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BEFORE THE ARIZONA CORPORATION COMMISSION

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COMMISSIONERS

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Docket No.: G-01551A-10-0458

In the Matter of the Application of Southwest Gas Corporation for the Establishment of Just and Reasonable Rates and Charges Designed to Realize a Reasonable Rate of Return on the Fair Value of the Properties of Southwest Gas Corporation Devoted to its Arizona Operations; Approval of Deferred Accounting Orders; and for Approval of an Energy Efficiency and Renewable Energy Resource Technology Portfolio Implementation Plan.

Arizona Corporation Commission
DOCKETED

SEP 23 2011

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**REPLY BRIEF OF
SOUTHWEST GAS CORPORATION**

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1 *Efficiency and Decoupled Rate Structures* ("Policy Statement"), the Commission rightly
2 recognized that those challenges can be adequately addressed - to the benefit of both the
3 utility and its customers - through rate structures that completely eliminate this link, and
4 allow the utility to fully partner with its customers to achieve energy savings and lower bills.
5 For Southwest Gas, this case begins the implementation phase of this regulatory transition,
6 and it is significant that its resolution comes before the Commission in the form of a
7 Settlement Agreement supported by all but one of the parties to this proceeding, who
8 represent a variety of interests. As the Settlement Parties¹ overwhelmingly demonstrated
9 during the hearing and in their Post-Hearing Briefs, the Settlement Agreement results in just
10 and reasonable rates, is in the public interest, and should be approved in its entirety.

11 The Residential Utility Consumer Office ("RUCO") supports the Commission's EE
12 Rules.² It also supports the Policy Statement, calling it, "...a good policy with the right
13 intention."³ Nevertheless, RUCO's position in this case gives no deference to the Policy
14 Statement and wholly resists effectuating its terms. Indeed, RUCO's inconsistent, and in
15 some cases erroneous, objections to the Settlement Agreement reflect a fundamental lack
16 of understanding as to how decoupling works.

17 II.

18 THE PROBLEM

19 In what is perhaps the most frustrating of RUCO's arguments, it cautions the
20 Commission to, "...be assured in every case where decoupling is being considered that
21 there is a 'problem' before finding a solution."⁴ Clearly, the "problem" is that under the
22 current regulatory model, utilities recover a portion of their fixed costs through rates that are
23 tied, in this case, to the number of therms used. This creates an obvious conflict with
24 respect to energy efficiency because promoting energy efficiency means advocating for
25 reduced usage and reduced usage results in less revenue to cover the Commission-
26 approved fixed costs of providing safe and reliable service.

27 ¹ "Settlement Parties" includes the Arizona Corporation Commission Utilities Division Staff ("Staff"), the Southwest Energy
28 Efficiency Project ("SWEEP"), the Arizona Investment Council ("AIC"), the Natural Resources Defense Council ("NRDC"), and
Cynthia Zwick.

² Tr. Vol. III (Jerich) at 715.

³ RUCO's Opening Brief at 26.

⁴ Id. at 16.

1 The Commission recognized this obstacle in its Policy Statement⁵ and the record in
2 this proceeding undoubtedly demonstrates that a sustained decline in consumption
3 contributed to Southwest Gas' inability to earn the rate of return authorized in its last rate
4 case - and has in fact hampered Southwest Gas' ability to earn its authorized rate of return
5 for the past 15 years.⁶ The recent passage of the EE Rules stands to guarantee the
6 continuation of the problem. It goes without saying that in order to fulfill the requirements
7 outlined in the EE Rules consumption must decrease even further, and likely at an
8 accelerated pace.⁷ RUCO did not, and cannot, offer any evidence to suggest that
9 Southwest Gas will be able to achieve the standards set forth in the EE Rules and at the
10 same time have a realistic opportunity to earn its authorized revenues, absent the approval
11 of a decoupling mechanism.

12 Indeed, RUCO's assertion that it, "...is by no means convinced that there is a
13 'problem'..."⁸ is insincere at best. RUCO has frequently acknowledged the very problem it
14 now proclaims might not exist. RUCO has stated that, "[E]nergy efficiency requirements can
15 hinder a utility's ability to achieve its authorized earnings because of the reduced volume in
16 sales..."⁹ that "...decoupling eliminates the financial disincentive to offer an energy
17 efficiency program..."¹⁰ and that "[F]inding a balance which will promote energy efficiency
18 and at the same time enticing [sic] utilities to meet energy efficiency standards is imperative,
19 given the numbers and other benefits at stake."¹¹ And during the hearing, Ms. Jerich once
20 again confirmed that a disincentive to promoting energy efficiency exists under the current
21 regulatory model.¹²

22 There is no question that the key to effective energy efficiency is found in eager and
23 cooperative utilities who are active and interested partners in energy conservation.¹³
24 Without completely eliminating the financial disincentives, the necessary partnership

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26 ⁵ Ex. RUCO-1 at 1, 2, 26, 29, 30.

