ORIGINAL

OPEN MEMORANDUM

TO: THE COMMISSION

FROM: Utilities Division

DATE: May 29, 2013

RE: SOUTHWEST GAS CORPORATION – APPLICATION FOR A WAIVER OF CERTAIN AFFILIATED INTERESTS RULES, OR IN THE ALTERNATIVE, PRIOR APPROVAL OF CERTAIN TRANSACTIONS (DOCKET NO. G-01551A-12-0497)

<u>*Background*</u>

<u>Application</u>. On December 21, 2012, Southwest Gas Corporation ("Southwest" or "Company") filed an application requesting limited waivers of A.A.C. R14-2-804.B.1-3 of the Commission's Affiliated Interests Rules. These waivers would allow Southwest to make certain loans and investments involving unregulated affiliates, and to sell interests in certain subsidiaries, without prior Commission approval. In the alternative, Southwest requests prior approval of certain affiliate transactions.

<u>Rules</u>. The language of R14-2-804.B.1-3 of the Commission's Affiliated Interest Rules is quoted below:

"B. A utility will not consummate the following transactions without prior approval by the Commission:

1. *Obtain a financial interest in any affiliate not regulated by the Commission, or guarantee, or assume the liabilities of such affiliate;*

2. *Lend to any affiliate not regulated by the Commission, with the exception of short-term loans for a period less than 12 months in an amount less than $100,000; or*

3. *Use utility funds to form a subsidiary or divest itself of any established subsidiary."*

<u>Existing Limited Waivers</u>. Limited waivers of R14-2-804.B.1 and B.2 were previously approved for Southwest. Decision Nos. 58162 (Feb. 4, 1993) and 59502 (Jan. 31, 1996) raised the level of loans that can be made to specified affiliates without prior Commission approval from $100,000 to $13 million. Decision No. 58063 (Nov. 3, 1992) allowed existing investments to be increased or decreased by various amounts, depending on the total value of a utility's assets. (Based on Southwest's assets, the increase or decrease can be up to $50 million.)

Summary of the Limited Waivers Being Requested

Southwest is currently requesting waivers or, in the alternative, prior approval for the following:

- Loan Threshold. Southwest has asked to increase the amount it may advance or loan to affiliates within a 12-month period without Commission approval. The Company wants to increase the threshold from $13 million to $40 million. In communications with Staff, the Company clarified that it was asking for a total limit of $40 million per year, rather than $40 million per affiliate per year. In addition, the Company has proposed an overall cap of $120 million, meaning that the total amount in outstanding loans (accumulated over multiple years) could not exceed $120 million.

- Loans to All Affiliates. Southwest has asked that it be allowed to make loans and advances to all its existing and future affiliates, rather than to a list of specific affiliates.

- Financial Interests in Non-regulated Businesses. Southwest has asked that it be allowed to obtain initial financial interests in non-regulated energy or construction-related businesses for up to $50 million per year, without prior Commission approval. Southwest is currently only allowed to increase or decrease an existing financial interest in non-regulated affiliates up to $50 million per year without Commission approval.

- Sale of Subsidiaries. Southwest has asked that it be allowed to sell interests in subsidiaries without seeking prior Commission approval, with the exception of subsidiaries selling the gas air conditioning or gas heat pumps (in accordance with Decision No. 73555 [Oct. 17, 2012]).

Potential Issues Related to Affiliate Transactions

Background. As stated in Decision No. 56618 (Aug. 25, 1989), the Commission's affiliated interests rules were originally designed with four basic principles in mind:

> *"First, utility funds must not be commingled with non-utility funds. Second, cross-subsidization of non-utility activities by utility ratepayers must be prohibited. Third, the financial credit of the utility must not be negatively affected by non-utility activities. Fourth, the utility and its affiliates must provide the Commission with the information necessary to carry out its regulatory responsibilities."*[1]

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1 Decision No. 56618 at 2:2-8

Potential Issues. Southwest has indicated that any losses associated with loans or investments related to its affiliates would be absorbed by shareholders. However, transactions between regulated utilities and their unregulated affiliates can impact the financial health of those utilities, thereby directly or indirectly impacting the rates paid by utility customers.

