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BEFORE THE ARIZONA CORPORATION COMMISSION

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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 TESTIMONY IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") hereby files the testimony of Steven M. Olea, Ralph C. Smith and Barbara Keene in support of the proposed Settlement Agreement that was docketed July 15, 2011.

RESPECTFULLY SUBMITTED this 29th day of July, 2011.

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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 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

DIRECT TESTIMONY

IN SUPPORT OF

THE SETTLEMENT AGREEMENT

STEVEN M. OLEA

DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2011

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Mr. Olea's testimony supports the adoption of the Settlement Agreement ("Agreement") as proposed by the Signatories in this case. This testimony describes the settlement process as open, candid and inclusive of all parties to this case. Mr. Olea explains why Staff believes this Agreement is in the public interest. In addition, Mr. Olea summarizes the different portions of the Agreement and explains the two decoupling Alternatives put forth in the Agreement.

Mr. Olea's testimony recommends that the Commission adopt the Agreement as proposed, with the selection of either decoupling Alternative A or B.

SECTION I - INTRODUCTION

Q. Please state your name and business address.

A. Steven M. Olea, 1200 West Washington, Phoenix, Arizona, 85007.

Q. By whom and in what capacity are you employed?

A. I am employed by the Arizona Corporation Commission ("Commission") as the Director of the Utilities Division ("Division").

Q. Please state your educational background.

A. I graduated from Arizona State University ("ASU") in 1976 with a Bachelors Degree in Civil Engineering. From 1976 to 1978 I obtained 47 graduate hours of credit in Environmental Engineering at ASU.

Q. Please state your pertinent work experience.

A. From April 1978 to October 1978 I worked for the Engineering Services Section of the Bureau of Air Quality Control in the Arizona Department of Health Services ("ADHS"). My responsibilities were to inspect air pollution sources to determine compliance with ADHS rules and regulations.

From November 1978 to July 1982 I was with the Technical Review Unit of the Bureau of Water Quality Control ("BWQC") in ADHS (this is now part of the Arizona Department of Environmental Quality ["ADEQ"]). My responsibilities were to review water and wastewater construction plans for compliance with ADHS rules, regulations, and Engineering Bulletins.

From July 1982 to August 1983 I was with the Central Regional Office, BWQC, ADHS. My responsibilities were to conduct construction inspections of water and wastewater facilities to determine compliance with plans approved by the Technical Review Unit. I also performed routine operation and maintenance inspections to determine compliance with ADHS rules and regulations, and compliance with United States Environmental Protection Agency requirements.

From August 1983 to August 1986 I was a Utilities Consultant/Water-Wastewater Engineer with the Division. My responsibilities were to provide engineering analyses of Commission regulated water and wastewater utilities for rate cases, financing cases, and consumer complaint cases. I also provided testimony at hearings for those cases.

From August 1986 to August 1990 I was the Engineering Supervisor for the Division. My primary responsibility was to oversee the activities of the Engineering Section, which included one technician and eight Utilities Consultants. The Utilities Consultants included one Telecommunications Engineer, three Electrical Engineers, and four Water-Wastewater Engineers. I also assisted the Chief Engineer and performed some of the same tasks as I did as a Utilities Consultant.

In August 1990 I was promoted to the position of Chief Engineer. My duties were somewhat the same as when I was the Engineering Supervisor, except that now I was less involved with the day-to-day supervision of the Engineering Staff and more involved with the administrative and policy aspects of the Engineering Section.

In April 2000 I was promoted to the position of one of two Assistant Directors of the Division. In this position I assisted the Division Director in the policy aspects of the Division. I was primarily responsible for matters dealing with water and energy.

In August 2009 I was promoted to my present position as Director of the Utilities Division. In this position I manage the day-to-day operations of the Utilities Division with the assistance of the Utilities Division Assistant Director and oversee the management of the Division's Telecom & Energy Section, the Financial & Regulatory Analysis Section, the Consumer Services Section, the Engineering Section and the Administrative Section. In addition, I am responsible for making policy decisions for the Division.

In early 2010 I was given the task of being the Interim Director for the Commission's Safety Division (Railroad and Pipeline). The day-to-day activities of the Safety Division are overseen by the managers of the Railroad Safety Section and the Pipeline Safety Section with input from me. Together with the Commission's Executive Director, I am responsible for the policy decisions for the Safety Division.

Q. What is the purpose of your testimony in this case?

A. The purpose of my testimony is to support the Proposed Settlement Agreement ("Agreement"). I will also provide testimony which addresses the settlement process, public interest benefits and general policy considerations.

Q. Did you participate in the negotiations that led to the execution of the Agreement?

A. Yes, I did.

Q. How is your testimony being presented?

A. My testimony is organized into five sections. Section I is this introduction, Section II provides discussion of the settlement process, Section III discusses the various parts of the Agreement, Section IV identifies and discusses the reasons why the Agreement is in the public interest and Section V addresses general policy considerations.

Q. Will there be other Staff witnesses providing testimony in this case?

A. Yes. Mr. Ralph Smith will be providing testimony to explain the earnings test for decoupling Alternative B, and Ms. Barbara Keene will be providing testimony with regard the energy efficiency process resulting from the Agreement. In addition, all Staff witnesses that filed Direct Testimony prior to the Agreement will be available if the Commission has questions for them.

SECTION II – SETTLEMENT PROCESS

Q. Please discuss the settlement process.

A. The settlement process was open, transparent and inclusive. All parties received notice of the settlement meetings and were accorded an opportunity to raise, discuss, and propose resolution to any issue that they desired.

