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SOUTHWEST GAS CORPORATION

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AZ CORP COMMISSION
DOCKET CONTROL

April 29, 2016

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

Re: Docket No. G-01551A-10-0458; Decision No. 72723

Southwest Gas Corporation (Southwest Gas) respectfully submits to the Arizona Corporation Commission an original and thirteen (13) copies of its Application for Approval of Energy Efficiency Enabling Provision Rate Adjustment. This Application requests approval to adjust the previously approved rate related to Southwest Gas' revenue decoupling mechanism, the Energy Efficiency Enabling Provision, to reflect 2015 activity.

In addition, pursuant to ordering paragraph #7 Decision No. 72723, Exhibit 1 of this Application contains Southwest Gas' annual Revenue Decoupling Report covering the period from January 1, 2015 through December 31, 2015.

If you have any questions, please do not hesitate to contact me at 602-395-4058.

Respectfully submitted,

Matthew D. Derr
Regulatory Manager/Arizona

Cc: Jodi Jerich, ACC
Tom Broderick, ACC
Bob Gray, ACC
Barbara Keene, ACC
David Tenney, RUCO

Arizona Corporation Commission

DOCKETED

APR 29 2016

DOCKETED BY

1 3. Southwest Gas' corporate offices are located at 5241 Spring Mountain
2 Road, Las Vegas, Nevada 89193-8510. Communications regarding this filing should
3 be addressed to:

4
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19
20 4. Southwest Gas is a public utility subject to the jurisdiction of the
21 Commission pursuant to Article XV of the Arizona Constitution and the applicable
22 chapters of Title 40 of the Arizona Revised Statutes (A.R.S.). Southwest Gas currently
23 serves approximately 1.9 million customers in the states of Arizona, California, and
24 Nevada. Approximately 54 percent of the Company's customers are located in the state
25 of Arizona, including portions of Cochise, Gila, Graham, Greenlee, La Paz, Maricopa,
26 Mohave, Pima, Pinal, and Yuma counties. For operational purposes, Southwest Gas'
27 Central Arizona division is headquartered in Phoenix and its Southern Arizona division
28 is headquartered in Tucson.

19 **Background**

20 5. The Commission authorized Southwest Gas to implement full revenue
21 decoupling as part of its 2010 general rate case. The decoupling mechanism, which is
22 referred to as the EEP, has two components: 1) a monthly weather component that
23 provides "real-time" bill adjustments when actual weather during the winter months
24 differs from the average weather used to calculate rates; and 2) a non-weather
25 component that adjusts rates on an annual basis to reflect any differences between the
26 Company's authorized revenues per customer and its actual revenues per customer,
27 thereby protecting customers and ensuring that the Company recovers only its
28

1 Commission-authorized revenue per customer – no more, no less. It is the second
2 component of the EEP that is the subject of this filing.

3 6. As part of the approval of the EEP, Southwest Gas agreed to file a report
4 with the Commission in April of each year to provide various details on the EEP's
5 performance.¹ The Company's Revenue Decoupling Report (Report), covering the
6 period from January 1, 2015 through December 31, 2015, is attached hereto as Exhibit
7 1.

8 7. Upon its review of the Company's last filed report (covering the period
9 from January 1, 2014 through December 31, 2014), the Commission concluded "the
10 revenue decoupling mechanism has accomplished its objectives, including both
11 enhanced revenue stability for the Company and bill stabilization for consumers, as well
12 as removal of disincentives to energy efficiency,"² and the Commission unanimously
13 approved the Company's application. As detailed in the accompanying Report, the
14 mechanism continues to perform as intended, and the Company's Arizona customers
15 continue to recognize many EEP-related benefits, including, but not limited to, bill
16 stability and a mechanism that financially protects both the customers and the Company
17 by ensuring that the Company only retains the margin per customer authorized by the
18 Commission.

19 **Request to Adjust EEP Rate**

20 8. Southwest Gas hereby requests approval to adjust its EEP rate based
21 upon its EEP Balancing Account balance at December 31, 2015, which is the aggregate
22 of the EEP Balancing Account balance at December 31, 2014 and the results for the
23 period January 1, 2015 through December 31, 2015.

24 9. In 2015, the Company collected more than its authorized revenues,
25 resulting in accruals during 2015 of \$8,299,299. These accruals combined with an EEP
26 Balancing Account credit balance at December 31, 2015, result in the Company
27

28 ¹ Settlement Agreement at § 3.23.

² Decision No. 75356 at pp. 7-8.

1 requesting to adjust the existing credit rate of \$(0.05058) to \$(0.04053) per therm. The
2 Company's surcredit calculations are attached hereto as Exhibit 2.

3 10. The Company respectfully requests that the Commission approve the
4 updated EEP rate at its earliest convenience, such that the credit can be implemented
5 by September 1, 2016, or as soon as otherwise practicable.

6 11. Although not at issue in the instant Application (because of the surcredit
7 to customers), Southwest Gas agreed to submit an annual earnings test as part of the
8 annual review.³ As illustrated in the results of the Company's 2015 earnings test,
9 notwithstanding the Company's recovery of its authorized level of revenue per customer
10 through the EEP, it is still not earning its Commission authorized return (primarily due
11 to the continuing upward pressure on the costs of providing safe and reliable natural
12 gas service to customers). A copy of the earnings test is attached hereto as Exhibit 3.

13 **Conclusion**

14 12. Based upon the foregoing, Southwest Gas respectfully requests that the
15 Commission adjust the EEP rate as set forth herein, with an effective date of September
16 1, 2016, or as soon as otherwise practicable.

17 Respectfully submitted this 29th day of April 2016.

18
19 SOUTHWEST GAS CORPORATION

20 

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27 *Attorney for Southwest Gas Corporation*

28 _____
³ Settlement Agreement at §§ 3.25-3.27.

Exhibit 1

Southwest Gas Corporation

Revenue Decoupling Report

**Reporting Period:
January 1, 2015 – December 31, 2015**

Docket No. G-01551A-10-0458



I. INTRODUCTION

Southwest Gas Corporation (Southwest Gas or Company) hereby submits to the Arizona Corporation Commission (Commission) its annual Revenue Decoupling Report (Report). Pursuant to the Settlement Agreement in Southwest Gas' 2010 general rate case, which was approved by the Commission in Decision No. 72723 (Decision), the Company agreed to report annually on the effects of its revenue decoupling mechanism, the Energy Efficiency Enabling Provision (EEP).

Southwest Gas' Report covers the period from January 1 through December 31, 2015, and demonstrates that the EEP continues to perform as designed, while benefitting customers by stabilizing their monthly bills and ensuring the Company only recovers its authorized revenue. The EEP continues to perform precisely as the Settlement Parties¹ intended. As the Commission noted in its unanimous Decision No. 75356 issued in December 2015, "the revenue decoupling mechanism has accomplished its objectives, including both enhanced revenue stability for the Company and bill stabilization for consumers, as well as removal of disincentives to energy efficiency".² Southwest Gas respectfully submits that the performance of the EEP during this reporting period was consistent with prior reporting periods and supports the Commission reaching the same conclusion this year.

In the short term, Arizona customers continue to recognize many benefits of the EEP, including, but not limited to, bill stability and a mechanism that financially protects both the customers and the Company by ensuring the Company only retains the margin per customer authorized by the Commission. Customers will also benefit from lower debt costs in the Company's next rate case.

¹ In addition to the Company, "Settlement Parties" includes the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Southwest Energy Efficiency Project ("SWEET"), the Arizona Investment Council ("AIC"), the Natural Resources Defense Council ("NRDC"), and Cynthia Zwick.

² Decision No. 75356 at pp. 7-8.

II. DECOUPLING OVERVIEW

Decoupling (also commonly referred to as “revenue decoupling”, “full revenue decoupling”, and “revenue per-customer decoupling”), at its highest level, is a rate design methodology that separates a utility’s fixed cost recovery from its sales.³ Decoupled utilities collect revenues according to a predetermined revenue requirement or revenue per customer established by the governing regulatory body, and utilize an automatic rate adjustment mechanism to periodically reflect the difference between the predetermined revenues and actual revenues.⁴ Therefore, unlike more traditional ratemaking, which links a utility’s fixed cost recovery to their sales volumes, decoupling allows utilities to recover their Commission-approved fixed costs irrespective of the volumes sold.⁵ The prevalence of decoupled and other non-volumetric rate designs continues to increase in the United States. As noted in **Appendix A**, as of February 2016 gas decoupling is found in 23 states and 56 utilities.⁶ There are also multiple utilities with similar types of regulatory mechanisms in place that remove the connection between fixed cost recovery and sales.

Decoupling also differs from other rate adjustment mechanisms that are sometimes categorized as “partial decoupling”, such as Lost Fixed Cost Recovery (LFCR) mechanisms (also referred to as “net lost revenue recovery”, “lost revenue adjustments”, and “conservation or load management adjustment clauses”). LFCR mechanisms adjust rates for revenue changes (i.e., losses) that result from conservation and energy efficiency programs and only result in upward adjustments to rates. Conversely, full revenue decoupling adjusts rates for any difference, upward or downward, between authorized and actual revenues, regardless of the cause. Moreover, full revenue decoupling refunds customers for any over-collections, thus completely eliminating the link between sales and revenues.

³ *Decoupling for Electric & Gas Utilities: Frequently Asked Questions*, National Association of Regulatory Utility Commissioners (NARUC), Grants & Research Department (Sept. 2007), at p.2.

⁴ *Id.*

⁵ *Id.* at pg. 4.

⁶ American Gas Association, Innovative Rates presentation, February 2016.

III. SOUTHWEST GAS' EEP MECHANISM

As noted in the Decision, Southwest Gas had been unable to earn its Commission-authorized rate of return for at least 15 years, primarily because of a continuing trend of declining usage per customer and a dependence on maintaining or increasing throughput to recover its fixed costs. The Commission acknowledged that without recourse, the Company's financial profile could deteriorate, thereby making it more difficult for the Company to finance debt at reasonable rates, and ultimately lead to higher customer rates.⁷ Historically, the Company's declining usage was addressed by traditional approaches, such as increased basic service charges and declining block rate structures; however, these approaches were never completely successful in removing the detrimental financial impacts of declining usage.