More specifically, potential issues arising from affiliate transactions include the following: (i) losses may be subsidized by ratepayers; (for example, costs may be shifted from an unregulated affiliate to a utility due to the higher probability of recovering costs through the utility.); (ii) impacts to a utility's credit rating may increase the cost of borrowing by the utility; (iii) impacts to a utility's financial health may affect the quality or cost of service to ratepayers; (iv) utility assets necessary for the provision of service, including customer deposits, could be used as collateral for transactions with unregulated affiliates; (v) there may be overcharges arising from transactions between the utility and an affiliate, where prices are not based on the market; and (vi) transparency of records, data and information pertaining to the regulated utility could be impacted.

Mitigation of Potential Issues. The issues listed in (i) through (v) can be mitigated, in part, by limiting the size and type of affiliate transaction that can go forward without prior Commission approval. The waivers requested in the current application would allow larger loans and a wider variety of transactions to go forward without prior Commission review and approval.

With respect to issue (iv), in addition, Staff recommends that Southwest not use utility assets necessary for the provision of service, including customer deposits, as collateral in any affiliate transactions.

Issue (vi), maintenance of transparency, is addressed in the Commission's Rules. R14-2-804.A provides, among other things, that "[a] utility will not transact business with an affiliate unless the affiliate agrees to provide the Commission access to the books and records of the affiliate. . . ."

Confidentiality of Customer Data. There is, in addition, the issue of protecting utility customer data. Maintaining the confidentiality of customer data is important in order to (i) protect customers' privacy; and (ii) protect customers' financial data. An additional issue is that exclusive access to a utility's customer database may provide an unfair competitive advantage to the utility's unregulated affiliate. Staff recommends that access to Southwest customer data remain confidential from Southwest's unregulated affiliates.

Loan Threshold

Background. In Decision No. 58162, the Commission approved Southwest's application for a limited waiver of R14-2-804.B.2. R14-2-804.B.2 limits loans to affiliates to less than $100,000, for a period of less than 12 months, without prior Commission approval of the affiliate transaction. Decision No. 58162 increased the cap to $13 million on loans or advances to Paiute Pipeline Company ("Paiute"), Southwest Gas Transmission Company ("SGTC"), and Carson

Water Company ("Carson") without prior Commission approval. The Decision also ordered that:

> *". . .when Southwest Gas makes advances or loans to Paiute, SGTC and/or Carson (pursuant to existing notes, or otherwise) which exceed $13.0 million in any 12 month period, Southwest Gas must apply for approval under A.A.C. R14-2-804.B.2. for any additional transactions between Southwest Gas and Paiute, SGTC or Carson for which any bonds, notes, or other evidences of indebtedness are issued by any of those subsidiaries to Southwest Gas."*[2]

Northern Pipeline Construction Company, now NPL Construction Company ("NPL") was added to the list of affiliates eligible for loans or advances in Decision No. 59502.

Southwest now wants to increase the threshold from $13 million to $40 million. In communications with Staff, the Company clarified that it was asking for a $40 million limit, in the aggregate, rather than per affiliate.

Southwest also reports that it has (i) increased its assets from $1.27 billion to $4.0 billion; (ii) experienced an increase in its total common equity ratio from 35% to 53%; and (iii) experienced an increase in its credit ratings, from Ba1 to Baa1 (Moody's), from BBB- to BBB+ (S&P) and from BB+ to A-(Fitch). The Company states that the original $13 million threshold was set when it represented approximately 1% of Southwest's total assets and that the $40 million currently being requested would represent approximately 1% of its present-day assets.

The Company's affiliates do not currently owe on any loans from Southwest. The highest loan balance was $35.5 million, in January 2005. The $35.5 million balance was associated with a $22 million loan to Paiute for the purchase of a natural gas storage facility and associated pipeline. (The $22 million loan was approved by the Commission in Decision No. 67520. [Jan. 20, 2005])

Southwest believes that the updated threshold would increase administrative efficiency and lower administrative costs by eliminating the need to file applications regarding short-term loans or advances to affiliates of $40 million or less.

In addition to the $40 million annual limit, in communications with Staff, Southwest proposed a $120 million total overall cap for loans or advances to its affiliates, without prior Commission approval. This proposal would allow Southwest to make loans or advances to its affiliates equaling up to $120 million over time (with a $40 million per year limit), without Commission approval.

