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BEFORE THE ARIZONA CORPORATION COMMISSION

2007 JAN -4 P 4: 35

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES
BARRY WONG

ARIZONA CORP COMMISSION
DOCUMENT CONTROL

IN THE MATTER OF THE APPLICATION OF
ENERGY WEST, INC. AND SEMSTREAM
ARIZONA PROPANE, L.L.C. FOR APPROVAL OF
THE TRANSFER OF ENERGY WEST'S ASSETS
TO SEMSTREAM

Energy West
DOCKET NO. G-02696A-06-0515
SemStream, L.P.
DOCKET NO. G-20471A-06-0515

**NOTICE OF FILING OF JOINT
RESPONSE TO STAFF REPORT**

(Assigned to the Hon. Teena Wolfe,
Administrative Law Judge)

SemStream Arizona Propane, L.L.C. and Energy West, Inc., through undersigned counsel
and pursuant to the Commission's Procedural Order of October 19, 2006, file the attached
Response to the Utilities Division Staff Report in the above-captioned matter.

RESPECTFULLY SUBMITTED this 4th day of January, 2007.

QUARLES & BRADY L.L.P.

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Arizona Corporation Commission
DOCKETED

JAN 04 2007

DOCKETED BY

1 **Original and fifteen copies** of the foregoing
filed this 4th day of January, 2007, with:

2 Docket Control
3 Arizona Corporation Commission
1200 West Washington Street
4 Phoenix, Arizona 85007

5 **Copies** of the foregoing hand delivered
this 4th day of January, 2007, to:

6 Teena Wolfe
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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE APPLICATION OF
ENERGY WEST, INC. AND SEMSTREAM
ARIZONA PROPANE, L.L.C. FOR APPROVAL OF
THE TRANSFER OF ENERGY WEST'S ASSETS
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Energy West
DOCKET NO. G-02696A-06-0515
SemStream, L.P.
DOCKET NO. G-20471A-06-0515

JOINT RESPONSE
BY SEMSTREAM ARIZONA PROPANE, L.L.C.
AND ENERGY WEST, INC.
TO
UTILITIES DIVISION STAFF REPORT
DATED DECEMBER 14, 2006

JANUARY 4, 2007

1 **I. INTRODUCTION**

2 Pursuant to the Commission’s Procedural Order dated October 19, 2006, Energy West,
3 Inc. (“Energy West”) and SemStream Arizona Propane, L.L.C. (“SemStream Arizona”)
4 (collectively the “Applicants”) submit this Joint Response to the Utilities Division Staff Report
5 in this docket dated December 14, 2006 (“Staff Report”). The Staff Report finds SemStream
6 Arizona to be a fit and proper entity to acquire the Payson area propane system, concludes that
7 the transaction is in the public interest and recommends approval of the Joint Application filed
8 on August 11, 2006 to transfer Energy West’s regulated assets and CC&N to SemStream
9 Arizona (the “Application”).

10 In this response, the Applicants clarify some factual matters and comment on Staff’s
11 recommended conditions. Energy West’s Douglas Mann and SemStream Arizona’s Larry
12 Payne, who pre-filed direct testimony on September 29, 2006, will testify concerning these
13 issues at the hearing on January 11, 2007.

14 **II. FACTUAL CLARIFICATIONS**

15 To ensure the accuracy of the record on this matter, the Applicants note the following
16 clarifications in relation to a few statements in the Staff Report:

17 1) In the first sentence of the third paragraph of the Executive Summary and in the
18 fourth paragraph of the Background section on page 1 of the Staff Report, SemStream Arizona is
19 described as a “Delaware Limited Liability Company located in Tulsa, Oklahoma and
20 Wilmington, Delaware.” While SemStream Arizona maintains a statutory agent for service of
21 process in Delaware, it does not have a physical presence in Wilmington, Delaware.

22 2) In the fourth sentence of the third paragraph of the Executive Summary and in the
23 Background section on the first line of page 2, the reference to SemStream, L.P.’s transportation
24 of “natural gas” should be to natural gas liquids.

25 3) In the first sentence of the third paragraph of the Background section, page 1,
26 Energy West owns ten 30,000-gallon storage tanks.

1 4) In the fourth sentence of the fourth paragraph of the Background section, page 1,
2 SemStream, L.P. owns and leases in excess of 10 million gallons of physical storage.

3 5) In the fifth sentence of the Transaction section, page 2, on July 25, 2006,
4 SemStream, L.P. assigned its right to acquire the regulated business assets under the Agreement
5 to SemStream Arizona.

