BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Application of Southwest Gas Corporation for authority to increase its rates and charges for natural gas service for all classes of customers in Southern and Northern Nevada. Docket No. 09-04003

At a general session of the Public Utilities Commission of Nevada, held at its offices on October 28, 2009.

PRESENT: Chairman Sam A. Thompson
Commissioner Jo Ann P. Kelly
Commissioner Rebecca D. Wagner
Assistant Commission Secretary Nancy Krassner

ORDER

The Public Utilities Commission of Nevada ("Commission") makes the following findings of fact and conclusions of law:

I. INTRODUCTION

Southwest Gas Company ("Southwest") filed an Application with the Commission, designated as Docket No. 09-04003, for authority to increase its rates and charges for natural gas service for all classes of customers in southern and northern Nevada.

II. SUMMARY

The Commission grants Southwest’s Application as modified by this Order. The Commission grants a return on equity ("ROE") of 10.15 percent, which reflects the reduction in risk as a result of the Commission’s acceptance of Southwest’s General Revenues Adjustment ("GRA or decoupling") provision. The Commission accepts Southwest’s proposed expected changes for the Southern Nevada Operations Centers, the Boulder Highway steel replacement project, and the postage increase.

III. PROCEDURAL HISTORY

- On April 3, 2009, Southwest filed an Application with the Commission, designated as Docket No. 09-04003, for authority to increase its rates and charges for natural gas service for all classes of customers in Southern and Northern Nevada.
- The Application is filed pursuant to the Nevada Revised Statutes ("NRS") and the Nevada Administrative Code ("NAC") Chapters 703 and 704, including but not limited to NRS

1 The general revenue adjustment is also referred to as “decoupling” in this Order.
704.110 and 704.992; and the regulations approved in LCB File No. R095-08 and LCB File Nos. T004-08 and T005-08.

- The Regulatory Operations Staff ("Staff") of the Commission participates as a matter of right pursuant to NRS 703.301.
- On April 15, 2009, the Commission issued a Notice of Application by Gas Company to Increase Rates and Charges for Natural Gas Service and Notice of Prehearing Conference.
- On April 15, 2009, the Office of the Attorney General’s Bureau of Consumer Protection ("BCP") filed a Notice of Intent to Intervene pursuant to NRS 228.360.
- On May 8, 2009, Nevada Cogeneration Associates #1 and #2, Limited Partnerships, ("NV Cogen") filed a Petition for Leave to Intervene ("PLTI").
- On May 18, 2009, the Commission held a prehearing conference.
- On May 29, 2009, the Commission issued a Notice of Consumer Sessions.
- On May 29, 2009, the Commission issued a Notice of Hearing.
- On May 29, 2009, the Commission issued Procedural Order No. 1.
- On May 29, 2009, the Commission issued an order granting NV Cogen’s PLTI.
- On July 6, 2009, Southwest filed direct testimony updating its expected change in circumstance data pursuant to the temporary regulation in LCB File No. T005-08.
- On July 10, 2009, Southwest filed its certification.
- On July 16, the Commission held a consumer session.
- On July 27, 2009, the Commission held a second consumer session.
- On August 4, 2009, Staff and BCP filed direct testimony regarding the cost of capital.
- On August 5, 2009, Southwest filed Errata to its Application.
- On August 11, 2009, Staff and BCP filed direct testimony regarding revenue requirement.
- On August 17, 2009, Southwest filed rebuttal testimony regarding cost of capital.
- On August 18, 2009, BCP and Staff filed direct testimony regarding rate design.
- On August 24, 2009, Southwest filed rebuttal testimony regarding revenue requirement.
- On August 25, 2009, Southwest filed a Motion to Strike Direct Testimony of BCP Witness David Effron. On August 28, 2009, BCP filed a response. On September 1, 2009, Southwest filed a reply. On September 9, 2009, the Commission issued an Order on Motion to Strike, granting Southwest’s Motion to Strike.
- On August 31, 2009, Southwest filed rebuttal testimony regarding rate design.
- On September 4, 2009, NV Cogen filed a Motion to be Excused from Hearing. No party objected to NV Cogen’s request. On September 28, 2009, the Commission issued an Order granting NV Cogen’s request.
- From September 8, 2009 through September 11, 2009, the Commission held a hearing at which Southwest, Staff, and BCP participated. Ninety-three exhibits were accepted into evidence.
- On September 25, 2009, Staff, BCP, NV Cogen, and Southwest filed their respective legal briefs.
IV. COST OF CAPITAL

a. Capital Structure

Southwest’s Position

1. Southwest proposed a capital structure comprised of 48.91 percent total debt, 4.0 percent preferred equity, and 47.09 percent common equity as of the certification period ended April 30, 2009. The total debt portion includes the weighted cost of long and short term debt and customer deposits. (Exhibit 14 at 2; Exhibit 2 at Schedule F.)

Staff’s Position

2. Staff supported Southwest’s proposed capital structure as of the certification period ended April 30, 2009. (Tr. at 119.)

BCP’s Position

3. BCP supported Southwest’s proposed capital structure as of the certification period ended April 30, 2009. (Exhibit 17 at 56; Tr. at 86.)

Commission Discussion and Findings

4. Staff and BCP supported Southwest’s proposed capital structure as of the certification period ended April 30, 2009. The Commission agrees it is reasonable. Therefore, the Commission finds that the capital structure comprised of 48.91 percent total debt, 4.0 percent preferred equity, and 47.09 percent common equity as of April 30, 2009, is accepted.

b. Cost of Debt

Southwest’s Position

5. Southwest proposed a cost of debt of 4.68 percent and 6.52 percent for the southern and northern Nevada divisions, respectively, as of the certification period ended April
30, 2009. The proposed cost of debt included a customer deposit rate of 0.43 percent. (Exhibit 14 at 2; Exhibit 2 at Schedule F.)

**Staff’s Position**

6. Staff supported Southwest’s cost of debt with the exception of the customer deposit rate. (Tr. at 119.) Staff proposed using a customer deposit rate of 0.29 percent based on the June 5, 2009, change of rate required by statute. (Exhibit 22 at 2, 34.)

**BCP’s Position**

7. BCP supported Southwest’s proposed cost of debt. (Exhibit 17 at 56.)

**Southwest’s Rebuttal**

8. Southwest argued that Staff’s recommended customer deposit rate of 0.29 percent is beyond the certification period ended April 30, 2009, and should not be used. (Exhibit 26 at 7.)

**Commission Discussion and Findings**

9. The Commission agrees with Southwest and BCP that the cost of debt, including customer deposits, as of the certification period ended April 30, 2009, is reasonable. Therefore, the Commission finds that the cost of debt of 4.68 percent and 6.52 (including a customer deposit rate of 0.43 percent) for the southern and northern Nevada divisions, respectively, is accepted. The Commission rejects Staff’s proposal of a customer deposit rate of 0.29 percent as it is beyond the certification period. The Commission finds that the customer deposit rate should be based on the rate that was in effect at the time of certification.

c. **ROE**

**Southwest’s Position**
10. Southwest requested an increase of its current ROE from 10.5 percent to 11.5 percent. (Exhibit 12 at 2.) Southwest's evaluation relied in part upon the market data of a proxy group of eight similar risk local distribution facilities ("LDCs"). Southwest argued that it is more risky than the average gas LDC as evidenced by its bottom of investment grade bond rating by the two major bond rating agencies. By contrast, the average bond rating of the proxy group of eight LDCs was Moody's A3 and Standard & Poor's A, or one full and one and one-third rating gradations higher than Southwest's ratings. Southwest argued that adjustments were necessary in order for the proxy group's cost rates to be applicable. (Exhibit 12 at 3-4.)

11. Southwest testified that its substandard achieved ROEs have been the result of its rapid growth and related capital expenditures combined with the loss of net income attributable to declining per customer usage exacerbated by warmer than normal weather. Consequently, Southwest was not able to achieve the anticipated operating margins. (Exhibit 12 at 3-5.)

12. Southwest utilized the Discounted Cash Flow Model ("DCF"), the Risk Premium Model ("RPM"), the Capital Asset Pricing Model ("CAPM") and the Comparable Earnings Model ("CEM") to arrive at its recommended ROE. Southwest stated that due to extreme high-side outliers, it placed no reliance on its CEM analyses. (Exhibit 12 at 5.)

13. Southwest acknowledged that its balance sheet has improved since its last general rate case. (Tr. at 78.) Southwest testified that while rating agencies are concerned about regulatory lag, they look favorably upon mechanisms which reduce regulatory lag, such as the hybrid test year and quarterly Base Tariff Energy Rate ("BTER") updates. (Tr. at 79.)

14. Southwest testified that its capital expenditures for the most recent year were approximately $258 million. (Tr. at 80.) Southwest stated that it expected capital expenditures of $720 million over the next three years in its report to the Securities and Exchange Commission.
Southwest could not identify how much of this would be made in Nevada, but assumed that it was in the range of 35 percent to 36 percent. (Tr. at 80-81.) Southwest stated that it did not breakdown these budgets between new customer growth and exiting customers. (Tr. at 82.) Southwest testified that the expected growth rate is 1 percent this year and next year for all of its jurisdictions, but did not know what the growth rate was in Nevada. (Tr. at 82-83.)

**Staff's Position**

15. Staff proposed an ROE range of between 9.50 percent and 10.50 percent with a mid-point of 10.0 percent. Staff's proposed 10.0 percent ROE reflects both the GRA provision proposed by Southwest and its capital structure. Staff argued that Southwest is only slightly more leveraged than the utility-industry average which makes Southwest's risk similar to the industry average risk levels. (Exhibit 22 at 38).

16. Staff utilized six models to compute a range of ROEs based on data through the end of the second quarter of 2009. The six models include: two DCF models, capital appreciation-plus-income ("CA+I"), Value Line Blume-adjusted CAPM, Decile-size Empirical CAPM, and Fama-French 3-Factor. The average of the six models was 10.09 percent. These computations include any cost of capital premium appropriate to Southwest's financial condition and its business risks relative to those for the utility universe. (Exhibit 22 at 5, 38.)

17. Staff identified several shortcomings in Southwest’s ROE analyses including the reliance on a proxy group of only eight firms. Staff argued that this proxy group is too small of a sample and can introduce sampling error and make the results unreliable. (Exhibit 22 at 36-37.)

**BCP's Position**

18. BCP argued that Southwest's proposed 11.4 percent ROE is an overstatement of the required ROE to hold and attract equity capital and fails to reflect the enhanced financial
metrics and risk shifting that results from the hybrid test year and risk reduction associated with
the proposed GRA. (Exhibit 17 at 5.) BCP contended that Southwest's required ROE is in the
range of 9.5 percent to 10.3 percent, and a midpoint estimate of 10.0 percent is reasonable.
(Exhibit 17 at 5.)

19. BCP argued that a 10.0 percent ROE was sufficient to ensure its financial metrics
and to improve its overall bond ratings. BCP testified that the financial metrics that bond rating
agencies consider in evaluating risk include cash flow coverage of interest, cash flow as a
percentage of debt, and debt leverage ratio. (Exhibit 17 at 58.)

20. BCP employed the DCF methodology for estimating the cost of equity, based on
the general premise that any utility's cost of equity capital is the risk free return plus the premium
required by investors for accepting the risk of investing in an equity instrument of the utility.
BCP stated that the DCF is the best analytical technique for measuring a utility's cost of common
equity. (Exhibit 17 at 28.)

21. BCP applied the DCF method employing market data, as well as forecasted data
of financial parameters, for the comparable group of gas utility companies. The comparable
group of utility companies used in BCP's analysis came from the same group of companies used
by Southwest. (Exhibit 17 at 34.)

22. The relevant range of results for the comparable group is 9.5 percent to 10.5
percent with a midpoint estimate of 10.0 percent. The relevant range for Southwest is 9.7 percent
to 10.5 percent with a midpoint estimate of 10.1 percent. BCP concluded that an ROE estimate
of 10.0 percent was a reasonable estimate of Southwest's equity costs. (Exhibit 17 at 5.)

23. While BCP generally agreed with Southwest's DCF analyses, it recommended
that Southwest's RPM analysis should not be relied on because Southwest used outdated data,
relied on estimated annual market returns of 28.85 percent per annum, and mixed and matched risk premiums based on bond ratings. BCP argued that Southwest’s risk premium measures are substantially overstated, and the overall analysis should not be a basis for establishing an ROE in this case. (Exhibit 17 at 64-65.)

24. BCP argued that Southwest’s CAPM analyses suffered from the same flaws as the RPM analyses and should not be used. (Exhibit 17 at 66.)

Southwest’s Rebuttal Position

25. Southwest updated its ROE recommendation to 10.9 percent noting that nearly six months had elapsed since the testimony was prepared and significant changes in the capital markets had taken place. (Exhibit 25 at 3.)

26. Southwest noted the following key issues of concern regarding the recommendations by Staff and BCP: (1) how the recommended ROE and the resulting overall ROR will impact the Southwest’s ability to maintain or improve its existing credit ratings; and, (2) Southwest’s ability to continue to attract capital on a reasonable basis. (Exhibit 26 at 4.)

27. Southwest testified that in considering the recommendations of Staff and BCP, it is important to recognize that Southwest competes in global financial markets for capital. From a capital attraction basis, the ROE should be compared to those of the proxy group to assess their reasonableness. (Exhibit 26 at 5.) Recognizing that the investment risk associated with Southwest is higher than the average investment risk of the proxy group companies, approving an authorized ROE below the level expected for other natural gas utilities, as recommended by the BCP and Staff, would place Southwest at a competitive disadvantage in terms of attracting capital. (Exhibit 26 at 6.)
28. Southwest argued that there are flaws associated with certain analyses of both Staff and BCP. (Exhibit 25 at 4-5.)

**Commission Discussion and Findings**

29. The recommendations of the experts in the proceeding established a range of options for the Commission to utilize in determining an appropriate ROE. Each party identified certain methodological and analytic issues and shortcomings. The Commission acknowledges that while the derivation of the ROE relies on established methodologies, the practical application of these methods requires professional judgment be exercised by the analyst. Such criticisms are common in these proceedings and that is why the Commission uses these analyses to establish a range for an ROE. The evidence in the record supports a range of ROEs including 10.0 percent (BCP), 10.2 percent (Staff) and 10.9 percent (Southwest). Based on the range of ROEs developed by cost of capital experts, the Commission finds that an ROE of 10.4 is reasonable and will allow Southwest to continue to achieve comparable earnings, maintain and improve its financial integrity, and attract capital.

30. In considering the range of recommended ROEs it is important to consider the financial position of Southwest. Southwest has improved its financial position since its last general rate case evidenced by an upgraded outlook and rating. Further, Southwest enjoys a positive cash flow, improved common equity ratios and reduced leverage.

31. In addition to Southwest’s financial position, the supportive regulatory environment has helped reduce Southwest’s risk and has helped improve cash flows. In its last general rate case, the Commission authorized the use of a hypothetical capital structure allowing a higher overall rate of return than would have been allowed with Southwest’s actual capital structure. Additionally, the Nevada Legislature allowed for the implementation of the quarterly BTER update and a hybrid test year that improve utility cash flows, which is generally viewed
positively by rating agencies. The Commission agrees with Staff and BCP that these mechanisms help reduce Southwest’s risk and support a reduction in the ROE from 10.5 percent to 10.4 percent.

d. Revenue Decoupling Risk Adjustment

Southwest’s Position

32. Southwest proposed a decoupling mechanism or GRA in order to decouple its general revenues pursuant to the regulations adopted by the Commission in Docket No. 07-06046 (LCB File No. T004-08). (Exhibit 9 at 2.) Southwest acknowledged that revenue stabilization mechanisms, such as decoupling, reduce risk and proposed a minimal reduction of 10 basis points to the ROE. (Exhibit 12 at 55-56.)

33. Southwest testified that a decoupling mechanism is one that removes the link between a gas distribution company’s non-gas revenues and its sales volumes. By removing the link between sales and revenues, a decoupling mechanism makes the utility indifferent to the level of sales of its costumers, thereby removing the utility’s disincentive to promote efficiency and conservation. (Exhibit 9 at 3-4.)

34. Southwest provided the results of a survey of 26 gas decoupling programs and how regulatory agencies have treated ROE in the context of reduced risk. Southwest stated that decoupling mechanisms vary throughout the country but the analysis assumed that they were similar enough to provide a reasonable comparison between utilities that have a significant increase in the degree of revenue stability and utilities that do not. (Tr. at 58.) Of the 26 utilities, 17 utilities made no explicit acceptance or rejection of an ROE reduction. Every state commission that has considered the risk implications of revenue decoupling concluded that
decoupling reduces risk. ROE reductions that have accompanied decoupling range from 0 basis points to 25 basis points with a simple average reduction of 12.5 basis points. (Exhibit 9 at 4-5.)

35. Southwest acknowledged that the survey did not distinguish between a decoupling mechanism created by legislation or by regulation, nor did the survey compare the legislative language in each jurisdiction. (Tr. at 48-50.)

36. Southwest argued that in terms of setting the ROE within the context of decoupling, the most effective way to address this issue is through the proxy group used for the ROE estimates. This provides an example of the returns awarded other comparable gas utilities that have decoupling mechanisms. This is the market-based effect of these mechanisms. (Tr. at 40 and 50.)