<u>Analysis</u>. Increasing the loan cap to $40 million allows Southwest the flexibility to make loans to its unregulated affiliates without prior approval from the Commission, but still limits potential impacts to the overall financial health of the utility. Such an increase would essentially

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2 Decision No. 58162 at 5:24-6:3.

reflect an update in the dollar amount that can be loaned, while maintaining the overall cap at 1% of the Company's assets.

A $120 million overall cap would increase the current cap by more than $100 million. Neither the benefit nor the necessity of such a large increase has been demonstrated.

Staff believes the increase in Southwest Gas' credit ratings, which have resulted from a series of credit-supportive policies adopted by this Commission, should be carefully protected and preserved for the benefit of Southwest Gas' ratepayers, not its affiliates. Increasing the overall cap to $120 million may expose the Company, and its rate payers, to excessive risk.

Recommendation. Staff recommends that Southwest's proposal to increase its loan threshold to $40 million without prior approval be approved, but be treated as a total cap. Outstanding advances or loans to affiliates should not, at any one time, exceed $40 million without prior approval from the Commission.

Staff recommends that the $120 million total cap on loans or advances to affiliates without prior Commission approval not be approved. If the Company believes that a loan above the $40 million cap is necessary and beneficial to its ratepayers, the Company can seek approval of the loan from the Commission.

Loans to All Affiliates

Background and Rationale. Decision Nos. 58162 and 59502 allowed Southwest to make loans or advances of up to $13 million without prior approval, but limited the affiliates eligible for such loans or advances to Paiute, SGTC, Carson, and NPL. In the current application, Southwest indicated that its affiliates have changed and may continue to change and that the new threshold "not be limited to Paiute, SGTC, Carson, and NPL, but rather be expanded to include all existing and future Southwest Gas affiliates."

Analysis. Southwest has not supplied sufficient information to support an expansion of eligibility to existing and future affiliates. The waiver is overbroad, particularly with respect to its proposed expansion of eligibility to all future affiliates, the nature and financial condition of which are unknown.

Recommendation. Staff recommends that Southwest's proposal to automatically expand eligibility for loans to all current and future affiliates not be approved.

Staff also recommends that, if Southwest wishes to expand eligibility for loans, the Company file an application specifying the affiliate or affiliates that it proposes to make eligible and supply information, including the name, business type, and financial condition of each such affiliate, along with the nature of the loans that Southwest contemplates. This will allow the Commission the opportunity to evaluate the creditworthiness of the affiliate and weigh risk to Southwest Gas' ratepayers.

Financial Interests in Non-regulated Businesses

Background. Decision No. 58063 required prior Commission approval for (i) initial investments in affiliates not regulated by the Commission; (ii) guaranteeing or assuming the liabilities of an unregulated affiliate; and (iii) increasing or decreasing its financial interest in an unregulated affiliate by an amount in excess of $50 million (based on assets in the range of $3-6 billion). In addition, Decision No. 58063 provided an exemption for existing investments. The exemption allows utilities with assets in the $3-6 billion range to increase or decrease investments in a cumulative amount of $50 million or less without prior Commission approval.

In its application, Southwest has asked for a waiver from (i), the limitation on making initial investments in affiliates without prior Commission approval. Southwest has asked that it be allowed to obtain an initial financial interest in non-regulated energy or construction-related businesses for up to $50 million per year, without prior Commission approval.

The $50 Million Per-Year Cap. Decision No. 58063 states that "[t]he 'exempt amounts' are to be measured on a cumulative basis over the calendar year in which the transactions will be made." As an annual limit, as opposed to an overall limit, investments made without Commission review could accumulate over successive years ($50 million in Year 1, increasing to $100 million in Year 2, and to $150 million in Year 3, etc.). Currently, however, any multi-year accumulation of investment is limited to only those companies where Southwest has existing investments.

Rationale. Southwest states that "the overall impact of an investment, whether it be in a new or existing affiliate, is substantially similar, if not the same, and such transactions should be treated consistently." Southwest asserts that easing its ability to invest in new businesses will improve its financial strength, reduce costs as efficiencies are acquired and enhance service based on the insight and experience acquired from such investments. The Company also states that the time and uncertainty involved in the regulatory process has discouraged potential business partners and that such a waiver would not have a material adverse impact on either Southwest or its customers.

