

ORIGINAL

OPEN MEETING



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MEMORANDUM

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Arizona Corporation Commission

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DOCKETED

AZ CORP COMMISSION JUL 06 2012  
DOCKET CONTROL

TO: THE COMMISSION

FROM: Utilities Division

DATE: July 6, 2012

DOCKETED BY [Signature]

RE: SOUTHWEST GAS CORPORATION – FILING OF ITS ACCOUNTING OF DEVELOPMENT COSTS PAID BY ARIZONA RATEPAYERS AND ITS APPLICATION FOR APPROVAL OF ITS GAS HEAT PUMP TECHNOLOGY REIMBURSEMENT PLAN (DOCKET NO. G-01551A-10-0458)

The Gas Heat Pump Technology Reimbursement Plan (“Reimbursement Plan”)

On April 6, 2012, Southwest filed its Reimbursement Plan as a compliance item, as required by Decision No. 72723 (January 6, 2012). In its application, Southwest proposes to reimburse Arizona customers for ratepayer funds spent in development of Gas Heat Pump (“GHP”) technology. The Company proposes to do this by crediting ratepayers for each gas engine driven air conditioning (“GEDAC”) and GHP unit sold by Southwest or its affiliates (\$250 for each GEDAC unit and \$200 for each GHP unit). The credits would be tracked as a regulatory liability and the balance, as of the test year for Southwest’s next case, would be returned to Arizona ratepayers over the course of approximately one rate case cycle (approximately three to five years). Southwest would cease to account for the regulatory liability as of December 31, 2021, or when it no longer had a financial interest in an affiliate selling the GECAC or GHP units.

Background.

Ratepayer Funding. Ratepayer funds were used to develop GHP/GEDAC technologies in two ways: (i) approximately \$4.2 million in research and development (“R&D”) costs were included in operating expenses, which are, in turn, included in the Company’s base rates; and (ii) approximately \$160,0000 was funded through the Company’s R&D surcharge.

Transfer of GHP/GEDAC Assets to Non-regulated Subsidiary. In the last rate case, Staff testified that Southwest had transferred assets and intellectual property related to gas heat pump development into a non-regulated subsidiary, IntelliChoice Energy LLC (“ICE”), doing so for the purpose of commercially developing and selling GHP/GEDAC.<sup>1</sup> Staff expressed concern that “. . .under Southwest’s recent arrangements, the GHP equipment will be commercialized and sold by a non-regulated subsidiary, without any apparent compensation to Southwest Gas or its ratepayers for the significant development funding incurred to date.” Staff also expressed

<sup>1</sup> See Ex. S-1 at 46-53, Smith Dir.

concern because ratepayer funding for gas-on-electric competition or commercial development of competitive products has “generally been disfavored.”

Settlement Agreement: Funding. With respect to funding the gas heat pump technology, the Settlement Agreement provided that:

- (i) For ratemaking purposes, all gas heat pump technology costs would be removed from operating expenses; and
- (ii) Southwest would not fund new gas heat pump projects through the Commission-approved R&D surcharge.

Settlement Agreement: Accounting and Reimbursement. With respect to accounting for and reimbursing development costs paid for by Arizona ratepayers, the Settlement Agreement provided that:

- (i) Southwest would prepare an accounting for all gas heat pump technology development costs funded by Arizona ratepayers through base rates and the research and development surcharge;
- (ii) The accounting would cover the period through the date of the Commission’s final order in the current rate case;
- (iii) Southwest would track Arizona ratepayer funding for gas heat pump technology development as a potential regulatory liability, to be returned to ratepayers only to the extent commercial development occurs and revenues and royalties are received by Southwest Gas and its affiliates;
- (iv) Southwest would prepare a plan to be filed with the Commission to reimburse Arizona ratepayers for their proportionate level of funding of gas heat pump technology development costs; and
- (v) The plan would include a methodology for sharing the benefits of any commercialization with Southwest Gas’ Arizona ratepayers “to ensure that customers receive credit for any investment that contributed to the development of this technology.”