37. Southwest acknowledged that while decoupling does reduce risk, there is no way to empirically quantify its effect. Southwest concluded that 25 basis points would be the maximum benefit. Southwest testified that the Nevada jurisdiction constitutes 35 percent of its operating margin. By taking 25 basis points (under the assumption that the maximum value of decoupling is 25 basis points) and multiplying it by 35 percent, the result is 8.75 basis points. This forms the basis of Southwest’s proposal of a reduction of ROE by 10 basis points.

38. Southwest noted that decoupling mechanisms have become more prevalent in recent years and as a consequence the impact of risk reduction is already accounted for in the market prices paid for common stock. Southwest argued that in the proxy group used for determining the ROE, the majority of the LDCs have weather or conservation mitigation measures. As a result, a reduction of 10 basis points is reasonable. (Exhibit 12 at 55-56.)

Staff's Position
39. Staff testified that the ROE reduction for decoupling and rate design benefits is at least 20 basis points and no more than 70 basis points. (Exhibit 22 at 33.) Staff stated that its recommended ROE would be 10.0 percent with decoupling and 10.20 percent without. (Exhibit 22 at 38.) Staff utilized two methodologies to estimate an ROE risk reduction due to decoupling. The low end was based on the return for all utilities. The high end was based on gas utilities, all of which all had some level of revenue variability mitigation. (Tr. at 126).

40. Staff argued that Southwest focused on the regulatory responses to such decoupling proposals in rate cases. This effort is plagued by the fact that rate orders simultaneously address many issues that impact the market-required ROE. Consequently identifying the effects of adopting a decoupling mechanism is a challenge. (Exhibit 22 at 28.)

41. Staff testified that there is an error in the approach used by Southwest that seeks to ratio downward any ROE decrement to its allowed ROE in Nevada based on a 35 percent operating margin. Staff contends that the Commission is not determining Southwest's overall allowed ROE, but is merely setting it for Nevada jurisdictional use. For that purpose, it should be given full effect as reflected in market data and ROE models. (Exhibit 22 at 29.)

BCP’s Position

42. BPC argued that Southwest failed to properly address the risk impact of revenue decoupling. (Exhibit 17 at 10.) Southwest’s entire margin for the residential, and small, medium and large customers is guaranteed recovery under the GRA proposal. (Exhibit 17 at 11.) The risk associated with weather, declining usage and customer growth has been shifted from shareholders to customers. (Exhibit 17 at 24.)

43. BCP recommended a 50 basis point reduction in the ROE. The impact of a 50 basis point reduction to the ROE is about $2,867,194 and $342,886 for the Southern Nevada and
Northern Nevada jurisdictions. In return, customers are assuring all volumetric revenue subject to the GRA will be recovered by Southwest. The revenues involved exceed $100 million per annum. A 50 basis point equity return adjustment is reasonable in that such adjustment represents less than three percent of the revenue stream being guaranteed by customers. (Exhibit 17 at 15-16.)

44. BPC argued that while the companies included in the proxy group have some form of revenue stabilization, some of these companies have weather normalization adjustments and others have mechanisms that attempt to capture investment between rate cases. (Tr. at 102.) BCP argued that there was a difference between adjusting for weather and complete revenue decoupling. (Tr. at 112.) BCP’s proposed adjustment of 50 basis points did not represent the difference in ROE between firms that are fully decoupled to firms that are not fully decoupled. (Tr. at 103.)

Southwest’s Rebuttal Position

45. Southwest argued that BCP and Staff erred in their conclusions of the extent to which approval of the GRA provision would reduce the common equity cost rate. (Exhibit 24 at 2.)

46. Southwest contended that BCP is laboring under the misconception that every reduction in utility risk is matched by an equivalent increase in ratepayer risk. The argument that decoupling shifts risk from the utility to its ratepayers is often used in an attempt to justify large reductions in the utility’s allowed ROE. (Exhibit 24 at 2-3.)

47. Southwest argued that Staff’s approach does not provide any evidence to support the use of a comparison of an all-utility ROE to a gas-only ROE as an indication of the change in
Southwest’s ROE following the adoption of decoupling. Virtually all of the natural gas companies in Staff’s sample have some form of revenue stabilization. (Exhibit 24 at 12.)

48. Southwest explained that the survey of explicit ROE adjustments was intended to provide guidance regarding the size of the adjustments that have been used in other jurisdictions. This research produced estimates of ROE adjustments that ranged from 0 to 25 basis points. The correct method of accounting for the effects of decoupling on ROE is to employ a proxy group of utilities that have decoupling or equivalent mechanisms. (Exhibit 24 at 8.)

Commission Discussion and Findings

49. In light of the Commission’s acceptance of Southwest’s request for revenue decoupling, it is necessary to adjust the ROE to reflect the reduction of risk. While all parties agree that a reduction in the ROE is warranted due to revenue decoupling, each party proposed adjustments that included reductions of 10 basis points (Southwest), 20 basis points (Staff) and a range of 25 to 50 basis points (BCP). The central issue is to what extent, if any, should Southwest’s ROE be adjusted to reflect lower risk due to decoupling. In considering the risk adjustment issue, the focus should be on the plain language of the NRS 704.992 and which methodology/reasoning most closely approaches implementing the plain language of the statute. In relevant part, NRS 704.992 reads:

The regulations adopted…. must ensure that the methods and programs consider the recovery of costs, stabilization of revenue and any reduction of risk for the public utility which purchases natural gas for resale.

50. Southwest’s proposed ROE reduction was based, in part, on its survey of 26 utilities which indicated that 17 ROE findings did not consider an ROE adjustment for decoupling. Southwest’s framework of analysis was problematic because the practices in other states do not inform the Commission as to the meaning and interpretation of the statute in this
jurisdiction. Southwest was unable to distinguish between Nevada’s decoupling mechanism and that of other states.

51. Southwest argued that no further adjustment was needed to reflect risk reduction because it is already reflected in its proxy group. Southwest’s position assumes that all decoupling mechanisms are equal and as BCP noted they are not. BCP contended that the decoupling mechanism authorized by the Nevada Legislature and implemented by the Commission brings a high level of stability to Southwest compared to other decoupling programs. The Commission agrees with BCP and finds that an explicit adjustment is necessary to capture the reduction of risk as a result of the implementation of the GRA provision.

52. The Commission agrees with Staff that Southwest’s proposed 10 basis point reduction to the ROE based on Nevada’s jurisdictional contribution to its revenues is flawed. The Commission is establishing the ROE for Southwest’s Nevada jurisdiction and not for the entire company. An adjustment of 25 basis points is within the ranges proposed by both Staff and BCP. The Commission finds that a 25 basis point reduction is adequate to maintain Southwest’s financial viability and is sufficient to allow it to raise the capital necessary to provided adequate, safe and reliable service.

V. REVENUE REQUIREMENT

a. Southwest’s Corporate Office as “Business Office”

Southwest’s Position

53. Southwest did not address this issue in its direct testimony.

Staff’s Position
54. Staff argued that Southwest’s corporate office qualifies as a de facto “business office” as that term is defined by NAC 703.017 because it contains a payment drop box and a telephone that allows customers to contact customer service. Staff argued that the Commission should therefore require Southwest to post a notice of its Application at its corporate offices. (Exhibit 54 at 1.) Staff stated that Southwest maintained a copy of its Application at its corporate offices, but did not post a copy of the notice of the Application at its corporate offices as required by NAC 703.2481(1)(b). (Exhibit 54 at 3.)

Southwest’s Rebuttal Position

55. Southwest disagreed that its corporate office is a “business office” as defined by NAC 703.017, but did not oppose posting a notice of its Application there. (Exhibit 62 at 2.) Southwest pointed out that its corporate office does not have a customer service personnel presence. Rather, customers are directed to visit Southwest’s public offices. The payment drop box is only maintained for customers’ convenience. (Exhibit 62 at 2-3.)

Commission Discussion and Findings

56. The Commission finds that Southwest’s corporate business office should not be deemed a business office pursuant to NAC 703.017. Although the Commission concurs with Staff and Southwest that the posting of a notice of a general rate application at the corporate office might be beneficial to Southwest’s customers, maintenance of a payment box solely for customer convenience is not sufficient to qualify the corporate office as a business office. Southwest does not maintain a customer service presence there and directs customers with questions to its business offices for service.

b. Deferred Debit and Credit Rate Base Error

2 NAC 703.017 defines a business office as “[a]ny office of a public utility which is frequented by and regularly opened to the public but not a bank or other agent authorized by the utility to accept, for the convenience of a customer, the payment of a bill of charges.”
Southwest’s Position

57. Southwest did not address this issue in its direct testimony.

Staff’s Position

58. Staff recommended that the Commission adjust Southwest’s northern Nevada other deferred debit and credit rate base amount to correct a mathematical error. (Exhibit 53 at 2, 12-13.) Southwest inadvertently reported the injury and damages reserve account incorrectly as an increase rather than a reduction to rate base, and the debt balance in the other accrued liabilities account as a reduction rather than an increase to rate base. Correcting the error would increase Southwest’s Northern Nevada rate base by $322,720. (Exhibit 53 at 12, Attachment KEL-7.)

Southwest’s Rebuttal Position

59. Southwest concurred with Staff’s recommendation. (Exhibit 74 at 22-23.)

Commission Discussion and Findings

60. The Commission finds that Staff’s recommended adjustment should be implemented to correct the mathematical error. Southwest and Staff agreed that the error existed and should be corrected.

c. Transportation Service

Southwest’s Position

61. Southwest requested authority to modify the pertinent sales tariffs to allow deviation on a case-by-case basis from the requirement that a customer converting from transportation service to sales service must make an annual three-year commitment to sales service. (Exhibit 48 at 18.) Southwest’s transportation service tariff allows a customer to convert to sales service on November 1st if notice is provided by April 1st of the same year. (Exhibit 1 at Proposed Tariff Sheets Vol.1, Exhibit 1, PUCN Sheet No. 54.)
Staff's Position

62. Staff recommended the Commission deny Southwest's requested tariff modification for transportation customers converting to sales service. Instead, Staff recommended the Commission institute two other tariff changes for sales customers converting to transportation service. (Exhibit 57 at 7-9.) Because Southwest's natural gas procurement plan covers an 18-month period, Staff recommended implementing an 18-month noticing requirement prior to a sales customer's conversion to transportation service. (Exhibit 57 at 8-9.) Staff also recommended implementing an exit fee for sales customers converting to transportation service. Staff reasoned that because Southwest procures interstate transportation capacity using a 10-year planning horizon some costs may be left behind. (Exhibit 57 at 7-8.)

Southwest's Rebuttal Position

63. Southwest agreed with Staff's recommendations with the exception that an exit fee should only be assessed when a sales customer moves to transportation service if the change in service occurs outside the parameters described in the tariff. The exit fee should only be assessed to the extent costs are incurred as a result of the change in service. (Exhibit 62 at 9.)

Commission Discussion and Findings

64. The Commission finds that Southwest should retain the requirement that a transportation customer converting to sales service must annually make a three-year commitment to sales service. The Commission finds that prior to converting to transportation service a sales customer should be required to provide 18-months notice, and sales customers converting to transportation service should pay an exit fee only to the extent that their change in service takes place outside of the parameters proposed by Staff, and only to the extent that Southwest finds that
there are costs associated with the change of service. These aspects of the tariff should avoid unfair cost shifting when customers change service.

d. **Southwest’s Energy Efficient Technology Department Expenses**

**Southwest’s Position**

65. Southwest did not address this issue in its direct testimony.

**Staff’s Position**

66. Staff recommended that the Commission adjust Southwest’s proposed GRA provision to include the revenues earned by Southwest on end-use products it has developed. (Exhibit 60 at 2, 25.) Staff stated that the test period in the current docket includes the costs associated with the Energy Efficiency Technology Department (“EETD”), which was created in 2005. (Exhibit 60 at 26, Attachment JG-17.2 p.1) The test period also includes fees paid to Cascade and Associates, which was instrumental in obtaining $9 million of federal funding for Southwest’s EETD. (Exhibit 60 at 26, Attachment JG-17.3).

67. Alternatively, Staff recommended removing internal research and development (“R&D”) costs and revenues³ from ratemaking because Southwest’s competitive ventures should be separated from its monopoly services to prevent cross-subsidization of competitive products by utility customers. (Exhibit 60 at 27.) Staff referenced statements made by Southwest regarding the function of the EETD and its role in development of products that are commercially viable. (Exhibit 60 at Attachment JG-17.4 p.1.)

**Southwest’s Rebuttal Position**

68. Southwest argued that funding the EETD is akin to Southwest’s membership in the Utilization Technology Development Program (“UTDP”), the purpose of which is to pursue energy efficiency research and development and demonstration. Southwest argued that its

³ At this time, there are no revenues. (Exhibit 61 at 6; Tr. at 697.)
membership in UTDP was supported by Staff. (Exhibit 61 at 2.) Southwest argued that its EETD will allow customers to take advantage of products that are specifically designed for use in desert conditions. (Exhibit 61 at 3.) Southwest argued that customers benefit from the results of the EETD’s research, development and demonstration in many ways. Southwest’s explanation focused mainly on increased efficiency due to using natural gas rather than electricity. (Exhibit 61 at 2-3.)

69. Southwest stated that exactly how the EETD’s function will be incorporated into the Energy Efficiency and Conservation Plan is unclear at this time. (Tr. at 608.)

Commission Discussion and Findings

70. The Commission finds that Staff’s GRA provision recommendation should be denied because it would violate LCB File No. T004-08 by including non-sales related revenues in the GRA provision process, which was designed to recover only sales-related revenues. While decoupling addresses the risk associated with variances in sales-related revenues, the utility bears the risk associated with any variance between non-sales revenues received and non-sales revenues included in the development of general rates, as well as any expense variances.

71. The Commission finds that Staff’s alternative recommendation, that Southwest’s EETD costs should be removed from the cost of service, should be granted. Ratepayers generally should not subsidize the competitive activities of a regulated monopoly. Southwest demonstrated that the EETD’s research efforts are directed at developing competitive products that do not fit the Commission’s definition of energy efficiency pursuant to NAC Chapter 704 as modified by LCB File No. R095-08, Section 3, because they are not directed at the end result of a reduction in the use of natural gas. Additionally, Southwest was not able to provide

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4 LCB File No. T004-08 at Section 8.3 calculates the revenue that will be collected pursuant to the GRA process by comparing the actual per customer general rate revenue to that authorized to be collected in general rates.
information regarding how EETD activities might dovetail with the Conservation and Energy Efficiency Plan.

e. Management Incentive Program ("MIP") and Restricted Stock/Unit Plan ("RSUP")

Southwest’s Position

72. Southwest requested recovery of expenses associated with its MIP, a variable at-risk incentive plan available to officers and key management employees. The MIP award is based upon four performance measures: ROE; customer-to-employee ratio; customer satisfaction; and operating costs. The MIP is paid 40 percent in cash and 60 percent in performance shares that vest three years in the future. Southwest argued that the future vesting of the performance shares acts as a retention tool and helps align the interests of management, shareholders, and customers. (Exhibit 31 at 3-4.)

73. Southwest requested recovery of 100 percent of the costs associated with the RSUP, a stock incentive-based plan that is designed to enhance the competitiveness of the total compensation package and encourage management ownership of Southwest stock. The RSUP award is determined by the three-year average MIP award. (Exhibit 31 at 6.)

Staff’s Position

74. Staff recommended that the Commission disallow 50 percent of the MIP costs because it is not a balanced tool to incent management. Staff argued that this type of incentive plan does not encourage management to consider customers’ interests on an equal basis with shareholders’ and management’s interests. (Exhibit 60 at 10.) Staff argued that the MIP will no longer benefit both customers’ and company interests because the new decoupling mechanism proposed in this case will reduce the “at-risk” aspect of the plan. (Exhibit 60 at 11-13.) Staff argued that, of the four metrics used to determine the MIP award, the decoupling mechanism
impairs management incentives from a ratepayer perspective for two of the metrics: ROE and operating costs. Therefore, the proposed adjustment transfers the responsibility for these two metrics to shareholders. (Exhibit 60 at 12-14; Tr. at 553-556.)

75. Staff noted that Southwest’s MIP expense was at a historically high level during the test year. (Exhibit 60 at 12.)

**BCP’s Position**

76. BCP recommended the disallowance of 50 percent of short-term incentives and all long-term incentives, approximately 80 percent of the MIP in total. (Tr. at 376-378.) BCP argued that these types of incentive awards are based upon measures that are tied to corporate performance, which is largely financial and should be borne by shareholders. (Exhibit 51 at 3.)

**Southwest’s Rebuttal Position**

77. Southwest argued that it complied with the Commission’s direction regarding MIP in Docket Nos. 93-3003, 93-3004, 93-1076, and 91-5055, and explained how the MIP is designed to comply with that direction. (Exhibit 67 at 8-9; Exhibit 64 at 11-12.) Specifically regarding decoupling, Southwest argued that the proposed mechanism would have no impact on its expenses. Southwest pointed out that the ROE metric is based upon a weighted measure of all of Southwest’s authorized ROEs, of which Nevada represents only one-third. (Exhibit 67 at 13-14.)

78. Southwest stated that MIP costs were 5.5 percent greater in the test year than the previous year, and 6.0 percent higher than in 2004. (Exhibit 67 at 13.)

