Case No. 80911

In the Supreme Court of Nevada

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Elizabeth A. Brown
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SOUTHWEST GAS CORPORATION,

Appellant,

vs.

PUBLIC UTILITIES COMMISSION OF NEVADA; and STATE OF NEVADA BUREAU OF CONSUMER PROTECTION,

Respondents.

APPEAL

from the Eighth Judicial District Court, Clark County
The Honorable WILLIAM KEPHART, District Judge
District Court Case No. A-19-791302-J

JOINT APPENDIX
VOLUME 1
PAGES 1–250

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CERTIFICATE OF SERVICE

I certify that on January 4, 2021, I submitted the foregoing "Joint Appendix" for filing *via* the Court's eFlex electronic filing system. Electronic notification will be sent to the following:

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CASE NO: A-19-791302-J
Department 19

DISTRICT COURT
CLARK COUNTY, NEVADA

SOUTHWEST GAS CORPORATION, Petitioner, *vs.* PUBLIC UTILITIES COMMISSION OF NEVADA, Respondent.	Case No.: Dep't No.: **PETITION FOR JUDICIAL REVIEW**

PETITION FOR JUDICIAL REVIEW

1. Petitioner Southwest Gas Corporation seeks judicial review of the February 15, 2019 "Order on Petitions for Reconsideration and Clarification" and the February 15, 2019 "Modified Order" issued by the Public Utilities Commission of Nevada, as well as any other orders made reviewable by the foregoing. Copies of the orders are attached hereto as Exhibits "1" and "2."

2. Southwest Gas will be filing a memorandum of points and authorities pursuant to NRS 703.373(6) within the time required by that statute following notice to Southwest Gas that the record of the proceedings has been filed with this Court.

3. This petition is the notification required to commence judicial review and should not be construed as Southwest Gas's memorandum of points and authorities under NRS 703.373(6).

BACKGROUND

4. On May 29, 2018, Southwest Gas filed an application with the Commission (Docket No. 18-05031) for approval to increase its retail natural-gas service rates and to reset its gas infrastructure rates in southern and northern Nevada.

5. These increases are necessary to offset changes in the cost of service and to account for certain gas infrastructure projects that the Commission previously approved.

6. In addition to the Commission's regulatory operations staff, who participates as of right under NRS 703.301, the Attorney General's Bureau of Consumer Protection and Nevada Cogeneration Associates # 1 and #2, Limited Partnerships, intervened in the application.

7. On December 23, 2018, the Commission issued an order granting in part and denying in part the application.

8. Southwest Gas and the Commission staff separately petitioned for reconsideration and clarification, and on February 15, 2019, the Commission granted reconsideration in part and entered a modified order.

9. Southwest Gas seeks judicial review to get clarity on the procedural rules and presumptions that govern in these types of proceedings, and to recover the costs to which it is entitled based on prevailing law and the record as a whole, but which the Commission improperly rejected.

THE STANDARD ON JUDICIAL REVIEW

10. Under NRS 703.373(11), this Court may set aside any part of the Commission's decision that is

a. In violation of constitutional or statutory provisions;

b. In excess of the statutory authority of the Commission;

c. Made upon unlawful procedure;

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d. Affected by other error of law;

e. Clearly erroneous in view of the reliable, probative and substantial evidence on the whole record; or

f. Arbitrary or capricious or characterized by abuse of discretion.

PRINCIPAL ISSUES ON JUDICIAL REVIEW

A. Evidentiary Standards, Including the Application of a Rebuttable Presumption of Prudence

11. The United States Supreme Court and the Nevada Supreme Court have long recognized a presumption of prudence in the exercise of judgment by the management of regulated utilities, including in making utility expenditures. *See West Ohio Gas Company v. Pub. Utilities Comm'n of Ohio*, 294 U.S. 63 (1935); *Pub. Servs. Comm'n v. Ely Light & Power Co.,* 80 Nev. 312, 393 P.2d 305 (1964).

12. And the Commission itself recognized such a presumption, *e.g.*, *Re Nev. Power Co.*, 74 P.U.R. 4th 703 (May 30, 1986), including in other general rate-setting cases, *Re Sierra Pac. Power Co.*, 96 P.U.R. 4th 1, at II.B.1 (June 24, 1988); *Application of Nev. Power Co.*, 2009 WL 1893687, at *75 (June 24, 2009).

13. In 2007, the Legislature overturned the Supreme Court's decision in *Nevada Power Co. v. Pub. Utilities Comm'n of Nevada*, which had adopted the Commission's presumption for applications "for recovery of losses documented by deferred energy accounting." 122 Nev. 821, 834, 138 P.3d 486, 495 (2006). *See* 2007 Nev. Stat. 551–56, AB 7 (amending NRS 704.110 and NRS 704.185). The statute did not eliminate any presumption in general rate-setting cases.

14. The Commission nonetheless rejected a rebuttable presumption in rate cases in this proceeding and stated that its earlier decisions recognizing that presumption were wrongly decided. (Order on Reconsideration ¶¶ 64–66.)

15. That rejection is both wrong and impracticable. NRS chapter 704,

and its targeted carveout of a presumption in deferred-energy cases, is enacted against the background of such a presumption. And in setting rates, the Commission necessarily includes expenditures that are not specifically contested or addressed during the proceedings, meaning that the Commission implicitly applies such a presumption as to those uncontested items.

16. In addition to its rejection of the rebuttable presumption, the Commission also improperly denied recovery of certain costs in the absence of sufficient evidence. The Nevada Supreme Court has expressly held that in the absence of evidence demonstrating arbitrary or unreasonable decision-making on the part of utility management, the Commission shall not substitute its judgment for that of management. *See Pub. Servs. Comm'n v. Ely Light & Power Co.*, 80 Nev. 312, 323–24, 393 P.2d 305, 311 (1964).

17. It is essential to obtain a judicial ruling on the existence and application of the rebuttable presumption as well as the Commission's obligation to make decisions based on the record as a whole, not only because they affected several of the issues before the Commission in this case, but also because they will impact how these kinds of cases will proceed in the future:

Challenged Work Orders

a. For five critical software projects that were challenged during the proceeding, the Commission denied *any* recovery to Southwest Gas. (Order on Reconsideration ¶ 98.) No one asked for that. Commission staff even recommended a 50% recovery—a more than $25 million reduction of the $51 million expended on these projects.

b. Although the Commission purported to deny 100% of these costs regardless of its finding on the presumption of prudence, in practice the Commission demanded evidence "that the costs associated with the

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Challenged Work Orders were prudently occurred," and considered Southwest Gas's alleged "failure" to offer that evidence dispositive. (Order on Reconsideration ¶¶ 89–92.)

c. This indicates that the absence of such a presumption determined the outcome on this question.

d. The Commission also disregarded the direct and rebuttal testimony substantiating those costs and unjustifiably substituted its own judgment for that of Southwest Gas management in concluding that these costs were not prudently incurred and therefore, not recoverable.

e. The 100% denial of costs for these challenged work orders was error.

Pension Expense

f. The Commission also rejected Southwest Gas's actual 2018 pension costs in favor of a three-year "normalization" of those expenses, even though that expense was not challenged and normalization for this expense has not been used previously in Southwest Gas's most recent general rate cases. (Order on Reconsideration ¶ 122.) In addition, the Commission modified 2018 discount rate for pension expense—an issue that neither staff nor any intervening party had raised. (Order on Reconsideration ¶¶ 123–24.)

g. Had the Commission applied a presumption of prudence, it could not have denied Southwest Gas these actual expenses absent affirmative evidence challenging their reasonableness.

h. The Commission again unjustifiably substituted its own judgment for that of Southwest Gas management.

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B. Procedural Due Process

18. This case also provides a good opportunity for the Court to establish and clarify the applicable procedural rules governing these proceedings to ensure that all participants are treated fairly and in an impartial manner.

19. Commission staff is permitted to investigate and present its positions as an ostensibly independent party before the Commission. In exchange, the Commission, the Presiding Officer, and policy advisors may ask questions to clarify witness testimony but are not an interested party.

20. Here, however, the Commission acted like an interested party, raising issues and arguments without prior notice to Southwest Gas, conducting its own investigation, and then limiting the scope of Southwest's ability to respond to the new allegations.

21. This violates the Commission's own regulations and procedures and constitutes a denial of due process. It also places in one body both investigative and adjudicatory power, depriving Southwest Gas of an impartial adjudication.

22. The following examples show how the lack of notice and the Commission's efforts to inject itself as a party impacted the proceedings:

Pension Expense

a. The Commission *sua sponte* and without notice asked Southwest Gas to justify a 3.75% discount rate for pension expense—an issue that neither staff nor any intervening party had raised. (Modified Order ¶¶ 424, 425, 428.) As Southwest Gas had not prepared witnesses to testify about the undisputed discount rate, the Commission rejected it, but then applied the prior year's 3.75% discount rate without justifying that rate.

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Rate of Return on Equity

b. The Commission also *sua sponte* adopted a rate of return on equity of just 9.25%, lower than both staff's recommendation of 9.40% and the Bureau of Consumer Protection's recommendation of 9.30%. (Modified Order ¶¶ 65, 92, 195.)

c. Disregarding evidence of both the industry average of 9.68% and the authorized rates of return provided to the uncontested peer group that average 10.23%, the Commission adopted a self-described "zone of reasonableness" of 9.10% to 9.70%, from which it then adopted without explanation a rate at the bottom end of that range. (Order on Reconsideration ¶¶ 109–10.) While assailing the absence of a statutory basis for the rebuttable presumption of prudence, the Commission identifies no statutory support for a "zone of reasonableness" in general or that the criteria for setting such a zone were followed in this case.

23. Judicial review is necessary to establish and enforce the rules and principles that are designed to give regulated utilities fair notice before an impartial tribunal, in this and in future cases.

* * *

24. The Commission's actions and decisions are arbitrary, capricious, and clearly erroneous in light of the evidence, are based upon unlawful procedure, and reflect a misunderstanding of the applicable case law, statutes, regulations, and procedural rules.

JURISDICTION

25. Jurisdiction with this Court is proper pursuant to NRS 703.373, allowing judicial review of a "final decision upon the exhaustion of all administrative remedies," including "final action by the Commission on reconsideration or

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rehearing." The orders here represent the Commission's final decision and are not reviewable by any other administrative body.

VENUE

26. Venue is proper under NRS 703.373(2) ("Proceedings for review may be instituted by filing a petition for judicial review in the District Court . . . in and for the county in which the party of record seeking judicial review resides, or in and for the county where the act on which the proceeding is based occurred.").

PRAYER FOR RELIEF

This Court should:

1. Grant the petition for review under NRS 703.373;
2. Vacate the Commission's February 15, 2019 "Order on Petitions for Reconsideration and Clarification" and February 15, 2019 "Modified Order";
3. Provide the relief consistent with this petition and as requested in Southwest Gas's petition for reconsideration before the Commission; and
4. Provide all legal, declaratory, and equitable or injunctive relief that arises from or is implied by the facts of this petition, regardless of whether it was specifically requested.

Dated this 18th day of March, 2019.

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EXHIBIT 1

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EXHIBIT 1

BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Application of Southwest Gas Corporation for authority to increase its retail natural gas utility service rates and to reset the Gas Infrastructure Replacement Rates for Southern and Northern Nevada.	Docket No. 18-05031

At a general session of the Public Utilities Commission of Nevada, held at its offices on February 15, 2019.

PRESENT: Chairman Ann Wilkinson
Commissioner Ann Pongracz
Commissioner C.J. Manthe
Assistant Commission Secretary Trisha Osborne

ORDER ON PETITIONS FOR RECONSIDERATION AND CLARIFICATION

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

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I. INTRODUCTION

On May 29, 2018, Southwest Gas Corporation ("SWG") filed an Application with the Commission, designated as Docket No. 18-05031, for authority to increase its retail natural gas utility service rates and to reset the Gas Infrastructure Replacement Rates for Southern and Northern Nevada (the "Application").

On December 24, 2018, the Commission issued an Order granting in part and denying in part SWG's Application as modified by the Commission's Order.

On January 9, 2019, SWG timely filed a Petition for Reconsideration, and the Regulatory Operations Staff ("Staff") of the Commission timely filed a Petition for Clarification and Reconsideration.

II. SUMMARY

The Commission grants both SWG's Petition for Reconsideration and Staff's Petition for Clarification and Reconsideration and issues a modified final order, which is attached hereto as Attachment 1.

III. PROCEDURAL HISTORY

- On May 29, 2018, SWG filed its Application.

• SWG filed the Application pursuant to the Nevada Revised Statutes ("NRS") and the Nevada Administrative Code ("NAC"), Chapters 703 and 704, including but not limited to NRS 704.110 and 704.992. Pursuant to NAC 703.5274, SWG requested confidential treatment of certain information.

• Staff participates as a matter of right pursuant to NRS 703.301.

• On May 30, 2018, the Attorney General's Bureau of Consumer Protection ("BCP") filed a Notice of Intent to Intervene.

• On June 1, 2018, the Commission issued a Notice of Application for Authorization to Increase Rates and Charges for Natural Gas Service and Notice of Prehearing Conference.

• On June 21, 2018, Nevada Cogeneration Associates #1 and #2, Limited Partnerships, ("NCA") filed a Petition for Leave to Intervene ("PLTI").

• On July 2, 2018, the Commission held a prehearing conference. SWG, BCP, NCA, and Staff (collectively, the "Parties") made appearances. NCA's PLTI and a procedural schedule were discussed. The prehearing conference was continued on the record to September 28, 2018.

• On July 6, 2018, the Commission issued an Order granting NCA's PLTI.

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• On July 6, 2018, the Presiding Officer issued a Procedural Order requiring Parties to submit information to the Commission regarding negotiated rate contracts, the agreed upon procedural schedule, and an outline of issues that the Parties agree to address in pre-hearing briefs.

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• On July 9, 2018, Staff filed a letter on behalf of the Parties responsive to the July 6, 2018, Procedural Order. Staff requested confidential treatment of certain information contained in the letter pursuant to NAC 703.5274. ("Staff's July 9, 2018, Letter")

• On July 12, 2018, the Presiding Officer issued Procedural Order No. 2, establishing a procedural schedule and addressing discovery disputes and rules.

• On July 16, 2018, the Commission issued a Notice of Consumer Session and Notice of Hearing.

• On July 27, 2018, SWG, BCP, NCA, and Staff submitted pre-hearing briefs responsive to the Commission's July 6, 2018, Procedural Order.

• On July 27, 2018, Saguaro Power Company, a Limited Partnership ("Saguaro") filed comments addressing Staff's July 9, 2018, Letter.

• On August 24, 2018, the Presiding Officer issued Procedural Order No. 3, establishing a procedural schedule, rescheduling a continued prehearing conference, and setting the scope of the proceeding as it relates to negotiated rate contracts.

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- On August 24, 2018, SWG filed its prepared certification testimony and applicable supporting schedules for its NND and SND.

- On August 30, 2018, Staff filed a letter correcting and addressing a mistake in its July 9, 2018, Letter. Staff requested confidential information of certain information contained in its letter pursuant to NAC 703.5274(2)(c).

- On August 31, 2018, SWG submitted its certification filing.

- On August 31, 2018, SWG filed a partially redacted copy of the prepared direct testimony of Brian T. Holmen.

- On August 31, 2018, SWG filed its prepared GIR certification testimony and supporting exhibits.

- On September 7, 2018, SWG filed its Summary of Operations and Rate of Return for Southern and Northern Nevada for calendar years 2013-2017.

- On September 11, 2018, the Commission conducted a consumer session at the Commission's office in Las Vegas, Nevada and via video-conference to Carson City, Nevada.

- On September 14, 2018, SWG filed its Prepared GIR Certification Testimony.

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- On September 21, 2018, BCP and Staff filed Prepared Direct Testimony.

- On September 21, 2018, NCA filed a request to participate in the continued prehearing conference telephonically.

- On October 1, 2018, the Commission held a prehearing conference. SWG, BCP, and Staff made appearances. NCA also made an appearance telephonically.

- On October 3, 2018, BCP and Staff filed Prepared Direct Testimony.

- On October 5, 2018, BCP and Staff filed Prepared Direct Testimony and SWG filed Prepared Rebuttal Testimony.

- On October 10, 2018, Staff filed Direct Testimony.

- On October 12, 15, and 16, 2018, SWG filed Rebuttal Testimony.

- On October 16, 2018, BCP filed an Errata to the Direct Testimony of David Lawton.

- On October 19, 2018, BCP filed an Errata and Notice of Adoption of Testimony.

- On October 22 through 25, 2018, and October 29 through 30, 2018, the Commission held a hearing. The Parties made appearances. Exhibit Nos. 1-115 and Confidential Exhibit Nos. 1-20 were accepted into the record.

