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July 28, 2011

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

Subject: Docket No. G-01551A-10-0458
Southwest Gas Corporation - General Rate Case
Testimony in Support of Proposed Settlement Agreement

Southwest Gas Corporation hereby submits an original and 13 copies of the Prepared Direct Testimony of John P. Hester in Support of the Proposed Settlement Agreement filed with the Arizona Corporation Commission on July 15, 2011, in the above-referenced proceeding,

Should you have any questions, please do not hesitate to contact me at (702) 876-7163.

Respectfully submitted,

Debra S. Gallo by amz

Debra S. Gallo, Director
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IN THE MATTER OF
SOUTHWEST GAS CORPORATION
Docket No. G-01551A-10-0458

PREPARED DIRECT TESTIMONY
IN SUPPORT OF THE PROPOSED SETTLEMENT AGREEMENT
OF
JOHN P. HESTER

ON BEHALF OF
SOUTHWEST GAS CORPORATION

July 29, 2011

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BEFORE THE ARIZONA CORPORATION COMMISSION

Prepared Direct Testimony
in Support of the Proposed Settlement Agreement
of
John P. Hester

I. INTRODUCTION

Q. 1 Please state your name and business address.

A. 1 My name is John P. Hester. My business address is 5241 Spring Mountain Road, Las Vegas, Nevada 89150.

Q. 2 By whom and in what capacity are you employed?

A. 2 I am employed by Southwest Gas Corporation (Southwest Gas or the Company) as Senior Vice President/Regulatory Affairs and Energy Resources.

Q. 3 Please summarize your educational background and relevant business experience.

A. 3 My educational background and relevant business experience are summarized in Appendix A to this testimony.

Q. 4 Have you previously testified before any regulatory commission?

A. 4 Yes. I have previously testified before the Arizona Corporation Commission (Commission), the Public Utilities Commission of Nevada, the California Public Utilities Commission, and the Illinois Commerce Commission.

Q. 5 What is the purpose of your prepared direct testimony in this proceeding?

A. 5 I am sponsoring testimony in support of the proposed settlement agreement filed with the Commission July 15, 2011 (Settlement Agreement). The Settlement Agreement resolves all issues arising from the Company's November 12, 2010 general rate case application (Application) and was entered into by and among Southwest Gas, the Arizona Corporation Commission's Utilities Division Staff

(Staff), the Arizona Investment Council (AIC), the Southwest Energy Efficiency Project (SWEEP), the Natural Resources Defense Council (NRDC), and Cynthia Zwick (collectively, the Settlement Parties).

Q. 6 Please summarize your prepared direct testimony.

A. 6 My prepared direct testimony consists of the following key areas:

- An overview and summary of the settlement process and negotiations.
- An overview of Alternative A and Alternative B.
- An explanation of the various enhancements to low income programs.
- An overview of the agreed upon cost of capital and rate base amounts.
- An explanation of treatment of the Company's proposed Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation Plan (EE and RET Plan).
- An explanation of the customer-owned yard line (COYL) replacement program.
- A summary of the agreed upon rate design and revenue allocation.
- An explanation of other miscellaneous settlement terms and tariff changes.

II. THE SETTLEMENT PROCESS AND NEGOTIATIONS

Q. 7 Did you participate in the settlement negotiations?

A. 7 Yes. In addition to Southwest Gas, the other settlement participants included Staff, the Residential Utility Consumer Office (RUCO); Tucson Electric Power Company (TEP), Cynthia Zwick, AIC, SWEEP, and the NRDC (collectively referred to as the Parties to this Docket). All Parties to this Docket chose to become signatories to the Settlement Agreement, with the exception of RUCO and TEP.

Q. 8 Please provide a brief summary of the chronology of events leading up to the settlement negotiations.

A. 8 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 EE and RET Plan and corresponding budget; (iv) its proposed COYL pilot program, inclusive of 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.

RUCO, TEP, Cynthia Zwick, AIC, SWEEP, and NRDC requested to intervene and each of their requests was granted. Staff, RUCO, and Cynthia Zwick filed direct testimony June 10, 2011. Staff, RUCO, NRDC, and SWEEP filed direct rate design testimony June 24, 2011. Southwest Gas filed a Notice of Settlement Discussions on June 21, 2011. The Parties to this Docket subsequently held settlement discussions beginning June 28, 2011 and continuing through July 14, 2011.