79. Southwest argued that the RSUP encourages management to focus on the long term success of the utility, which benefits both ratepayers and shareholders. (Exhibit 67 at 20.)

**Commission Discussion and Findings**
80. The Commission finds that Southwest should be denied recovery of 10 percent of the expenses associated with MIP. The Commission agrees with the general premise underlying the arguments of Staff and BCP. An incentive pay package should only be included in customers' rates if it incent utility employees to improve service delivery at reasonable rates. To the extent that it incent decisions weighted to enhance management or shareholder's interests over those of its customers, the costs should not be included in rates. Southwest adequately explained how its MIP was designed to encompass all four of the factors designated by the Commission, and demonstrated that the MIP has been effective in balancing the interests of ratepayers and shareholders. However, the regulatory context in which the MIP was conceived has changed. In particular, the Commission agrees with Staff that the operation of the decoupling mechanism now impairs the effectiveness of the ROE metric from a ratepayer perspective. The Commission is disallowing 10 percent rather than Staff's proposed 25 percent because the ROE metric is based upon the total company, of which Nevada is only a fraction. The Commission declines to find that any other metric underlying the MIP is impaired.

81. The Commission finds that Southwest’s MIP expenses should be normalized (prior to the calculation of the 10 percent disallowance). Southwest did not explain why MIP costs increased by 5.5 percent in the test year, after increasing only 0.5 percent over the three previous years. To allow recovery of costs that are the result of an unexplained anomaly would result in unjust and unreasonable rates.

82. The Commission finds that Southwest should be denied recovery of 10 percent of the expenses associated with RSUP for the same reasons listed above regarding MIP, because the RSUP award is determined based upon the three-year average MIP award. It is thus affected by the same rationale regarding the effect of decoupling on the ROE metric.
f. Supplemental Executive Retirement Plan ("SERP") and Executive Deferred Compensation Plan ("EDP")

Southwest’s Position

83. Southwest requested recovery of costs related to SERP in rates. Southwest explained that executives participate in SERP because the Internal Revenue Service ("IRS") places a limit on the amount of annual compensation that can be considered in determining benefits under the basic plan. (Exhibit 31 at 10.) SERP is an unqualified plan; participants are not guaranteed payments as they are considered general creditors of the corporation. (Exhibit 31 at 11.) Southwest stated that this type of benefit is common in the utility industry, and Southwest is structured similarly to benefits provided by similarly situated companies. (Exhibit 30 at 2.)

84. Southwest requested recovery of costs related to EDP in rates. Southwest explained that EDP is offered to executives at the vice president level and above, and is also an unqualified plan. Southwest stated that executives may defer up to 100 percent of their annual compensation and cash incentive awards. (Exhibit 31 at 11-12.) Southwest stated that some form of deferred compensation is common in the utility industry, and that Southwest’s EDP is in line with contemporary professional practices and standards. (Exhibit 31 at 11-12; Exhibit 30 at 7-8.)

Staff’s Position

85. Staff argued that, pursuant to NAC 703.2451(2), Southwest has failed to provide required new evidence in the form of relevant facts and policy regarding SERP and EDP benefits. Staff argued that the Commission should therefore disallow SERP and EDP benefits costs.
86. Staff argued that Southwest’s justification is based solely on comparisons with what other companies in its peer group pay their executives and that is not, in and of itself justification. (Exhibit 60 at 8-9.)

**BCP’s Position**

87. BCP argued that the Commission should disallow costs of SERP and EDP because Southwest has not provided any new information to substantiate the inclusion of SERP and EDP. BCP argued that Southwest provided testimony in this docket similar to that provided in its previous dockets in which these costs were disallowed. (Exhibit 39 at 11-12.)

**Southwest’s Rebuttal Position**

88. Southwest argued that as compensation components become common within the industry, they become necessary to attract and retain executives. Southwest argued that it did provide additional evidence in the form of the compensation study and testimony regarding the study. Southwest argued that the information it provided demonstrated that SERP and EDP are standard and customary business expenses in the industry. (Exhibit 67 at 4-5.)

89. Southwest argued that SERP and EDP do not provide benefits beyond those provided to other employees of Southwest, but rather work to compensate them equivalently given the IRS’s restrictions. Southwest stated that while officers are allowed to defer 100 percent of their cash compensation, the deferred amounts are not included in the calculation of pension entitlement. (Exhibit 67 at 5-6.)

90. Southwest argued that its philosophy is to target its compensation at the 50th percentile, and thus offering benefits such as SERP and EDP is more critical. Southwest argued that with all benefits included, its executives are paid below the median for the market. (Exhibit 67 at 7; Exhibit 64 at 13-14.)
Commission Discussion and Findings

91. The Commission finds that Southwest should recover 100 percent of the costs of SERP and EDP. While Staff argued that more information was necessary, Staff did not identify the additional information it was seeking. Southwest did provide new evidence in the form of a compensation study, although its argument regarding why these costs should be included remained essentially unchanged. The Commission has inadequate evidence to conclude that the study is so fundamentally flawed that it should be completely disregarded. Even if slightly skewed, the study indicates that Southwest’s overall compensation is reasonable, and that SERP and EDP are standard components of executive pay in the industry. The Commission has no specific evidence regarding impairment of the functioning or status of Southwest as a company to suggest that these costs should be disallowed. Finally, there is no evidence in the record to indicate why, as a policy matter, SERP and EDP are inappropriate costs for ratepayers to bear.

92. The Commission finds that in its next general rate case, Southwest shall file information regarding how much compensation is actually deferred by executives and how much is actually deferred by all other employees. Southwest shall describe how the actual amounts deferred translate into actual pension payment amounts, including the calculation to determine pension payment amounts and the average inputs for an executive versus an employee who repairs and/or maintains infrastructure.

g. Transmission Integrity Management Program (“TRIMP”) and Tropicana Operations Center (“TOC”)

Southwest’s Position

93. Southwest provided Adjustment No. 24 to account for TRIMP expenses both going forward and amortizing over four years those expenditures made between 2004 and 2007,
which were authorized to be treated as a regulatory asset pursuant to Docket No. 04-9012.

(Exhibit 41 at 9; Schedule H-24.)

94. Southwest proposed to amortize the $20,522,142 gain associated with the sale of the TOC over a 20-year period. (Exhibit 2 at Statement I p. 6 – So. NV Certification; Exhibit 41 at 29.)

Staff’s Position

95. Staff recommended that the Commission reject Southwest’s proposed TRIMP regulatory asset for the southern Nevada division because Southwest utilized a 13-month average balance as of April 30, 2009, to determine the balance of the regulatory assets as opposed to the actual balance as of December 31, 2007, as prescribed by the Commission’s Order in Docket No. 04-9012. (Exhibit 53 at 6-7.)

96. Staff recommended the Commission amortize the gain on the TOC over a four-year period, which is consistent with Southwest’s requested TRIMP treatment. (Exhibit 60 at 2, 30.) The four-year amortization period represents the average time between Southwest’s filed general rate cases. (Exhibit 60 at 30.) The Commission has historically adopted a four-year amortization period rather than two years in order to mitigate cash flow impacts and promote rate stabilization. (Exhibit 60 at 29.)

BCP’s Position

97. BCP argued that an eight-year amortization for the deferred TRIMP expenses is more appropriate and would better mitigate the impact on ratepayers. (Exhibit 39 at 21-22.) The effect of modifying the amortization period from four years to eight years would be approximately $738,000 in annual amortization expenses for the southern Nevada division. (Exhibit 39 at 23.)
98. BCP recommended an eight-year amortization period for the TOC, and agreed with Southwest’s argument that rate stability and the life of the asset are relevant to setting an amortization period. (Exhibit 39 at 23-24.) BCP argued that the magnitude of the gain in this proceeding is similar to the level of costs in Docket No. 03-10001 for which the Commission authorized an eight-year amortization. ⁵ (Exhibit 39 at 24.)

Southwest’s Rebuttal Position

99. Southwest argued that a four-year amortization period is most appropriate for the TRIMP because it is more representative of one rate case cycle. (Exhibit 74 at 13.)

100. Southwest proposed an alternative to its initial request: netting the deferred TRIMP expenses with the deferred gain on the sale of the TOC. Southwest argued that its alternative proposal would alleviate concerns regarding the appropriate amortization period, and the netting of the TOC gain and the deferred TRIMP costs is the most equitable approach. If this approach is adopted, the southern Nevada land account should be reduced for the cost of the land for the two new operations centers and restored to the amount that existed prior to the sale of the TOC. The remaining amount of $1,758,783 could then be amortized over four, eight, or 20 years. (Exhibit 74 at 15; Tr. at 749.) ⁶

Commission Discussion and Findings

101. The Commission finds that Southwest’s proposed alternative is the most reasonable approach for treatment of both the TRIMP and TOC. Amortizing the net of the TRIMP and TOC amounts makes the most sense because these amounts offset each other even if not netted in the manner proposed by Southwest. Southwest’s proposal also promotes rate

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⁵ Docket No. 03-10001 was a Nevada Power Company’s general rate case.
⁶ Southwest was able to defer approximately $12 million of the gain for tax purposes. The Internal Revenue Service considered the funds used to acquire the land for the two new Southern Nevada operation centers a tax free exchange. (Tr. at 168, 313.)
stability because the amount being amortized is less, and a four-year period is most reasonable given the small amount to be amortized and the average time between Southwest’s rate cases. The land account shall be restored to the amount of $3,767,698 and the remaining $1,758,783 shall be amortized over four years.

h. Line Break Accounting Treatment

Southwest’s Position

102. Southwest did not address this issue in its direct testimony.

Staff’s Position

103. Staff recommended that the Commission order Southwest to change its accounting method for LUFG related to contractor line breaks. Staff stated that Southwest currently accounts for all costs associated with line breaks including LUFG in FERC Account No. 887. Staff argued that the LUFG portion of this transaction should be recorded in Deferred Energy Account No. 191, because this would allocate the costs more equitably between transportation and sales customers. Staff recommended that this adjustment should be applied on a going forward basis effective as of the date that rates go into effect. (Exhibit 54 at 4-5.) Staff did not oppose Southwest’s proposal that the proper amount to record in FERC Account No. 191 is the net of billed and collected amounts. (Tr. at 411-412.)

Southwest’s Rebuttal Position

104. Southwest argued that if the Commission accepts Staff’s recommended accounting treatment, the amount to be recorded in FERC Account No. 191 should be the net of the billed and recovered amounts. (Exhibit 62 at 3-4.)

Commission Discussion and Findings
105. The Commission finds that Staff’s recommended accounting treatment for LUFG and Southwest’s proposed modification to Staff’s recommendation should be adopted because the costs and collected amounts associated with dig-ins are commodity related and should be accounted for with all other natural gas costs in an annual rate adjustment proceeding. This change of accounting treatment shall be effective on a going forward basis, effective on the date that new rates are effective.

i. **Employee Relocation Program Gains and Losses**

**Southwest’s Position**

106. Southwest requested recovery of gains or losses charged to operating expenses associated with employee home sales due to relocation. The Commission previously denied this request, stating that the program is unreasonable because it will almost always show a loss. Southwest argued that this is no longer true, noting that during the test year six houses were sold with a gain, two with a loss, and one broke even. Southwest argued that the program is necessary to incent employees to transfer to new locations and to further corporate objectives.

(Exhibit 32 at 35; Statement P at 4-5.)

**Staff’s Position**

107. Staff recommended that Southwest remove the losses associated with the sales of employee homes purchased for relocation and any associated sales commissions from operating expenses. (Staff stated that there were no gains associated with the transactions.) Staff argued that ratepayers should not be placed in the position of participating in real estate transactions related to employee relocations. Staff stated that these transactions are between Southwest and its employees and, as a matter of ratemaking policy, the gains and losses should be retained by shareholders. (Exhibit 56 at 1-3.)
108. Staff recommended that the commissions associated with sales of homes purchased by Southwest should be included in the calculation of losses and/or gains on the transaction, and should therefore also be removed from operating expenses. (Exhibit 56 at 7-8.)

109. Staff recommended that recorded equity in employee homes be removed from rate base for the same policy reasons previously stated. (Exhibit 56 at 7, 8-9.)

110. Staff noted that Southwest did not provide information regarding the particular value of employees selected for participation in the program. (Exhibit 56 at 6.)

**BCP’s Position**

111. BCP recommended that equity in employee homes be removed from rate base.

BCP argued that Southwest provided no evidence to demonstrate how the current program differs from that which existed in 1993. BCP also recommended removing net losses on the sale of employee homes from operation and maintenance expense. (Exhibit 39 at 9-10.)

**Southwest’s Rebuttal Position**

112. Southwest explained that, in recent years, due to a severe slowdown in the housing market a number of homes have taken a very long time to sell. Southwest argued that this unfortunate circumstance had nothing to do with the design of Southwest’s relocation plan, but is more a function of the current marketplace. (Exhibit 69 at 27-28.)

113. Southwest argued that sales commissions related to homes purchased by Southwest should be treated equivalently to sales commissions related to homes sold by the employees to others; both should be allowed. (Exhibit 67 at 29.)

114. Southwest argued that these costs are reasonable business expenses that allow Southwest to transfer experienced employees to areas where they are needed, and to develop employee talent by allowing them to gain critical experience. (Exhibit 67 at 29-30.)
Commission Discussion and Findings

115. The Commission finds that the net losses associated with the purchase and sale of employee homes by Southwest should be removed from operating expenses, and the equity in employee homes should be removed from rate base. On a going forward basis, both losses and gains associated with home purchases and sales should be the responsibility of the shareholders. The Commission agrees with Staff that ratepayers should not be placed in a position in which they are subject to picking up the losses or gains associated with home sales, especially those due to market fluctuations. The Commission agrees that this may be an important and useful program; however, ratepayers should not have to bear the associated financial risk. Further, Southwest did not provide the criteria used to determine when to offer participation in the plan. For example, it is unclear whether Southwest does a cost/benefit analysis prior to offering participation in the plan. There is also nothing in the record to suggest that there is a cap on the expense Southwest is willing to incur to purchase and then sell an employee’s home.

116. The Commission finds that, to the extent that Southwest pays sales commission twice in order to purchase and then sell an employee’s home, the second set of sales commissions is out of step with the normal moving expenses that Southwest would reimburse when not purchasing an employee’s home, and should be disallowed. If there are two sets of sales commissions for these purchases and sales of employee homes, the disallowance should be in the amount of the second set of sales commissions.

j. Southwest’s Proposed Expected Changes in Circumstances (“expected changes”)

Southwest’s Position
117. Pursuant to NRS 704.110(4) and LCB File No. T005-08, Southwest requested that the Commission allow it to include nine\(^7\) expected changes as adjustments to its test year revenues and expenses and rate base. The expected changes included the 2009 wage increase, the 2009 postage increase, regulatory commission expense, the Southern Nevada Operations Centers ("SEOC and NEOC"), the Boulder Highway steel replacement, the distribution system improvement at Tropicana and Koval ("Tropicana Project"), the Tompkins to Dean Martin steel replacement ("Tompkins Project"), the new Fernley Operations Center ("FOC"), and the replacement of the SCADA system.\(^8\) (Exhibit 32 at 27; Exhibit 41 at 26-42.)

118. Southwest stated that the construction of the new SEOC and NEOC had already been in progress for several months at the time Southwest filed its Application. Southwest provided specific recorded capital expenditures in construction work in progress ("CWIP"), and stated that the SEOC and NEOC were expected to be complete in May or June 2009. (Exhibit 41 at 26-27.) This expected changes included several offsets.\(^9\) (Exhibit 41 at 28-33.)

119. Southwest stated that the Boulder Highway steel replacement project would occur in two phases, the first phase having been completed by March 2009. Southwest stated that the first phase involved the installation of 9,000 feet of steel pipe and took four months to complete. Southwest stated that the second phase involved installation of 8,700 feet of steel pipe. It began construction in March 2009, and was subject to a contractual requirement that it be completed by June 2009. (Exhibit 41 at 33-35.) Southwest stated that the adjustment was measurable by recorded capital expenditures that "will be captured in a specific work authorization." (Exhibit 41

\(^{7}\) SouthEast's adjustment EC7 is an offset to the other adjustments. (Exhibit 41 at 42.)

\(^{8}\) Southwest also requested as one of its expected changes that, to the extent that the expected changes accepted by the Commission impact O&M expenses and the lead/lag study, that those effects be ordered to flow through the other data in the Application. (Exhibit 41 at 42.)

\(^{9}\) SouthWest proposed offsets of depreciation, property taxes, and deferred taxes for each of its plant related expected changes, and sometimes included them as part of the rationale for the expected changes being primarily based upon recorded or verifiable data. (Exhibit 41 at 27, 34, 36, 37, 39, 40-41.)
at 34.) Southwest stated that phase two of the project would cost $1,901,860.\(^\text{10}\) (Exhibit 41 at 34-35.)

120. Southwest stated that the Tropicana Project was expected to begin in May or June of 2009 and would take less than a month to complete. (Exhibit 41 at 36.) Southwest stated that the project was measurable by recorded capital expenditures that “will be captured in a specific work authorization.” (Exhibit 41 at 36.) Southwest stated the project would cost approximately $1 million. (Exhibit 41 at 36.)