⁶ Ex. A-1, at 4; Tr. Vol. I (Hester) at 87, 97-98.

⁷ Tr. Vol. I (Hester) at 86, 98.

⁸ RUCO's Opening Brief at 16.

⁹ RUCO Comments (March 26, 2010) at 1-2.

¹⁰ RUCO Comments (April 16, 2009) at 2.

¹¹ RUCO Comments (November 2, 2010) at 2.

¹² Tr. Vol. III (Jerich) at 716-17.

¹³ Tr. Vol. II (Hansen) at 269; Tr. Vol. II (Cavanagh) at 369, 373-75; Tr. Vol. II (Schlegel) at 419, 421-23, 464-65.

1 between a utility and its customers will not develop to the fullest extent possible. Add to that
2 the potential consequences of a utility not meeting the energy savings standards set forth in
3 the EE Rules and the likely result will be an increased number of adversarial regulatory
4 proceedings that are wrongly focused on why the utility is not meeting its energy efficiency
5 goals rather than how it can best promote energy efficiency to its customers. And as
6 demonstrated by Mr. Schlegel's testimony, it is the ratepayers who lose at the end of the
7 day:

8 SWEEP has made a few attempts to quantify the total savings that would
9 come from the gas energy efficiency rule...the first year would deliver about
10 35 million in total societal benefits or about 14 million in societal net benefits
11 just from the first year of the implementation of the energy efficiency standard
12 for just one company, for just Southwest Gas.¹⁴

13 The Policy Statement acknowledges that decoupling – full revenue decoupling in
14 particular - is a simple, cost-effective and beneficial solution to the problem.¹⁵ And the
15 Settlement Parties have undeniably shown that decoupling, whether in the form of
16 Alternative A or Alternative B represents the necessary and appropriate resolution to the
17 problem for Southwest Gas.

18 III.

19 DECOUPLING DOES NOT CREATE CONSTITUTIONAL ISSUES

20 In response to the Constitutional question raised during the hearing, RUCO correctly
21 states that the rate adjustments related to both Alternative A and Alternative B tie to the
22 rates approved by the Commission after determining fair value - an indication that it agrees
23 with the Settlement Parties' view that decoupling poses no Constitutional problems.¹⁶
24 RUCO also states that the decoupling provisions are not adjustor mechanisms – a position
25 that contradicts Dr. Johnson's testimony¹⁷, but with which the Company generally agrees.¹⁸

26
27 ¹⁴ Tr. Vol. II (Schlegel) at 439-40. Southwest Gas recently filed its Revised Energy Efficiency and Renewable Energy Technology
28 Portfolio Implementation Plan, which reflects even greater first year savings. Under the Revised Plan, there are approximately
\$61 million in total societal benefits and approximately \$33 million in societal net benefits.

¹⁵ Ex. RUCO-1 at 4, 31.

¹⁶ RUCO's Opening Brief at 21.

¹⁷ Tr. Vol. III (Johnson) at 664-65.

¹⁸ Southwest Gas' Post-Hearing Brief at 13-14.

1 However, RUCO then shifts gears, arguing that while initial rates are established
2 according to fair value, subsequent rate adjustments are not – a scenario that, according to
3 RUCO, improperly bolsters Southwest Gas' earnings and constitutes the type of "piecemeal"
4 ratemaking prohibited by the *Scates* decision.¹⁹ This proposition is absolutely false. In
5 *Scates* the Commission approved, outside of a rate case, a \$4.9 million increase in rates
6 charged for certain services. The Court held that approval of such an increase without
7 inquiry into its impact on the rate of return authorized in the utility's last rate case violated
8 Arizona's Constitutional ratemaking provisions.²⁰ This case is entirely different. **The only**
9 **difference between decoupling and traditional cost of service ratemaking is that**
10 **decoupling presents a different methodology for recovering the fixed costs approved**
11 **by the Commission in a rate case.** Decoupling does not result in utility recovery of
12 additional costs between rate cases. In sharp contrast to *Scates*, the decoupling provisions
13 in the Settlement Agreement are Constitutional because they will recover only the fixed
14 costs that the Commission approves in this rate case and they will hold constant the rate
15 base and fair value rate of return ("FVROR") established by the Commission as a result of
16 its fair value determination in this proceeding. Further, the "piecemeal" ratemaking relied
17 upon by RUCO and discussed in *Scates* refers to the utility's argument that a fair value
18 determination was not necessary because it only sought a partial rate increase²¹ – another
19 situation that is wholly inapplicable here.