6 6) In the third sentence of the Staff Analysis section, pages 2-3, it is stated that “the
7 Company does not provide services in Arizona.” It is believed that the reference was intended to
8 be to SemStream, L.P. or SemStream Arizona, in which case it would be more accurate to state
9 that the SemStream entities currently do not provide retail services in Arizona.

10 **III. RESPONSE TO STAFF’S RECOMMENDED CONDITIONS**

11 At pages 7-8 of the Staff Report, Staff recommends that the Commission approve the
12 Joint Application subject to 14 conditions. By and large, the recommended conditions appear
13 reasonable and the Applicants appreciate Staff’s attention to the details of the subject transaction.
14 The Applicants do object to one condition and request minor amendments to five others.

15 **A. Objection to Recommended Condition No. 6**

16 In Condition No. 6, Staff recommends that “SemStream Arizona shall not seek regulatory
17 recovery of any costs, including Acquisition Adjustment that might arise from this transaction, in
18 a future rate proceeding.” The Applicants request that the Commission not adopt this condition,
19 as it would be contrary to public policy to deprive SemStream Arizona of the *opportunity* to
20 establish and demonstrate operational and administrative efficiencies and consumer benefits
21 justifying an acquisition adjustment in a later, publicly noticed rate proceeding. A condition
22 automatically prohibiting future cost recovery is not in the public interest if it might act to
23 discourage transactions that could produce net consumer benefits or if it counteracts the
24 incentive for regulated companies to strive toward peak efficiency. Condition No. 6 is nearly
25 identical to two conditions Staff offered and all other parties opposed in Southwest Gas
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1 Company's acquisition of the Black Mountain Gas Company in 2003.¹ In rejecting the proposed
2 conditions in that matter, the Commission found as follows:

3 We recognize that Staff's position is premised on Staff's belief that it is in
4 the public interest to protect ratepayers from bearing the costs of the transaction in
5 the absence of a showing of significant benefit to consumers. However, we do not
6 believe it is in the public interest to make a final decision on these issues without
7 having all relevant information before us. Until SWG is able to operate the BMG
8 system, we do not know if there will be significant efficiencies that would warrant
9 recovery [of] a portion of the acquisition premium from ratepayers. We do not
10 want to foreclose SWG from being able to bring forth evidence of significant
11 improved efficiencies from acquisitions. To do so might discourage transactions
12 that would benefit the public.

13 (Decision No. 66101, July 25, 2003, page 13, lines 20-27.)

14 Staff states at page 4 of the Staff Report that the subject transaction between Energy West
15 and SemStream Arizona "is in the public interest because of its potential of positively impacting
16 ratepayers, in terms of propane price stability, supply security and quality of service." Staff also
17 acknowledges that the Commission may allow recovery of an acquisition adjustment arising
18 from a sale of assets in extenuating or extraordinary circumstances. Staff Report, pages 3-4.
19 Staff notes that "the Applicants have not demonstrated extraordinary circumstances" in this
20 transaction. Id. page 4. Demonstrating extraordinary consumer benefit arising from SemStream
21 Arizona's acquisition and operation of Energy West's regulated assets cannot be accomplished
22 before it occurs. This is consistent with the Commission's recognition that "we do not believe it
23 is in the public interest to make a final decision on these issues without having all relevant
24 information before us. Until [the transferee] is able to operate the [regulated propane] system,

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26 ¹ For the Commission's convenience, the relevant pages of Decision No. 66101, dated July 25, 2003,
concerning this issue are attached.

1 we do not know if there will be significant efficiencies that would warrant recovery [of] a portion
2 of the acquisition premium from ratepayers.” (Decision No. 66101, supra.) Under the same
3 reasoning, SemStream Arizona should not be foreclosed now from being able to demonstrate in a
4 future rate case the substantial benefits its acquisition has brought to customers of the Payson
5 area propane system.

6 The Applicants do not argue that SemStream Arizona should be awarded an acquisition
7 adjustment or cost recovery in this Decision, but the opposite ruling—precluding SemStream
8 Arizona from ever making a demonstration justifying recovery of such costs—also should not be
9 part of this Decision. For these reasons, the Applicants request that the Commission approve the
10 transfer of assets without imposing Staff’s Recommended Condition No. 6.

11 **B. Requested Clarifying Amendments To Recommended Condition Nos. 2, 3, 4,**
12 **12, 13 and 14**

13 Condition No. 2: In Recommended Condition No. 2, Staff recommends that “SemStream
14 Arizona retains Energy West’s PGA surcharge of \$0.55 per therm, as approved in Decision
15 No. 68814, dated June 29, 2006.” Consistent with Staff’s Recommended Condition No. 1, the
16 Applicants request that Condition No. 2 be amended by adding the phrase “pending any change
17 by the Commission in a future PGA surcharge proceeding.”