In its 2010 rate case, Southwest Gas, in cooperation with the other Settlement Parties, developed a decoupling mechanism that was supported by Staff and ultimately approved by the Commission. The resulting EEP mechanism has two components: 1) a weather component, which stabilizes customer bills by providing a "real-time" bill adjustment when actual weather during the winter months of November to April differs from the average weather used to calculate rates; and 2) a revenue per customer decoupling component that benefits both customers and the Company by adjusting revenues on an annual basis to reflect any difference between the Company's authorized (non-gas) revenues and its actual (non-gas) revenues, thereby ensuring that the Company recovers only its Commission-authorized revenue – no more, no less.

The EEP also facilitates a partnership between Southwest Gas and its customers by aligning their interests with respect to lowering monthly utility bills. However, the EEP also offers multiple benefits beyond aligning utility and customer interests – some of which are inherent to full revenue decoupling, and others that were incorporated into the mechanism by the Settlement Parties. These benefits include:

⁷ Id.

Benefits Inherent to Full Revenue Decoupling

- Mechanism with a ceiling and a floor – Company receives its Commission-authorized revenues and provides a refund to customers when it over-collects;
- Enhanced bill stability through less frequent rate cases;
- Enhanced revenue stability, resulting in improved financial health and lower long-term debt costs;
- Administratively and mechanically simple – reduces the frequency of rate cases and does not require lengthy and often contentious hearings to determine lost fixed costs associated with energy efficiency programs.

Benefits Incorporated by the Settling Parties

- Enhanced bill stability through “real-time” bill adjustments during extreme weather events through the EEP Weather Adjustment;
- Cap on amounts collected through the surcharge, with no limit on the amounts refunded to customers in the event of an over-collection;
- 5 year stay-out provision which prevents the Company from bringing another rate case until at least April of 2016 as long as the EEP is in place;
- Annual earnings test that prevents the Company from collecting a surcharge if it will result in the Company over-earning;
- Accountability through quarterly and annual reporting requirements;
- Required customer outreach and education.
- A 25 basis point reduction in Return on Equity (ROE).⁸

⁸ There were 3 instances where utilities received 25 basis point ROE reductions in conjunction with the approval of a decoupling mechanism; however, Southwest Gas’ was the only case where the ROE reduction resulted from a settlement. See, *A Decade of Decoupling for US Energy Utilities: Rate Designs, Impacts, and Observations*, Pamela Morgan (revised February, 2013), at pp. 14-15.

IV. 2015 EEP RESULTS

As mentioned previously, the EEP mechanism has two components: 1) an annual component; and 2) a monthly weather component.

Annual Component

The annual component of the EEP adjusts rates on an annual basis such that the Company recovers *only* its authorized revenue per customer. If the Company over-collects in a given year, customers receive a refund. Southwest Gas' Arizona customers will experience this benefit - which is unique to full revenue decoupling – as a result of the EEP's performance in 2015. As indicated in the accompanying application, in the period from January 1, 2015 through December 31, 2015, Southwest Gas collected more than its authorized revenues, resulting in accruals during 2015 of \$8,299,299. These accruals combined with an EEP Balancing Account credit balance at December 31, 2015 results in the Company requesting to change the rate to \$(0.04053) per therm.

The historical volumes used in the 2010 rate case occurred during the downturn in the economy. It is reasonable to conclude that subsequent improvements in Arizona's economy, such as a decrease in the unemployment rate from 10.5% to 5.9%⁹, has led to an increase in customer volumes when compared to 2010, along with other factors.

The EEP annual component compares weather normalized differences in authorized and actual revenues based on weather normalized consumption. Since weather normalized consumption is higher in 2015 than in the 2010 rate case, the annual component is reflected as a credit. However, regardless of the variations in the average volumes per customer, the Company is only recovering the Commission- authorized margin per customer as evidenced in the accruals during 2015 of approximately \$8.3 million.

⁹ Bureau of Labor Statistics, State and Area Employment Data for Arizona.

Monthly Weather Adjustment

The EEP's monthly weather component provides immediate customer relief from high energy bills when weather is colder than normal and an additional layer of revenue stability, by adjusting customer bills during the winter months of November through April when weather conditions are either colder or warmer than normal.¹⁰ Calendar year 2015 was one of the warmest years ever recorded in Arizona. In past winter seasons, customers received credits on their bills when actual weather was colder than normal. However, the January 2015 – March 2015 timeframe was among the warmest weather on record, which resulted in upward adjustments to customer bills. A review of customer bill impacts in Arizona during 2015 illustrates the effect that the weather component had on bills during this period.

As indicated in the graph attached as **Appendix B**, the warmer-than-normal weather throughout the year generally resulted in upward adjustments to the average residential customer's bill. However, these weather adjusted bills were still less, in most months, than the predicted bill (the predicted, or authorized bill, represents the estimated bill for this time period that was set in the last general rate case). The weather component worked to avoid the "peaks and valleys" effect that abnormal weather typically has on customer bills, and instead stabilized bills with moderate adjustments.

Cost of Capital

Full revenue decoupling provides for greater revenue and cash flow stability for a utility. This enhances the utility's credit quality by providing greater assurance for fixed cost recovery. In addition, the approval of a decoupling mechanism demonstrates constructive regulatory support, which is also a positive factor for a utility's credit ratings. As a result, decoupling is viewed by rating agencies as credit positive and therefore assists a utility to obtain and maintain higher credit ratings, which benefits its customers through lower debt costs.

¹⁰ Pursuant to Sections 3.21 and 3.22 of the Settlement Agreement, the Company reports on the EEP's weather component in quarterly reports to the Commission.

Credit ratings play an important role in capital markets by providing an effective and objective tool for market participants to evaluate and assess credit risk. As a result, Southwest Gas' credit ratings are a key factor in determining the required yield on the Company's debt securities and bank facilities, and the amount and terms of available unsecured trade credit. Indeed, decoupled rates, in conjunction with: (1) improved operating results; and (2) an improved capital structure, have resulted in upgrades to Southwest Gas' credit ratings. The table below displays the Company's current unsecured credit ratings compared to the ratings at June 30, 2010 (the end of the test period in the 2010 general rate case).

Rating Agency	Last Change	Current	June 30, 2010
S&P	October 2014	BBB+	BBB
Moody's	January 2014	A3	Baa2
Fitch	May 2013	A	BBB

A utility's regulatory environment is another key factor in its credit ratings. In order to gauge the level of regulatory risk for a utility and assess regulatory jurisdictions on a relative basis, S&P evaluates the relative credit supportiveness of regulatory jurisdictions based on quantitative and qualitative ratemaking factors that focus on four main categories: (1) the stability of the basic regulatory paradigm employed in the jurisdiction; (2) tariff-setting procedures; (3) financial stability; and (4) the political independence of the regulator.¹¹ S&P then classifies each jurisdiction into one of five categories: (1) Strong; (2) Strong/Adequate; (3) Adequate; (4) Adequate/Weak; and (5) Weak. In its January 2014 update of regulatory assessments, S&P listed Arizona's regulatory jurisdiction as Strong/Adequate. In addition, both Moody's and Fitch have recognized an improved regulatory environment in Arizona, which have been a positive factor for credit ratings. Fitch, in a recent publication, a copy of which is attached as **Appendix C**, commented on the improved regulatory environment in Arizona:

¹¹ Standard & Poor's Ratings Direct, *Utility Regulatory Assessments For U.S. Investor-Owned Utilities*, January 7, 2014.

In a credit supportive development, the ACC authorized partial decoupling for electric utilities and a full decoupling for local gas distribution companies (LDCs) since 2012. Revenue decoupling separates recovery of fixed costs from sales, supporting Arizona's energy efficiency and Renewable Portfolio Standard (RPS) targets while stabilizing utility earnings and cash flows.¹²

Energy Efficiency

The revenue stability provided by the EEP has provided Southwest Gas with the liberty to embrace conservation and energy efficiency without unduly harming its ability to recover its cost of providing service. The most recent Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation Plan (EE/RET Plan) approved by the Commission authorized an annual budget of \$4.7 million,¹³ with an average cost to customers of approximately \$0.22 per month. Southwest Gas has prudently managed the approved budget, and is aggressively promoting energy efficiency programs that are both cost-effective and responsive to market demands. As a result, in Year 3 of its EE/RET Plan,¹⁴ the Company achieved 4,036,023 annual therm savings – helping save customers approximately \$2,171,259.

V. COMMUNICATION ENHANCEMENTS

As discussed in last year's report, the Company made several enhancements to its communication efforts to ensure greater customer communication and transparency with respect to the EEP. During this reporting period, the Company updated information on the EEP website (www.swgas.com/eed) to include a video on the EEP. Southwest Gas is committed to continuing to review its communication efforts to ensure all customers have access to the information they need to understand the EEP and the benefits it provides to customers and the Company.

To better understand how best to communicate with customers the EEP, the Company conducted focus group meetings in Phoenix and Tucson in July 2015. Each customer who called

¹² Fitch Ratings, *Special Report: Arizona Regulation: Improved Regulatory Compact*, January 7, 2016, p. 1.

¹³ In Decision Nos. 73231 and 73229, the Commission approved an annual DSM budget of \$4.7 million for Plan Year 1 with projected annual program savings of 1.4 million therms. The \$4.7 million budget was continued for Plan Year 3 and Plan Year 4.

¹⁴ The Year 3 Plan was effective June 1, 2014 through May 31, 2015.

the Commission with a bill related inquiry, or contacted the Company about the EEP, was invited to participate. From these focus groups, Southwest Gas identified three factors that contributed to the heightened customer interest during the time period of November 2014 through June 2015: 1) addition of line items for the EEP weather adjustment and EEP annual components, 2) increase in gas costs and 3) record warm weather. Feedback from these focus groups was instrumental in the development of the EEP video on the Company's website (refer to Section V of the report).

