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**SOUTHWEST GAS CORPORATION**

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Andrew W. Bettwy, Assistant General Counsel

AZ CORP COMMISSION  
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April 4, 2003

Arizona Corporation Commission  
**DOCKETED**

APR 04 2003

Arizona Corporation Commission  
Attention: Docket Control  
1200 West Washington Street  
Phoenix, Arizona 85007

DOCKETED BY	<i>mac</i>
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Re: Filing of **Closing Brief of Southwest Gas Corporation**  
Docket No. G-01551A-02-0425

Accompanying this letter are the original and fourteen (14) copies of the above-referenced document. Please accept the original and thirteen (13) of the copies for filing, and date/time stamp the remaining copy and return it to me in the stamped, self-addressed envelope which also accompanies this letter.

Thank you for the usual courtesy.

Respectfully,

Andrew W. Bettwy

Enclosures

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BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

2003 APR -4 A 10: 35

AZ CORP COMMISSION  
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IN THE MATTER OF THE APPLICATION OF )  
SOUTHWEST GAS CORPORATION FOR )  
APPROVAL OF ACQUISITION PLAN AND, IF )  
APPROPRIATE, WAIVER OF SELECTED )  
PROVISIONS OF THE AFFILIATE RULES, )  
\_\_\_\_\_ )

DOCKET NO. G-01551A-02-0425

CLOSING BRIEF OF SOUTHWEST GAS CORPORATION

Southwest Gas Corporation ("Southwest") respectfully submits this Closing Brief in accordance with the schedule announced by Administrative Law Judge ("ALJ") Jane L. Rodda at the conclusion of the hearing on March 3, 2003.

**Summary of Southwest's Position**

The acquisition by Southwest, without unnecessary conditions, of the facilities utilized by Black Mountain Gas Company ("Black Mountain") to provide natural gas and propane service is in the public interest. Southwest witness Edward A. Janov offers the following overall perspective:

"Southwest has been providing safe and cost-effective gas service throughout the southwestern United States for more than 70 years and in Arizona for nearly a half century. Southwest is financially sound and has access to reasonably-priced capital to fund and operate these properties. The greater presence and vested interest Southwest has in Arizona will provide economy-of-scale benefits to the Commission and the natural gas customers of Black Mountain, which will ultimately result in a "win-win" for all involved." [lines 18-27, page 10, Exhibit A-2A].

The uncontradicted evidence of record is that the acquisition by Southwest of Black Mountain's facilities (1) would not impair the financial status of Southwest, (2) would not prevent Southwest from attracting capital at fair and reasonable terms and (3) would not impair the ability of Southwest to provide safe, reasonable and adequate service. [lines 5-10, page 3, Exhibit A-2A]. Accordingly, the acquisition meets the "public interest" standard promulgated by the Commission in the rules governing affiliate transactions. [A.A.C. R14-2-801 through R14-2-806].

As is more fully developed later in this Closing Brief, Staff has interjected a "public interest" standard<sup>1</sup> which is inconsistent with Commission rules and the applicable provisions of Arizona statutes, as evidenced by the judicial gloss on the legislation.

Further, as is more fully developed later in this Closing Brief, Staff's recommendation that the Commission-established rates for the customers of Black Mountain in the Cave Creek Division be reduced outside of a general rate case is contrary to firmly-embedded Arizona ratemaking principles.

Southwest's decision to acquire Black Mountain was premised on a valid assumption that Southwest would be permitted to provide natural gas service to the customers of Black Mountain at a compensatory revenue level – not a confiscatory revenue level. Southwest's willingness to consummate the stock purchase transaction continues to be premised on the same assumption. It would be an unfortunate result, indeed, particularly for the customers of Black Mountain, if the stock purchase transaction failed to consummate as a consequence of the imposition of conditions which have no support in the law and which are otherwise unnecessary.

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Staff's newfound "public interest" standard would require the demonstration of an "obvious, direct, immediate and significant benefit" to the customers to be acquired.

Southwest urges the Commission to approve the Acquisition Plan,<sup>2</sup> as proposed.