Q. How many settlement meetings were held?

A. There were approximately six large group settlement meetings relating to revenue requirement, decoupling, energy efficiency programs and rate design. In addition, there were numerous other discussions involving individual parties.

Q. Who participated in those meetings?

A. The following parties were participants in some or all of the meetings: Southwest Gas Corporation ("Southwest" or "Company"); the Residential Utility Consumer Office ("RUCO"); the Arizona Investment Council ("AIC"); the Southwest Energy Efficiency Project ("SWEEP"), Cynthia Zwick, Tucson Electric Power Company ("TEP"), Natural Resources Defense Council ("NRDC") and Division Staff ("Staff").

Q. Could you identify some of the diverse interests that were involved in this process?

A. Yes. The diverse interests included Staff, RUCO, Southwest, a shareholders association, consumer representatives, demand-side management ("DSM") advocates, low-income costumer advocates, and renewable energy advocates.

Q. How many of these parties executed the Agreement?

A. The Agreement was signed by Southwest, Staff, Ms. Zwick, SWEEP, NRDC and AIC ("Signatories").

Q. Were there parties who chose not to execute the Agreement?

A. Yes, RUCO and TEP.

Q. Why did RUCO and TEP not sign on to the Agreement?

A. I do not know and would not want to speculate.

Q. Was there an opportunity for all issues to be discussed and considered?

A. Yes, each party had the opportunity to raise and have its issues considered.

Q. Were the Signatories able to resolve all issues?

A. Yes, the Signatories were able to resolve and reach agreement on all issues.

Q. How would you describe the negotiations?

A. I believe that all participants zealously advocated and represented their interests. I would characterize the discussions as candid but professional. While acknowledging that not all parties executed the Agreement, I must re-emphasize that all parties had the opportunity to be heard and to have their issues fairly considered.

Q. Would you describe the process as requiring give and take?

A. Yes, I would. As a result of the varied interests represented in the settlement process, a willingness to compromise was necessary. As evidenced in the Agreement, the Signatories compromised on what could be described as vastly different litigation positions.

Q. Because of such compromising, do you believe the public interest was compromised?

A. No. As I will discuss later in this testimony, I believe that the compromises made by the various parties further the public interest.

Q. Mr. Olea, you have indicated that the Agreement incorporates diverse interests including those of low-income customers, residential customers, energy efficiency advocates and the investment community. Please discuss how the Agreement addresses the diverse interests of these entities.

A. In the Agreement, there are specific provisions which address many of the concerns expressed by the various interests. For example, the low-income customer issues are addressed in Section IV. Another example is Section V.C., which addresses the interests of those concerned about promoting energy efficiency. The Revenue Decoupling piece (Part III) addresses the concerns of those interested in not only energy efficiency, but also those concerned with the financial integrity of the Company and protection of the rate payers.

SECTION III – SETTLEMENT AGREEMENT

Q. Please describe Part I of the Agreement.

A. Part I is a general description of the settlement process and the Agreement itself.

Q. Please describe Part II of the Agreement.

A. Part II is a summary of the Direct Testimony revenue requirement recommendations of the Company, Staff and RUCO. The Company's and Staff's recommendations are discussed later in this testimony. Depending on which decoupling Alternative is considered, the revenue requirement in the Agreement is equal to or less than that recommended by Staff in its Direct Testimony.

Q. Please describe Part III of the Agreement.

A. Part III describes, in detail, the decoupling Alternative A and decoupling Alternative B. These Alternatives are discussed later in this testimony.

Q. Please discuss Part IV of the Agreement.

A. Part IV details the benefits to customers on the Company's low-income tariffs. The Company commits to working with the parties to enhance its education and outreach for its Low Income Energy Conservation weatherization program and to provide $1 million of non-rate payer funds over the next five years for this program. Any increase to the DSM adjustor shall not be passed on to customers on the low-income tariffs. The proposed

Customer Owned Yard Line ("COYL") adjustor shall not be passed on to customers on the low-income tariffs. The average bill increase for customers on the low-income tariffs will be less than the general rate increase and the current 20 percent discount for the first 150 therms in each winter month will be increased to 30 percent.

Q. Please describe Part V of the Agreement.

A. Part V discusses other items that were agreed to by the Signatories, such as Cost of Capital, Rate Base, Energy Efficiency, COYL Replacement Program, an Expense Reduction Plan, costs incurred by Southwest for Development of Gas Heat Pump Technology, and various other items.

Q. Would you like to elaborate on how the Agreement addresses some of the specific items covered in Part V?

A. Yes. I would like to specifically describe the COYL program because it is not discussed anywhere else in this testimony and the Agreement proposes the establishment of an adjustor mechanism for the replacement of COYLs. I would also like to highlight how the Agreement provides for an Expense Reduction Plan, and addresses costs incurred by Southwest for the Development of Gas Heat Pump Technology,

Q. What is a COYL?

A. A COYL results from residential service that is not provided by the "normal" meter and service line configuration. The normal configuration is one where the meter serving the residence is located immediately adjacent to the housing structure and the service line from the gas main to the meter is owned by Southwest. In the Tucson area of Southwest's service territory there are over 100,000 services that are provided where the meter is at or near the property line of the residence and the service line from the meter to the residence is owned by the customer or property owner (very similar to a water system), hence the term Customer Owned Yard Line.