20 Remarkably, in what can only be construed as an attempt to hedge its position,
21 RUCO states that it has not yet completed its legal research and since there may be fair
22 value concerns it has not identified, it wants to consider the Settlement Parties' arguments
23 before presenting its own.²² To the extent the Commission is willing to consider any new
24 arguments that are offered in RUCO's Reply Brief on this issue, Southwest Gas reserves the
25 right to supplement its Reply Brief so that it has an opportunity to respond accordingly.

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28 ¹⁹ RUCO's Opening Brief at 14, 21, 23; *Scates v. Arizona Corporation Commission*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (Ariz.App. Div. 1 1978).

²⁰ *Scates*, 118 Ariz. at 533-34, 614-15.

²¹ *Id.* at 534.

²² RUCO's Opening Brief at 23.

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IV.

RUCO'S OPPOSITION TO THE SETTLEMENT AGREEMENT

The Settlement Parties definitively proved that the Settlement Agreement is just, reasonable and in the public interest, and that it should be approved, and they effectively demonstrated that RUCO's objections to the Settlement Agreement are meritless. The Settlement Parties also established that RUCO's alternate proposal to increase the basic service charge pales in comparison to the decoupling proposals outlined in the Settlement Agreement, and directly conflicts with the Commission's Policy Statement. It is indeed unfortunate that despite the substantial evidence presented by the Settlement Parties, RUCO's primary objection to the Settlement Agreement is premised on misguided and completely unsubstantiated assumptions about decoupling – each of which was thoroughly discussed and considered during the Commission's extensive workshops, and addressed in the resulting Policy Statement.

A. RUCO's opposition to decoupling is grounded in myth.

RUCO's suggestion that the regulatory model should not have to change in order for utilities to do what is already required of them highlights RUCO's self-serving position on the issues of energy efficiency and decoupling – RUCO wants the benefit of reduced consumption to the detriment of the utility.²³ First, RUCO wrongly insists that decoupling will discourage conservation, and that customers will end up paying more when they conserve.²⁴ The Settlement Parties presented considerable evidence to show that decoupling – and particularly full revenue decoupling – results in bill savings that far outweigh the cost of a potential surcharge spread across a class of customers. According to Dr. Hansen:

[T]here are two misconceptions. . . One is that the entire rate reduction is repaid, which is not the case. If you use a therm less gas. . . you get a bill reduction in the amount of the gas cost [and] that gas cost is never repaid through decoupling. It is completely outside of the mechanism. The other misconception...is that if your non-gas bill goes down by a dollar, the utility is going to come back to you next year and add a dollar to your bill, and I just described how that's not the case.²⁵

²³ RUCO's Opening Brief at 16.

²⁴ Id. at 12-13.

²⁵ Tr. Vol. II (Hansen) at 284-85. See also, Ex. AIC-3 at 17; Tr. Vol. II (Cavanagh) at 375-76.

1 In addition, RUCO attempts to shock the Commission into rejecting the Settlement
2 Agreement by emphasizing that the Company would have collected \$62 million had
3 decoupling been in place from 2007 through 2010.²⁶ However, RUCO fails to point out that
4 this hypothetical amount represents revenue the Commission authorized Southwest Gas to
5 recover. Further, as Mr. Hester explained, since the Company is not seeking to implement
6 decoupling retroactively, the appropriate calculation for the purposes of this Application
7 would use the current estimated volumes (297 therms) rather than the estimated volumes
8 from several years ago, which ranged from 332 to 347 therms; and the result would be a
9 **refund** to customers of about \$66 million.²⁷

10 Second, RUCO argues that decoupling shifts risk from the utility to its customers and
11 guarantees the utility a continued stream of revenue – which, according to RUCO is
12 inappropriate in trying economic times²⁸ However, RUCO offers no evidence to dispute that
13 even under a decoupled rate structure, Southwest Gas remains subject to risk in terms of
14 how it manages its costs.²⁹ Further, the notion of guaranteed income is simply false. The
15 basic premise of full revenue decoupling is that the utility never recovers more than its
16 Commission-authorized revenue per customer.³⁰ Indeed, as Mr. Cavanagh testified:

17 [T]here is a reason...why the entire utility industry hasn't reached out to
18 embrace decoupling. And it has to do with the loss of an upside, particularly at
19 a time when I think all of us devoutly hope that the country is poised on the
20 edge of significant economic recovery. If you move to revenue decoupling in
21 2011 you are kissing good-bye the upside associated with that recovery in
22 terms of increased use of natural gas...³¹

23 Third, RUCO incorrectly claims that declining use is a normal risk faced by utilities in
24 the course of ordinary business, and that decoupling unfairly shifts the risk associated with
25 regulatory lag from the utility to the ratepayers.³² According to RUCO, regulatory lag can
26 work in favor of the shareholders or the ratepayers at any given time but the decoupling
27 proposals in the Settlement Agreement permanently shift the ratepayer benefits to

26 RUCO's Opening Brief at 3-4.

27 Tr. Vol. I (Hester) at 77-79.

28 RUCO's Opening Brief at 11-12.

29 Tr. Vol. I (Hester) at 148-49, 155; Tr. Vol. I (Olea) at 201-02; Tr. Vol. II (Hansen) at 353-54; Tr. Vol. II (Cavanagh) at 396-98; Tr. Vol II (Yaquinto) at 503-04, 508.