• On October 25, 2018, SWG filed Late-Filed Exhibit 61.

• On October 29, 2018, SWG filed an Errata to the Direct Testimony of Randi Cunningham.

• On November 2, 2018, SWG filed Late-filed Confidential Exhibit No. 20.

• On November 9, 2018, the Presiding Officer issued Procedural Order No. 4, requiring that Parties submit legal briefs to the Commission on or before November 30, 2018.

• On November 9, 2018, SWG late-filed Exhibit No. 109.

• On November 13, 2018, the Presiding Officer issued Corrected Procedural Order No. 4.

• On November 30, 2018, SWG, BCP, Staff, and Nevada Cogeneration Associates #1 and #2 ("NV Cogen #1 and NV Cogen #2," respectively) filed post-hearing briefs.

• On December 23, 2018, the Commission issued an Order granting in part and denying in part SWG's Application (the "Order")

• On January 9, 2019, SWG filed a Petition for Reconsideration ("SWG's Petition")

• On January 9, 2019, Staff filed a Petition for Clarification and Reconsideration ("Staff's Petition").

• On January 24, 2019, SWG filed an Answer to Staff's Petition ("SWG's Answer").

• On January 24, 2019, Staff filed an Answer to SWG's Petition ("Staff's Answer").

• On January 24, 2019, BCP filed an Answer to SWG's Petition ("BCP's Answer").

• On January 24, 2019, Nevada Cogeneration Associates #1 and #2 ("NV Cogen #1 and #2") filed a Response to Staff's Petition and SWG's Petition ("NV Cogen #1 and #2's Response").

IV. PETITIONS FOR RECONSIDERATION AND/OR CLARIFICATION

A. Standard for Reconsideration

1. A party may file for reconsideration within ten business days after the effective date of a Commission order.[1] Pursuant to NAC 703.801(1), "[a] petition for reconsideration must specifically:

[1] *See* NAC 703.801(3).

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(a) Identify each portion of the challenged order which the petitioner deems to be unlawful, unreasonable or based on erroneous conclusions of law or mistaken facts; and

(b) Cite those portions of the record, the law or the rules of the Commission which support the allegations in the petition. The petition may not contain additional evidentiary matter or require the submission or taking of evidence.

. . .

(7) If the Commission grants a petition for reconsideration, it will reexamine the record and order with regard to the issues on which reconsideration was granted and issue a modified final order or reaffirm its original order.

. . .

(9) A modified final order of the Commission issued upon reconsideration or rehearing will incorporate those portions of the original order which are not changed or modified by the modified final order. A modified final order is the final decision of the Commission.

B. SWG's Petition for Reconsideration

SWG's Position

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2. SWG seeks reconsideration of the portions of the Order pertaining to the following five items: (1) the discussion and finding regarding the rebuttable presumption of prudence in paragraphs 7 through 13; (2) the discussion and finding regarding the Challenged Work Orders in paragraphs 621 through 627; (3) the discussion and finding regarding the ROE in paragraphs 179, 194 and 195; (4) the discussion and finding regarding the normalization of pension expense in paragraphs 426 through 428, 435 through 437; and (5) the discussion and finding regarding violations of NAC 704.518 and SWG's Tariff in paragraphs 867, 869, 870, 876, and 879. (Pet. at 1-2.) SWG argues that the Commission's findings on these foregoing issues "are unlawful, unreasonable, based upon either a misapplication of the law or mistake as to the evidence presented, and lack support from the record." (*Id.*)

Commission Discussion and Findings

3. SWG has specifically identified the paragraphs of the Order for which it seeks reconsideration, which it argues "are unlawful, unreasonable, based upon either a misapplication

of the law or mistake as to the evidence presented, and lack support from the record." (Pet. at 1.) To support its request for reconsideration of items 1-4 above, SWG generally cites to the same portions of its testimony that has already been considered and weighed by the Commission, and SWG references mostly the same case law that it provided during hearing and in its post-hearing legal brief; and to support its request for reconsideration of item 5, SWG offers specific reasons based on the record for the Commission to modify its decision. Therefore, the Commission grants SWG's Petition because it has met the procedural threshold standard for reconsideration under NAC 703.801(1). Accordingly, the Commission reexamines the record and its decision to address the issues raised in SWG's Petition.

Rebuttable Presumption of Prudence

SWG's Position

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4. SWG reiterates the same arguments and provides mostly the same case law that it provided in its post-hearing legal brief in support of its allegation that it enjoys a rebuttable presumption of prudence.

5. SWG alleges that the Order "misinterprets" Nevada law, which SWG claims "eliminated the rebuttable presumption for proceedings involving deferred energy accounting only but did not eliminate the rebuttable presumption for other proceedings, including general rate case proceedings." (*Id.* at 2.) SWG claims that the Order's "erroneous conclusion of law is premised on the misinterpretation of [Assembly Bill No. 7 ('AB 7'), 2007 Leg., 74^{th} Sess. (Nev. 2007.)] that superseded the application of a rebuttable presumption of prudence for rate proceedings involving deferred energy accounting only, but did not supersede or otherwise change the application of a rebuttable presumption of prudence for general rate cases." (*Id.*)

6. SWG, citing to a footnote in a concurring opinion of Justice Brandeis in *Missouri ex. rel. Southwestern Bell Telephone Co. v. Public Service Commission,* 262 U.S. 276 (1923), claims that "it is a longstanding and widely-accepted principle in [general rate case ('GRC')] proceedings that a regulated utility is entitled to a rebuttable presumption that the expenses reflected in its rate applications are prudently incurred, and Nevada is no exception." (*Id.*) The footnote in this concurring opinion reads as follows:

> The term 'prudent investment' is not used in a critical sense. There should not be excluded, from the finding of the base, investments which, under ordinary circumstances, would be deemed reasonable. The term is applied for the purpose of excluding what might be found to be dishonest or obviously wasteful or imprudent expenditures. Every investment may be assumed to have been made in the exercise of reasonable judgment, unless the contrary is shown.[2]

7. SWG also cites to the Federal Energy Regulatory Commission's ("FERC") decision in *Re Minnesota Power & Light Co.,* 11 FERC 61, 312 (1980), as supporting the proposition that it is entitled to a rebuttable presumption of prudence in general rate case proceedings before the Commission.

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8. SWG continues that "[t]he rebuttable presumption of prudency derives from the fundamental premise articulated by the U.S. Supreme Court and followed in Nevada," citing to the following language contained in the U.S. Supreme Court's decision in *W. Ohio Gas Co. v. Pub. Utilities Comm'n of Ohio,* 294 U.S. 63 (1935), for support[3]:

> Good faith is to be presumed on the part of the managers of a business... In the absence of a showing of inefficiency or improvidence, a court will not substitute its judgment for theirs as to the measure of a prudent outlay. (internal citation omitted)

(*Id.* at 3.)

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[2] *Missouri ex. rel.*, 262 U.S. at 289 n. 1. SWG also cites to the following Nevada Supreme Court case and two Commission proceedings for support: *Nevada Power Co. v. Pub. Utilities Comm. of Nevada,* 122 Nev. 821, 138 P3d 146 (2006); *In re Nevada Power Company* 74 P.U.R. 4th 703 (May 30, 1986); *Application of Nevada Power Company,* 2009 WL 1893687 (June 24, 2009).

[3] SWG also cites, but does not quote, the Nevada Supreme Court's decision in *Public Service Comm'n of Nevada v. Ely Light and Power Co., 80 Nev. 312 (1964)*, at p. 324, for support.

9. SWG, citing to the Federal Energy Regulatory Commission's ("FERC") decision in *Pacific Gas and Electric Company*, 165 FERC 63,001 (2018), proclaims that "[w]hile it does not alter the utility's ultimate burden of proof in demonstrating its proposed rates are just and reasonable, the rebuttable presumption of prudence provides a procedural framework for increased efficiencies in ratemaking proceedings." (*Id.*)

10. Additionally, SWG cites to a number of Commission decisions to support its position that the Commission recognizes the applicability of the rebuttable presumption of prudence standard in its GRC proceedings, stating that the Commission recognized the applicability of the standard in the following three proceedings: *Re Nevada Power Co.* 74 P.U.R. 4^{th} 703 (May 30, 1986); *Re Sierra Pacific Power Co.*, 96 P.U.R. 4^{th} 1 (June 24, 1988); and *Application of Nevada Power Co.*, 2009 WL 1893687 (June 24, 2009). (*Id.* at 3-5.)

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11. SWG states that the principles articulated in *Re Nevada Power Co.* and in *Re Sierra Pacific Power Co.* "were further recognized" by the Nevada Supreme Court in its decision in *Nevada Power Co. v. Pub. Utilities Commission of Nevada,* 122 Nev. 821, 138 P.3d 486 (2006). While SWG acknowledges that AB 7 superseded the *Nevada Power* decision, SWG claims that AB 7 "superseded the application of the rebuttable presumption standard only in proceedings involving deferred energy accounting." (*Id.* at 4.) SWG claims that the Order "erroneously extends the purpose, and the plain language of AB 7 to general rate case proceedings" and that the Commission's "reliance on AB 7 as support for the finding that the application of the rebuttable presumption of prudence in a general rate case has been superseded is an erroneous conclusion of law." (*Id.* at 5.) SWG then references the Commission's specific recognition of the rebuttable presumption of prudence standard in the 2009 proceeding *Application of Nevada Power Company* as being particularly notable given that the Commission's recognition of the standard occurred after enactment of AB 7. (*Id.* at 5-6.)

12. Moreover, SWG states that the Order misapplies NAC 703.2231 because the Order's "reference to the utility's burden of proof to demonstrate prudence in a rate case pursuant to NAC 703.2231 does not circumvent the utility's presumption of prudence." (*Id.* at 6.) Rather, SWG claims that, "when applied correctly, NAC 703.2231 harmonizes with the rebuttable presumption of prudence." (*Id.*)

13. SWG states that "[t]here is no requirement that the application contain all possible documentation to support a particular cost, or that the application address all possible arguments that could be raised by other parties at hearing in order to support a particular cost." (*Id.*) SWG claims that such a requirement would create "an impractical situation" and would make rebuttal testimony "meaningless." Consistent with this reasoning, SWG claims that it "satisfied its initial burden of proof and complied with NAC 703.2231." (*Id.* at 7.)

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14. SWG further claims that "[t]he operational effect of the [Order] is inconsistent with the Commission's finding that 'SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures' because of "numerous expenditures included in the Application that were not challenged by and of the parties, and that are included in the new rates following this proceeding." (*Id.* at 8.)

15. SWG concludes that the Commission's refusal "to recognize [SWG's] rebuttable presumption of prudence" in the Order "is contrary to Nevada law, an unfounded departure from long-standing and widely accepted principles of utility ratemaking, and inconsistent with its own operation effect." (*Id.*)

BCP's Position

16. BCP disagrees with SWG and states that the Order correctly indicates that SWG has the ultimate burden of proof and properly characterizes any rebuttable presumption of prudence. (BCP Answer at 2.)

17. BCP states that paragraph 7 of the Order correctly reflects "the ambiguity with which SWG approached this proceeding" given that SWG offered conflicting statements with regard to whether it has an obligation to justify expenditures that form the basis of its request to change rates. (*Id.*)

18. BCP states that paragraph 8 of the Order revisits the fact that SWG circulated the Nevada Supreme Court's decision in *Nevada Power Co.* and the 1986 Commission decision *In re Nevada Power* "despite the Legislature later addressing the issue of rebuttable presumption of prudence in 2007, through [AB 7]." (*Id.*) Similar to Staff, BCP also states that the 2006 NPC case is irrelevant to the decision in this case because that case dealt with deferred energy accounting whereas this case is a general rate case proceeding. (*Id.*)

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19. Regarding SWG's challenge to paragraph 10 of the Order, which addresses the fact that Nevada's natural gas utilities are not subject to resource planning, BCP asserts that "SWG has not supported the conclusion that somehow [SWG] obtains a presumption of prudence without getting approval through the resource planning process, which other utilities are required to go through." (*Id.* at 3.)

20. Regarding SWG's challenge to paragraph 11 of the Order, which addresses the fact that natural gas utilities must seek a determination of prudence with regard to GIR projects, BCP states that "this is consistent with requiring a natural gas utility to demonstrate prudence in the general rate case process." (*Id.*)

21. Similarly, regarding SWG's challenge to paragraph 12 of the Order, which addresses the manner in which SWG may recover costs associated with the Solar Thermal Demonstration program, BCP explains that "[t]his again demonstrates a lack of any presumption of prudence for expenditures that SWG would expend for this program in a general rate case." (*Id.*)

22. BCP also agrees with the Commission that SWG cites to a number of decisions that do not have precedential effect. (*Id.*) BCP explains that the "express language of AB 7 indicates that it was intended to speak to cases involving deferred energy and reflected a policy that there should be no presumption of prudence applied in deferred energy cases. (*Id.* at 3-4.) BCP concludes that "[i]n the only case when the Nevada Supreme Court adopted a rebuttable presumption as an intermediate step in the utility decision making process, that presumption was rejected by the Nevada Legislature, and the ultimate burden on the utility was reaffirmed." (*Id.* at 4.)

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Staff's Position

23. Staff states that the Order lawfully finds that utilities do not enjoy a rebuttable presumption of prudence in GRC proceedings in Nevada. (Staff Answer at 1.)

24. Regarding SWG's reliance on a footnote contained in the concurring opinion of Justice Brandeis in *Missouri ex rel.* to support its argument that utilities are entitled to a presumption of prudence for their expenditures, Staff states that "[w]hile a concurring opinion may be considered persuasive authority (assuming there is no binding precedent already in effect on a particular point of law), it has no binding precedential authority over any lower court or agency." Therefore, Staff states that the concurrence of Justice Brandeis in *Missouri ex rel.*,

especially a footnote contained within that concurrence, has no binding precedential authority over the Commission. (*Id.* at 2.)

25. Moreover, Staff explains that Justice Brandeis' reference to the "prudence of an investment" was not a proposition that utilities be granted a presumption of prudence for its investments, but rather, it was a proposition of "a more practical methodology for determining fair return of the amount prudently invested by utilities." (*Id.* at 3.) Staff further explains that at the time (1923) when *Missouri ex rel.* was decided, the U.S. Supreme Court's ruling in *Smyth v. Aymes*, 169 U.S. 466, 18 S. Ct. 418, 42 L. Ed. 819 (1898), provided "the legal test for determining a fair return," which Staff explains was predicated on whether the rates allowed by a utility were based on the fair value of a utility's property. (*Id.*) Therefore, Staff states that Justice Brandeis' "prudent investment" analysis sought to "shift the focus from a fair market valuation analysis to historical costs." Indeed, Staff explains that the Court adopted Justice Brandeis' view in *FPC v. Hope Natural Gas Co.,* 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944), "when it shifted away from using the fair value of property to determine rates and held that a regulator is not bound by any single formula in determining rates." (*Id.*) Staff notes that even despite the Court's citation to Justice Brandeis' concurrence in reaching this decision to shift away from the fair value of property test, the Court in *Hope* "did not adopt any presumption of prudence for historically incurred costs." (*Id.*)

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26. Staff explains that, subsequently, in *Duquesne Light Co. v. Barasch,* 488 U.S. 299, 109 S. Ct. 609, 102 L. Ed. 2d 646 (1989), the U.S. Supreme Court reiterated that a single ratemaking formula is not mandated by the Constitution. Staff cites to the following language in *Duquesne,* 488 U.S. at 316 (footnote omitted), for support:

> The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since *Hope Natural*

> *Gas, supra.* As demonstrated in *Wisconsin v. FPC*, circumstances may favor the use of one ratemaking procedure over another. The designation of a single theory of ratemaking as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interests of the utility and the public.

(*Id.* at 3.)

27. Regarding SWG's reliance on *W. Ohio Gas Co.* as support for its argument that utilities are entitled to a presumption of prudence in GRC proceedings, Staff acknowledges the same quote referenced by SWG above, but interprets the Court's ruling differently. (*Id.* at 4.) Specifically, Staff explains that the Court "did not find that a utility is entitled to a presumption of prudence – only that the managers of the business were presumed to have acted in good faith." (*Id.*) Staff further explains that "a utility manager can act with good intentions in authorizing a business or utility expenditure, but still make an imprudent decision," and, similarly, "a utility manager can authorize a prudent expenditure that was made in bad faith." (*Id.*) Staff asserts that the Court's decision in *W. Ohio Gas Co.* requires a state commission to base its decisions on the evidentiary record, which effectively means that if a utility files for recovery of costs that it is able to demonstrate were prudently incurred, then the state commission cannot arbitrarily find such costs as being imprudent or not just and reasonable for inclusion in rates if the evidentiary record fails to contradict or otherwise confirms the utility's showing of prudence. (*Id.*) Staff states, however, that a state commission can disallow a cost "for which the utility has not met its initial burden to demonstrate was prudently incurred." (*Id.* at 5.)