In cases where these COYLs develop leaks, the responsibility for repairing these leaks falls on the customer. When Southwest becomes aware of such a leak, the Company notifies the customer that the leak must be repaired and turns off service to that customer until the leaking line is repaired or replaced. Many of these COYLs are on older homes where the customer may have difficulty (financially) in replacing or repairing the COYL.

Q. Please discuss the Company's proposed pilot program for COYLs.

A. In its application, Southwest had proposed a pilot program to spend $10,000,000 to replace a portion of these lines. The total cost to replace all these lines could exceed $200,000,000. Staff's recommendation was to deny the Company's pilot program request, and instead have Southwest perform a leak survey to determine the extent of the COYL leak problem and then come up with a replacement program.

Q. What is the resolution of the COYLs?

A. The Agreement at Section V-D, paragraphs 5.13 through 5.19, calls for Southwest to purchase Remote Methane Leak Detection ("RMLD") devices to conduct leak surveys of these COYLs. As a leak is discovered (either through the Company's leak survey program or through a customer call to Southwest), Southwest will replace these COYLs with a normal service configuration. Southwest will account for these replacements on an annual basis and submit this accounting to the Commission on an annual basis. Based on the amount of plant installed each year, Southwest will be allowed to add a surcharge to its bills that would basically be equal to the amount that would have been assessed had this additional plant been in rate base during the test year. Using this method will allow

Southwest to maintain a system free of COYL leaks without requiring customers that may not be able to fix such leaks from having their gas service terminated.

Q. Please describe the expense reduction plan that is provided for in the Agreement.

A. Part V-E, paragraph 5.20 provides for an expense reduction plan that requires Southwest 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.

Q. Please describe how the issues relating to costs incurred by Southwest relating to developing Gas Heat Pumps are addressed in the Agreement.

A. The Agreement addresses the issues raised in Staff's direct testimony concerning the costs incurred by Southwest related to developing Gas Heat Pump Technology in Part V-K, paragraphs 5.29 through 5.32. In summary:

- All gas heat pump technology development costs shall be removed from operating expenses.

- No new gas heat pump projects shall be funded through the research and development surcharge.

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

- Southwest 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's Arizona ratepayers to ensure that customers receive credit for any investment that contributed to the development of this technology. Southwest 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's submittal of this plan and related information, Staff will submit its recommendation to the Commission for its consideration.

Q. Please describe Part VI of the Agreement.

A. This is the Force Majeure provision which allows Southwest, in an emergency situation, to request from the Commission relief from the rate increase application moratorium, if the Commission chooses Alternative B.

Q. Please describe Part VII of the Agreement.

A. Part VII sets forth the Signatories understanding of the Commission's independent authority in the review and consideration of the Agreement. This section also describes the rights of the Signatories should the Commission fail to adopt the material terms of the Agreement. In this section, the Signatories agree to waive the right to challenge a Commission decision solely on the basis of the Commission selection of either Alternative A or B.

Q. Please describe Part VIII of the Agreement.

A. Part VIII is the legal "fine print" that describes the settlement process as a give and take; sets forth the role of the Signatories to support the Agreement. It also describes the Signatories legal rights with respect to the Agreement and future proceedings.

SECTION IV - PUBLIC INTEREST

Q. Mr. Olea, is the Agreement in the public interest?

A. Yes, in Staff's opinion, the Agreement is fair, balanced, and in the public interest.

Q. Would you summarize the reasons that lead Staff to conclude that the Agreement is fair, balanced, and in the public interest?

A. This Agreement results in a settlement package that addresses Southwest's need for a rate increase while balancing this need with terms and conditions that provide customer benefits, such as:

- 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) for the first 150 therms in each winter month.

- A Company commitment to increase funding for Low Income Energy Conservation Weatherization program with non-ratepayer funds of at least $1 million over 5 years.
- A Company commitment to develop enhanced communication programs to increase awareness of low-income programs.

- Rate Stability.
  - Alternative decoupling mechanisms each of which will improve Southwest's revenue stability, which, in turn, has a positive impact on its financial profile and credit ratings - benefiting customers through keeping future debt costs as low as possible.
  - Alternative decoupling mechanisms, with rate payer protections, each of which will mitigate future rate increases and reduce the frequency of time consuming and expensive rate cases.
  - A moratorium on general rate case applications for over five years if the Commission chooses decoupling Alternative B.

- A Company commitment to reduce expenses by at least $2.5 million per year.

- Continuation of a 20-Year Plan to replace Early Vintage Plastic Pipe.

- The Establishment of a COYL Replacement Program.

- Provisions to address costs incurred by Southwest for development of Gas Heat

Pump technology, including an accounting by Southwest of all such costs charged to Arizona ratepayers, and development by Southwest of a plan to reimburse Arizona ratepayers for their proportionate level of funding of gas heat pump technology development costs.

- Energy efficiency initiatives resulting in customer annual energy savings of at least 1,250,000 therms within nine months of the Commission's approval of the modified EE and RET plan.

- Implementation of a decoupling mechanism - either Alternative A or B.
    - Aligns utility, customer and societal interests to pursue annual customer bill savings through the recently enacted gas energy efficiency rules.
    - Providing the Company with incentives to support customer energy efficiency.
    - Providing protection for customers from high winter monthly bills following extreme weather events.

- Rate Design.
    - No increase to the monthly basic service charge to enhance customer bill savings through energy efficiency and conservation efforts.