30 Tr. Vol I (Hester) at 97; Tr. Vol. II (Hansen) at 348; Tr. Vol. II (Schlegel) at 420.

31 Tr. Vol. II (Cavanagh) at 396.

32 RUCO's Opening Brief at 14.

1 shareholders.³³ The reality is that declining use is not a normal risk encountered during the
2 ordinary course of business when it stems from energy efficiency mandates such as the EE
3 Rules. Further, decoupling provides the benefit of eliminating the “winners and losers”
4 mentality advocated by RUCO by holding the revenue per customer received by Southwest
5 Gas constant, regardless of the factors that would otherwise fluctuate between rate cases
6 and that could result in the Company recovering more revenue per customer than what the
7 Commission authorizes.³⁴ RUCO simply ignores the fact that decoupling provides important
8 benefits to customers by preventing the Company from increasing sales to increase profits,
9 and limiting the revenue per customer that the Company can recover.

10 Importantly, RUCO fails to consider that even though the above arguments have
11 been rebuffed in actual practice³⁵ they are nevertheless adequately addressed in the
12 Settlement Agreement. Southwest Gas understands that with the implementation of any
13 new policy comes a certain degree of trepidation. It therefore worked diligently with the
14 other Settlement Parties to incorporate a wide array of additional provisions into both
15 decoupling proposals, and especially Alternative B, which benefit and protect customers by
16 ensuring that decoupling works as intended. For instance, both Alternatives offer “real-time”
17 adjustments to protect customers from large bill fluctuations following an extreme weather
18 event, and both Alternatives require customer outreach and education concerning
19 decoupling. They are also subject to Commission oversight – which includes the ability to
20 modify or eliminate the mechanism if it is not working as planned. Alternative B also
21 includes:

- 22 • An earnings test to ensure that the Company will not collect a surcharge if it will
23 over-earn;
- 24 • A 5% cap on non-gas revenues which limits the amount the Company can collect
25 through the surcharge to approximately \$1.40;

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27
28 ³³ Id.

³⁴ Tr. Vol. II (Hansen) at 335-38.

³⁵ Dr. Hansen testified that in his experience, there is no reduced incentive to conserve as a result of decoupling, no guaranteed revenue stream, and continued economic and business risk to the utility. Tr. Vol. II (Hansen) at 265, 348, 353-54.

- A 5 year stay-out provision that stabilizes rates and prevents the Company from collecting any increased costs that occur before its next rate case; and
- A reduced return on equity (ROE) that accounts for any perceived shifting of risk.

It is these additional provisions that push the Settlement Agreement well above the bar set in other states that have successfully implemented decoupling, and which further support its approval.

B. Alternatives A and B are both in the public interest.

Beyond its general objections to decoupling, RUCO also criticizes the 2 decoupling proposals contained in the Settlement Agreement. These objections are also manifestations of RUCO's misunderstanding of decoupling, and they are wholly unsupported by the evidence presented in this case.

For example, RUCO asserts that the Settlement Agreement should not be approved because the public opposition in this case shows that neither Alternative A nor Alternative B is in the public interest.³⁶ As previously discussed, the public opposition to decoupling does not appear to be as overwhelming as RUCO would like to believe.³⁷ Notwithstanding, and contrary to RUCO's assertion,³⁸ it is important for the Commission to look at the customer response in other jurisdictions that have implemented decoupling – and to note the testimony of Dr. Hansen, whose studies in New Jersey and Oregon revealed little public opposition to decoupling, and in fact identified marked improvement in customer satisfaction levels after decoupling was implemented.³⁹ It is equally important to look at what Southwest Gas has accomplished in its other jurisdictions. The Company has decoupled rates in California and more recently, it successfully implemented decoupling in Nevada. Significantly, the Company's seamless transition to a decoupled rate structure in Nevada reflects its commitment to work with the appropriate stakeholders to develop education and outreach materials for customers – a commitment identical to the one incorporated into the Settlement Agreement in this case.

³⁶ RUCO's Opening Brief at 9.

³⁷ Southwest Gas' Post-Hearing Brief at 11-12.

