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BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
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COMMISSIONER

IN THE MATTER OF THE APPLICATION
OF SOUTHWEST GAS CORPORATION
FOR APPROVAL OF ACQUISITION PLAN
AND, IF APPROPRIATE, WAIVER OF
SELECTED PROVISION OF THE
AFFILIATE RULES.

Docket No. G-01551A-02-0425

Arizona Corporation Commission

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NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the redacted Direct Testimony of Rodney L. Moore, in the above-referenced matter. Unredacted versions of Mr. Moore's testimony being provided to parties who have executed appropriate confidentiality agreements.

RESPECTFULLY SUBMITTED this 20th day of December 2002.

[Signature]
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Attorney

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of the foregoing filed this 20th day of
2 December 2002 with:

3 Docket Control
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6 mailed this 20th day of December 2002 to:

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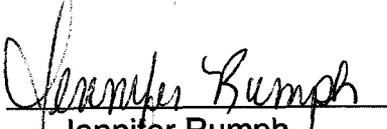
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SOUTHWEST GAS CORPORATION

DOCKET NO. G-01551A-02-0425

REDACTED

DIRECT TESTIMONY

OF

RODNEY L. MOORE

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

DECEMBER 20, 2002

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1 **INTRODUCTION**

2 Q. Please state your name and address.

3 A. My name is Rodney L. Moore. My business address is 1110 West
4 Washington Street, Suite 220, Phoenix, Arizona 85007.

5
6 Q. By whom are you employed and in what capacity?

7 A. The Residential Utility Consumer Office ("RUCO") employs me in the
8 position of a Public Utilities Analyst V.

9
10 Q. Please state your educational background and work experience.

11 A. I obtained a Bachelor's Degree in Business Administration in 1993 from
12 Athabasca University. I have attended several training classes and
13 courses regarding auditing, rate design, income taxes, and other utility
14 related matters. From 1966 to 1993, I was employed by Telus
15 Corporation, Inc., a large telecommunication company, where I assumed
16 various positions from lineman to office administrator. In 1995, I began
17 my employment with the Arizona Corporation Commission ("ACC" or
18 "Commission"). I worked in the Consumer Service Section until accepting
19 a position as an Auditor in October 1999 with the Accounting and Rates
20 Section. In May of 2001, I succeeded to my current position at RUCO.
21 My duties include review and analysis of financial records and other
22 documents of regulated utilities for accuracy, completeness, and
23 reasonableness. I am also responsible for the preparation of work papers

1 and Schedules resulting in testimony and/or reports regarding utility
2 applications for increase in rates, financings, and other matters.

3

4 Q. Please state the purpose of your testimony.

5 A. The purpose of my testimony is to present RUCO's recommendations
6 regarding Southwest Gas Corporation's ("Southwest" or "SWG")
7 application for approval of an acquisition plan and, if appropriate, waiver of
8 selected provisions of the affiliated rules.

9

10 Q. What is RUCO's recommendation?

11 A. Based on the findings of my review and analysis of the Company's
12 application and records, RUCO recommends approval of the application,
13 with some conditions.

14

15 **BACKGROUND**

16 Q. Please summarize the application.

17 A. Southwest is applying for approval of the acquisition of the shares of, and
18 the subsequent transfer of the assets of, Black Mountain Gas Company
19 ("Black Mountain" or "BMG") to Southwest and the dissolution of Black
20 Mountain; referred to collectively in this application as the "Acquisition
21 Plan". Under the terms of the Acquisition Plan, Southwest would succeed
22 to the ownership of Black Mountain. BMG provides natural gas and
23 propane service within the State of Arizona as a public service

1 corporation. Xcel Energy Inc. ("Xcel"), a Minnesota corporation, owns one
2 hundred percent of the outstanding shares of stock in Black Mountain.
3 Southwest and Xcel have executed a stock purchase agreement, by which
4 SWG has agreed to purchase and Xcel has agreed to sell these shares.
5 Southwest intends to own the shares for a limited period of time (no more
6 than 12 months) prior to having all of the assets of Black Mountain
7 transferred to SWG and dissolving BMG. Accordingly, by virtue of the
8 Arizona Revised Statutes, Commission approval of the Acquisition Plan is
9 required and Commission approval or waiver may also be required for
10 such other reasons as:

