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SOUTHWEST GAS CORPORATION

EXCEPTION

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Andrew W. Bettwy, Assistant General Counsel

AZ CORP COMMISSION
DOCUMENT CONTROL

July 16, 2003

Arizona Corporation Commission
DOCKETED

JUL 17 2003

VIA OVERNIGHT MAIL

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

DOCKETED BY 

Re: Filing of **Exceptions by Southwest Gas Corporation**
Docket No. G-01551A-02-0425

Accompanying this letter are the original and fourteen (14) copies of a document, entitled **Exceptions by Southwest Gas Corporation**. 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

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Enclosures

EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

RECEIVED

MARC SPITZER
Chairman
JIM IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner

2003 JUL 17 A 11: 24

ORIGINAL

AZ CORP COMMISSION
DOCUMENT CONTROL

Arizona Corporation Commission

DOCKETED

JUL 17 2003

DOCKETED BY *CA*

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-1551A-02-0425

Exceptions by Southwest Gas Corporation

Pursuant to A.A.C. R14-3-110.B, Southwest Gas Corporation (Southwest) respectfully submits exceptions to the proposed opinion and order filed in the above-captioned Docket on July 8, 2003.

The Proposed Opinion And Order Is Contrary To Law

The proposed opinion and order is contrary to law, insofar as it contemplates that the Commission, effective July 1, 2004, would order a reduction in the rates currently in effect for the customers of Black Mountain Gas Company (Black Mountain) without the conduct of a proceeding in which the Commission establishes just and reasonable rates in accordance with the mandate in §§ 3 and 14 of Article XV of Arizona's Constitution, as interpreted consistently since statehood by Arizona's appellate courts.

The proposed opinion and order is devoid of any legal analysis whatsoever regarding the propriety of ordering a reduction in rates without the conduct of a proceeding in the nature of a general rate case. If such an analysis had been undertaken and exposed, not a single provision of Arizona's Constitution or Arizona's legislative enactments or the related judicial gloss by Arizona's appellate courts would be identified. There is absolutely no support in the law for such an order.

If a legal analysis had been undertaken, the research would have disclosed, *inter alia*, the Arizona appellate court decisions in Scates v. Arizona Corporation Commission, 118 Ariz. 531, 578 P.2d 612 (1978), Pueblo Del Sol Water Company v. Arizona Corporation Commission, 160 Ariz. 285, 772 P.2d 1138 (1988) and Residential Utility Consumer Office v. Arizona Corporation Commission, 199 Ariz. 588, 20 P.3d 1169 (2001), all three of which were cited in the post-hearing briefs submitted in this proceeding.

The proposed opinion and order ignores the law. Instead of including a legal analysis, the proposed opinion and order relies on statements such as: “[i]t is not in the public interest for customers in the BMG territory to pay rates that are not reasonable” and “[t]o prevent harm to the public interest from unreasonable rates, it is reasonable to condition approval of the transaction on SWG implementing its authorized rates in the current BMG service area upon the dissolution of BMG and no later than July 1, 2004. [See, respectively, proposed Finding of Fact No. 19 and proposed Finding of Fact No. 20]. Both statements inherently are premised on an unwarranted assumption that the rates being paid by customers in the Black Mountain service territory either are unreasonable or will become unreasonable at some time prior to July 1, 2004. Only after the conduct of a proceeding in the nature of a general rate case can such a determination lawfully be made by the Commission.

The rates currently in effect for the customers of Black Mountain were established on March 30, 2001 in Decision No. 63545. The Commission necessarily determined in Decision No. 63545 that the rates established in the related general rate case were justified because they were 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 customers in the Black Mountain service territory; and, to this day and until new rates are established in a general rate case, the rates established in Decision No. 63545 are and will be presumptively just and reasonable.

The sole factual support in the proposed opinion and order for an order reducing the rates currently in effect for Black Mountain customers is embodied in the following statement in proposed Finding of Fact No. 17: "SWG asserts the acquisition is likely to result in operational efficiencies." In that regard, during cross-examination, Staff witness Robert G. Gray confirmed that (1) no party to this proceeding attempted to calculate operational efficiencies that may occur post-consummation and (2) the Scates doctrine is "that rates ought not change in between general rate cases without taking a look at the impact on the earnings of the company." [See lines 19 through 21 on page 259 and lines 5 through 18 on page 265 of the Reporter's Transcript].

