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IN THE MATTER OF THE ARIZONA
CORPORATION COMMISSION'S
INVESTIGATION OF REGULATORY
AND RATE INCENTIVES FOR GAS
AND ELECTRIC UTILITIES

DOCKET NO. E-00000J-08-0314
G-00000C-08-0314

NOTICE OF FILING

NOTICE OF FILING PROPOSED REGULATION

Southwest Gas Corporation hereby provides notice of filing a proposed regulation that:
(1) establishes conservation and energy efficiency goals and targets; (2) establishes a process for implementing a methodology for obtaining recovery of the costs of the plans and programs used to obtain those goals and targets; (3) establishes a process for implementing a methodology ensuring gas utility costs for providing natural gas service are recovered without regard to the difference in the quantity of natural gas actually sold so that gas utility incentives align with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers; and (4) maximizes gas utility efforts and performance by establishing a process for implementing performance incentives. A copy of Southwest's proposed regulation is enclosed herewith as Attachment A.

**BRIEF STATEMENT OF RATIONALE SUPPORTING
SOUTHWEST GAS CORPORATION'S PROPOSED REGULATION**

One of the stated purposes of the above-captioned docket was to address rate design modifications to promote energy efficiency investment standards as required by the Energy

Independence and Security Act of 2007. In addition to discussing rate design modifications, the parties discussed various issues pertaining to energy efficiency standards.

As stated by Southwest during the course of the workshops, Southwest is supportive of any proposed energy efficiency goal and annual targets that are sufficiently tailored to address Southwest's unique operating conditions and challenges, that are realistically attainable, and that are established in conjunction with the removal of the financial disincentives that currently serve as a barrier to achieving energy efficiency goals. Based upon the information gathered by Southwest during the numerous investigatory workshops, Southwest has drafted a proposed regulation that it believes can be implemented in a timely manner, that establishes an aggressive, yet achievable energy efficiency goal and annual targets, and that provides guidelines for establishing the necessary methodologies and programs to align the gas utility incentives with the delivery of the benefits of cost-effective conservation and energy efficiency programs for natural gas customers.

Southwest submits that its proposed rule addresses the rate design modifications to promote energy efficiency investments as set forth in the Energy Independence and Security Act of 2007, reflects feedback from the parties that participated in the investigatory workshops, and reflects approaches to establishing energy efficiency goals and addressing necessary regulatory and rate design modifications from other jurisdictions that have been discussed in the workshops – specifically, identifying an energy efficiency standard, providing for cost recovery, establishing a methodology for the removal of financial disincentives, and establishing performance incentives.

Set forth below are statements briefly explaining Southwest's rationale for each section

of its proposed regulation.

Section 1: Applicability and Definitions.

As noted above, Southwest's proposed rule establishes an aggressive, yet achievable energy efficiency goal and annual targets in a timely manner, and provides guidelines for establishing the necessary methodologies and programs to align gas utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers. Southwest submits that separate regulations for gas and electric utilities are appropriate and offers its proposed regulation from the perspective of a Commission regulated natural gas utility and has proposed a rule that would apply to regulated natural gas utilities only. This section also provides definitions of key terms that appear throughout the proposed regulation.

Section 2: Conservation and Energy Efficiency Goal.

This section establishes an aggressive, yet attainable, goal for conservation and energy efficiency that all natural gas utilities will be obligated to strive towards, and establishes the timeframe of 2020 for obtaining that goal. In addition this section establishes annual targets so that parties can measure the gas utility's performance towards attaining the goal of a 15% reduction in retail sales by 2020.

