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1 Timothy M. Hogan (004567)  
2 ARIZONA CENTER FOR LAW  
3 IN THE PUBLIC INTEREST  
4 202 E. McDowell Rd., Suite 153  
5 Phoenix, Arizona 85004  
6 (602) 258-8850

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Attorneys for Southwest Energy Efficiency  
Project and Natural Resources Defense Council

**BEFORE THE ARIZONA CORPORATION COMMISSION**

8 JEFF HATCH-MILLER, CHARIMAN  
9 MARC SPITZER  
10 WILLIAM A. MUNDELL  
11 MIKE GLEASON  
12 KRISTIN K. MAYES

13 IN THE MATTER OF THE APPLICATION OF  
14 SOUTHWEST GAS CORPORATION FOR THE  
15 ESTABLISHMENT OF JUST AND  
16 REASONABLE RATES AND CHARGES  
17 DESIGNED TO REALIZE A REASONABLE  
18 RATE OF RETURN ON THE FAIR VALUE OF  
19 THE PROPERTIES OF SOUTHWEST GAS  
20 CORPORATION DEVOTED TO ITS  
21 OPERATIONS THROUGHOUT THE STATE  
22 OF ARIZONA

Docket No. G-01551A-04-0876

**REPLY BRIEF OF SOUTHWEST  
ENERGY EFFICIENCY PROJECT  
AND NATURAL RESOURCES  
DEFENSE COUNCIL  
(SWEEP/NRDC)**

**I. INTRODUCTION**

23 Southwest Energy Efficiency Project and the Natural Resources Defense Council  
24 (“SWEEP/NRDC”) respectfully reply on three topics: demand side management (“DSM”)  
25 energy efficiency programs and funding, the financial disincentive to natural gas utility support  
of energy efficiency, and customer rate design.

1 **II. NATURAL GAS DEMAND SIDE MANAGEMENT/ENERGY**  
2 **EFFICIENCY PROGRAMS**

3 SWEEP/NRDC address five DSM issues below: increased funding for the residential  
4 new construction DSM program, the \$50,000 in DSM program funding for an emergency bill  
5 assistance element of the Low Income Energy Conservation ("LIEC") program, the DSM  
6 program performance incentive, the DSM adjustor mechanism or surcharge, and the Preliminary  
7 DSM plan and Commission approval of the DSM programs.

8 SWEEP/NRDC support the two existing and seven additional natural gas DSM programs,  
9 and the DSM funding increase from \$0.6 million to \$4.385 million, proposed by Southwest Gas.  
10 Schlegel Direct at 4. SWEEP/NRDC also support increasing DSM program funding from  
11 \$4.385 million proposed by Southwest Gas to \$5.135 million (an increase of \$0.750 million), to  
12 ensure that at least \$1 million is available to support the residential new construction program  
13 (ENERGY STAR Home Certification) throughout the Southwest Gas service territory.

14 Southwest Gas supports this funding increase while Staff recommends a funding level of \$4.335  
15 million, which does not provide adequate funding for the increase. Southwest Gas Brief at 70;  
16 Staff Brief at 20. The ENERGY STAR Home Certification funding should be increased, to at  
17 least \$1 million annually, to better address the cost-effective opportunities in new construction  
18 throughout the Southwest Gas service territory. Additional DSM funding is necessary to capture  
19 energy efficiency opportunities in the fast-growing new home market, including promoting and  
20 incentivizing new homes that exceed the ENERGY STAR threshold. Also, additional DSM  
21 funding is needed to offer the program throughout the Southwest Gas service territory; the new  
22 home program should not be limited to the Tucson area as the EAP program has been in the past.  
23 Schlegel Direct at 5.  
24  
25

1 Staff does not support allocating \$50,000 in DSM funding for the emergency bill  
2 assistance element of the LIEC program. Staff Brief at 20. SWEEP/NRDC support funding of  
3 up to \$50,000 because it is a relatively low level of DSM funding focused on emergency  
4 situations of low income customers; this is supported by the additional information in Southwest  
5 Gas rebuttal testimony.<sup>1</sup> If the \$50,000 is not spent on bill assistance emergencies in a given  
6 year, it should be allocated to weatherization. SWEEP/NRDC suggest that the funding remain in  
7 the Preliminary DSM Plan budget at this time, and that any proposed revisions to the scope and  
8 budget of the LIEC program, including the bill assistance element, be reviewed by the  
9 collaborative DSM working group prior to Southwest Gas submitting a final DSM Plan.  
10 Surrebuttal Testimony of Jeff Schlegel at 3.  
11