121. Southwest stated that the Tompkins Project would begin in May 2009 and be completed by October 2009. Southwest stated that the project was measurable by recorded capital expenditures, depreciation and property taxes. Southwest stated that the cost would be approximately $2.3 million and “will be captured in a specific work authorization.” (Exhibit 41 at 37.)

122. Southwest stated that the FOC would cost approximately $3.3 million, and would be completed by October 2009. Southwest stated that the cost of constructing the facility “will be captured in a specific work authorization.” (Exhibit 41 at 39.)

123. Southwest requested recovery of expenses associated with the replacement of the open vector SCADA system. (Exhibit 41 at 40.) Southwest stated that the project consists of $1.7 million of planning, co-engineering and implementation expense, $500,000 for computers and equipment, and another $500,000 for network and communications expense. Southwest stated that approximately $727,000 of the total cost had already been charged to CWIP. (Exhibit 41 at 40-41.) Southwest stated that the cost of the project “will be captured in a specific work authorization.” Southwest stated that the project would be complete by September 2009. (Exhibit

\(^\text{10}\) The total cost provided in Southwest's direct testimony was also provided in workpaper Statement H-EC2, Sheet 2 of 3, entitled Cost Estimate Work Request Detail. The Application contained no explanation regarding the contents of the workpaper.
Southwest explained that the SCADA closing date is the date Southwest’s Information Services department issues a closing report. The in-service date is the date of implementation and may occur months earlier than the closing date. (Tr. 314-315.)

124. Southwest requested recovery of expenses associated with its 2009 general wage increase. Southwest argued that the wage increase was reasonably known and measureable with reasonable accuracy because a wage increase is considered by the Board of Directors each May, and becomes effective each June. Southwest uses data from national and regional surveys and factors in business and economic conditions to determine what the increase should be. Recent increases have been between 2.0 and 3.25 percent. (Exhibit 32 at 28.)

125. Southwest requested recovery of expenses related to the 2009 postage increase, calculated by applying the new unit price of postage to the number of customer bills reflected in the certification filing. (Exhibit 32 at 30.)

126. Southwest requested recovery of $430,000 in rate case expenses, and argued that these expenses are more properly categorized as an expected change than a certification adjustment. Southwest stated that a portion of the adjustment is based on recorded data, and that the remainder is based on contracts, Southwest’s professional judgment, and past experience with rate cases. The adjustment includes costs incurred for the depreciation study, estimates of the costs of consultants, noticing, postage and freight, Commission fees, court reporter fees, and travel. Southwest stated that most of the costs would be incurred during the processing of the rate case.\textsuperscript{11} (Exhibit 32 at 32.)

127. Southwest did not classify the estimated depreciation expense between the expected plant in-service date and the end of the expected change in circumstance period to be an

\textsuperscript{11} Southwest also noted the fact that prior to the adoption of NRS 704.110(4), Southwest recovered rate case expenses through a proforma adjustment to test year expenses. (Exhibit 32 at 31.)
offset. (Exhibit 1 at Statement 1 p.6; Exhibit 2 at Statement 1 p.6 – Certification; Exhibit 43 at 4, 6-12.)

Staff's Position

128. Staff recommended that the Commission exclude from the establishment of rates the expected change adjustments for the Tropicana Project, the Tompkins Project, the 1.5 percent wage increase, and the rate case expense. (Exhibit 57 at 2; Exhibit 58 at 2; Exhibit 60 at 1.) Staff argued that these adjustments failed to meet the expected changes criteria in NRS 704.110(4). (Exhibit 57 at 3; Exhibit 58 at 2; Exhibit 60 at 2-3, 17.)

129. Staff argued that the Tropicana and the Tompkins steel replacement projects were not reasonably known and measurable with reasonable accuracy at the time Southwest filed its Application because both adjustments were based solely upon budgeted amounts. (Exhibit 57 at 4; Exhibit 58 at 8.) Staff noted that the updated Tropicana Project estimate was 36 percent less than the original estimate. (Exhibit 58 at 8, Attachment DSC-5 p. 4.)

130. Staff asserted that the wage increase was not a specific event but a general trend, pattern, or development and therefore did not qualify as an expected change. (Exhibit 60 at 2-3; Tr. at 591, 593-596.) Staff argued the wage increase was not reasonably known at the time the application was filed because it required Board of Director approval, which had not occurred as of the filing date. (Exhibit 60 at 3.) Staff provided Watson Wyatt press releases dated December 18, 2008, and February 25, 2009, which demonstrated that recent surveys disclosed a significant increase in employers either expecting to implement salary freezes or having already done so. (Exhibit 36; Exhibit 37; Tr. at 234-236.)

131. Staff recommended the Commission reduce the rate case expense allowed in this proceeding to that experienced by Southwest through the certification period, or $292,220.
(Exhibit 60 at 17, Attachment JG-11.) Staff argued that Southwest’s rate case expense proforma adjustment does not qualify as an expected change because the costs did not have a high probability of occurring in the amount or at the time proposed by Southwest. The amount was not primarily based upon recorded expenses. (Exhibit 60 at 17.) Staff also asserted it could not ascertain the purpose for some of the expenses listed by Southwest. (Exhibit 60 at 17-19, Attachment JG-11.1; Tr. at 571-572.) One of the two contracts provided by Southwest contained barely sufficient information to ascertain the purpose of the contract. (Tr. at 573-575.)

132. Staff recommended that the Commission adjust the SESC and NEOC and Boulder Highway steel replacement projects to reflect the estimated depreciation expense from the expected plant in-service date to the end of the expected changes period, October 31, 2009, as an offset. (Exhibit 59 at 4-5, 7, Attachments DSC-2 and DSC-3.)

133. Staff examined the Boulder Highway steel replacement project, but did not recommend any adjustments related to it. (Exhibit 57 at 1.) Staff commented that there are different estimating techniques, and that Southwest used primarily what would be a budget estimate to support its expected changes. The kind of estimate Staff found acceptable under the standard in NRS 704.110(4) is a construction estimate, in which items such as a firm price contract and the cost of materials are identifiable. (Tr. at 459-461.)

BCP’s Position

134. BCP recommended the Commission remove the Tompkins Project, the replacement of the SCADA system, and the FOC expected changes adjustments from the establishment of rates in this proceeding. (Exhibit 39 at 8, Attachment C-2.) BCP asserted that these proposed expected changes failed the test in NAC 704.110(4) because Southwest did not
establish that there was an objectively high probability that they would be complete by the end of the 210-day period. (Exhibit 39 at 7-8.)

Southwest’s Rebuttal Position

135. Southwest argued that it was irrelevant that on the date this general rate case was filed the Tropicana Project work order was not included in CWIP. (Exhibit 74 at 25.) Southwest argued it is relevant that the project was completed and placed into service on August 7, 2009, nearly three months prior to the end of the prescribed 210-day period. (Exhibit 74 at 25-26.) Southwest argued that the project was reasonably known and measureable with reasonable accuracy because Southwest had a detailed design for the project and its estimate was developed using routine engineering and construction practices, and costs for similar projects. (Exhibit 73 at 2-3.)

136. Southwest explained the new SCADA system needed to be in-service by the 2009-2010 winter heating system. (Exhibit 74 at 29.)

137. Southwest argued that considering the economic conditions, it was reasonable to assume the Board of Directors would accept management’s recommended “very modest increase” in wages. (Exhibit 69 at 3, 4.) Southwest stated that the Board of Directors has accepted management’s general wage increase recommendations for the proceeding five years. (Tr. at 675.)

138. Southwest argued that the Commission has consistently allowed it to include an adjustment for rate case expenses in previous general rate cases. (Exhibit 69 at 15.)

Commission Discussion and Findings

139. The Commission finds that Southwest’s expected changes adjustment for the Tropicana Project should be denied because it was not reasonably known and measurable with
reasonable accuracy at the time Southwest filed its Application. 

Southwest failed in its Application to demonstrate that there was a high probability that the Tropicana Project expenses would be in the amount stated in the Application. Southwest characterized the estimate it provided as having been developed using routine engineering and construction practices, and costs for similar projects rather than recorded or verifiable data from the Tropicana Project itself. The Commission notes that it is the information that was available at the time of the filing and included in the Application that is relevant to the determination of whether an event or program meets the criteria contained in NRS 704.110(4). Further, the information must be included in the Application in sufficient detail for the Commission to reasonably ascertain how the criteria in NRS 704.110(4) have been met.

140. The Commission finds that the Tompkins Project was not reasonably known and measurable with reasonable accuracy at the time Southwest filed its Application. Southwest stated that the project was measurable by recorded capital expenditures, depreciation and property taxes. However, Southwest did not demonstrate how the project was primarily measurable at the time of the filing by recorded capital expenditures. Additionally, depreciation and taxes are offsets and therefore do not figure in to whether the project meets the expected changes standard; as offsets they are required to meet a separate, more relaxed standard found in NRS 704.110(4)(a). 

Offsets are not considered unless the expected change itself first meets the

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12 NRS 704.110(4) states in pertinent part: The Commission shall consider expected changes in circumstances to be reasonably known and measurable with reasonable accuracy if the expected changes in circumstances consist of specific and identifiable events or programs rather than general trends, patterns or developments, have an objectively high probability of occurring to the degree, in the amount and at the time expected, are primarily measurable by recorded or verifiable revenues and expenses and are easily and objectively calculated, with the calculation of the expected changes relying only secondarily on estimates, forecasts, projections or budgets.

13 NRS 704.110(4)(a) states: The Commission shall consider the statement submitted pursuant to this subsection and evidence relevant to the statement, including all reasonable projected or forecasted offsets in revenue and expenses that are directly attributable to or associated with the expected changes in circumstances under consideration, in addition to the statement required pursuant to subsection 3 as evidence in establishing just and reasonable rates for the public utility... (Emphasis added.)
standard in NRS 704.110(4). Additionally, the statement that costs will be captured in a specific work authorization does not demonstrate to the Commission that those costs are reasonably known with reasonable accuracy at the time of the filing.

141. The Commission finds that Southwest failed to meet its burden to demonstrate that the FOC meets the standard in NRS 704.110(4). Southwest did not provide enough information in its Application to demonstrate how this requested item might have met the standard in NRS 704.110(4). Southwest stated only that the project would cost approximately $3.3 million, would be completed by October 2009, and that the cost of constructing the facility "will be captured in a specific work authorization." Southwest provided no evidence in its Application regarding how much of the estimated cost had already been experienced compared to the total estimated cost. Southwest presented no evidence regarding how the estimated costs it provided were measurable by recorded or verifiable data. In its Application, Southwest mentioned no contracts, no materials having been purchased, no construction having begun. Without further details in the Application regarding the basis for the expense associated with the project and the expected completion date, the Commission cannot grant the inclusion of this item as an expected change.

142. The Commission finds that Southwest did not provide enough information to warrant the inclusion of expenses related to the replacement of the open vector SCADA system expected change in rates. It is unclear from the information included in the Application whether this expected change met the criteria in NRS 704.110(4). Southwest had charged less than half of the estimated cost to CWIP at the time of the filing and provided no explanation regarding the

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14 LCB File T005-08 states in pertinent part at the section entitled "Statement of Expected Changes in Circumstance": For each event or program, the application must include a separate and specific analysis explaining in detail, sufficient to satisfy the applicant's burden of proof, how each such event or program meets each of the criteria contained in subsection 4 of NRS 704.110.
basis for the remaining estimated costs. Therefore, the project was not primarily measurable by recorded or verifiable data at the time of the filing.

143. The Commission finds that the wage increase expected change requested by Southwest does not meet the criteria in NRS 704.110(4). The wage increase is subject to approval by the Board of Directors, which had not yet met to consider the increase as of the time of the filing. At the time of the filing, there was no reliable way to determine whether it was highly probable that Southwest's Board of Directors would approve a 1.5 percent increase, or some other percent increase, or no increase at all. Because the Board of Directors had not yet approved the increase, the increase was not primarily measurable by recorded or verifiable data at the time of the filing.

144. The Commission finds that the rate case expense expected change does not meet the criteria of NRS 704.110(4) because very little was recorded at the time of the filing. Southwest stated that most of the costs would not be incurred until after the filing, and provided little or no evidence of how costs would be calculated. The rate cases in which Southwest has in the past recovered rate case expense occurred prior to the Legislature's 2007 adoption of Assembly Bill 103 ("AB 103"). AB 103, which was codified in NRS 704.110(4), requires that certain criteria be met in order for expected changes to be included in a rate case. The Commission does not have the authority to deviate from its statutory obligations.

145. The Commission finds that Southwest should recover the rate case expense included as of the date of its certification filing as proposed by Staff. Southwest has not requested to alter the classification of its rate case expense.\textsuperscript{15} However, Staff's proposed reclassification of

\textsuperscript{15} The regulations in LCB File No. T005-09 allow reclassification of an expected changes as a certification adjustment where good cause is shown. The temporary regulations state in pertinent part:
the rate case expected changes adjustment as a certification adjustment is reasonable. Southwest clearly did not meet the expected changes criteria for rate case expense, but should be allowed to recover the incremental costs that may be included by the certification process.

146. The Commission finds that the events and programs in Southwest’s Application that meet the expected change criteria in NRS 704.110(4) include the postage rate increase, the NEOC and SEOC, and the Boulder Highway steel replacement project. These expected changes and their offsets should be incorporated into rates.

147. The Commission notes that the Boulder Highway steel replacement project met the standard with the bare minimum amount of evidence possible. Southwest stated that the first phase of Boulder Highway steel replacement project had been completed and the second phase begun in March 2009. Southwest stated that the second phase of the project was contractually required to be complete by June 2009. Southwest stated that phase two of the project would cost $1,901,860 and provided what appears to be a detailed construction type estimate in workpapers. Nowhere did Southwest explain the basis for the estimate, or even comment upon it. It is fortunate for Southwest that no party took exception to the inclusion of this project. By not taking exception, Staff implied that the type of estimate Southwest provided is indeed the detailed construction-type estimate that indicates that it is likely that an expected change meets the known and measurable standard.16 It is also fortunate for Southwest that the Commission can conclude from the scant information provided by Southwest in its Application, in addition to the types of estimates discussed by Staff, that at the time the Application was filed, Southwest must have already accepted a bid for the project, signed a contract for its construction, ordered materials, etc.

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Absent a showing of good cause, at no time subsequent to the filing of the initial application may an applicant alter the classifications contained in the initial application, including but not limited to the date of certification. (Emphasis added.)

16 It is the information underlying the construction-type estimate that meets the known and measurable standard.
Accordingly, Southwest must have not only obligated itself to complete this project, but also incurred some of the cost of this project at the time of the filing. This additional information was available at the time of the filing, but not included by Southwest. A more complete explanation in the Application regarding the status of the project and the basis for the estimate contained in workpapers would have made a much stronger argument for the inclusion of this item, and would have been the subject of vastly more efficient consideration by the Commission.

148. The Commission finds that Southwest should use the expected changes revenue and expense data filed with Southwest’s Application to calculate rates. The Commission finds that there should be two exceptions to the use of expected changes data from the Application: 1) Southwest should use the accumulated depreciation offset data recommended by Staff; and, 2) To the extent that Southwest’s update corrected errors from its initial filing, those changes should be implemented.

149. The Commission notes that the update to the expected changes information is meant to be used primarily as a discovery tool. It is true that, per LCB File T005-08, the Commission may use the information in the update to “set just and reasonable rates.” This provision provides some flexibility to the Commission to ensure that the expected changes that meet the standard result in just and reasonable rates. It does not require that the Commission use updated expected changes revenue and expense data to set rates. Further, the practical result of the application of the standard in NRS 704.110(4) is that, for the expected changes that meet the standard, there should be very little difference between the revenue and expense data included in the Application and the revenue and expense data provided in the update. The reason for this

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17 LCB File No. T005-08 states that updated data may be used to aid in directing discovery, to test the reasonableness of monetary and other values included in the Application, and by the Commission as evidence in setting just and reasonable rates.
practical reality was stated in the testimony of then Commission Chairman Soderberg before the Assembly Committee on Commerce and Labor, on February 26, 2009:

An example is where we had the Commission actually take some liberties; it was a Nevada Power Company general-rate case. There was a land transaction where Nevada Power was selling a valuable piece of property near Flamingo Road and the Strip in Las Vegas. That transaction was contracted for during the test period, but not consummated. After the case was filed, but prior to the hearing, that transaction consummated, we knew the numbers. We knew exactly how much Nevada Power made on the transaction and we knew exactly how much was owed to ratepayers... We are not looking for estimates, projections or getting hours of testimony from economists. We want to see specific things we know have occurred or are going to occur that we can, so to speak, grab and touch, and put that into the rate case...

The reason for the likelihood that the revenue and expense data will not change significantly for expected changes that meet the standard is that at the time of the filing, the event in question, like the event in the example provided to the Legislature, should literally be known and measurable.

The revenue and expense data should be known, if not exactly as in the example, then almost exactly. There must be a high probability, as in the example, that the expected change will occur to the degree, in the amount and at the time expected. As then Commission Chairman Soderberg stated, the Commission is not looking for estimates or projections.

k. Southwest’s Lead - Lag Study

Southwest’s Position

150. Southwest included both prepaid expense amortization to operation and maintenance ("O&M") expenses and pension costs charged to O&M expenses in the lead-lag study and the underlying account balances in rate base as other working capital. The number of lead days assigned to these two lead-lag study components was zero. (Exhibit 2 at Schedule G-5.) Southwest has consistently included both components for 25 years. (Tr. at 307-308.) The
theory is the 13-month average account balance represents Southwest’s investment. Including
the expense with zero days matches revenues with expenses. (Tr. at 309-310.)