³⁸ RUCO's Opening Brief at 9.

³⁹ Tr. Vol. II (Hansen) at 267-69, 321, 338-39.

1 RUCO also suggests that delaying new infrastructure is the “primary” goal of
2 decoupling, and that because this goal is not encompassed by either Alternative, the
3 Settlement Agreement must be rejected.⁴⁰ RUCO fails to provide any reliable basis for its
4 assertion, or its complete disregard of the Policy Statement - which unambiguously states
5 that decoupling serves, “...the primary purpose of reducing utility disincentives to
6 implementing demand side management programs and reducing energy consumption.”⁴¹
7 RUCO also offers no explanation (and certainly no evidence) to counter the testimony of the
8 Settlement Parties, which clearly established that infrastructure development is a greater
9 concern for electric utilities – an issue the Commission presumably considered when it set a
10 22% savings standard for electric utilities, and a 6% standard for gas utilities.⁴² RUCO also
11 does not dispute that gas customers receive an immediate and permanent benefit through
12 decoupling in that they immediately save on the commodity rate, and will permanently save
13 the gas cost portion of that commodity rate.⁴³

14 Indeed, the increased opportunity to pursue energy efficiency, and to meet or exceed
15 the standards set forth in the EE Rules is one of the most significant reasons that both
16 Alternatives A and B are in the public interest. It is abundantly clear that the Settlement
17 Agreement works hand-in-hand with the Policy Statement and the EE Rules. As the
18 Commission noted when it approved the Policy Statement:

19 [W]e passed an energy efficiency standard...And not a single person has come
20 before this Commission and said, at least not with a straight face, that we can
21 meet the standard without decoupling...⁴⁴

22 Nonetheless, in one of the most significant contradictions espoused by RUCO in this case, it
23 claims to support both the EE Rules and the Company’s Energy Efficiency and Renewable
24 Energy Resource Technology Portfolio Implementation Plan (“EE and RET Plan”),⁴⁵ while at
25 the same time adamantly objecting to the most reasonable means of enabling Southwest
26 Gas to effectuate its EE and RET Plan and achieve the target energy savings contemplated

27 ⁴⁰ RUCO’s Opening Brief at 5-6.

28 ⁴¹ Ex. RUCO-1 at 4.

⁴² Id. at 1-2.

⁴³ Southwest Gas’ Post-Hearing Brief at 21.

⁴⁴ Tr. ACC Open Meeting (December 15, 2010) Vol. III at 193.

⁴⁵ Tr. Vol. III (Jerich) at 715-16.

1 by the EE Rules; and without offering a plausible methodology of its own. Although the EE
2 and RET Plan will be funded through the DSM surcharge in accordance with the EE Rules,
3 Southwest Gas denies RUCO's implication that the DSM surcharge overshadows the
4 customer benefits derived from the EE and RET Plan.⁴⁶ In accordance with the Settlement
5 Agreement, Southwest Gas recently filed its Revised EE and RET Plan. The Revised EE
6 and RET Plan reflects an estimated \$33 million in societal net benefits - a substantial benefit
7 to customers that clearly disproves RUCO's assertion.

8 **C. Alternative B provides substantial customer benefits.**

9 Southwest Gas supports the Settlement Agreement with the inclusion of either
10 Alternative A or Alternative B but prefers Alternative B. Alternative B is the methodology that
11 Southwest Gas believes is the most consistent with the Policy Statement. Moreover, as the
12 Company detailed in its Post-Hearing Brief, Alternative B makes the most sense for customers
13 because it has significant customer benefits that go beyond energy efficiency.⁴⁷ By itself, full
14 revenue decoupling offers customers benefits such as immediate bill savings on the
15 commodity rate and permanent savings on the gas-cost component, enhanced bill stability
16 through less frequent rate cases, and revenue stability that leads to positive credit ratings and
17 reduced debt costs. It also prevents the Company from increasing its profits through
18 increased sales, and provides a cap on the revenue per customer the Company can receive,
19 thereby allowing for refunds to customers when the Company over-collects revenue.
20 However in this case, the Settlement Parties carefully incorporated several other customer
21 benefits and protections into Alternative B, including but not limited to a 5% cap on the
22 amounts the Company can collect through the decoupling surcharge, an annual earnings test
23 that prevents the Company from collecting a surcharge if it will over-earn, quarterly and
24 annual reporting requirements, and customer outreach and education.

25 RUCO's failure to recognize these benefits as anything other than significant highlights
26 once again its fundamental misunderstanding of how revenue per customer decoupling works
27 – and more importantly, how willing RUCO is to compromise what should be common sense
28

⁴⁶ RUCO's Opening Brief at 9.

⁴⁷ Southwest Gas' Post-Hearing Brief at 6-8.

