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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION FOR) DOCKET NO.
APPROVAL OF ACQUISITION PLAN AND,)
IF APPROPRIATE, WAIVER OF SELECTED) G-01551A-02-0425
PROVISIONS OF THE AFFILIATE RULES.)

AUIA'S POST-HEARING BRIEF

Pursuant to the instructions of the Administrative Law Judge at the close of hearing March 3, 2003, the ARIZONA UTILITY INVESTORS ASSOCIATION, INC., (AUIA) hereby files its post-hearing brief in the above-captioned matter.

1. Introduction

All of the parties to this proceeding have concluded that Southwest Gas Corporation (SWG) is a fit and proper entity to acquire and operate Black Mountain Gas Company (BMG) and, therefore, that the proposed acquisition is in the public interest. As a result, the fundamental question before the Commission has been resolved in favor of the acquisition.

However, the Commission Staff's approval is contingent on the imposition of all or most of 14 conditions on the transaction.

The conditions that were most controversial at hearing were Numbers One, Two and Five. Not surprisingly, these conditions also have the most financial impact on the transaction.

Condition One prohibits SWG from ever seeking rate recovery of any acquisition adjustment related to the transaction.¹

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¹ Exhibit S-1-A, P. 14

1 Condition Two asserts that SWG may never seek rate recovery of any
2 costs associated with the acquisition.²

3 Condition Five requires SWG to dissolve BMG as a corporation by July 1,
4 2004, and to apply its lower rate structure to BMG customers at that time.
5 However, if BMG is not dissolved by that date, it must file a general rate case.³

6 These conditions, especially Condition Five, are driven by Staff's
7 compulsion to find significant and immediate consumer benefits in order to
8 conclude that the transaction is in the public interest. Testimony on these issues
9 disclosed a serious conundrum:

10 On one hand, Staff conceded that the acquisition probably would produce
11 long-term benefits for BMG customers, but claimed they are not sufficient to
12 satisfy its public interest standard.⁴ On the other, the Staff's proposed conditions
13 not only eliminate any financial incentives for SWG to complete the merger but
14 actually transform it into a negative financial transaction.

15 SWG witness Edward Janov testified that if the conditions imposed on this
16 transaction were too adverse, SWG would be willing to walk away from the
17 deal.⁵

18 In the final analysis, is it really beneficial to consumers to extract so much
19 from the deal that it kills a transaction that would otherwise be in the public
20 interest? That is the key question raised by the Staff's case.

21 **2. The Public Interest, in General**

22 In Arizona, it is difficult to determine what defines the public interest in
23 mergers and acquisitions. A.R.S. § 40-282 provides direction to the Commission
24 on granting Certificates of Convenience & Necessity (CC&Ns) to public service
25 corporations (PSCs). It says the Commission may grant or reject a CC&N, but it
26 provides no standard and doesn't mention the public interest, let alone define it.

27 In addition, A.R.S. § 40-285 (A) & (D) govern the transfer of assets and the
28 acquisition of stock in PSCs, but this statute also fails to provide a standard for
29 approval or disapproval or to mention or define the public interest.

² Id.

³ Id., P. 15

⁴ Tr. P. 332

⁵ Tr. P. 22

1 Finally, the Commission's Holding Company and Affiliate Interest Rules,
2 R14-2-801 et seq., do require a public interest finding as a prerequisite to granting
3 a waiver to the rules. However, the standards for approving the formation of
4 holding companies and affiliate transactions are no-harm provisions. They relate
5 solely to preventing financial impairment of the regulated utility.⁶ If the same
6 standards were applied here, the Staff's conditions would be irrelevant and
7 unnecessary.

8 In this case, Staff apparently assumes that Conditions One and Two are in
9 the public interest because they eliminate a potential cost to ratepayers. As
10 AUIA will demonstrate below, at least one other jurisdiction has determined that
11 this assumption is erroneous.

12 With regard to Condition Five, the Staff asserts that the public interest
13 requires that there be an "obvious and significant immediate consumer benefit"
14 embodied in the transaction.⁷ However, the hearing record shows that
15 Condition Five is seriously flawed and not in the public interest.