Omitted from the proposed opinion and order is the fact that, during the post-consummation transition, it is expected that Southwest would incur incremental expenses associated with the assimilation of data into Southwest's record keeping systems and the upgrading, *inter alia*, of customer billing and mapping systems. [See lines 4 through 18 of Exhibit No. A-2A]. There is no evidence whatsoever in the record to support a finding of whether and/or when the incremental conversion costs may be offset by operational efficiencies. Further, there is no evidence whatsoever in the record to support a finding regarding what revenue stream, as of July 1, 2004 [i.e., the date on

which the proposed opinion and order contemplates that the current margin rates for Black Mountain customers would be decreased by approximately twenty-five percent], would be sufficient to provide Southwest with an opportunity to earn a fair rate of return on the fair value of the properties devoted to providing natural gas service to the current customers of Black Mountain.

It is noteworthy Staff witness Joel M. Reiker testified it is intuitive that, since Black Mountain's current margin rates are substantially higher than Southwest's current margin rates, the cost of service in Black Mountain's service territory is higher than the cost of service in Southwest's service territory. [See lines 14 through 22 on page 357 of the Reporter's Transcript]. Mr. Reiker testified further: "I always believe the Commission should be fully informed" before making determinations regarding either customer rates or company earnings. [See line 25 on page 358 through line 13 on page 359 of the Reporter's Transcript].

A brief review of the facts in the above-cited Scates, Pueblo Del Sol Water Company and Residential Utility Consumer Office Arizona appellate court decisions is instructive.

In Scates, Mountain States Telephone and Telegraph Company provided evidence during a hearing to the effect that the charges for installing, moving and changing telephones, which charges had been established by the Commission in a general rate case, covered only forty-one percent of the associated costs and that the increase being sought would cover only sixty-four percent of the associated costs. The Commission authorized the requested increase. Arizona's Court of Appeals determined that the Commission's action violated Arizona's constitutional provisions regarding rate making and stated, *inter alia*:

In Arizona, the Corporation Commission is the body charged with the responsibility for establishing utility rates which are "just and reasonable." Ariz.Const. Art. 15, § 3; A.R.S. § 40-250. The general theory of utility regulation is

that the total revenue, including income from rates and charges, should be sufficient to meet a utility's operating costs and to give the utility and its shareholders a reasonable rate of return on the utility's investment. *See Simms v. Round Valley Light & Power Co.*, 80 Ariz. 145, 153, 294 P.2d 378, 383 (1956); *see generally* Phillips, *The Economics of Regulation* 178-302 (Rev. Ed. 1969). To achieve this, the Commission must first determine the "fair value" of a utility's property and use this value as the utility's rate base. *Arizona Corp. Comm'n v. Arizona Pub. Serv. Co.*, 113 Ariz. 368, 370, 555 P.2d 326, 328 (1976). The Commission then must determine what the rate of return should be, and then apply that figure to the rate base in order to establish just and reasonable tariffs. *Id.*

* * *

Thus, the rates established by the Commission should meet the overall operating costs of the utility and produce a reasonable rate of return. **It is equally clear that the rates cannot be considered just and reasonable if they fail to produce a reasonable rate of return or if they produce revenue which exceeds a reasonable rate of return.** [Bolding added]. [578 P.2d at page 615].

The proposed opinion and order contemplates that the Commission would order a reduction in rates and a corresponding reduction in Southwest's revenue stream without having any idea whatsoever whether the resulting rates would be just and reasonable – i.e., whether the resulting revenue stream would produce a reasonable rate of return.

In Pueblo Del Sol Water Company, a joint application was submitted to the Commission for approval of a transfer of utility assets, including a certificate of public convenience and necessity, from Pueblo Del Sol Water Company to Arizona Water Company. Similar to the facts in this proceeding, the rates of the acquiring utility (Arizona Water Company) were lower than the rates of the utility (Pueblo Del Sol Water Company), the assets of which were being acquired. The Commission approved the asset acquisition with the condition that, although the higher rates would remain in effect until the next general rate case, the higher rates would be interim – i.e., "subject to refund or other reconciliation." The Court of Appeals confirmed the Commission's power to impose rates on an interim basis.

