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AZ CORP COMMISSION
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BEFORE THE ARIZONA CORPORATION COMMISSION

8 COMMISSIONERS

Arizona Corporation Commission

DOCKETED

9 GARY PIERCE – CHAIRMAN
10 BOB STUMP
11 SANDRA D. KENNEDY
12 PAUL NEWMAN
13 BRENDA BURNS

SEP 2 2011

DOCKETED BY

13 IN THE MATTER OF THE APPLICATION OF
14 SOUTHWEST GAS CORPORATION FOR THE
15 ESTABLISHMENT OF JUST AND REASONABLE
16 RATES AND CHARGES DESIGNED TO
17 REALIZE A REASONABLE RATE OF RETURN
ON THE FAIR VALUE OF ITS PROPERTIES
THROUGHOUT ARIZONA.

Docket No. G-01551A-10-0458

**SOUTHWEST ENERGY
EFFICIENCY PROJECT'S
POST HEARING BRIEF**

18 **I. SWEEP SUPPORTS THE SETTLEMENT AGREEMENT**

19 The Proposed Settlement Agreement (“Agreement”), filed by Staff on July 15, 2011, is in the
20 public interest and the Commission should approve the Agreement in its entirety with the selection of
21 Alternative B and the rejection of Alternative A. The Settlement Agreement was developed in an
22 open, transparent, and inclusive process with fair opportunities for all parties to participate.¹

23 In addition to the full decoupling mechanism proposed in Alternative A, discussed below, the
24 Agreement includes important energy efficiency and low income customer provisions that are in the
25 public interest. The Company’s proposed Energy Efficiency (EE) and Renewable Energy Resource
26 Technology (RET) portfolio plan (“EE and RET Plan”) includes programs that provide opportunities
27

28 ¹ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

1 for all customer segments to benefit from the EE and RET programs, including low income
2 customers, residential consumers, small businesses, municipalities and schools, and large commercial
3 and industrial customers. The energy efficiency provisions in the Agreement require the Company to
4 provide supplemental energy efficiency information to support both modified and new/revised EE
5 and RET Plans that will incrementally improve the Company's current customer offerings and
6 increase customer energy savings. The introduction of new, cost-effective energy efficiency
7 opportunities will ensure that customers can achieve greater energy savings and larger reductions in
8 their gas bills. The advent of these offerings will come at an opportune time, as they will help
9 customers to lessen the impact of new rates. Commission Staff has agreed to provide
10 recommendations on as many energy efficiency measures in the modified EE and RET Plan as
11 possible in a report filed prior to the Open Meeting when the Commission intends to vote on the
12 Recommended Opinion and Order approving the Agreement.²

14 Under the low income provisions in the Agreement, the Company has agreed to enhance and
15 increase funding of the Low Income Energy Conservation (LIEC) weatherization program. The
16 Company will commit non-ratepayer funding to LIEC each year for the next five years, and this
17 commitment will result in a contribution equivalent to at least \$1 million. The Company has also
18 agreed to meet with Parties to the Docket within forty-five days of the effective date of any order
19 approving the Agreement to develop a plan to enhance customer education and outreach for its LIEC
20 program.³

22 The impacts of new rates to consumers on low-income residential rate schedules will be
23 mitigated through the following:

- 24 • The demand-side management adjustor rate for the low-income residential rate schedules will not
25 be increased above the current rate;

27
28 ² Id.

³ Id.

- 1 • The Customer Owned Yard Line cost recovery mechanism will not apply to the low-income
2 residential rate schedules; and
- 3 • The Low-Income Rate Assistance discount will be increased to thirty percent, from the current
4 twenty percent for the first 150 therms in the winter months of November through April.⁴

6 **II. THE COMMISSION SHOULD ADOPT ALTERNATIVE B**

7 Alternative B (full revenue decoupling) should be adopted by the Commission because it
8 effectively reduces the utility disincentive to energy efficiency and better aligns the financial interest
9 of the Company with the interests of customers, thereby resulting in more opportunities for customers
10 to reduce their energy bills.⁵ Alternative B is fully consistent with the Commission-approved Policy
11 Statement on Decoupling.⁶ Further, Alternative B results in a lower base rate increase than
12 Alternative A.⁷

13 The financial interest of Southwest Gas should be better aligned with the interests of
14 Southwest Gas customers by reducing financial disincentives to utility support of energy efficiency,
15 thereby resulting in more energy savings and larger reductions in customer energy bills – and
16 Alternative B will achieve this result.⁸

17 The decoupling mechanism in Alternative B consists of two components that together present
18 an effective full decoupling mechanism: (1) customer bills will be adjusted each month (November
19 through April) when actual weather during the billing cycle differs from the average weather used in
20 the calculation of rates (which can provide customers with timely relief from periods of extreme
21 weather); and (2) rates will be adjusted annually to true-up the difference between authorized and
22 experienced non-gas revenues.⁹

25 ⁴ Id.

