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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

Arizona Corporation Commission

DOCKETED

OCT 17 2012

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IN THE MATTER OF SOUTHWEST GAS
CORPORATION'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. 73555

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 \$160,0000 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/GEDAC¹. 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 ¹ 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 \$250 for each GEDAC
28 or GHP unit sold.

- 1 • Credits to Arizona ratepayers arising from their investment in GEDAC/GHP
2 technology be continued until: (i) it has been **clearly** established that the GEDAC
3 and the GHP units are not economically feasible; (ii) the GEDAC and GHP units
4 have ceased to generate revenues and/or royalties subject to the reimbursement or
5 benefit sharing as required by the Settlement Agreement; or (iii) further order of the
6 Commission.
- 7 • To the extent Arizona ratepayers are reimbursed the \$4,402,593 in accordance with the
8 terms and conditions of the Settlement Agreement, Southwest Gas shall make a filing with
9 the Commission identifying the value of the on-going benefit of the investment made by
10 Arizona ratepayers contributing to the commercialization of GEDAC and GHP units.
11 Southwest Gas shall also submit a proposal to the Commission to consider what additional
12 payment should be made to customers for the value of the on-going benefit associated with
13 Arizona ratepayer investment in the commercialization of GEDAC and GHP units.
- 14 • Credits to Arizona ratepayers associated with their investment in the GEDAC and
15 GHP units should be disbursed to Arizona ratepayers through the R&D Surcharge.
16 On an annual basis, the R&D Surcharge should be reset, taking into account any
17 credits payable to Arizona ratepayers, either as reimbursement or as a sharing of the
18 benefits of commercialization.
- 19 • In disposing of financial interest in an affiliate selling the GEDAC and/or GHP
20 units, Southwest should in no way impair Arizona ratepayers' right to be
21 reimbursed for their proportionate share of funding for GHP/GEDAC technology
22 development, as provided in the Settlement Agreement and approved in Decision
23 No. 72723. Therefore, if Southwest proposes to sell or otherwise dispose of its
24 interest in an affiliate that sells either the GEDAC or the GHP units, then Southwest
25 must first obtain the approval of the Commission and Staff shall issue its
26 recommendation and proposed order within sixty (60) days of Southwest Gas filing
27 its application for approval.
- 28 ...

1 Gas shall make a filing with the Commission identifying the value of the on-going benefit of the
2 investment made by Arizona ratepayers contributing to the commercialization of GEDAC and
3 GHP units. Southwest Gas shall also submit a proposal to the Commission to consider what
4 additional payment should be made to customers for the value of the on-going benefit associated
5 with Arizona ratepayer investment in the commercialization of GEDAC and GPH units.

6 IT IS FURTHER ORDERED that credits to Arizona ratepayers associated with their
7 investment in the GEDAC and GHP units be disbursed to Arizona ratepayers through the R&D
8 Surcharge. On an annual basis, the R&D Surcharge shall be reset, taking into account any credits
9 payable to Arizona ratepayers, either as reimbursement or as a sharing of the benefits of
10 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 and Staff will issue
 4 its recommendation and proposed order within sixty (60) days of Southwest Gas filing its
 5 application for approval.

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

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

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

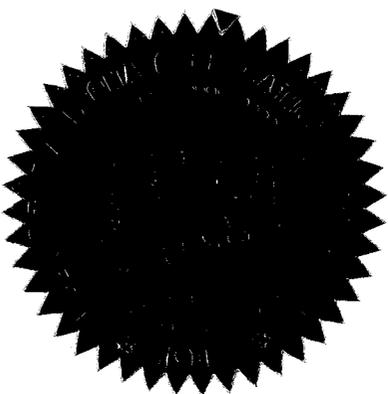
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 13 CHAIRMAN

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 15 COMMISSIONER

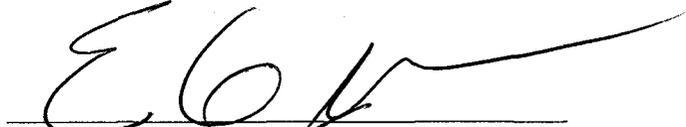
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22 IN WITNESS WHEREOF, I, ERNEST G. JOHNSON,
 23 Executive Director of the Arizona Corporation
 24 Commission, have hereunto, set my hand and caused the
 25 official seal of this Commission to be affixed at the
 26 Capitol, in the City of Phoenix, this
 27 17th day of October, 2012.

28 
 ERNEST G. JOHNSON
 EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

SMO:JMK:sms

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