1 to argue against the merits of the Settlement Agreement. For example, RUCO alleges that
2 the 5 year rate case moratorium is not beneficial because during that 5 year span, the
3 Company's commitment to reduce expenses by \$2.5 million per year inures to the benefit of
4 shareholders.⁴⁸ However, as Mr. Olea testified, RUCO's assertion is only true to the extent
5 permitted by the earnings test.⁴⁹

6 RUCO also reasserts that Alternative B will result in automatic per-unit rates
7 increases between rate cases.⁵⁰ However, the rate adjustments that occur between rate
8 cases simply "true-up" and "true-down" to the revenue requirement approved by the
9 Commission, and will in fact result in a refund if the Company ever collects more than what
10 the Commission authorizes. Further, the 5% cap limits the amount the Company can
11 recover annually through the surcharge – a limit that does not apply in the event of a refund.
12 And the earnings test provides yet another level of checks and balances by preventing the
13 Company from collecting under the decoupling surcharge if it will over-earn.

14 Most importantly, RUCO fails to address that the overarching benefits included in
15 both Alternatives are the oversight provisions providing for frequent reporting by the
16 Company and annual reviews by Staff. In the case of Alternative B, the Company must
17 submit quarterly and annual reports, with the annual reports being the subject of an Open
18 Meeting. Accordingly, if the Commission finds that the mechanism is not working as
19 intended, it can modify or eliminate it.

20 **D. Alternative B is consistent with the Policy Statement.**

21 In addition to erroneously suggesting that Alternative B provides no significant
22 customer benefits, RUCO alleges that the Policy Statement is unclear about which type of
23 decoupling it prefers – stating that Paragraph 8 indicates a preference for Alternative B
24 because it states a preference for full decoupling, but Paragraph 13 indicates a preference
25 for Alternative A because it "...states a preference for decoupling applied in a manner that
26 encourages energy efficiency."⁵¹ Unfortunately, RUCO's no holds barred approach to
27

28 ⁴⁸ RUCO's Opening Brief at 7.

⁴⁹ Tr. Vol. I (Olea) at 234-35.

⁵⁰ RUCO's Opening Brief at 7.

⁵¹ Id. at 15.

1 opposing decoupling results in a misrepresentation of Paragraph 13 that is as blatant now
2 as it was during the hearing.⁵² The Policy Statement clearly explains that during the
3 workshops, stakeholders discussed how full revenue decoupling could facilitate rate designs
4 that encourage conservation and other goals.⁵³ The full text of Paragraph 13 is consistent
5 with those discussions, stating, "Decoupling adjustments applied in a manner to encourage
6 energy efficiency are preferred, such as applying decoupling surcharges to rates and higher-
7 usage blocks to encourage energy efficiency, and applying decoupling surcredits to reward
8 customers who use less energy."⁵⁴ Despite RUCO's attempt to discredit the Settlement
9 Agreement by quoting the plain language of the Policy Statement out of context, Paragraph
10 13 clearly refers to the application of decoupling surcharges. Indeed, as the Commission
11 noted, a desire to apply decoupling surcharges in a manner that encourages energy
12 efficiency is not an endorsement for partial decoupling.⁵⁵

13 I am interested in making sure we have some language ... that does indicate
14 the Commissioners' strong belief that decoupling is necessary to achieve
15 the...energy efficiency Standard...we are not providing the guidance that we
16 want partial decoupling...we believe full decoupling is necessary in large part
17 because of the energy efficiency standard.⁵⁶

18 Next, RUCO attempts to condemn the weather component contained in both
19 decoupling mechanisms by again misconstruing the Policy Statement, and flatly
20 contradicting its own direct testimony. According to RUCO's skewed reading of Paragraph 9
21 of the Policy Statement, the Commission frowns upon weather normalization components
22 because they "...reduce the size of surcredits...following an extreme weather event."⁵⁷
23 Relying yet again on its flawed interpretation of the Policy Statement, RUCO construes a
24 statement referring to the "application of decoupling deferral amounts" as an indictment
25 against the concept of weather normalization. As noted throughout the Policy Statement,
26 the Commission's intent is to provide customers immediate relief following extreme weather

27 ⁵² Tr. Vol. II. (Cavanagh) at 384-85.

28 ⁵³ Ex. RUCO-1 at 15.

⁵⁴ Id. at 31.

⁵⁵ Tr. ACC Special Open Meeting (November 4, 2010) at 119-123.

⁵⁶ Id. at 122.

⁵⁷ RUCO's Opening Brief at 15.