26 ⁵ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

27 ⁶ Final ACC Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures,
Docket Nos. E-00000J-08-0314 and G-00000C-08-0314, p. 30 (Dec. 29, 2010).

28 ⁷ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

⁸ Id.; Testimony of Dan Hansen and Ralph Cavanagh.

⁹ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

1 The Company's EE and RET Portfolio in concert with its proposed revenue per customer full
2 decoupling mechanism in Alternative B is consistent with the Commission's Decoupling Policy
3 Statement.¹⁰ Alternative B meets the following policies set forth in the Policy Statement:

- 4
- 5 ■ "Utilities should pursue all cost-effective energy efficiency and demand side management
6 resources, and should meet Arizona's Electric and Gas Efficiency Standards of at least... 6%
7 gas savings by 2020."
- 8 ■ "Revenue decoupling may offer significant advantages over alternative mechanisms for
9 addressing utility financial disincentives to energy efficiency."
- 10 ■ "While other decoupling models are appropriate in general, non-fuel revenue per customer
11 decoupling may be well suited for Arizona."
- 12 ■ "Adoption of decoupling. . . should not occur as a pilot as this insufficiently supports demand-
13 side management efforts, discourages beneficial changes in rate design, and is unlikely to
14 encourage financial ratings improvements."
- 15 ■ "Full decoupling is preferable to partial decoupling."
- 16 ■ "Decoupling adjustments should occur at least on an annual basis, however, parties may
17 propose more current adjustments as this may provide ratepayers with weather related relief
18 following extreme events."
- 19 ■ "Broad participation in decoupling is preferred; however, the unique characteristics of each
20 utility may merit different treatment of some customer classes."
- 21 ■ "Collars or caps on decoupling adjustments should be designed to encourage gradualism, and
22 to minimize the short-term effects on customers."¹¹

23 Alternative B should be adopted to reduce the financial disincentive to utility support of
24 energy efficiency and the automatic penalty that the Company experiences when it supports customer
25 energy efficiency. The reduction of this financial disincentive and automatic penalty is very
26 important to support Commission efforts to encourage the Company to assist its customers in
27 increasing their energy efficiency and reducing their energy bills, through the Energy Efficiency (EE)
28 and RET programs proposed to achieve the savings required in the Gas Energy Efficiency Standard
and Rule.¹²

Alternative B also would reduce the financial disincentive and automatic penalty the
Company experiences when it would support other policies that reduce customer energy bills,

¹⁰ Final ACC Policy Statement Regarding Utility Disincentives to Energy Efficiency and Decoupled Rate Structures, Docket Nos. E-00000J-08-0314 and G-00000C-08-0314, p. 30 (Dec. 29, 2010).

¹¹ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

¹² Id.

1 including building energy codes, appliance efficiency standards, and state initiatives and legislation,
2 in addition to the Gas Energy Efficiency Standard and the EE and RET programs. These other
3 policies are very effective and cost-efficient ways to help customers reduce their energy use. And
4 they achieve the gas bill savings at lower costs to ratepayers than conventional ratepayer-funded
5 energy efficiency programs. Therefore, increasing utility support for (and reducing utility
6 disincentives to) these other policies will help to maximize the energy bill reductions that customers
7 receive through increased energy efficiency while reducing total costs to ratepayers. Only
8 Alternative B would achieve this result because only Alternative B addresses the utility financial
9 disincentive to building energy codes, appliance efficiency standards, and state initiatives and
10 legislation.¹³

12 This is true even for policies, such as building energy codes and appliance standards, which
13 are allowed to count towards the energy savings required in the Gas Energy Efficiency Standard.
14 Only a portion (up to one third) of the energy savings from building energy codes and appliance
15 standards are allowed to count towards the Gas Energy Efficiency Standard, yet the gas customers
16 experience 100% of the energy savings and utility bill reductions. Alternative B would reduce the
17 utility disincentive and automatic penalty, thereby increasing Company support for the energy
18 efficiency codes and standards, resulting in the achievement of the energy bill savings at lower total
19 ratepayer costs.¹⁴

21 The decoupling adjustments could be either up or down, either increases or decreases to
22 customer bills. Analysis of prior experience with decoupling has shown the adjustments to be small,
23 generally less than 3% and typically less than \$1.50 per month for residential gas customers.¹⁵

26 ¹³ Oral testimony of Jeff Schlegel, SWEEP. August 12, 2011.