Southwest Proposal

In order to comply, Southwest proposes the following:

- (i) Credits. To the extent that the conditions for reimbursement set in the Settlement Agreement are met, Southwest would credit Arizona customers \$250 for each 10-ton rooftop GEDAC unit and \$200 for each GHP unit sold by Southwest or any of its affiliates;

- (ii) Tracking. Southwest track the credits as a regulatory liability;
- (iii) Amortization. The balance of the regulatory liability as of the end of the test year for Southwest's next general rate case be amortized over a "period that is approximately equal to one rate case cycle"; and
- (iv) Termination. The Company proposes to "account for the regulatory liability through December 31, 2021 or until Southwest Gas no longer has a financial interest in an affiliate that sells either the GEDAC or AISIN GHP units, whichever occurs first."

### Southwest Accounting

Southwest states that \$4,402,593 of the total Gas Heat Pump technology development cost is subject to the reimbursement, and will be tracked as a potential regulatory liability.

### Analysis

Staff believes that the Company's proposals would unduly delay, and render less certain, payments due to Arizona ratepayers based on their investment in the development of the GHP/GEDAC technology. Southwest's proposals also fail to clearly address the sharing of any benefits of commercialization.

While the Settlement Agreement directs that *Arizona ratepayer funding* for gas heat pump technology development be tracked as a potential regulatory liability, tracking the *credits* to Arizona customers as a regulatory liability is unnecessary. Although the amount of money which may eventually be generated by the GEDAC/GHP technology is unknown, should such revenues and royalties actually accrue there is no reason to postpone payments due to ratepayers for their investment until the next rate case, or beyond.

Based on its review, Staff believes that:

- (i) Credits. The \$200 and \$250 credits are too limited and may require more time and a higher level of sales than a credit structure based on ratepayers' actual 27.4% investment in the technology;
- (ii) Tracking. Tracking ratepayer credits as a regulatory liability could unnecessarily delay the return of funding to Arizona ratepayers. One issue is that any reimbursement would have to await resolution of Southwest's next rate case, meaning that (according to Southwest) reimbursement could not begin earlier than May 1, 2017. Another issue is that the actual timing of Southwest's next rate case, as to either filing or resolution, is currently unknown, so that reimbursement may take significantly longer to commence;

- (iii) Amortization. Amortizing the future balance over a “period that is approximately equal to one rate case cycle” is not reasonable. Staff believes that, rather than amortizing an unknown amount over an uncertain period of time, a methodology should be established to promptly return any funds due ratepayers under the Settlement Agreement;
- (iv) Termination. Southwest’s proposals could mean that Arizona’s ratepayers could lose an opportunity to recover their investment or share in the benefits of commercialization, either because the deadline passed during the commercialization process, or because Southwest in some way disposed of its financial interest in affiliates selling GEDAC or GHP units; and
- (v) Ratepayer Share in the Benefits of Commercialization. The Settlement Agreement states that the Reimbursement Plan must include a methodology for sharing the benefits of commercialization with ratepayers. The benefits of commercialization are not limited simply to reimbursement, but also include “credit for any investment that contributed to development of this technology.” Staff is concerned that the Reimbursement Plan does not clearly address how ratepayers would share in the benefits of commercialization over and above simply being reimbursed for ratepayer funds invested in the GHP technology.

#### Recommendations

Below are Staff’s recommendations regarding the methodology for reimbursing Arizona ratepayers for their investment in the GEDAC/GHP technology, and for allowing ratepayers to share in the benefits of commercializing the GEDAC/GHP technology.

