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BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
Chairman
GARY PIERCE
Commissioner
BRENDA BURNS
Commissioner
BOB BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner

Arizona Corporation Commission

DOCKETED

JUN 27 2013

DOCKETED BY NR

IN THE MATTER OF SOUTHWEST GAS CORPORATION'S APPLICATION FOR A WAIVER OF CERTAIN AFFILIATED INTERESTS RULES, OR IN THE ALTERNATIVE, PRIOR APPROVAL OF CERTAIN TRANSACTIONS

DOCKET NO. G-01551A-12-0497

DECISION NO. 73915

ORDER

Open Meeting
June 11 and 12, 2013
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.

Background

2. Application. On December 21, 2012, Southwest Gas Corporation filed an application requesting limited waivers of A.A.C. R14-2-804.B.1-3 of the Commission's Affiliated Interests Rules. These waivers would allow Southwest to make certain loans and investments involving unregulated affiliates, and to sell interests in certain subsidiaries, without prior Commission approval. In the alternative, Southwest requests prior approval of certain affiliate transactions.

...

1 3. Rules. The language of R14-2-804.B.1-3 of the Commission's affiliated interest rules
2 is quoted below:

3 *"B. A utility will not consummate the following transactions without prior*
4 *approval by the Commission:*

- 5 1. *Obtain a financial interest in any affiliate not regulated by*
6 *the Commission, or guarantee, or assume the liabilities of*
7 *such affiliate;*
- 8 2. *Lend to any affiliate not regulated by the Commission with*
9 *the exception of short-term loans for a period less than 12*
10 *months in an amount less than \$100,000; or*
- 11 3. *Use utility funds to form a subsidiary or divest itself of any*
12 *established subsidiary."*

13 4. Existing Limited Waivers. Limited waivers of R14-2-804.B.1 and B.2 were
14 previously approved for Southwest. Decision Nos. 58162 (Feb. 4, 1993) and 59502 (Jan. 31,
15 1996) raised the level of loans that can be made to specified affiliates without prior Commission
16 approval from \$100,000 to \$13 million. Decision No. 58063 (Nov. 3, 1992) allowed existing
17 investments to be increased or decreased by various amounts, depending on a utility's assets.
18 (Based on Southwest's assets, the increase or decrease can be up to \$50 million.)

19 Summary of the Limited Waivers Being Requested

20 5. Southwest is currently requesting waivers or, in the alternative, prior approval for
21 the following:

- 22 • Loan Threshold. Southwest has asked to increase the amount it may
23 advance or loan to affiliates within a 12-month period without Commission
24 approval. The Company wants to increase the threshold from \$13 million to
25 \$40 million. In communications with Staff, the Company clarified that it
26 was asking for a total limit of \$40 million per year, rather than \$40 million
27 per affiliate per year. In addition, the Company has proposed an overall cap
28 of \$120 million, meaning that the total amount in outstanding loans
(accumulated over multiple years) could not exceed \$120 million.

- 1 • Loans to All Affiliates. Southwest has asked that it be allowed to make
2 loans and advances to all its existing and future affiliates, rather than to a list
3 of specific affiliates.
- 4 • Financial Interests in Non-regulated Businesses. Southwest has asked that it
5 be allowed to obtain initial financial interests in non-regulated energy or
6 construction-related businesses for up to \$50 million per year, without prior
7 Commission approval. Southwest is currently only allowed to increase or
8 decrease an existing financial interest in non-regulated affiliates up to \$50
9 million per year without Commission approval.
- 10 • Sale of Subsidiaries. Southwest has asked that it be allowed to sell interests
11 in subsidiaries without seeking prior Commission approval, with the
12 exception of subsidiaries selling the gas air conditioning or gas heat pumps
13 (in accordance with Decision No. 73555 [Oct. 17, 2012]).

14 Potential Issues Related to Affiliate Transactions

15 6. Background. As stated in Decision No. 56618, (Aug. 25, 1989), the Commission's
16 affiliated interests rules were originally designed with four basic principles in mind:

17 *"First, utility funds must not be commingled with non-utility funds. Second,*
18 *cross-subsidization of non-utility activities by utility ratepayers must be prohibited.*
19 *Third, the financial credit of the utility must not be negatively affected by non-utility*
20 *activities. Fourth, the utility and its affiliates must provide the Commission with the*
21 *information necessary to carry out its regulatory responsibilities."*¹

22 7. Potential Issues. Southwest has indicated that any losses associated with loans or
23 investments related to its affiliates would be absorbed by shareholders. However, transactions
24 between regulated utilities and their unregulated affiliates can impact the financial health of those
25 utilities, thereby directly or indirectly impacting the rates paid by utility customers.