Q. 9 How was the settlement process conducted?

A. 9 All Parties to this Docket were notified of settlement meetings. Each settlement meeting was available telephonically through a dial-in number if interested parties were unable to attend in person. To the extent practicable, accommodations were made in the scheduling for those parties who expressed meeting conflicts and indicated a desire for such accommodation. The negotiations were inclusive of all interested Parties to this Docket – even those who indicated they would likely not be signatories to the Settlement Agreement. The provisions of the Settlement Agreement reflect the input of all the Parties to this Docket, resulting in a thorough analysis, discussion and resolution of issues. Settlement negotiation participants were provided with either electronic or hard copies of all documents presented during discussions. To encourage openness and transparency, the parties agreed that the content of settlement discussions would be confidential, as they generally are in civil litigation under Arizona's Rules of Civil Procedure and Evidence.

Q. 10 Please summarize your perspective of the settlement negotiations and the resulting Settlement Agreement.

A. 10 The settlement discussions were open, transparent, and inclusive of all Parties to this Docket. As is the nature of all settlement negotiations and resulting compromises, no one party received everything they wanted and instead the Settlement Parties agreed upon a compromise that when viewed as a complete package was in the best interest of each and every party. Southwest Gas believes the Settlement Agreement results in a balanced and complete package that addresses its need for a rate increase with the continuation of safe and reliable service to customers at just and reasonable rates and charges. In addition, Southwest Gas believes the Settlement Agreement results in several specific customer benefits that would not otherwise have been accomplished through a litigated proceeding.

Southwest Gas commends all the Parties to this Docket, especially the Settlement Parties, for their willingness to come together and reach solutions that are fair, just and reasonable, and that are in the public interest.

III. REVENUE DECOUPLING - ALTERNATIVE A AND ALTERNATIVE B

Q. 11 Please explain the Settlement Agreement's resolution of the Company's revenue decoupling proposal.

A. 11 The Settlement Parties agreed that revenue decoupling should be implemented, but wanted to provide the Commission an opportunity to select the decoupling methodology it prefers. Therefore, the Settlement Agreement includes two alternatives – Alternative A and Alternative B. However, in addition to each specific decoupling methodology, the Settlement Parties carefully crafted other key terms and conditions to accompany the selection of each alternative. Accordingly, the Settlement Parties respectfully request the Commission select one Alternative in its entirety as part of this Settlement Agreement.

Q. 12 Please briefly explain Alternative A.

A. 12 Alternative A consists of a partial revenue decoupling methodology, an overall revenue increase of $54.9 million, a return on common equity capital of 9.75 percent, and a FVROR of 7.02 percent of fair value rate base (FVRB).

Q. 13 Please explain the proposed partial revenue decoupling methodology.

A. 13 Should the Commission select Alternative A, the Company will implement a partial revenue decoupling methodology consisting of two components - a Lost Fixed Cost Recovery (LFCR) component and a weather component. The partial revenue decoupling methodology permits Southwest Gas to recover lost base revenues attributable to achievement of the Commission's required annual energy savings targets and to adjust customer bills each month during the winter season when actual weather during the billing cycle differs from the average weather used in the calculation of rates. 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 adjusted to reflect actual lost base revenue due to energy efficiency during an annual reconciliation process each April. For instance, if the Commission selects Alternative A, the initial LFCR surcharge will be set at $0.00213 per therm, beginning when rates under this Settlement Agreement become effective. This surcharge amount is based on the Commission's 2011 energy efficiency savings targets and the anticipated lost base revenue associated with achieving those targets.

Q. 14 What if the Company does not achieve the Commission's required annual energy savings target for that year, or exceeds the required annual energy savings target?

A. 14 If the Company does not meet 100 percent of the Commission's required annual energy savings target, the difference between the 100 percent it was allowed to collect and the actual lost revenue will be refunded to customers during the next annual reconciliation process. If the Company exceeds its energy efficiency goals in any reconciliation period, the Company will be permitted to recover 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.