- In light of the 27.4% contributed to the GEDAC/GHP’s technology’s development costs, Southwest’s Arizona customers should be credited with either 27.4% of the profits for each GEDAC or GHP unit sold, or \$250, whichever is greater.
- Credits to Arizona ratepayers arising from their investment in GEDAC/GHP technology be continued until: (i) it has been **clearly** established that the GEDAC and the GHP units are not economically feasible; (ii) the GEDAC and GHP units have ceased to generate revenues and/or royalties subject to the reimbursement or benefit sharing as required by the Settlement Agreement; or (iii) further order of the Commission.
- Credits to Arizona ratepayers associated with their investment in the GEDAC and GHP units should be disbursed to Arizona ratepayers through the R&D Surcharge. On an annual basis, the R&D Surcharge should be reset, taking into account any credits payable to Arizona ratepayers, either as reimbursement or as a sharing of the benefits of commercialization.

- In disposing of financial interest in an affiliate selling the GEDAC and/or GHP units, Southwest should in no way impair Arizona ratepayers' right to be reimbursed for their proportionate share of funding for GHP/GEDAC technology development, as provided in the Settlement Agreement and approved in Decision No. 72723. Therefore, if Southwest proposes to sell or otherwise dispose of its interest in an affiliate that sells either the GEDAC or the GHP units, then Southwest must first obtain the approval of the Commission.
- The balance due ratepayers for reimbursement, and the accumulated balance of funds subject to reimbursement or benefit sharing, should be reported as a compliance item in this Docket every January and July, beginning January 2013. Once reporting begins, it should continue until: (i) it has been **clearly** established that the GEDAC and the GHP units are not economically feasible; (ii) the GEDAC and GHP units have ceased to generate revenues and/or royalties subject to the reimbursement or benefit sharing as required by the Settlement Agreement; or (iii) further order of the Commission.



Steven M. Olea  
Director  
Utilities Division

SMO:JMK:sms\RRM

ORIGINATOR: Julie McNeely-Kirwan

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BEFORE THE ARIZONA CORPORATION COMMISSION

- GARY PIERCE  
Chairman
- BOB STUMP  
Commissioner
- SANDRA D. KENNEDY  
Commissioner
- PAUL NEWMAN  
Commissioner
- BRENDA BURNS  
Commissioner

IN THE MATTER OF SOUTHWEST GAS  
 COPORATION'S FILING OF ITS  
 ACCOUNTING OF DEVELOPMENT  
 COSTS PAID BY ARIZONA RATEPAYERS  
 AND ITS APPLICATION FOR APPROVAL  
 OF ITS GAS HEAT PUMP TECHNOLOGY  
 REIMBURSEMENT PLAN

DOCKET NO. G-01551A-10-0458  
 DECISION NO.  
ORDER

Open Meeting  
 July 18 and July 19, 2012  
 Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACT

1. Southwest Gas Corporation ("Southwest" or "the Company") is engaged in providing natural gas service within portions of Arizona, pursuant to authority granted by the Arizona Corporation Commission.

The Gas Heat Pump Technology Reimbursement Plan ("Reimbursement Plan")

2. On April 6, 2012, Southwest filed its Reimbursement Plan as a compliance item, as required by Decision No. 72723 (January 6, 2012). In its application, Southwest proposes to reimburse Arizona customers for ratepayer funds spent in development of Gas Heat Pump ("GHP") technology. The Company proposes to do this by crediting ratepayers for each gas engine driven air conditioning ("GEDAC") and GHP unit sold by Southwest or its affiliates (\$250 for each GEDAC unit and \$200 for each GHP unit). The credits would be tracked as a regulatory liability and the balance, as of the test year for Southwest's next case, would be returned to

1 Arizona ratepayers over the course of approximately one rate case cycle (approximately three to  
2 five years). Southwest would cease to account for the regulatory liability as of December 31,  
3 2021, or when it no longer had a financial interest in an affiliate selling the GECAC or GHP units.

4 Background.

5 3. Ratepayer Funding. Ratepayer funds were used to develop GHP/GEDAC  
6 technologies in two ways: (i) approximately \$4.2 million in research and development (“R&D”)  
7 costs were included in operating expenses, which are, in turn, included in the Company’s base  
8 rates; and (ii) approximately \$160,000 was funded through the Company’s R&D surcharge.