26 8. More specifically, potential issues arising from affiliate transactions include the
27 following: (i) losses may be subsidized by ratepayers; (For example, costs may be shifted from an
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¹ Decision No. 56618 at 2:2-8

1 unregulated affiliate to a utility due to the higher probability of recovering costs through the
2 utility.); (ii) impacts to a utility's credit rating may increase the cost of borrowing by the utility;
3 (iii) impacts to a utility's financial health may affect the quality or cost of service to ratepayers;
4 (iv) utility assets necessary for the provision of service, including customer deposits, could be used
5 as collateral for transactions with unregulated affiliates; (v) there may be overcharges arising from
6 transactions between the utility and an affiliate, where prices are not based on the market; and (vi)
7 transparency of records, data and information pertaining to the regulated utility could be impacted.

8 9. Mitigation of Potential Issues. The issues listed in (i) through (v) can be mitigated,
9 in part, by limiting the size and type of affiliate transaction that can go forward without prior
10 Commission approval. The waivers requested in the current application would allow larger loans
11 and a wider variety of transactions to go forward without prior Commission review and approval.

12 10. With respect to Issue (iv), in addition, Staff has recommended that Southwest not
13 use utility assets necessary for the provision of service, including customer deposits, as collateral
14 in any affiliate transactions.

15 11. Issue (vi), maintenance of transparency, is addressed in the Commission's Rules.
16 R14-2-804.A provides, among other things, that "[a] utility will not transact business with an
17 affiliate unless the affiliate agrees to provide the Commission access to the books and records of
18 the affiliate. . . ."

19 12. Confidentiality of Customer Data. There is, in addition, the issue of protecting
20 utility customer data. Maintaining the confidentiality of customer data is important in order to (i)
21 protect customers' privacy; and (ii) protect customers' financial data. An additional issue is that
22 exclusive access to a utility's customer database may provide an unfair competitive advantage to
23 the utility's unregulated affiliate. Staff has recommended that access to Southwest customer data
24 remain confidential from Southwest's unregulated affiliates.

25 Loan Threshold

26 13. Background. In Decision No. 58162 (February 1993), the Commission approved
27 Southwest's application for a limited waiver of R14-2-804.B.2. R14-2-804.B.2 limits loans to
28 affiliates to less than \$100,000, for a period of less than 12 months, without prior Commission

1 approval of the affiliate transaction. Decision No. 58162 increased the cap to \$13 million on loans
2 or advances without prior Commission approval. The Decision also ordered that:

3 *“ . . .when Southwest Gas makes advances or loans to Paiute, SGTC and/or*
4 *Carson (pursuant to existing notes, or otherwise) which exceed \$13.0 million in*
5 *any 12 month period, Southwest Gas must apply for approval under R14-2-804.B.2*
6 *for any additional transactions between Southwest Gas and Paiute, SGTC or*
7 *Carson for which any bonds, notes, or other evidences of indebtedness are issued*
8 *by any of those subsidiaries to Southwest Gas.”²*

9 Northern Pipeline Construction Company, now NPL Construction Company, was added to the list
10 of affiliates eligible for loans or advances in Decision No. 59502.

11 14. Southwest now wants to increase the threshold from \$13 million to \$40 million. In
12 communications with Staff, the Company clarified that it was asking for a \$40 million limit, in the
13 aggregate, rather than per affiliate.

14 15. Southwest also reports that it has (i) increased its assets from \$1.27 billion to \$4.0
15 billion; (ii) experienced an increase in its total common equity ratio from 35% to 53%; and (iii)
16 experienced an increase in its credit ratings, from Ba1 to Baa1 (Moody's), from BBB- to BBB+
17 (S&P) and from BB+ to A-(Fitch). The Company states that the original \$13 million threshold
18 was set when it represented approximately 1% of Southwest's total assets and that the \$40 million
19 currently being requested would represent approximately 1% of its present-day assets.

20 16. The Company's affiliates do not currently owe on any loans from Southwest. The
21 highest loan balance was \$35.5 million, in January 2005. The \$35.5 million balance was
22 associated with a \$22 million loan to Paiute Pipeline for the purchase of an LNG facility. (The
23 \$22 million loan was approved by the Commission in Decision No. 67520 [Jan. 20, 2005].)