- 11
- 12 a. Southwest's acquisition of the shares may constitute the utilization
 - 13 of utility funds to form a subsidiary;
 - 14 b. Southwest's acquisition of the shares may constitute the
 - 15 organization of a Holding Company; and
 - 16 c. Southwest's dissolution of the shares may constitute the divestiture
 - 17 of an established subsidiary.
- 18

19 In conclusion, the Acquisition Plan respectively requests the Commission
20 to permit Southwest to acquire one hundred percent of BMG's shares and
21 to authorize the subsequent transfer of Black Mountain's assets to
22 Southwest including the certificates of public convenience and necessity
23 ("CC&N") granted to Black Mountain. It is Southwest's intention to

1 dispose of all of the propane facilities in the Page, Arizona area, both the
2 Commission-jurisdictional facilities as well as the non-utility facilities, as
3 soon as practical but no later than 12 months following consummation of
4 the Acquisition Plan.

5

6 Q. Please briefly describe Southwest.

7 A. According to Southwest's data, SWG continues to be the fastest growing
8 local distribution company in the United States with approximately \$2.4
9 billion in total assets. The Company's capital structure as of December
10 31, 2001 consisted of \$621 million (including \$57 million in retained
11 earnings) in equity and \$796 million in long-term debt, producing a ratio of
12 equity to debt of 44% to 56%. Southwest has focused its energies and
13 efforts on the three-state area encompassing Arizona, Nevada and
14 California; in fact, Arizona is SWG's largest jurisdiction with 785,000
15 customers. Southwest has served Central Arizona and Phoenix
16 metropolitan area for nearly 20 years.

17

18 Q. Please briefly describe Xcel.

19 A. According to Xcel's data, the Company is headquartered in Minneapolis,
20 Minnesota and is the nation's fourth largest utility company serving 3.2
21 million electricity customers and 1.6 million natural gas customers. As per
22 Form 10-Q ending June 30, 2002, the Company has \$30.4 billion in total
23 assets with a capital structure consisting of \$8.0 billion (including \$2.4

1 billion in retained earnings) in equity and \$8.3 billion in long-term debt,
2 producing a ratio of equity to debt of 49% to 51%. Xcel has regulated
3 operations in 12 Western and Midwestern states. Xcel also has other
4 business entities, among them are: Xcel International, NRG Energy Inc.,
5 Seren Innovations, and Xcel Energy Utility Engineering. Xcel's presence
6 in Arizona is limited to the 8,620 customers of Black Mountain.

7
8 In a recent newspaper article in the Minneapolis / St. Paul Star Tribune,
9 dated October 21, 2002, Xcel will take a \$2 billion charge to its earnings
10 and probably give up all ownership of its teetering subsidiary, NRG Energy
11 Inc., as part of a debt restructuring plan that Xcel is negotiating with banks
12 and other creditors.

13
14 Q. Please briefly describe Black Mountain.

15 A. As per the Acquisition Plan, BMG is a financially strong public corporation,
16 the stock of which is wholly owned by Xcel, with total assets of \$23 million.
17 BMG serves approximately 8,620 customers. Of those customers, 7,280
18 customers are located in an area around Cave Creek, Arizona and receive
19 natural gas service, while the other 1,340 customers are located in an
20 area around Page, Arizona and receive propane gas service through an
21 underground pipeline. BMG has been growing rapidly from a total of
22 3,241 customers in 1993 to the current 8,620. BMG also provides non-
23 regulated bulk propane sales. BMG's capital structure consists of \$12.3

1 million (including \$7.6 million in retained earnings) in equity and \$6.1
2 million in long-term debt, producing a ratio of equity to debt of 67% to
3 33%. In 2001, BMG earned net income of \$1.0 million generated by
4 revenues of \$9.2 million.