27 ¹⁴ Oral testimony of Jeff Schlegel, SWEEP. August 12, 2011.

28 ¹⁵ Pamela Lesh, Rate Impacts and Key Design Elements of Gas and Electric Utility Decoupling: A Comprehensive Review, Electricity Journal (October 2009), p. 67. Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

1 The full decoupling mechanism in Alternative B contains important customer protections,
2 including the cap of 5% of non-gas revenue on any upwards adjustments (increases in customer
3 natural gas bills). Note that this cap is applied to *non-gas* revenue only, and not to the full gas bill,
4 which results in a lower cap than the caps proposed and analyzed during the decoupling workshops.
5 Under Alternative B no cap would be applied to any downwards adjustments (i.e., the credits on
6 customer bills would not be limited by a cap).¹⁶
7

8 There are important reporting, earnings test, and customer education provisions in Alternative
9 B to enable Commission review, implementation, and monitoring of the performance of the
10 decoupling mechanism in the early years of its implementation. Alternative B includes several
11 provisions including quarterly reports on the performance on the decoupling mechanism, annual
12 reports commencing in April 2013, annual review at Commission Open Meetings, and annual review
13 by Staff with the assistance of an independent consultant. Also, Southwest Gas will be subject to an
14 annual earnings test (Sections 3.21 through 3.28). Further, Southwest Gas is required to develop and
15 submit a proposed customer outreach/education plan outlining how the Company will explain
16 decoupling to customers (Section 3.31).¹⁷
17

18 Two other provisions in Alternative B provide additional customer value. Alternative B has
19 the lower revenue requirement of the two alternatives, and therefore results in a lower base rate
20 increase out the gate than Alternative A. And importantly, Alternative B has a stay out provision and
21 moratorium on general rate case applications of over five years (Section 3.30), a provision that
22 applies for Alternative B only.¹⁸
23

24 Finally, as clarified in oral testimony, under the full decoupling mechanism in Alternative B,
25 if a customer uses less energy, a customer pays less. This is a fact that stands in contrast to the
26 apparent misunderstandings of some customers who have written letters to the docket.¹⁹
27

28 ¹⁶ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

¹⁷ Id.

¹⁸ Id.

¹⁹ Oral testimony of Jeff Schlegel, SWEEP. August 12, 2011.

1 **III. THE COMMISSION SHOULD NOT ADOPT ALTERNATIVE A**

2 Alternative A (partial decoupling) is clearly inferior to Alternative B because it:

- 3
- 4 • Would result in a higher base rate increase for customers than Alternative B;
 - 5 • Almost certainly guarantees future rate increases due to the lost fixed cost recovery
6 mechanism that is a component of Alternative A only (and in contrast, the decoupling
7 adjustments under Alternative B could be up or down);
 - 8 • Allows the recovery of *anticipated* lost-base revenues, thereby paying the Company for
9 lost revenues in advance of actually experiencing such lost-base revenues;
 - 10 • Would create perverse incentives by encouraging the Company to develop and defend
11 energy efficiency proposals that may look good on paper but that do not actually deliver
12 the energy savings;
 - 13 • Would likely result in contentious and protracted technical proceedings at the Commission
14 (as has been the experience in lost revenue recovery mechanism proceedings in other
15 states);
 - 16 • Would not encourage the Company to support building energy codes, appliance efficiency
17 standards, and state initiatives and legislation; and
 - 18 • Would not adequately reduce the utility disincentive to energy efficiency (thereby
19 resulting in fewer opportunities for customers to reduce their energy bills).²⁰

20 Under Alternative A, the Company's financial interests would still not be aligned with the
21 interests of customers, leading to wasteful energy use and higher utility bills for customers.²¹

22 **IV. THE COMMISSION SHOULD REJECT RUCO'S PROPOSED INCREASE IN THE**
23 **BASIC SERVICE CHARGE**

24 An increase in the basic service charge, as RUCO proposes, would negatively impact low
25 income and fixed income customers, and each and every month a higher basic service charge would
26

27
28 ²⁰ Schlegel Testimony in Support of the Settlement Agreement. July 29, 2011.