Q. Mr. Olea, do you believe that the Agreement results in just and reasonable rates for consumers?

A. Yes. In its Rate application, Southwest proposed a revenue increase in the amount of $73.2 million. Staff recommended a revenue increase of $54.9 million. In the Agreement, based on the decoupling alternative ultimately adopted by the Commission (Alternative A or B), the Signatories recommended a revenue increase of $54.9 million for Alternative A and $52.6 million for Alternative B, which represent an increase that is considerably less than the $73.2 million the Company requested in its application. In other words, if the Agreement is adopted by the Commission, the revenue increase will be no higher than that recommended by Staff in its Direct Testimony. In addition, the approval of a decoupling mechanism will mitigate rate increases in future rate proceedings and reduce the frequency of time consuming and expensive rate cases.

Q. Please discuss how the Agreement is fair to the utility.

A. The revenue recommended will provide Southwest with adequate funds to provide reliable and safe service, while at the same time ensuring the financial health of the Company. The approval of a decoupling mechanism will also improve Southwest's revenue stability, which will have a positive impact on its financial profile and credit ratings.

Q. Mr. Olea, what was Staff's goal when it agreed to be a signatory to the Agreement?

A. The primary goal of Staff in this matter, as in all rate proceedings before the Commission, is to protect the public interest by recommending rates that are just, fair and reasonable for both the rate payers and the Company. Staff believes it has accomplished this by reviewing the facts presented and making the appropriate recommendations to the Commission for its consideration, which will balance the interest of the Company and the ratepayers, by promoting the Commission's desire to ensure that the Company has the tools and financial health to provide safe, adequate and reliable service and fulfill the Commission's energy efficiency goals.

SECTION V – POLICY CONSIDERATIONS

Q. Mr. Olea, would you say that there was one major policy consideration the parties had to deal with in this Docket?

A. Yes, the major policy consideration that Staff and other signatories dealt with in order to balance the interest of all parties was revenue decoupling. The Commission, in Docket Nos. E-00000J-08-0314 and G-00000C-08-0314, issued its Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures ("Policy Statement"). The Policy Statement did not adopt a requirement or mandate for a specific revenue decoupling mechanism, but noted that utilities may file a proposal for decoupling or an alternative mechanism for addressing disincentives, in their next general rate case. Southwest was the first utility after the issuance of the Policy Statement that proposed a revenue decoupling mechanism as part of its rate application.

Q. Please describe the Company's decoupling proposal.

A. Southwest proposes to implement revenue decoupling on a revenue per customer ("RPC") basis. An RPC-based mechanism is a form of revenue decoupling that starts with the determination of an allowed RPC, typically derived from the outcome of a concurrent rate proceeding. The allowed (test year) revenue requirement, divided by the total number of test year customers is then utilized as the allowed RPC for future revenue decoupling reconciliation purposes. Future decoupling reconciliations compare actual RPC (actual revenues collected from the actual number of customers in the reconciliation period) to allowed RPC to determine a per-customer revenue deficiency or surplus. This per customer difference is then multiplied by the number of actual customers in the reconciliation period to arrive at a total revenue deficiency or surplus. This deficiency or surplus is divided by reconciliation period sales to develop a per therm surcharge or credit that will be applied to the upcoming twelve-month recovery period. The second component of the Company's revenue decoupling mechanism includes a true-up for weather-related differences in usage during its heating season months. Ratepayers would be issued a credit (or assessed a charge) if the prior month's weather was colder (or warmer) than normal.

Q. What was Staff's recommendation on this issue in its Direct Testimony?

A. Staff recommended that the Commission deny the Company's request. Staff proposed an alternative decoupling mechanism that would tie the Company's performance in its energy efficiency efforts to potential lost base revenue recovery. Staff believes that if the Commission is going to require Southwest to achieve specific energy efficiency goals, i.e., sell less natural gas per customer than it did in the test year, then the Commission should not expect Southwest to do this without accounting for these lower sales. Therefore, Staff's proposal assumes the Company will begin meeting these goals once the rates from this case go into effect and as such the rates have been designed based on these lower gas sales. The Company would not be allowed to begin recovering the second step of energy efficiency until it meets the first step goal.

Q. Please briefly explain what is stipulated in the Agreement on the issue of decoupling.

A. Because of the unique circumstances of decoupling, the Signatories agreed to present the Commission with two alternative decoupling proposals. Alternative A, is a partial revenue decoupling mechanism consisting of two components: a Lost Fixed Cost Recovery ("LFCR") component and a weather component. It is basically a melding of Staff's original proposal and Staff's understanding of the alternative weather decoupling concept put forth by RUCO in its direct testimony. Alternative A would permit Southwest to recover lost base revenues attributable to achievement of the Commission's required annual energy savings (as described in my preceding answer) 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. The Agreement also requires the Company to make a refund to customers for those years where it did not meet the energy efficiency targets. Any party can also petition to have this decoupling mechanism modified or eliminated if Southwest misses the energy efficiency targets two years in a row.

Alternative B is 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 also includes a monthly weather component. Alternative B calls for an annual review with an earnings test to ensure that the Company does not earn more than its authorized rate of return resulting from this Docket. This Alternative also contains a rate filing moratorium whereby the Company cannot file for an increase in rates that would take effect prior to May 1, 2017.

Q. What is the revenue increase and cost of equity under Alternative A?

A. Alternative A proposes an overall revenue increase of $54,927,101, a return on common equity of 9.75 percent, and a fair value rate of return ("FVROR") of 7.02 percent on the fair value rate base ("FVRB") of $1,452,932,391. This is the same as Staff's original recommendation contained in its Direct Testimony.