Analysis. Southwest can currently invest up to $50 million each year without Commission approval, by increasing or decreasing existing investments in unregulated affiliates. The requested waiver would significantly broaden that latitude by allowing Southwest to invest up to $50 million per year, without prior Commission approval, in any company, or companies, that it considered energy- or construction-related. If a waiver is approved, Southwest could accumulate successively larger investments in companies over which the Commission has no direct authority and about which the Commission has no information, beyond the fact that Southwest deems them energy- or construction-related.

Staff does not agree that there is little or no difference between an initial investment and changing the level of an existing investment. Eliminating prior approval for initial investments could eliminate the Commission's ability to assess the level of risk associated with a specific unregulated entity. Moreover, waiver of prior approval, combined with the Company's existing ability to invest $50 million each year, would substantially limit the Commission's ability to oversee transactions potentially large enough to materially and adversely impact Arizona ratepayers.

Recommendation. Staff recommends that Southwest's proposal that it be allowed to obtain up to $50 million yearly in initial financial investments without prior approval by the Commission not be approved. Southwest still has the ability to file an application with the Commission for approval of initial investments.

Sale of Subsidiaries

Southwest has asked for a limited exemption to R14-2-804.B.3, which requires a utility to obtain prior approval for using "utility funds to form a subsidiary or divest itself of any established subsidiary." The Company has asked to be allowed to sell interests in subsidiaries without seeking prior Commission approval (with the exception of subsidiaries selling the gas air conditioning or gas heat pumps, as discussed in Decision No. 73555).

Rationale. The application states that in selling a subsidiary Southwest "has every interest in maximizing its return on the sale. Further this limited waiver will not negatively impact Southwest Gas' customer service, and there will be no change in the current rates or terms and conditions of service as a result of this exemption."

Analysis. Waiving this exemption does not benefit ratepayers. Staff believes that such transactions should continue to be subject to prior Commission approval in order to ensure that ratepayer interests have been adequately protected.

Staff recommends that Southwest's proposal that it be allowed to divest itself of a subsidiary without prior Commission approval not be approved.

Additional Recommendation

Southwest requested waivers or, in the alternative, that the Commission grant prior approvals. Staff recommends that the Commission not grant any prior approvals with respect to loans or investments relating to its affiliates, or with respect to sales of its subsidiaries.

Summary of Recommendations

Staff recommends the following:

- that Southwest not use utility assets necessary for the provision of service, including customer deposits, as collateral in any affiliate transactions;

- that Southwest's customer data remain confidential with respect to Southwest's unregulated affiliates;

- that Southwest's proposed increase to $40 million in loans or advances to affiliates be approved, but be treated as a total cap;

- that the $120 million total cap on loans or advances to affiliates without prior Commission approval not be approved;

- that Southwest's proposal to automatically expand eligibility for loans to all current and future affiliates not be approved;

- that, if Southwest wishes to expand eligibility for loans, the Company file an application specifying the affiliate or affiliates that it proposes to make eligible and supply information, including the name, business type, and financial condition of each such affiliate, along with the nature of the loans that Southwest contemplates;

- that Southwest's proposal that it be allowed to obtain up to $50 million yearly in initial financial investments without prior approval by the Commission not be approved;

- that Southwest's proposal that it be allowed to divest itself of a subsidiary without prior Commission approval not be approved; and

- that the Commission not grant any prior approvals with respect to loans or investments relating to Southwest's affiliates, or with respect to sales of its subsidiaries.

Steven M. Olea
Director
Utilities Division

SMO:JMK:sms\SH

ORIGINATOR: Julie McNeely-Kirwan

BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
Chairman
GARY PIERCE
Commissioner
BRENDA BURNS
Commissioner
BOB BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner

IN THE MATTER OF SOUTHWEST GAS CORPORATION'S APPLICATION FOR A WAIVER OF CERTAIN AFFILIATED INTERESTS RULES, OR IN THE ALTERNATIVE, PRIOR APPROVAL OF CERTAIN TRANSACTIONS	DOCKET NO. G-01551A-12-0497 DECISION NO. __________ ORDER

Open Meeting
June 11 and 12, 2013
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

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

Background

2. Application. On December 21, 2012, Southwest Gas Corporation filed an application requesting limited waivers of A.A.C. R14-2-804.B.1-3 of the Commission's Affiliated Interests Rules. These waivers would allow Southwest to make certain loans and investments involving unregulated affiliates, and to sell interests in certain subsidiaries, without prior Commission approval. In the alternative, Southwest requests prior approval of certain affiliate transactions.