28. Staff asserts that the Nevada Supreme Court's decision in *Pub. Serv. Comm'n v. Ely Light & Power Co.,* 80 Nev. 312, 393 P.2d 305 (1964), further supports Staff's interpretation of *W. Ohio Gas Co.* Specifically, Staff cites to the following language in *Ely Light & Power Co.*, 80 Nev. at 311, for support:

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> In the absence of an abuse of discretion on the part of the utility and in the absence of showing lack of good faith, inefficiency or improvidence, and if the amounts in question are reasonable and are actually paid as pensions or are allocated to a proper fund under a feasible plan, the commission should not substitute its judgment for that of management.

29. Staff explains that the foregoing analysis provided by the Nevada Supreme Court supports the notion that the Court "did not find that a utility's incurrence of a cost, in and of itself and in the absence of other evidence, entitles the utility to a finding of prudence or a presumption of prudence." Rather, Staff clarifies, the Court sought to ensure that if a cost is reasonable and actually incurred by a utility, the Commission would not be able to disallow the cost if the evidentiary record supports its recovery. (*Id.*) Staff concludes that *Ely Light & Power Co.* does not support a finding that a utility is entitled to a presumption of prudence. (*Id.*)

30. Regarding SWG's reliance on two FERC decisions – *Re Minnesota Power & Light Co.* and *Pacific Gas and Electric Co.* – to support its argument that utilities are entitled to a presumption of prudence in GRC proceedings, Staff explains that decisions by FERC "are not binding precedent" on the Commission given that "FERC's jurisdictional oversight over rates charged in interstate commerce transactions is not the same as this Commission's jurisdiction over rates charged in intrastate commerce." (*Id.* at 5-6.)

31. Staff also explains that neither of these FERC decisions supports the notion that the law provides that utilities are entitled to a presumption of prudence as SWG claims. Specifically, Staff cites to the following language in *Re Minnesota Power & Light Co.* to discuss its counterargument:[4]

> As Section 205(e) of the Federal Power Act states, 'the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the public utility.' As a matter of practice, utilities seeking a rate increase are not required to demonstrate in their cases-in-chief that all expenditures were prudent unless the Commission's filing requirements,

[4] Staff appropriately notes that while SWG cites to both *Re Minnesota Power & Light Co.* and *Pacific Gas and Electric Co.*, both of these decisions stand for the same proposition. (Pet. at 5.)

policy or precedent otherwise require.[5]

32. Based on its reading of this case, Staff argues that while FERC, "as a matter of practice," does not require utilities to demonstrate the prudence of all expenditures in their cases-in-chief, it does not necessarily follow "that the law provides that utilities are entitled to a presumption of prudence as SWG has attempted to argue." (*Id.* at 6.) Staff, again citing to *Re Minnesota Power & Light Co.*, notes that FERC specifically retains the authority to require a utility to demonstrate the prudence of its expenditures when setting a matter for hearing, or in any order issued later.[6]

33. After acknowledging FERC's "well-developed case law indicating when a presumption of prudence does and does not apply," Staff concludes that SWG's request that the Commission "apply a presumption of prudence akin to FERC" fails to recognize that "the FERC case law cited does not stand for the proposition that utilities are entitled to such a presumption in rate cases before state commissions, and from a more practical perspective, there is no similarly well-developed case law in Nevada to demonstrate when such a presumption may or may not apply and the scope of that presumption." (*Id.* at 6-7.)

34. Regarding SWG's reliance on the Nevada Supreme Court's decision in *Nevada Power Co.* and the Commission's 1986 decision in *Re Nevada Power Co.* to support its argument that utilities are entitled to a presumption of prudence in GRC proceedings, Staff explains that both decisions resolved deferred energy accounting filings and that the rebuttable presumption of prudence standard adopted by the Court in *Nevada Power Co.* was explicitly sourced from the Commission's decision resolving a deferred energy accounting application in *Re Nevada Power*

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[5] *Re Minnesota Power & Light Co.*, 11 FERC 61, 312 (1980)

[6] *Id.* at 61, 645 n.44. ("In addition, the Commission has the option of requiring that the utility demonstrate the prudence of particular expenditures in an order setting the increase for hearing or by later order.")

Co. (*Id.* at 7.) Staff provides the following language from the Court's decision in *Nevada Power Co.* for support:

> Under the PUCN's presumption framework, a utility requesting a customer rate increase enjoys a presumption that the expenses reflected in its deferred energy application were prudently incurred and taken in good faith.[7]
>
> Accordingly, we conclude that a utility enjoys a rebuttable prudence presumption as to its incurred costs in deferred energy accounting proceedings.[8]

35. Staff states that given the Court's findings are "consistently specific" to deferred energy accounting proceedings and not to GRC proceedings, "any application of the Court's findings in the deferred energy case to a general rate case proceeding is inappropriate." (*Id.* at 7.) Accordingly, Staff disagrees with SWG's claim that the Order erroneously extends the purpose and plain language of AB 7 to general rate case proceedings. Staff explains that because the Court in *Nevada Power Co.* limited the applicability of its findings to deferred energy application proceedings and did not extend the standard to general rate case proceedings, the Legislature, in passing AB 7, had no need "to supersede such a nonexistent finding." (*Id.* at 7-8.)

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36. Moreover, Staff, in acknowledging that the Legislature, through AB 7, "wanted to ensure a utility is not entitled to a presumption of prudence with respect to pass-through natural gas costs," costs on which the utility is not entitled to earn a profit, questions whether the Legislature would be supportive of a presumption of prudence with respect to costs for which a utility may earn a profit. (*Id.* at 8.) Specifically, Staff states that "[i]t is highly improbable that if the Legislature previously refused to grant utilities a presumption of prudence with respect to their pass-through energy costs that do not earn a return, that the Legislature would now be supportive

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[7] *Nevada Power Co.*, 122 Nev. at 834-35 (citing *Re Nevada Power Co.*, 74 P.U.R. 4^{th} at 706 ("[w]hen an applicant files the documentation for a rate adjustment with explanatory supporting testimony, as required by commission regulations, [the applicant] enjoys a presumption that the expenses reflected in the application have been made as a result of prudent management decisions taken in good faith")).

[8] *Id.* at 836.

of a presumption of prudence finding with respect to costs for which a utility may earn a return [on] its investments." (*Id.*)

37. Additionally, Staff explains that the Commission's regulations, including NAC 703.2231, do not support the argument that utilities are entitled to a presumption of prudence in GRC proceedings. (*Id.* at 8-9.) Notably, Staff explains that nothing in NAC 703.2231 states that a utility is entitled to a presumption of prudence. (*Id.*) Staff distinguishes the standard under this Nevada law, which does not provide a presumption of prudence, from the standard applied in states like Arizona that do apply a presumption of prudence in rate cases pursuant to statutes or regulations that explicitly provide for such a presumption. (*Id.*) As an example, Staff references Arizona Administrative Code R14-2-103(A)(3)(l) , which defines and qualifies the term "prudently invested" as follows:

> Investments which under ordinary circumstances would be deemed reasonable and not dishonest or obviously wasteful. All investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made.

38. Staff also challenges SWG's argument that utilities are entitled to a presumption of prudence in GRC proceedings by explaining that such a finding "could render several of the Commission's statutes and regulations meaningless and strip the Commission of its ability to *sua sponte* determine that a cost is imprudent, despite evidence to the contrary." (*Id.* at 9.) Staff asserts, for example, that if utilities in general enjoy a presumption of prudence, then the Commission's integrated resource planning statutes and regulations applicable to electric and water utilities would be rendered obsolete. (*Id.*) Specifically, Staff asserts that if the Legislature "already decided that a utility is entitled to a presumption of prudence, then there would have been little or no need for the Legislature to create the resource planning construct, wherein a Commission

finding accepting a utility's plan in an IRP case deems any facility investment contained in that plan as 'prudent' [pursuant to NRS 704.110(13) or NRS 704.661(6)]." (*Id.*) Moreover, Staff explains that recently-adopted Commission regulations regarding gas infrastructure replacement and expansion applications confirm that no presumption exists, given that these regulations "specifically state that a utility must demonstrate that its costs were prudent in its general rate case." (*Id.* at 9-10.) Accordingly, Staff states that "SWG's argument is either incorrect or incomplete, in that it does not harmonize all Nevada laws in concert or account for the fact that its presumption argument would render certain Nevada laws meaningless." (*Id.* at 10.)

39. Staff also raises practical concerns regarding SWG's argument that utilities are entitled to a presumption of prudence in GRC proceedings, especially to the extent that SWG is arguing that the Commission is unable to unilaterally find a cost item to be imprudent absent a challenge from an intervening party. (*Id.*) Specifically, Staff interprets SWG's argument to mean that even if an evidentiary record supports a finding of imprudence, the Commission would be "powerless to combat or prevent a finding of prudency" unless an intervening party specifically addresses such imprudence in its testimony. (*Id.*)

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40. Additionally, Staff explains that if SWG's logic is adopted and contextualized within the regulatory paradigm in which SWG conducts business, which does not require natural gas utilities like SWG to file a GRC or IRP at specific intervals, SWG would be able to "file a general rate case when it chooses, having spent as much money as it needed to in the intervening years between rate cases and having not received any prudency determination from the Commission in a resource plan, and still be awarded with a presumption of prudence for all its costs besides gas infrastructure replacement or expansion." (*Id.*) Therefore, Staff asserts that while electric and water utilities must file IRPs (where prudence is pre-determined for projects) and

GRCs in regular intervals, "SWG believes state and federal law permits it to sit out for as many years as it chooses with no resource plan or general rate case and still enjoy the benefit of a presumption of prudency, no matter how much money is at stake." (*Id.* at 10-11.)

41. Staff acknowledges that "a number of jurisdictions, including FERC, apply a presumption of prudence for public utilities in rate cases." (*Id.* at 11.) However, Staff concludes that, based on its review, these other jurisdictions appear to have statutes, rules, or well-developed case law that "provides guidance to parties as to what the presumption means for utilities, including the reach and scope of the presumption, as well as how other parties can refute the presumption." (*Id.*) Staff cites to regulations from Arizona and Colorado, along with commission decisions from Missouri, California, and Illinois for support. (*Id.* at n. 34-35.)

42. Staff concludes that by taking into consideration each of the statutes, rules, and case law discussed above "that both explain the rebuttable presumption and place limits on the scope of the presumption," SWG's reliance on Justice Brandeis' concurrence in *Missouri ex rel.*, and the U.S. Supreme Court decisions in *W. Ohio Gas Co.* is misplaced. (*Id.* at 11-12.) Specifically, Staff states that "[i]f these cases stood for the proposition that a utility is entitled by law to a rebuttable presumption of prudence, all of the statutes, rules and case law from FERC and other states that have specified instances in which the standard should not apply in rate case proceedings would have been overturned." (*Id.* at 12.)

43. Regarding SWG's claim that it satisfied both its initial burden of proof and NAC 703.2231 when it filed its Application, Staff states that while it recognizes that SWG filed an application including testimony, schedules, statements, and exhibits, Staff disputes the notion that "SWG's filing substantiates and demonstrates the reasonableness of all of its proposed changes in rates." (*Id.* at 12.) Staff explains that where SWG did provide evidentiary support for certain

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expenditures, Staff "did not take issue with those items," like, for example, the evidence provided by SWG to support its GIR projects. (*Id.* at 12-13.) However, Staff laments that SWG failed, on a number of occasions, to include any supporting testimony regarding some of the costs it incurred, and when it did, it provided very limited testimony. (*Id.* at 13.) For example, Staff references how an SWG witness was not even aware until hearing that her direct testimony lacked any evidentiary support for the Challenged Work Orders. (*Id.*)

44. Arguing in the alternative, Staff asserts that even if SWG were entitled to a presumption of prudence, "it cannot merely list its expenses in its application and expect that such expenses be deemed prudent, and authorized as just and reasonable." (*Id.*) Citing to a Mississippi Public Service Commission decision and a Supreme Court of Texas decision regarding a decision by the Public Utility Commission of Texas, Staff asserts that, even when state commissions utilize a presumption of prudence, more is expected than a mere listing of costs and transactions to establish a prima facie case that the costs were prudently incurred. (*Id.*)

45. Regarding SWG's assertion that the operational effect of the Order is inconsistent with a finding that SWG does not enjoy a rebuttable presumption of prudence, Staff argues that SWG falsely assumes that Staff and BCP only address in testimony those expenditures they have investigated, despite the fact that both parties "investigated numerous issues during discovery that were not ultimately addressed in testimony." (*Id.* at 13-14.) Likewise, Staff alleges that "SWG is also assuming that the Commission did not engage in its own analysis of any of the costs included in SWG's filing or the evidence presented." (*Id.* at 14.) Staff asserts that if it were to take "SWG's argument to its logical conclusion," SWG would not only be entitled to a presumption of prudence but would also be entitled to a presumption that its costs are just and reasonable. (*Id.*)

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Staff asserts that this "argument is unworkable, nonsensical, contrary to law, and would leave [the] Commission with diminished power to ensure rates are just and reasonable." (*Id.*)

46. Finally, while Staff concedes that it is "practically impossible for Staff and BCP to review every single cost item presented for recovery by a utility," Staff states that this does not mean the utility is entitled to a presumption of prudence; rather, the utility, SWG, must still bear its burden of showing "that its investments were prudently-incurred and its costs are just and reasonable with respect to any cost item that Staff, BCP, or the Commission commonly and/or randomly select for audit, investigation, and further analysis." (*Id.*)

Commission Discussion and Findings

47. SWG begins its challenge of the Commission's finding that it does not enjoy a rebuttable presumption of prudence by asserting that the Order misinterprets both Nevada law and the Legislature's intent in passing AB 7. Therefore, in the absence of any statute or regulation codifying a rebuttable presumption of prudence, the Commission begins its analysis of the discussion provided by the parties above by exploring the legislative intent of AB 7.

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<u>Legislative Intent of AB 7</u>

48. Before introducing AB 7, then-Assemblywoman (and Speaker of the Assembly) Barbara Buckley, sponsor and presenter of the bill, addresses the Nevada Supreme Court's decision in *Nevada Power Co.*, explaining how the Court reversed a portion of a Commission disallowance on the grounds that "a utility requesting a customer rate increase enjoys a presumption that the expenses reflected in its deferred energy application were prudently incurred and taken in good faith."[9] Subsequently, Assemblywoman Buckley introduces AB 7 and explains its intent:

[9] Minutes of the March 7, 2007, Meeting of the Assembly Committee on Commerce and Labor, Seventy-Fourth Session of the Nevada Legislature, at page 8. (quoting *Nevada Power Co.*, 122 Nev. at 834-835.)

> Assembly Bill 7 is intended to correct the court's interpretation of our legislative intent. When we reinstated deferred cost accounting, we told the utilities that they could not use this to ask for rate increases unless it was to recover costs resulting from reasonable and prudent business practices. That is what we meant. There is no presumption favoring a public utility when it files a rate change. We do not burden Nevada consumers for mistakes. They must demonstrate that any cost they seek to recover was reasonably and prudently incurred. That is what this bill does.[10]

49. The Commission notes the lack of qualifiers in Assemblywoman Buckley's explanation. Specifically, despite recognizing that the Court in *Nevada Power Co.* addresses a rate increase in a deferred energy accounting proceeding, Assemblywoman Buckley unequivocally states that a utility does not have a "presumption favoring" it when it files a "rate change" and that it must demonstrate that "any cost" it seeks to recover is "reasonably and prudently incurred."[11]

50. In reading the legislative intent of AB 7, the Commission agrees with Staff's view that it seems highly improbable that the Legislature, which unequivocally refused to grant utilities a presumption of prudence regarding pass-through energy costs that do not earn a return, would somehow be supportive of a presumption of prudence with respect to costs on which utilities may earn a return.[12]

51. However, as SWG points out, the stated purpose of AB 7 was specific to deferred energy proceedings:

> ...
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> 3. The provisions of this act are intended to supersede the holding of the Nevada Supreme Court in Nevada Power Company v. Public Utilities Commission of Nevada, 122 Nev. Adv. Op. 72 (2006), to the extent that the Court determined that the rebuttable presumption of prudence is the controlling procedure in proceedings involving deferred energy accounting.
> 4. Because the rebuttable presumption of prudence is a rule of procedure...