24 17. Southwest believes that the updated threshold would increase administrative
25 efficiency and lower administrative costs by eliminating the need to file applications regarding
26 short-term loans or advances to affiliates of \$40 million or less.

27 18. In addition to the \$40 million annual limit, in communications with Staff,
28 Southwest proposed a \$120 million total overall cap for loans or advances to its affiliates, without

² Decision No. 58162 at 5:24-6:3.

1 prior Commission approval. This proposal would allow Southwest to make loans or advances to
2 its affiliates equaling up to \$120 million over time (with a \$40 million per year limit), without
3 Commission approval.

4 19. Analysis. Increasing the loan cap to \$40 million allows Southwest the flexibility to
5 make needed loans to its unregulated affiliates without prior approval from the Commission, but
6 still limits potential impacts to the overall financial health of the utility. Such an increase would
7 essentially reflect an update in the dollar amount than can be loaned, while maintaining the overall
8 cap at 1% of the Company's assets.

9 20. A \$120 overall cap would increase that total by \$80 million. Neither the benefit nor
10 the necessity of such a large increase has been demonstrated.

11 21. Staff believes the increase in Southwest Gas' credit ratings, which have resulted
12 from a series of credit-supportive policies adopted by this Commission, should be carefully
13 protected and preserved for the benefit of Southwest Gas' ratepayers, not its affiliates. Increasing
14 the overall cap to \$120 million may expose the Company, and its ratepayers, to excessive risk.

15 22. Recommendation. Staff has recommended that Southwest's proposal to increase its
16 loan threshold to \$40 million without prior approval be approved, but be treated as a total cap.
17 Outstanding advances or loans to affiliates should not, at any one time, exceed \$40 million without
18 prior approval from the Commission. However, we believe the cap should be \$80 million.

19 23. Staff has recommended that the \$120 million total cap on loans or advances to
20 affiliates without prior Commission approval not be approved. If the Company believes that a
21 loan above the \$40 million cap is necessary and beneficial to its ratepayers, the Company can seek
22 approval of the loan from the Commission.

23 Loans to All Affiliates

24 24. Background and Rationale. Decision Nos. 58162 and 59502 allowed Southwest to
25 make loans or advances of up to \$13 million without prior approval, but limited the affiliates
26 eligible for such loans or advances to Paiute, SGTC, Carson Water Company and NPL. In the
27 current application, Southwest indicated that its affiliates have changed and may continue to

28 . . .

1 change and that the new threshold “not be limited to Paiute, SGTC, Carson, and NPL, but rather be
2 expanded to include all existing and future Southwest Gas affiliates.”

3 25. Analysis. Southwest has not supplied sufficient information to support an
4 expansion of eligibility to existing and future affiliates. The waiver is overbroad, particularly with
5 respect to its proposed expansion of eligibility to all future affiliates, the nature and financial
6 condition of which are unknown.

7 26. Recommendation. Staff has recommended that Southwest’s proposal to
8 automatically expand eligibility for loans to all current and future affiliates not be approved.

9 27. Staff has also recommended that, if Southwest wishes to expand eligibility for
10 loans, the Company file an application specifying the affiliate or affiliates that it proposes to make
11 eligible and supply information, including the name, business type, and financial condition of each
12 such affiliate, along with the nature of the loans that Southwest contemplates. This will allow the
13 Commission the opportunity to evaluate the creditworthiness of the affiliate and weigh risk to
14 Southwest Gas’ ratepayers.

15 Financial Interests in Non-regulated Businesses

16 28. Background. Decision No. 58063 required prior Commission approval for (i) initial
17 investments in affiliates not regulated by the Commission; (ii) guaranteeing or assuming the
18 liabilities of an unregulated affiliate; and (iii) increasing or decreasing its financial interest in an
19 unregulated affiliate by an amount in excess of \$50 million (based on assets in the range of \$3-6
20 billion). In addition, Decision No. 58063 provided an exemption for existing investments. The
21 exemption allows utilities with assets in the \$3-6 billion range to increase or decrease investments
22 in a cumulative amount of \$50 million or less without prior Commission approval.

23 29. In its application, Southwest has asked for a waiver from (i), the limitation on
24 making initial investments in affiliates without prior Commission approval. Southwest has asked
25 that it be allowed to obtain an initial financial interest in non-regulated energy or construction-
26 related businesses for up to \$50 million per year, without prior Commission approval.