18 Condition No. 3: In keeping with Staff’s Recommended Condition No. 3, SemStream
19 Arizona intends to maintain separate accounting records for its operations in Arizona and retain
20 books and records related to the Payson area operation in its Payson Office. SemStream
21 Arizona’s understanding is that this Condition imposes a requirement to maintain day-to-day
22 records, accounts receivable and customer service books for the Payson area operations in
23 Payson, while SemStream Arizona will keep its overall financial records and books in its Tulsa,
24 Oklahoma office. SemStream Arizona intends to acquire additional regulated propane systems
25 in Arizona (including the Black Mountain Gas propane system in Page, for which an application
26 for Commission approval is pending). Because SemStream Arizona anticipates operating

1 multiple systems in Arizona, it will keep customer-related account information at each area
2 office but will maintain overall financial records at a central location in Tulsa. Consistent with
3 Staff's Condition No. 4, these books and records will be made available to Staff upon request in
4 a rate case or other proceedings.

5 Condition No. 12: In Condition No. 12, Staff recommends that (i) SemStream Arizona
6 add an additional page to its monthly PGA report listing any propane purchases in that month
7 from an affiliate, and (ii) in March of each year, it also provide a summary of the previous year's
8 propane purchases from any affiliate. The Applicants agree to this condition, but request that the
9 annual summary of affiliate transactions be provided in April rather than in March. The winter
10 supply season normally continues into March. April reporting will provide Staff and the
11 Commission with a more complete summary of affiliate transactions occurring in the prior,
12 complete winter season and also allows preparation when Payson Office employees are in a
13 better position to dedicate time to the project.

14 Condition No. 13: Staff recommends in Condition No. 13 that "SemStream continues to
15 adhere to Pipeline Safety Section's audit findings, requiring Energy West to be in compliance
16 with all noted probable non-compliance issues by December 31, 2006." Although Energy West
17 timely filed its response to the Pipeline Safety Section's findings on December 28, 2006,
18 SemStream Arizona has not yet acquired Energy West's regulated assets and was not in a
19 position to ensure that Energy West is in compliance with all noted probable non-compliance
20 issues by December 31, 2006. For that reason, the Applicants suggest that Condition No. 13
21 require that "SemStream Arizona continues to adhere to Pipeline Safety Section's audit
22 findings."

23 Condition No. 14: The Applicants request that Staff's Recommended Condition No. 14
24 be amended to clarify that it is meant to apply to SemStream Arizona.
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IV. CONCLUSION

Energy West and SemStream Arizona request that the Commission enter its Order approving the Application subject to the Staff Report's Condition Nos. 1-5 and 7-14, with the clarifications identified above. The Applicants would like to be able to close the transaction on March 1, 2007 so that they can commence the planning, procurement, supply and other operational arrangements for the next winter season which normally begin in that month. For that reason, the Applicants request the Recommended Opinion and Order be prepared in time for this matter to be decided at the Commission's February 13, 2007 Open Meeting. To assist in that regard, the Applicants will order an expedited transcript of the January 11 hearing and are agreeable to abide by a five-day exception period in place of the ten-day exception period under A.A.C. R14-3-110.B.

DECISION NO. 66101

EXCERPTS

BEFORE THE ARIZONA CORPORATION COMMISSION
Arizona Corporation Commission

COMMISSIONERS

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

DOCKETED

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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
PROVISION OF THE AFFILIATE RULES.

DOCKET NO. G-01551A-02-0425

DOCKET NO. G-01970A-02-0425

DECISION NO. 66101

OPINION AND ORDER

DATE OF HEARING:

February 24, 2003 and March 3, 2003

PLACE OF HEARING:

Phoenix, Arizona

ADMINISTRATIVE LAW JUDGE:

Jane L. Rodda

APPEARANCES:

Mr. Andrew Bettwy, Attorney, on behalf of
Southwest Gas Corporation;

Mr. Timothy Berg, Fennemore Craig, on behalf
of Black Mountain Gas;

Mr. Daniel Pozefsky, Attorney, on behalf of the
Residential Utility Consumer Office;

Mr. Walter Meek, President, Arizona Utility
Investors Association; and

Ms. Lisa Vandenberg and Jason Gellman, Staff
Attorneys, Legal Division, on behalf of the
Utilities Division of the Arizona Corporation
Commission.