16 **3. Conditions One and Two**

17 As these conditions are proposed, the Commission would be prevented
18 permanently from considering the recovery of either an acquisition adjustment
19 or the direct costs associated with this transaction.

20 The amount of the premium in this transaction is protected by
21 confidentiality, but it is a small percentage of book value. Other acquisition costs
22 could include regulatory expenses, financing costs and workforce revisions.

23 Staff apparently believes that prohibiting recovery of these costs is in the
24 public interest simply because they would not be charged to ratepayers.
25 However, Staff appears to be driven to protect the Commission from itself.

26 In response, AUIA offers the following arguments:

27 1) The Commission should not be precluded or "protected" from
28 considering whether cost recovery is appropriate on a case-by-case basis at a
29 time when the costs and benefits can be quantified.

⁶ See R14-2-802 C. and 805 B.

⁷ Exhibit S-1-A, P. 13

1 2) Determination of the public interest in mergers and acquisitions should
2 not be a one-sided measurement; it should result from balancing the costs and
3 benefits that will accrue to customers, plus the furtherance of any relevant
4 Commission policy (such as consolidation).

5 3) No condition prohibiting cost recovery is automatically in the public
6 interest if it would act to negate a transaction that would otherwise produce net
7 consumer benefits in either the near term or long term.

8 These are almost exactly the conclusions reached by the Massachusetts
9 Department of Public Utilities at the conclusion of a generic investigation to
10 resolve what standards should be considered in determining whether a
11 proposed merger or acquisition is in the public interest. The investigation was
12 initiated in September 1993 and the resulting order was issued 11 months later.⁸

13 As a result of this inquiry, the Massachusetts D.P.U. abandoned a rule that
14 disallowed *per se* any rate recovery of acquisition premiums and decided that
15 merger proposals involving such premiums would henceforth be judged on a
16 case-by-case basis.⁹

17 The Department concluded that in determining whether a transaction is in
18 the public interest it has a statutory duty to balance the costs and countervailing
19 benefits attendant to any proposed merger or acquisition.¹⁰ Although, as we
20 have noted, Arizona statutes offer no direction in this regard, nothing in statute
21 would prevent the Commission from adopting a balanced test.

22 Parties that favored recovery in the Massachusetts proceeding agreed that
23 recovery should be allowed only to the extent that demonstrated or projected
24 cost savings accrue from the merger.¹¹

25 Finally, the Massachusetts D.P.U. ruled: "Where the potential benefits for
26 customers exist, it would not be in their interests to maintain a *per se* barrier
27 against mergers. If it can be demonstrated that denying recovery of an
28 acquisition premium prevents consummation of a particular merger that would
29 otherwise serve the public interest, then we may be willing to allow recovery of

⁸ See D.P.U. 93-167-A, reported at 155 PUR 4th, 320 (1994)

⁹ Id. P.320

¹⁰ Id. P. 323

¹¹ Id. P. 327

1 an acquisition premium. Therefore, we will no longer follow the practice of
2 denying acquisition premium recovery on a *per se* basis."¹²

3 In this case, the Commission should retain its prerogative to judge the
4 issues of cost recovery in a rate case and reject Conditions One and Two.

5 **4. Condition Five, the Big Carrot**

6 Staff admits that it is focused on obtaining SWG's lower margin rates for
7 BMG customers as soon as possible.¹³ They have elevated this objective to their
8 highest public interest standard, that of providing an obvious and significant
9 immediate consumer benefit.

10 SWG introduced into evidence a substantial list of customer service and
11 other benefits that could flow from the acquisition.¹⁴ However, Staff witness Joel
12 Reiker asserted that such benefits "wouldn't rise to that direct and significant
13 public benefit standard that we applied in this case."¹⁵

14 Neither Mr. Reiker nor Staff witness Robert Gray could articulate any
15 statutory or regulatory requirement that such a standard must be met in order
16 to justify a finding that the transaction is in the public interest.¹⁶

17 In response to a question from ALJ Rodda, Mr. Reiker said the Utilities
18 Division Staff is "directed" to find such a benefit and he added, "In this case, we
19 happened to see a big carrot hanging out there in terms of lower rates for Black
20 Mountain customers. And we saw that as a significant consumer benefit."¹⁷

21 There is no doubt that BMG customers will eventually benefit from SWG's
22 lower margin rates, but in trying to force the issue, Staff has waded into a legal
23 swamp.