**Overview of the Acquisition Plan – Post-Consummation**

Under Southwest's current proposal,<sup>3</sup> the following is envisioned:

1. Black Mountain's current margin rates in the Cave Creek Division would remain in effect unless and until changed in a general rate case, with the objective of having uniform rates established for the customers of Southwest and the customers of Black Mountain in the Cave Creek Division in the next general rate case;
2. Black Mountain's current terms and conditions of service in the Cave Creek Division, including miscellaneous charges, would remain in effect, unless and until changed with prior Commission approval, except that any optional services provided by Southwest, which are not currently provided by Black Mountain, would be made available to customers of Black Mountain in accordance with the charges set forth in Southwest's Commission-approved Tariff;

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Under the Acquisition Plan, Southwest initially would purchase from Xcel Energy, Inc. all of the outstanding shares of stock in Black Mountain and, subsequent to consummation of the stock purchase transaction [estimated to occur within twelve months], the assets of Black Mountain would be transferred to Southwest and Black Mountain would be dissolved.

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Initially, Southwest had proposed to have Southwest's miscellaneous charges be applicable for the customers of Black Mountain in the Cave Creek Division immediately upon consummation of the stock purchase transaction. In response to concerns expressed by Staff regarding the potential for confusion if certain components of rates and charges were changed and others were not, Southwest has revised its initial proposal to ensure there is no rate impact associated with the acquisition, **except** with respect to gas costs or non-margin rates. [line 19 on page 7-line 6 on page 8, Exhibit A-2C].

3. At the time of the monthly purchased gas adjustments for Southwest and Black Mountain, immediately following consummation of the stock purchase transaction, (a) the respective gas cost balancing accounts would be frozen, (b) on a go forward basis, there would be one gas cost applicable to both Southwest and the Cave Creek Division of Black Mountain and (c) Southwest would make a filing with the Commission seeking approval of a mechanism to surcharge or surcredit the balances in the frozen gas cost balancing accounts; and
4. The Page Division of Black Mountain would continue to be operated under Black Mountain's current rates and terms and conditions of service until Southwest's disposition of the propane properties.

### **Argument**

*The Acquisition Plan, As Proposed, Is Consistent With The Public Interest And The Commission-Promulgated Standard In The Rules Governing Affiliate Transactions*

As a general proposition, one would have a difficult time persuading anyone that the Commission ought to act at any time in a manner inconsistent with the public interest. The concept of "acting in the public interest" is inherently embedded in a regulatory context, just as "fundamental fairness" is inherently embedded in a judicial context.

However, there is no governing law, Commission rule or judicial gloss supporting the following "public interest" standard being touted by Staff:

"In examining the question of "public interest," Staff believes the Commission should look for public interest in the acquisition of the stock, the subsequent transfer of assets, the transfer of the CC&N, **and in any direct consumer benefits.**" [Bonding added]. [lines 6-10, page 13, Exhibit S-1A].

Rather, the standard embraced by Staff is contrary to law, Commission rule and well-established judicial gloss in the following respects:

1. To the extent that subparagraphs A and D of A.R.S. § 40-285<sup>4</sup> are applicable in connection with the Acquisition Plan, it is instructive that the Court of Appeals stated as follows in Pueblo Del Sol Water Company v. Arizona Corporation Commission, 160 Ariz. 285, 772 P.2d 1138 (1988):

"A Certificate of Convenience and Necessity (CCN) granting operating authority to a corporation is initially issued by the Commission only upon a showing that its issuance would serve the public interest. [citing cases]. It logically follows that prior to approving a transfer of assets and CCN, **the Commission should examine all the evidence available to it to determine whether or not the transfer is detrimental to the public interest. . . .**" [Emphasis added]. [772 P.2d at 1139].

As evidenced by the Pueblo Del Sol case, Arizona has adopted a "no harm" public interest standard. Staff's assertion that the Commission, in examining the question of "public interest" in this proceeding, should look not only for the public interest but, as well, for any direct consumer benefits [see lines 5-10 on page 13 of Exhibit No. S-1A] does not square with the judicial gloss on A.R.S. § 40-285 provided in the Pueblo Del Sol case -- i.e., **"the Commission should examine all the evidence available to it to determine whether or not the transfer is detrimental to the public interest"**;

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A.R.S. § 40-285.A prohibits the disposition by a public service corporation of utility-related assets without Commission authorization, and A.R.S. § 40-285.D prohibits a public service corporation from acquiring the capital stock of any other Arizona public service corporation without the permission of the Commission.