This section also identifies the measurement criteria for measuring progress towards the goal. The proposed measurement criteria are critical to Southwest's support of a 15% goal because it includes all conservation and energy efficiency. Southwest believes that comparing all weather normalized changes in consumption to a base line year is a preferred approach for natural gas utilities to measure conservation and energy efficiency progress because it better reflects what is occurring in the marketplace as a whole. A conservation and energy efficiency

benchmark tied solely to conservation and energy efficiency programs will not provide natural gas utilities an incentive to continue or increase program activities that encourage and result in customer usage reductions that cannot be specifically measured, i.e. customer outreach and educational programs, building code improvements, and overlap from non-gas energy efficiency programs. Each of these programs can significantly impact customer behavior and yield reduced consumption, yet they are not precisely measurable. Southwest submits that these are important programs that should be supported and pursued by gas utilities. However, if they are excluded from the measurement criteria a perverse incentive will exist to not aggressively pursue them as compared to other programs. Accordingly, Southwest's proposal provides a more comprehensive approach to measuring customers' reduced gas consumption, which is aligned with Southwest's understanding of one of the primary policy objectives of this regulation – comprehensive increased energy efficiency.

Southwest is concerned that if all changes in consumption are not measured, we will lose sight of the overall objective of using less energy, create a forum for arguing about what caused specific reductions in consumption, and consequently incent utilities to focus efforts only on programs that can measure specific results. At a time when utilities and governmental agencies are looking for ways to increase administrative efficiency, Southwest submits that there is no need to frustrate the effort by creating incremental future regulatory proceedings where multiple parties will retain multiple paid consultants to play a game of "my estimate is better than yours." Rather, all conservation and energy efficiency, and corresponding customer savings are good and should be captured.

Furthermore, gas utilities have a limited number of opportunities to curb customer usage

patterns because there are a limited number of end-use gas applications and the price elasticity of demand for natural gas is relatively inelastic - which translates to gas use being primarily a necessity not a discretionary commodity for customers. If a comprehensive approach to measuring conservation and energy efficiency is not adopted, then the conservation and energy efficiency goal and annual targets should be modified to reflect the change in measurement criteria. This will result in a significantly lower achievable goal in the range of 6-7%, which is consistent with other recent decisions that were studied in the workshops.^a

Southwest submits that despite this comprehensive approach to measuring conservation and energy efficiency, gas utilities will still be held accountable to an aggressive standard and for aggressively pursuing conservation and energy efficiency as there is a great deal of uncertainty surrounding how much decline in consumption per customer Southwest has historically experienced will continue absent aggressive conservation and energy efficiency plans, as has been expressed by Commission Staff and RUCO in prior Southwest proceedings. In addition, the annual reporting requirement and the 3-year filing requirement set forth in the proposed regulation will provide further oversight of gas utility performance by the Commission to ensure that aggressive pursuit of conservation and energy efficiency is occurring.

This section also provides language that permits the Commission and the gas utilities to establish additional goals beyond the 2020 timeframe so that the gas utilities can continue to use the framework established by this regulation on a go-forward basis beyond 2020.

^a See Case 07-M-0548, *Proceeding on Motion of the Commission Regarding an Energy Efficiency Portfolio Standard*, pp. 13-14, May 19, 2009. The New York Public Service Commission established a natural gas energy efficiency target resulting in a 5.8% reduction in forecasted gas usage from gas utility programs by 2020, but when combined with savings from other sources the savings is 14.7%.

Section 4: Application for Approval of Conservation and Energy Efficiency Plan.

The purpose of this section is to provide a framework for establishing the methodologies that will align gas utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers.

This section identifies the items that must be included in an application to the Commission by the gas utility. They include: (1) a conservation and energy efficiency plan; (2) a schedule identifying annual targets of the utility's progress towards the goal; (3) a methodology to account for any fuel optimization programs; (4) a cost recovery methodology; (5) a methodology for removing financial disincentives; (6) performance incentives; and (7) any other information deemed to be appropriate for consideration by the Commission in approving the conservation and energy efficiency plan. Each of these items is discussed in more detail below.

In addition to identifying the items that must be included in an application to the Commission, this section sets forth aggressive timelines for the gas utility to make filings as well as timeframes for Commission orders. The alignment of gas utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers is extremely important to the success of increased conservation and energy efficiency in Arizona. Accordingly, Southwest has proposed aggressive timelines for filing applications pursuant to this regulation and for the Commission to issue final orders. This section also clarifies that all existing approved plans, programs, goals, and annual targets will continue in effect until the Commission takes further action so as to alleviate any confusion regarding the termination of existing plans and the implementation of new plans.