VI. ADDITIONAL INFORMATION REQUIRED BY THE SETTLEMENT AGREEMENT

Section 3.23 of the Settlement Agreement requires Southwest Gas to address various factors related to the EEP's revenue decoupling component in its annual report. The remaining items are addressed below.¹⁵

Customer Complaints Resulting From or Associated With Decoupling

As discussed in last year's annual report, in November 2014, Southwest Gas began itemizing the annual decoupling component and weather adjustment component on customer bills. From mid-December 2014 through April 2015, Southwest Gas saw an uptick in customer calls and billing-related inquiries, related to the weather adjustment component of the EEP. For the year, the Company received 133 billing-related inquiries from the Commission on the weather adjustment where the Company explained, among other things, how the monthly weather component of the EEP affects customer bills. The Company considered each of these inquiries a very high priority. As previously reported to the Commission in Docket No. G-01551A-13-0327, Southwest Gas has an escalation queue for customers who wish to understand the details of the decoupling calculations. When further explanation was necessary, the Company utilized its defined escalation process, whereby a senior member of its Rates and Regulatory Analysis Department contacted the customer personally to ensure their concerns were fully addressed.

¹⁵ The Company discusses other items listed in Section 3.23 of the Settlement Agreement, such as the removal of disincentives to energy efficiency and compliance with the EE Rules, in Section IV of this Report.

Southwest Gas did not receive any inquiries or complaints regarding the annual decoupling component of the EEP during the reporting period.

Usage Per Customer Differences Between New and Existing Customers

The information attached as **Appendix D** displays the usage per customer (UPC) for residential customers initiating service during 2012 and 2013 (the most recent years for which a full twelve-months of data is available), and those initiating service between 2001-2010; 1991-2000; 1981-1990; 1971-1980; and prior to 1971. **Appendix D** also includes a comparison of the recorded and weather-adjusted monthly UPC for customers initiating service in 2012 and 2013, and those initiating service prior to 2012. This data indicates that, in general, new customer UPC is less than it has been historically.

Overall Customer Usage, UPC, and Customer Growth per Class on a Pre- and Post-Decoupling Basis

Southwest Gas analyzed the changes in recorded number of customers and recorded volumes on a pre- and post-decoupling basis for those rate schedules included in the EEP. The two time periods analyzed were 2009-2011 for pre-decoupling and 2012-2015 for post-decoupling. The total recorded average changes in overall customer usage, customer volume and UPC are summarized in the table below.

	Residential	Non-Residential
Volume		
Pre-Decoupling	282,066,888	184,152,790
Post-Decoupling	272,975,979	180,407,633
Change	(9,090,909)	(3,745,158)
Customers		
Pre-Decoupling	945,342	39,844
Post-Decoupling	980,722	39,463
Change	35,379	(381)
UPC		
Pre-Decoupling	298.4	4,621.9
Post-Decoupling	278.3	4,571.6
Change	(20.1)	(50.3)

In addition, actual and weather normalized UPC for Southwest Gas' single-family residential customers for the twelve-year period from 2002 through 2015 is attached as **Appendix E**. This data shows a trend of increasing weather normalized UPC over the period for residential customers, the Company's largest customer class.

Customer Migration

No Southwest Gas customers have migrated (i.e. elected to move) from a decoupled rate schedule to a non-decoupled schedule. The Company's non-decoupled rate schedules, with only one exception (Schedule No. G-25 – Transportation Eligible), either require the customer to install and operate a specific natural gas appliance, or are closed to service to new customers. Southwest Gas is not aware of any customers that converted to non-gas energy service.

Support for New Customer Growth Including the Encouragement of New and Economic Uses of Natural Gas

Southwest Gas continues to support new economic uses of natural gas and opportunities for new customer growth. For example, the Company continues to evaluate proposals for multi-family residential DSM programs, as it believes greater utilization of natural gas in the multi-family market will result in greater overall energy efficiency for all Arizona customers. The Company has also been aggressively promoting the use of liquefied natural gas (LNG) and compressed natural gas (CNG) as a cleaner burning, domestically abundant and less expensive alternative transportation fuel for use by private individuals, commercial light duty fleets, heavy duty fleets, transit bus fleets, school bus fleets and refuse truck fleets.

In 2015, Southwest Gas entered into two additional agreements with Liberty Utilities to serve two of their compressed natural gas (CNG) fueling stations in Goodyear and Sierra Vista. Liberty Utilities built these two private CNG fueling stations to serve their company owned light duty pickup trucks. Southwest Gas has also been working with the Town of Gilbert, Waste Management and UPS to build private CNG refueling stations at each respective location. The Town of Gilbert will refuel refuse trucks in Gilbert Arizona; and Waste Management will refuel

refuse trucks in Marana, Arizona. UPS will refuel Class-8 long haul trucks at their main Phoenix, Arizona distribution center. In addition to these successful efforts, Southwest Gas continues to pursue additional opportunities to accelerate the use of natural gas as a cleaner burning, domestically abundant and less expensive alternative transportation fuel.

VII. CONCLUSION

In its analysis of the Company's 2014 EEP Annual Report, the Commission concluded, "the revenue decoupling mechanism has accomplished its objectives, including both enhanced revenue stability for the Company and bill stabilization for consumers, as well as removal of disincentives to energy efficiency"¹⁶, and the Commission unanimously approved the Company's surcredit application. The EEP results for this reporting period support the same conclusion.

As demonstrated herein, customers continue to benefit from the Commission's decision to implement the EEP and full revenue decoupling is functioning as the Commission and the Settlement Parties intended. Customers continue to benefit from enhanced bill stability by reducing the frequency of rate cases, by adjusting customer bills to remove the vagaries of abnormal weather, and by preventing Southwest Gas from increasing profits through increased sales.

The Company therefore respectfully submits that the EEP remains in the public interest, that no good cause exists to suspend, terminate or modify the mechanism, and that the EEP should be continued in its current form.

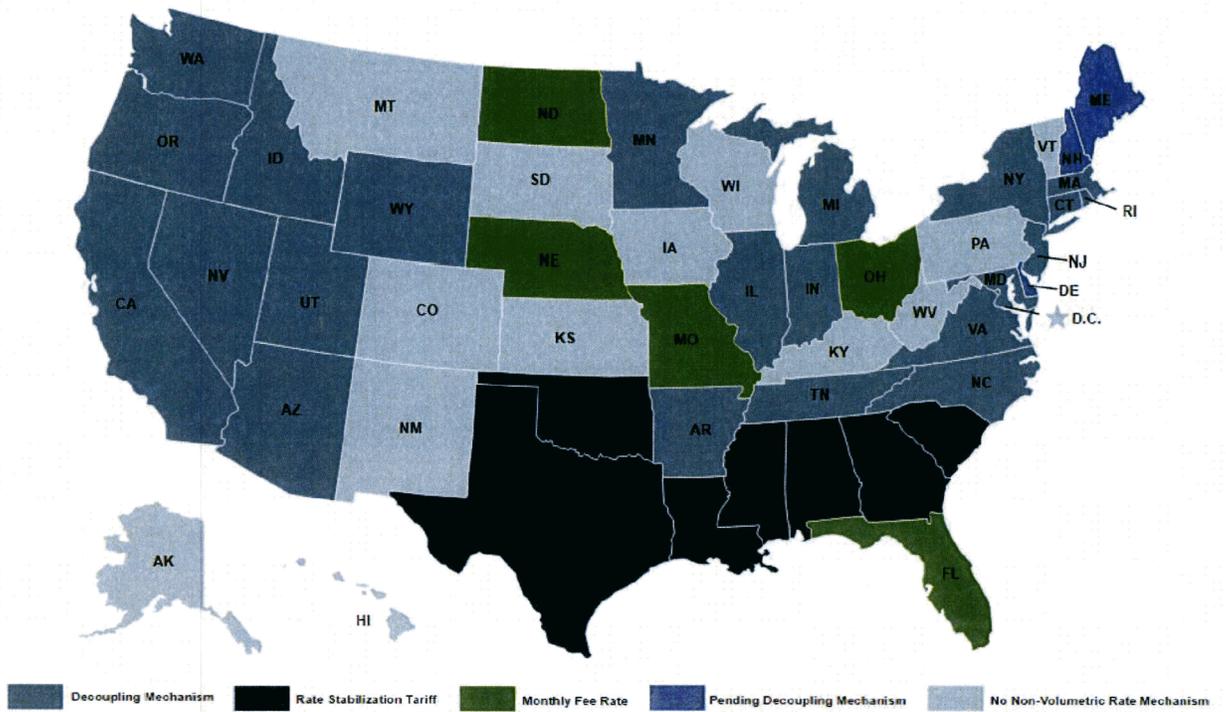
¹⁶ Decision No. 75356 at pp. 7-8.

Appendix A

Innovative Rates, Non-Volumetric Rates, and Tracking Mechanisms: Current List

AGA
American Gas
Association

States with Non-Volumetric Rate Designs



Utilities with Approved Decoupling Mechanisms

- | | |
|--|---|
| 1. AR – Arkansas Oklahoma Gas | 30. MN – Minnesota Energy Resources |
| 2. AR – SourceGas | 31. NC – Piedmont Natural Gas |
| 3. AR – CenterPoint Energy | 32. NC – Public Service Company of North Carolina |
| 4. AZ – Southwest Gas | 33. NJ – New Jersey Natural Gas |
| 5. AZ – UNS Gas | 34. NJ – South Jersey Gas |
| 6. CA – Pacific Gas and Electric | 35. NV – Southwest Gas |
| 7. CA – San Diego Gas and Electric | 36. NY – Corning Natural Gas |
| 8. CA – Southern California Gas | 37. NY – National Grid NYC |
| 9. CA – Southwest Gas | 38. NY – National Grid Long Island |
| 10. CT – Connecticut Natural Gas | 39. NY – National Grid Niagara Mohawk |
| 11. GA – Liberty Utilities | 40. NY – National Fuel Distribution |
| 12. ID – Avista | 41. NY – New York State Electric and Gas |
| 13. IL – Ameren Illinois | 42. NY – Orange and Rockland |
| 14. IL – Peoples Gas | 43. NY – Rochester Gas and Electric |
| 15. IL – North Shore Gas | 44. NY – Central Hudson Gas and Electric |
| 16. IN – Citizens Energy Group | 45. OR – Cascade Natural Gas |
| 17. IN – Vectren North Indiana Gas | 46. OR – Northwest Natural Gas |
| 18. IN – Vectren South SIGECO | 47. RI – National Grid Narragansett |
| 19. MA – Columbia Gas of Massachusetts | 48. TN – Chattanooga Gas |
| 20. MA – Fitchburg Gas and Electric | 49. UT – Questar Gas |
| 21. MA – National Grid Massachusetts | 50. VA – Columbia Gas of Virginia |
| 22. MA – Eversource Energy | 51. VA – Virginia Natural Gas |
| 23. MA – Liberty Utilities | 52. VA – Washington Gas |
| 24. MD – Baltimore Gas and Electric | 53. WA – Avista Corp. |
| 25. MD – Columbia Gas of Maryland | 54. WA – Puget Sound Energy |
| 26. MD – Washington Gas | 55. WY – SourceGas |
| 27. MI – Consumers Energy | 56. WY – Questar Gas |
| 28. MI – DTE | |
| 29. MN – CenterPoint Energy | |