9 4. Transfer of GHP/GEDAC Assets to Non-regulated Subsidiary. In the last rate  
10 case, Staff testified that Southwest had transferred assets and intellectual property related to gas  
11 heat pump development into a non-regulated subsidiary, IntelliChoice Energy LLC (“ICE”), doing  
12 so for the purpose of commercially developing and selling GHP/GEDAC<sup>1</sup>. Staff expressed  
13 concern that “. . .under Southwest’s recent arrangements, the GHP equipment will be  
14 commercialized and sold by a non-regulated subsidiary, without any apparent compensation to  
15 Southwest Gas or its ratepayers for the significant development funding incurred to date.” Staff  
16 also expressed concern because ratepayer funding for gas-on-electric competition or commercial  
17 development of competitive products has “generally been disfavored.”

18 5. Settlement Agreement: Funding. With respect to funding the gas heat pump  
19 technology, the Settlement Agreement provided that:

- 20 (i) For ratemaking purposes, all gas heat pump technology costs would be  
21 removed from operating expenses; and  
22 (ii) Southwest would not fund new gas heat pump projects through the  
23 Commission-approved R&D surcharge.

24 6. Settlement Agreement: Accounting and Reimbursement. With respect to  
25 accounting for and reimbursing development costs paid for by Arizona ratepayers, the Settlement  
26 Agreement provided that:

27 \_\_\_\_\_  
28 <sup>1</sup> See Ex. S-1 at 46-53, Smith Dir.

- 1 (i) Southwest would prepare an accounting for all gas heat pump technology  
2 development costs funded by Arizona ratepayers through base rates and the  
3 research and development surcharge;
- 4 (ii) The accounting would cover the period through the date of the  
5 Commission's final order in the current rate case;
- 6 (iii) Southwest would track Arizona ratepayer funding for gas heat pump  
7 technology development as a potential regulatory liability, to be returned to  
8 ratepayers only to the extent commercial development occurs and revenues  
9 and royalties are received by Southwest Gas and its affiliates;
- 10 (iv) Southwest would prepare a plan to be filed with the Commission to  
11 reimburse Arizona ratepayers for their proportionate level of funding of gas  
12 heat pump technology development costs; and
- 13 (v) The plan would include a methodology for sharing the benefits of any  
14 commercialization with Southwest Gas' Arizona ratepayers "to ensure that  
15 customers receive credit for any investment that contributed to the  
16 development of this technology."

17 Southwest Proposal

18 7. In order to comply, Southwest proposes the following:

- 19 (i) Credits. To the extent that the conditions for reimbursement set in the  
20 Settlement Agreement are met, Southwest would credit Arizona customers  
21 \$250 for each 10-ton rooftop GEDAC unit and \$200 for each GHP unit sold  
22 by Southwest or any of its affiliates;
- 23 (ii) Tracking. Southwest track the credits as a regulatory liability;
- 24 (iii) Amortization. The balance of the regulatory liability as of the end of the  
25 test year for Southwest's next general rate case be amortized over a "period  
26 that is approximately equal to one rate case cycle"; and
- 27 (iv) Termination. The Company proposes to "account for the regulatory liability  
28 through December 31, 2021 or until Southwest Gas no longer has a financial

1 interest in an affiliate that sells either the GEDAC or AISIN GHP units,  
2 whichever occurs first.”

3 Southwest Accounting

4 8. Southwest states that \$4,402,593 of the total Gas Heat Pump technology  
5 development cost is subject to the reimbursement, and will be tracked as a potential regulatory  
6 liability.

7 Analysis

8 9. Staff believes that the Company’s proposals would unduly delay, and render less  
9 certain, payments due to Arizona ratepayers based on their investment in the development of the  
10 GHP/GEDAC technology. Southwest’s proposals also fail to clearly address the sharing of any  
11 benefits of commercialization.