12 Staff does not support the DSM program performance incentive proposed by  
13 SWEEP/NRDC in direct testimony. Staff Brief at 21; Schlegel Direct at 6. SWEEP/NRDC  
14 support a positive performance incentive that Southwest Gas would earn if it implements  
15 effective DSM programs that meet program goals. A performance incentive mechanism, with a  
16 cap, based largely on a portion of the net economic benefits of the DSM programs, as  
17 SWEEP/NRDC recommend, would encourage Southwest Gas to be aggressive in achieving such  
18 net benefits for customers. Schlegel Direct at 6. The proposed performance incentive  
19 mechanism and incentive cap (no more than 10% of DSM program funding) should be  
20 described in the final DSM portfolio and program plan to be submitted by Southwest Gas for  
21 Commission review and approval. The portion (%) of the net economic benefits that Southwest  
22 Gas is eligible to receive should be proposed as a component of the incentive mechanism design  
23 in the final DSM plan. The performance incentive mechanism should include a threshold for  
24

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25 <sup>1</sup> Rebuttal testimony of Vivian Scott, p. 3, beginning at line 18.

1 minimum performance level; if actual performance is less than the threshold Southwest Gas  
2 would not receive any incentive. The performance incentive earned should be based on actual  
3 DSM results. *Id.*

4 SWEEP/NRDC agree with Southwest Gas that the current adjustor mechanism should be  
5 used to recover the costs of Commission-approved DSM programs. All customer classes should  
6 pay the surcharge in the future since there will be DSM programs to benefit all customer classes.  
7 Southwest Gas should be able to increase the level of the adjustor mechanism and the associated  
8 surcharge in the future, without a rate case proceeding, if the Commission approves increases in  
9 DSM funding for previously-approved programs or if the Commission approves additional DSM  
10 programs. Schlegel Direct at 7.

12 SWEEP/NRDC urge Commission approval of the Preliminary DSM plan attached as  
13 Exhibit SS-2 to Schlegel Surrebuttal; no party opposed the Preliminary DSM plan, except for the  
14 specific elements addressed above. Then, within 120 days of the Commission's order in this  
15 proceeding, Southwest Gas should file a final DSM portfolio and program plan, based on the  
16 Preliminary Plan and collaborative DSM working group input, describing the details of the  
17 programs and their cost-effectiveness. The DSM portfolio and program plan should describe the  
18 proposed programs, and include estimated benefits, costs, cost-effectiveness, and measurement  
19 and evaluation plans for Commission review. *Id.*

21 **III. FINANCIAL DISINCENTIVE TO NATURAL GAS UTILITY SUPPORT  
22 OF ENERGY EFFICIENCY**

23 Traditional utility regulation links the utility's financial health to the volume of natural  
24 gas sold, resulting in a financial disincentive to invest in energy efficiency and other demand-  
25 side resources (e.g., appliance standards and building codes) that reduce natural gas sales. The  
financial disincentive is particularly strong for natural gas utilities that have experienced an

1 overall trend of declining gas usage per customer, which is the situation for Southwest Gas.  
2 Schlegel Direct at 8. SWEEP/NRDC agree that the issue of the financial disincentive to natural  
3 gas utility support of energy efficiency should be addressed in Arizona in a timely manner. This  
4 will be necessary if Arizona wants to fully tap the potential for its lowest cost natural gas  
5 resource – cost-effective energy efficiency improvements. *Id.*

6 SWEEP/NRDC continue to believe that the gas utility financial disincentive issue and a  
7 full analysis of the pros and cons of mechanisms for removing the financial disincentive,  
8 including but not limited to the Company-proposed Conservation Margin Tracker (“CMT”),  
9 should be reviewed and evaluated prior to Commission adoption of a specific mechanism. This  
10 issue would benefit from a broader and more in-depth discussion. Mr. Schlegel raised several  
11 questions and concerns in his written and oral testimony focused on the importance of balancing  
12 the Company’s and customer interests. Schlegel Direct at 8; Tr. at 1053-55. Despite the  
13 assertions in its Brief (Southwest Gas Brief at 41), the CMT, as proposed by Southwest Gas,  
14 does not adequately address the interests of customers or the questions and concerns raised by  
15 Mr. Schlegel.  
16

17 If not addressed fully in this proceeding, SWEEP/NRDC recommend that the issue of the  
18 financial disincentive and potential mechanisms to address it be discussed in the DSM policy  
19 process, either through additional comments on the proposed DSM policies or through additional  
20 DSM policy workshops, with a workshop report filed with the Commission no later than 180  
21 days of the order. Schlegel Direct at 8.  
22

23 While SWEEP/NRDC are sympathetic to the financial issues Southwest Gas has raised,  
24 including the declining average consumption per residential customer and the impact of  
25 additional energy savings on Southwest Gas, the proposed DSM programs and funding should be

1 approved by the Commission in any event, and not be linked to the outcome of the CMT and  
2 customer rate design issues, because of the significant cost-effective benefits to customers  
3 including the assistance to customers in mitigating future increases in natural gas prices. Schlegel  
4 Surrebuttal at 3.