. . .

3. Rules. The language of R14-2-804.B.1-3 of the Commission's affiliated interest rules is quoted below:

> "B. *A utility will not consummate the following transactions without prior approval by the Commission:*
>
> 1. *Obtain a financial interest in any affiliate not regulated by the Commission, or guarantee, or assume the liabilities of such affiliate;*
> 2. *Lend to any affiliate not regulated by the Commission with the exception of short-term loans for a period less than 12 months in an amount less than $100,000; or*
> 3. *Use utility funds to form a subsidiary or divest itself of any established subsidiary."*

4. Existing Limited Waivers. Limited waivers of R14-2-804.B.1 and B.2 were previously approved for Southwest. Decision Nos. 58162 (Feb. 4, 1993) and 59502 (Jan. 31, 1996) raised the level of loans that can be made to specified affiliates without prior Commission approval from $100,000 to $13 million. Decision No. 58063 (Nov. 3, 1992) allowed existing investments to be increased or decreased by various amounts, depending on a utility's assets. (Based on Southwest's assets, the increase or decrease can be up to $50 million.)

Summary of the Limited Waivers Being Requested

5. Southwest is currently requesting waivers or, in the alternative, prior approval for the following:

- Loan Threshold. Southwest has asked to increase the amount it may advance or loan to affiliates within a 12-month period without Commission approval. The Company wants to increase the threshold from $13 million to $40 million. In communications with Staff, the Company clarified that it was asking for a total limit of $40 million per year, rather than $40 million per affiliate per year. In addition, the Company has proposed an overall cap of $120 million, meaning that the total amount in outstanding loans (accumulated over multiple years) could not exceed $120 million.

- Loans to All Affiliates. Southwest has asked that it be allowed to make loans and advances to all its existing and future affiliates, rather than to a list of specific affiliates.
- Financial Interests in Non-regulated Businesses. Southwest has asked that it be allowed to obtain initial financial interests in non-regulated energy or construction-related businesses for up to $50 million per year, without prior Commission approval. Southwest is currently only allowed to increase or decrease an existing financial interest in non-regulated affiliates up to $50 million per year without Commission approval.
- Sale of Subsidiaries. Southwest has asked that it be allowed to sell interests in subsidiaries without seeking prior Commission approval, with the exception of subsidiaries selling the gas air conditioning or gas heat pumps (in accordance with Decision No. 73555 [Oct. 17, 2012]).

Potential Issues Related to Affiliate Transactions

6. Background. As stated in Decision No. 56618, (Aug. 25, 1989), the Commission's affiliated interests rules were originally designed with four basic principles in mind:

> *"First, utility funds must not be commingled with non-utility funds. Second, cross-subsidization of non-utility activities by utility ratepayers must be prohibited. Third, the financial credit of the utility must not be negatively affected by non-utility activities. Fourth, the utility and its affiliates must provide the Commission with the information necessary to carry out its regulatory responsibilities."*[1]

7. Potential Issues. Southwest has indicated that any losses associated with loans or investments related to its affiliates would be absorbed by shareholders. However, transactions between regulated utilities and their unregulated affiliates can impact the financial health of those utilities, thereby directly or indirectly impacting the rates paid by utility customers.

8. More specifically, potential issues arising from affiliate transactions include the following: (i) losses may be subsidized by ratepayers; (For example, costs may be shifted from an

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[1] Decision No. 56618 at 2:2-8

unregulated affiliate to a utility due to the higher probability of recovering costs through the utility.); (ii) impacts to a utility's credit rating may increase the cost of borrowing by the utility; (iii) impacts to a utility's financial health may affect the quality or cost of service to ratepayers; (iv) utility assets necessary for the provision of service, including customer deposits, could be used as collateral for transactions with unregulated affiliates; (v) there may be overcharges arising from transactions between the utility and an affiliate, where prices are not based on the market; and (vi) transparency of records, data and information pertaining to the regulated utility could be impacted.