Q. What is the revenue increase and cost of equity under Alternative B?

A. Alternative B proposes an overall revenue increase of $52,607,414, a return on common equity of 9.50 percent, and a FVROR of 6.92 percent on FVRB of $1,452,932,391. As can be seen, these values are all less than Staff's original recommendation.

Q. Mr. Olea, please explain Staff's rationale for being a signatory to the Agreement which contains a different recommendation with regard to decoupling than the recommendation offered by Staff in its Direct Testimony.

A. As noted above, the Agreement contains two options for the Commission consideration – with Alternative A basically being Staff's and RUCO's positions combined and Alternative B being the Company's full revenue decoupling proposal.

Let me speak to Alternative A first. Alternative A is basically the adoption of all Staff's recommendations, not just revenue decoupling, with the addition of a weather component that would offer some protection from high bills during extreme cold-weather events. Therefore, it was rather easy for Staff to agree to Alternative A.

Alternative B is somewhat of a deviation from Staff's Direct Testimony. I say 'somewhat', because in its Direct Testimony, Staff stated that it could not support the full revenue decoupling mechanism as proposed by the Company, without some rate payer protections and benefits. Staff believes that the Alternative B as proposed in the Agreement contains the ratepayer protections and benefits that were implicitly required by Staff in its Direct Testimony. Those protections/benefits include:

- The Company may not file a new rate increase application with rates that take effect prior to May 1, 2017.

- The Return on Equity is 25 basis points less (9.5% instead of 9.75%) than recommended by Staff in its Direct Testimony, resulting in a revenue increase that is $2,319,687 less than Staff's original recommendation.

- The cap on the decoupling mechanism surcharge is five percent (5%) of the non-gas base revenues, which is actually less than five percent of the total bill, since a customer's bill consists of both gas and non-gas components.

- There is no cap on any surcredit (refund) to customers resulting from the decoupling mechanism.

- Southwest is required to file quarterly reports and an annual report that will be reviewed at an Open Meeting by the Commissioners each year. At this Open Meeting, if the Commissioners determine that the decoupling mechanism is not working as intended, the Commission can begin a proceeding to modify or eliminate the decoupling mechanism.

- As a result of this decoupling mechanism, Southwest will be subject to an annual earnings test to ensure that it does not earn more than its authorized rate of return and that a decoupling surcharge will not be implemented, regardless of how successful Southwest is in achieving the energy efficiency targets, if the earnings test indicates that Southwest is earning its authorized rate of return.

- A customer outreach and education program regarding decoupling.

Q. Is there anything else you would like to add regarding the Agreement?

A. Yes. First, I would like to point out that with most settlement agreements I have seen come before the Commission, the agreements have recommended a revenue increase that is somewhere between Staff's original proposal and the utility's. In this case, the Agreement has a revenue increase that is equal to or less than that originally proposed by Staff.

Second, based on all the above, Staff believes that the Agreement as proposed is fair, balanced, and in the public interest. Therefore, Staff recommends that the Agreement be approved by the Commission as proposed with the adoption of either decoupling mechanism Alternative A or B.

Q. Does this conclude your testimony?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

DIRECT TESTIMONY

IN SUPPORT OF

THE SETTLEMENT AGREEMENT

RALPH C. SMITH

ON BEHALF OF THE

UTILITIES DIVISION STAFF

ARIZONA CORPORATION COMMISSION

JULY 29, 2011

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EXECUTIVE SUMMARY
SOUTHWEST GAS CORPORATION
DOCKET NO. G-01551A-10-0458

My testimony in support of the settlement addresses the earnings test that would be applied under Alternative B for decoupling.

SECTION I – INTRODUCTION

Q. Please state your name and business address.

A. Ralph C. Smith, Larkin & Associates PLLC, 15728 Farmington Road, Livonia, MI 48154.

Q. Are you the same Ralph C. Smith who has filed Direct Testimony in this proceeding?

A. Yes.

Q. What is the purpose of your testimony in this case in support of the Settlement Agreement?

A. The purpose of my testimony is to support the Proposed Settlement Agreement ("Agreement") by discussing the earnings test that would apply under the Alternative B decoupling scenario.

Q. Did you participate in discussions that led to the execution of the Agreement?

A. Yes, I did.

Q. How is your testimony being presented?

A. My testimony is organized into two sections. Section I is this introduction. Section II provides a discussion of the earnings test for decoupling Alternative B.

SECTION II – EARNINGS TEST UNDER DECOUPLING ALTERNATIVE B

Q. What is an earnings test?

A. An earnings test is a review of a utility's accounting information, typically with required ratemaking adjustments, to examine or "test" how the utility's earnings compare with its authorized rate of return.

Q. Please discuss the earnings test that would apply under Decoupling Alternative B.

A. As described by Staff witness Olea, the Agreement provides for an Alternative B decoupling proposal, which includes an annual earnings test. Southwest Gas Corporation ("Southwest") will be subject to an annual earnings test to ensure that it does not earn more than its authorized rate of return, and a decoupling surcharge will not be implemented, regardless of how successful Southwest is in achieving the energy efficiency targets, if the earnings test indicates that Southwest is earning its authorized rate of return. Southwest shall include in its annual report, commencing April 30, 2013, the results of its annual earnings test in a format consistent with the report attached as Exhibit A to the Agreement.

Q. How would the earnings test operate?

A. The fair value rate base ("FVRB") and fair value rate of return ("FVROR") would be held at the same levels as Staff's filed Direct Testimony. Southwest's earnings would be tested by reviewing recorded operating income statement information, adjusted for ratemaking adjustments.