Staff’s Position

151. Staff recommended that the Commission exclude both prepaid expenses
amortized to O&M and pension costs charged to O&M from the lead-lag study. (Exhibit 53 at 1-
2.) Staff argued that because of the inclusion of the same cost category in two separate rate base
components Southwest will overstate rate base. (Exhibit 53 at 9; Tr. at 405, 408.) For example,
assuming prepaid insurance was $12 million, the entire $12 million would be included in the
lead-lag study and the $6 million 13-month average balance would also be included in rate base.
(Tr. at 406.)

Southwest’s Rebuttal Position

152. Southwest argued that the inclusion of both the prepaid account balance and the
expense in the lead-lag study is necessary to recognize the two different points of measurement
that are occurring. The 13-month average account balance represents the end of the month
accounting measurement date. The lead-lag study component measures the cash flow associated
with the transaction. (Tr. at 733-734.) The assignment of zero days recognizes Southwest’s due
inclusion presentation and retains the accuracy of the study, as it maintains equality between
revenues and expenses. (Tr. 742-743.) Assigning zero days to the expense limits the cash flow
timing difference measured by the lead-lag study for these costs to approximately 38 days, the
approximate 38 day revenue lag less the zero expense days. (Tr. at 744.) Removing the prepaid
account balance from rate base would increase the timing difference by approximately 184 days.
(Tr. 745.)
153. While the “Accounting for Public Utilities” excerpt provided indicates that prepayments are not included in lead-lag studies, including the expense as proposed by Southwest is an acceptable practice. (Exhibit 75 at page 5-3). Southwest used a standard methodology similar to that used by several other states and other experts. (Tr. at 733-734.)

Commission Discussion and Findings

154. The Commission finds that Staff’s adjustment should be denied. Staff did not demonstrate that Southwest’s presentation would lead to overstating rate base. The lead-lag study calculates the difference in the timing of payment of expenses and receipt of funds collected from the customer for services rendered by the utility. By reducing the expense days to zero, Southwest’s cash working capital presentation reasonably eliminates the potential for overstating rate base.

1. Directors and Officers (“D&O”) Insurance

Southwest’s Position

155. Southwest did not specifically address this issue in its direct testimony.

Staff’s Position

156. Staff recommended that the Commission exclude both 50 percent of the D&O insurance expense and 50 percent of the associated prepaid asset from rate base. (Exhibit 53 at 2.) Staff incorporated the Commission’s recent rationale regarding this issue by reference to the Commission’s decision in Docket No. 08-12002, in which the Commission stated:

A 50-50 sharing of D&O liability insurance between shareholders and ratepayers recognized that usually the insurance policy comes into play when a shareholder sues the management of a public company, whereas ratepayers benefit because the existence of the insurance improves the ability to attract and retain qualified directors and enables them to make decisions without fear of personal liability. (Order at Paragraph 584.)
Staff argued that shareholders receive a tangible benefit and should pay 50 percent of the cost. (Exhibit 53 at 10-11; Tr. at 403.) Staff argued that the actual D&O insurance coverage inures directly to the benefit of the shareholder. (Tr. at 390, 404.)

**BCP’s Position**

157. BCP recommended excluding both 50 percent of D&O insurance expense and 50 percent of the associated prepaid asset from rate base, which reflects a sharing of associated costs between the ratepayer and the shareholder. (Exhibit 51 at 4, 40, 44.) BCP argued that this allocation recognizes that shareholders are the primary beneficiaries of the coverage. (Exhibit 51 at 40.) Ratepayers should participate in the cost of D&O insurance because they benefit from Southwest’s ability to attract and retain qualified directors. (Exhibit 51 at 41; Tr. at 364.) However, shareholders would benefit exclusively from any payouts under the policy that would reduce the level of costs not recoverable from ratepayers. (Exhibit 51 at 41; Tr. at 366, 371-372.) BCP noted that three other state utility regulatory authorities have required a sharing between ratepayers and shareholders for the same benefit rationale, two (Arkansas, California) on a 50-50 basis and one (Connecticut) on a 25-75 basis. (Exhibit 51 at 41-43.)

**Southwest’s Rebuttal Position**

158. Southwest asserted that the D&O insurance is a normal cost of business and, therefore, should be recovered from the ratepayers in total. (Exhibit 69 at 23-24.) Southwest argued that whether shareholders benefit from D&O insurance is speculative. Southwest argued that D&O insurance is necessary to attract and retain qualified directors and officers. (Exhibit 69 at 23-24.) Southwest argued that D&O insurance claims may be brought by a wide variety of entities beyond shareholders, including competitors, vendors, and customers. (Exhibit 69 at 22;
Southwest concurred that the prepaid D&O insurance rate base amount should reflect the D&O insurance expense decision. (Exhibit 69 at 25.)

**Commission Discussion and Findings**

159. The Commission finds that a 50-50 sharing of the expense associated with D&O insurance is reasonable and should be implemented. Additionally, as indicated by all the parties, the Commission should find that the prepaid amount included in rate base should reflect the 50-50 sharing. Unlike most costs incurred in operating the business, the shareholder is the exclusive potential beneficiary of D&O liability coverage. Ratepayers should also participate in the cost of D&O insurance because they benefit from Southwest’s ability to attract and retain qualified directors, and from their ability to make decisions without fear of personal liability.

**m. American Gas Association (“AGA”) Membership Fees**

**Southwest’s Position**

160. Southwest adjusted the AGA membership dues expense item to exclude lobbying and marketing services. (Exhibit 32 at 11.)

**Staff’s Position**

161. Staff recommended the Commission disallow 21.51 percent of Southwest’s AGA membership dues, which represents the three AGA mission statement functions that primarily benefit shareholders. (Exhibit 60 at 24, Attachment JG-14 – Jeff.) Of the six functions identified by the AGA mission statement, these three functions primarily benefit the shareholders:

a. Advocacy of natural gas issues that are priorities for the membership and that are achievable in a cost-effective way;

b. Serving as a voice on behalf of the energy utility industry and promoting natural gas demand growth by emphasizing before a variety of audiences the energy efficiency,
environmental and other benefits of natural gas, and promoting natural gas supply growth by advocating public policies favorable to increase supplies and lower prices to customers;

c. Delivering measurable value to AGA members.

(Exhibit 60 at 24, Attachment JG-15; Tr. at 581.)

162. Staff argued that while Southwest removed the 2008 AGA budgeted 5.18 percent of dues for lobbying and marketing services, Southwest failed to detail the costs associated with the AGA’s other functions. (Exhibit 60 at 22, 24.) Staff calculated its adjustment by removing the budgeted costs for these three functions and the associated general and administrative costs, assuming each of the six functions was weighted evenly. (Exhibit 60 at 24; Tr. at 576-577.)

163. Staff noted that the AGA addresses issues of safety, accounting, and efficient gas delivery. (Exhibit 60 at 24, Attachment JG-16.) The AGA provides member utilities access to a network of experts in many disciplines (e.g. finance, customer service, operations, engineering), develops and implements public information campaigns (e.g. Call Before You Dig), and collects and compiles a large amount of natural gas industry data which is available for its member’s use (e.g. benchmarking studies, Operating and Engineering Best Practices program). (Exhibit 60 at Attachment JG-16 pp. 2-3.)

Southwest’s Rebuttal Position

164. Southwest argued that Staff’s adjustment should be denied, and noted that Staff cited many of the benefits Southwest’s ratepayers receive from AGA membership. (Exhibit 69 at 22.) Southwest recommended adjusting the total lobbying and marketing expense reduction to represent the actual calendar year 2008 dues allocated to the lobbying function, a slight increase. (Exhibit 69 at 20.) Southwest explained that pursuant to Internal Revenue Code section 162(e) lobbying expenses are not tax deductible. (Exhibit 69 at 20, Attachment RLA-6.)
Commission Discussion and Findings

165. The Commission finds that Southwest should recover the entire cost of its AGA membership dues. Staff did not identify any specific activities associated with the AGA mission statements that would benefit shareholders to the exclusion of ratepayers. However, both Staff and Southwest identified many specific activities of the AGA that benefit both shareholders and ratepayers equally.

166. The Commission finds that Southwest's proposed increase of the dues allocated to lobbying and marketing activities is immaterial and should not be accepted. The 0.38 percent disallowance represents $1,604, of which Southern Nevada and Northern Nevada would be allocated $423 and $87, respectively.

n. Investigation Regarding Contracting Between Southwest and Affiliates

Staff's Position

167. Staff recommended the Commission open an investigatory docket to examine Southwest's contracting activities with its construction affiliates, particularly NPL Construction Company ("NPL"). (Exhibit 57 at 2, 7; Exhibit 60 at 30.) Staff did not note any unusual practices in its review, but stated that it was only able to review a very small sample of Southwest's contracts. (Tr. at 418, 505-506, 507.) Staff stated a concern that Southwest's internal procurement processes could create barriers to entry and thereby place other pipeline construction companies at a disadvantage in Southwest's bidding process. (Exhibit 57 at 5.) A market with fewer participants may be less competitive and could increase the cost of construction. (Exhibit 60 at 32.) As an indicator of the potential problem, Staff noted that of the bids awarded in 2008, Southwest's affiliates were awarded 9 of 29 normal total company bids,
which represented 49.1 percent of the total dollar amount of the work bid out by Southwest.

(Exhibit 60 at 33.)

Southwest’s Rebuttal Position

168. Southwest disagreed with Staff’s assertion that an investigation may be necessary. Southwest has a “Pipeline Contractor Evaluation Program” in which NPL and Arizona Pipeline Company do not participate because when the program was created in 1999 they had been providing service since 1987 without an incident. However, these firms and other grandfathered firms are required to maintain the appropriate licensing, insurance, and training. (Exhibit 55 at 4; Tr. 420.) Southwest stated that NPL receives no additional information beyond that provided to other bidders by Southwest. (Exhibit 55 at 7.)

169. Southwest argued that implementation of the Pipeline Contractor Evaluation Program does not create artificial barriers to entry. Prequalification rather than post bid qualification shortens the bidding process by ensuring bids are awarded to qualified entities. (Exhibit 55 at 6-7.) Southwest stated that Staff may review Southwest’s construction contracts. (Tr. 421.)

Commission Discussion and Findings

170. The Commission finds that Staff’s recommendation to open an investigatory docket into Southwest’s construction procurement process should be denied at this time. Although Staff did not find anything in this review for which Southwest did not have an explanation, the number of contracts Staff was able to review was a very small fraction of the total contracts that could have been inspected. Staff has the authority pursuant to NRS 703.195 to examine Southwest’s construction contracts and contracting processes, and Southwest offered to aid Staff in a review of its construction contracts. If upon further review of Southwest’s
contracts, Staff finds reason to petition the Commission to open an investigation, the
Commission encourages Staff to do so.

o. Conservation and Energy Efficiency Labor Costs

Southwest’s Position

171. Southwest stated that pursuant to regulations in LCB File No. R095-08 at Section
14, conservation and energy efficiency program related labor costs were deferrable. (Tr. 246.)
The budget included in Southwest’s recently filed conservation and energy efficiency plan
(Docket No. 09-03015) failed to include labor costs and Southwest is asking to correct that
oversight in this proceeding. (Tr. 246.) Southwest requested authority to defer the labor and
labor-related costs associated with the two additional demand side management department
employee positions it intends to fill to implement the Nevada conservation and energy efficiency
plan. (Exhibit 32 at 34.) The incremental labor costs would be recovered in the same manner as
the non-labor costs associated with the conservation and energy efficiency plan. (Exhibit 32 at
34-35.)

Staff’s Position

172. Staff recommended that the Commission reject Southwest’s request to defer the
costs associated with two employee positions created by Southwest’s conservation and energy
efficiency efforts in the state of Nevada. (Exhibit 60 at 5-6, Attachment JG-5.) Staff argued that
Southwest has not justified the regulatory asset treatment for this labor cost. (Exhibit 60 at 6.) It
is not clear that the rates authorized by the Commission will be recovering the costs associated
with these employees because they could be hired from in-house and Southwest could decline to
fill the existing empty positions. (Exhibit 60 at 5; Tr. 579.)
173. Staff acknowledged that rates established in a general rate case are intended to recover a level of costs, not specific costs. (Tr. 582-583.) Staff stated that a determination of the reasonableness of the cost is one for a future proceeding. (Tr. 579-580.)

Southwest’s Rebuttal Position

174. Southwest reiterated its request. (Exhibit 69 at 6-8.)

Commission Discussion and Findings

175. The Commission finds that Staff’s adjustment should be accepted because the Stipulation approved by the Commission in Southwest’s conservation and energy efficiency plan filing in Docket No. 09-03015 appears to prohibit Southwest’s proposed request. Paragraph 20 of the Stipulation states:

The Settlement Parties stipulate and agree that all other program features and estimated budgets not specifically addressed herein shall remain as proposed in Southwest’s application.

p. Conservation and Energy Efficiency Plan Compliance Items

Southwest’s Position

176. Southwest stated it would explain to its customers that the conservation and rate mechanisms approved by the Commission were designed to achieve dual goals of conservation, which will ultimately lead to lower customer bills, and allow Southwest to recover its costs. (Exhibit 48 at 5.) These education goals would be accomplished through coordinated efforts including media messages and targeted news releases, customer bill inserts, strategic opportunities for communicating with customers to increase their understanding, and web posting and informational links to relevant and helpful sources. (Exhibit 48 at 6-7; Tr. 791-792, 824-825.) The message would explain the concepts and emphasize conservation. (Tr. 792-793, 794-795.) Southwest stated it will receive indirect benefits from the education program because
consumers indicate higher satisfaction when utilities inform them of energy conservation and environmental issues. (Exhibit 48 at 6; Tr. 794.)

**Staff’s Position**

177. Staff recommended two modifications to Southwest’s annual conservation and energy efficiency plan report, filed pursuant to Section 13 of the Commission’s regulations in LCB File No. R095-08. Specifically, Southwest should be required to include a description of how the appliances in southern Nevada’s NEOC’s appliance demonstration area promote conservation, and a description of how Southwest educated its customers about decoupling in the initial year of decoupling. (Exhibit 58 at 1-2.)

178. Staff explained that it would use the information regarding the appliances in the southern Nevada’s NEOC’s appliance demonstration area to determine if it should pursue an adjustment in Southwest’s next general rate case. (Exhibit 58 at 5.) Considering decoupling, Staff stated one year of data should be sufficient for its analysis. (Tr. 514-515.)

179. Staff recommended the Commission require Southwest to include in its first annual conservation and energy efficiency plan report a section describing how Southwest educated its customers during the initial year of decoupling. (Exhibit 58 at 12; Tr. 512.) Staff acknowledged the temporary regulations only require the inclusion of an outline of its plan to educate the customers as to general rates decoupling, but asserted that Southwest’s outline was deficient because it only included broad general concepts. (Exhibit 58 at 11; Tr. 509.) Because the requirement was set forth in regulation, Staff argued the education outline is a significant component of decoupling and a more detailed outline should have been developed. (Exhibit 58 at 11-12; Tr. 509-512.) Staff recommended including the requirement as part of the initial
annual conservation and energy efficiency report, which will be filed after December 31, 2010. (Tr. 512-513.)

Southwest’s Rebuttal Position

180. Southwest did not object to providing the appliance and customer visit information requested by Staff in its initial conservation and energy efficiency annual report. However, Southwest argued against making it an ongoing annual reporting requirement. (Exhibit 93 at 4.)

Commission Discussion and Findings

181. The Commission finds that Southwest’s initial annual conservation and energy efficiency plan report should, at a minimum, contain a description of each appliance demonstrated at the NEOC’s appliance demonstration area and address how the appliance promotes conservation and/or energy efficiency. The Commission agrees with Staff and Southwest that including a description of the appliances demonstrated at the NEOC in the initial annual conservation and energy efficiency report is appropriate and will be helpful.

182. The Commission finds that Southwest should file a description as to how it has and how it will continue to educate customers about decoupling and energy conservation as a compliance filing within 60 days of the issuance of this Order, and again in its initial annual conservation and energy efficiency plan report. Considering decoupling is a significant change in the regulatory paradigm, the Commission concurs with Staff that a more detailed education outline would have been beneficial for both the parties and the Commission to comment upon. Southwest’s discussion should include but not be limited to a description of each media campaign and the information provided in that campaign and a timeline for communicating the
decoupling and energy conservation and energy efficiency messages through the initial months of decoupling.

q. Natural Gas Uncollectible Expense Tracking Mechanism

Southwest's Position

183. Southwest requested authority to establish a tracking mechanism that would collect, or refund, the difference between the actual bad debt expense it incurred on natural gas cost collections and the expense included in general rates.\(^{18}\) (Exhibit 1 at Vol. 1 Attachment 1 p. 90; Exhibit 48 at 15-16; Tr. 326, 335-336.) Southwest stated that natural gas cost collections account for a significant portion of its revenues, as noted by the following test year revenues:\(^{19}\)

<table>
<thead>
<tr>
<th></th>
<th>Southern Nevada</th>
<th>Northern Nevada</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Gas Cost</td>
<td>$303,230,386</td>
<td>$83,737,129</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>185,911,075</td>
<td>42,345,848</td>
</tr>
<tr>
<td>Total Revenues</td>
<td>$489,141,461</td>
<td>$126,082,977</td>
</tr>
</tbody>
</table>

(Exhibit 1 at Vol. II-A Statement H p.1; Exhibit 1 at Vol. II-B Statement H p.1.)