Pending Mechanisms

1. DE – Delmarva Power and Light
2. ME – Maine Natural Gas
3. NH – Passed Legislation
4. OR – Avista Corp.
5. WA – Cascade Natural Gas

Utilities with Flat Monthly Fee Rate Designs (SFV)

Approved SFV

1. GA – Atlanta Gas Light – Individually determined monthly demand charge
2. MO – Missouri Gas Energy – Flat monthly fee
3. ND – Montana-Dakota Utilities
4. ND – Xcel Energy – Flat monthly fee
5. OH – Columbia Gas of Ohio – Flat monthly fee
6. OH – Dominion East Ohio – Flat monthly fee
7. OH – Duke Energy – Flat monthly fee
8. OH – Vectren Ohio – Flat monthly fee

Similar to SFV

1. FL – TECO Peoples Gas – Three-tier monthly charge plus a small variable charge
2. IL – Ameren Illinois – 80% revenue for Residential and Small GS Customers per flat fee plus small variable charge
3. IL – Nicor Gas – Flat fee plus a small variable charge
4. MO – Ameren – Modified rate blocks for Residential Service customers
5. MO – Liberty Utilities – Flat fee plus a small variable charge
6. MO – Laclede Gas – Modified rate blocks
7. NE – Black Hills – Declining rate blocks
8. NE – SourceGas – Modified rate blocks
9. OK – Oklahoma Natural Gas – Two-tier plan – Offers customers a choice
10. TX – Texas Gas Service – Flat fee up to 200 ccf/month

Pending

1. DE – Delmarva Power and Light

Current Status of Rate Stabilization Tariffs

Approved

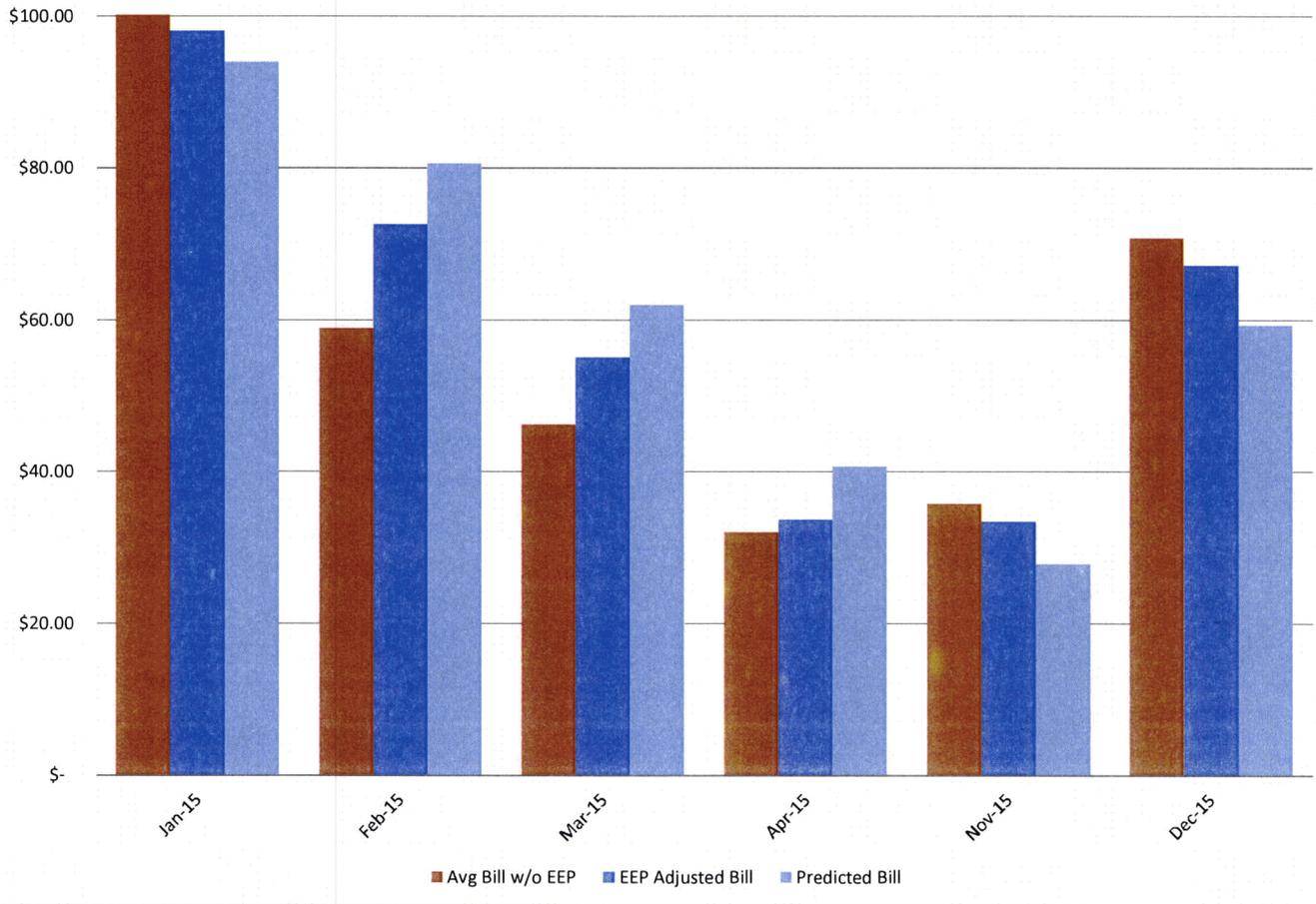
1. AL – Alabama Gas
2. AL – Mobile Gas
3. GA – Liberty Utilities
4. LA – Atmos Energy
5. LA – CenterPoint Energy
6. LA – Entergy
7. MS – Atmos Energy
8. MS – CenterPoint Energy
9. OK – CenterPoint Energy
10. OK – Oklahoma Natural Gas
11. SC – Piedmont Natural Gas
12. SC – South Carolina Electric and Gas
13. TN – Atmos Energy
14. TX – Atmos Energy

Pending

1. KS – Atmos Energy

Appendix B

Single Family Residential Average Bills



Appendix C

Arizona Regulation: Improved Regulatory Compact

Special Report

Improved Regulatory Compact: The regulatory compact in Arizona is balanced and has improved meaningfully in recent years, supported by constructive general rate case (GRC) outcomes, decreasing regulatory lag, decoupling for both electric and gas utilities, and implementation of regulatory mechanisms to facilitate more timely cost recovery outside of GRCs. In Fitch Ratings' opinion, regulation in Arizona will continue to be a key driver of credit quality for the state's investor-owned utilities (IOUs).

Decreased Regulatory Lag: Regulatory lag remains a concern due to a mismatch of when costs are incurred and recovered, primarily reflecting use of historical test years in GRCs. However, rate case duration has been decreasing and has contracted from more than 20 months, in at least one instance, to approximately 11 months. Relatively timely GRC adjudication and adoption of various cost recovery mechanisms have improved earned returns. Unexpected deterioration in the regulatory compact could trigger future credit downgrades.

ACC Net Metering Review: While distributed generation (DG) installations represent a relatively small proportion of kilowatt-hour (kWh) sales in Arizona, Fitch believes strong expected growth of DG is a potential secular threat to IOU's creditworthiness. The ACC opened a generic docket focused on net metering and related cost shifting issues affecting residential ratepayers. The ACC's generic proceeding to address rate design and net metering is a constructive development for the IOUs operating in Arizona.

Revenue Decoupling Adopted: In a credit supportive development, the ACC authorized partial decoupling for electric utilities and a full decoupling for local gas distribution companies (LDCs) since 2012. Revenue decoupling separates recovery of fixed costs from sales, supporting Arizona's energy efficiency and Renewable Portfolio Standard (RPS) targets while stabilizing utility earnings and cash flows. Arizona is targeting a 15% RPS by 2025 and 22% in cumulative annual electricity savings by 2020, using 2009 as a baseline year.

Authorized ROEs Trending Downward: Authorized returns on equity (ROE) for electric IOUs in Arizona have trended modestly downward since 2010, consistent with industry trends. In its last rate case completed in May 2012 Arizona Public Service Company (APS) was authorized a 10% ROE, compared with an authorized ROE of 11% in its previous rate case settled in December 2009. Fitch does not expect future authorized ROEs to dip materially below current levels, as significant declines in interest rates from current levels seem unlikely.

Regulatory Fatigue: Fitch expects IOUs' financial stability to sustain in the near to intermediate term, but is concerned that regulatory fatigue stemming from the size and frequency of past and future rate increases may lead to customer backlash and increased regulatory uncertainty. As a partial offset, residential electric retail rates in Arizona approximate industry averages and compare favorably regionally. Retail rates for gas utilities are higher than industry averages primarily due to geography and supply constraints.

Elevated Capex: A credit supportive regulatory framework is essential to the IOUs' ratings, given their elevated, projected capital spending. Balanced rate outcomes that allow adequate recovery of capex on a timely basis will be critical to maintaining IOU credit quality. Fitch estimates combined capex for the three largest Arizona IOUs will be over \$5.8 billion over the next three years, an increase of roughly 25% over the previous three years.

Related Research

Outlook Report: 2016 Outlook: U.S. Utilities, Power and Gas (Glimpse of the Dark Side) (December 2015)

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Balanced Regulatory Compact

Fitch believes the regulatory compact in Arizona has improved in recent years and is a key factor driving improved financial profiles for the state's IOUs. This view is supported by constructive GRC outcomes observed over the past five years in which Arizona-based utilities received above 50% of the requested amount, on average. Current IOU ratings are also supported by adoption by the ACC of revenue decoupling for electric and gas utilities and regulatory cost recovery mechanisms that underpin the IOUs relatively stable earnings and cash flows.