Q. Please describe the specific data points and ratemaking adjustments that will be made.

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

- The annual reporting period shall consist of the twelve months ended December 31;
- Fair value rate base shall be held constant at $1,452,933,391;

- Fair value rate of return shall be 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).

The earnings test will use:

- Experienced non-gas revenue for the reporting period; and
- 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;
- 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 Research and Development Expenses shall be excluded;
- C-11, fifty percent (50%) of all Directors' and Officers' Liability Insurance expense shall be excluded; and

- C-13, leased aircraft expense shall be limited to the lesser of (1) the actual recorded amount or (2) an allowance of $472,000.

Q. How will the other issues addressed in Staff's adjustments be handled in the earnings test calculations?

A. 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 Adjustment 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 FVRB and FVROR will be held constant.

Finally, any surcharge revenues and expenses will not be included in the earnings test.

Q. Does this conclude your testimony in support of the settlement?

A. Yes.

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 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

DIRECT TESTIMONY

SUPPORTING THE SETTLEMENT AGREEMENT

OF

BARBARA KEENE

PUBLIC UTILITIES ANALYST MANAGER

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

JULY 29, 2011

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APPENDICES

EXECUTIVE SUMMARY
SOUTHWEST GAS CORPORATION
DOCKET NO. G-01551A-10-0458

This testimony addresses the provisions of the Settlement Agreement regarding Energy Efficiency and Renewable Energy Resource Technology.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Barbara Keene. My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. By whom are you employed and in what capacity?

A. I am employed by the Utilities Division ("Staff") of the Arizona Corporation Commission as a Public Utilities Analyst Manager. My duties include supervising the energy portion of the Telecommunications and Energy Section. A copy of my résumé is provided in Appendix 1.

Q. As part of your employment responsibilities, were you assigned to review matters contained in Docket No. E-01345A-10-0458?

A. Yes.

Q. What is the subject matter of this testimony?

A. This testimony will provide support for the Settlement Agreement ("Agreement") filed on July 15, 2011, by addressing Section V.C. of the Agreement regarding Energy Efficiency and Renewable Energy Resource Technology.

ENERGY EFFICIENCY AND RENEWABLE ENERGY RESOURCE TECHNOLOGY

Q. What does the Agreement address regarding Energy Efficiency and Renewable Energy Resource Technology?

A. Section V.C. of the Agreement describes how Southwest Gas Corporation ("Southwest") intends to meet the Commission's energy efficiency goals, as established in the Gas Utility Energy Efficiency Standards (A.A.C. R14-2-2501 through 2520 *et seq.*).

Q. Please describe the energy efficiency goals contained in R14-2-2504.

A. R14-2-2504 requires Southwest to achieve cumulative annual energy savings, expressed as therms or therm equivalents, equal to at least six (6) percent of Southwest's retail gas energy sales for calendar year 2019. The goals are shown in Table 1.

Table 1
Energy Efficiency Standard

Year	Cumulative Annual Energy Savings as % of Retail Energy Sales in Prior Calendar Year
2011	0.50%
2012	1.20%
2013	1.80%
2014	2.40%
2015	3.00%
2016	3.60%
2017	4.20%
2018	4.80%
2019	5.40%
2020	6.00%

Q. How can Southwest meet these energy savings requirements?

A. At least 75 percent of the therms or therm equivalents must be saved through energy efficiency ("EE") programs. The remaining therms or therm equivalents may be saved through combined heat and power ("CHP") programs, renewable energy resource technology ("RET") programs, and through building codes and appliances standards.

Q. What is EE?

A. EE is the production or delivery of an equivalent level and quality of end-use gas service using less energy, or the conservation of energy by end-use customers.

Q. What is CHP?

A. CHP uses a primary energy source to simultaneously produce electrical energy and useful process heat. CHP would be used to displace space heating, water heating, or another load.

Q. What is RET?

A. A RET is an application utilizing an energy resource that is replaced rapidly by a natural, ongoing process and that displaces conventional energy resources otherwise used to provide energy.

Q. Was Southwest required to file an implementation plan, describing how Southwest plans to meet the EE standards?

A. Yes. R14-2-2505 requires an Implementation Plan to be filed at least in every odd year.

Q. Did Southwest file an Implementation Plan pursuant to R14-2-2505?

A. Yes. Southwest included an Arizona Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation Plan ("EE & RET Plan") as part of its rate case application.

Q. Did Staff have concerns with the EE and RET Plan that Southwest filed with the rate case application?

A. Yes. As discussed in the Direct Testimony of Staff witness Julie McNeely-Kirwan, Southwest had performed its cost-effectiveness analyses at the program level rather than the measure level. However, Staff believes the cost-effectiveness analyses should be performed at the measure level, which would be consistent with the methodology used by

Staff in previous recommendations and is consistent with the intent of the Gas Energy Efficiency Rules.

Q. Does the Agreement provide for modifications to Southwest's EE and RET Plan?

A. Yes. Under the Agreement, Southwest agrees to modify the EE and RET Plan by providing supplemental information to Staff for EE measures that are cost-effective at the measure level. With the addition of cost-effective measures, Southwest expects to save at least 1,250,000 therms from existing and new Commission-approved measures within nine months of Commission approval of the modified EE and RET Plan.