²¹ Id.

1 reduce the energy bill cost savings that customers would experience when they increase their energy
2 efficiency.²²

3
4 **V. THE DECOUPLING PROPOSAL SATISFIES RATEMAKING REQUIREMENTS
UNDER THE ARIZONA CONSTITUTION**

5 Although no party to this proceeding has challenged the legality of the decoupling
6 mechanisms proposed in the settlement agreement, RUCO witness Ben Johnson raised certain
7 questions regarding the decoupling mechanisms that the administrative law judge requested
8 the parties to address in their briefs.

9
10 The question occurs because of the following exchange between the administrative
11 law judge and Dr. Johnson:

12 Q. (ALJ Nodes): ...[D]oesn't the decoupling mechanism such as has been presented in
13 this case have a certain measure of acceptability in the sense that it is fairly simple in that it
14 holds constant the fair value rate base as well as the authorized rate of return and all the other
15 elements so that there is not the potential for violation of a fair value finding being challenged
16 as not meeting Arizona's constitutional requirement?

17 A. (Dr. Johnson): I honestly don't know if it is any less vulnerable to that challenge...
18 And it might be successfully argued that in fact you're not establishing a rate not tied to fair
19 value, you are establish a rate plus a decoupling mechanism that effectively, locks down a
20 revenue per customer. You might try to claim that some type of rate. But the normal rates
21 are the per therm rates. Those are clearly going to be increasing over time without a fair
22 value finding. And it allows the number of customers to fluctuate. So you would be hard
23 pressed to argue that we have assurances as to what the return is going to be.

24
25 ...I am just trying to hint at what I think are the elements of a legal challenge if one
26 ever made it.

27
28

²² Oral testimony of Jeff Schlegel, SWEEP. August 12, 2011.

1 Transcript, Volume III at 664-665.

2 In this case, the decoupling mechanism is as much rate design as it is rate adjustment.
3 The issue for Southwest Gas is that virtually 100% of its non-gas costs are fixed. Direct
4 Testimony of Edward B. Giesecking at 9. Southwest Gas has experienced a steady decline in
5 usage per customer since 1986. That means that when new rates are approved for Southwest
6 Gas, they are by definition insufficient to provide the company with an opportunity to earn its
7 authorized rate of return. The issue now requires attention because the company is required
8 to reduce usage even further through compliance with the energy efficiency standard rules.
9

10 Nobody disputes that one way to address this problem would be to increase the
11 monthly basic service charge from its current level of \$10.70 per month to whatever level is
12 necessary for the company to recover its fixed costs. The testimony in this case was that the
13 basic service charge would have to be increased to \$28 in order to do that. Transcript,
14 Volume II at 270.

15 For a variety of good reasons, the Commission has chosen over the years to allow for
16 recovery of only some of the fixed costs in the basic service charge and provide recovery for
17 the remaining fixed costs in the volumetric charge.
18

19 To the extent that the decoupling mechanism is regarded as an automatic adjustment
20 clause, it possesses all the attributes that the courts have determined are necessary for the
21 lawful establishment of an automatic adjustment clause. In *Scates v. Arizona Corporation*
22 *Commission*, the Commission approved an application by Mountain States Telephone and
23 Telegraph Company for an increase in rates associated with the installation, moving and
24 changing of telephones within Arizona. 118 Ariz. 531, 578 P.2d 612 (App. 1978). The
25 Commission approved the increase without any examination of the costs of the utility apart
26 from the affected services and without any determination of the utility's investment and
27
28

1 without any inquiry into the effect of the substantial increase upon Mountain State's rate of
2 return on that investment.

3 The court held that the Commission's action violated the Arizona Constitution because
4 the rates were adjusted without a consideration of the fair value of the utility's property
5 required by the Arizona Constitution. The court rejected the argument that the increase could
6 be upheld as an automatic adjustment clause. The court noted that such clauses are initially
7 adopted as part of the utility's rate structure in accordance with all statutory and constitutional
8 requirements and because they are designed to insure that, through the adoption of a set
9 formula geared to a specific readily identifiable cost, the utility's profit or rate of return does
10 not change. In *Scates*, the court noted that the Commission did not consider all of the utility's
11 costs when it approved the increases although it stopped short of determining that a full rate
12 case must be conducted in connection with every increase in rates and allowed for the
13 possibility that some more limited proceeding that examines the company's financial
14 condition and the impact of the increase on the utility's rate of return could be considered.