In March 2005 Regulatory Research Associates (RRA) upgraded the ranking of Arizona regulation to 'Average/3' from 'Below Average/1', suggesting a notable improvement in regulation. Arizona was rated 'Below Average/1' from 1990 to 2002. RRA rankings are classified into three categories: 'Above Average', 'Average' and 'Below Average', with 'Above Average/1' being the strongest ranking and 'Below Average/3' being the weakest. RRA considers Arizona regulation to be improved and relatively balanced from an investor perspective.

Upward Ratings Migration

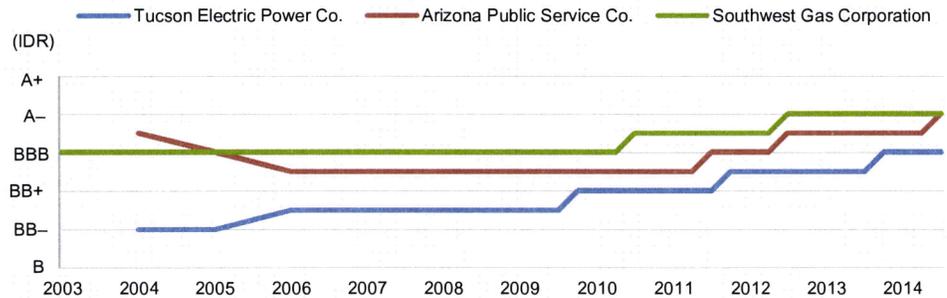
The credit quality of Arizona's three largest IOUs has significantly improved in recent years with all three rated solidly in the investment-grade category, as illustrated in the chart below. The Issuer Default Rating (IDR) of APS, Arizona's largest electric utility, has improved markedly, and was recently upgraded to 'A-' in May 2015 from a low of 'BBB-' from January 2006 to May 2011. The upgrade reflects strong credit metrics, reduced regulatory lag and improved earned returns. The ACC eliminated a restrictive sharing mechanism that has been a part of APS's power supply adjustor in their most recent rate case.

The IDR of Tucson Electric Power Company (TEP), Arizona's second largest electric utility, was upgraded to 'BBB' August 2014 and its Rating Outlook was recently revised to Positive, a stark contrast from the utility's non-investment-grade rating of 'BB' July 2006 through June 2009. The upgrade from 'BBB-' to 'BBB' and Positive Outlook reflect the acquisition of Tucson Electric Power Co. (TEP) by Fortis Inc. in 2014.

TEP was upgraded to 'BBB-' in September 2012 and reflecting the utility's strong performance at the end of its five-year, nonfuel base rate freeze, an improved regulatory environment and expectations for a constructive outcome in its 2012 GRC. TEP's 2012 GRC settlement was constructive, in Fitch's opinion, authorizing recovery of significant rate base additions, partial revenue decoupling and recovery of higher operating expenses.

The IDR for Southwest Gas Corp. (SWX), Arizona's largest LDC, has also seen marked improvement and was upgraded to 'A-' in May 2013 from a recent low of 'BBB' during July 1996 to June 2010. The upgrade reflects strong operational performance, improved earnings and reduced regulatory lag. The constructive outcome of SWX's last settled GRC has resulted in stronger credit metrics and a lower business risk profile.

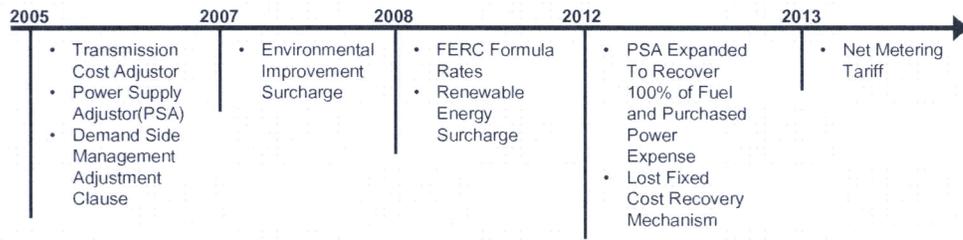
Rating History For Fitch Rated Arizona Utilities



IDR – Issuer Default Rating.
Source: Fitch.

Constructive Regulatory Mechanisms

APS Rate Design Timeline



Source: Fitch.

The ACC has adopted several regulatory mechanisms to facilitate cost recovery outside of GRCs, supporting the investment-grade credit profile of Arizona’s largest IOUs. Arizona rate design includes a fuel-adjustment clause adjusted annually that permits recovery of 100% of fuel and purchased power expenses. Cost recovery mechanisms include an environmental compliance adjustor, a property tax rider, a transmission cost adjustor, demand side management and renewable energy surcharges, and a Lost Fixed Cost Recovery Mechanism (LFCR), which facilitates partial revenue decoupling for electric utilities. The LFCR is designed to recover a portion of lost revenues associated with energy efficiency and distributed generation programs. In addition, the ACC authorized full revenue decoupling for most gas LDCs in 2012. The state’s LDCs also benefit from a purchased gas adjustment mechanism, with monthly adjustments that allow for timely recovery of gas commodity costs.

Furthermore, the ACC authorized a one-time rate rider for APS in December 2014 to collect \$57.1 million of incremental annual costs related to the acquisition of the additional interests in Units 4 and 5 of the Four Corners coal-fired generating facility. ACC approval of the rider is a constructive development for APS from a credit point-of-view.

Fitch highlights in its credit analysis of IOUs the timely ability to recover fuel and commodity costs as a key driver of cash flow stability and stable ratings over time. In a notable development for gas LDC’s, the ACC recently authorized a limited infrastructure recovery mechanism (IRM) for SWX, the first time the ACC authorized an IRM. The use of an IRM permits LDC’s to recover costs associated with infrastructure improvement projects outside of GRC proceedings, mitigating regulatory lag. As part of its last GRC, SWX was authorized to

implement a limited infrastructure system replacement surcharge rider to replace and relocate leaking customer-owned yard lines (COYL). In January 2014 SWX received authority to expand the scope of the infrastructure rider to include the replacement of non-leaking COYLs. The expansion of SWX's IRM is indicative of continued constructive support from the ACC.

Rate Design Continues to Evolve

Net metering remains a contentious and politicized issue in Arizona between utilities and solar DG customers and advocates. On one side, the utilities favor net metering rate design changes that address the current cost shifting of fixed costs between solar and nonsolar customers. TEP has proposed a three-part rate design for residential customers to better align fixed costs with rates. The proposed three-part rate design would include a fixed charge, a demand charge and a volumetric component for residential net metering customers.

Most commercial electric utility customers already take service under a three-part rate design. On the other side, net metering customers, roof-top solar companies and solar advocates, including the powerful solar lobby group, The Alliance for Solar Choice (TASC), favor continuing current retail net metering policies and contend that any additional fixed or demand charges on net metering customers would stifle DG growth. TASC includes the leading solar installer Sunrun.

The utilities contend that net metering results in an unfair cost shift of fixed costs between net metering and non-net metering customers. The ACC has authorized a limited monthly fixed charge on APS' residential solar net metering customers effective January 2014 that addresses a portion of the cost shift. The ACC authorized a monthly fixed charge of \$0.70 per kW (approximately \$5 per customer per month) for APS' net metering customers in December 2013 for rates effective January 2014, the first time a net metering tariff was instituted in Arizona.

Net metering in Arizona remains politicized and the solar company SunRun recently introduced failed motions with the ACC in September 2015 to recuse current commissioners Bob Stump, Doug Little and Tom Forese from net metering decisions due to accusations of bias in favor of utilities. Additionally, there have been accusations that APS is alleged to have spent millions in dark money campaign contributions to help elect Forese and Little to the ACC in November 2014.

Meanwhile, rate design regarding DG and net metering continues to evolve in Arizona and the ACC recently voted to proceed with a generic docket to consider rate design and cost of service issues on distributed generation and net metering with the findings used to inform prospective GRC filings. Concurrently, the ACC also dismissed APS' request to increase its grid access charge to \$3/kW from \$0.70/kW. Fitch expects the cost-of-service hearings to begin in April 2016 and the findings to be incorporated in APS' next GRC filing expected in June 2016.

APS filed with the ACC in April 2015 to increase its rooftop solar grid access charge to \$3/kW effective Aug. 1, 2015 from \$0.70/kW currently, which would result in a monthly charge of \$21 for a typical residential customer, based on a 7kW system. The current grid access charge of \$0.70/kW addresses a portion of the cost shift, which APS estimates at \$67 per month per rooftop solar customer. Fitch views the potential adoption of an increased grid access charge as positive for APS and notes the previously requested grid access charge had been supported by the ACC, ACC staff and the Residential Utility Consumer Office (RUCO) as reasonable. The grid access charge is revenue neutral and credited to the LFCR mechanism.

TEP has proposed a new net metering tariff as part of its latest GRC filing in November 2015 having withdrawn its previous request to revise its net metering tariff in June. TEP is currently seeking net metering rate design changes as part of its GRC filing that would reduce the reliance on volumetric sales to recover fixed costs and is proposing a three-part rate design, which would include a fixed charge, a demand charge and a volumetric component for new net metering customers. TEP also proposed to purchase excess solar generation from new customer rooftop systems at a utility scale solar rate rather than the current full retail rate, which would largely address future cost-shifting issues between TEP's solar and nonsolar customers.

Fitch views the potential adoption of a new net metering tariff that addresses current cost shifting issues as positive for TEP. TEP's sister company, UNS Electric Inc., filed its 2015 GRC with the ACC in May and is seeking similar net metering rate design changes. Intervenor testimony in UNS Electric's GRC was filed on Dec. 9, 2015. Among key intervenors, RUCO supports the concept of a minimum customer bill and time of use rates along with TASC. APS, also an intervenor in the proceeding, supports the concept of a three-part rate design and ACC staff supports the concept of a three-part rate design for all customers. Fitch expects a decision by the ACC in UNS Electric's GRC during second-quarter 2016.

The ACC has also authorized the approval of limited company-owned residential rooftop solar programs for both APS and TEP. For APS, the ACC had no objection to a 10 MW utility-owned residential rooftop solar program focused on low-income customers, and for TEP the ACC authorized a limited company-owned residential rooftop solar program to install 3.5 MW of distributed generation.