This section also requires the filing of annual reports on the status of programs and the

gas utility's progress towards the goals and targets, as well as a requirement that the gas utility make a new filing every 3 years to review and refresh the goals and targets, and the list of programs and methodologies that align utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers.

Section 5: Conservation and Energy Efficiency Plan.

This section identifies the minimum requirements to be included in a gas utility conservation and energy efficiency plan, including what should be included with each proposed program.

Section 6: Annual Conservation and Energy Efficiency Targets.

This section identifies the minimum requirements for including a schedule of the approved annual savings targets and a demonstration by the gas utility of how the proposed conservation and energy efficiency programs will make progress towards achieving the approved goals and annual targets. This requirement also forms the basis for holding the gas utility accountable with respect to implementing aggressive conservation and energy efficiency programs and for determining recoverability of any authorized performance incentives or other performance-related methodologies.

Section 7: Accounting Methodology for Fuel Optimization Programs.

If the policy objective is to move Arizona in a more energy efficient direction, Southwest submits that it is important to recognize that some conservation and energy efficiency programs may be designed as fuel optimization programs where end-use applications are being modified to take advantage of the most efficient energy resource. Accordingly, Southwest believes that the regulation should recognize this possibility and provide gas utilities a framework in which to

propose programs that optimize the most energy efficient fuel as an end-use fuel and a methodology to account for these programs and how these programs will impact the approved goals and annual targets.

Southwest does not believe it is necessary to address methodologies in the regulation, but rather to recognize the need for addressing appropriate methodologies as future plans and programs are proposed, which will facilitate the regulated utilities efforts in pursuing the overall policy objective of making Arizona a more energy efficient state.

Section 8: Cost Recovery, Removal of Financial Disincentive, and Performance Incentives.

This section provides the framework for parties to propose methodologies to permit timely recovery of conservation and energy efficiency program costs, propose methodologies to remove financial disincentives so that the gas utilities are indifferent to their level of sales, and to propose reasonable performance incentives to maximize gas utility performance. This section sets forth the necessary model for implementing effective conservation and energy efficiency programs by aligning gas utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers.

Southwest believes that flexibility for all three components of this model are important. Accordingly, this section provides the minimum requirements and policy objectives for developing appropriate methodologies for cost recovery, removal of financial disincentives, and for establishing performance incentives.

As has been expressed in prior comments, Southwest believes the only way to move Arizona in a more energy efficient direction is through programs and methodologies that make the utility indifferent to its level of sales, which can be accomplished through revenue

decoupling methodologies. However, recognizing that parties may want to propose different methodologies for removing financial disincentives, Southwest has proposed a regulation that grants each utility and stakeholder an opportunity to propose different methodologies for accomplishing this objective. The key is the Commission must approve a methodology that accomplishes the stated policy objective - to ensure gas utility costs for providing natural gas service are recovered without regard to the difference in the quantity of natural gas actually sold so that gas utility incentives align with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers. As long as the approved methodology meets this standard, Southwest believes that utilities will be indifferent to their level of sales and can then truly focus on promoting conservation and energy efficiency programs.

Southwest also believes including performance incentives is a necessary part of a rule, as there is a role for the use of incentives to maximize performance. As expressed in relation to the New Mexico model, performance incentives can be utilized to make conservation and energy efficiency “financially more attractive to the utility than supply-side utility resources,” which will result in a greater incentive to maximize implementation of conservation and energy efficiency programs. Similar to cost recovery and removal of financial disincentive methodologies and programs, a framework for developing utility-specific performance incentives is more effective than specifically identifying a set of performance incentives in a rule because it will allow utilities to develop and tailor specific performance incentives to maximize their own performance based upon their unique operating conditions and experiences.

However, as noted in the proposed regulation, Southwest believes that the performance incentive should be reasonable, should be designed to maximize performance, and it should be

tied directly to gas utility performance and the approved goal and annual targets.