BY THE COMMISSION:

Southwest Gas Corporation ("SWG") is a public service corporation that is engaged in the business of purchasing, transporting and distributing natural gas in portions of Arizona, Nevada and California. SWG serves over 800,000 customers in Arizona, a rapidly growing service territory that adds approximately 30,000 new customers per year. In 2001, SWG had total assets of \$2.3 billion, generated revenues of \$1.4 billion and earned a net income of \$37 million.

Black Mountain Gas Company ("BMG") is a public service corporation that provides retail

1 convenience and necessity require.” A.R.S. § 40-282 permits the Commission to attach conditions to
2 a CC&N that are necessary to promote the public interest.

3 The Commission must consider all of relevant standards in considering whether to approve
4 this transaction. The public interest includes the safety and adequacy of service certainly, but also
5 involves the impact of disparate rates, the reasonableness of those rates, the impact of Commission
6 policy on utility operations in the state, advancement of Commission policy goals and legal
7 precedent, as well as other factors. The Commission has the authority to impose conditions on the
8 transaction that mitigate potential harm to the public interest or which may be required by the public
9 necessity and convenience, as those interests are broadly defined. We believe that although Staff
10 couches its recommendations in terms of providing an immediate and substantial consumer benefit
11 which some parties have interpreted as creating a novel standard for reviewing acquisitions, in fact,
12 we find many of Staff’s recommendations are terms and conditions required by the public
13 convenience and necessity or to prevent harm to the public interest.

14 Acquisition Adjustment and Cost of Acquisition

15 Conditions Nos. 1 and 2

16 Staff recommends that the Commission preclude SWG from seeking recovery of the
17 acquisition premium paid for BMG and from recovering the costs of the acquisition in its next rate
18 case. All other parties advocate deferring a decision on these issues until the next rate case when
19 SWG will have an opportunity to provide evidence that might support such recovery.

20 We recognize that Staff’s position is premised on Staff’s belief that it is in the public interest
21 to protect ratepayers from bearing the costs of the transaction in the absence of a showing of
22 significant benefit to consumers. However, we do not believe it is in the public interest to make a
23 final decision on these issues without having all relevant information before us. Until SWG is able to
24 operate the BMG system, we do not know if there will be significant efficiencies that would warrant
25 recovery a portion of the acquisition premium from ratepayers. We do not want to foreclose SWG
26 from being able to bring forth evidence of significant improved efficiencies from acquisitions. To do
27 so might discourage transactions that would benefit the public. Our decision here does not mean that
28 ratepayers should or will bear any portion of the costs associated with this acquisition, only that when

1 the relevant information becomes available, SWG should have an opportunity to show sufficient
2 consumer benefits to justify recovery of the acquisition premium or other costs from ratepayers.
3 SWG will bear the burden of proving clear and quantifiable savings for all ratepayers directly related
4 to the acquisition and SWG's management/operation of the BMG system.

5 SWG's Rates
6 Condition No. 5

7 The most contentious of Staff's proposed conditions is the requirement that SWG charge its
8 margin rates in the BMG service area by July 1, 2004, or file a rate case. Staff believed that because
9 SWG did not adequately address Staff's questions about future benefits to BMG consumers and
10 concerns about maintaining service and safety quality in the BMG area, that SWG should provide an
11 immediate and substantial consumer benefit in the form of lower margin rates. Staff also argued that
12 it is potentially confusing and not in the public interest for neighboring SWG and BMG consumers to
13 pay different rates.

14 SWG's approach to wait to adjust the BMG customers' rates until the next SWG (as yet
15 unscheduled) rate case ignores its own arguments in favor of the transaction. SWG will begin
16 integrating the BMG operations into its own as soon as the Commission approves the acquisition.
17 Such integration will alter the very basis of BMG's current rates which were set based upon that
18 company's rate base, operating costs and return on capital. It is not in the public interest for BMG
19 customers to pay unreasonable rates. Neither do we believe having neighboring customers pay
20 different rates to be in the public interest.

21 We find that it is not in the public interest for current BMG customers to continue to pay the
22 higher BMG margin rates after July 1, 2004. Once the current assets and CC&N are transferred to
23 SWG, and BMG is dissolved, the customers of BMG become customers of SWG. At that point,
24 BMG ceases to exist as a public service corporation and there is no reason to differentiate one SWG
25 customer from another. SWG has not provided evidence that in this case it is reasonable for it to
26 continue charging the rates of a dissolved public service corporation once the acquisition and
27 integration is complete.

28 The Scates and Rio Verde cases cited by opponents in support of the contention the