Marginal DG Impact

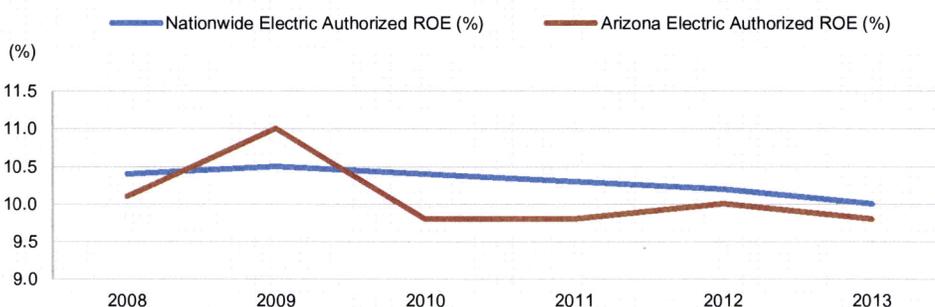
Currently, the DG effects to Arizona utilities creditworthiness are not considered material, given their relatively small market share, but the continued growth of DG installations could become a credit concern if the trend materially increases in the future. Residential DG installations in APS service territory have been increasing at a 14% CAGR since 2012, with 57 MW installed in 2014, but ultimately penetration levels remain small, with 265 MW installed since 2009, approximating 4% of APS' 2014 generating capacity. For APS, DG currently comprises 0.5% or less of the negative impact to retail sales growth and the company expects that approximately 12% of the company's retail sales in 2015 will be met by renewable resources, more than double the 2015 RPS requirement of 5%. Cost recovery is provided through the LFCR mechanism, which is estimated to offset 30%–40% of revenues lost due to ACC-mandated energy efficiency (EE) and distributed renewable generation initiatives, subject to an annual year-over-year cap at 1% of revenues. At the margin, this under-recovery of DG- and EE-related costs impedes the Arizona utilities' ability to earn their authorized ROEs.

Authorized ROEs Approximate Industry Average

Authorized ROEs in Arizona currently approximate the U.S. industry average, as reflected in the most recent rate cases of Arizona's two largest electric IOU's, where Arizona Public Service and Tucson Electric Power Co. were both granted ROEs of 10%, respectively. The electric mean industry average ROE was 9.91% in 2014 and 10.03% in 2013. In SWX's most recent rate case, the utility was authorized an ROE of 9.5%, in line with the U.S. industry gas LDC average. The LDC mean industry average ROE was 9.78% in 2014 and 9.68% in 2013. Fitch views the ACC's recent allowance of a premium rate of return on fair value of rate base as a credit positive for IOU's in the state and help to bolster overall ROE.

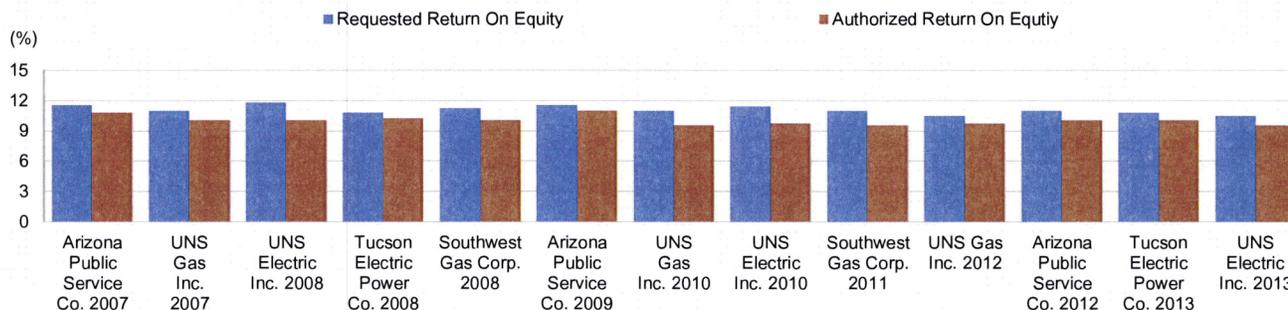
Authorized ROEs of Arizona electric IOUs have trended modestly downward in recent years, declining 25 basis points (bps) to 9.75% in 2013 from 10% in 2012, in line with national trends. The downward trend primarily reflects the prolonged low interest rate environment and regulatory concerns regarding rising rates in a still somewhat challenging national economic environment. However, economic conditions in Arizona are improving as evidenced by a downward trending unemployment rate and increased housing starts. Arizona's unemployment rate was 5.9% in June 2015, slightly above the 5.3% U.S. national average, and is at its lowest level in six years. Fitch does not expect authorized ROEs to dip materially below current levels. However, future rate decisions that result in authorized ROEs significantly below current levels would be a negative development from a credit point of view, with credit ratings likely to be pressured as a result.

Arizona versus Nationwide Mean Authorized ROE



Source: Fitch, SNL Financial.

Arizona Rate Case ROE Requests and Outcomes



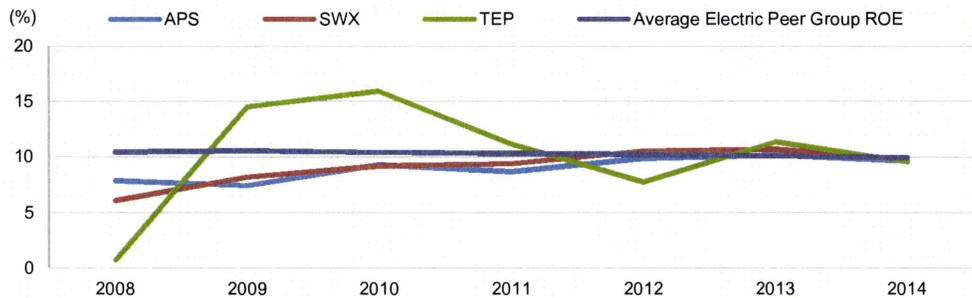
Source: Fitch, SNL Financial.

Reduced Regulatory Lag

Regulatory lag in Arizona has been decreasing but remains a credit concern for IOUs in a state historically known for pervasive regulatory lag and high customer growth. Regulatory lag primarily stems from the use of historical test years and the disallowance of construction work in progress (CWIP). However, the more timely adjudication of rate filings in recent years, including the ACC's recognition of an extended post-test year period for new plant additions, are constructive mitigants. Fitch views the ACC's policy commitment to make a good faith effort to process future GRCs within 12 months of a sufficiency finding as a key driver of reduced regulatory lag.

Regulatory lag has decreased in recent years but remains a key credit concern for Arizona IOU's with a rate review period currently averaging nearly 12 months. In contrast, the rate review period in the constructive regulatory compact of Wisconsin averages about six months. Reduced regulatory lag is evidenced by APS's last rate GRC, which was adjudicated in just 11 months as compared to 21 months previously. Earned rates of return of Arizona's IOU's have markedly improved over the last five years due to a combination of reduced regulatory lag, balanced rate outcomes and the implementation of regulatory cost recovery mechanisms.

Arizona's Largest IOUs Earned ROEs versus National Average



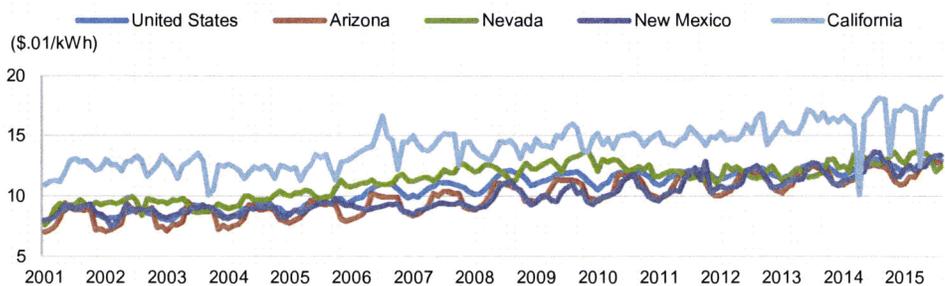
ROE – Return on equity.
Source: Fitch, SNL Financial.

Fitch expects regulatory lag to persist in the near to intermediate term but expects it to be much less pervasive than has been the case historically. Balanced rate outcomes and efficient cost-control measures will be critical to Arizona IOUs maintaining stable ratings and improved credit profiles in light of relatively elevated capital spending projected in the near term. Fitch estimates combined capex for the largest Arizona IOUs will be greater than \$5.8 billion in 2015–2017.

Arizona Electric Retail Rates

Arizona's modestly below average residential electric rates partially mitigates near-term pressure on customer ratepayers from future base rate increases, compares favorably to neighboring states, and trends in line with the national average. The U.S. Energy Information Administration reported the Arizona monthly average residential electric retail price in October 2015 to be \$0.1222/kWh against a national average of \$0.1273/kWh and rates in adjacent states of \$0.1498/kWh (California), \$0.1299/kWh (Nevada) and \$0.1271/kWh (New Mexico). By comparison, the Arizona residential retail rate was \$0.1096/kWh against a national rate of \$0.1186/kWh in October 2010. The *Monthly Average Residential Electricity Prices* chart below illustrates the historical variations in retail rates in 2001–2015.

Monthly Average Residential Electricity Prices (2001–2015)



Source: E.I.A.

Commission Overview

Commissioners Little and Forese are the newest elected members of the ACC, having won the general election in November 2014. Commissioners Little and Forese replaced fellow Republicans Brenda Burns and Gary Pierce and are serving four-year terms (limited to two consecutive) that expire in January 2019. Arizona is one of only 13 states with elected commissioners, whereas in the 37 other states commissioners are appointed by either the governor or the legislature. As the five member ACC remains composed of all Republicans, Fitch does not expect the addition of commissioners Little and Forese to change the dynamics of the commission and policy goals.

Governor Doug Ducey won the gubernatorial elections in November 2014, succeeding former governor Jan Brewer, a fellow Republican. Gov. Ducey was the former CEO of Cold Stone Creamery and will serve a four-year term that extends to January 2019.

Arizona Corporation Commission

Name	Title	Party	Began Serving	Term Ends
Andy Tobin	Commissioner	Republican	2016	2016
Bob Stump	Commissioner	Republican	2009	2017
Robert Burns	Commissioner	Republican	2013	2017
Doug Little	Acting Chairman	Republican	2015	2019
Tom Forese	Commissioner	Republican	2015	2019

Source: SNL Financial.