Section 9: Deviation from Regulation.

Given the uncertainty about levels of market potential for cost effective conservation and energy efficiency programs, cost effective incentive levels for programs, corresponding participation levels of customers, and the need to modify programs to respond to customer demand and response, Southwest believes it is necessary that there be a provision that allows a party to request deviation from the minimum requirements set forth in the proposed regulation upon a showing of good cause and a demonstration that it is in the public interest. Accordingly, this section provides a framework for requesting a deviation from the regulation.

CONCLUSION

Based upon the foregoing, Southwest submits that the attached proposed regulation can be implemented in a timely manner, that it establishes an aggressive, yet achievable energy efficiency goal as well as annual targets, and that it provides sufficient guidelines for establishing the necessary methodologies that will align gas utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers.

Southwest further submits that its proposed rule addresses the rate design modifications to promote energy efficiency investments as set forth in the Energy Independence and Security Act of 2007, and reflects approaches to establishing energy efficiency goals and addressing necessary regulatory modifications implemented in other jurisdictions that have been

examined by the parties during the investigatory workshops.

DATED this 3rd day of June 2009.

SOUTHWEST GAS CORPORATION

 for

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ATTACHMENT A

**PROPOSED REGULATION OF
SOUTHWEST GAS CORPORATION
June 3, 2009**

**Docket Nos.
G-00000C-08-0314
E-00000J-08-0314**

Section 1: Purpose; Applicability.

A. The purpose of this regulation is to establish conservation and energy efficiency goals and targets; to establish a process for implementing a methodology for obtaining recovery of the costs of the plans and programs used to obtain those goals and targets; to establish a process for implementing a methodology ensuring gas utility costs for providing natural gas service are recovered without regard to the difference in the quantity of natural gas actually sold so that gas utility incentives align with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers; and to maximize gas utility efforts and performance by establishing a process for implementing performance incentives.

B. This regulation shall apply to all natural gas utilities that are regulated by the Commission.

Section 2: Definitions. As used herein, inclusive, unless the context otherwise requires, the words and terms defined herein, have the meanings ascribed to them.

A. "Approved annual targets" defined. "Approved annual targets" means the annual savings targets set forth in Section 3 or any subsequent or modified annual target established by the Commission pursuant to this regulation.

B. "Approved goal" defined. "Approved goal" means the initial conservation and energy efficiency goal set forth in Section 3 or any subsequent or modified goal established by the Commission pursuant to this regulation.

C. "Authorized margin per customer" defined. "Authorized margin per customer" means the monthly authorized margin for per customer approved by the Commission in the gas utility's most recent general rate case.

D. “Commission” defined. “Commission” shall refer to the Arizona Corporation Commission.

E. “Conservation” defined. “Conservation” is the planning, implementation, and evaluation of reduced energy consumption.

F. “Cost effective” defined. “Cost effective” means that the conservation and energy efficiency program being evaluated satisfies the total resource cost test, or is otherwise determined by the Commission to be in the public interest and result in net benefits to customers.

G. “Cumulative energy efficiency savings” defined. “Cumulative energy efficiency savings” shall mean all weather normalized changes in consumption per customer.

H. “Energy efficiency” defined. “Energy efficiency” is the use of products, services, or practices aimed at the practical and economical use of energy in end-use applications generally by substituting technically more advanced (compared to what is presently used in a specific situation) equipment or practices to produce the same or an improved level of end-use service with less energy use.

I. “Fuel optimization” defined. “Fuel optimization” means utilization of the most efficient energy source for an end-use application, after consideration of a site-to-source analysis of the energy source utilized in the end-use application.

J. “Full revenue decoupling” defined. “Full revenue decoupling” means a methodology that results in a gas utility’s revenues not being affected by changes in customers’ natural gas consumption.

K. “Gas utility” defined. “Gas utility” means a Commission regulated public utility that distributes natural gas to end-use customers.