Q. 15 Please explain the weather component.

A. 15 The weather-related component will be incorporated through a monthly true-up to winter bills (November through April). 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' bills. 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.

Q. 16 What other terms and conditions did the Settlement Parties agree upon for Alternative A?

A. 16 The Settlement Parties crafted and negotiated several special terms and conditions unique to the Commission's selection of Alternative A. Some of the key provisions include the following:

- **Reporting Requirement.** Southwest Gas shall make an annual filing, 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.
- **Communication Plan.** Southwest Gas is required to submit to Staff a proposed customer outreach/education plan outlining how the Company intends to explain the Alternative A decoupling methodology to customers.

Q. 17 Please briefly explain Alternative B.

A. 17 Alternative B consists of a full revenue decoupling methodology, an overall revenue increase of $52.6 million, a return on common equity capital of 9.50 percent and a FVROR of 6.92 percent on FVRB.

Q. 18 Please explain the proposed full revenue decoupling methodology.

A. 18 Should the Commission select Alternative B, the Company will implement a full revenue decoupling methodology 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. Similar to Alternative A, this methodology also includes a monthly weather component during the winter months and an annual non-weather component.

Q. 19 Please explain the weather component.

A. 19 The weather-related component is identical to the weather-related component in Alternative A – a monthly true-up to winter bills reflecting differences between actual weather during the billing cycle and average weather used in the calculation of rates. Accordingly, 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.

Q. 20 Please explain the annual true-up component.

A. 20 The annual true-up will reconcile any differences between the non-gas revenues authorized by the Commission and the actual non-gas revenues experienced by Southwest Gas. Accordingly, each year the Company will multiply the total number of customers billed for service during each month by the Commission-authorized monthly revenue per customer, and then it will compare that to the actual billed non-gas revenue for the month and account for any differences, both positive and negative, in a deferral account. 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 for the affected rate schedules. The resulting rate will remain in effect for a 12-month period to refund or collect the deferred account balance.

Q. 21 What other terms and conditions are included with Alternative B?

A. 21 Similar to Alternative A, the Settlement Parties crafted and negotiated several special terms and conditions unique to the Commission's selection of Alternative B.

- **Reporting Requirement**. Southwest Gas shall file quarterly and annual reports to permit the Commission an opportunity to review the performance of the decoupling mechanism. The quarterly reports will be filed each April, July, October and January, with the first quarterly report being filed no later than April 30, 2012. The annual reporting requirement will consist of both a review of the performance of the full revenue decoupling mechanism, and also an annual earnings test.
- **Earnings Test**. To the extent that recovery would increase earnings such that the Company would be earning more than its authorized return on equity (ROE), the Company will be prohibited from recovering any decoupling deferral amounts in excess of its authorized ROE. The Company's annual reporting requirement shall commence April 2013 and shall be the subject of an Open Meeting for the Commissioners to deliberate the performance of the full revenue decoupling mechanism.
- **Cap on Upward Adjustments**. An additional customer protection is that any upward adjustments in rates resulting from the full revenue decoupling mechanism will be capped each year. Accordingly, each year any increase in non-gas revenue that is to be collected through the annual adjustment component of the decoupling mechanism that is greater than 5 percent of the authorized (or test-year) non-gas base revenue per customer will be capped at 5 percent. Any amounts that are unrecovered due to the cap will be carried forward to future years for recovery. There will be no cap on annual surcharge decreases.

- **Rate Case Moratorium.** The Settlement Parties also negotiated a general rate case moratorium to accompany Alternative B. With the selection of Alternative B, Southwest Gas shall be prohibited from filing a general rate case application prior to April 30, 2016 with a test year no earlier than November 30, 2015 as long as the Commission does not suspend, terminate, or materially modify the decoupling mechanism between rate cases.
- **Communication Plan.** Similar to Alternative A, Southwest Gas will also submit a proposed customer outreach/education plan to Staff outlining how the Company intends to explain decoupling to customers.