5

6 Q. Please describe Southwest's relationship to Black Mountain.

7 A. Southwest's territory almost surrounds Black Mountain's Cave Creek
8 territory but is not near the Page operation. There are presently four
9 interconnection points between Southwest Gas and Black Mountain in the
10 Cave Creek area. BMG receives gas from SWG at two of the points and
11 SWG receives gas from BMG at the other two. There is no differentiation
12 between service territories as it relates to Blue Stake. According to a
13 Commission Staff Report filed April 29, 1998, Southwest has previously
14 performed due diligence twice in preparation for a possible acquisition of
15 the Cave Creek division of Black Mountain. However, Southwest has
16 stated in its application that SWG intends to dispose of all BMG's propane
17 facilities.

18 ...

19 ...

20 ...

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22 ...

23 ...

1 **THE ACQUISITION PLAN**

2 Q. Please summarize the benefits of the proposed Acquisition Plan as
3 identified by Southwest.

4 A. In response to several data requests, Southwest cites the following
5 benefits to the existing and future Black Mountain customers under SWG
6 ownership versus Xcel ownership:

7

8 a. Excellent customer service from dedicated, skilled and professional
9 Southwest employees will provide exemplary service and attention
10 to customer's needs;

11 b. Skill and experience in procuring natural gas will provide lower cost
12 and more reliable service;

13 c. Southwest's close proximity and knowledge of the area and
14 operations will lead to more effective and efficient operations and
15 thus a lower cost of service;

16 d. Southwest has the resources and experience to respond
17 immediately and in force to any major natural gas or pipeline
18 incident, thus providing a higher level of public safety;

19 e. Southwest has a major and continuing presence and commitment
20 to Central Arizona including the Phoenix metropolitan area, thus
21 SWG has a greater focus of energies and effort in the three-state
22 area encompassing Arizona;

23 ...

- 1 f. SWG's larger size in Arizona and its operational efficiencies have
2 produced lower margin rates than Black Mountain's, which should
3 lead to lower natural gas bills to BMG customers after Commission
4 approval of Southwest's next Arizona general rate case; and
- 5 g. Southwest is financially strong. Xcel has been required to take a
6 \$2 billion charge to its earnings as part of a debt restructuring,
7 which may have serious repercussions for the continued provision
8 of quality service to the customers of Black Mountain under Xcel
9 ownership.

10

11 Q. Did you determine a monetary value for these benefits to the customers of
12 Black Mountain under Southwest ownership?

13 A. No, I did not. Per SWG's response to RUCO's data request item No. 2-4,
14 Southwest has agreed not to perform any truly in-depth and hands-on
15 investigations and/or analyses of Black Mountain's administration or
16 operations to accurately determine or quantify potential savings.

17

18 Q. When will the benefits of the Acquisition Plan be quantified and any
19 savings realized by Black Mountain's customers?

20 A. After Southwest has an opportunity to operate Black Mountain and
21 accurately measure operational and administrative efficiencies; the
22 quantified savings will be appropriately assigned through recognized
23 ratemaking principles in Southwest's next Arizona general rate case.

1 Q. Do you agree with this procedure?

2 A. Yes, I do. Furthermore, I recommend SWG be required to file its Arizona
3 general rate case within three years to facilitate the realization of these
4 projected savings and benefits for the BMG customers.

5
6 Q. What is the agreed purchased price for one hundred percent ownership of
7 Black Mountain, which Southwest will pay Xcel?

8 A. ****Confidential**** [REDACTED]
9 [REDACTED]

10
11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED] ****Confidential****.

19 [REDACTED]

20 Q. Did you analyze the total value of Black Mountain assets being purchased
21 by Southwest?

22 A. Yes, I did. As per Schedule 4.5 of Southwest's application, SWG valued
23 BMG's total assets at ****Confidential**** [REDACTED] ****Confidential****.

1 Q. Have you quantified any material adjustments to Southwest's valuation of
2 Black Mountain's total assets?

3 A. No, I have not. As per Southwest's response to RUCO's data request
4 item Nos. 1-3.e, 2-2 and 3-2, I was unable to quantify certain assets that
5 should or should not be included in BMG's total asset value.