L. “Methodology for removing financial disincentives” defined. “Methodology for removing financial disincentives” means a methodology that ensures that the costs of the gas utility for providing natural gas service are recovered without regard to the quantity of natural gas sold by the gas utility resulting in the alignment of gas utility incentives with the delivery of cost-effective conservation and energy efficiency programs for natural gas customers, and shall include full revenue decoupling, straight fixed variable rates, or some other comparable methodology.

M. "Total usage" defined. "Total usage" means the gas utility's customer volumes as approved by the Commission in the gas utility's most recent general rate case at the time this regulation becomes effective.

Section 3: Conservation and Energy Efficiency Goal and Annual Targets.

A. Unless otherwise ordered by the Commission, each gas utility shall strive to achieve cost-effective conservation and energy efficiency consisting of at least a 15% reduction of retail sales by 2020, and consisting of the following annual targets:

<u>Year</u>	<u>Annual Target</u>	<u>Cumulative Savings</u>
2009	.52%	.52%
2010	.65%	1.17%
2011	.79%	1.96%
2012	.91%	2.87%
2013	1.05%	3.92%
2014	1.18%	5.10%
2015	1.31%	6.41%
2016	1.45%	7.86%
2017	1.58%	9.44%
2018	1.72%	11.16%
2019	1.85%	13.01%
2020	1.99%	15.00%

B. The approved goal and approved annual targets shall be measured using cumulative energy efficiency savings as a percentage of total usage.

C. Upon a showing of good cause, this Commission may establish additional conservation and energy efficiency goals and annual targets beyond the timeframes set forth herein.

D. A gas utility that determines it cannot achieve the approved goal or approved annual targets shall report to the Commission on why it cannot meet those requirements and shall propose alternative requirements. If the Commission determines, that the approved goal or approved annual targets exceed the achievable amount of conservation and energy efficiency available to the gas utility, the Commission shall establish lower goals or lower annual targets, as may be necessary, for the gas utility based upon the maximum amount of energy efficiency that it determines can be achieved by the gas utility.

Section 4: Application for Approval of Conservation and Energy Efficiency Plan.

A. A gas utility shall submit to the Commission an application for approval of its proposed conservation and energy efficiency plan, as provided for herein, within 6 months of the adoption of this regulation.

B. Each gas utility shall file an application with the Commission requesting approval of a conservation and energy efficiency plan sufficient to achieve the approved goal and approved annual targets. The application shall include the following:

1. A proposed conservation and energy efficiency plan that achieves savings commensurate with the approved goal and approved annual targets.

2. A schedule detailing how the conservation and energy efficiency plan will make progress towards achieving any approved goals and approved annual targets, including consideration of any market transformation impacts, building code and appliance standard impacts, or other anticipated changes in customer behavior which the gas utility proposes as part of its program portfolios.

3. A proposed methodology to account for any fuel optimization programs that are part of the gas utility's conservation and energy efficiency plan.

4. A cost recovery methodology for the costs of the conservation and energy efficiency plan, including bill impact analysis.

5. A methodology for removing financial disincentives.

6. At the discretion of the gas utility, a request for performance incentives.

7. Any other information that may be deemed to be appropriate for consideration in approving the application.

C. The gas utility shall file annual reports June 1 with the Commission demonstrating the gas utility's progress toward the approved goal as measured against the annual targets, which shall include a brief description of each program; program modifications or terminations; program goals, objectives, and savings targets; the levels of participation; a description of the evaluation and monitoring activities and results; energy savings; estimated environmental benefits; problems encountered and proposed solutions; and costs incurred during the reporting period.

D. The gas utility shall file a report every 3 years setting forth all updates and/or revisions to its conservation and energy efficiency plan, the approved goal, and the approved annual targets, as may be necessary.

E. The Commission shall issue a final order approving a conservation and energy efficiency plan; authorizing a cost recovery methodology, a methodology for removing financial disincentives, and performance incentives within 180 days of the filing of such a proposal, but in no event later than 12 months following the effective date of this regulation.

F. The Commission shall act expeditiously on all gas utility filings made pursuant to this regulation and shall issue final orders within 180 days of the filing.