24 Mr. Gray believes that this transaction for SWG is analogous to absorbing
25 a new subdivision, which would be subjected to the same rates and tariffs as
26 existing SWG customers.¹⁸ While customer count may support that analogy, it
27 has no legal efficacy.

¹² Id. P. 328

¹³ Tr. P. 249

¹⁴ Exhibit A-3

¹⁵ Tr. P. 332

¹⁶ Tr. P. 345 and 252, respectively

¹⁷ Tr. P. 413

¹⁸ Tr. P. 235

1 Based on established legal precedent, the Commission cannot simply
2 order a change in rates and charges for BMG customers outside of a rate case
3 and without a determination of fair value. [See *Scates v. Arizona Corporation*
4 *Commission*, 118 Ariz.. 531, 578 P. 2d 612 (1978) and *Residential Utility Consumers*
5 *Office v. Arizona Corporation Commission*, 199 Ariz. 588, 20 P. 3rd 1169 (2001)]

6 Furthermore, BMG's current rates were set by the Commission only 24
7 months ago and Staff is not alleging that the rates are too high or unfair.¹⁹

8 SWG might be ordered to file a rate case as soon as possible, but that
9 could result in a premature rate increase for all of its customers, which certainly
10 would not be in the public interest.

11 The Staff's alternative is Condition Five, which would require SWG to
12 dissolve BMG by July 2004 and apply its lower rates to BMG customers at that
13 time. If BMG were not dissolved by that date, it would be required to file a
14 general rate case as a stand-alone entity.

15 Given the dictates of the cases cited, the first requirement of Condition
16 Five is on shaky legal footing. The second requirement simply makes no sense
17 and is clearly not in the public interest because if it were carried out, it probably
18 would produce higher rates for BMG customers than they are paying now.

19 SWG expects to keep BMG's rates intact until it completes its next general
20 rate case. SWG typically operates on a rate cycle of three to four years and its
21 last rate case was based on a 1999 test year. Although there is no guarantee, it
22 seems probable that SWG would file a rate case in 2004 based on a 2003 test year.

23 As it is written, Condition Five -- the Big Carrot -- should be rejected.

24 **5. Conclusion**

25 SWG has been found to be a fit and proper entity to acquire and operate
26 the business of BMG and that should be the end of it. Yet, the total financial
27 impact of the conditions recommended by Staff is such that SWG shareholders
28 will be damaged by this transaction and Southwest Gas could be forced to walk
29 away from an acquisition that is otherwise in the public interest.

¹⁹ Tr. P. 246

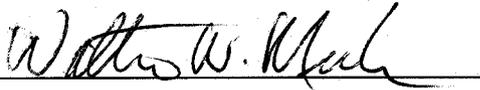
1 This is the same scenario that caused Massachusetts to re-examine its
2 approach to defining the public interest and to abandon its automatic prohibition
3 against recovery of acquisition premiums.

4 This Commission should also reserve judgment on whether the recovery
5 of acquisition costs is appropriate until there is a factual record available. That
6 decision would only arise when an Applicant determines that it can present
7 convincing evidence in a rate case that efficiencies resulting from the merger
8 have produced net customer benefits.

9 If the Commission believes it should apply a public interest standard in its
10 examination of mergers and acquisitions, it should be a balanced test that weighs
11 the known costs and benefits completely and fairly. It should not be an ad hoc
12 standard invented by Staff and designed solely to produce gratuitous benefits for
13 customers, as is the case with Condition Five.

14 For all of the reasons we have cited, AUIA urges the Commission to reject
15 the financially adverse Conditions One, Two and Five and to otherwise approve
16 SWG's acquisition of BMG.

17
18 Respectfully submitted, this Fourth day of April, 2003.

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20 

21 Walter W. Meek, President
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23

24 **CERTIFICATE OF SERVICE**

25
26 An original and 13 copies of the
27 foregoing Brief were filed this
28 Fourth day of April, 2003, with:

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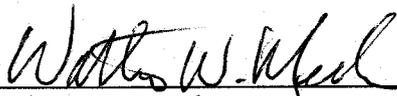
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