5 **IV. CUSTOMER RATE DESIGN: FIXED CHARGES AND FLAT OR ONE-**  
6 **TIER RATE**

7 Southwest Gas continues to propose higher fixed charges and a declining tier structure in  
8 its rate design.

9 SWEEP/NRDC oppose higher fixed charges for natural gas customers because higher  
10 fixed charges would mute and reduce the price signal customers would receive when they reduce  
11 energy use and become more energy efficient thereby reducing the ability of customers to  
12 manage their own utility bills. Schlegel Surrebuttal at 5.

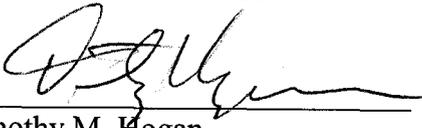
13 SWEEP/NRDC support the concept of a flat or one-tier rate structure proposed by  
14 RUCO, and do not support the continuation of a two-tiered declining rate structure. A one-tier  
15 rate structure would provide greater encouragement for customers to reduce their natural gas  
16 consumption through increased energy efficiency and conservation. *Id.*

17  
18 **V. CONCLUSION**

19 SWEEP/NRDC urge the Commission to implement programs, policies, and mechanisms  
20 that *encourage* cost-effective energy efficiency, not discourage it, for customers and for natural  
21 gas utilities. Increasing natural gas energy efficiency will provide significant and cost-effective  
22 benefits for Southwest Gas customers, the natural gas and electric utility systems, the economy,  
23 and the environment.

1 **DATED** this 14<sup>th</sup> day of November, 2005.

2 ARIZONA CENTER FOR LAW IN  
3 THE PUBLIC INTEREST

4 By 

5 Timothy M. Hogan  
6 202 E. McDowell Rd., Suite 153  
7 Phoenix, Arizona 85004  
8 Attorneys for Southwest Energy  
Efficiency Project and Natural Resources  
Defense Council

9 ORIGINAL and 13 COPIES of  
10 the foregoing filed this 14<sup>th</sup> day  
of November, 2005, with:

11 Docketing Supervisor  
12 Docket Control  
13 Arizona Corporation Commission  
1200 W. Washington  
Phoenix, AZ 85007

14 COPIES of the foregoing  
15 mailed this 14<sup>th</sup> day of  
November, 2005 to:

16 Andrew Bettwy  
17 Southwest Gas Corporation  
5241 Spring Mountain Road  
18 Las Vegas, NV 89102

Walter W. Meek  
AUIA  
2100 N. Central Avenue, Suite 210  
Phoenix, AZ 85004

19 Raymond S. Heyman  
20 Laura E. Sixkiller  
Roshka, Heyman & DeWulf  
21 One Arizona Center  
400 E. Van Buren Street, Suite 800  
Phoenix, AZ 85004  
22 *Attorneys for Tucson Electric Power  
23 Company*

Cynthia Zwick  
Arizona Community Action Association  
2700 N. 3<sup>rd</sup> Street, Suite 3040  
Phoenix, AZ 85004

24 Michelle Livengood  
25 Tucson Electric Power Company  
One S. Church Street, Suite 200  
Tucson, AZ 85702

Lewis and Roca  
40 N. Central Avenue  
Phoenix, AZ 85004  
*Attorneys for Yuma Cogeneration  
Associates*

1 Peter Q. Nyce, Jr.  
2 General Attorney  
3 Regulatory Law Office  
4 Department of Army  
5 901 N. Stuart Street  
6 Arlington, VA 22203-1837

7  
8 Scott S. Wakefield  
9 RUCO  
10 1110 W. Washington, Suite 220  
11 Phoenix, AZ 85007

12 Ernest G. Johnson, Director  
13 Utilities Division  
14 Arizona Corporation Commission  
15 1200 W. Washington Street  
16 Phoenix, AZ 85007

17  
18  
19  
20  
21  
22  
23  
24  
25



Thomas L. Mumaw  
Karilee S. Ramaley  
Pinnacle West Capital Corporation  
MS 8695  
Phoenix, AZ 85004

Christopher Kempley, Chief Counsel  
Legal Division  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007