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[10] *Id.* (emphasis added).
[11] *Id.*
[12] Staff Answer at 8.

52. Therefore, the question is whether the Legislature intended to establish an exception to a rule of procedure. That is, did it intend for there to be a rebuttable presumption in rate case proceedings generally, but not in deferred energy accounting proceedings; or did the Legislature recognize that, because the Court in *Nevada Power Co.* limited the applicability of its findings to deferred energy accounting proceedings, utilities did not enjoy a rebuttable presumption of prudence in other proceedings, such as general rate cases, making it unnecessary, as Staff suggests, "to supersede such a nonexistent finding?"[13] The answer is unclear, at least based on the legislative history; but in identifying the rebuttable presumption of prudence as a rule of procedure, the Legislature provides a starting point from which the Commission may analyze this issue.

<u>Rule of Procedure</u>

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53. Given that the rebuttable presumption standard is not codified in Nevada law, the Commission turns to Nevada courts to address whether it may adopt or apply a rule of procedure without going through the rulemaking process outlined in the Nevada Administrative Procedures Act ("APA"), which has been codified as NRS Chapter 233B. The Nevada Supreme Court has explained that "[w]hen an agency takes certain action not expressly noticed as rule making, the issue becomes whether the agency is engaging in rule making such that the APA safeguards for promulgating regulations apply or whether the agency is merely making an 'interpretive ruling.'"[14] As the Court further discusses, NRS 233B.038 defines a regulation as "[a]n agency rule, standard, directive or statement of general applicability which effectuates or interprets law or policy, or describes the organization, procedure or practice requirements of any agency."[15] By contrast, the Court explains that "an interpretive ruling is merely a statement of how

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[13] Staff's Answer at 8.
[14] *State Farm Mut. Auto. Ins. Co. v. Comm'r of Ins.*, 114 Nev. 535, 543, 958 P.2d 733, 738 (1998).
[15] *Id.* (quoting NRS 233B.038).

the agency construes a statute or a regulation according to the specific facts before it."[16] Indeed, the Court "has not hesitated to invalidate agency actions in which the agency was formulating a rule of policy or general application and not merely making an interpretive ruling according to the facts before it."[17] For example, the Court once found that because a Commission order changing SWG's rate design had a generally-applicable effect on other gas utilities, the order was "of such significance to all utilities and consumers that it cannot be characterized as a simple adjudication in a contested case and thus outside of the statutory definition of a regulation."[18]

54. Together, NRS 233B and multiple Nevada Supreme Court holdings help contextualize and explain the Commission's authority with respect to its ability to adopt and apply rules, as well as when it may make interpretive rulings. It is in recognition of these laws and rulings that the Commission finds that it would not have been able to lawfully recognize and generally apply the rebuttable presumption of prudence standard "to proceedings in Nevada when an applicant files documentation for a rate adjustment"[19] without having gone through the required rulemaking process to adopt such a generally-applicable rule of procedure in the first place.[20]

55. Nonetheless, given the Commission's past recognition of a presumption in the three dockets referenced by SWG, the Commission will continue its analysis of SWG's claims.

Case Law

56. Regarding SWG's reliance on two FERC decisions – *Re Minnesota Power & Light Co.* and *Pacific Gas and Electric Co.* – to support its argument that utilities are entitled to a

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[16] *Id.* (citations omitted).
[17] *Id.*
[18] *Pub. Serv. Comm'n of Nevada v. Sw. Gas Corp.*, 99 Nev. 268, 273, 662 P.2d 624, 627 (1983).
[19] Pet. at 3.
[20] As Staff explains, states like Arizona that do apply a presumption of prudence in rate cases do so pursuant to statutes or regulations that explicitly provide for such a presumption. (Staff Answer at 9.) Notably, SWG provides utility service in Arizona.

presumption of prudence in GRC proceedings, the Commission finds that decisions by FERC are not binding on the Commission given that "FERC's jurisdictional oversight over rates charged in interstate commerce transactions is not the same as this Commission's jurisdiction over rates charged in intrastate commerce."[21] Moreover, the Commission finds that FERC has well-developed case law indicating when the presumption of prudence applies, and neither of these cases cited by SWG dictates that utilities are entitled to such a presumption in rate cases before this (or any other state) Commission.

57. Regarding SWG's reliance on a footnote contained in the concurring opinion of Justice Brandeis in *Missouri ex rel.* to support its argument that utilities are entitled to a presumption of prudence for their expenditures, the Commission finds that this footnote in a 1923 concurring opinion may only be considered persuasive authority and, therefore, has no binding precedential authority on the Commission. Moreover, despite the U.S. Supreme Court's citation to Justice Brandeis' concurrence in reaching its decision to shift away from the fair value of property test in its decision in *Hope*, the Court never adopted a presumption of prudence standard.[22]

58. Regarding SWG's reliance on *W. Ohio Gas Co.*, the Commission finds that this decision only requires a state commission to base its findings on the evidentiary record, which effectively means that if a utility files for recovery of costs that it is able to demonstrate were prudently incurred, then the state commission cannot arbitrarily find that such costs are imprudent or not just and reasonable for inclusion in rates if the evidentiary record fails to contradict or otherwise confirms the utility's showing of prudence. Therefore, even under this decision, the Commission finds that it would still be able to disallow a cost when the utility has

[21] Staff Answer at 5-6.

[22] The Court in *Duquesne* reiterated that a single ratemaking formula is not mandated by the Constitution. *See Duquesne,* 488 U.S. at 316.

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not met its initial burden to demonstrate that the costs for which it seeks recovery were prudently incurred.

59. SWG's reliance on *Ely Light & Power Co.* is also misplaced. Similar to the U.S. Supreme Court's decision in *W. Ohio Gas Co.*, this Nevada Supreme Court decision sought to ensure that if a cost is reasonable and actually incurred by a utility, the Commission would be barred from arbitrarily disallowing the cost if the evidentiary record supports its recovery.

Previous Recognition of the Presumption in Nevada

60. Given that SWG has failed to identify any controlling case law establishing the rebuttable presumption of prudence as the standard rule of procedure in Nevada, the Commission will address SWG's remaining contention that it enjoys a rebuttable presumption of prudence due to the Commission's previous recognition of the standard in its past proceedings. While the Commission notes that "administrative agencies are not bound by stare decisis,"[23] the Commission will nonetheless address its past decisions given SWG's heavy reliance on these cases.

61. SWG cites to the following three Commission decisions to support its position that the Commission recognizes the applicability of the rebuttable presumption of prudence standard in its GRC proceedings: *Re Nevada Power Co.*, *Re Sierra Pacific Power Co.*, and *Application of Nevada Power Co.* Given the nexus between the Commission's decision in *Re Nevada Power Co.* and the Nevada Supreme Court's decision in *Nevada Power Co.*, the Commission will address these decisions together.

[23] State, Dept. of Taxation v. Chrysler Group LLC, 129 Nev. Adv. Op. 29, 300 P.3d 713, 717 at fn.3 (2013) (quoting Motor Cargo v. Public Service Comm'n, 108 Nev. 335, 337, 830 P.2d 1328, 1330 (1992); see also Desert Irrigation, Ltd. v. State of Nevada, 113 Nev. 1049, 1058, 944 P.2d 835,841 (1997) ("[N]o binding effect is given to prior administrative determinations.")

62. The Commission finds that the decision on which SWG relies most heavily, *Re Nevada Power Co.*, applied the rebuttable presumption of prudence standard within the context of a deferred energy accounting proceeding, not a GRC proceeding.[24] Indeed, prior to discussing the rebuttable presumption of prudence, the Commission "deem[ed] it important to state the applicant's burden in initially proposing a deferred energy rate adjustment and the burden of parties who wish to challenge the applicant's proposal."[25] Likewise, the Court's decision in *Nevada Power Co.* was only controlling with respect to the matter it addressed – the review of a Commission ruling in a deferred energy accounting proceeding. Each of these decisions occurred prior to the Legislature passing AB 7, which clarified that utilities do not enjoy a rebuttable presumption of prudence in deferred energy accounting proceedings.

63. The Commission's recognition of the presumption of prudence in *Re Sierra Pacific Power Co.* preceded the passage of AB 7, and given the discussion above regarding legislative intent and the inability of the Commission to adopt a generally-applicable rule of procedure without following the rulemaking process, the Commission finds that this decision was either in error or superseded by AB 7, which illuminated the Legislature's intent for utilities to demonstrate the prudence of all costs ultimately borne by ratepayers.

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64. The Commission concedes that a presumption of prudence was acknowledged in *Application of Nevada Power Co.*, a decision reached after the passage of AB 7. However, the Commission's acknowledgement of the presumption in that case specifically and erroneously cites to the Commission's superseded decision in *Re Nevada Power Co.* The Commission is not persuaded that its misstatement of the appropriate standard within the context of an electric utility

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[24] These two proceedings are separately distinguished in Nevada law. *See for example* NRS 704.110(12) ("If an electric utility files an annual deferred energy accounting adjustment application...while a general rate application is pending...)

[25] *Re Nevada Power Co.*, 74 P.U.R. 4th at 706.

rate proceeding nearly a decade ago is enough to override well-established case law explaining that Commission decisions fail to establish precedent and that Nevada law requires the Commission to undergo the rulemaking process before it adopts or applies a rule of general applicability.

65. Accordingly, the Commission rejects any attempt by SWG to turn the Commission's statutory responsibility in a rate case proceeding to set just and reasonable rates into a pass-through review governed by a presumptive standard that is not required by Nevada law but is being advanced by SWG in these proceedings to defend against the substantial evidence offered by Staff that credibly questions whether the costs associated with the Challenged Work Orders were prudently incurred.

66. Thus, for all of these reasons, the Commission reaffirms its finding that SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures in GRC proceedings.

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Challenged Work Orders

SWG's Position

67. SWG asserts that, "[c]ontrary to the recommendations of any intervening party and without any support from the record, the [Order] disallows 100 percent of the Challenged Work Orders." (Pet. at 9.) SWG further asserts that the Order's disallowance of these costs "is premised on an erroneous conclusion of law and is otherwise unreasonable." (*Id.*) Specifically, SWG claims that the Order's disallowance of 100 percent of the Challenged Works Orders "is premised on the [Order's] misapplication and erroneous conclusion of law" because the Challenge Order (at paragraph 622) provides that "SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures in GRC proceedings." (*Id.*)

68. SWG claims that, "[i]ncidentally, the rebuttable presumption of prudence and [SWG's] right to offer rebuttable evidence to challenges of costs is implicitly incorporated into other issues raised in the [Order]." (*Id.*) SWG notes that the Commission permitted SWG to recover costs associated with non-executive payroll expenses and the Las Vegas Apartments despite the fact that SWG's Application supported recovery for these costs "in a similar fashion (arguably with less specificity) as [SWG] supported the Challenged Work Orders." (*Id.*) SWG states that once these costs were challenged through intervener testimony, it "then filed rebuttable testimony that explained, repelled and rebutted the doubts raised by those intervening parties." (*Id.*) SWG states that "more than 140 other work orders that were specifically identified in the Application in the same manner as the Challenged Work Orders... are now being included in new rates due to the rebuttable presumption of prudence because none of the intervening parties took issue with them." (*Id.* at 10.)

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69. SWG states that, similar to how it addressed concerns raised regarding its other work orders, "when concerns were raised about the Challenged Work Orders, [SWG] provided rebuttable testimony to overcome and rebut concerns raised." (*Id.*) SWG states that, between the written rebuttal testimony of witnesses Cunningham and Murandu, SWG was able to rebut Staff's recommendations regarding the Challenged Work Orders by describing "the purpose, benefits realized, project structure, steering and oversight personnel, as well as project controls, and... by providing details about the rationale and justification for the expenditures questioned, and specifically refuting the unsupported assertions that costs were excessive, unreasonable or imprudent." (*Id.*)

70. SWG further states that the Order's "attempt to discount the testimony of [SWG] witnesses because of the witness' time with [SWG] ignores the principle of corporations

providing witnesses in the form of a person most knowledgeable and that personal knowledge in the context of a company witness does not require a first-hand account; rather, information learned in the ordinary course of business, including through review of documents and procedures predating employment, is admissible." (*Id.*) SWG asserts that the Order's "reasoning also runs contrary to the fact that the aforementioned rebuttal testimony was submitted and accepted into [the] evidentiary record without objection from any party." (*Id.*)

71. SWG also asserts that the Order should be reconsidered because the disallowance of 100 percent of the costs associated with the Challenged Work Orders "is unreasonable and an erroneous conclusion based upon the record." SWG claims that each of the Challenged Work Orders implements software programs "integral to providing utility service to [SWG's] Nevada customers, something that was acknowledged by other parties." SWG then cites to Exhibits 64 (prepared direct testimony of Staff-witness Danise) and 80 (prepared rebuttal testimony of SWG witness Murandu) as it explains the importance of each of the software projects that are included in the Challenged Work Orders. (*Id.* at 11-13.)

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72. SWG claims that "[t]he record is void of any evidence even suggesting that these systems are unreasonable or imprudent investments, not used and useful, or that the systems do not provide direct benefit to Nevada customers." (*Id.* at 13.) SWG further claims that "no party asserted that any of the systems were overpriced or fail to perform as designed." (*Id.*) SWG concludes that, "[i]n other words, [SWG's] Nevada customers are receiving a benefit from those systems but are not required to pay for the costs associated with that benefit." (*Id.*)

73. Finally, SWG finds irony in the Commission's decision to disallow 100 percent of the costs associated with the Challenged Work Orders despite finding Staff's recommendation for a 50-percent disallowance arbitrary and unsupported by the record. (*Id.*) SWG states that if

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Staff's recommendation is arbitrary and unsupported by the record, "then so is the [Order's] finding of 100 percent disallowance as no party actually recommended such a punitive finding." (*Id.*) SWG claims that while it provided testimony to rebut Staff's challenges, "there is only support on the record for the disallowance of approximately $1,000,000, which represents the amount of the costs specifically identified by Staff." (*Id.* at 13-14.) SWG states that it has already removed more than $400,000 of this amount from its revenue requirement prior to certification. (*Id.* at 14.)

BCP's Position

74. BCP states that the Commission's disallowance of 100 percent of the costs associated with the Challenged Work Orders is based on a finding of substantial evidence. (BCP Answer at 4.)

75. BCP states that, given the absence of a rebuttable presumption of prudence, SWG's lack of evidence regarding the Challenged Work Orders required a determination that SWG failed to meet the applicable preponderance of the evidence standard regarding those work orders. (*Id.*)

76. BCP rebuts SWG's discussion regarding what constitutes personal knowledge by explaining that "even if testimony with a lack of personal knowledge is permitted, the testifying witness needs to be able to state the basis for the company to make the decision to incur the costs." (*Id.*)

Staff's Position

77. Staff states that the finding in the Order to disallow 100 percent of the costs associated with the Challenged Work Orders was based on a correct interpretation of the law. (Staff Answer at 15.) Therefore, Staff disagrees with SWG that the Commission erred in

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disallowing these costs and that the Commission erroneously found that SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures. (*Id.*)

78. Staff disagrees with SWG's incidental argument that the Commission "implicitly incorporated" the rebuttable presumption of prudence in other areas of the Order because the Commission approved the costs associated with non-executive payroll expenses and the costs associated with the Las Vegas Apartments despite the fact that these costs were both challenged by intervening parties and supported in a similar fashion as the Challenged Work Orders. (*Id.*) Therefore, Staff "disagrees with the premise that the limited evidence provided for certain expenditures requested by [SWG] indicates [SWG] is entitled to a presumption of prudence." (*Id.* at 16.)

79. Staff explains that while there is no specific amount of evidence or data that a utility must provide to support a finding of prudence or a finding that an investment was just and reasonable, the evidence should meet the standards set forth in NRS 233B.123 and NRS 233B.135, which Staff interprets as requiring that "the evidence relied upon must be of the type commonly relied upon by reasonable and prudent persons in the conduct of their affairs (NRS 233B.123) and must be sufficient for a reasonable mind to accept as adequate to support a conclusion (NRS 233B.135)." (*Id.* at 16.) Staff provides the following examples:

> … a finding of prudence with respect to non-executive payroll expenses may be derived by the commonly relied upon notion that in order to carry out its operations and statutory mandate as a public utility to provide safe, economic, efficient, prudent, and reliable service to its customers—something the Commission is statutorily mandated to ensure in its oversight of public utilities and in the ratemaking process—a utility necessarily must employ individuals to serve and effectuate its operating functions. Additionally, it is reasonable that a utility cannot lawfully expect that its employees will work for free—there are various labor laws and rules surrounding worker compensation and benefits in Nevada. Some level of expense for non-executive employee compensation is always necessary in order to run a utility… (*Id.*)

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80. Accordingly, Staff asserts that while there is no presumption of prudence, prudence "may be evaluated and established through commonly relied upon facts." (*Id.*)

81. Regarding SWG's argument that it satisfied its burden on rebuttal because its rebuttal testimony was entered into the evidentiary record without controversy or objection from any party, Staff states that "[t]his argument is absurd and confuses the standard for admissibility of evidence with an applicant's evidentiary burden of proof." (*Id.* at 16-17.) Staff, after explaining the applicable standard for admission of evidence, explains that it did not object to the admission of SWG's rebuttal testimony into the evidentiary record because it did not dispute that it was relevant to the proceeding. Staff explains that this does not mean, however, that it found SWG's rebuttal testimony sufficient to rebut the challenges raised by Staff. (*Id.* at 17.)