27 30. The \$50 Million Per-Year Cap. Decision No. 58063 states that “[t]he ‘exempt
28 amounts’ are to be measured on a cumulative basis over the calendar year in which the transactions

1 will be made.” As an annual limit, as opposed to an overall limit, investments made without
2 Commission review could accumulate over successive years (\$50 million in Year 1, increasing to
3 \$100 million in Year 2, and to \$150 million in Year 3, etc.) Currently, however, any multi-year
4 accumulation of investment is limited to only those companies where Southwest has existing
5 investments.

6 31. Rationale. Southwest states that “the overall impact of an investment, whether it
7 be in a new or existing affiliate, is substantially similar, if not the same, and such transactions
8 should be treated consistently.” Southwest asserts that easing its ability to invest in new
9 businesses will improve its financial strength, reduce costs as efficiencies are acquired and
10 enhance service based on the insight and experience acquired from such investments. The
11 Company also states that the time and uncertainty involved in the regulatory process has
12 discouraged potential business partners and that such a waiver would not have a material adverse
13 impact on either Southwest or its customers.

14 32. Analysis. Southwest can currently invest up to \$50 million each year without
15 Commission oversight, by increasing or decreasing existing investments in unregulated affiliates.
16 The requested waiver would significantly broaden that latitude by allowing Southwest to invest up
17 to \$50 million per year, without prior Commission approval, in any company, or companies, that it
18 considered energy- or construction-related. If a waiver is approved, Southwest could accumulate
19 successively larger investments in companies over which the Commission has no direct authority
20 and about which the Commission has no information, beyond the fact that Southwest deems them
21 energy- or construction-related.

22 33. Staff does not agree that there is little or no difference between an initial investment
23 and changing the level of an existing investment. Eliminating prior approval for initial
24 investments could eliminate the Commission’s ability to assess the level of risk associated with a
25 specific unregulated entity. Moreover, waiver of prior approval, combined with the Company’s
26 existing ability to invest \$50 million each year, would substantially limit the Commission’s ability
27 to oversee transactions potentially large enough to materially and adversely impact Arizona
28 ratepayers.

1 34. Recommendation. Staff has recommended that Southwest's proposal that it be
2 allowed to obtain up to \$50 million yearly in initial financial investments without prior approval
3 by the Commission not be approved. Southwest still has the ability to file an application with the
4 Commission for approval of initial investments. However, we will approve the establishment of a
5 \$50 million floating bank account which will decrease by the amount of any initial investment by
6 Southwest Gas Corporation and increase by the same amount if the Commission subsequently
7 grants after-the-fact approval or a waiver for that investment.

8 Sale of Subsidiaries

9 35. Southwest has asked for a limited exemption to R14-2-804.B.3, which requires a
10 utility to obtain prior approval for using "utility funds to form a subsidiary or divest itself of any
11 established subsidiary." The Company has asked to be allowed to sell interests in subsidiaries
12 without seeking prior Commission approval (with the exception of subsidiaries selling the gas air
13 conditioning or gas heat pumps, as discussed in Decision No. 73555).

14 36. Rationale. The application states that in selling a subsidiary Southwest "has every
15 interest in maximizing its return on the sale. Further this limited waiver will not negatively impact
16 Southwest Gas' customer service, and there will be no change in the current rates or terms and
17 conditions of service as a result of this exemption."

18 37. Analysis. Waiving this exemption does not benefit ratepayers. Staff believes that
19 such transactions should continue to be subject to prior Commission approval in order to ensure
20 that ratepayer interests have been adequately protected.

21 38. Staff has recommended that there be no waiver of prior Commission approval in
22 cases where Southwest is divesting itself of a subsidiary.

23 Additional Recommendation

24 39. Southwest requested waivers or, in the alternative, that the Commission grant prior
25 approvals. Staff has recommended that the Commission not grant any prior approvals with respect
26 to loans or investments relating to its affiliates, or with respect to sales of its subsidiaries.

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CONCLUSIONS OF LAW

1. Southwest is an Arizona public service corporation within the meaning of Article XV, Section 2, of the Arizona Constitution.
2. The Commission has jurisdiction over Southwest and over the subject matter of the application.
3. The Commission, having reviewed the application and Staff's Memorandum dated May 29, 2013, concludes that it is in the public interest to address the requested limited waivers, as discussed herein, and to not make the requested prior approvals proposed as alternatives to limited waivers.