6

7 Q. Which specific Black Mountain plant assets did you feel may require
8 adjustment?

9 A. In the Acquisition Plan SWG states its intention to make major
10 improvements and replacements to Black Mountain's infrastructure in the
11 very near future. Therefore, it is reasonable to suspect that some of
12 BMG's existing plant assets may be destined to immediate
13 replacement/retirement or not be used and useful; and thus their net plant
14 value should not be included in the purchase price.

15

16 Q. Why were you unable to identify and quantify specific Black Mountain
17 plant assets?

18 A. Southwest's responses indicated it would require actual experience in
19 operating the BMG system to determine the exact net value of plant to be
20 retired or replaced.

21 ...

22 ...

23 ...

1 Q. Do you agree with this position?

2 A. Yes, I do. After analyzing SWG's responses, I understand Southwest's
3 position of not having the in-depth inspections and operating experience of
4 BMG's system to make an accurate and quantifiable assessment of
5 BMG's plant items that may be incompatible, obsolete or destined for
6 immediate replacement.

7
8 Q. When will an accurate analysis of the actual total value of Black
9 Mountain's assets be reviewed?

10 A. When Southwest files its next Arizona general rate case, the value of
11 BMG's assets will be scrutinized under generally accepted rate-making
12 principles to determine the fair value of plant in service. Accordingly, the
13 Commission's approval of SWG's acquisition of BMG in this docket does
14 not constitute authority for inclusion of the acquired asset in rate base.

15
16 Q. ****Confidential**** [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21 [REDACTED]

22 [REDACTED]

23 ****Confidential****

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Q. ****Confidential**** [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] ****Confidential****.

Q. ****Confidential**** [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

b. [REDACTED]

[REDACTED]

[REDACTED] ****Confidential****.

...

...

1 ****Confidential**** [REDACTED] ****Confidential****

2 [REDACTED]

3 [REDACTED]

4 [REDACTED]

5 [REDACTED]

6 [REDACTED]

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8

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

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15 [REDACTED]

16 [REDACTED]

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8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED] ****Confidential****.

RATE ANALYSIS

15 Q. After acquisition, how does Southwest intend to handle Black Mountain –
16 Page division rates and charges?

17 A. It is Southwest's intent is to sell off the Page division; therefore, the
18 Acquisition Plan does not address the issue of Page rates. BMG's
19 currently effective tariff rates for its regulated propane service in its Page
20 division would remain in effect until changed by the Commission in the
21 next general rate case application, which would be filed as a standalone
22 ratemaking jurisdiction.

23 ...

1 Q. Do you agree with this procedure?

2 A. Yes, I do.

3

4 Q. Please compare the current effective tariff rates for both Southwest and
5 Black Mountain – Cave Creek division.

6 A. Southwest's response to RUCO's data request item No. 1-13 provides a
7 comparison chart of rates and charges for the various classes of service
8 for SWG and BMG – Cave Creek division.

9

10 Q. What would be the affect on the average BMG residential customer's
11 monthly natural gas bill if calculated using Southwest's current tariff rates?

12 A. Using the average monthly consumption of 59 therms for a typical BMG
13 residential customer, there would be a reduction in a consumer's cost for
14 service under SWG's tariffs. The average residential customer's monthly
15 statement would be reduced from \$72.38 to \$64.27. This \$8.10 saving is
16 a 12.61% reduction in cost of provisioning of natural gas service. BMG
17 customers would not immediately realize this saving. The saving is based
18 on SWG's current base rate tariffs and its current PGA rate.