Q. 22 Does Southwest Gas prefer Alternative A or Alternative B?

A. 22 As part of the negotiations, Southwest Gas agreed to support the inclusion of both Alternative A and Alternative B in their entirety as part of this Settlement Agreement. However, Southwest Gas strongly supports Alternative B as the Company believes it is a superior decoupling methodology and is more consistent with the Commission's recently approved Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decouple Rate Structures. In addition, Southwest Gas believes Alternative B provides an increased number of customer protections that are inherent to full revenue decoupling, as opposed to partial revenue decoupling.

Q. 23 Please explain why Southwest Gas believes Alternative B is a superior methodology.

A. 23 First and foremost, unlike Alternative A, Alternative B is consistent with the Commission's recently signed policy statement that resulted from numerous workshops and analysis regarding utility disincentives and revenue decoupling. As noted in the Policy Statement and at the workshops and hearings leading to its approval, full revenue decoupling is the preferred methodology. Some of the reasons why it is the preferred methodology include:

- Prevents utility profit from increased sales.

- Ensures customers pay no more than Commission-authorized costs.
- Enhances utility focus on cost control.
- Protects customers from high winter bills following an extreme weather event.
- Does not result in additional complex contested proceedings.
- Decreases frequency of general rate cases.
- Commission approval is growing nationwide.
- Allows both upward and downward rate adjustments.
- Addresses long-term chronic decline in gas utility customer usage.
- Retains immediate permanent customer savings on commodity costs.

Q. 24 Please explain why Southwest Gas believes the Commission's selection of either Alternative A or Alternative B results in rates, charges, and conditions of service that are just and reasonable and in the public interest.

A. 24 While each alternative contains specifically negotiated special terms and conditions unique to each alternative, the following table provides a comparison of the various revenue requirement increases and ROE proposals compared with those contained in the Settlement Agreement and with the selection of either Alternative A or Alternative B.

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

As reflected in the table above, irrespective of the Commission's selection of Alternative A or Alternative B, the result falls within the range or even below the range of the Settlement Parties' recommended revenue increase and ROE.

IV. LOW INCOME PROGRAMS

Q. 25 Please describe how the Settlement Agreement will affect Southwest Gas' low-income customers.

A. 25 The Settlement Agreement mitigates the bill impact on low income customers by increasing the Low-Income Rate Assistance (LIRA) discount to 30 percent from the current 20 percent for the first 150 therms in the winter months (November through April). Depending upon the alternative selected by the Commission, low-income customers will experience an average monthly bill increase of either $0.70 (Alternative A) or $0.59 (Alternative B). As stated earlier, Southwest Gas prefers Alternative B, which also happens to be the better result for low-income customers in term of bill impact. The Settlement Parties also agreed to hold the low income rate schedules harmless from any rate increase associated with the COYL program and the COYL cost recovery mechanism and any increases in the demand side management adjustor mechanism. In addition to these bill impact mitigation provisions, the Settlement Parties agreed to other enhancements related to the Company's LIEC program.

Q. 26 Please explain the enhancements to the LIEC program.

A. 26 Southwest Gas has agreed to increase the funding level for the weatherization component of the LIEC program by committing to make non-ratepayer funded contributions to the program each year for the next 5 years. This commitment results in a total contribution over the 5-year period of at least $1 million. In addition, the Settlement Parties have agreed to meet within 45 days of the effective date of an order approving the Settlement Agreement to develop a plan to enhance customer education and outreach for its LIEC weatherization program.

Q. 27 Why does Southwest Gas believe the result of the Settlement Agreement benefits low-income customers?

A. 27 Absent the parties entering into the Settlement Agreement, it is highly unlikely the commitments that have been made by the Settlement Parties would have made their way into a Commission decision following a litigated proceeding. Most, if not all, of the commitments that have been negotiated by the Settlement Parties were outside the scope of the Settlement Parties' filed positions and would not normally be addressed during a traditional litigated proceeding. Instead, they are the result of concessions and commitments that arise outside the normal ratemaking process and typically only appear in negotiated settlements.