184. Southwest argued that including the natural gas costs in the determination of the bad debt expense in a general rate case effectively assumes that those natural gas costs will remain at approximately the same level, but natural gas costs are subject to significant fluctuation. (Exhibit 48 at 16; Tr. 326) Southwest noted that today's natural gas costs are substantially lower than those experienced in the two 12-month periods preceding the test year. (Tr. 326.)

185. At hearing, Southwest stated that it should have requested to track all natural gas cost-related bad debt expense rather than a portion of these costs, which also excludes the

\(^{18}\) Southwest initially requested to track only part of the difference between the bad debt expense it incurred on natural gas cost collections and the expense included in general rates, but agreed when asked by the Commission that a tracking mechanism should address the total difference.

\(^{19}\) Test year bad debts for Southern Nevada and Northern Nevada were $2,130,554 and $437,165, respectively. (Exhibit 1 at Vol. II-A Schedule H-7; Exhibit 1 at Vol. II-B Schedule H-7.)
associated expense from the revenue requirement established in this proceeding. (Tr. 336.)

While the method proposed in the Application would be an improvement, tracking the total costs would be a “cleaner mechanism.” (Tr. 336, 338.)

**Staff’s Position**

186. Staff recommended that the Commission deny Southwest’s request to collect the natural gas cost portion of uncollectible expense through a tracking mechanism, as being premature. (Exhibit 58 at 2, 9, 10; Tr. 490-491, 492, 506-507.) Staff stated that Southwest should not be allowed to implement the mechanism because its request was unsupported. Staff also stated that it had concerns that the change would lessen Southwest’s incentive to collect bad debts. (Exhibit 58 at 9, 10-11.)

**Southwest’s Rebuttal Position**

187. Southwest argued that its Application contained sufficient information supporting the proposed tracking mechanism as it included the proposed methodology and the philosophical support (that bad debt expense should be collected in a manner similar to the underlying costs). (Exhibit 62 at 5; Tr. 634-635.) Southwest argued that it would still have incentive to pursue collection of bad debts. Staff and other parties would scrutinize any tracking mechanism filing, and even if all natural gas cost-related bad debt were removed from general rates, approximately 40 percent of total bad debt would remain embedded in rates. (Exhibit 62 at 6; Tr. 624-625.)

**Commission Discussion and Findings**

188. The Commission finds that Southwest should revise its tariff to track all natural gas cost-related bad debt expense. To implement this tracking mechanism, Southwest should remove from the calculation of revenue requirement authorized in this proceeding the bad debt
expense associated with natural gas costs, including the expense percentage calculation.\textsuperscript{20} The Commission agrees with Southwest that natural gas costs are subject to significant fluctuation and Southwest’s proposal is a more accurate and fair method of collecting the costs in issue.

189. The Commission finds that Southwest should make a compliance filing implementing this mechanism at the same time that it files its tariffs pursuant to this Order.

r. **Normalization of Office Supplies & Expenses (Account 921)**

**Southwest’s Position**

190. Southwest did not address this issue specifically in its direct testimony.

**Staff’s Position**

191. Staff recommended the Commission normalize Southwest’s office supplies and expenses to reflect an ongoing level of expenses. (Exhibit 60 at 16, Attachment JG-8.) Staff observed that the test year expense level was significantly greater than the calendar year 2007 amount. (Exhibit 60 at 17.) Staff argued that normalization attempts to provide a reasonable level of ongoing expenses. (Tr. at 582-583.)

192. Staff stated that when questioned, Southwest explained that the increase was primarily attributable to a $1 million increase in network capacity, service upgrades, and implementation of the call center virtualization project. Of this amount, calendar years 2008 and 2009 contain non-recurring costs for an interim interactive voice response system, $561,365 and $126,794, respectively. (Exhibit 60 at Attachment JG-10.1.) Southwest represented to Staff that

\textsuperscript{20} NRS 704.185(3) provides the Commission with statutory authority to establish Southwest’s proposed unrecovered gas cost expense tracking mechanism. Specifically NRS 704.182(3) states:

A public utility which purchases natural gas for resale may request approval from the Commission to record upon its books and records in deferred accounts any other cost or revenue which the Commission deems appropriate for deferred accounting and which is not otherwise subject to provisions of subsections 1 and 2. If the Commission approves such a request, the Commission shall determine the appropriate requirements for reporting and recovery that the public utility must follow with regard to each such deferred account.
the interactive voice response system costs will be replaced by the virtual call center and related 800 service charges. (Exhibit 60 at Attachment JG-10.1) However, Staff stated that Southwest failed to quantify the expected recurring network and communication facilities charges. (Exhibit 60 at 17.)

193. Staff argued that if the Commission were to concur with Southwest that the interactive voice response system costs are representative of the replacement system costs, the interactive voice activated system costs should be removed from the calculation of the normalization adjustment. (Tr. at 583.)

**BCP's Position**

194. BCP recommended an adjustment to normalize office supplies and expenses by excluding the $561,000 charge for an interim interactive voice response system. (Exhibit 39 at 14.) BCP observed that the test year office supplies & expenses exceeded the calendar year 2007 amount of $10.3 million by 18 percent. Southwest explained to BCP that the increase was primarily attributable to utility/telephone and systems related expenses, including $561,000 for an interactive voice response system. Southwest classified the interactive voice response system as a non-recurring charge. (Exhibit 39 at 13.) Although Southwest asserted the interactive voice response system cost would be replaced by other new expenses, BCP argued that Southwest did not delineate the nature of the new expenses nor provide data quantifying the expected expense level. (Exhibit 39 at 13-14.)

**Southwest's Rebuttal Position**

195. Southwest argued that neither BCP’s non-recurring item adjustment nor Staff’s proposed normalization was appropriate. (Exhibit 69 at 14.) Southwest argued that both BCP and Staff acknowledged that the interactive voice response system expenses were going to be
replaced, which did occur. (Exhibit 69 at 12.) Southwest argued that removing the interim expenses interactive voice response system expenses would understate recurring expenses. Southwest explained that until the interactive system was supplemented, the network, phone line, and 800 service costs were paid to Intervoice. Upon implementation of the New Interactive Intelligence Customer Interaction Center system, which was deployed in September and October 2008, the costs formerly paid to Intervoice were paid to Cox Communications. Annualizing the payments made to Cox Communications for the period November 2008 (first full production deployment month) through June 2009 resulted in a total cost of $712,789, which is similar to the test year $698,817 in combined payments to Intervoice and Cox Communication. (Exhibit 69 at 12-13, Attachment RLA-4.)

196. Southwest argued that if Staff’s adjustment were accepted, the adjustment calculation should be modified to use the amount Southwest is seeking to recover in this proceeding, not the recorded test year amount. The adjustment should be calculated by comparing the normalized expense level to the proforma adjusted recorded cost level. (Exhibit 69 at 9; Tr. at 700-701.)

**Commission Discussion and Findings**

197. The Commission finds that Staff’s adjustment should be accepted, modified to use the proforma dollar amounts proposed by Southwest, and modified to remove the interim voice activated call center costs. The actual expense level Southwest is seeking to recover in this proceeding should be used in deriving the adjustment (i.e. the proforma adjusted office expense amount from the test year less the normalized office expense amount). The calculation of the adjustment should reflect that Southwest reasonably justified retention of the interim voice activated call center costs. A significant increase in Southwest’s office supplies and expenses
did occur over calendar year 2007 and Southwest failed to account for more than one-half of the approximate $1.8 million increase. Staff's normalization adjustment, with the modifications above, addresses this issue.

s. Normalization of Outside Services Expense (Account 923)

Southwest’s Position

198. Southwest did not address this issue in direct testimony.

Staff’s Position

199. Staff recommended the Commission normalize Southwest’s outside services expense. (Exhibit 60 at 14, Attachment JG-8.) Staff reasoned that a test year expense should be normalized when the actual incurred expense does not accurately represent an ongoing and normal level of expense. (Exhibit 60 at 14-15.) Staff argued outside services expense meets the normalization criteria, as evidenced by the significant change in expense since 2004:

<table>
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<tr>
<th></th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>April 2009</th>
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<tr>
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<td>$8,354,431</td>
<td>$8,727,773</td>
<td>$8,659,790</td>
<td>$9,353,638</td>
<td>$11,006,164</td>
<td>$11,760,058</td>
</tr>
</tbody>
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(Exhibit 60 at 15, Attachment JG-9.)

200. Staff noted that when asked to explain the post 2004 increases, Southwest only provided an explanation comparing the 12 months ended April 2009 to calendar year 2008. (Exhibit 60 at 15, Attachment JG-9.1.) Further, Southwest modified its response to reclassify contracts initially identified as temporary (non-recurring) to continuing. (Exhibit 60 at 15-16, Attachments JG-9.2, JG-9.3.) Staff calculated its adjustment by comparing Southwest’s test year recorded $11,239,062 expense level with a four-year average of $9,495,066. (Exhibit 60 at Attachment JG-8.)

Southwest’s Rebuttal Position
201. Southwest argued that Staff’s adjustment should be denied as the requested level of outside services expense reflects recurring expense. (Exhibit 69 at 11.) Southwest stated that the annual average increase over the previous calendar year was 7.4 percent, and the test year increase was 17.7 percent over calendar year 2007. (Exhibit 69 at 10, Attachment RLA-3 p.2.) Southwest argued that a significant amount of the annual increase is attributable to software maintenance and computer equipment maintenance. (Exhibit 69 at 10.) Calendar year 2008, exceeded calendar year 2007 by $1,652,528. Of this amount, approximately $1,551,000 was associated with software maintenance and computer equipment maintenance. (Exhibit 69 at RLA-2.) In 2008, Southwest upgraded the Hedge Capture and Control system, implemented an interactive voice response system, and replaced its 1980’s vintage Work Order system with a new system called PowerPlant. (Exhibit 69 at 10.) About $949,000 was a December 2008 payment to Logica, which was reclassified in 2009 as a prepayment. (Exhibit 69 at Attachment RLA-2 p.2.)

202. Southwest argued that if Staff’s adjustment is accepted, the adjustment calculation should be modified to use the amount Southwest is seeking to recover in this proceeding rather than the recorded test year amount. The adjustment would be calculated by comparing the normalized expense level to the proforma adjusted recorded cost level. (Exhibit 69 at 9; Tr. at 700-701.)

Commission Discussion and Findings

203. The Commission finds that Staff’s normalization adjustment should be granted. Staff correctly observed that a significant increase in outside services expenses has occurred and Southwest failed to adequately explain the increase. The actual expense level Southwest is seeking to recover in this proceeding should be used in deriving the adjustment (i.e. the proforma
adjusted office expense amount). Southwest accounted for approximately a $1.6 million increase of which $949,000 was related to a December 2008 payment. The test year ended November 30, 2008. Therefore, Southwest potentially explained less than one-third of the $2.4 million test year increase over calendar year 2007.

t. **Negotiated Transportation Contracts**

**Staff's Position**

204. Staff observed that there are large differences between Southwest’s Special Contract rates and Tariff rates for transportation customers. Staff observed that the initial term for many of Southwest’s Special Contracts has expired and the Special Contracts are being continued on a month-to-month or year-to-year basis. (Exhibit 58 at 13.)

**Southwest’s Rebuttal Position**

205. Southwest stated that it is not reasonable to assume that Special Contract customers would be subject to or willing to pay Southwest’s existing full-tariff rates and that the difference in rates does not represent what would commonly be thought of as a discount. Southwest stated that each of these customers was able to negotiate a competitive rate because each had a competitive alternative to Southwest’s service in the form of an alternate fuel or bypass. (Exhibit 62 at 7-8.) Southwest stated that at the time many of the Special Contracts were entered into, the Special Contract customers were served under tariffs that were very different from the current general service tariff, and that were ultimately no longer utilized and were withdrawn. (Exhibit 62 at 7.)

**Commission Discussion and Findings**

206. The Commission finds that it would not be appropriate to require the filing for approval by the Commission of all service agreements between Southwest and transportation
customers under the ST-1 and NT-1 tariffs. The requirement would require deviation from NAC 704.518 and would likely violate NRS 704.075.\textsuperscript{21} NRS 704.075 allows rates for qualifying customers to take effect in 30 days or less. The intent of the statute was to allow the utility to negotiate expeditiously with customers who are legitimate by-pass threats because they can either utilize a fuel other than gas in their operations, or can by-pass the utility’s distribution system and buy directly from a pipeline company. Commission approval is required under NAC 704.518(2)(c) for Special Contract rates negotiated outside of the range provided for in the Transportation Eligible tariff. Commission approval is not required for rates negotiated within the range provided for under the ST-1 and NT-1 tariffs. In the event that Staff determines that Southwest has violated its ST-1 or NT-1 tariffs, it can raise the issue in a general rate case by proposing a loss margin adjustment for the specific customer at issue.

207. The Commission finds that negotiated Transportation service agreements and Special Contracts should continue to be afforded confidential treatment provided that Southwest makes the appropriate request and demonstrates the basis for such treatment pursuant to the Commission’s regulations. Although the Commission can appreciate concerns regarding transparency, to fail to allow confidential filing of these service agreements and Special Contracts could work to the detriment of ratepayers.

208. The Commission finds that Southwest should file as a compliance filing within 60 days of the issuance of this Order, all existing executed service agreements and supporting economic studies to demonstrate that each customer meets one of the two applicable requirements. The Commission is ordering this filing in order to be sure that it has complete

\textsuperscript{21} NRS 704.075 requires the Commission establish standards for the setting, increase or decrease of rates for natural gas to generating, industrial and large commercial customers. These standards must authorize increases or decreases on less than 30 days notice. The Commission implemented NAC 704.518 to address this statute.
records, especially as some of the existing agreements have been in place for a very long time. The Commission reminds Southwest that it continues to be obligated to file all Transportation Eligible service agreements and economic studies supporting those service agreements as required by the ST-1 and NT-1 tariffs.

209. The Commission finds that Southwest should be required to renegotiate expired service agreements to ensure that the customers in question still meet one of the two qualifying requirements under NAC 704.518. Staff identified negotiated service agreements that have expired, pursuant to the terms of which customers continue to be provided service. The Commission agrees with Staff that these contracts should be revisited.

u. Exempt Employee Overtime

Southwest’s Position

210. Southwest did not address this issue specifically in its testimony.

Staff’s Position

211. Staff asserted that utilities generally do not pay overtime to exempt employees, and that overtime pay to exempt employees does not reflect market conditions. Staff stated that Southwest acknowledges that overtime pay for exempt employees is not considered in its review of the labor market. (Exhibit 60 at 20-21.)

212. At the hearing, Staff stated that it had performed further analysis regarding the issue of utilities paying overtime to certain exempt employees. Staff contacted another utility that pays overtime to exempt employees in emergency situations. Staff stated that there may be situations where it is important to pay overtime to exempt employees, and that Southwest has a policy that must be followed in order for an exempt employee to receive overtime pay. (Tr. at 585-586.)
Southwest’s Rebuttal Position

213. Southwest stated that it pays overtime to exempt employees in emergency situations in which first-line supervisors must supervise their employees who are working overtime, or in order to complete time-sensitive projects for which employees need management direction. Further, the employees only receive overtime at straight-time pay rates. (Exhibit 67 at 20-22.) Southwest argued it is reasonable to include and recover overtime compensation paid to certain exempt employees because this type of overtime payment is infrequent, applied only at a straight-time pay rate, and is a necessary part of its business. (Exhibit 67 at 21-22.)

Commission Discussion and Findings

214. The Commission finds that Staff’s recommended adjustment should be denied. Although the Commission agrees with Staff that this issue was important to look into, Southwest adequately explained why this type of compensation is necessary and should be included in rates. Southwest has policy guidelines regarding when overtime pay should be available to exempt employees. Both Staff’s and Southwest’s review of other utilities uncovered similar practices.

VI. COST OF SERVICE

a. General Revenues Adjustment Provision (Decoupling)

Southwest’s Position

215. Southwest requested approval of a General Revenues Adjustment provision in accordance with the requirements set forth in LCB File No. T004-08, the temporary regulations adopted by the Commission in Docket No. 07-06046. (Exhibit 48 at 3.)

216. Southwest testified that LCB File No. T004-08 requires that a general revenues decoupling mechanism be applied to all customer classes except customers served under negotiated contracts. Southwest requested an exemption from the GRA rate for certain classes
because some schedules have been effectively decoupled through rate design (costs are
recovered through a fixed charge) and other schedules may yield undesirable results from the
application of the GRA provision. (Exhibit 48 at 9.)

217. Southwest testified that it plans to educate its customers regarding the GRA provision simultaneously with its conservation and energy communications. This will be accomplished with media messages and targeted new releases, customer bill inserts, strategic opportunities for communication (public outreach events), and website postings. (Exhibit 48 at 5-7.)