Q. Has Southwest provided the supplemental information to Staff?

A. Yes.

Q. How will the supplemental information be processed?

A. Staff is currently reviewing the supplemental information provided by Southwest Gas. This information will be utilized in conducting Staff's cost-benefit analyses of various energy efficiency measures. Once this review is completed, Staff will file a memo and proposed order prior to the Open Meeting where the Commission intends to vote on the Recommended Opinion and Order regarding the Agreement. Staff will strive to include recommendations regarding as many measures as possible in its memo and proposed order. The Settlement states that the Signatories urge the Commission to vote on Staff's proposed Order on the same date that the Commission votes on the Agreement.

Q. With the EE and RET Plan modified by the supplemental information discussed above, do the Signatories to the Agreement believe that Southwest will be able to meet the 2011 energy savings goal required by R14-2-2504?

A. Southwest may not be able to meet the 2011 energy savings goal with only the EE and RET Plan modified with the supplemental information discussed above.

Q. Does the Agreement provide Southwest with a means to increase the opportunity for energy savings so that it is more likely to meet the energy savings goals for 2011 and beyond?

A. Yes. Within 60 days of filing the Agreement Southwest will file, in a new docket, a new and revised EE and RET Implementation Plan. This new EE and RET Implementation Plan will be incremental to the EE and RET Plan modified with the supplemental information discussed above. Southwest intends to meet the 2011 energy savings goal within 12 months of Commission approval of the new EE and RET Implementation Plan. For all subsequent years, Southwest will file its implementation plans consistent with R14-2-2505. This rule requires the plans to be filed on June 1 of each odd year or annually at the election of each utility. Southwest has committed to work with Staff and Southwest Energy Efficiency Project ("SWEEP") to avoid the need to file a request for a waiver during any plan year from 2011-2015 in lieu of submitting a plan designed to achieve the energy savings goals.

Q. Does this conclude your Direct Testimony?

A. Yes, it does.

RESUME

BARBARA KEENE

Education

B.S.	Political Science, Arizona State University (1976)
M.P.A.	Public Administration, Arizona State University (1982)
A.A.	Economics, Glendale Community College (1993)

Additional Training

Management Development Program - State of Arizona, 1986-1987
UPLAN Training - LCG Consulting, 1989, 1990, 1991
Various seminars, workshops, and conferences on ratemaking, energy efficiency, rate design, computer skills, labor market information, training trainers, and Census products

Employment History

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst Manager (May 2005-present). Supervise the energy portion of the Telecommunications and Energy Section. Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters.

Arizona Corporation Commission, Utilities Division, Phoenix, Arizona: Public Utilities Analyst V (October 2001-May 2005), Senior Economist (July 1990-October 2001), Economist II (December 1989-July 1990), Economist I (August 1989-December 1989). Conduct economic and policy analyses of public utilities. Coordinate working groups of stakeholders on various issues. Prepare Staff recommendations and present testimony on electric resource planning, rate design, special contracts, energy efficiency programs, and other matters. Responsible for maintaining and operating UPLAN, a computer model of electricity supply and production costs.

Arizona Department of Economic Security, Research Administration, Economic Analysis Unit: Labor Market Information Supervisor (September 1985-August 1989), Research and Statistical Analyst (September 1984-September 1985), Administrative Assistant (September 1983-September 1984). Supervised professional staff engaged in economic research and analysis. Responsible for occupational employment forecasts, wage surveys, economic development studies, and over 50 publications. Edited the monthly **Arizona Labor Market Information Newsletter**, which was distributed to about 4,000 companies and individuals.

Testimony

Resource Planning for Electric Utilities (Docket No. U-0000-90-088), Arizona Corporation Commission, 1990; testimony on production costs and system reliability.

Trico Electric Cooperative Rate Case (Docket No. U-1461-91-254), Arizona Corporation Commission, 1992; testimony on demand-side management and time-of-use and interruptible power rates.

Navopache Electric Cooperative Rate Case (Docket No. U-1787-91-280), Arizona Corporation Commission, 1992; testimony on demand-side management and economic development rates.

Arizona Electric Power Cooperative Rate Case (Docket No. U-1773-92-214), Arizona Corporation Commission, 1993; testimony on demand-side management, interruptible power, and rate design.

Tucson Electric Power Company Rate Case (Docket Nos. U-1933-93-006 and U-1933-93-066) Arizona Corporation Commission, 1993; testimony on demand-side management and a cogeneration agreement.

Resource Planning for Electric Utilities (Docket No. U-0000-93-052), Arizona Corporation Commission, 1993; testimony on production costs, system reliability, and demand-side management.

Duncan Valley Electric Cooperative Rate Case (Docket No. E-01703A-98-0431), Arizona Corporation Commission, 1999; testimony on demand-side management and renewable energy.

Tucson Electric Power Company vs. Cyprus Sierrita Corporation, Inc. (Docket No. E-0000I-99-0243), Arizona Corporation Commission, 1999; testimony on analysis of special contracts.

Arizona Public Service Company's Request for Variance (Docket No. E-01345A-01-0822), Arizona Corporation Commission, 2002; testimony on competitive bidding.

Generic Proceeding Concerning Electric Restructuring Issues (Docket No. E-00000A-02-0051), Arizona Corporation Commission, 2002; testimony on affiliate relationships and codes of conduct.

Tucson Electric Power Company's Application for Approval of New Partial Requirements Service Tariffs, Modification of Existing Partial Requirements Service Tariff 101, and Elimination of Qualifying Facility Tariffs (Docket No. E-01933A-02-0345) and Application for Approval of its Stranded Cost Recovery (Docket No. E-01933A-98-0471), Arizona Corporation Commission, 2002, testimony on proposals to eliminate, modify, or introduce tariffs and testimony on the modification of the Market Generation Credit.