V. COST OF CAPITAL AND RATE BASE

Q. 28 Please explain the Settlement Parties' agreement regarding the Company's cost of capital.

A. 28 The Settlement Agreement results in a capital structure utilizing the Company's actual test period capital structure and cost of debt, consisting of 47.70 percent long-term debt and 52.30 percent common equity, and an embedded cost of long-term debt of 8.34 percent. The Settlement Parties further negotiated an ROE for each alternative – 9.75 percent if the Commission selects Alternative A or 9.50 percent if the Commission selects Alternative B.

Q. 29 How does the Settlement Parties' agreement on these cost of capital components compare to the Settlement Parties' filed positions?

A. 29 As noted in the table below, the agreed upon capital structure, embedded cost of long term debt and ROE are reasonable in relation to the Settlement Parties' recommendations in their direct testimony.

	Proposed Capital Structure (Debt/Equity)	Proposed Cost of Debt	Proposed ROE
Company Direct	47.70/52.30	8.34	11.00%
Staff Direct	47.70/52.30	8.34	9.75%
Settlement - Alternative A	47.70/52.30	8.34	9.75%
Settlement - Alternative B	47.70/52.30	8.34	9.50%

Also, when compared to the average authorized amounts for gas utilities as reported by the American Gas Association (AGA)[1], the reasonableness of the Settlement Parties' agreed upon capital structure and ROE is confirmed.

	Proposed Capital Structure (Equity Component)	Proposed ROE
AGA Average Authorized 2011	52.82%	10.12%
Settlement - Alternative A	52.30%	9.75%
Settlement - Alternative B	52.30%	9.50%

Q. 30 What were the various rate base amounts agreed upon by the Settlement Parties?

A. 30 For the test year ending June 30, 2010, the Settlement Parties agreed upon the following: (i) an original cost rate base (OCRB) of $1,070,115,558; (ii) a reconstruction cost new depreciated (RCND) rate base of $1,835,749,225; and (iii) a fair value of Southwest Gas' jurisdictional rate base of $1,452,932,391.

[1] American Gas Association Rate Case Database.

Q. 31 How do the various rate base amounts agreed upon by the Settlement Parties compare to the rate base amounts included in the Settlement Parties' filed testimony?

A. 31 The Settlement Parties have agreed upon OCRB, RCND, and FVRB amounts that were supported and recommend by Staff in its prepared direct testimony. A comparison of the various rate base amounts are set forth in the table below.

	Proposed OCRB	**Proposed RCND**	**Proposed FVRB**
Company	$1,073,700,633	$1,839,334,300	$1,456,517,468
Staff	$1,070,115,558	$1,835,749,225	$1,452,932,391
Settlement Agreement	$1,070,115,558	$1,835,749,225	$1,452,932,391

VI. ENERGY EFFICIENCY AND RENEWABLE ENERGY RESOURCE TECHNOLOGY PORTFOLIO IMPLEMENTATION PLAN

Q. 32 Please explain the Settlement Parties' agreement regarding the Company's proposed EE and RET Plan.

A. 32 Southwest Gas included in its Application an EE and RET Plan designed to achieve the first year energy savings goals set forth in the Commission's recently approved Gas Utility Energy Efficiency Standards (Gas EE Rules). The Settlement Agreement reflects the result of the Settlement Parties' agreement to work together to pursue prompt implementation of all EE measures that can easily be verified to demonstrate cost effectiveness coincident with the Commission's vote on this Settlement Agreement. This is anticipated to result in an incremental improvement of EE that exceeds the Company's currently-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 these cost effective measures – this is referred to in the Settlement Agreement as the modified EE and RET Plan.

In addition, since the energy savings proposed in the modified EE and RET Plan may not be sufficient to meet the 2011 energy savings goals that are being agreed to as part of the Settlement Agreement, the Settlement Parties further agreed to have Southwest Gas file a new and revised EE and RET Implementation Plan within 60 days of filing the Settlement Agreement in a new docket setting forth a plan for how it proposes to increase the customer annual energy savings to comply with the energy savings goals set forth in the Gas EE Rules.

VII. COYL REPLACEMENT PROGRAM

Q. 33 What is a COYL?

A. 33 COYL is an acronym for "customer-owned yard line". A COYL is a pipe that typically begins from a point of delivery connection at the outlet of the Company's meter at the property line or public right-of-way, and extends underground from the meter to the house, building or gas utilization equipment where gas is consumed. Since Southwest Gas does not own this piping, the customer is solely responsible for inspecting and maintaining that yard line.