Staff’s Position

218. Staff supported Southwest’s proposed GRA provision and agreed that it comports with the requirements of LCB File No. T004-08. Staff also supported Southwest’s request for the waiver from the LCB File No. T004-08 for specific rate classes whose costs are primarily recovered through a fixed charge or who possess certain characteristics which may cause unfavorable results if the GRA rate is applied to them. (Exhibit 88 at 9, 12.)

219. Staff supported Southwest’s request to exempt certain rate classes from the GRA rate because no conservation programs will be available for these customer classes so it would be unfair to charge customers in these rate classes for conservation gains in other classes without giving them any incentive to conserve as well. (Exhibit 88 at 12.)

220. Staff requested that the Commission order Southwest to provide semi-annual updates on the progress of the GRA provision in order to monitor its effects. (Exhibit 88 at 16-18.)

221. Staff recommended that the GRA rate be presented as a separate line item on the customer’s bill in order to show customers how the GRA provision affects their bills as well as
to send a clear price signal to customers, and facilitate customer understanding. (Exhibit 88 at 15.)

Southwest’s Rebuttal Position

222. Southwest opposed Staff’s recommendation to include the GRA rate as a separate line item on the bill because it is premature given that the first GRA rate will not be implemented until 2011. (Exhibit 62 at 8.)

223. Southwest testified that it will make a recommendation in 2011 as to how the GRA rate should be presented on a customer’s bill because it will have more information about the customers’ understanding of the decoupling mechanism. Staff will have an opportunity to address the issue at that time. (Exhibit 62 at 8.)

224. Southwest disagreed with Staff’s recommendation that it provide semi-annual updates on the GRA provision because it is already required to make an annual filing. (Exhibit 62 at 9.)

Commission Discussion and Findings

225. On November 20, 2008, the Commission adopted LCB File No. T004-08 which established methods and programs for a public utility which purchases natural gas for resale that remove the financial disincentives which discourage the public utility from supporting energy conservation. These regulations were a result of Senate Bill 437 from the 2007 Nevada Legislature.

226. LCB File No. T004-08 requires that a natural gas utility include the following in a general rate application: 1) identification of any change in risk and an adjustment to quantify the impact, 2) identification of the impact on the current and required rate design, and 3) an outline of the plan to educate customers as to the revenue decoupling plan.
227. The Commission agrees with Staff that Southwest has met the requirements of LCB File No. T004-08. Southwest’s request for a GRA provision is approved.

228. Southwest and Staff supported a deviation from LCB File No. T004-08, Section 7.3, for certain customer classes because of concerns of rate volatility for rate classes with a small number of customers and for rate classes which have already been effectively decoupled through rate design by significant fixed charges. The Commission agrees with Southwest and Staff that the unintended consequences of the GRA provision could be harmful to certain customer classes. Good cause exists for the deviation. Therefore, the Commission finds that it is in the public interest and not contrary to statute to grant a deviation of LCB File No. T004-08, Section 7.3, as requested by Southwest.

229. Staff recommended that Southwest reflect the GRA rate as a separate line item on customers’ bills. The Commission agrees with Southwest that this issue can be deferred until Southwest makes it first GRA rate filing expected in 2011.

b. Allocation of Transmission Mains Plant

Southwest’s Position

230. Southwest did not address this issue in its direct testimony.

BCP’s Position

231. BCP proposed to change the allocation of transmission mains plant from coincident peak demand to an allocator based 50 percent on demand and 50 percent on gas consumption. BCP asserted that its recommendation to split the allocation evenly between a demand and gas consumption allocator is a reasonable and conservative adjustment to Southwest’s proposed allocation factor. (Exhibit 87 at 2.)
232. BCP argued that Southwest’s transmission allocator assumes that transmission mains were built solely to meet peak demand. BCP asserted that Southwest’s transmission mains were used all year to provide large volumes of gas during non-coincident peak periods in addition to supplying load during coincident peak periods. (Exhibit No. 87 at 3)

Southwest’s Rebuttal Position

233. Southwest stated that BCP’s recommendation of allocating transmission mains on 50 percent demand and 50 percent commodity was presented in Docket No. 04-3011 by BCP and rejected by the Commission. The Commission also rejected this allocation method in Docket No. 01-7023. (Exhibit 91 at 7.)

234. Southwest stated that in Docket No. 04-3011, both Southwest and Staff agreed that transmission mains are designed and constructed to serve forecasted peak hour load requirements. Allocating transmission mains on each customer class’s coincident peak demand follows cost causation related to how transmission mains are designed and constructed. (Exhibit No. 91 at 8)

235. Southwest noted that in Docket No. 04-0311 the Commission concluded that an allocation based upon annual throughput, as recommended by BCP, would punish customer classes that use capacity more efficiently. (Exhibit No. 91 at 8.)

Commission Discussion and Findings

236. The Commission agrees with Southwest that peak day demand includes the level of capacity needed to meet customers’ annual throughput and that an allocation based upon BCP’s proposal would punish the customer classes that use their peak day capacity more efficiently.
237. The Commission agrees with Southwest that transmission mains are designed to serve forecasted peak hour load requirements and should be allocated based upon coincident peak demand. Therefore, the Commission finds that Southwest properly allocated transmission plant in its Cost of Service study. BCP’s proposal is rejected.

c. Allocation of Distribution Mains Plant

Southwest’s Position

238. Southwest did not address this issue in its direct testimony.

BCP’s Position

239. BCP disagreed with Southwest’s proposed allocation factor for distribution mains based upon a 50 percent customer allocator and 50 percent demand allocator. BCP argued that distribution mains should be treated as common facilities because they are not dedicated to an individual customer. An allocation factor such as demand or demand and commodity, is an appropriate allocation method for common facilities. (Exhibit 87 at 7.)

Southwest’s Rebuttal Position

240. Southwest’s stated that its proposal to allocate distribution mains on a 50 percent demand and 50 percent customer-related basis is consistent with prior Commission decisions. Southwest argued that BCP’s proposed allocation method for distribution mains should be rejected because it is not based upon cost causation and is not consistent with the direction given by the Commission in prior Southwest general rate cases. (Exhibit 91 at 8, 9.)

Commission Discussion and Findings

241. BCP’s proposed allocation of distribution main investment fails to consider the dual purpose of distribution main facilities, which is to reach new customers and meet the peak demand of customers in a specific area.
242. The Commission agrees with Southwest that distribution main investment is driven by both demand and the number of customers on the system. Therefore, the Commission finds that Southwest properly allocated distribution mains in its Cost of Service study. BCP's proposal is rejected.

d. Allocation of Federal Energy Regulatory Commission (“FERC”) Account Nos. 901-Supervision and 905-Miscellaneous Customer Accounting Expenses

Southwest's Position

243. Southwest did not address this issue in its direct testimony.

BCP's Position

244. BCP asserted that Southwest has allocated FERC Account Nos. 901-Supervision and 905-Miscellaneous Customer Accounting Expenses using an internally generated allocation factor based upon the allocation of costs for FERC Account Nos. 902-Meter Reading, 903-Customer Records and Collections, and 904-Uncollectible Accounts. (Exhibit 87 at 11.)

245. BCP proposed to exclude FERC Account No. 904-Uncollectible Accounts from the internally generated allocation factor. The allocation of FERC Account Nos. 901 and 905 would be limited to an internally generated allocation factor based upon the allocation of FERC Account Nos. 902 and 903 expenses. BCP justified this change in allocation on the basis that there are really no administrative or supervisory functions associated with accounting for the uncollectible expenses other than recording the uncollectible expenses as a ledger item in Southwest’s books. (Exhibit 87 at 11.)

Southwest’s Rebuttal Position

246. Southwest disagreed with BCP’s rationale for excluding Uncollectible Accounts Expense from the allocation process on the premise that it does not require administrative and supervisory functions. Southwest argued that administrative and supervisory time is spent on
uncollectibles and that Southwest recently completed a management review of its bad debt recovery procedures. (Exhibit 91 at 10.)

**Commission Discussion and Findings**

247. The Commission agrees with Southwest’s explanation that administrative and supervisory time and resources are required to manage its efforts in the recovery of bad debts. BCP’s proposed change in the allocation factor for FERC Account Nos. 901 and 905 to exclude Uncollectible Accounts Expense in the allocation factor is rejected. The Commission finds that Southwest has properly allocated the costs in FERC Account Nos. 901 and 905 in its Cost of Service study. BCP’s proposal is rejected.

e. **Record-Keeping-Uncollectible Accounts Expense**

**Southwest’s Position**

248. Southwest did not address this issue in its direct testimony.

**BCP’s Position**

249. BCP recommended that Southwest be required to keep more detailed data on which particular customer classes are responsible for uncollectible accounts expenses. Southwest’s current records separate uncollectible accounts expenses into only a residential/non-residential split. (Exhibit No. 87 at 11)

**Southwest’s Rebuttal Position**

250. Southwest agreed with BCP’s recommendation that it track uncollectibles expense by rate schedule. Southwest indicated that it had already initiated efforts to obtain additional uncollectibles data in conjunction with its proposal to record the cost of uncollectibles related to gas cost to a new deferred account. (Exhibit 91 at 10.)

**Commission Discussion and Findings**
251. The Commission agrees with BCP that Southwest’s accounting records should separate Uncollectible Accounts Expense by rate code so that proper assignment of this cost can be accomplished in a Cost of Service study. Southwest is directed to maintain records which identify Uncollectible Accounts Expense for the Single-Family Residential, Multi-Family Residential, and the Small, Medium and Large General Service rate classes.

f. **Cost of Service Study – Recognition of Special Contracts**

**Southwest’s Position**

252. Southwest did not address this issue in its direct testimony.

**Staff’s Position**

253. Staff contended that Southwest should have included the Special Contract customer class in the Cost of Service study filed with its Application. (Exhibit 89 at 4.) Staff asserted that the Order in Docket No. 01-7023 required that Southwest include the Special Contract customer class in the Cost of Service study. Staff noted that Southwest did incorporate the Special Contract customer class in the Cost of service study filed in Docket No. 04-3011. However, Staff expected the Cost of Service study in this Docket to include the Special Contract customer class. (Exhibit 89 at 4, 5.)

254. Staff testified that it received additional information from Southwest related to the cost of providing service to the Special Contract customer class. Staff compared the data provided to the information provided by Southwest in the certification filing. After analysis, Staff was unclear as to whether the Special Contract customer class is being subsidized by the other customer classes. (Exhibit 89 at 6.)

255. In order to eliminate the uncertainty on this issue, Staff recommended that the Commission require Southwest to modify its Cost of Service study to incorporate the Special
Contract customer class. Staff will verify the mechanics prior to the implementation of the new rates. (Exhibit No. 89 at 9.)

Southwest’s Rebuttal Position

256. Southwest did not dispute that the Order in Docket No. 01-7023 required it to include Special Contract customers in its next general rate case. Southwest asserted that it complied with the Commission’s Order and included Special Contract customers in the Cost of Service study filed in Docket No. 04-3011. (Exhibit 91 at 3.)

257. Southwest testified that the results of the Cost of Service study presented in Docket No. 04-3011 demonstrated that the revenue received from Special Contract customers was covering the cost of service. The Commission found Southwest’s Cost of Service study to be acceptable in its Order. (Exhibit No. 91 at 4.)

258. Southwest contended that based upon the Commission’s decision in Docket No. 04-3011, it could credit the Special Contract revenue back to the customer classes included in the Cost of Service study in this Docket as it had done in Nevada prior to Docket No. 04-3011. (Exhibit 91 at 4.)

259. Southwest asserted that the revenue received from Special Contract customers is controlled by contract. Since there is no revenue impact by including Special Contract customers in the Cost of Service study, the Commission should accept Southwest’s revenue credit method. (Exhibit 91 at 7.)

Commission Discussion and Findings

260. The Commission agrees with Southwest that it was not required to include the Special Contract customer class in the Cost of Service study filed in this Docket. Staff’s request
that Southwest be ordered to update its Cost of Service study to reflect the Special Contract customer class is denied.

261. The Commission agrees with Southwest that allocating the actual revenues back to each customer class is the proper approach for reflecting the revenue from Special Contracts in the revenue requirement allocation process because the revenues result from negotiated contracts.

262. The Commission shares Staff's concern that all special contracts have been limited to customers who have legitimate options for bypass and the negotiated rates result in a margin contribution for the benefit of Southwest's captive ratepayers.

263. Special contracts negotiated outside of the range provided under Southwest's ST-1 and NT-1 Transportation Eligible tariffs require Commission approval which gives the parties an opportunity to challenge the reasonableness of the contract and whether it qualifies under NAC 704.518.

264. In order for the parties to examine the reasonableness of new service agreements negotiated under the ST-1 and NT-1 tariffs and determine compliance with NAC 704.518, Southwest shall file a Cost of Service study analysis for all new ST-1 and NT-1 service agreements in the first general rate case following the effective date of a new service agreement.

**g. Allocation of Revenue Requirement to Rate Classes**

**Southwest's Position**

265. Southwest testified that it used the same method to determine customer class revenue requirements as it did in the last two general rate cases and that this method was approved by the Commission. (Exhibit 91 at 11.)

**Staff's Position**
266. Staff argued that Southwest used a non-traditional method to calculate revenue requirement by rate class. Staff testified that the allocation of revenue requirement is typically done by determining total revenue requirement and allocating it to each customer class based upon allocation factors developed in a class Cost of Service study. Staff contended that Southwest's methodology causes the rate of return to vary by rate class resulting in inter-class subsidies. (Exhibit 89 at 2-4.)

267. Staff argued that a fixed rate of return assumption should be used for each rate class in order to eliminate the cross subsidization between customer classes. (Exhibit 89 at 8.)

**BCP's Position**

268. BCP proposed a number of adjustments and recommendations to Southwest's proposed Cost of Service model that it contended more properly reflect the costs and attributes of the gas system. (These adjustments and recommendations are addressed in a separate section.) BCP incorporated the results of its adjustments into Southwest's Cost of Service model and made recommendations on assigning rate increases to customer classes. (Exhibit 87 at 1.) Using its proposed revenue requirement and adjusting Southwest's Cost of Service model, BCP recommended an average revenue increase of 7 percent for southern Nevada and a revenue decrease of 3.53 percent for northern Nevada. BCP proposed to hold certain rate classes at current rates and to move other rate classes closer to cost-based rates. (Exhibit 87 at 14-15.)

**Southwest's Rebuttal Position**

269. Southwest argued that BCP's proposed allocation of revenue requirement to the customer classes must be rejected because it is based upon BCP's flawed allocation of transmission and distribution costs. Southwest stated that the Commission's rationale for rejecting BCP's allocation in Docket No. 04-3011 applies equally to BCP's proposed allocation
in this docket. In its decision in Docket No. 04-3011, the Commission stated that the customer classes that make the most efficient use of Southwest's system are the very classes that are disadvantaged by BCP's proposed allocation method. (Exhibit 91 at 11.)

270. Southwest's argued that their approach is well balanced and should be adopted by the Commission in this case. (Exhibit 91 at 14, 15.) However, Southwest admitted that its proposed revenue requirement allocation method will not eliminate existing interclass subsidies. (Tr. at 785.)

**Commission Discussion and Findings**

271. BCP's recommended allocation of revenue requirement to the customer classes is based upon adoption of its proposed allocation factors for transmission and distribution plant. The Commission has rejected BCP's proposed allocation changes for transmission and distribution plant and, therefore, rejects the results of BCP's allocation of revenue requirement to the customer classes.

272. Staff's method for allocating total revenue requirement assumes that each customer class is paying its share of the return on rate base using the authorized rate of return which will eliminate interclass subsidization. Due to the modest increases recommended by Southwest for both northern and southern Nevada, the adoption of Staff's Cost of Service study allocation methodology will not produce significant changes in a customer's total bill which includes the charge for gas commodity. The Commission agrees with Staff and finds that its methodology is reasonable. Staff's revenue requirement allocation method is adopted with the exception of the Street Lighting rate class in northern Nevada. Moving this class to full cost will result in a 50 percent increase in the total bill. The Commission finds that the rate should be increased by 33 percent of the increase for cost-based rates.
VII. RATE DESIGN

a. Consolidation of the Residential and Multi-Family Customer Classes

Southwest’s Position

273. Southwest proposed that Single-Family and Multi-Family residential classes be consolidated into a single schedule with the same rates and differentiated by consumption blocks. (Exhibit 48 at 14.)

Staff’s Position

274. Staff opposed Southwest’s proposal to consolidate the Single-Family and Multi-Family residential classes because the specific data for each class does not support consolidation. (Exhibit 89 at 15.)

Southwest’s Rebuttal Position

275. Southwest testified that its proposed consolidation of the Single-family and Multi-family residential rate classes is dependent upon the Commissions acceptance of its declining block rate design. Southwest further testified that in the event the Commission rejects the declining block rate design, its proposed consolidation of the Single-family and Multi-family residential classes should be rejected. (Tr. at 808.)