19

20 Q. When will Black Mountain customers realize these rate savings?

21 A. Immediately upon acquisition, BMG customers will realize any savings
22 generated through the cost of gas. SWG will adjust the PGA rate for BMG
23 customers so that both SWG and BMG pay the same total cost of gas on

1 a going forward basis. The base rate BMG tariffs will not change until a
2 determination is made through a rate case. Thus, BMG customers will not
3 realize any savings achieved in margin until SWG files a rate application.
4 I recommend that Southwest be required to file a rate application within
5 three years to flow through any margin savings to BMG's customers.
6

7 Q. Do you agree with this procedure?

8 A. Yes.
9

10 **PURCHASED GAS ADJUSTOR BALANCING ACCOUNT**

11 Q. What is the PGA balancing account?

12 A. The PGA balancing account is used to accumulate any under or over
13 recoveries of actual gas cost due to lags in PGA rate adjustments. The
14 PGA provisions of each gas utilities' tariff sets forth the procedures for
15 rates to be adjusted so that:
16

17 a. Customers' rates are properly matched to the current level of
18 purchased gas costs; and

19 b. The gas utility company will be reimbursed over time for its actual
20 cost of purchased gas.
21 ...
22 ...
23 ...

1 Q. What are the current balances in the SWG and BMG PGA balancing
2 accounts?

3 A. Presently, Southwest has an over-recovered balance of approximately
4 \$18 million while Black Mountain has an under-recovered balance of
5 \$305,641. Therefore, SWG is proposing to implement a specific
6 surcharge on BMG designed to recover the balance over the initial twelve-
7 month period following the acquisition. This PGA surcharge will be
8 applicable to only the former Black Mountain customers in order for SWG
9 to collect the then-existing BMG's PGA bank balance. Southwest will
10 implement a surcredit for original SWG customers only. The surcredit will
11 be designed to return the over-recovered PGA bank balance to SWG
12 customers over the initial twelve-month period following acquisition.
13 Twelve months after the acquisition, any residual amount in the Black
14 Mountain PGA bank balance will be consolidated into Southwest's Arizona
15 PGA bank balance.

16
17 Q. Do you agree with the consolidation of the two bank balances after the
18 initial twelve-month period?

19 A. Yes, I do, assuming that any residual balance that remains in either the
20 BMG or SWG balancing account is minimal. RUCO would not support the
21 charge or credit of any material balances except to the specific customers
22 who originally contributed to the account.

23 ...

1 **DEFERRED TAXES**

2 Q. Why are deferred taxes an important issue in this acquisition?

3 A. Briefly, deferred taxes are income taxes collected through rates but not
4 actually paid by the company. Deferred taxes primarily arise from the use
5 of straight-line depreciation for ratemaking while the utility claims
6 accelerated depreciation on its income taxes. The deferred taxes are
7 customer-supplied capital and are deducted from the rate base.
8 Occasionally, when one company acquires another, the ratepayers of the
9 dissolved company can lose the benefit of the deferred taxes.

10

11 Q. How is SWG proposing to treat deferred taxes?

12 A. In response to RUCO data request item No. 3-3, Southwest indicates the
13 Acquisition Plan states the methodology by which SWG and BMG have
14 elected to use.

15

16 Q. Have you reviewed the anticipated treatment of the deferred taxes?

17 A. Yes, I have.

18

19 Q. Do you believe this is the appropriate treatment of the deferred income tax
20 accounts?

21 A. Yes, I do; but only as it pertains to the Internal Revenue Code. Black
22 Mountain's deferred taxes will be paid by BMG prior to the recording of the
23 acquisition by Southwest. As a result, there will be no deferred taxes on

1 day-one of the acquisition. Therefore, Southwest and its pre-acquisition
2 customers will not have to bear the burden of the Black Mountain deferred
3 taxes.

4

5 Q. Do you believe the Black Mountain customers will receive the appropriate
6 benefit.

7 A. There are certain ramifications arising from SWG's proposed treatment of
8 Black Mountain's deferred income tax liability, which affect the BMG
9 customers. For instance, when BMG's deferred taxes are paid in full on
10 the acquisition date, the customers will lose the benefit of lower rates
11 calculated from a reduced rate base, which includes a company's deferred
12 income tax liability.

13

14 Q. How will the impact of Southwest's treatment of Black Mountain's deferred
15 income tax liability on the customers be resolved?