9. Mitigation of Potential Issues. The issues listed in (i) through (v) can be mitigated, in part, by limiting the size and type of affiliate transaction that can go forward without prior Commission approval. The waivers requested in the current application would allow larger loans and a wider variety of transactions to go forward without prior Commission review and approval.

10. With respect to Issue (iv), in addition, Staff has recommended that Southwest not use utility assets necessary for the provision of service, including customer deposits, as collateral in any affiliate transactions.

11. Issue (vi), maintenance of transparency, is addressed in the Commission's Rules. R14-2-804.A provides, among other things, that "[a] utility will not transact business with an affiliate unless the affiliate agrees to provide the Commission access to the books and records of the affiliate. . . ."

12. Confidentiality of Customer Data. There is, in addition, the issue of protecting utility customer data. Maintaining the confidentiality of customer data is important in order to (i) protect customers' privacy; and (ii) protect customers' financial data. An additional issue is that exclusive access to a utility's customer database may provide an unfair competitive advantage to the utility's unregulated affiliate. Staff has recommended that access to Southwest customer data remain confidential from Southwest's unregulated affiliates.

Loan Threshold

13. Background. In Decision No. 58162 (February 1993), the Commission approved Southwest's application for a limited waiver of R14-2-804.B.2. R14-2-804.B.2 limits loans to affiliates to less than $100,000, for a period of less than 12 months, without prior Commission

approval of the affiliate transaction. Decision No. 58162 increased the cap to $13 million on loans or advances without prior Commission approval. The Decision also ordered that:

> *". . .when Southwest Gas makes advances or loans to Paiute, SGTC and/or Carson (pursuant to existing notes, or otherwise) which exceed $13.0 million in any 12 month period, Southwest Gas must apply for approval under R14-2-804.B.2 for any additional transactions between Southwest Gas and Paiute, SGTC or Carson for which any bonds, notes, or other evidences of indebtedness are issued by any of those subsidiaries to Southwest Gas."* [2]

Northern Pipeline Construction Company, now NPL Construction Company, was added to the list of affiliates eligible for loans or advances in Decision No. 59502.

14. Southwest now wants to increase the threshold from $13 million to $40 million. In communications with Staff, the Company clarified that it was asking for a $40 million limit, in the aggregate, rather than per affiliate.

15. Southwest also reports that it has (i) increased its assets from $1.27 billion to $4.0 billion; (ii) experienced an increase in its total common equity ratio from 35% to 53%; and (iii) experienced an increase in its credit ratings, from Ba1 to Baa1 (Moody's), from BBB- to BBB+ (S&P) and from BB+ to A-(Fitch). The Company states that the original $13 million threshold was set when it represented approximately 1% of Southwest's total assets and that the $40 million currently being requested would represent approximately 1% of its present-day assets.

16. The Company's affiliates do not currently owe on any loans from Southwest. The highest loan balance was $35.5 million, in January 2005. The $35.5 million balance was associated with a $22 million loan to Paiute Pipeline for the purchase of an LNG facility. (The $22 million loan was approved by the Commission in Decision No. 67520 [Jan. 20, 2005].)

17. Southwest believes that the updated threshold would increase administrative efficiency and lower administrative costs by eliminating the need to file applications regarding short-term loans or advances to affiliates of $40 million or less.

18. In addition to the $40 million annual limit, in communications with Staff, Southwest proposed a $120 million total overall cap for loans or advances to its affiliates, without

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[2] Decision No. 58162 at 5:24-6:3.

prior Commission approval. This proposal would allow Southwest to make loans or advances to its affiliates equaling up to $120 million over time (with a $40 million per year limit), without Commission approval.

19. Analysis. Increasing the loan cap to $40 million allows Southwest the flexibility to make needed loans to its unregulated affiliates without prior approval from the Commission, but still limits potential impacts to the overall financial health of the utility. Such an increase would essentially reflect an update in the dollar amount than can be loaned, while maintaining the overall cap at 1% of the Company's assets.