1 events through a weather normalization component to decoupling.⁵⁸ Ironically, RUCO's
2 claim that the Policy Statement disavows weather comes on the heels of Dr. Johnson's
3 direct testimony, which recommended a weather normalization adjustor in response to the
4 Policy Statement.⁵⁹

5 RUCO also alleges that the 5% cap provided under Alternative B is "...higher than
6 the 3% minimum discussed in the workshops and does not appear to be designed with
7 'gradualism' in mind."⁶⁰ This is yet another issue clarified by the Settlement Parties at the
8 hearing. The 5% cap applies only to the non-gas portion of customer bills, whereas the 3%
9 cap discussed in the workshops was intended to apply to the entire bill.⁶¹ Further, the
10 record clearly establishes that due to the 5% cap, the largest possible monthly bill impact is
11 approximately \$1.40⁶² – undoubtedly a gradual approach to the decoupling surcharge,
12 especially when compared to RUCO's proposal to increase the monthly service charge for
13 all residential customers by \$1.15 regardless of customer consumption levels.⁶³

14 Finally, RUCO claims that an analysis of new versus existing customers was not
15 done in this case.⁶⁴ To the contrary, this analysis was done when Southwest Gas
16 developed its Energy Efficiency Enabling Provision ("EEP"). The direct testimony of
17 Company witness Edward B. Gieseke explains that all customers subject to the
18 decoupling mechanism will be treated the same.⁶⁵ Moreover, the Settlement Agreement
19 specifically states that the full revenue decoupling mechanism outlined in Alternative B will
20 be implemented, "...as proposed by the Company in its Application."⁶⁶

21 **E. RUCO's proposal is by no means superior to the decoupling proposals.**

22 RUCO's argument that its proposal (to increase the basic service charge from
23 \$10.70 to \$11.85) is superior to either Alternative A or Alternative B is fraught with
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26 ⁵⁸ Ex. RUCO-1 at 8, 21-22, 29. Indeed, the Commission stated that one of the reasons full decoupling is preferred is because it,
"...offers opportunities for rate relief following extreme weather events." *Id.* at 31.

27 ⁵⁹ Ex. RUCO-7 at 26-27.

⁶⁰ RUCO's Opening Brief at 15.

⁶¹ Tr. Vol. I (Hester) at 90-91.

⁶² Tr. Vol. II (Hansen) at 263.

28 ⁶³ RUCO's Opening Brief at 16-17.

⁶⁴ *Id.* at 15.

⁶⁵ Ex. A-12 at 4.

⁶⁶ Ex. A-14 at 10.

1 contradiction.⁶⁷ First, in suggesting that its proposal is superior, RUCO implies that it
2 actually compared its proposal to the decoupling provisions in the Settlement Agreement.
3 The evidence undeniably establishes that it did not. Dr. Johnson admitted that he never
4 analyzed the rate-per-therm impact of a potential decoupling adjustment in this case⁶⁸ and
5 Ms. Jerich could not identify what the basic service charge would need to be in order to fully
6 decouple Southwest Gas' revenues from its sales.⁶⁹ The Settlement Parties, on the other
7 hand, did compare the Settlement Agreement to RUCO's proposal, and convincingly
8 demonstrated the fatal flaws in RUCO's approach. Dr. Hansen testified that the per-therm
9 increase associated with Alternative B would only amount to approximately \$0.05 cents per
10 therm.⁷⁰ Further, the monthly service charge would have to increase by approximately \$16
11 or \$17 (instead of \$1.15) in order for RUCO's proposal to effectively eliminate the
12 Company's financial disincentives.⁷¹

13 Second, RUCO states that its proposal, "...mirrors the Company's current rate
14 design...",⁷² and in the next breath urges that its proposal, "...is designed to mitigate the
15 Company's risk of not recovering its authorized revenue requirement..."⁷³ Given RUCO's
16 repeated recognition of the financial disincentives present under the current regulatory
17 model, and the wholly undisputed evidence that under the same model, Southwest Gas has
18 not earned its authorized revenue requirement in nearly 15 years, it is unreasonable for
19 RUCO to suggest that an acceptable resolution to this case lies in maintaining the status
20 quo. Lastly, by the admission of its own witnesses, RUCO's proposal discourages
21 conservation – a result that directly conflicts with the Policy Statement and undermines the
22 EE Rules that RUCO claims to support.⁷⁴

23 **F. RUCO's remaining objections are also unsubstantiated.**

24 RUCO also objects to the methodology used to normalize weather and the FVROR
25 calculation used by the Settlement Parties. Weather normalization is addressed in Southwest

26 ⁶⁷ RUCO's Opening Brief at 16-17, 26.

27 ⁶⁸ Tr. Vol. III (Johnson) at 594-95.

⁶⁹ Tr. Vol. III (Jerich) at 741-42.

⁷⁰ Ex. AIC-3 at 17.

28 ⁷¹ Tr. Vol. II (Hansen) at 270.