82. Regarding SWG's assertion that the evidentiary record supports its recovery of the costs associated with the Challenged Work Orders, Staff disagrees that the weight of SWG's direct and rebuttal evidence demonstrate that the costs associated with the Challenged Work Orders were prudent and just and reasonable. (*Id.* at 17.)

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83. Staff specifically discounts the rebuttal testimony of SWG-witness Murandu given that "nothing" in his curriculum vitae or testimony supports the notion that "his alleged independent review of SWG's voluminous records," which Staff calculates must have occurred over one week,[26] "qualifies him as the person most knowledgeable not only concerning SWG's processes and procedures, but also with respect to the specific oversight and prudency of each of SWG's expenditures that were incurred during a four-year period that preceded [his] one-year period of employment with SWG (2012 to 2016)." (*Id.* at 17.)

[26] Staff states that given the fact that it filed its direct testimony on October 3, 2018, and that SWG filed its rebuttal testimony on October 12, 2018, "Staff is assuming that a couple days were spent drafting the testimony that was filed." (Staff Answer at 17, n. 55.)

84. Staff further challenges the weight of SWG-witness Murandu's testimony by claiming: (1) he "was never able to testify to the managerial decisions that were made at the time the Challenged Work Order were undertaken by SWG"; (2) there is a "dearth of evidence indicating he has any utility ratemaking experience or that he routinely has experience authorizing costs or documenting support for whether a cost is prudently incurred and just and reasonable"; (3) he failed to explain "how SWG determined each Challenged Work Order project… was prudent or the best available option"; and (4) he supported his testimony with his opinions regarding his disagreement with Staff's testimony instead of providing sufficient factual or documentary support to overcome the challenges raised by Staff. (*Id.* at 18-19.)

85. Staff concludes that "SWG has provided insufficient evidence to justify why certain work order projects were necessary, how SWG made the decision to select a particular project, and/or whether that decision was prudent or the best available option." (*Id.* at 20.)

86. Staff also states that the Order should be reaffirmed because the disallowance of 100 percent of the costs associated with the Challenged Work Orders is reasonably based on substantial evidence in the record. (*Id.* at 20.) While SWG claims that the software programs involved in the Challenged Work Orders are integral to the utility's operations, Staff asserts that the evidentiary record does not support such a claim. Specifically, Staff provides as follows:

> Conspicuously absent from the evidentiary record is factual evidence demonstrating why these particular programs were found to be necessary or 'integral to' SWG's provision of utility service; whether SWG issued any requests for proposals or engaged in comparison shopping prior to selecting these specific programs; why the decision was made to proceed with a particular program as opposed to some other comparable program that could serve the same purpose or achieve the same goals; why the budgets allocated for these programs were reasonable; or how the quantity and qualifications of employees needed to execute the programs was determined. These are just some of the examples of information lacking from the evidentiary record in this case. (*Id.* at 20.)

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87. Moreover, while Staff acknowledges that its recommendation to disallow only 50 percent of the costs associated with the Challenged Work Orders shows that it "agreed that some benefit was being provided to SWG's customers," Staff cites to the testimony of Staff witness Danise and states that it "was simply unable to quantify the benefit and determined that given the lack of support for the programs, an equal sharing of the costs between ratepayers and shareholders was reasonable under the circumstances." (*Id.* at 21.) Nonetheless, Staff states that the Commission "acted within its discretion" when it determined "that a 100 percent disallowance was appropriate in light of the lack of evidentiary support demonstrating the costs were prudent, and just and reasonable." (*Id.*) Notably, Staff recognizes that "[t]here is nothing prohibiting the Commission from making a finding *sua sponte* so long as there is substantial evidence in the record to support such a finding." (*Id.*)

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88. Lastly, regarding SWG's "meager assertions" that the Order "is unreasonable because it unfairly burdens SWG by creating a situation in which customers are benefiting from a program for which they are not required to pay," Staff acknowledges that the Commission did not disallow these costs with prejudice; rather, the Commission explicitly stated that SWG may again seek recovery of the costs associated with these Challenged Work Orders in a future GRC. (*Id.* at 21.) Therefore, Staff states that if these programs are truly integral to SWG's operations, then SWG "should seize upon the opportunity to demonstrate its program costs were prudently incurred and just and reasonable in its next general rate case proceeding." (*Id.*)

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Commission Discussion and Findings

89. The Commission's decision to disallow 100 percent of the costs associated with the Challenged Works Orders is separate from the Commission's finding that SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures in GRC proceedings.

Rather than simply rejecting the Challenged Work Orders based solely on SWG's initial failure to support them, the Commission's decision to disallow these costs is substantiated by the underlying evidentiary record, which preponderantly reveals a systemic lack of accountability, oversight, and prudent management by SWG as it incurred costs which it sought to recover from ratepayers in this case.[27] In fact, based on the evidence presented, there is no standard – presumed, rebuttable, or otherwise – in the laws of any jurisdiction that would have been able to cure SWG's consistent failure to provide any evidence that its investments related to the Challenged Work Orders were prudently incurred and were the product of reasonable management practices. Ultimately, SWG's discussion of a rebuttable presumption of prudence is irrelevant because any such presumption was clearly rebutted during these proceedings when the Challenged Work Orders were *challenged* by other parties to the proceeding. Once challenged, SWG failed to provide the substantial evidence necessary for the Commission to allow recovery of the costs associated with these projects.

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90. Accordingly, the Commission modifies paragraph 622 of the Order to clarify that the decision to disallow recovery of the costs of the Challenged Work Orders did not hinge on the Commission's view regarding the non-existence of a presumption of prudence. Rather, the Commission's decision to disallow the costs was based on testimony challenging the work orders and SWG's failure to produce evidence supporting them. The Commission declines to modify paragraphs 621 and 623 through 627 of the Order. For all of the reasons identified by BCP and Staff above, in addition to the reasons the Commission explains below, the Commission finds these paragraphs to be lawful, reasonable, and based on correct conclusions of law and fact.

91. The Commission finds that SWG is unable to substantiate its assertion that the operational effect of the Order is inconsistent with a finding that SWG does not enjoy a

[27] *See* Order at paragraphs 621-626.

rebuttable presumption of prudence because the Commission permitted the recovery of two other challenged cost items (non-executive payroll expenses and the Las Vegas Apartments) that SWG supported "in a similar fashion (arguably with less specificity)"[28] as it supported the Challenged Work Orders. The Commission finds this argument to be irrelevant given that the Order relied on substantial evidence rather than the application of a presumption. Therefore, while SWG may view the "operational effect" of the Commission's decisions as implicitly incorporating a rebuttable presumption of prudence, the only operational effect that should be assumed from the Commission's Order is that it performed its statutory review of the evidentiary record, weighed the evidence, and reached a decision based on substantial evidence.

92. In this matter, the Commission found that the evidentiary record reveals a lack of credible evidence to support a conclusion that the costs associated with the Challenged Work Orders were prudently incurred. As the Order addresses in paragraphs 621-627, the Commission reviewed the entirety of the evidence offered by SWG regarding these costs and found it to be insufficient to justify the inclusion of these costs in rates. Upon reexamination, the Commission continues to find that substantial evidence supports its decision and that it weighed the evidence appropriately.

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93. In paragraph 623, the Commission examines and sets forth its conclusions regarding the testimony of SWG witness Cunningham. Witness Cunningham, the only witness to sponsor direct testimony regarding the Challenged Work Orders, stated that she was not involved in the execution of the underlying software projects, did not review the charges of any work order, and was generally unable to even provide the Commission with information demonstrating SWG's basis for incurring these costs.

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[28] *Id.*

94. By contrast, in paragraph 624, the Commission reviews and cites to the substantial evidence offered by Staff regarding the lack of evidence supporting the Challenged Work Orders, and identifying a number of questionable costs that were originally included in SWG's Application for recovery. In addition to outlining the lack of evidence offered by SWG to support the costs associated with the Challenged Work Orders, Staff was also able to provide the Commission with a plethora of substantial evidence revealing the astounding lack of accountability, oversight, and management on SWG's behalf.[29]

95. In paragraph 625, the Commission appropriately rejects SWG's attempt to rely on Staff's discovery responses to sustain its burden of proof and satisfy the requirements of NAC 703.2231, noting that the review of those responses also fails to establish the prudence, or justness and reasonableness for inclusion in rates, of SWG's expenditures related to the Challenged Work Orders.

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96. In paragraph 626, the Commission addresses the rebuttal testimony of SWG witness Murandu and finds that, similar to witness Cunningham, witness Murandu, who did not start working for SWG until May 2017, was also unable to provide the Commission with any evidence regarding the prudence of the expenditures associated with the Challenged Work Orders "that closed to plant sometime between 2012 and 2016."[30] While SWG argues that the Commission should not discount the testimony of witness Murandu because he was unable to relay "a first-hand account" of the management of the Challenged Work Orders, SWG is unable to identify any evidence to support its assertion in its Petition that witness Murandu was able to credibly establish the prudence of the expenditures associated with the Challenged Work

[29] *See* Order at paragraphs 551-556, 567-571, 586-588, 597, 608; *See also* Ex. 64.
[30] Tr. at 968-969.

Orders.[31] As Staff notes, witness Murandu was never able to testify to the managerial decisions that were made at the time the Challenged Work Orders were undertaken by SWG, nor was he able to provide any evidence to justify why certain work order projects were necessary, how SWG made the decision to select a particular project, and/or whether that decision was prudent or the best available option.[32] Instead, witness Murandu only offered his opinions regarding his disagreement with Staff's testimony, made general statements about SWG's internal processes, and, in totality, failed to provide sufficient factual or documentary support regarding the prudence or reasonableness of the costs associated with the Challenged Work Order projects to outweigh Staff's evidence to the contrary.[33]

97. Lastly, in paragraph 627, the Commission finds and agrees with Staff's alternate proposal that SWG's failure to provide adequate documentary and decision-maker support for the costs associated with the Challenged Work Order projects requires the Commission to determine that none of these costs are reasonable for inclusion in rates. SWG challenges this Commission finding because it alleges that the Commission lacks evidentiary support to reach a determination that 100 percent of the costs should be disallowed, and suggests that because no party explicitly recommended disallowing 100 percent of the costs, the Commission's decision is

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[31] Tangential to this challenge, SWG argues that the Commission's review and assessment of witness Murandu's testimony is somehow contradicted by the fact that no party objected to his testimony being entered into the evidentiary record. The Commission rejects this argument as it fails to acknowledge that while evidence may be admissible due to its relevance, the weight that it is ultimately given must be determined by the trier of fact – the Commission.

[32] Moreover, in reexamining witness-Murandu's testimony, the Commission is inclined to agree with Staff that it is questionable how thorough of an independent review he would have been able to perform on the Challenged Work Orders if SWG waited until Staff's challenge to satisfy its burden of proof, especially given the dearth of evidence suggesting he has any utility ratemaking experience or that he routinely has experience authorizing costs or documenting support for whether a cost is prudently incurred and just and reasonable.

[33] Ironically, at least one of the FERC cases SWG relies upon to argue that the Commission is bound to entitle SWG to a rebuttable presumption of prudence explains the very type of information SWG fails to provide. *See Pacific Gas and Electric Company*, 165 FERC ¶ 63001 ("To determine the prudence of an investment, the Commission evaluates whether a reasonable utility manager would have made the same investment under the same circumstances. A prudence inquiry addresses whether the [utility] conducted reasonable evaluation of the costs and benefits prior to incurring a financial commitment. A prudence determination is based upon what the [utility] knew or should have known at the time a decision was made").

arbitrary. As discussed above, there is substantial evidence in the underlying record that shows the projects associated with the Challenged Work Orders were plagued by a systemic lack of accountability, oversight, and prudent management. Given this substantial evidence, the Commission was unwilling to permit SWG to recover an arbitrarily-calculated amount and, instead, chose to disallow these costs until a proceeding where SWG could sustain and satisfy its burden of proof.

98. Accordingly, consistent with its findings above, the Commission reaffirms its decision to disallow the costs associated with the Challenged Work Orders.

ROE

SWG's Position

99. SWG states that the Order's finding that an ROE of 9.25 percent results in just and reasonable rates "should be reconsidered as the finding is unreasonable and not supported by the record." (Petition at 14.) SWG alleges that a 9.25-percent ROE "is below any ROE recommended by any party." (*Id.*) SWG further alleges that the ROE of 9.25 percent "is also well below the average authorized aggregate ROE of approximately 10.23 [percent] awarded to utilities in [SWG's] proxy group." (*Id.*)

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100. SWG claims that all of the parties "supported the proxy group used by [SWG] as being representative of natural gas utility companies that are similarly situated to [SWG]." (*Id.* at 15.) SWG then extrapolates that if the aggregate ROE of its proxy group is 10.23 percent, then a 9.25-percent ROE is not commensurate with returns on investments in other enterprises having corresponding risk. (*Id.*) Moreover, SWG alleges that a 9.25-percent ROE is also lower than the industry average authorized ROE of 9.68 percent for natural gas utilities. (*Id.* at 15.)

101. SWG also claims that it should be awarded a higher ROE because of its self-selected capital structure and because "the credit rating agencies actually rank [SWG] at a higher relative risk than all but one of the proxy group companies." (*Id.* at 16.)

BCP's Position

102. BCP states that the Commission's finding of an authorized ROE of 9.25 percent is reasonable and based on substantial evidence. (BCP Answer at 5.)

103. BCP, citing to paragraph 181 of the Order, states that the record evidence supports the Commission's finding of an ROE of 9.25 percent. In fact, citing to Exs. 12 and 15, BCP states that "[a] simple review of the record evidence presented by BCP and Staff ROE experts show ROEs as low as 9.0 [percent] could be supported as reasonable in this case." (*Id.*) Therefore, BCP states that the Commission's finding of an ROE of 9.25 percent "is well within the range of results presented by BCP[34] and Staff experts." (*Id.*)

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104. Regarding SWG's reliance on Ex. 21 to assert that the Commission's finding of an ROE of 9.25 percent is below the average authorized ROE of 10.23 percent, BCP explains that the Commission relied upon "forward-looking ROE estimates and not the historical authorized equity returns presented in the SWG [Ex. 21]." (*Id.* at 5-6.) BCP concludes that SWG's "mere disagreement with the Commission's analysis does not make such Commission conclusions an abuse of discretion." (*Id.* at 6.)

Staff's Position

105. Staff states that there is no merit to SWG's arguments that the Commission's decision to set its ROE is unreasonable or unsupported by the record. (Staff Answer at 22-24.) After questioning whether SWG satisfies the standard for reconsideration for this issue, and

[34] Notably, BCP states that SWG incorrectly represents in its Petition that BCP recommended an ROE of 9.4 percent. BCP clarifies that it recommended an ROE of 9.3 percent, with a reasonable range of 9.0 to 9.5 percent. (*Id.*)

whether SWG may have introduced new evidence in violation of NAC 703.801(b), Staff recommends that the Commission "reject SWG's request for reconsideration and find that its authorized ROE of 9.25 percent is within the zone or range of reasonableness between 9.1 percent and 9.7 percent, is supported by the evidentiary record, and reflects current economic conditions. (*Id.* at 22.)

106. Regarding SWG's claim that the ROE set by the Commission is too low and is not commensurate with ROEs awarded to other similarly-situated utilities because the proxy group average authorized ROE is approximately 10.23 percent, Staff explains that this stated average is not explicitly memorialized in SWG's testimony, and it is unclear how SWG derives this percentage. (*Id.*) However, even if this claim were to be substantiated in SWG's testimony, Staff states that this average ROE would represent the average ROE since 1980 and, therefore, "certainly does not reflect the current economic conditions, including historically low risk-free rates." (*Id.* at 22.)