Former ACC chairman Susan Bitter Smith recently announced her resignation from the ACC effective Jan. 4, 2016 due to allegations of conflict of interest by state attorney general Mark Brnovich. In the interim commissioner Little will assume the role of acting chairman of the ACC having been elected by the four remaining commissioners and could possibly be the permanent chairman, pending a final vote by the ACC. On Dec. 30, 2015 Gov. Ducey appointed Andy Tobin, a republican and former House speaker as the newest commissioner of the ACC to fill the vacancy created by Smith's resignation until the next general election in November. Mid-term vacancies at the ACC are fulfilled by gubernatorial appointment until the next general election. Smith was elected to a four-year term on the ACC starting in January 2013, having replaced prior chairman and fellow commissioner Stump. The remaining two commissioners are serving terms that expire in January 2017 and new ACC elections will be held in November 2016. ACC members, party affiliation, titles, and appointment and end-of-service dates are summarized in the *Arizona Corporation Commission* table above.

Former ACC Chairman Smith Resigns

On Dec. 17, 2015 former ACC chairman Smith announced she will resign from the ACC, effective Jan. 4, 2016. Smith's resignation follows Arizona attorney general Brnovich's recent petition with the state Supreme Court seeking to remove her from office due to an alleged breach of conflict of interest.

The petition was filed Nov. 30, 2015 and asserted that Smith was violating the state conflict-of-interest law by working as executive director of the Southwest Cable Communications Association (SWCCA) and as a lobbyist for Cox Communications. State law prohibits corporation commission members from working for or having a financial interest in companies that they regulate.

The attorney general has stated that because the cable companies or their affiliates offer telephone service, they are regulated by the ACC. In addition to utilities, the ACC regulates local telephone providers in the state. These include affiliates of members of the SWCCA, including Cox Communications.

Additionally, commissioners Robert Burns and Stump are involved in separate investigations by the attorney general. Prior to being elected to the ACC, former chairman Smith was executive director of the Arizona-New Mexico Cable Communications Association. Fitch does not expect Smith's resignation to materially affect pending and future GRC filings with the ACC.

Pending Rate Cases

Fitch expects outcomes of pending rate cases will continue to support the IOUs' stable credit profiles. TEP, the second largest electric IOU in Arizona and a subsidiary of Fortis, Inc., filed with the ACC in November 2015 for an electric rate increase of approximately \$110 million based on a 10.35% ROE. TEP received a balanced outcome in their prior rate case settlement with the ACC, which established constructive changes to their rate design while the authorized rate increase was supportive of improved credit quality. Under TEP's last GRC settlement, the utility received approximately 60% of its rate request effective July 1, 2013 based on a ROE of 10%, 25 bps less than before and approximating the 10% national average in 2013. The settlement approved a partial revenue decoupling mechanism to recover lost sales related to energy efficiency and distributed generation and an environmental compliance adjustor.

Additionally, UNS Electric, the smallest electric IOU in Arizona and a subsidiary of Fortis, Inc., filed in May with the ACC for an electric rate increase of approximately \$22.6 million based on a 10.35% ROE. UNS Electric received a relatively balanced outcome in their prior rate case settlement with the ACC when the utility received approximately 43% of its rate request for rates effective Jan. 1, 2014 based on a ROE of 9.5%, 25 bps less than before. The settlement authorized monthly true-ups of their fuel adjustment clause and introduced a partial revenue decoupling mechanism and a transmission cost adjustor rider.

Regarding future rate cases, Fitch expects APS and SWX to both file their next GRCs with the ACC in mid-2016. Meanwhile, for the respective Arizona IOU's, Fitch expects a decision by the ACC within 12 months from the filing dates. For TEP, Fitch expects a decision in their pending GRC in fourth-quarter 2016 for rates effective Jan. 1, 2017, and for UNS Electric, Fitch expects a decision by the ACC by May 2016 for rates effective in June 2016.

Elevated Capex

Fitch expects the largest Arizona IOU's to spend over \$5.8 billion on capital investments through 2017. New generation investments including environmental compliance, along with upgrades to distribution and transmission infrastructure, including renewables and energy-efficiency investments, will represent a significant portion of electric IOUs' capex. Fitch expects SWX's capex to primarily focus on investments in gas distribution system replacement projects, including pipeline replacement.

Arizona's constructive rate design including the implementation of various cost recovery trackers provide for the timely recovery of invested capital and make viable Arizona's RPS and EE targets. Arizona is targeting a 15% RPS by 2025 and 22% in cumulative annual electricity savings by 2020, using 2009 as a baseline year.

Arizona's electric IOU's are well positioned to comply with the Mercury Air Toxics Standards rule in 2016. However, given their significant coal fired capacity, compliance with new emissions targets under the clean power plan may necessitate existing plant retirements coupled with new generation and environmental compliance investments. APS and TEP's latest 15-year integrated resource plans reflected plans to diversify their current generation fuel mix away from coal and toward cleaner generation resources, including natural gas and solar, along with increased investments in distributed generation and energy efficiency. The EPA issued final carbon emission regulations for existing power plants in August 2015 that targets a state wide reduction in carbon emissions of 24% by 2022 and 34% by 2032, using 2012 as a baseline year. Fitch believes Arizona's IOUs will continue to be committed to maintaining investment-grade ratings and expects utilities to finance capex in a conservative manner, consistent with established regulatory capital structures.

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Appendix D

SOUTHWEST GAS CORPORATION
TOTAL ARIZONA: DISTRICTS 32 - 49
RESIDENTIAL GAS SERVICE G-5 SINGLE FAMILY
INSTALL YEAR 2011
JANUARY 2015 - DECEMBER 2015
WEATHER NORMALIZATION ADJUSTMENT

Month	Year	Actual Consumption Per Customer (Therms)	Weather Normalized Consumption Per Customer (Therms)	Normal Heating Degree Days (Cycle Billed)	Actual Heating Degree Days (Cycle Billed)	Billed Customers	Actual Sales Volumes (Therms)	Weather Normalized Sales Volumes (Therms)	Weather Normalization Adjustment (Therms)	HDD Coefficients
July	2015	8.5	8.5	0.0	0.0	5,998	50,689	50,689	0	
August	2015	7.8	7.8	0.0	0.0	6,004	47,062	47,062	0	
September	2015	8.4	8.4	0.0	0.0	6,001	50,701	50,701	0	
October	2015	9.7	9.7	1.5	0.5	6,016	58,229	58,229	0	
November	2015	17.7	13.5	26.0	56.0	6,037	106,883	81,491	(25,392)	0.140200
December	2015	41.7	37.6	220.5	251.5	6,042	252,219	227,289	(24,930)	0.133100
January	2015	57.0	56.3	343.5	348.0	5,841	332,983	329,135	(3,848)	0.146400
February	2015	33.0	58.0	274.0	107.0	6,050	199,493	350,641	151,148	0.149600
March	2015	25.8	43.8	173.0	55.5	6,051	155,945	265,153	109,208	0.153600
April	2015	18.7	27.0	52.0	4.5	6,038	112,638	162,944	50,306	0.175400
May	2015	15.1	16.2	9.5	4.0	6,009	90,645	97,308	6,663	0.201600
June	2015	11.7	11.7	0.5	0.5	6,002	70,523	70,523	0	
Total		255.1	298.5	1,100.5	827.5	72,089	1,528,010	1,791,165	263,155	

SOUTHWEST GAS CORPORATION
TOTAL ARIZONA: DISTRICTS 32 - 49
RESIDENTIAL GAS SERVICE G-5 SINGLE FAMILY
INSTALL YEAR 2012
JANUARY 2015 - DECEMBER 2015
WEATHER NORMALIZATION ADJUSTMENT

<u>Month</u>	<u>Year</u>	<u>Actual Consumption Per Customer (Therms)</u>	<u>Weather Normalized Consumption Per Customer (Therms)</u>	<u>Normal Heating Degree Days (Cycle Billed)</u>	<u>Actual Heating Degree Days (Cycle Billed)</u>	<u>Billed Customers</u>	<u>Actual Sales Volumes (Therms)</u>	<u>Weather Normalized Sales Volumes (Therms)</u>	<u>Weather Normalization Adjustment (Therms)</u>	<u>HDD Coefficients</u>
July	2015	8.8	8.8	0.0	0.0	8,696	76,376	76,376	0	
August	2015	8.1	8.1	0.0	0.0	8,692	70,418	70,418	0	
September	2015	8.7	8.7	0.0	0.0	8,693	75,847	75,847	0	
October	2015	9.9	9.9	1.5	0.5	8,697	86,291	86,291	0	
November	2015	17.1	12.9	26.0	56.0	8,702	149,217	112,616	(36,601)	0.140200
December	2015	42.9	38.8	220.5	251.5	8,685	372,841	337,006	(35,835)	0.133100
January	2015	59.0	58.3	343.5	348.0	8,520	502,713	497,100	(5,613)	0.146400
February	2015	33.1	58.1	274.0	107.0	8,687	287,728	504,757	217,029	0.149600
March	2015	25.3	43.3	173.0	55.5	8,699	219,699	376,699	157,000	0.153600
April	2015	18.8	27.1	52.0	4.5	8,689	163,146	235,538	72,392	0.175400
May	2015	15.2	16.3	9.5	4.0	8,681	132,121	141,746	9,625	0.201600
June	2015	12.2	12.2	0.5	0.5	8,686	106,122	106,122	0	
Total		259.1	302.5	1,100.5	827.5	104,127	2,242,519	2,620,516	377,997	

SOUTHWEST GAS CORPORATION
TOTAL ARIZONA: DISTRICTS 32 - 49
RESIDENTIAL GAS SERVICE G-5 SINGLE FAMILY
INSTALL YEAR 2013
JANUARY 2015 - DECEMBER 2015
WEATHER NORMALIZATION ADJUSTMENT