Commission Discussion and Findings

276. Southwest testified that its proposed consolidation of the Single-Family and Multi-Family rate classes should be rejected unless a declining block rate design is accepted by the Commission. The Commission has rejected a continuation of a declining block rate design. Therefore, Southwest’s request to consolidate the Single-Family and Multi-Family residential rate classes is denied.

b. Reclassification of Master Meter Mobile Home Park Class

Southwest’s Position
277. Southwest testified that Master Meter Mobile Home Park ("MMMHP") customers have been moved to an appropriate General Service Class (Medium or Large) schedule. The MMMHP schedule, which has been closed to new customers for several years, has been eliminated. (Exhibit 48 at 14.)

Staff's Position

278. Staff opposed Southwest's proposal to reclassify the MMMHP class because Southwest failed to provide evidence supporting its request. Staff also noted that the applicability section of the General Service schedules would need to be expanded to include MMMHP customers. (Exhibit 89 at 19, 20.)

Southwest's Rebuttal Position

279. Southwest agreed with Staff's recommendation that the applicability section of its General Service rate schedule would need to be expanded to include MMMHP customers. (Exhibit 91 at 17.)

280. Southwest asserted that the Staff had not produced any compelling evidence to deny Southwest's proposal to reclassify MMMHP customers to their respective general service rate schedules. The comparisons provided by Southwest are equitable to customers and should be accepted by the Commission. (Exhibit 91 at 19.)

281. Southwest stated that in the event that the Commission denied its reclassification proposal, the MMMHP customer class should be excluded from the GRA decoupling charge. (Exhibit No. 91 at 19)

Commission Discussion and Findings

282. The Commission agrees with Staff that Southwest's direct testimony failed to provide adequate support for the requested reclassification of the MMMHP rate class to a
General Service rate class. However, the Commission is persuaded by Southwest's rebuttal testimony which indicates that the MMMHP customers can be reclassified to an appropriate General Service rate class with some modification to the tariff language. Southwest's request to reclassify the MMMHP rate class to an appropriate General Service rate class is accepted.

c. Reclassification of Condominium Customers

Southwest's Position

283. Southwest proposed to reclassify condominiums customers from the Single-Family residential class to the Multi-Family residential class. Southwest argued that reclassifying condominium customers to the Multi-Family service schedule better aligns the average cost of service and customer load profile for this customer class, and produces a more useful cost of service for formulating Southwest's proposed rate design. (Exhibit 79 at 5.)

Staff's Position

284. Staff opposed the reclassification on the grounds that Southwest failed to provide evidence in its application that the cost and average facilities required to serve a condominium customer are similar to the Multi-Family residential customer. Staff does not dispute Southwest's evidence that the usage pattern for condominiums customers is more aligned with the Multi-Family residential class. (Exhibit 89 at 16.)

285. Staff asserted that Southwest's tariffs do not include a definition of a condominium. Without a clear definition, it is not possible for Staff to determine what impacts, if any, would result from reclassifying these customers. (Exhibit 89 at 18.)

286. Staff testified that from a theoretical view, it would agree with Southwest's assumption that the cost to serve a condominium customer is the same as a Multi-Family
customer, but that Southwest failed to provide the evidence supporting this assumption. (Tr. at 851.)

**Southwest’s Rebuttal Position**

287. Southwest asserted that if the Commission accepts Southwest’s proposed reclassification of condominium customers from the Single-Family to Multi-Family residential class, the volume and revenue impacts for the correction of the classification errors will be reflected in the compliance schedules resulting from this Order. (Exhibit 90 at 3.)

288. Southwest argued that denying their proposal to reclassify condominiums customers to the Multi-Family rate class will ensure that all condominium customers will continue to pay the higher Single-Family rate for service. (Exhibit No. 91 at 16)

289. Southwest proposed the following definition to address Staff’s concern: Any structure where more than one permanent residential dwelling receives the benefits of natural gas service through individual meters. (Exhibit 91 at 17.)

**Commission Discussion and Findings**

290. There is no disagreement regarding the evidence that indicates that the annual usage for condominium customers is much more closely aligned to that of a Multi-Family residential customer than a Single-Family customer. The Commission also accepts Southwest’s argument that because the construction of condominiums is similar to that of a Multi-Family dwelling the cost of common facilities to serve a condominium would be more comparable than the cost to serve a Single-Family dwelling.

291. Southwest indicated that it has addressed the reclassification errors raised by Staff and would incorporate the corrections in the compliance tariffs filed in response to the Commission’s Order.
292. The Commission finds that Southwest's request to reclassify condominium customers to the Multi-Family rate class is reasonable and is accepted.

d. **Declining Block Rate**

**Southwest's Position**

293. Southwest proposed to retain the same rate design that was approved in Docket No. 04-03011 which included a declining block rate. (Exhibit 48 at 13, 15.)

294. Southwest argued that it does not believe that an increase in the amount of the cost of service recovered through a variable charge is required in order to meet the intent of the decoupling regulations which require the Commission to harmonize the incentives of general revenues decoupling with the rate design. (Exhibit 48 at 12, 13.)

**Staff's Position**

295. Staff recommended that the Commission deny Southwest's proposed declining block rate for the Residential and Multi-Family Residential customer classes and instead implement a flat commodity rate for all Southwest customer classes. (Exhibit 89 at 14.)

296. Staff argued that Southwest's proposal to use a declining block rate is inappropriate given the goals of promoting conservation supported by the Commission and the Nevada Legislature. Staff contended that a flat commodity rate or inclining block commodity rate is better suited for that goal. (Exhibit 89 at 13.)

**BCP's Position**

297. BCP argued that a decoupling mechanism results in less need to incorporate other rate design measures such as declining block rates. BCP contended that because revenue decoupling protects the utility against revenue variations, there is less need to incorporate this mechanism in rate design. BCP recommended that the Commission revisit the issue of
residential customer charges and declining block rates in Southwest’s next general rate case after the utility and the Commission have a number of years of experience with Southwest’s GRA provision. (Exhibit 87 at 17, 18.)

**Southwest’s Rebuttal Position**

298. Southwest acknowledged that LCB File No. T004-08 requires the Commission to harmonize the incentives of general revenue decoupling methodology with rate design. Southwest argued that the regulations do not specify what or how the harmonization should occur. Southwest argued that its rate design proposal is in harmony with incentives of the general revenues decoupling methodology. (Exhibit 93 at 4.)

299. Southwest disagreed with Staff’s assertion that a declining block rate structure could encourage higher usage. Southwest argued that Staff’s assertion is unsupported by any empirical data or analysis and that the declining block rate design more accurately reflects the cost incurred to serve customers. (Exhibit 93 at 5.)

**Commission Discussion and Findings**

300. LCB File No. T004-08 requires the Commission to harmonize rate design with the decision to implement a revenue decoupling mechanism. The Commission is compelled by Staff’s argument that a flat commodity rate sends a stronger price signal than a declining block rate design and as a result should encourage conservation. The Commission agrees with Staff that a flat commodity rate dovetails into the policy objectives of the Nevada Legislature to promote conservation. The Commission accepts Staff’s single commodity rate design.

e. **Fixed Monthly Charges**

**Southwest’s Position**
301. Southwest proposed changes to the monthly service charges of certain rate classes. (Statements J and O.)

**Staff’s Position**

302. Staff supported Southwest’s proposed fixed monthly service charges for all customer classes except for the Water Pumping Gas Service class and the Gas Service for Compression class, both in northern Nevada. Staff recommended a fixed monthly service charge of $30.00 for the Water Pumping Gas Service class and $33.00 for the Gas Service for Compression class. (Exhibit 89 at 12, 14.)

**BCP’s Position**

303. BCP opposed Southwest’s request to increase the residential customer charge from $8.50 to $9.00 because decoupling increases Southwest’s protection against revenue variations. BCP argued that increasing customer charges unduly harms residential customers that consume small amounts of gas and is a rate design that sends the wrong conservation signal to customers. (Exhibit 87 at 17.)

**Southwest’s Rebuttal Position**

304. Southwest argued that BCP’s proposal to retain the existing $8.50 residential basic service charge is not based upon Cost of Service principles. BCP’s argument that increasing customer service charges unduly harms residential customers that consume small amounts of gas fails to recognize that the cost of providing service to a small use customer is similar to the cost of service for an average use or larger customer. (Exhibit 93 at 7, 8.)

305. Southwest supported Staff’s proposed modifications to the fixed monthly service charges for the Gas Service for Compression and Water Pumping Gas Service customer classes in northern Nevada. (Exhibit 93 at 11.)
Commission Discussion and Findings

306. The Commission agrees with Southwest and Staff that based on the Cost of Service study an increase for specific customer classes is warranted and reasonable. The Commission also agrees with Staff’s recommendations regarding the fixed monthly service charges for the Service for Compression and Water Pumping Gas Service customer classes in northern Nevada. Southwest’s proposal to change the fixed monthly service charges for certain customer classes as modified by Staff’s recommendation is accepted.

f. Introduction of a Residential Air-Conditioner Rider Rate

Southwest’s Position

307. Southwest proposed a Residential Air-Conditioning Rider Rate which provides a lower cost distribution rate that is more reflective of the costs of providing this service to residential customers who have installed natural gas cooling equipment. (Exhibit 48 at 15.)

Staff’s Position

308. Staff opposed Southwest’s proposal of a Residential Air-Conditioning Rider Rate because Southwest’s Application lacks supporting data and it is tied to a declining block rate structure which Staff opposed in this case. (Exhibit 89 at 21.)

Southwest’s Rebuttal Position

309. Southwest disagreed with Staff’s contention that it failed to provide supporting information such as cost or efficiency figures. Southwest testified that currently there is no residential natural gas cooling market in the United States. If a market for natural gas cooling is eventually developed, the margin will be incremental to Southwest’s cost of providing service and will be returned to customers through the GRA rate. (Exhibit 62 at 9.)
310. Southwest asserted that it will be in a better position in its next general rate case to provide cost and efficiency analyses. (Exhibit 62 at 10.)

311. Southwest testified that no additional facilities are required to serve the gas air conditioning load and that the margin generated will be reflected in the annual GRA rate which will benefit all customers. (Tr. at 904-906.)

**Commission Discussion and Findings**

312. Southwest argued that there is currently no market in the United States for gas air conditioning. If a market can be developed, consumers could benefit from the reduced need for incremental electric generation and transmission capacity, reduced electric fuel costs, reduced greenhouse gas emissions, and more efficient use of energy resources and lower overall energy costs to customers.

313. The Commission agrees with Southwest that the development of a market for natural gas air-conditioning will potentially result in lower energy costs to consumers. The Commission also agrees with Southwest that any additional margin generated will benefit customers when reflected in the annual GRA rate. Southwest’s request for a gas air conditioning tariff is accepted.

**g. Request for Investigatory Docket Regarding Southwest’s Rule 9 Tariff**

**Staff’s Position**

314. Staff stated that Southwest has not collected a line extension fee from a residential customer in the past three years. Staff contended that it is appropriate to review Southwest’s Rule 9 tariff under an investigatory docket and requested the Commission open a docket to address the issue. (Exhibit 89 at 22.)

**Southwest’s Rebuttal Position**
315. Southwest agreed with Staff that any issue regarding the Rule 9 line extension tariff are beyond the scope of this general rate case proceeding. Southwest recommended that they meet with Staff informally to see if any modifications to the tariff can be agreed to prior to a formal investigatory docket. (Exhibit 61 at 12.)

Commission Discussion and Findings

316. The Commission shares Staff’s concern that Southwest’s Rule 9 tariff may be too generous given the fact that no line extension fees have been collected by Southwest in the last three years. The Commission agrees with Southwest that they should meet informally to determine if any modifications can be agreed upon prior to a formal investigatory docket. In the event that the issue cannot be resolved informally, the Commission encourages Staff to file a petition with the Commission requesting that an investigatory docket be opened.

317. Any proposed adjustments by the interveners not expressly discussed in this Order are denied. All arguments of the parties raised in this proceeding not expressly discussed in this Order have been considered and either rejected or found to be non-essential.

THEREFORE, it is ORDERED that:

1. The Application of Southwest Gas Corporation is GRANTED as modified by this Order.

2. Southwest Gas Corporation shall use the capital structure designated by the Commission in Paragraph 4 of this Order.

3. Southwest Gas Corporation shall use the cost of debt and customer deposit rate designated by the Commission in Paragraph 9 of this Order.

4. Southwest Gas Corporation’s return on equity shall be set at 10.15 percent.

5. Southwest Gas Corporation shall adjust its Northern Nevada other deferred debit and credit rate base amount to correct the mathematical error noted by Staff as described in Paragraph 60 of this Order.
6. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 64 regarding requirements for customers changing to sales service from transportation service and vice versa.

7. Southwest Gas Corporation shall remove the costs associated with its Energy Efficiency Technology Department from the calculation of its revenue requirement as described in Paragraph 71 of this Order.

8. Southwest Gas Corporation shall remove 10 percent of the expenses associated with its Management Incentive Program and 10 percent of the expenses associated with its Restricted Stock/Unit Plan from the calculation of revenue requirement as described in Paragraphs 80 and 82 of this Order.

9. Southwest Gas Corporation shall include 100 percent of the expenses associated with the Supplemental Executive Retirement Plan and the Executive Deferred Compensation Plan in its calculation of revenue requirement as described in Paragraph 91.

10. Southwest Gas Corporation shall, in its next general rate case, include the information requested by the Commission in Paragraph 92 of this Order.

11. Southwest Gas Corporation shall treat the expenses associated with the Transmission Integrity Management Program and the gain associated with the sale of the Tropicana Operations Center as described by the Commission in Paragraph 101 of this Order.

12. Southwest Gas Corporation shall change its accounting treatment for Lost and Unaccounted for Gas as described by the Commission in Paragraph 105 of this Order.

13. Southwest Gas Corporation shall remove the net losses associated with the purchase and sales of employees' homes from operating expenses, and remove the equity in employee homes from rate base as described by the Commission in Paragraphs 115 and 116 of this Order.

14. Southwest Gas Corporation shall include its rate case expense as of the date of its certification filing in the calculation of revenue requirement as described by the Commission in Paragraph 145 of this Order.
15. Southwest Gas Corporation shall include revenues and expenses for the postage rate increase expected change, the Southern Nevada Operations Centers expected change, and the Boulder Highway steel replacement project expected change in the calculation of its revenue requirement as described by the Commission in Paragraphs 146 and 148 of this Order.

16. Southwest Gas Corporation shall exclude 50 percent of the expense associated with Directors and Officers Insurance from the calculation of revenue requirement, and remove 50 percent of the prepaid amount from rate base as described by the Commission in Paragraph 159 of this Order.

17. Southwest Gas Corporation shall remove labor expenses associated with its conservation and energy efficiency plan budget from the calculation of revenue requirement as described by the Commission in Paragraph 175 of this Order.

18. Southwest Gas Corporation shall file additional information regarding its appliance demonstration area and its customer education regarding decoupling as described by the Commission in Paragraphs 181 and 182, including a compliance item regarding customer education within 60 days of the issuance of this Order.

19. Southwest Gas Corporation shall revise its tariff to track all natural gas cost-related bad debt expense as described by the Commission in Paragraph 188 of this Order. Southwest shall make a compliance filing regarding this new mechanism as described in Paragraph 189 of this Order.

20. Southwest Gas Corporation shall normalize its Office Supplies and Expenses and Outside Services Expenses as described by the Commission in Paragraphs 197 and 203 of this Order.

21. Southwest Gas Corporation shall file with the Commission, within 60 days of the issuance of this Order, all of its existing negotiated transportation service agreements and supporting economic studies to ensure that the Commission has complete records.

22. Southwest Gas Corporation shall renegotiate expired transportation service agreements as described by the Commission in Paragraph 209 of this Order.
23. Southwest Gas Corporation shall implement its proposed general revenues adjustment as filed.

24. Southwest Gas Corporation’s request to deviate from LCB File No. T004-08 is approved.

25. Southwest Gas Corporation shall maintain records which identify Uncollectible Accounts Expense as described by the Commission in Paragraph 251 of this Order.

26. Southwest Gas Corporation shall file a Cost of Service study analysis for all new ST-1 and NT-1 service agreements in the first general rate case following the effective date of a new service agreement as described by the Commission in Paragraph 264 of this Order.

27. Southwest Gas Corporation shall adopt the revenue requirement allocation methodology described by the Commission in Paragraph 272 of this Order.

28. Southwest Gas Corporation shall not consolidate the Single-Family and Multi-Family residential rate classes as described in Paragraph 276 of this Order.

29. Southwest Gas Corporation shall implement a single commodity rate design as described by the Commission in Paragraph 300 of this Order.

30. Southwest Gas Corporation shall implement an increase for specific customer classes as described by the Commission in Paragraph 306 of this Order.

31. Southwest Gas Corporation shall file new tariff sheets implementing the Commission’s findings in this Order as a compliance item.

32. Southwest Gas Corporation’s request for confidential treatment of the testimony of Sandra L. Gaffin pursuant to NRS 703.196 and NAC 703.5274 is GRANTED. This information is to remain confidential for three years from the date of the issuance of this Order.

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33. The Commission may correct any errors that may have occurred in the drafting or issuance of this Order without further proceedings.

By the Commission,

SAM A. THOMPSON, Chairman

JO ANN P. KELLY, Commissioner

REBECCA D. WAGNER, Commissioner and Presiding Officer

Attest: Nancy Krassner, Assistant Commission Secretary

Dated: Carson City, Nevada

11/3/09

(SEAL)