Agreement.

8.6 To the extent any provision of this Agreement is inconsistent with any existing Commission order, rule, or regulation, this Agreement shall control.

8.7 Each of the terms of this Agreement is in consideration of all other terms of this Agreement. Accordingly, the terms are not severable.

8.8 The Signatories shall make reasonable and good faith efforts necessary to obtain a Commission order approving this Agreement. The Signatories shall support and defend this Agreement before the Commission. Subject to paragraph 7.5, if the Commission adopts an order approving all material terms of the Agreement, the Signatories will support and defend the Commission's order before any court or regulatory agency in which it may be at issue.

8.9 This Agreement may be executed in one or more counterparts and each counterpart shall have the same force and effect as an original document and as if all the Signatories had signed the same document. Any signature page of this Agreement may be detached from any counterpart of this Agreement without impairing the legal effect of any signatures thereon, and may be attached to another counterpart of the Agreement identical in form hereto but having attached to it one or more signature page(s).

8.10 Nothing contained in this Agreement is intended to interfere with the Commission's authority to exercise any regulatory authority by the issuance of orders, rules or regulations.

DATED this 15th day of July 2011.

By: [signature]

Printed Name: Gary Yaquinto

Company: Arizona Investment Council

Title: President

DATED this 15th day of July 2011.

By: ______________________________

Printed Name: Justin Lee Brown

Company: Southwest Gas Corporation

Title: Assistant General Counsel

DATED this 15th day of July 2011.

By: ______________________________

Printed Name: Steven Olea

Company: Utilities Division - Arizona Corp. Comm.

Title: Director

DATED this 15th day of July 2011.

By: Jeffrey A Schlegel

Printed Name: Jeffrey A. Schlegel

Company: Southwest Energy Efficiency Project (SWEEP)

Title: Arizona Representative of SWEEP

DATED this 15th day of July 2011.

By: ______________________

Printed Name: LAURA E. SANCHEZ

Company: NRDC

Title: STAFF ATTORNEY

DATED this 15^{th} day of July 2011.

By: ______________________________

Printed Name: CYNTHIA ZWICK

Company: ______________________________

Title: ______________________________