15 In *Residential Utility Consumer Office v. Arizona Corporation Commission*, the court
16 similarly held that a rate surcharge imposed outside of a rate case for CAP water expenses
17 was unlawful. 199 Ariz. 588, 20 P.3d 1169 (App. 2001). The Commission had argued that
18 the surcharge could be classified as an automatic adjustment clause because no case law
19 required that an automatic adjustment clause be established in a full rate case. The court
20 rejected the argument because there had been no showing that an automatic adjustment was
21 ever contemplated or that a clause was ever approved. In discussing automatic adjustment
22 clauses, the court stated:
23
24

25 Automatic adjustment clauses are designed to ensure that utilities
26 maintain a relatively constant profit despite an increase in a specific
27 cost anticipated by the adjustment clause. An automatic increase
28 allows a utility to recoup cost increases by passing the costs onto the

1 customer while at the same time maintaining the utility's net income.
2 *Id.* The same is true in the converse situation, that of an automatic
3 decrease. The decrease in cost is passed onto the customer without
4 disturbing a utility's profit. In essence, an automatic adjustment
5 clause is designed to offset increases or decreases, leaving the
6 utility's ultimate net income unchanged.

7 199 Ariz. 588, 591-592, 20 P.3d 1169, 1172-1173.

8 The legal foundation for automatic adjustment clause is that the structure of the clause is
9 established in a proceeding in which the Commission establishes rates based upon the fair
10 value of the utility's property dedicated to public service.

11 Those requirements are satisfied in this case with regard to the decoupling mechanism.
12 The decoupling mechanism is being established in a full rate case in which the Commission
13 has examined the revenues and expenses of Southwest Gas and made a determination of the
14 fair value of the utility's property. The decoupling mechanism identifies Southwest Gas'
15 fixed costs as appropriate for recovery through the mechanism just as they would have been
16 had the Commission instead chosen to increase the monthly basic service to recover those
17 fixed costs. All other things being equal, the decoupling mechanism is designed to insure that
18 Southwest Gas' net income is unaffected by a change in usage per customer.

19 If usage per customer does change, the difference is passed on to customers. If, for
20 example, usage per customer for Southwest Gas decreases (as it should with energy
21 efficiency), then the decoupling mechanism will insure that the fixed costs are still recovered
22 by the company through an increase charged to customers. If, on the other hand, usage per
23 customer increases, the over collection by Southwest Gas will be refunded to customers.

24 That is not to say that Southwest Gas is guaranteed to earn its authorized rate of return.
25 The amount of its fixed costs are determined in the rate case but elements of those costs could
26 and undoubtedly will change between rate cases. For example, personnel costs could
27 increase but would not be recovered through the decoupling mechanism because those costs
28

1 were fixed at the time of the rate case. As a result, the company's net income would decline
2 if all other factors are held constant. It is this feature that distinguishes the decoupling
3 mechanism from the rate increases rejected by the courts in the *Scates* and *RUCO* cases.

4
5 In approving the decoupling mechanism, the Commission is not approving a change in
6 the return on equity as it was in *Arizona Community Action Association v. Arizona*
7 *Corporation Commission*, 123 Ariz. 228, 599 P.2d 184 (1979). In that case, the Commission
8 authorized stepped rate increases for APS triggered by APS' decline in return on common
9 stock equity. The court expressed concern over the "potential danger of tying rates to one
10 factor over which APS exercises total control." 123 Ariz. at 231, 599 P.2d at 197. The court
11 noted that APS has the power to issue and to buy and sell stock and thereby influence the
12 return on common stock which in turn could trigger a stepped rate increase under the terms of
13 the Commission's order. *Id.*

14
15 No such thing is occurring here. The decoupling mechanism simply allows for the
16 recovery of specifically identifiable costs that could have otherwise been addressed in the rate
17 case through an increase in the monthly basic service charge (though with other negative
18 effects on customers and the Commission's policies, which is why SWEEP opposes an
19 increase in the basic service charge). Providing for the recovery of those costs does not
20 guarantee a particular rate of return nor does it change the rate of return authorized by the
21 Commission in this case.

22 In conclusion, the decoupling mechanisms proposed for adoption by the Commission
23 in this case satisfies all of the relevant constitutional requirements for just and reasonable
24 rates based upon a determination of the fair value of the company's property dedicated to
25 public service in a full rate proceeding.
26
27
28

1 RESPECTFULLY SUBMITTED this 2nd day of September, 2011.

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21 2nd day of September, 2011 to:

22 All Parties of Record

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