Approximately twelve years later, Arizona's Court of Appeals, in the Residential Utility Consumer Office case, made the following observation regarding the meaning and effect of the Pueblo Del Sol Water Company case:

Pueblo Del Sol involved the sale of substantially all of one utility's assets to another utility. The selling utility had been authorized to charge a higher rate to its customers than had the buying utility. The buying utility sought and received the Commission's approval to continue charging the higher rate to the selling utility's customers. Although depicted as an "interim rate," the rate that was being charged by the selling utility was a final rate set by the Commission for that particular company. *Id.* At 286-87, 772 P.2d at 1139-40. We do not believe *Pueblo Del Sol* to be an "interim rate" case as contemplated by *Scates*. **The Commission's approval in *Pueblo Del Sol* was, in effect, an approval of the continued use of a previously authorized rate.** [Bolding added]. [20 P.3d at 1173].

Perhaps the most significant aspect of the Court of Appeals' 2001 decision in Residential Utility Consumer Office is the recognition that Scates continues to be the governing law. Additionally, the court included the following statement:

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 P.2d 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 the same level of protection when the government seeks to increase the utility rates that the public is obligated to pay. [Bolding added]. [20 P.3d at 1174].

The proposed opinion and order shrugs off the Arizona appellate court decisions articulating constitutional rate making principles by stating that they "do not involve transfers of assets or CC&N's." [See line 28 on page 14 through line 1 on page 15]. First, the statement is inaccurate because the Pueblo Del Sol Water Company did involve a transfer of assets, including a certificate of public convenience and necessity, from Pueblo Del Sol Water Company to Arizona Water Company and the higher rates of Pueblo Del Sol Water Company remained in effect [albeit on an interim basis] pending review in a general rate case. Second, there is no support in the law for the

notion that in a transfer proceeding the constitutional ratemaking principles can be ignored and, of course, the proposed opinion and order makes no effort to suggest that any such support in the law exists.

The proposed opinion and order, insofar as it contemplates an order reducing rates without the conduct of a proceeding in the nature of a general rate case, runs afoul of every pronouncement ever made by the appellate courts in Arizona regarding the establishment of just and reasonable rates pursuant to the applicable constitutional rate making principles.

The Existence Of Separate And Distinct Rate Areas Is Not Contrary To The Public Interest

The proposed opinion and order has invented a public interest standard which, in addition to being contrary to constitutional rate making principles, is a marked departure from Commission precedent. The proposed opinion and order includes statements such as: “[W]e do not believe having neighboring customers pay different rates to be in the public interest” and “SWG has not provided evidence that in this case it is reasonable for it to continue charging the rates of a dissolved public service corporation once the acquisition and integration is complete.” [See lines 17 and 18 on page 14 and lines 2 through 4 on page 21].

The fact that Black Mountain is to be dissolved at some future time is of no moment in the analysis. The essence of the proposed transaction is that Southwest would acquire the assets of Black Mountain. Instead of acquiring the assets on day one, the assets would remain with Black Mountain, a separate entity, until Black Mountain is dissolved. Focusing on the dissolution simply distracts attention away from the pivotal and relevant facts.

To the best knowledge of Southwest, the Commission has never expressed concern over the fact that, in an asset acquisition transaction between two utilities, the rates of the utility [the assets of which are being acquired] remain in effect until reviewed in a general rate case.

In each of three instances involving an asset acquisition transaction between Southwest and another utility, in which Southwest was the acquiring utility, the Commission approved the transaction, and the rates of the utility [the assets of which were acquired] remained in effect until reviewed in a general rate case. The transactions involved the acquisition of the natural gas facilities of then-Tucson Gas & Electric Company in 1979, the acquisition of the natural gas facilities of Arizona Public Service Company in 1984 and the acquisition of the natural gas facilities of Ajo Improvement Company in 1997. In the latter case, the Ajo acquisition, “[T]he existing Southwest Gas customers were paying different rates [than the rates being paid by the Ajo customers], and they were literally across the street from each other.” [Bracketed information added]. [See lines 17 through 20 on page 170 of the Reporter’s Transcript].