Q. 34 Please explain the agreement among the Settlement Parties regarding the Company's proposed COYL program.

A. 34 The Settlement Parties agreed that Southwest Gas will purchase, field test and validate the effectiveness of 4 Remote Methane Leak Detection (RMLD) units, and will work with Staff to obtain approval for the use of the RMLD equipment. Once the equipment is approved, Southwest Gas will begin to leak survey COYLs, obtaining permission and notifying customers where necessary. The Settlement Parties intend for Southwest Gas to replace all leaking COYLs, whether determined through the leak survey process or a leak survey resulting from an odor call complaint.

Q. 35 How does the Company intend to account for and recover the costs associated with the COYL program?

A. 35 The Settlement Parties agreed that the capital investment associated with the COYL program shall be recovered through a COYL cost recovery mechanism (CCRM) that will be adjusted annually. The CCRM will be based solely on actual costs and costs eligible for recovery, and the Settlement Parties have agreed to cap the annual increase in the surcharge amount to no greater than $0.01 per therm in any single year.

Q. 36 What other checks and balances were agreed to by the Settlement Parties?

A. 36 The Settlement Parties also agreed to have the Company file a report with the Commission detailing its findings and recommendations regarding the leak surveying program. The initial report will be filed upon the completion of the first 6 months of leak surveying.

Q. 37 How many customers will Southwest Gas leak survey each year?

A. 37 As part of the Settlement Agreement, Southwest Gas commits to leak survey approximately 1/3 of the COYLs every year. Southwest Gas currently estimates that there are approximately 102,000 COYLs throughout its Arizona service territory.

Q. 38 Why do you believe this program results in rates, charges, and conditions of service that are just and reasonable and in the public interest?

A. 38 Through the Company's public awareness programs and information collection practices, it has become evident that many customers are not managing their aging COYLs. Southwest Gas submits that the COYL program will mitigate the financial burden on customers who need to replace their COYL by replacing the COYL with a Southwest Gas owned and maintained service extension line. This provides a least-cost alternative, results in a minimal cost to other customers, and replaces aging customer-owned natural gas delivery infrastructure to the benefit to all customers.

VIII. RATE DESIGN AND REVENUE ALLOCATION

Q. 39 What did the Settlement Parties agree upon for rate design?

A. 39 With respect to the residential rate design, the Settlement Parties agreed to not make any changes to the existing residential rate designs of Southwest Gas, with the exception of the changes to the low income programs mentioned previously in my testimony. As such, Southwest Gas will retain the monthly basic service charge of $10.70 and a single commodity charge, adjusted to reflect the proposed residential revenue requirement. With respect to the other rate schedules, the Settlement Parties agreed to accept the Company's proposed changes that were reflected in its Application. These changes, as well as the resulting bill impacts, are reflected in more detail in Exhibits C and D to the Settlement Agreement.

Q. 40 What did the Settlement Parties agree upon for revenue allocation?

A. 40 The Settlement Parties agreed upon an equal percentage increase among all customer classes, with the exception of the low income rate schedules.

Q. 41 Why do you believe an equal percentage revenue allocation is a just and reasonable result that is in the public interest?

A. 41 An equal percentage revenue allocation mitigates the bill impact to any particular class of customers and spreads the rate increase evenly among all customer classes. The resulting average rate increase and average monthly bill impact compares favorably to the filed positions of the Settlement Parties. The following table contains 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 the filed positions of the Settlement Parties, including the results of the Commission's selection of either Alternative A or Alternative B (which includes gas costs but not surcharges):

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

IX. OTHER MISCELLANEOUS SETTLEMENT TERMS AND TARIFF CHANGES

Q. 42 Please explain the other miscellaneous items were agreed upon by the Settlement Parties and that were specifically addressed by the Settlement Parties in the Settlement Agreement.

A. 42 As part of the Settlement Agreement, Southwest Gas agreed to many of Staff's recommendations that were set forth in Staff's direct testimony, including recommendations pertaining to tariff changes to address sub-metering, the Yuma Manors pipe replacement project, the Company's 20-year plan to replace EVPP, the Company's Annual Gas Procurement Plan and Purchased Gas Adjustor Report, the Company's depreciation rates, and improvement in customer communications.