2. Independently, the Commission formally has defined the "public interest" standard in A.A.C. R14-2-801 through R14-2-806 [the rules governing holding companies and affiliate transactions]. In the provision of the rules requiring Commission prior approval in connection with certain affiliate transactions, as well as the provision of the rules requiring Commission review of diversification activities [e.g., the formation of a holding company], the Commission-promulgated standard of review is to determine if the transaction and/or diversification activity "would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service" -- the "public interest" standard being advanced by Staff does not square with the Commission's own rules, and Staff's insistence that the Acquisition Plan, as proposed, is not in the public interest is particularly curious in light of Staff's own testimony;<sup>5</sup> and

3. To the extent Staff is advancing the notion that, in this proceeding, the Commission should interpret or prescribe law or policy which

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In addressing the financial effect of the Acquisition Plan on Black Mountain, Staff witness Joel M. Reiker included the following observations: "[U]nder SWG [BMG] will be shielded from the near-term company-specific risks that Xcel currently faces," "In recent months, Value Line has lowered Xcel's financial strength rating two notches from 'B+' to 'C++'," "In its August and November reports, Value Line recommends that its subscribers avoid purchasing Xcel's stock," "As of the date this testimony was filed, Xcel cut its quarterly dividend in half, wrote off its \$2.9 billion investment in NRG, and received a waiver from the SEC allowing its equity ratio to fall below 30 percent of total capitalization," "[I]f Xcel's financial strength and ultimately its bond rating were to continue to deteriorate in the near term, this could have negative implications for BMG if it were to remain an Xcel subsidiary" and "[T]he proposed transaction would prevent BMG from being exposed to the possible worsening financial condition of Xcel in the near term." [line 11 on page 8 through line 3 on page 11, Exhibit S-1A].

varies from the interpretation of A.R.S. § 40-285, as rendered both by the Court of Appeals in Pueblo Del Sol and the Commission in its own rules governing affiliate transactions, Staff is proposing *ad hoc* rulemaking contrary to the provisions of the Arizona Administrative Procedure Act – i.e., the establishment of a rule without following the rulemaking provisions enacted by Arizona's Legislature in A.R.S. §§ 40-1001, *et seq.*

There is no room for any reasonable debate regarding the fact that Commission approval of the Acquisition Plan, as proposed, without conditions, would be consistent with the public interest. It is intuitive, and the record as a whole demonstrates that fact.

*Staff's Quest For A \$1,000,000+/Year<sup>6</sup> "Big Carrot Hanging Out There" Comports Neither With Any Established Public Interest Standard Nor The Commission-Promulgated Standard In The Rules Governing Affiliate Transactions*

During questioning by ALJ Rodda, Staff witness Reiker testified that, if an acquisition transaction involved two companies virtually identical in terms of financial wherewithal, rates and any other material considerations, the Commission "could find a consumer benefit in the fact that you have a company whose owners don't want it anymore." [lines 8-10, page 372, Reporter's Transcript].

As a follow-up question, ALJ Rodda inquired of Staff witness Reiker: "[A]re you saying that right now in Arizona . . . it's the policy that if there's a neutral transaction - - and let's say where everything is the same . . . so the customer wouldn't see a change except maybe the heading on the bill . . . [a]nd the acquired company is well-run because the

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Exhibit A-5 illustrates that the difference in annual margin, comparing Southwest's margin rates to the margin rates for the Cave Creek Division of Black Mountain, exceeds \$1,000,000.

management has a conscience and knows that it's their public obligation, that it wouldn't be approved in Arizona"? [lines 5-13, page 412, Reporter's Transcript].

Following a discussion during which Staff counsel announced Mr. Reiker "isn't really qualified to speak to general policy decisions either in Arizona or for Staff," ALJ Rodda inquired further: "Is it your understanding that there needs to be some measurable benefit to a customer to approve a merger"? Following is Mr. Reiker's response:

"My understanding is that Staff is directed to find this benefit and however you find it. And it's dependent on the particular case.