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107. Regarding SWG's reliance on the industry-average ROE of 9.68 percent, Staff laments "SWG's focus on this one data point" given that it "ignores the fact that the Commission considered a broad range of financial models and inputs" in setting SWG's ROE at 9.25 percent. (*Id.* at 23.) Therefore, Staff concludes that a reference to this single data point "cannot overcome the weight of the Commission's evidence set forth in the [Order]." (*Id.*)

108. Regarding SWG's argument that its ROE should be higher due to its self-selected capital structure, Staff notes that the Commission explicitly addresses SWG's capital structure in paragraph 189 of the Order, and that SWG fails to identify how the Commission's determination of this issue was unlawful, unreasonable, or based on erroneous conclusions of law or mistaken facts. (*Id.*)

Commission Discussion and Findings

109. The Commission reaffirms its decision to award SWG an ROE of 9.25 percent for the reasons set forth below.

110. SWG requests reconsideration of its ROE on the basis that an ROE of 9.25 percent is unreasonable. As Paragraph 179 of the Commission's Order notes, the Commission established a range or zone of reasonableness between 9.10 percent and 9.70 percent. In determining the range, the Commission relied upon expert testimony and evidence which applied the principles "of finance, accounting, and economics to the cost of a [SWG's] common equity."[35] Such evidence was carefully considered and included each expert's ROE studies, the experts' judgement in assessing macroeconomic conditions, capital markets, SWG's unique circumstances, and each expert's critique of the other experts' analyses.[36]

111. Staff's and BCP's expert witnesses explicitly testified that their recommended ROEs fell within broader *ranges of reasonableness,*[37] meaning that any number within those ranges would be considered reasonable. Indeed, during the hearing, and specifically at SWG's request, Staff's expert witness confirmed that Staff considered any number within its range of ROEs to be reasonable.[38] The Commission ultimately adopted Staff's range of reasonableness; however, the Commission notes that an ROE of 9.25 percent falls within the range of reasonableness of multiple expert witnesses in this proceeding.

112. As the Commission previously found and reaffirms today, based on substantial evidence on the record, an ROE of 9.25 percent is reasonable, commensurate with returns on

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[35] *See* Paragraph 179 of the Order.
[36] *Id.*
[37] See Ex. 15 at 2; Ex. 12 at 39.
[38] Tr. at 104.

investments in other enterprises having corresponding risks, and is both sufficient to assure confidence in the financial integrity of the enterprise and for SWG to attract capital.

113. The Commission notes, and the Supreme Court of Nevada has held, that "[i]n fixing any particular rate of return for utilities, the Commission operates within a "zone of reasonableness."[39] Within the context of ratemaking, it is a well-established principle that "an agency may issue, and courts are without authority to invalidate, rate orders that fall within a "zone of reasonableness," where rates are neither "less than compensatory" nor "excessive."[40] Here, on the weight of substantial evidence, the Commission selected an ROE that fell squarely within the range of reasonableness of multiple expert witnesses. Accordingly, the Commission reaffirms its decision to award SWG an ROE of 9.25 percent.

Normalization of Pension Expense

SWG's Position

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114. SWG claims that the Order's "modification of [SWG's] requested pension expense is unreasonable and raises questions about due process." (Petition at 17.) SWG claims that "[h]istorically, the test year amount of [its] pension expense has been utilized to set rates, without modification." (*Id.*) SWG states that the Order "normalizes an expense when the accuracy was not challenged by any party in the docket." (*Id.*) SWG claims that the record does not support a deviation from past practices and that Staff's suggestion to normalize the amount does not overcome a practice "used consistently for nearly the past 15 years."

115. Moreover, SWG alleges that the Order's "unilateral modification" of SWG's actual pension expense "compounds the prejudice" to SWG because no party recommended in testimony that the 2018 pension expense be modified from the actual expense, which SWG

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[39] *Consumers League of Nevada v. Sw. Gas Corp.*, 94 Nev. 153, 157, 576 P.2d 737, 740 (1978) at footnote 4.
[40] *Farmers Union Cent. Exch., Inc. v. F.E.R.C.*, 734 F.2d 1486, 1502 (D.C. Cir. 1984).

claims deprives it of due process because it was unable to provide testimony, evidence, or cross-examination to refute the "proposal." (*Id.*) SWG further alleges that the Order "usurps the ratemaking legal process by not allowing [SWG] (or any party) to examine, investigate, or rebut the modification of the actual 2018 pension costs." (*Id.*)

BCP's Position

116. BCP states that, at hearing, it indicated "that upper-level management has some control over the two biggest factors affecting volatility and pension costs – discount rate and expected rate of return." (BCP Answer at 6.) BCP explains that the Commission determined, at paragraphs 426 and 427 of the Order, that SWG "did not adequately support its reduction in the discount rate from 4.50 percent in 2017 to 3.75 percent in the test year for this [GRC]." (*Id.*) BCP further explains that "the Commission found that SWG failed to provide evidence supporting an increase of approximately $4.0 million in pension costs for its Nevada gas operations." (*Id.*) Notably, BCP asserts that the Commission's decision "to place more credibility on the testimony of a Certified Public Accountant, with both public and private experience, over SWG's actuarial firm, is well within the discretion of the Commission." (*Id.*)

117. BCP, addressing the Commission's findings and discussion in paragraphs 435-437, concludes that the Commission's ultimate adoption of a three-year normalization to manage volatility is "a move that is well within the Commission's discretion." (*Id.*)

Staff's Position

118. Staff disagrees with SWG's claim that the Commission's modification of SWG's requested 2018 annual pension expense is unreasonable and should be reconsidered both for the normalization of the pension expense, as well as for modification of the SWG's actual 2018 pension expense used in the normalization approved by the Commission. (Staff Answer at 24.)

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Citing to a number of paragraphs in the Order (e.g. paragraphs 422 and 436), Staff explains that the Commission's decision is well-supported by the facts in the evidentiary record, as well as by the Commission's findings that SWG failed to present evidence after being provided an opportunity to do so. (*Id.* at 24-25) Staff further notes that the Commission is free to utilize any ratemaking methodology that ultimately achieves just and reasonable rates. (*Id.* at 25.)

119. Staff rejects SWG's allegation that it did not have an opportunity to address the Commission's modification of its 2018 expense "given that its own application and direct testimony addresses this issue." (*Id.* at 25.) To the extent that SWG is suggesting the Commission cannot make a unilateral finding based on substantial evidence if that finding was not explicitly recommended by a party, Staff characterizes this suggestion as "the height of absurdity" and explains that the Commission "has a statutory duty to ensure that rates are just and reasonable, and if the Commission is presented with no evidence to support a finding that inclusion of a particular cost will result in just and reasonable rates, the Commission has the authority to disallow the cost." (*Id.* at 26.)

120. Staff concludes that, with respect to this issue, SWG was permitted to present evidence to support its recommendation but simply failed to do so. (*Id.*)

Commission Discussion and Findings

121. As the Supreme Court of Nevada notes, the Commission has broad authority to establish just and reasonable rates.[41] Accordingly, the Commission agrees with Staff's proposition that if the Commission is presented with no evidence to support a finding that inclusion of a particular cost would result in just and reasonable rates, the Commission has the authority to disallow the cost. In this instance, the Commission was not persuaded that SWG

[41] *Nevada Power Co. v. Eighth Judicial Dist. Court of Nevada ex rel. County of Clark*, 120 Nev. 948, 957, 102 P.3d 578, 584 (2004)

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provided evidence sufficient to justify its proposed pension expense, particularly in light of the issues raised by Staff in its Direct Testimony and the Commission's attempts to solicit additional information at hearing.

122. The Commission reiterates that expense normalization is a common practice in ratemaking for addressing costs that can vary from year to year. Given the anomalous test year level and lack of evidence on the record to support it once challenged, the Commission disallowed the $4 million increase resulting from the change in the discount rate and determined an appropriate normalization period to address annual volatility. The Commission was not persuaded that a five-year normalization was adequate. Moreover, SWG proposed a three-year normalization period for its Management Incentive Plan. It stands to reason that a three-year period is sufficient. Accordingly, the Commission reaffirms its decision regarding pension expense normalization.

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123. The Commission further finds that SWG's suggestion that it was deprived of due process is unfounded. SWG proffered a witness to support its requested pension expenses. In pre-filed testimony and at hearing, the witness put forth by the utility was unable to provide information requested by the Commission to help it understand the justification for its $4 million requested increase due to the change in the discount rate. In fact, SWG's own witness testified that the company did not have a witness present that could discuss the calculation or decision-making process regarding the discount rate used for the pension expenses with any particularity.[42]

124. The Commission finds that SWG had ample opportunity to provide pre-filed testimony and prepare a witness capable of speaking to its pension costs in direct and rebuttal

[42] Tr. at 948-950.

testimony, yet it failed to do so. Accordingly, the Commission rejects any notion that SWG did not receive due process regarding this matter.

Violations of NAC 704.518 and SWG's Tariff

SWG's Position

125. SWG alleges that the Order's finding that it violated NAC 704.518 and its tariff "is inconsistent with prior review of those contracts and potentially premature as the Commission has requested [SWG] to provide additional information regarding [SWG's] negotiated rate contracts." (Petition at 18-19.) SWG states, however, that it "will willingly provide the information requested by the [Order] regarding negotiated rate contracts and participate in the investigation referenced in [p]aragraph 887." (*Id.* at 19.)

NCA's Position

126. NCA states that it "agrees with [SWG] that the Commission's findings in this case must respect and be consistent with its findings in prior cases." (NCA Answer at 2.) NCA concludes: "Where the Commission has in the past considered issues related to negotiated rate contracts, and has issued findings on those issues, it must respect those findings in this proceeding. Where the issues have been raised and evidence presented, but no determinations issued by the Commission, that history is at least relevant to whether the utility has been prudent and responsive to expression of regulatory concern." (*Id.* at 3.)

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BCP's Position

127. BCP asserts that the Order's finding that SWG violated NAC 704.518 and SWG's tariff with negotiated rate contracts is supported by substantial evidence. (BCP Answer at 7.) BCP notes that "SWG's assertion that the Commission's finding with regards to the negotiated

rate contracts is inconsistent with prior review of these contracts is without merit given the Commission's findings in [paragraphs 877 and 879 of the Order]." (*Id.*)

Staff's Position

128. Staff states that SWG's request for reconsideration regarding this issue does not "rise to a level that warrants reconsideration." (Staff Answer at 26.)

129. Staff objects to SWG's "ongoing reliance on Staff's mistaken belief in 2012 that SWG had satisfied Commission direction from a prior rate case." (*Id.* at 28.) Staff states that its "much more thorough review in this case revealed SWG's ongoing noncompliance with its tariffs and Commission rules." (*Id.*) Staff states that the weight of evidence associated with its mistaken belief in 2012 "should carry little weight." Instead, Staff states that the weight of the evidence in this record "clearly demonstrates SWG's noncompliance with Commission rules and its own tariff regarding its contracting practices and rate design." (*Id.*)

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Commission Discussion and Findings

130. Upon reexamining this issue, the Commission modifies the Order by removing paragraphs 867-886 and ordering paragraphs 42 and 43, and revising paragraph 887 as follows:

> In assessing the claims made by the parties within the context of these clarifications, the Commission finds that both NAC 704.518 and SWG Tariff Schedules NT-1 and ST-1 need to be revisited in an investigation and rulemaking docket to ensure that the underlying practices are consistent with Nevada law and do not frustrate the Commission's statutory charge to set just and reasonable rates. Moreover, given the lack of clarity regarding the implications of previous Commission findings (e.g. in SWG's 2012 GRC) regarding these same issues, the Commission is not inclined to find, at this time, that SWG violated either or both NAC 704.518 and Tariff Schedules NT-1 and ST-1. While the Commission acknowledges that there is evidence that indicates that SWG may have violated these provisions, the Commission must also acknowledge the previous lack of clarity regarding what is expected of SWG when it enters into these contracts. Accordingly, the Commission will open an investigation and rulemaking docket with the following caption: *Investigation and Rulemaking to amend NAC 704.516 et seq. to establish additional procedures and guidelines necessary to ensure that a public utility's use of the schedule and contracts contemplated under NAC 704.518 is consistent with Nevada law and does not result in unjust or unreasonable rates.*

131. While the Commission acknowledges that the underlying evidentiary record could support its original findings, the Commission is compelled to modify its decision given the confusion associated with SWG's contracting practices under NAC 704.518 and Tariff Schedules NT-1 and ST-1, the implications of Staff's mistaken belief in 2012 that SWG had satisfied Commission direction from a prior rate case, and the associated finding made by the Commission in 2012 based on Staff's review. Accordingly, the Commission, upon reexamination, finds it more equitable to resolve this confusion with only a call for an investigation and rulemaking and not with a corresponding finding of noncompliance.

C. Staff's Petition for Clarification and Reconsideration

Cost of Capital

132. Staff seeks clarification on the Commission's decision regarding approval of SWG's capital structure. (*Id.* at 2.) Staff states that the Commission accepted the capital structure provided by SWG in its certification filing. (*Id.*) Staff provides that that SWG proposed a different breakdown of the components of its debt ratios for its Southern Nevada Division ("SND") and its Northern Nevada Division ("NND") than what the table on page 12 of the Commission's Order reflects. Staff requests that the Commission clarify that it approved the different debt ratios for the NND and SND as separately certified to by SWG, which are reflected in the following table:

NND Debt Ratios	
Debt Components	**Certified Ratios**
Long-Term Debt	45.50%
Short-Term Debt	2.37%
Customer Deposits	2.46%
Total Debt	50.34%

SND Debt Ratios	
Debt Components	**Certified Ratios**
Long-Term Debt	47.16%
Short-Term Debt	1.77%
Customer Deposits	1.40%
Total Debt	50.34%

(*Id.* at 3; Ex. 8 at Statement F, Northern Nevada, Sheet 1 of 4; Ex. 8 at Statement F, Southern Nevada, Sheet 1 of 4.)

133. Staff requests that the Commission clarify that it approved the different debt ratios for SWG's NND and SND as separately certified by SWG and as shown in the above tables. (Staff's Petition at 3.) Staff provides that the Order should be modified to reflect the more detailed information in the tables above regarding separate debt components of SWG's NND and SND. (*Id.*)

SWG's Position

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134. SWG supports Staff's request and states that it identifies (in the Order) the correct debt components for SWG's NND and SND. (SWG's Petition at 1-2.)

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Commission Discussion and Findings

135. The Commission inadvertently included inaccurate information regarding SWG's proposed capital structure in the Order. Accordingly, the Commission grants Staff's request for clarification, and modifies paragraphs 14 and 18 of the Order.

Account 376 – Distribution Mains for the SND

Staff's Position

136. Staff provides that paragraph 227 on page 78 refers to Account 376 as "Account 367." (Staff's Petition at 3.) Staff recommends that the Commission clarify and correct the erroneous reference. (*Id.*)

Commission Discussion and Findings

137. The Commission grants Staff's request for clarification and finds that the reference to Account 367 in paragraph 227 of the Order was a typographical error. Accordingly, the Commission accepts Staff's clarifying language and modifies the erroneous reference to Account 367 to Account 376, as reflected in the attached Modified Final Order.

<u>Account 380 – Services for the NND</u>

Staff's Position

138. Staff states that paragraph 285 of the Order accepts the lower accrual rate of 1.59 percent for Account 380 as recommended by Staff. (*Id.*) Staff notes that its proposed 55-year average service life ("ASL") for the account was mentioned; however the Order does not specifically address the net salvage for the NND's Account 380. (*Id.* at 3-4.) Staff seeks clarification from the Commission that by accepting an accrual rate of 1.59 percent, it has approved a recommendation from SWG to reduce the negative net salvage on the account from -35 percent to -25 percent. (*Id.* at 4.)

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139. Staff states that, in the event the Commission agrees with Staff's clarification, it modify paragraph 285 of the Order as follows:

> The Commission accepts Staff's recommendation to lower the accrual rate from 2.72 percent to 1.59 percent based on the remaining life of 37.04 (L2.5-55), which reflects Staff's proposed 55-year ASL for this account and SWG's proposal to reduce the negative net salvage on this account from -35 percent to -25 percent. (*Id.*)

Commission Discussion and Findings

140. The Commission grants Staff's request for clarification on this matter and finds that Staff's proposed clarifying language more accurately expresses the intent of the Order, which intended to adopt Staff's complete position on the matter. Accordingly, the Commission modifies paragraph 285 of the Order to reflect Staff's language.