Q. 43 Will Southwest Gas continue the use the Incremental Contribution Method (ICM) and ICM Model as a tool in implementing its line extension policy reflected in Rule 6 of its Arizona Gas Tariff?

A. 43 Yes, Southwest Gas will continue the use of its ICM and ICM model. However, as part of the Settlement Agreement the Company agreed to submit to the Commission a revised ICM Model that prevents Southwest Gas 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.

Q. 44 Are there any other terms or conditions set forth in the Settlement Agreement that you would like to address?

A. 44 Yes. Consistent with Staff's recommendations pertaining to Southwest Gas' involvement in the development of gas heat pump technology, the Company agrees that all gas heat pump technology development costs shall be removed from operating expenses and that no new gas heat pump projects will be funded through the Commission-approved research and development surcharge. In addition, Southwest Gas will identify and track the Arizona customer funding of the gas heat pump technology development and propose a plan to reimburse Arizona customers for their proportionate level of funding, to be returned to customers 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.

Another key provision of the Settlement Agreement is Southwest Gas' commitment to identify cost reduction initiatives to reduce its expenses on an annual basis by an average of $2.5 million per year beginning in 2012. This commitment will continue through the end of the test year in the Company's next general rate case. I believe it is important to note that, similar to the commitment of the Company contributing $1 million to enhance the LIEC weatherization program, this is a commitment that will typically only result from a negotiated settlement and not a litigated case.

X. CONCLUSION

Q. 45 Please identify and explain some of the key benefits that you believe will be delivered to customers as a result of this Settlement Agreement.

A. 45 The Settlement Agreement is the result of a collaborative effort by the Settlement Parties to resolve a number of significant issues related to Southwest Gas and its customers. Southwest Gas believes the Settlement Agreement results in rates, charges, and conditions of service that are just and reasonable and in the public interest. In this regard, the Settlement Agreement provides substantial benefits to Southwest Gas' customers and it allows Southwest Gas to continue to provide its customers a high level of service. For instance, some of these benefits include:

- Low income customer benefits. There are several terms and commitments that particularly benefit low income customers, including, an increase in the LIRA discount from 20 percent to 30 percent; a Southwest Gas commitment to increase funding for the LIEC weatherization program with non-ratepayer funds of at least $1 million over 5 years; and a commitment to develop enhanced communication programs to increase awareness of low income programs.
- An operating Expense Reduction Commitment of $2.5 million per year.
- Enhanced rate stability. Approval of a decoupling mechanism - to mitigate rate increases in future rate proceedings and reduce the frequency of time-consuming and expensive rate cases; and 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.
- A moratorium on general rate case applications for over five years – as reflected in Alternative B only.
- Continuation of a 20-year plan to replace EVPP.
- The establishment of a COYL replacement program.
- Implementation of full revenue decoupling as provided for in Alternative B, which protects customers by limiting utility profits from increased sales, protecting customers from high winter monthly bills following an extreme weather event, addressing long-term chronic decline in gas utility customer usage, aligning utility, customer and societal interests to pursue annual customer bill savings through the recently enacted Gas EE Rules, reducing

utility disincentives to support customer energy efficiency, and allowing for both upward and downward rate adjustments.

- Energy Efficiency Enhancements. Commitment to pursue immediate cost-effective EE initiatives resulting in customer annual energy savings of at least 1,250,000 therms.
- Rate Design. No increase to the monthly basic service charge to enhance customer bill savings through energy efficiency and conservation efforts.