ORDER

IT IS THEREFORE ORDERED that Southwest Gas Corporation not use utility assets necessary for the provision of service, including customer deposits, as collateral in any affiliate transactions.

IT IS FURTHER ORDERED that access to Southwest Gas Corporation customer data remain confidential from Southwest's unregulated affiliates.

IT IS FURTHER ORDERED that Southwest Gas Corporation's proposed increase to \$80 million in loans or advances to affiliates be approved, but be treated as a total cap.

IT IS FURTHER ORDERED that the \$120 million total cap on loans or advances to affiliates without prior Commission approval not be approved.

IT IS FURTHER ORDERED that Southwest Gas Corporation's proposal to automatically expand eligibility for loans to all current and future affiliates not be approved.

IT IS FURTHER ORDERED that, if Southwest Gas Corporation wishes to expand eligibility for loans, the Company file an application specifying the affiliate or affiliates that it proposes to make eligible and supply information, including the name, business type, and financial condition of each such affiliate, along with the nature of the loans that Southwest Gas Corporation contemplates.

...

...

1 IT IS FURTHER ORDERED that Southwest Gas Corporation's proposal that it be allowed
2 to make up to \$50 million in initial financial investments without prior approval by the
3 Commission is approved, such that a \$50 million floating bank account will decrease by the
4 amount of any initial investment by Southwest Gas Corporation and will increase by that same
5 amount if the Commission subsequently grants after-the-fact approval or a waiver for that
6 investment.

7 IT IS FURTHER ORDERED that any losses arising from investments made by Southwest
8 Gas Corporation using the \$50 million floating bank account be in no way subsidized by
9 ratepayers.

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1 IT IS FURTHER ORDERED that Southwest Gas Corporation's proposal that it be allowed
2 to divest itself of a subsidiary without prior Commission approval is not approved.

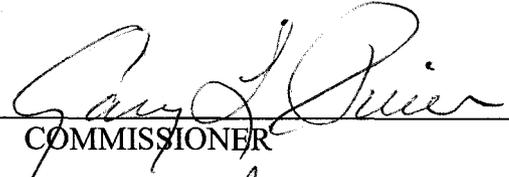
3 IT IS FURTHER ORDERED that no prior approvals with respect to loans or investments
4 relating to Southwest Gas Corporation's affiliates, or with respect to sales of its subsidiaries, are
5 granted.

6 IT IS FURTHER ORDERED that this Order shall take effect immediately.

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BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION

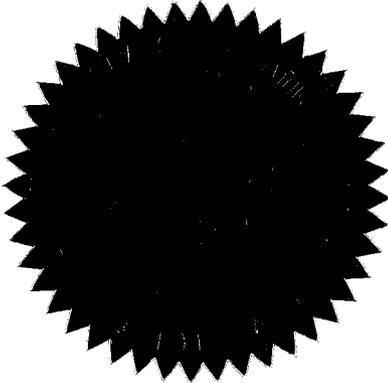

CHAIRMAN


COMMISSIONER


COMMISSIONER


COMMISSIONER


COMMISSIONER



IN WITNESS WHEREOF, I, JODI JERICH, Executive Director of the Arizona Corporation Commission, have hereunto, set my hand and caused the official seal of this Commission to be affixed at the Capitol, in the City of Phoenix, this 27th day of June, 2013.


JODI JERICH
EXECUTIVE DIRECTOR

DISSENT: _____

DISSENT: _____

SMO:JMK:sms\WVC

1 SERVICE LIST FOR SOUTHWEST GAS CORPORATION:
2 DOCKET NO. G-01551A-12-0497

3 Debra S. Gallo
4 Director/Government and State
5 Regulatory Affairs
6 Southwest Gas Corporation
7 P.O. Box 98510
8 Las Vegas, Nevada 89193-8510

9 Jason S. Wilcock
10 Senior Counsel
11 Regulatory Affairs
12 Southwest Gas Corporation
13 P.O. Box 98510
14 Las Vegas, Nevada 89193-8510

15 Mr. Steven M. Olea
16 Director, Utilities Division
17 Arizona Corporation Commission
18 1200 West Washington Street
19 Phoenix, Arizona 85007

20 Ms. Janice M. Alward
21 Chief Counsel, Legal Division
22 Arizona Corporation Commission
23 1200 West Washington Street
24 Phoenix, Arizona 85007

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26
27
28