In this case, **we happened to see a big carrot hanging out there in terms of lower rates** for Black Mountain customers. And we saw that as a significant consumer benefit." [Emphasis added].

[lines 11-17, page 413, Reporter's Transcript].

Staff's quest to seize the "big carrot" is extortionary within the ordinary meaning of the term. In other words, even though the Acquisition Plan satisfies the "public interest" standard articulated in A.R.S. § 40-285 and the Commission's rules governing affiliate transactions, Staff recommends penalizing Southwest as a condition of obtaining Commission approval -- i.e., the flip side of Staff's effort to secure a \$1,000,000+/year benefit for the customers of Black Mountain is a confiscation of Southwest's property by depriving Southwest of the revenue stream determined by the Commission to be necessary to provide a reasonable opportunity to earn a fair return on the fair value of the properties devoted to serving the customers of Black Mountain in the Cave Creek Division.

*Staff's Recommendation That The Commission-Established Rates For The Black Mountain Customers In The Cave Creek Division Be Reduced Outside Of A General Rate Case Is Contrary To Firmly-Embedded Arizona Ratemaking Principles*

Staff's recommendation that the rates in the Cave Creek Division of Black Mountain be reduced outside of a general rate case is violative of the doctrine announced in Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (1978). Although, in Scates, the Court of Appeals instructed the Superior Court to set aside a Commission order authorizing an increase of a rate "without any consideration of the overall impact of that rate increase upon the return of [the public service corporation]," the doctrine is equally applicable when a decrease of a rate is authorized.

It is noteworthy that, in Residential Utility Consumer Office v. Arizona Corporation Commission, 199 Ariz. 588, 20 P.2d 1169 (2001), twenty-three years after the Court announced the Scates decision, the Court of Appeals confirmed the continued efficacy of Scates and stated as follows:

"A public utility is entitled to due process when a ratemaking body undertakes to calculate a reasonable return for the use of its property and services by the public. See Simms, 80 Ariz. At 149, 294 P2d at 380 (citing Smyth v. Ames, 169 U.S. 466, 18 S.Ct. 418, 42 L.Ed. 819 (1898)). Conversely, the public is entitled to same level of protection when the government seeks to increase the utility rates the public is obligated to pay."

[20 p.3d at 1174].

Based on the opening statement by Staff counsel, Southwest gleans one of Staff's positions to be that, once Black Mountain is dissolved, the then-existing authorization for Black Mountain's rates would dissipate and there would be no other rates in existence other than Southwest's. That is not what would occur.

Rather, under the Acquisition Plan, all of the assets [including the Commission-approved tariff sheets] of Black Mountain would have been transferred to Southwest either prior to or simultaneous with the dissolution of Black Mountain. Those tariff sheets would continue to embody the Commission-established rates applicable to the customers in the service territories now served by Black Mountain.

Further, the rates currently being paid by Black Mountain customers were established to be just and reasonable by the Commission in a relatively recent general rate case. The Commission necessarily determined that the rates established in the general rate case are justified because they are designed to produce a revenue stream sufficient to provide an opportunity to earn a fair return on the fair value of the properties devoted to providing natural gas service to the customers of Black Mountain.

Regarding Staff's recommendation that, if Black Mountain is not dissolved by July 1, 2004, Black Mountain should be required to initiate a general rate case, Southwest does not understand the sense of the recommendation. The ultimate goal is to have uniform rates among the customers of Black Mountain and the customers of Southwest. The filing by Black Mountain of a general rate case most assuredly would run afoul of the ultimate goal.

The record reflects that Southwest's customer base in Arizona approximates 800,000 and Black Mountain's customer base in the Cave Creek Division approximates 8,000 or 1% of Southwest's customer base. Although it may not be reasonable to have the activities of 1% of Southwest's customer base drive a general rate case, RUCO's recommendation that a general rate case be filed within three years after the effective date of a decision in this proceeding is preferable to Staff's recommendation.