Q. 46 Please explain why Southwest Gas believes the Commission should approve the proposed Settlement Agreement.

A. 46 First, the Settlement Agreement reflects the input of parties with disparate and often conflicting interests resulting in rates, charges, and conditions of service that are just and reasonable and in the public interest. Second, this Settlement Agreement is the product of many hours of arms-length negotiations that were open and transparent and inclusive of all Parties to this Docket – even those who indicated they would likely not be signatories to the Settlement Agreement. The provisions of the Settlement Agreement reflect the input of all the Parties to this Docket, resulting in a thorough analysis, discussion and resolution of issues by sophisticated and knowledgeable parties. Third, the Settlement Parties have undertaken a very careful and comprehensive negotiation process whereby through compromise they each have agreed to specific terms and conditions as set forth in the Settlement Agreement. The Settlement Parties are knowledgeable and experienced regarding these issues and have used their collective experience to produce appropriate, well-founded recommendations. To that end, it is the Settlement Parties' intent that in conjunction with the approval of this Settlement Agreement the Commission approve one of two options for revenue decoupling detailed above - either the partial decoupling methodology (Alternative A) or the full revenue decoupling methodology (Alternative B). Alternative A and Alternative B were carefully negotiated and during the negotiation process, the Settlement Parties considered the type of decoupling mechanism and the necessary accompanying overall revenue increase, allowed return on common equity, fair value rate of return, and customer benefits and protections unique to each alternative in reaching their recommendations.

Finally, Southwest Gas believes the Settlement Agreement provides significant benefits to its Arizona customers, while providing its shareholders a period of regulatory certainty and a meaningful opportunity to recover costs and earn a reasonable rate of return on their utility investment. Indeed, several of the customer benefits identified above would likely not have been available to customers through a litigated proceeding. In further support of my prepared direct testimony and the overall reasonableness of the Settlement Agreement, I incorporate by reference into this testimony and refer the Commission to the direct testimony that Southwest Gas previously filed with the Commission in this docket. That testimony establishes important facts that are the foundation of Southwest Gas' support for the Settlement Agreement.

Based upon the foregoing, I urge the Commission to approve the Settlement Agreement, including the selection of either Alternative A or Alternative B in its entirety, but preferably Alternative B for the reasons I noted earlier.

Q. 47 Does this conclude your prepared direct testimony in support of the proposed settlement agreement?

A. 47 Yes.

SUMMARY OF QUALIFICATIONS
JOHN P. HESTER

I graduated from Northern Illinois University in 1984 with a Bachelor of Science degree in Economics. I subsequently earned a Master of Arts degree in Economics from Northern Illinois University in 1986.

In 1986, I began working as a Statistical Research Specialist at the Illinois Department of Energy and Natural Resources. My responsibilities included analyzing resource planning and energy issues affecting the State of Illinois.

I joined the Illinois Commerce Commission as an Economic Analyst in the Rate Department in 1987. My responsibilities at the Illinois Commerce Commission primarily involved performing cost-of-service studies and designing rates for gas, electric, water and sewer utilities.

I started my employment at Southwest Gas in 1989 as a Regulatory Analyst in the Rate Department. Later that year, I was promoted to Regulatory Specialist. My duties in the Rate Department involved working on rate case applications, regulatory compliance filings, and purchased gas adjustment filings in the areas of cost allocation and rate design.

In 1991, I began working in the Gas Supply Department on a rotational assignment. I was permanently transferred to the Gas Supply Department in 1992 and promoted to Senior Specialist. I was subsequently promoted to the position of Supervisor/Gas Purchases in 1994. My responsibilities in the Gas Supply Department concentrated on the areas of gas acquisition, spot and term contract negotiation, and administration of pipeline capacity release transactions.

In 1999, I was transferred to the Pricing and Tariffs Department and promoted to the position of Director, where I was responsible for the development of Southwest Gas' rate design and tariff proposals. Later, in 2002, I was appointed to the position of Director/Regulatory Affairs and Systems Planning, where I oversaw the Company's regulatory and government relations, as well as planning activities related to gas supply acquisition and distribution infrastructure.

In 2003, I was promoted to Vice President/Regulatory Affairs and Systems Planning, which encompassed management of Southwest Gas' state and federal rate and tariff activities, regulatory and governmental relations, and systems planning. I became Senior Vice President of Regulatory Affairs and Energy Resources, in 2006 when gas supply commodity and interstate transportation management was added to my previous responsibilities.

In addition to my duties at Southwest Gas, I serve on the University of Nevada Las Vegas Department of Economics Executive Advisory Board, and the New Mexico State University Center for Public Utilities Advisory Council.