12 10. While the Settlement Agreement directs that *Arizona ratepayer funding* for gas heat  
13 pump technology development be tracked as a potential regulatory liability, tracking the *credits* to  
14 Arizona customers as a regulatory liability is unnecessary. Although the amount of money which  
15 may eventually be generated by the GEDAC/GHP technology is unknown, should such revenues  
16 and royalties actually accrue there is no reason to postpone payments due to ratepayers for their  
17 investment until the next rate case, or beyond.

18 11. Based on its review, Staff believes that:

19 (i) Credits. The \$200 and \$250 credits are too limited and may require more  
20 time and a higher level of sales than a credit structure based on ratepayers’  
21 actual 27.4% investment in the technology;

22 (ii) Tracking. Tracking ratepayer credits as a regulatory liability could  
23 unnecessarily delay the return of funding to Arizona ratepayers. One issue  
24 is that any reimbursement would have to await resolution of Southwest’s  
25 next rate case, meaning that (according to Southwest) reimbursement could  
26 not begin earlier than May 1, 2017. Another issue is that the actual timing  
27 of Southwest’s next rate case, as to either filing or resolution, is currently  
28

1 unknown, so that reimbursement may take significantly longer to  
2 commence.

3 (iii) Amortization. Amortizing the future balance over a “period that is  
4 approximately equal to one rate case cycle” is not reasonable. Staff believes  
5 that, rather than amortizing an unknown amount over an uncertain period of  
6 time, a methodology should be established to promptly return any funds due  
7 ratepayers under the Settlement Agreement.

8 (iv) Termination. Southwest’s proposals could mean that Arizona’s ratepayers  
9 could lose an opportunity to recover their investment or share in the benefits  
10 of commercialization, either because the deadline passed during the  
11 commercialization process, or because Southwest in some way disposed of  
12 its financial interest in affiliates selling GEDAC or GHP units; and

13 (v) Ratepayer Share in the Benefits of Commercialization. The Settlement  
14 Agreement states that the Reimbursement Plan must include a methodology  
15 for sharing the benefits of commercialization with ratepayers. The benefits  
16 of commercialization are not limited simply to reimbursement, but also  
17 include “credit for any investment that contributed to development of this  
18 technology.” Staff is concerned that the Reimbursement Plan does not  
19 clearly address how ratepayers would share in the benefits of  
20 commercialization over and above simply being reimbursed for ratepayer  
21 funds invested in the GHP technology.

## 22 Recommendations

23 12. Below are Staff’s recommendations regarding the methodology for reimbursing  
24 Arizona ratepayers for their investment in the GEDAC/GHP technology, and for allowing  
25 ratepayers to share in the benefits of commercializing the GEDAC/GHP technology.

- 26 • In light of the 27.4% contributed to the GEDAC/GHP’s technology’s development  
27 costs, Southwest’s Arizona customers should be credited with either 27.4% of the  
28 profits for each GEDAC or GHP unit sold, or \$250, whichever is greater.

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- Credits to Arizona ratepayers arising from their investment in GEDAC/GHP technology be continued until: (i) it has been **clearly** established that the GEDAC and the GHP units are not economically feasible; (ii) the GEDAC and GHP units have ceased to generate revenues and/or royalties subject to the reimbursement or benefit sharing as required by the Settlement Agreement; or (iii) further order of the Commission.
- Credits to Arizona ratepayers associated with their investment in the GEDAC and GHP units should be disbursed to Arizona ratepayers through the R&D Surcharge. On an annual basis, the R&D Surcharge should be reset, taking into account any credits payable to Arizona ratepayers, either as reimbursement or as a sharing of the benefits of commercialization.
- In disposing of financial interest in an affiliate selling the GEDAC and/or GHP units, Southwest should in no way impair Arizona ratepayers' right to be reimbursed for their proportionate share of funding for GHP/GEDAC technology development, as provided in the Settlement Agreement and approved in Decision No. 72723. Therefore, if Southwest proposes to sell or otherwise dispose of its interest in an affiliate that sells either the GEDAC or the GHP units, then Southwest must first obtain the approval of the Commission.
- The balance due ratepayers for reimbursement, and the accumulated balance of funds subject to reimbursement or benefit sharing, should be reported as a compliance item in this Docket every January and July, beginning January 2013. Once reporting begins, it should continue until: (i) it has been **clearly** established that the GEDAC and the GHP units are not economically feasible; (ii) the GEDAC and GHP units have ceased to generate revenues and/or royalties subject to the reimbursement or benefit sharing as required by the Settlement Agreement; or (iii) further order of the Commission.