*From A Legal Standpoint, There Is No Inconsistency Associated With Changing Black Mountain's Current Gas Cost Rates And Not Changing Black Mountain's Current Margin Rates*

Based on questions asked by Staff counsel during cross-examination, it is evident that Staff may assert some inconsistency in changing gas cost rates and not changing margin rates. There is none, from a legal standpoint.

In the case of both Southwest and Black Mountain, the "pass-through" adjustment mechanisms related to the procurement of natural gas were established in general rate cases, which means that the "test year" expenses associated with the procurement of natural gas were removed from the cost of service and the revenue requirement determination for each utility was made without consideration of the historical expense levels for procuring natural gas. In other words, the mechanisms were designed to ensure that "the utility's profit or rate of return does not change." [*Scates, supra*, 578 P.2d at 616]. Accordingly, changing the gas cost rate for Black Mountain would have no overall impact on the earnings of Southwest.

On the other hand, the "margin" rates established in general rate cases for Southwest and Black Mountain were premised on the entire cost of service [exclusive of natural gas costs], including a sufficient revenue stream to provide each utility with the opportunity to earn a fair return on the fair value of the properties devoted to providing natural gas service in the utilities' respective service territories. The "margin" rates may not lawfully be changed without the conduct of a proceeding in which the overall impact on earnings is considered [*Scates, supra*, 578 P.2d at 618], and there is no evidence whatsoever in the record in this proceeding to support a change in the current "margin" rates of Black Mountain.

*Staff's Fourteen (14) Conditions Are Unnecessary And Punitive*

⇒ Staff recommends that Southwest be foreclosed forever from the opportunity to make a showing before the Commission that it would be just and reasonable to recover any portion of the acquisition premium or the costs associated with the transaction. Consistent with Southwest's position in this case, RUCO witness Rodney L. Moore testified: "Southwest's next Arizona general rate case is the appropriate time to analyze the acquisition premium, in conjunction with the total benefits realized from this acquisition." [lines 7-9, page 14, Exhibit R-1].

⇒ Staff recommends several conditions associated with maintaining current levels of service and safety. Mr. Miller clarified during the hearing that Staff has no problem with having the conditions stated in a manner that requires Southwest to maintain the same high levels of service and safety that Southwest currently maintains but does not include "a mandate for a specific staffing level or how operational field offices ought to be." [lines 4-17 on page 313, Reporter's Transcript].

Mr. Miller's clarification captures the gist of any concerns Southwest has expressed regarding the specific wording of several of Staff's recommended conditions.

Mr. Miller also confirmed during the hearing that, if Black Mountain completes its mapping and valve installation commitments by May 1, 2003, conditions 10, 13 and 14 set forth in Staff witness Reiker's testimony [pages 16 and 17, Exhibit S-1A] would be unnecessary. [lines 5-19, page 312, Reporter's Transcript].

All Southwest has sought throughout this proceeding with respect to several of Staff's recommended conditions is some clarification that Staff does not intend any of the conditions to impose any constraints on Southwest which would preclude Southwest from

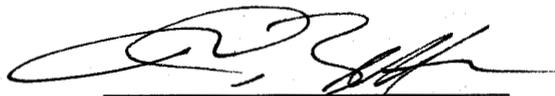
conducting its day-to-day operations utilizing "best practices." In principle, Southwest does not oppose conditions that current levels of service and safety not be diminished; that is because Southwest's intention is to provide the customers of Black Mountain with an even higher quality of service and level of safety than they currently enjoy.

**Conclusion**

The record in this proceeding demonstrates unequivocally that the Acquisition Plan is in the public interest and, more specifically, that the Acquisition Plan meets the standard established in the rules of the Commission governing affiliate transactions. There is no evidence whatsoever to support a determination that the Acquisition Plan, as proposed, is not in the public interest or does not meet the standard established in the Commission rules.

Accordingly, the Commission is respectfully requested to approve the Acquisition Plan, as proposed.

Respectfully submitted,



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CERTIFICATE OF SERVICE

I, Andrew W. Bettwy, hereby certify that I have this 4<sup>th</sup> day of April, 2003, served the foregoing **Closing Brief** by mailing a copy thereof to each of the following individuals:

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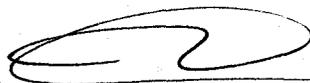
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