20. A $120 overall cap would increase that total by $80 million. Neither the benefit nor the necessity of such a large increase has been demonstrated.

21. Staff believes the increase in Southwest Gas' credit ratings, which have resulted from a series of credit-supportive policies adopted by this Commission, should be carefully protected and preserved for the benefit of Southwest Gas' ratepayers, not its affiliates. Increasing the overall cap to $120 million may expose the Company, and its ratepayers, to excessive risk.

22. Recommendation. Staff has recommended that Southwest's proposal to increase its loan threshold to $40 million without prior approval be approved, but be treated as a total cap. Outstanding advances or loans to affiliates should not, at any one time, exceed $40 million without prior approval from the Commission.

23. Staff has recommended that the $120 million total cap on loans or advances to affiliates without prior Commission approval not be approved. If the Company believes that a loan above the $40 million cap is necessary and beneficial to its ratepayers, the Company can seek approval of the loan from the Commission.

Loans to All Affiliates

24. Background and Rationale. Decision Nos. 58162 and 59502 allowed Southwest to make loans or advances of up to $13 million without prior approval, but limited the affiliates eligible for such loans or advances to Paiute, SGTC, Carson Water Company and NPL. In the current application, Southwest indicated that its affiliates have changed and may continue to

change and that the new threshold "not be limited to Paiute, SGTC, Carson, and NPL, but rather be expanded to include all existing and future Southwest Gas affiliates."

25. Analysis. Southwest has not supplied sufficient information to support an expansion of eligibility to existing and future affiliates. The waiver is overbroad, particularly with respect to its proposed expansion of eligibility to all future affiliates, the nature and financial condition of which are unknown.

26. Recommendation. Staff has recommended that Southwest's proposal to automatically expand eligibility for loans to all current and future affiliates not be approved.

27. Staff has also recommended that, if Southwest wishes to expand eligibility for loans, the Company file an application specifying the affiliate or affiliates that it proposes to make eligible and supply information, including the name, business type, and financial condition of each such affiliate, along with the nature of the loans that Southwest contemplates. This will allow the Commission the opportunity to evaluate the creditworthiness of the affiliate and weigh risk to Southwest Gas' ratepayers.

Financial Interests in Non-regulated Businesses

28. Background. Decision No. 58063 required prior Commission approval for (i) initial investments in affiliates not regulated by the Commission; (ii) guaranteeing or assuming the liabilities of an unregulated affiliate; and (iii) increasing or decreasing its financial interest in an unregulated affiliate by an amount in excess of $50 million (based on assets in the range of $3-6 billion). In addition, Decision No. 58063 provided an exemption for existing investments. The exemption allows utilities with assets in the $3-6 billion range to increase or decrease investments in a cumulative amount of $50 million or less without prior Commission approval.

29. In its application, Southwest has asked for a waiver from (i), the limitation on making initial investments in affiliates without prior Commission approval. Southwest has asked that it be allowed to obtain an initial financial interest in non-regulated energy or construction-related businesses for up to $50 million per year, without prior Commission approval.

30. The $50 Million Per-Year Cap. Decision No. 58063 states that "[t]he 'exempt amounts' are to be measured on a cumulative basis over the calendar year in which the transactions

will be made." As an annual limit, as opposed to an overall limit, investments made without Commission review could accumulate over successive years ($50 million in Year 1, increasing to $100 million in Year 2, and to $150 million in Year 3, etc.) Currently, however, any multi-year accumulation of investment is limited to only those companies where Southwest has existing investments.

31. Rationale. Southwest states that "the overall impact of an investment, whether it be in a new or existing affiliate, is substantially similar, if not the same, and such transactions should be treated consistently." Southwest asserts that easing its ability to invest in new businesses will improve its financial strength, reduce costs as efficiencies are acquired and enhance service based on the insight and experience acquired from such investments. The Company also states that the time and uncertainty involved in the regulatory process has discouraged potential business partners and that such a waiver would not have a material adverse impact on either Southwest or its customers.