Two weeks ago, on July 3, 2003, in Decision No. 66028, in connection with the UniSource/Citizens transaction, the Commission approved an asset acquisition transaction in which the electric rates of Citizens [the assets of which were being acquired by UniSource] remained in effect [as adjusted in the PPFAC Docket], and a disparity resulted between the rates charged by Tucson Electric Power Company and the neighboring customers of the newly-created wholly-owned subsidiary of UniSource. Although the factual distinctions between the UniSource/Citizens transaction and the Southwest/Black Mountain are pronounced, the fact is that neighboring customers are paying disparate rates – not unlike the factual settings in prior Commission proceedings.

Further, as discussed earlier in these exceptions, the Pueblo Del Sol Water Company case involved the acquisition of assets, including a certificate of public convenience and necessity, by one utility from another – and the higher rates of the utility [the assets of which were being acquired] remained in effect [albeit on an interim basis] pending review in a general rate case.

Recommended Modifications To Proposed Opinion And Order

The Appendix is comprised of Southwest's recommended modifications to the proposed opinion and order and accompanying explanations of the reasons for the recommended modifications.

For all of the foregoing reasons, the Commission is respectfully urged to adopt the proposed opinion and order with Southwest's recommended modifications.

Respectfully submitted,



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APPENDIX

Recommended Modifications To Proposed Opinion And Order

Substitute the following for the language beginning on line 13 of page 14 and ending on line 3 of page 15:

SWG contends that the rates currently in effect for customers in the Black Mountain service territory may be changed only after a review in a general rate case. Although it is expected that certain operational efficiencies may be experienced after Southwest acquires the Black Mountain customers, the record indicates that Southwest also expects to experience incremental expenses during the process of assimilating Black Mountain's records and updating and upgrading customer billing records and mapping systems.

There is no evidence in the record which purports to quantify either the potential cost savings or incremental expenses. Accordingly, it would be entirely speculative to conclude that the rates currently in effect for customers in the Black Mountain service territory either are unreasonable or will become unreasonable at any date certain in the future.

Explanation for recommended modification: The substitute language envisions that the rates currently in effect for customers in the Black Mountain service territory would remain in effect until reviewed in a general rate case. As a practical matter, the review would occur in a general rate case filing by Southwest for all of its Arizona properties.

Delete Findings of Fact Nos. 18 through 20 and the last sentence of Finding of Fact No. 24.a

Explanation for recommended modification: The deletions conform with a determination that the rates currently in effect for customers in the Black Mountain service territory would remain in effect until reviewed in a general rate case.

Delete the reference to Finding of Fact No. 20 in Conclusion of Law No. 10

Explanation for recommended modification: The deletion conforms with a determination that the rates currently in effect for customers in the Black Mountain service territory would remain in effect until reviewed in a general rate case.

Substitute the following for the Ordering paragraph on lines 1 through 3 of page 24

IT IS FURTHER ORDERED that, upon completion of the transfer of assets and dissolution of Black Mountain Gas Company, Black Mountain Gas Company's Certificate of Convenience and Necessity shall be deemed transferred to Southwest Gas Corporation without further Order of the Commission.

Explanation for recommended modification: The substitute language conforms with the fact that, upon dissolution of Black Mountain, the Certificate of Convenience and Necessity currently held by Black Mountain will transfer to Southwest – not cancelled.

Substitute the following for the Ordering paragraph on lines 6 through 10 of page 24

IT IS FURTHER ORDERED that, for any service that Southwest Gas Corporation provides to its customers for which Black Mountain Gas does not have an approved charge, Southwest Gas Corporation shall charge its approved charges.

Explanation for recommended modification: The substitute language conforms with a determination that the rates currently in effect for customers in the Black Mountain service territory would remain in effect until reviewed in a general rate case but that, for any service Southwest provides that Black Mountain does not provide, Southwest shall charge its approved charges.

Delete the Ordering paragraph on lines 11 through 13 of page 24

Explanation for recommended modification: The deletion conforms with a determination that the rates currently in effect for customers in the Black Mountain service territory would remain in effect until reviewed in a general rate case.

CERTIFICATE OF SERVICE

I, Andrew W. Bettwy, hereby certify that I have this 17th day of July, 2003, served the foregoing **Exceptions** by mailing a copy thereof to each of the following individuals:

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