G. Existing Commission approved plans, programs, goals, and annual targets will continue in effect until the Commission takes action upon a new filing by the gas utility or upon motion of the Commission.

Section 5: Conservation and Energy Efficiency Plan.

A. The gas utility's proposed conservation and energy efficiency plan shall contain the following:

1. A list of conservation and energy efficiency program(s) the gas utility plans to implement in order to achieve the approved goal and approved annual targets.

2. Each conservation and energy efficiency program submitted for Commission review and approval shall include the following:

- a. Description of the program(s) and the measures;
- b. Objectives and rationale for the program(s);
- c. Market segments to which each program is aimed;
- d. Estimated level of program participation;
- e. Estimated societal benefits and savings from the program(s);
- f. Estimated societal costs of the program(s);
- g. Customer outreach and delivery strategy;
- h. The gas utility's costs, budget, and implementation schedule; and
- i. Program monitoring and evaluation plan.

Section 6: Annual Conservation and Energy Efficiency Targets.

A. The gas utility's application shall include a schedule detailing how the proposed conservation and energy efficiency programs progress towards achieving the approved annual targets.

B. The gas utility's progress as measured against the approved annual targets shall form the basis for measuring the gas utility's performance and eligibility for any performance incentive proposed by the gas utility pursuant to Section 8 of this regulation.

Section 7: Accounting Methodology for Fuel Optimization Programs.

A. If the gas utility's application includes program(s) that result in fuel optimization, the gas utility shall include in its application a proposed methodology for how to account for total energy savings attributed to the fuel optimization program(s) and how the total energy savings shall be credited towards the gas utility's annual conservation and energy efficiency targets and approved goal.

Section 8: Cost Recovery, Removal of Financial Disincentive, and Performance Incentives.

A. Cost Recovery Methodology for Conservation and Energy Efficiency Plan.

1. As part of the Commission's approval of the natural gas utility's conservation and energy efficiency plan, the Commission shall approve a methodology for cost recovery of the conservation and energy efficiency program costs.

2. At the option of the gas utility, the approved cost recovery methodology shall result in timely cost recovery through a volumetric surcharge reset annually to reflect annual program costs or through deferral and amortization, with a return equal to the gas utility's last-approved weighted average cost of capital, or by a combination of the two. Any amortization of the program costs shall not exceed 5 years.

B. Methodology for Removing Financial Disincentives.

1. As part of the Commission's approval of the gas utility's conservation and energy efficiency plan, the Commission shall approve a methodology for removing financial disincentives.

2. The gas utility shall include in its application a request for approval of at least one methodology for removing financial disincentives, which shall include a full revenue decoupling proposal. For each such request, the application must include the following:

- a. What methodology the gas utility is requesting approval of;
- b. The classes of customers to which the methodology shall apply; and
- c. The necessary data and information to support the calculations under the proposed methodology.

3. Any approved methodology for removing financial disincentives that results in the deferral of authorized margin per customer shall be permitted to be recovered by the gas utility in a timely manner, not to exceed 12 months.

4. The Commission shall ensure that no additional costs per customer beyond those approved by the Commission in the gas utility's last general rate case are recovered by the gas utility through the methodology for removing financial disincentives.

C. Performance Incentives.

1. Upon request by the gas utility, the Commission shall approve reasonable performance incentives as part of the gas utility's conservation and energy efficiency plan.

2. The performance incentives shall be reasonable and shall be designed to maximize performance of the gas utility in obtaining the approved goals and approved annual targets.

Section 9: Deviation from Regulations.

A. A gas utility may petition and the Commission shall grant a deviation from any provision of this regulation upon a showing of good cause for the deviation and that the deviation is in the public interest and not contrary to statute. The petition must:

1. State the reason(s) for the deviation.
2. Identify each of the sections of this regulation for which a deviation is requested.
3. Describe the effect the variance will have, if granted, on compliance with the regulation.
4. Describe how granting the deviation will not compromise, or will further, the purposes of this regulation.
5. Indicate why the proposed deviation is a reasonable alternative to the requirements of this regulation.