32. Analysis. Southwest can currently invest up to $50 million each year without Commission oversight, by increasing or decreasing existing investments in unregulated affiliates. The requested waiver would significantly broaden that latitude by allowing Southwest to invest up to $50 million per year, without prior Commission approval, in any company, or companies, that it considered energy- or construction-related. If a waiver is approved, Southwest could accumulate successively larger investments in companies over which the Commission has no direct authority and about which the Commission has no information, beyond the fact that Southwest deems them energy- or construction-related.

33. Staff does not agree that there is little or no difference between an initial investment and changing the level of an existing investment. Eliminating prior approval for initial investments could eliminate the Commission's ability to assess the level of risk associated with a specific unregulated entity. Moreover, waiver of prior approval, combined with the Company's existing ability to invest $50 million each year, would substantially limit the Commission's ability to oversee transactions potentially large enough to materially and adversely impact Arizona ratepayers.

34. Recommendation. Staff has recommended that Southwest's proposal that it be allowed to obtain up to $50 million yearly in initial financial investments without prior approval by the Commission not be approved. Southwest still has the ability to file an application with the Commission for approval of initial investments.

Sale of Subsidiaries

35. Southwest has asked for a limited exemption to R14-2-804.B.3, which requires a utility to obtain prior approval for using "utility funds to form a subsidiary or divest itself of any established subsidiary." The Company has asked to be allowed to sell interests in subsidiaries without seeking prior Commission approval (with the exception of subsidiaries selling the gas air conditioning or gas heat pumps, as discussed in Decision No. 73555).

36. Rationale. The application states that in selling a subsidiary Southwest "has every interest in maximizing its return on the sale. Further this limited waiver will not negatively impact Southwest Gas' customer service, and there will be no change in the current rates or terms and conditions of service as a result of this exemption."

37. Analysis. Waiving this exemption does not benefit ratepayers. Staff believes that such transactions should continue to be subject to prior Commission approval in order to ensure that ratepayer interests have been adequately protected.

38. Staff has recommended that there be no waiver of prior Commission approval in cases where Southwest is divesting itself of a subsidiary.

Additional Recommendation

39. Southwest requested waivers or, in the alternative, that the Commission grant prior approvals. Staff has recommended that the Commission not grant any prior approvals with respect to loans or investments relating to its affiliates, or with respect to sales of its subsidiaries.

CONCLUSIONS OF LAW

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

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

3. The Commission, having reviewed the application and Staff's Memorandum dated May 29, 2013, concludes that it is in the public interest to address the requested limited waivers, as discussed herein, and to not make the requested prior approvals proposed as alternatives to limited waivers.

ORDER

IT IS THEREFORE ORDERED that Southwest Gas Corporation not use utility assets necessary for the provision of service, including customer deposits, as collateral in any affiliate transactions.

IT IS FURTHER ORDERED that access to Southwest Gas Corporation customer data remain confidential from Southwest's unregulated affiliates.

IT IS FURTHER ORDERED that Southwest Gas Corporation's proposed increase to $40 million in loans or advances to affiliates be approved, but be treated as a total cap.

IT IS FURTHER ORDERED that the $120 million total cap on loans or advances to affiliates without prior Commission approval not be approved.

IT IS FURTHER ORDERED that Southwest Gas Corporation's proposal to automatically expand eligibility for loans to all current and future affiliates not be approved.

IT IS FURTHER ORDERED that, if Southwest Gas Corporation wishes to expand eligibility for loans, the Company file an application specifying the affiliate or affiliates that it proposes to make eligible and supply information, including the name, business type, and financial condition of each such affiliate, along with the nature of the loans that Southwest Gas Corporation contemplates.

IT IS FURTHER ORDERED that Southwest Gas Corporation's proposal that it be allowed to obtain up to $50 million yearly in initial financial investments without prior approval by the Commission is not approved.

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IT IS FURTHER ORDERED that Southwest Gas Corporation's proposal that it be allowed to divest itself of a subsidiary without prior Commission approval is not approved.

IT IS FURTHER ORDERED that no prior approvals with respect to loans or investments relating to Southwest Gas Corporation's affiliates, or with respect to sales of its subsidiaries, are granted.

IT IS FURTHER ORDERED that this Order shall take effect immediately.

BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this ______ day of __________________, 2013.

JODI JERICH
EXECUTIVE DIRECTOR

DISSENT: ____________________________

DISSENT: ____________________________

SMO:JMK:sms\WVC

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