Arizona Public Service Company's Application for Approval of Adjustment Mechanisms (Docket No. E-01345A-02-0403), Arizona Corporation Commission, 2003, testimony on the proposed Power Supply Adjustment and the proposed Competition Rules Compliance Charge.

Generic Proceeding Concerning Electric Restructuring Issues, et al (Docket No. E-00000A-02-0051, et al), Arizona Corporation Commission, 2003-2005; Staff Report and testimony on Code of Conduct.

Arizona Public Service Company Rate Case (Docket No. E-01345A-03-0437), Arizona Corporation Commission, 2004; testimony on demand-side management, system benefits, renewable energy, the Returning Customer Direct Assignment Charge, and service schedules.

Arizona Electric Power Cooperative Rate Case (Docket No. E-01773A-04-0528), Arizona Corporation Commission, 2005; testimony on a fuel and purchased power cost adjustor, demand-side management, and rate design.

Trico Electric Cooperative Rate Case (Docket No. E-01461A-04-0607), Arizona Corporation Commission, 2005; testimony on the Environmental Portfolio Standard; demand-side management; special charges; and Rules, Regulations, and Line Extension Policies.

Arizona Public Service Company (Docket Nos. E-01345A-03-0437 and E-01345A-05-0526), Arizona Corporation Commission, 2005; testimony on the Plan of Administration of the Power Supply Adjustor.

Arizona Public Service Company Emergency Rate Case (Docket No. E-01345A-06-0009), Arizona Corporation Commission, 2006; testimony on bill impacts.

Arizona Public Service Company Rate Case (Docket Nos. E-01345A-05-0816, E-01345A-05-0826, and E-01345A-05-0827), Arizona Corporation Commission, 2006; testimony on funding for renewable resources, net metering, green pricing tariffs, and a Power Supply Adjustor surcharge.

Tucson Electric Power Company Filing to Amend Decision No. 62103 (Docket No. E-01933A-05-0650), Arizona Corporation Commission, 2007, testimony on demand-side management, time-of-use, direct load control, and renewable energy.

Consideration, Pursuant to A.R.S. § 40-252 to Modify Decision No. 67744 Relating to the Self-Build Option (Docket No. E-01345A-07-0420), Arizona Corporation Commission, 2008, testimony on the self-build option for Arizona Public Service Company.

Sempra Energy Solutions Application for Certificate of Convenience and Necessity (Docket No. E-03964A-06-0168), Arizona Corporation Commission, 2008, testimony on the overall fitness of Sempra Energy Solutions to provide competitive retail electric service in Arizona.

Tucson Electric Power Company rate case (Docket No. E-01933A-07-0402), Arizona Corporation Commission, 2008, testimony in support of the Settlement Agreement regarding renewable energy, demand-side management, Rules and Regulations, partial requirements service tariffs, interruptible tariff, demand response, and bill estimation.

Arizona Public Service Company rate case (Docket No. E-01345A-08-0172), Arizona Corporation Commission, 2009, testimony in support of the Settlement Agreement regarding

Power Supply Adjustment Plan of Administration, treatment of Schedule 3, withdrawal of APS' Impact Fee proposal, withdrawal of APS' System Facilities Charge proposal, revisions to Schedule 3, demand-side management, and renewable energy.

Publications

Author of the following articles published in the *Arizona Labor Market Information Newsletter*:

"1982 Mining Employees - Where are They Now?" - September 1984
"The Cost of Hiring" and "Arizona's Growing Industries" - January 1985
"Union Membership - Declining or Shifting?" - December 1985
"Growing Industries in Arizona" - April 1986
"Women's Work?" - July 1986
"1987 SIC Revision" - December 1986
"Growing and Declining Industries" - June 1987
"1986 DOT Supplement" and "Consumer Expenditure Survey" - July 1987
"The Consumer Price Index: Changing With the Times" - August 1987
"Average Annual Pay" - November 1987
"Annual Pay in Metropolitan Areas" - January 1988
"The Growing Temporary Help Industry" - February 1988
"Update on the Consumer Expenditure Survey" - April 1988
"Employee Leasing" - August 1988
"Metropolitan Counties Benefit from State's Growing Industries" - November 1988
"Arizona Network Gives Small Firms Helping Hand" - June 1989

Major contributor to the following books published by the Arizona Department of Economic Security:

Annual Planning Information - editions from 1984 to 1989
Hispanics in Transition - 1987

(with David Berry) "Contracting for Power," *Business Economics*, October 1995.

(with Robert Gray) "Customer Selection Issues," *NRRI Quarterly Bulletin*, Spring 1998.

Reports

(with Task Force) *Report of the Task Force on the Feasibility of Implementing Sliding Scale Hookup Fees*. Arizona Corporation Commission, 1992.

Customer Repayment of Utility DSM Costs, Arizona Corporation Commission, 1995.

(with Working Group) *Report of the Participants in Workshops on Customer Selection Issues*," Arizona Corporation Commission, 1997.

"DSM Workshop Progress Report," Arizona Corporation Commission, 2004.

(with Erin Casper) "Staff Report on Demand Side Management Policy," Arizona Corporation Commission, 2005.

"Staff Report on Interconnection for the Generic Investigation of Distributed Generation," Arizona Corporation Commission, 2007.