Account 381 – Meters for the SND

Staff's Position

141. Staff seeks clarification of the Commission's determination regarding Account 381 – Meters for the SND. (*Id.*) Staff states that the Order does not address SWG's recommendation to lower the ASL from 33-S1 to 29-L1.5. (*Id.*) Accordingly, Staff "requests that the Commission confirm whether it accepted SWG's recommendation for this account as filed." (*Id.*)

Commission Discussion and Findings

142. The Commission grants Staff's request for clarification regarding Account 381 – Meters for the SND. The Commission notes that none of the Parties to the proceeding contested SWG's recommendation and clarifies that it intended to accepted SWG's recommendation regarding Account Meters 381 – Meters for the SND to lower the ASL from 33-S1 to 29-L1.5 as filed.

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Account 381 – Meters for the NND

Staff's Position

143. Staff seeks clarification of the Commission's determination regarding Account 381 – Meters for the NND. (*Id.*) Staff provides that paragraph 295 of the Order sought to retain the current 33-year ASL for Account 381. (*Id.*) Staff notes that the current approved ASL for Account 381 – Meters for the NND is 34 years and recommends that the Commission correct the Order to reflect the correct ASL. (*Id.*)

Commission Discussion and Findings

144. The Commission grants Staff's request for clarification regarding paragraph 295 of the Order and finds that it made a typographical error. Accordingly, the Commission modifies paragraph 295 to reflect the retention of a 34-year ASL for Account 381.

<u>Account 390.10 – Structures Owned for the NND</u>

Staff's Position

145. Staff seeks to confirmation that the Commission rejected SWG's proposal to lower net salvage for Account 390.10 – Structures Owned for the NND. (*Id.*) Staff provides that paragraph 304 of the Order reflects the accrual rate recommended by Staff for the System Allocable portion of the account and also appears to accept Staff's recommendation to reject SWG's proposal to increase negative net salvage from zero percent to negative five percent. (*Id.* at 4-5.) Staff seeks confirmation regarding the net salvage rate for Account 390.10 and proposes the following clarifying language:

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> The Commission accepts Staff's recommendation to lower the accrual rate from 2.39 percent to 2.25 percent based on the remaining life of 34.80 (R3-45) and to set a net salvage rate of zero percent for System Allocable plant. The Commission also accepts Staff's recommendation to lower the accrual rate from 2.30 percent to 2.25 percent based on the remaining life of 34.80 (R3-45) and to set a net salvage rate of zero percent for SWG's NND. (*Id.* at 5.)

SWG's Position

146. SWG states that it does not object to the addition of clarifying language to paragraph 304 of the Order regarding the net salvage approved for Account No. 390.10; however, SWG contends that Staff's proposed language is over-inclusive and refers to inaccurate data with respect to the NND plant. (SWG's Answer at 2.) SWG recommends that the Commission adopt the following language for paragraph 304 of the Order:

> The Commission accepts Staff's recommendation to lower the accrual rate from 2.30 percent to 2.25 percent based on remaining life of 34.80 (R3-45) and to retain a net salvage rate of zero percent for System Allocable plant. The

> Commission also accepts Staff's recommendation to retain a net salvage rate of zero percent for SWG's NND plant.

(*Id.*)

Commission Discussion and Findings

147. The Commission finds that the Parties' recommended language clarifies the intent of the Order. The Commission further finds that SWG's provided language includes the most accurate figures and more precise language. Accordingly, the Commission adopts SWG's clarifying language for inclusion in the Modified Final Order.

Commerce Tax

Staff's Position

148. Staff states that the Order accepts Staff's and BCP's recommendation to recover the Commerce Tax in revenue requirement as opposed to a surcharge on customer bills; however, the Order is not clear which methodology should be used. (Staff's Petition at 5.) Staff provides that previous Commission decisions adopted various methods for including certain taxes or assessments in revenue requirement, including utilizing a calculation based upon SWG's test period as recommended by Staff, or utilizing a forward-looking calculation on an iterative basis using the approved revenue requirement. (*Id.* at 5-6.)

149. Staff states that, assuming the Order intended to accept its recommendation, it recommends modifying paragraph 520 of the Order to include the following language:

> The Commission accepts the proposal by Staff and BCP directly SWG to recover the Commerce Tax in its revenue requirement in lieu of a surcharge included on customers' bills. The amount included in the revenue requirement should reflect the amount of Commerce Tax that SWG paid in its test period.

(*Id.* at 6.)

SWG's Position

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150. SWG states that it agrees with Staff that the Order accepts Staff's and BCP's recommendation to require it to recover the Commerce Tax through the revenue requirement in lieu of a surcharge imposed on customer bills. (SWG's Answer at 2.) SWG states that it lacks certainty with respect to which of the two methodologies identified by Staff should be applied to calculate the Commerce Tax to be included in the revenue requirement. (*Id.*) SWG provides that the forward-looking approach would result in a Commerce Tax amount of $511,624.00 in its SND and $138,793 in its NND based upon the revenue requirement established in the instant Docket. (*Id.* at 3.) SWG contends that such an approach would be more representative of the level of tax liability that it experiences. (*Id.*)

151. SWG states that the historical test year payments would result in amounts of $444,435.00 and $129,090.00 for its SND and NND, respectively. (*Id.*) SWG provides that utilization of the historical test year payments would not result in a Commerce Tax amount representative of its liability based upon the revenue requirement established in this Docket. (*Id.*) Accordingly, SWG recommends the following clarifying language:

> The Commission accepts the proposal by Staff and BCP directing SWG to recover the Commerce Tax in its revenue requirement in lieu of a surcharge included on customers' bills. The amount included in the revenue requirement should reflect the amount of Commerce Tax calculated using the iterative calculation based on the revenue requirement established in this Docket.

(*Id.*)

Commission Discussion and Findings

152. The Commission grants Staff's request for clarification regarding the calculation of the revenue requirement calculation of the Commerce Tax. The Commission clarifies that it intended to accept Staff's recommendation to utilize a Commerce Tax amount in SWG's revenue requirement reflective of the test period with a corresponding adjustment to SWG's recorded tax expense to increase the "Taxes Other than Income" expense by $444,435.00 and $129,090.00 for

the SND and NND, respectively.[43] Accordingly, the Commission adopts Staff's clarifying language.

APL Contract

Staff's Position

153. Staff seeks clarification regarding paragraph 638 to correct a typographical error in the citation in the second sentence. (Staff's Petition at 6.) Staff provides that the Commission may have intended to cite to the Direct Testimony of Charles Whitman but instead cited to the direct testimony of Adam Danise. To remedy this, Staff recommends that the citation for the second sentence in paragraph 638 read as follows: "(Ex. 71 at 7-8.)." (*Id.* at 6-7.)

SWG's Position

154. SWG does not oppose Staff's proposed correction to paragraph 638; however, SWG notes that there should also be a conforming change to the stated GIR rate for SWG's SND effective January 1, 2019, from $0.02609 per therm to $0.02608 per therm. (SWG's Answer at 3.) SWG states that the conforming change is already reflected in its GIR Rate filed and reflected in its tariff for the SND rate jurisdiction. (*Id.*)

Commission Discussion and Findings

155. The Commission grants Staff's request for clarification on this matter and corrects Paragraph 638 to properly cite to Ex. 71 at 7-8.

SERP Benefits

Staff's Position

156. Staff seeks reconsideration to correct a mistaken fact included in paragraph 392 of the Order. (*Id.* at 7.) Specifically, Staff states that the Commission accepted its recommendation to exclude from recovery all SERP benefits exceeding the restoration benefit of $57,844.00 for

[43] As specified in Ex. 72 at 5 and Paragraph 514 of the Order.

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SWG's NND and $273,916.00 for SWG's SND. (*Id.*) Staff provides that those figures were obtained from its own testimony in Exhibit 63 at 11; however, those figures were not correct and were left uncorrected at hearing. (*Id.*) Staff provides that the correct figures, which can be found in Exhibit 63 at 2, 10, and 13, are $59.219.00 for SWG's NND and $279,925.00 in the SND. (*Id.*) Accordingly, Staff recommends that paragraph 392 of the Order be modified as follows:

> Staff therefore recommends that the SERP expenses for the NND and SND be decreased in the amounts of $59,219.00 and $279,925.00, respectively, to remove costs that are in excess of the restoration amount of SERP from the revenue requirements. (Ex. 63 at 11.)

(*Id.*)

SWG's Position

157. SWG agrees that the Order accepts Staff's recommendation to exclude from cost recovery all SERP benefits exceeding the restoration benefit; however, SWG states that the adjustment amounts of $59,219.00 and $279,925.00 for SWG's NND and SND, respectively, contained in Staff's proposed revisions to Paragraph 392 are incorrect. (SWG's Answer at 3-4.)

158. SWG states that the correct adjustment amounts are $59,747.00 for its NND and $282,574.00 for its SND. (*Id.* at 4.) SWG states that "the amounts are comprised of the non-service pension adjustment amounts ($51,828.00 for [its NND] and $249,007.00 for [its SND]) resulting from Labor and Benefits Adjustment." (*Id.*) SWG contends that these amounts are a more accurate reflection of the effect of the adjustments as calculated in its models. (*Id.*) SWG recommends that the Commission consider the following language:

> Staff therefore recommends that the SERP expenses for the NND and SND be decreased in the amounts of $59,747.00 and $282,574.00, respectively, to remove costs that are in excess of the restoration amount of SERP from the revenue requirements.

(*Id.*)

Commission Discussion and Findings

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159. The Commission finds that, consistent with the standard for reconsideration set forth in NAC 703.801(1), Staff properly identified a portion of the Order based upon a mistaken fact and supported its recommendation with an adequate citation to the record to correct the error. Accordingly, the Commission grants reconsideration on this matter.

160. Upon examination of the record, the Commission finds that the Order used inaccurate figures. The Commission further finds that SWG's recommended language and figures represent the most accurate reflection of the record as set forth in the prepared rebuttal testimony of Erin Potokar.[44] Accordingly, the Commission adopts SWG's proposed language for inclusion in the Modified Final Order.

<u>Leasehold Improvements to Former Elko Office Building</u>

Staff's Position

161. Staff "seeks clarification and/or reconsideration of paragraph 464 and ordering paragraph 18 of the Order concerning the amount of costs that should be removed from either rate base or the revenue requirement." (*Id.*) Staff provides that ordering paragraph 18 of the Order states that SWG will remove from its revenue requirement $375,170.00 in costs associated with leasehold improvements to the retired office in Elko, Nevada, consistent with paragraph 464 of the Order; however, paragraph 464 of the Order states that "[t]he Commission accepts Staff's recommendation to remove $375,170.00 in costs associated with leasehold improvements to the retired office in Elko, Nevada, from rate base." (*Id.* at 7-8.)

162. Staff states that its recommendation requested that the Commission "[a]pprove Staff's adjustment to retire $375,170.00 of leasehold improvements from the NND rate jurisdiction rate base related to the formerly leased Elko office building resulting in a revenue requirement reduction of $8,741 for depreciation expense." (*Id.* at 8; Ex. 70 at 2.) Staff provides

[44] *See* Ex. 62 at 3;

that "there is an inconsistency between paragraph 464, ordering paragraph 18, and [Staff's first recommendation in Ex. 70 at 2] concerning whether the $375,170.00.00 leasehold improvement costs should be removed from rate base (in accordance with paragraph 464 [of the Order]), removed from the revenue requirement (in accordance with ordering paragraph 18), or retired – but not removed from rate base – and remove only the depreciation expense associated with the costs from the revenue requirement (in accordance with Staff's recommendation [in Exhibit 70]). (*Id.* at 8.)

163. Staff states that its recommendation more precisely intended to remove the costs from "plant-in-service" rather than "rate base." (*Id.*) Staff's testimony did not recommend that the leasehold improvements be disallowed and excluded from rate base; rather, it recommended that the balance of the leasehold improvements be retired. (*Id.* at 8; Ex. 70 at 2.)

164. Staff provides that in normal utility accounting, the retirement of an asset has no effect on rate base and ratepayers still pay a return on the investment. (*Id.* at 8.) Staff further provides that the only revenue requirement effect is on depreciation expense and that there is no effect on rate base. (*Id.*) Staff states that "it calculated a revenue requirement reduction related to the depreciation expense in the amount of $8,741.00."

165. Staff provides that, if the Commission intended to accept Staff's recommendation regarding the leasehold improvements in its Order, it recommends that the Commission modify paragraph 464 as follows:

> The Commission accepts Staff's recommendation to remove $375,170.00 in costs associated with leasehold improvements to the retired office in Elko, Nevada, in the calculation of depreciation expense. As Staff notes, allowing these costs to remain in rate base would result in SWG earning a rate of return on the improvement as well as a return of investment through the annual depreciation expense. Moreover, SWG does not oppose Staff's adjustment. Accordingly, the Commission finds that the depreciation expense is not acceptable and accepts

> Staff's adjustment to remove $375,170.00 in costs from the calculation of the depreciation expense.

(*Id.* at 9.)

166. Staff states that, if the Commission intended to accept its recommendation regarding the leasehold improvements in its Order, a corresponding correction to ordering paragraph 18 of the Order should also be made as follows:

> Southwest Gas Corporation shall remove from its calculation of depreciation expense $375,170.00 in costs associated with leasehold improvements to the retired office in Elko, Nevada, consistent with Paragraph 464 of this Order.

(*Id.*)

Commission Discussion and Findings

167. The Commission grants Staff's request for clarification. The Commission clarifies that it intended to adopt Staff's recommendation, consistent with the language provided by Staff in its request for clarification. Accordingly, the Commission adopts Staff's proposed language and modifies paragraphs 464 and ordering paragraph 18, consistent with Staff's recommendation.

<u>Directors' & Officers' (D&O) Liability Insurance</u>

Staff's Position

168. Staff seeks clarification and/or reconsideration of Paragraphs 467 and 471 of the Order regarding the amount of D&O insurance expenses to be disallowed. (*Id.*) Staff states that Ordering Paragraph 19 requires that SWG "exclude 50 percent of costs associated with its Directors and Officers Liability Insurance, consistent with paragraph 471 of this [Reexamined] Order." (*Id.*) Staff provides that Paragraph 471 accepts Staff's recommendation regarding D&O liability insurance; however, the paragraph only addresses the amount of D&O liability insurance that should be removed from rate base and is does not specify the expenses authorized to be included in the revenue requirement. (*Id.*)

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169. Staff recommends that the Commission clarify whether it intended to accept Staff's entire recommendation regarding D&O liability insurance. (*Id.*) In the event that the Commission intended to accept Staff's entire recommendation regarding SWG's D&O liability insurance, Staff recommends that the Commission modify paragraph 467 of the Order as follows:

> Staff recommends that the Commission reduce SWG's requested revenue requirement by $145,344.00 for the SND and $30,278.00 for the NND, and reduce rate base by $40,321.00 for SND and $8,393.00 for NND for costs related to D&O liability insurance. (Ex. 70 at 4.) Staff argues that these costs should be shared 50-50 as was ordered in Docket No. 12-04005. (*Id.* at 6.)

(*Id.* at 10.)

170. Similarly, in the event that the Commission intended to accept Staff's entire recommendation regarding SWG's D&O liability insurance, Staff recommends the following corresponding modification to paragraph 471 of the Order:

> ...Accordingly, the Commission accepts Staff's recommendation to disallow 50 percent of D&O liability insurance expenses in the amount of $145,344.00 for SWG's SND and $30,278.00 for SWG's NND, and by reducing SWG's SND rate base by $40,321.00 and reducing SWG's NND rate base by $8,393.00.

(*Id.*)

SWG's Position

171. SWG states that the clarifying language provided by Staff includes figures that are slightly inaccurate and recommends the following language to paragraph 467:

> Staff recommends that the Commission reduce SWG's requested revenue requirement by $145,363.00 for the SND and $30,256.00 for the NND, and reduce rate base by $40,321.00 for SND and $8,393.00 for NND for costs related to D&O liability insurance. (Ex. 70 at 4.) Staff argues that these costs should be shared 50-50 as was ordered in Docket No. 12-04005. (*Id.* at 6.)

172. SWG recommends a corresponding modification to Paragraph 471 as follows:

> Accordingly, the Commission accepts Staff's recommendation to disallow 50 percent of D&O liability insurance expenses in the amount of $145,363.00 for

> SWG's SND and $30,256.00 for SWG's NND by reducing SWG's SND rate base by $40,321.00 and reducing SWG's NND rate base by $8,393.00.

(*Id.* at 5.)

Commission Discussion and Findings

173. The Commission grants Staff's request for clarification regarding D&O Liability Insurance. The Commission provides clarification that it intended to adopt Staff's entire recommendation regarding this matter. However, the Commission's examination of the record revealed that SWG's proposed language reflects the most accurate dollar amounts for the figures in paragraphs 467 and 471. Accordingly, the Commission adopts SWG's clarifying and corrective language for inclusion in the Modified Final Order.