CONCLUSIONS OF LAW

1  
2 1. Southwest Gas Corporation is an Arizona public service corporation within the  
3 meaning of Article XV, Section 2, of the Arizona Constitution.

4 2. The Commission has jurisdiction over Southwest Gas Corporation and over the  
5 subject matter of the application.

6 3. The Commission, having reviewed the application and Staff's Memorandum dated  
7 July 6, 2012, concludes that it is in the public interest to approve the Southwest Gas Heat Pump  
8 Technology Development Reimbursement Plan with modifications as discussed herein.

9 ORDER

10 IT IS THEREFORE ORDERED that the Southwest Gas Heat Pump Technology  
11 Development Reimbursement Plan is approved, with the modifications discussed herein.

12 IT IS FURTHER ORDERED that Southwest Gas Corporation's Arizona customers be  
13 credited with either 27.4% of the profits for each GEDAC or GHP unit sold, or \$250, whichever is  
14 greater.

15 IT IS FURTHER ORDERED that credits to Arizona ratepayers arising from their  
16 investment in GEDAC/GHP technology be continued until: (i) it has been clearly established that  
17 the GEDAC and the GHP units are not economically feasible; (ii) the GEDAC and GHP units have  
18 ceased to generate revenues and/or royalties subject to the reimbursement or benefit sharing as  
19 required by the Settlement Agreement; or (iii) further order of the Commission.

20 IT IS FURTHER ORDERED that credits to Arizona ratepayers associated with their  
21 investment in the GEDAC and GHP units be disbursed to Arizona ratepayers through the R&D  
22 Surcharge. On an annual basis, the R&D Surcharge shall be reset, taking into account any credits  
23 payable to Arizona ratepayers, either as reimbursement or as a sharing of the benefits of  
24 commercialization.

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1 IT IS FURTHER ORDERED that, if Southwest Gas Corporation proposes to sell or  
 2 otherwise dispose of its interest in an affiliate that sells either the GEDAC or the GHP units, then  
 3 Southwest Gas Corporation must first obtain the approval of the Commission.

4 IT IS FURTHER ORDERED that the balance due ratepayers for reimbursement, and the  
 5 accumulated balance of funds subject to reimbursement or benefit sharing, be reported as a  
 6 compliance item in this Docket every January and July, beginning January 2013. Such reporting  
 7 shall continue until further order of the Commission.

8 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

9 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

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12 CHAIRMAN COMMISSIONER

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15 COMMISSIONER COMMISSIONER COMMISSIONER

16 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,  
 17 Executive Director of the Arizona Corporation  
 18 Commission, have hereunto, set my hand and caused the  
 19 official seal of this Commission to be affixed at the  
 Capitol, in the City of Phoenix, this  
 \_\_\_\_\_ day of \_\_\_\_\_, 2012.

20  
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 22 \_\_\_\_\_  
 ERNEST G. JOHNSON  
 EXECUTIVE DIRECTOR

24 DISSENT: \_\_\_\_\_

26 DISSENT: \_\_\_\_\_

27 SMO:JMK:sms

28

1 SERVICE LIST FOR: Southwest Gas Corporation  
2 DOCKET NO. G-01551A-10-0458

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