16 A. The deferred income tax liability is just one element of the Acquisition
17 Plan; similar to the previously mentioned issues of
18 ****Confidential**** [REDACTED] ****Confidential****, consolidation of the
19 PGA accounts, basic gas cost rates, and the margin cost of gas. The full
20 impact of this acquisition on the customers of Southwest and Black
21 Mountain can only be determined by a complete analysis within the
22 framework of a rate case application. Again this is why I recommend that
23 Southwest be required to file a rate application within three years of the

1 decision in this docket, so as to determine all benefits to the Black
2 Mountain customers.

3
4 **IMPACT ON BLACK MOUNTAIN EMPLOYEES**

5 Q. What impact will the Acquisition Plan have on the employees of Black
6 Mountain?

7 A. Prior to closing of the transaction contemplated by this application,
8 Southwest shall extend conditional offers of employment to Black
9 Mountain employees. If the offer is accepted, employment shall become
10 effective immediately after closing. Southwest will not illegally terminate
11 or discriminate against any BMG employee in its employment or hiring
12 practices at or prior to closing.

13
14 Q. Do you agree with this procedure?

15 A. Yes, I do. It is equitable to the employees of Black Mountain and allows
16 Southwest to implement its projected efficient administrative, operating,
17 and maintenance strategies.

18
19 **CUSTOMER SERVICE CONSIDERATIONS**

20 Q. Did you review Southwest's service quality standards, customer
21 obligations, and overall customer satisfaction?

22 A. Yes, I did. In response to RUCO's data request item Nos. 1-6 and 1-16
23 and a review of their annual reports, Southwest provided extensive

1 documentation as to their commitment to a solid service relationship with
2 customers:

3
4 a. Provisioning of service to future customers in the Cave Creek area
5 will be governed by the currently effective SWG tariff. Existing
6 customers of BMG will continue to have their deposits remain
7 associated with their individual account and disposed of in
8 accordance with SWG's appropriate tariff;

9
10 b. An independent and impartial national research firm determines
11 Southwest's level of customer satisfaction. Southwest has
12 consistently maintained a customer satisfaction rating above 90
13 percent since the initiation of the program in 1994; and

14
15 c. Customer complaints filed at the Consumer Service Section of the
16 Commission regarding SWG indicate an average of 34 complaints
17 have been received and resolved annually over the last three
18 years. In comparison, Qwest Communications, Inc. had
19 approximately 800 complaints filed against it from Arizona
20 customers in the first nine months of 2002.

21 ...

22 ...

23 ...

1 Q. Based on your analysis, is Southwest a fit and proper company to acquire
2 and operate Black Mountain?

3 A. Yes.
4

5 **CONCLUSIONS AND RECOMMENDATIONS**

6 Q. Please summarize your conclusions and recommendations.

7 A. Southwest has considerable experience in providing gas service in
8 Arizona. I believe Southwest will remain focused on its core
9 competencies and continue to provide high quality service to its
10 customers, including the proposed acquisition of the natural gas
11 customers from the Black Mountain – Cave Creek Division. SWG is
12 financially sound and has the access to capital needed to complete this
13 Acquisition Plan and provide the improvements anticipated during the
14 three-year post-closing period. Southwest's greater market presence in
15 Arizona should provide an economy-of-scale benefit to the natural gas
16 customers of Black Mountain, which will fully manifest itself after
17 Southwest's next Arizona general rate case is approved by the
18 Commission.

19
20 Thus, I conclude that Southwest is a fit and proper entity to succeed to the
21 ownership of Black Mountain and that the acquisition will be consistent
22 with the public interest if the following recommendations are adopted by
23 the Commission:

- 1 a. Southwest be required to file an Arizona general rate case within
2 three years of the effective date of the decision on this matter; and
3 b. Southwest be required to maintain Black Mountain's financial
4 records for the two years prior this acquisition.

5

6 Subject to the above conditions, RUCO recommends approval of the
7 acquisition and transfer of the CC&Ns to Southwest.

8

9 RUCO also recommends approval of the acquisition transaction pursuant
10 to the Affiliated Interest Rules.

11

12 Q. Does this conclude your direct testimony?

13 A. Yes, it does.