⁷² RUCO's Opening Brief at 17.

⁷³ Id. at 17-18.

⁷⁴ Tr. Vol. III (Johnson) at 592-93; Tr. Vol. III (Jerich) at 742.

1 Gas' Post-Hearing Brief.⁷⁵ However, since RUCO makes no argument as to weather
2 normalization in its Opening Brief, the Company will not discuss it further herein.

3 Despite Dr. Johnson's admission that the FVROR approach adopted by the
4 Settlement Parties is "not as unstable as I was thinking",⁷⁶ RUCO continues to insist that the
5 FVROR methodology in this case will have "wide implications for future proceedings",⁷⁷ and
6 that the Settlement Agreement should be rejected simply because Dr. Johnson's
7 methodology was not used.⁷⁸ This argument is illogical given that the Settlement Agreement
8 explicitly states that its terms and provisions cannot be cited as precedent in future
9 proceedings.⁷⁹ Moreover, RUCO's implication that the Commission's decision in the recent
10 UNS Electric case forms the basis for how FVROR should be determined in the future is
11 vastly misplaced.⁸⁰ Indeed, in that very same decision the Commission emphasized:

12 The Court of Appeals' decision in *Chaparral City* recognized the Commission's
13 authority to craft appropriate methodologies for determining fair value. We
14 indicated previously that there are a number of methods that may be
15 appropriate for determining FVRB and FVROR and, **as the facts of this case
16 make clear, a one size fits all approach may not enable the Commission
17 to satisfy its obligation to establish just and reasonable rates without the
18 ability to tailor a remedy that balances the Commission's concurrent
19 constitutional obligations.**⁸¹ (emphasis added).

17 As previously discussed, the Settlement Parties utilized the same FVROR methodology
18 approved by the Commission in Southwest Gas' last rate case.⁸² It is not unsound or
19 unreasonable, and it provides no basis for rejecting the Settlement Agreement.

20 V.

21 CONCLUSION

22 As the Commission nears what the Settlement Parties hope will be its first decision
23 implementing a decoupling mechanism following the issuance of the Policy Statement, it is
24 unfortunate that RUCO continues to trail behind. RUCO unreasonably resists this important
25 shift in regulatory policy, claiming that it is simply waiting for the right utility to propose the

26 ⁷⁵ Southwest Gas' Post-Hearing Brief at 17.

27 ⁷⁶ Tr. Vol. III (Johnson) at 775-76.

⁷⁷ RUCO's Opening Brief at 25.

⁷⁸ Id. at 24-25.

28 ⁷⁹ Ex. A-14 at 26-27.

⁸⁰ RUCO's Opening Brief at 24-25.

⁸¹ D71914 (September 30, 2010) at 51-52.

⁸² Southwest Gas' Post-Hearing Brief at 16.

1 right mechanism at the right time.⁸³ However, the evidence very clearly shows that RUCO's
2 ideal decoupling scenario is found in the case it presently opposes. With a 15 year history
3 of not earning its authorized rate of return and the reality that consumption will continue to
4 decline, especially in light of the EE Rules, Southwest Gas is without question the right
5 utility. The Settlement Agreement, which is supported by every stakeholder except RUCO,
6 and provides 2 well-reasoned and comprehensive decoupling proposals and a number of
7 customer protections and benefits, undeniably proposes the right mechanism. And in light
8 of the Commission's approval of probably the most aggressive energy efficiency standards
9 in the nation, and its strong commitment to removing the financial disincentives that will
10 prevent utilities from achieving those standards, this is absolutely the right time.

11 As established previously, and reinforced herein, the Settlement Agreement
12 adequately addresses the Company's overall goal of securing the revenue increase
13 necessary to maintain and provide safe and reliable natural gas service to its Arizona
14 customers. Additionally, the decoupling provisions contained within the Settlement
15 Agreement were crafted with the guidance of the Commission's Policy Statement, and are
16 intended to work in tandem with the Policy Statement and EE Rules, to the benefit of both
17 Southwest Gas and its customers. The Settlement Parties have also clearly shown that
18 RUCO's objections to the Settlement Agreement are meritless, and that its efforts to pass off
19 its own proposal (which was considered and rejected by the Commission during the
20 decoupling workshops) as an acceptable alternative to decoupling should be denied.

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22 ...
23 ...
24 ...
25 ...
26 ...

⁸³ RUCO's Opening Brief at 25-26.

1 For the foregoing reasons, Southwest Gas respectfully requests that the Settlement
2 Agreement be deemed just, reasonable, and in the public interest, and that it be approved in
3 its entirety, inclusive of Alternative B.

4 Respectfully submitted this 23rd day of September, 2011.

5 SOUTHWEST GAS CORPORATION

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7

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