<u>Month</u>	<u>Year</u>	<u>Actual Consumption Per Customer (Therms)</u>	<u>Weather Normalized Consumption Per Customer (Therms)</u>	<u>Normal Heating Degree Days (Cycle Billed)</u>	<u>Actual Heating Degree Days (Cycle Billed)</u>	<u>Billed Customers</u>	<u>Actual Sales Volumes (Therms)</u>	<u>Weather Normalized Sales Volumes (Therms)</u>	<u>Weather Normalization Adjustment (Therms)</u>	<u>HDD Coefficients</u>
July	2015	9.0	9.0	0.0	0.0	9,812	88,368	88,368	0	
August	2015	8.3	8.3	0.0	0.0	9,816	81,521	81,521	0	
September	2015	9.0	9.0	0.0	0.0	9,823	88,587	88,587	0	
October	2015	10.3	10.3	1.5	0.5	9,835	101,310	101,310	0	
November	2015	18.0	13.8	26.0	56.0	9,841	177,357	135,966	(41,391)	0.140200
December	2015	44.6	40.5	220.5	251.5	9,842	438,789	398,180	(40,609)	0.133100
January	2015	59.3	58.7	343.5	348.0	9,622	570,724	564,385	(6,339)	0.146400
February	2015	33.6	58.6	274.0	107.0	9,798	329,143	573,928	244,785	0.149600
March	2015	25.7	43.7	173.0	55.5	9,810	251,635	428,686	177,051	0.153600
April	2015	18.7	27.0	52.0	4.5	9,817	183,450	265,240	81,790	0.175400
May	2015	15.6	16.7	9.5	4.0	9,814	152,746	163,628	10,882	0.201600
June	2015	12.6	12.6	0.5	0.5	9,814	123,396	123,396	0	
Total		264.7	308.2	1,100.5	827.5	117,644	2,587,026	3,013,195	426,169	

SOUTHWEST GAS CORPORATION
TOTAL ARIZONA: DISTRICTS 32 - 49
RESIDENTIAL GAS SERVICE G-5 SINGLE FAMILY
MINUS INSTALL YEARS 2011 - 2013
JANUARY 2015 - DECEMBER 2015
WEATHER NORMALIZATION ADJUSTMENT

<u>Month</u>	<u>Year</u>	<u>Actual Consumption Per Customer (Therms)</u>	<u>Weather Normalized Consumption Per Customer (Therms)</u>	<u>Normal Heating Degree Days (Cycle Billed)</u>	<u>Actual Heating Degree Days (Cycle Billed)</u>	<u>Billed Customers</u>	<u>Actual Sales Volumes (Therms)</u>	<u>Weather Normalized Sales Volumes (Therms)</u>	<u>Weather Normalization Adjustment (Therms)</u>	<u>HDD Coefficients</u>
July	2015	9.2	9.2	0.0	0.0	883,398	8,099,202	8,099,202	0	
August	2015	8.5	8.5	0.0	0.0	882,741	7,461,326	7,461,326	0	
September	2015	9.0	9.0	0.0	0.0	883,457	7,907,146	7,907,146	0	
October	2015	9.9	9.9	1.5	0.5	886,118	8,784,820	8,784,820	0	
November	2015	17.8	13.6	26.0	56.0	891,285	15,838,447	12,089,702	(3,748,745)	0.140200
December	2015	48.5	44.4	220.5	251.5	896,947	43,522,899	39,822,006	(3,700,893)	0.133100
January	2015	65.6	65.0	343.5	348.0	890,828	58,449,881	57,863,004	(586,877)	0.146400
February	2015	36.6	61.6	274.0	107.0	890,497	32,602,776	54,850,241	22,247,465	0.149600
March	2015	26.0	44.1	173.0	55.5	890,720	23,184,127	39,259,842	16,075,715	0.153600
April	2015	17.2	25.6	52.0	4.5	887,720	15,306,589	22,702,628	7,396,039	0.175400
May	2015	14.4	15.5	9.5	4.0	885,406	12,778,263	13,760,001	981,738	0.201600
June	2015	11.9	11.9	0.5	0.5	884,411	10,553,174	10,553,174	0	
Total		274.6	318.3	1,100.5	827.5	10,653,528	244,488,650	283,153,092	38,664,442	

SOUTHWEST GAS CORPORATION
 ARIZONA JURISDICTION
 2015 RESIDENTIAL USE PER CUSTOMER (in therms)
 BY INSTALL YEARS

	<u>2011-2015</u>	<u>2001-2010</u>	<u>1991-2000</u>	<u>1981-1990</u>	<u>1971-1980</u>	<u>up to 1970</u>
Jan	57.6	67.5	71.7	53.5	74.0	78.2
Feb	32.7	38.0	41.8	32.4	41.2	42.9
Mar	25.0	28.0	28.2	22.9	26.3	27.3
Apr	18.4	20.4	19.0	14.6	13.9	14.2
May	15.1	16.5	15.2	12.7	12.1	12.3
Jun	12.0	13.1	12.2	11.0	10.4	10.6
Jul	8.6	9.8	9.2	8.5	8.7	8.8
Aug	8.0	9.0	8.5	7.8	8.2	8.3
Sep	8.7	9.6	9.1	8.1	8.7	8.9
Oct	10.1	11.0	10.1	8.8	9.2	9.5
Nov	17.7	19.4	18.7	15.2	17.3	17.5
Dec	43.4	50.7	52.2	39.8	50.7	52.9
Total	257.3	293.0	295.9	235.3	280.7	291.4

Appendix E

**SOUTHWEST GAS CORPORATION
ARIZONA
G5 - SINGLE FAMILY RESIDENTIAL CUSTOMERS
ACTUAL AND WEATHER NORMALIZED CONSUMPTION PER CUSTOMER
12-MONTH TOTALS
MONTHLY, JANUARY 2002 - JANUARY 2016**

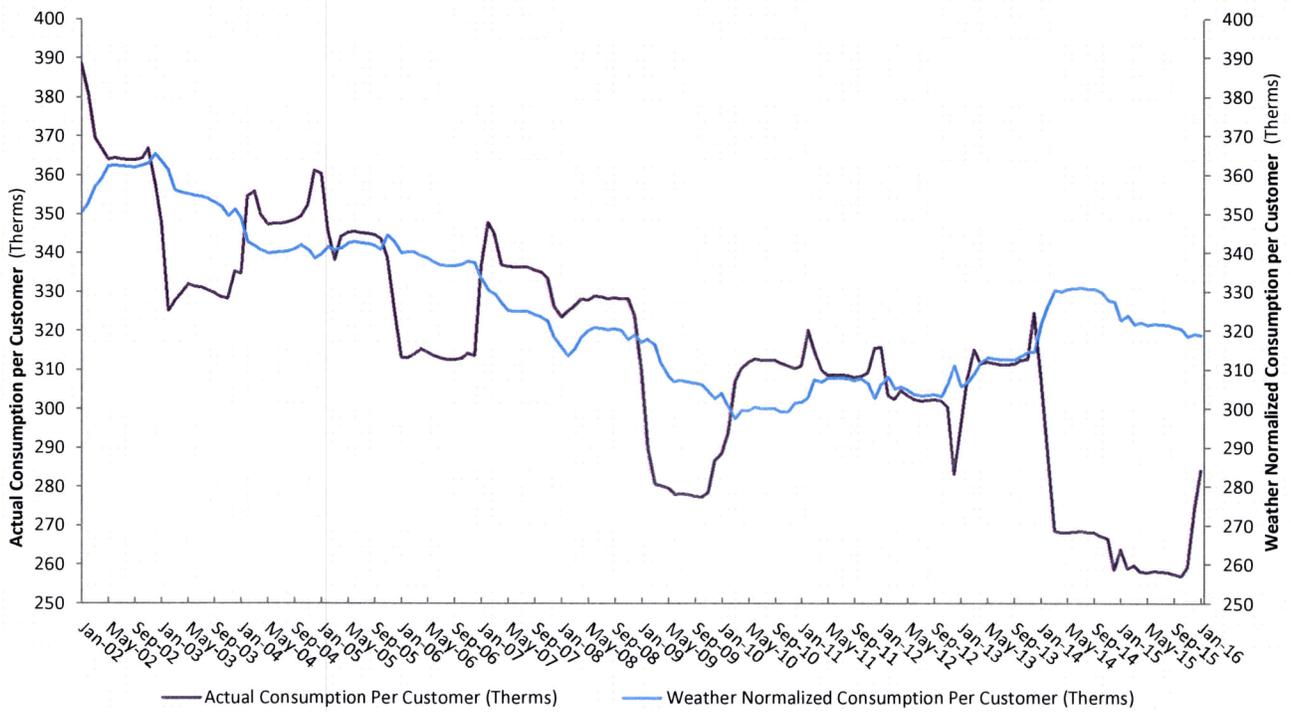


Exhibit 2

**SOUTHWEST GAS CORPORATION
ARIZONA JURISDICTION
CALCULATION OF ENERGY EFFICIENCY ENABLING PROVISION (EEP) RATE ADJUSTMENT**

Line No.	Description (a)	Volumes (b)	Amount (c)	Line No.
1	EEP Balancing Account Balance at December 31, 2015		\$(19,561,143)	1
	Applicable Therms [1]			
2	G-5 Residential	273,886,509		2
3	G-6 Multi-Family Residential	5,950,910		3
4	G-10 Low-Income Residential	10,828,561		4
5	G-11 Multi-Family Low-Income Residential	672,293		5
6	G-25(S) Small General Service	4,608,260		6
7	G-25(M) Medium General Service	44,331,366		7
8	G-25(L1) Large-1 General Service	103,861,608		8
9	G-25(L2) Large-2 General Service	29,539,045		9
10	All GTS Billed Volume	<u>8,917,565</u>		10
11	Total Therms	<u>482,596,117</u>		11
12	EEP Rate Adjustment Per Therm		<u>\$ (0.04053)</u>	12

[1] Sales for the 12 months ended March 2016

Exhibit 3

**SOUTHWEST GAS CORPORATION
ARIZONA
EARNINGS TEST CALCULATION
TWELVE MONTHS ENDED DECEMBER 31, 2015**

Line No.	Description (a)	Reference (b)	Amount (c)	Line No.
1	Fair Value Rate Base	Decision No. 72723	\$ 1,452,933,391	1
2	Fair Value Rate of Return	Decision No. 72723	6.92%	2
3	Operating Income Required	Ln 1 * Ln 2	\$ 100,542,991	3
4	Net Operating Income Available	Company Records	81,073,094	4
5	Earnings Deficit/(Excess)	Ln 3 - Ln 4	\$ 19,469,897	5
6	Gross Revenue Conversion Factor	Decision No. 72723	1.6579	6
7	Revenue Deficit/(Excess)	Ln 5 * Ln 6	\$ 32,279,141	7