Basic Service Charge

Staff's Position

174. Staff seeks clarification regarding the language contained in paragraph 694 of the Order. (*Id.* at 19.) Staff provides that SWG's proposal was "to maintain basic service charges while updating delivery charges, including an update to a demand for some larger customers." (*Id.* at 19-20.) Staff notes that the current language reflected in paragraph 694 of the Order states that SWG is requesting to maintain its basic service charge and demand charges. (*Id.* at 20.) Staff recommends that the reference to demand charges should be deleted. (*Id.*) Staff states that the delivery charges proposed by SWG and cited in the paragraph will change as the amount of SWG's revenue requirement is recalibrated in accordance with the Order. Accordingly, Staff recommends the following changes to paragraph 694 of the Order:

> SWG requests to maintain the basic service charges while updating its delivery charges for its NND and SND. Staff supports SWG's request, and BCP did not object to the proposals. Accordingly, the Commission approves SWG's request to maintain its existing basic service charge while updating delivery charges, including demand charges for large customers for the SND and NND.

(*Id.*)

SWG's Position

175. SWG agrees that the reference to the demand charges in Paragraph 694 should be deleted and that the delivery charges that SWG proposed have changed as a result of the various adjustments to the cost of service in the instant Docket. (SWG's Answer at 6.) SWG proposes the following revision to Staff's recommended language to clarify the applicability of the demand charge:

> SWG requests to maintain its basic service charges while updating its delivery charges for its NND and SND. Staff supports SWG's request, and BCP did not object to the proposals. Accordingly, the Commission approves SWG's request to maintain its existing basic service charge while updating delivery charges, including demand charges for customers receiving service under the SG-G4 and NG-G4 rate schedules in the SND and NND, respectively.

(*Id.*)

Commission Discussion and Findings

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176. The Commission grants Staff's request for clarification regarding the Basic Service Charge. The Commission finds that it inadvertently included inaccurate language in the drafting of the Order. The Commission further finds that SWG's recommended language provides additional clarity and precision to achieve the same end sought by Staff's recommendation. Accordingly, the Commission modifies paragraph 694 consistent with the adoption of SWG's proposed language.

<u>Class Cost of Service ("CCOS") Study</u>

Staff's Position

177. Staff seeks clarification, or in the alternative, reconsideration of the Commission's directive that SWG file two CCOS studies in its next rate case consistent with Paragraph 685 of the Order. (Staff's Petition at 20.)

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178. More specifically, Staff seeks clarification and confirmation that the types of CCOS studies to be filed in SWG's next rate case and that the purpose of those studies will be determined in the Commission's upcoming investigation. (*Id.* at 20-21.) Staff recommends that, given the impending investigation regarding contracting practices, including what changes may need to be done to SWG's CCOS studies prior to its next GRC, the Commission be less prescriptive in its Order as to what kinds of CCOS studies SWG will file and for what those CCOS studies will be utilized. (*Id.* at 20.)

NCA's Position

179. NCA states that the Commission ordered further investigation and potential future modifications of the CCOS studies prior to SWG's next rate case; however, the studies remained unchanged in this proceeding. (NCA's Response at 1-2.)

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180. NCA provides that paragraph 887 details the types of CCOS studies to be filed in SWG's next rate case in addition to the purpose of those studies in the Commission's upcoming investigation. (*Id.* at 2.) NCA states that while the CCOS studies filed in the instant Docket were not modified and only used to set rates, it asserts that the Commission intended to give the Parties a forum in the new investigatory docket to discuss changes to the study methodologies to be used in the next rate case. (*Id.*)

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Commission Discussion and Findings

181. The Commission grants Staff's request for clarification. The Commission clarifies that, currently, SWG is to file two CCOS Studies in its next GRC; however, as NCA discusses, the Commission intends to give the parties to this Docket and other interested participants a forum in the new investigatory docket – opened pursuant to paragraph 887 of the

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Order, as modified by this Order and the attached Modified Final Order – to address possible changes to the CCOS-study methodologies for use in the next general rate case.

<u>Findings regarding Negotiated Rate Contracts</u>

<u>Three-Prong Test Compliances</u>

Staff's Position

182. Staff seeks clarification regarding the compliance item in Ordering Paragraph 43 of the Order, which requires SWG to file contracts and supporting documents to ensure that it can satisfy the three-prong test delineated in Schedule No. ST-1/NT-1. (*Id.* at 13.) Staff provides that the three-prong test requires as "a condition precedent… [that] the customer … establish, to SWG's satisfaction, that bypass is economically, operationally, and physically imminent." (*Id.*) Staff argues that Schedule ST-1/NT-1 requires that, prior to the execution of a contract, a customer make a showing to the utility that it meets the three-prong test. (*Id.*) Accordingly, Staff requests clarification that the only documents that SWG will be allowed to provide to meet the three-prong test is information from its contract customers given to SWG prior to the execution of the contract to demonstrate that bypass was economically, operationally, and physically feasible and imminent. (*Id.*)

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183. Staff further requests clarification regarding what it intends SWG to provide to the Commission in satisfaction of the compliance filing. (*Id.*) Under the premise that SWG can only provide information given to it by its NRC customers prior to executing an agreement with them, Staff provides that it is unclear what information SWG could provide to bring its contracting practices into compliance with applicable law and tariff provisions as indicated by paragraph 882 of the Order. (*Id.* at 14.)

184. Staff also seeks clarification regarding how the Commission's finding that SWG violated its own tariff and the Commission's rules by violating the "bona fide alternative" requirement interplays with its compliance item requiring SWG to file contracts and supporting documents to ensure that it can satisfy the three-prong test. (*Id.* at 15.)

185. Finally, Staff further seeks clarification regarding what other documentation, if any, it expects SWG to provide in satisfaction of the compliance set forth in ordering paragraph 43. (*Id.*)

SWG's Position

186. SWG states that all relevant information relating to the NRCs should be considered and that recourse, if any, should be evaluated after evaluation of the NRC information and subsequent to the Commission's investigation referenced in Paragraph 887 regarding SWG's contracting practices. (SWG's Answer at 5.) SWG further states that if it is ordered to re-submit contracts to the Commission, it anticipates that NRCs themselves may desire to appear and comment. (*Id.* at 5-6.)

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<u>Staff's review of compliances</u>

Staff's Position

187. Staff seeks clarification regarding its own review of SWG's compliance filings. (Staff's Pet. at 15.) More specifically, Staff seeks to understand how it should treat NRC contracts that have already been found to have not met the bona fide alternative and whether the Commission is providing SWG with another opportunity to establish if it met the three-prong test in the tariff, including the contracts that the Commission has already found did not satisfy the test. (*Id.*)

SWG's Position

188. SWG states that the Order's finding that certain NRC contracts are in violation of NAC 704.518 and its tariff are premature given that further proceedings will be undertaken to review the NRC agreements and their regulatory compliance or noncompliance. (SWG's Answer at 6.)

Potential Show Cause proceeding

Staff's Position

189. Staff seeks clarification regarding the Order's requirement that Staff file a show cause if it determines that SWG violated the bona fide alternative provision given that the Commission has already determined that Staff violated it. (Staff's Pet. at 15.) More specifically, Staff requests that the Commission clarify whether it expects Staff to prove in its show cause that SWG did not comply with its tariff, or alternatively, whether the show cause is an opportunity for Staff to seek administrative fines for the findings in this docket. (*Id.* at 15-16.)

190. Staff states that even if SWG somehow satisfies the three-prong test, it would still not be in compliance with its tariff given the findings in the Order. (*Id.* at 15.) Staff provides that absent SWG re-negotiating all nine contracts at issue, the only remedy for SWG to totally cure its deficiencies with the tariff and the Commission's rules would be to seek approval of the contracts. (*Id.*) Accordingly, Staff seeks clarification of the Commission regarding its goals given that the Commission's findings in the Order already require bypass to be re-demonstrated when SWG either seeks approval for the nine contracts or re-submits them after re-negotiation. (*Id.* at 16.)

Compliances as they relate to Commission findings

Staff's Position

191. Staff seeks clarification regarding how the compliances in the Order relate to the Commission's expressed concern that "SWG's contracting practices might be imprudent and therefore conflict with the public interest by applying rates to contract customers which impose a burden or cause a harm to ratepayers by shifting to them the costs of serving the contract customers" in paragraph 879. (Staff's Pet. at 17.)

192. Staff provides that, to the extent the Commission wishes to bring SWG's contracting practices into compliance with its tariff and the law, it should consider requiring SWG to seek approval of its contracts and include in such a filing all required documents pursuant to applicable regulation, which at a minimum would include documents that show that the contract customer demonstrates its eligibility and documentation that the negotiated rates in the proposed contracts do not impose a burden or cause harm to other ratepayers by shifting the costs of serving the NRCs. (*Id.* at 17-18.) Staff provides that the latter is more crucial for evaluating and approving a contract for special services because such agreements are not bound by the limits of SWG's Schedule No. ST-1/NT-1. (*Id.* at 18.)

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<u>Findings regarding contracts that did not satisfy the Bona Fide Alternative Requirement</u>

193. Staff seeks reconsideration regarding the exclusion of NCA #1 and NCA #2 from the list of NRC contracts found to be in violation of NAC 704.518 and Schedule No. ST-1/NT-1 for failure to file information demonstrating that the customer had a bona fide bypass alternative. (*Id.*)

194. Staff argues that SWG admitted that NCA did not demonstrate bypass during its contract renewal in 2010. (*Id.* at 18-19; Tr. at 1421.) Staff states that although NCA had an analysis prepared to show bypass, there is no evidence on the record that SWG reviewed the analysis or considered compliance with its own tariff. (*Id.* at 19.) Staff further argues that

NCA's legal brief does not identify any specific place in the record where SWG satisfied its tariff by having NCA demonstrate to SWG that bypass was economically, operationally and physically feasible and imminent. (*Id.*) Staff provides that SWG also failed to demonstrate that NCA #1 and NCA #2 had bona fide alternatives when the contracts were executed. (*Id.*)

NCA's Position

195. NCA opposes Staff's request for reconsideration of the exclusion of NCA #1 and #2 from the finding in paragraph 867, which identified contracts that had not satisfied the bona fide alternative requirement. (*Id.* at 2.) NCA argues that the Commission properly excluded it from the finding in paragraph 867 based on evidence on the record that a bona fide bypass alternative had been established for the NCA projects. (*Id.* at 3.) NCA provides that such evidence included 1) SWG's consideration of the original evidence presented in 1993 by NCA during the original contract negotiation, including a BLM right of way; 2) the testimony of SWG's witness regarding the investigation and negotiation with NCA; and 3) the North Star study, which NCA claims to confirm SWG's conclusion that a bypass alternative was available. (*Id.* at 3-4; Tr. at 1419-1421.)

196. NCA disagrees with Staff's argument that the demonstration of a legitimate bypass option must be provided exclusively by the customer. (*Id.* at 4.) NCA argues that there is not any public interest consideration is protected by such an interpretation and no harm is caused if the proof of a legitimate bypass option is established by SWG instead of the customer. (*Id.* at 4.) NCA provides that the Commission should expect and require that a utility independently review and substantiate any proffer made by a customer. (*Id.*)

197. NCA argues if the Commission adopts the interpretation that SWG's tariff requires proof of a viable bypass option only at the inception of initial service, then there is no

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issue with non-compliance due to a contract renewal. (*Id.* at 4-5.) NCA contends that re-proving the existence of a bypass after a pipeline has already been constructed is impractical and serves no regulatory purpose. (*Id.* at 5.)

Commission Discussion and Findings

198. Given the Commission's findings in paragraphs 130 and 131, the Commission deems Staff's request for clarification regarding the issues discussed in this section (Findings regarding Negotiated Rate Contracts) moot.

THEREFORE, it is ORDERED:

1. The Petition for Reconsideration of Southwest Gas Corporation in Docket No. 18-05031 is GRANTED.

2. The Petition for Clarification and Reconsideration of the Regulatory Operations Staff of the Commission in Docket No. 18-05031 is GRANTED.

3. The Public Utilities Commission of Nevada's December 24, 2018, Order in Docket No. 18-05031 is MODIFIED as reflected in Attachment 1.

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4. All arguments of the parties raised in these proceedings not expressly addressed herein have been considered and either rejected or found to be non-essential for further discussion in this Order.

By the Commission,

ANN WILKINSON, Chairman

ANN PONGRACZ, Commissioner and Presiding Officer

C.J. MANTHE, Commissioner

Attest:
TRISHA OSBORNE,
Assistant Commission Secretary

Dated: Carson City, Nevada

2/15/19

(SEAL)

PUBLIC UTILITIES COMMISSION PUC OF NEVADA

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ATTACHMENT 1

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BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

Application of Southwest Gas Corporation for authority to increase its retail natural gas utility service rates and to reset the Gas Infrastructure Replacement Rates for Southern and Northern Nevada.	))))))	Docket No. 18-05031

At a special session of the Public Utilities Commission of Nevada, held at its offices on December 21, 2018.

PRESENT: Chairman Ann Wilkinson
Commissioner Ann C. Pongracz
Commissioner C.J. Manthe
Assistant Commission Secretary Trisha Osborne

MODIFIED **ORDER**

(The material to be omitted is in ~~strikethrough;~~ the material to be added is in ***bold italics***)

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

I. INTRODUCTION

On May ~~3~~ 29, 2018, Southwest Gas Corporation ("SWG") filed an Application with the Commission, designated as Docket No. 18-05031, for authority to increase its retail natural gas utility service rates and to reset the Gas Infrastructure Replacement Rates for Southern and Northern Nevada (the "Application").

In its Application, SWG requests approval of an increase in its retail natural gas utility service rates and to reset its Gas Infrastructure Rate ("GIR") in its Southern Nevada Division ("SND") and Northern Nevada Division ("NND"). (Ex. 1 at 1.) SWG's request "includes a statewide annual general rate increase of approximately $32.5 million to account for changes in the cost of service since the company's last general rate case (approximately $14.4 million over six years) and the inclusion in rate base of GIR projects previously approved by the Commission (approximately $18.1 million)."

More specifically, SWG requests authorization to increase general rates to recover annual revenues of $12,441,435.00, or approximately 3.8 percent in its SND, and annual revenues of $1,929,101.00, or approximately 1.9 percent, in its NND to account for changes in its cost of service since its last General Rate Case ("GRC"), including the incorporation of non-GIR projects into rate base. (Ex. 1 at 4.) SWG provides that the increases account for approximately six years of its investments. (*Id.*)

II. SUMMARY

The Commission grants in part and denies in part SWG's Application, as modified by this Order.

III. PROCEDURAL HISTORY

• On May 29, 2018, SWG filed its Application.

• SWG filed the Application pursuant to the Nevada Revised Statutes ("NRS") and the Nevada Administrative Code ("NAC"), Chapters 703 and 704, including but not limited to NRS 704.110 and 704.992. Pursuant to NAC 703.5274, SWG requested confidential treatment of certain information.

• The Regulatory Operations Staff ("Staff") of the Commission participates as a matter of right pursuant to NRS 703.301.

• On May 30, 2018, the Attorney General's Bureau of Consumer Protection ("BCP") filed a Notice of Intent to Intervene.

• On June 1, 2018, the Commission issued a Notice of Application for Authorization to Increase Rates and Charges for Natural Gas Service and Notice of Prehearing Conference.

• On June 21, 2018, Nevada Cogeneration Associates #1 and #2, Limited Partnerships, ("NCA") filed a Petition for Leave to Intervene ("PLTI").

• On July 2, 2018, the Commission held a prehearing conference. SWG, BCP, NCA, and Staff (collectively, the "Parties") made appearances. NCA's PLTI and a procedural schedule were discussed. The prehearing conference was continued on the record to September 28, 2018.

• On July 6, 2018, the Commission issued an Order granting NCA's PLTI.

• On July 6, 2018, the Presiding Officer issued a Procedural Order requiring Parties to submit information to the Commission regarding negotiated rate contracts, the agreed upon procedural schedule, and an outline of issues that the Parties agree to address in pre-hearing briefs.

• On July 9, 2018, Staff filed a letter on behalf of the Parties responsive to the July 6, 2018, Procedural Order. Staff requested confidential treatment of certain information contained in the letter pursuant to NAC 703.5274. ("Staff's July 9, 2018, Letter")

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• On July 12, 2018, the Presiding Officer issued Procedural Order No. 2, establishing a procedural schedule and addressing discovery disputes and rules.

• On July 16, 2018, the Commission issued a Notice of Consumer Session and Notice of Hearing.

• On July 27, 2018, SWG, BCP, NCA, and Staff submitted pre-hearing briefs responsive to the Commission's July 6, 2018, Procedural Order.

• On July 27, 2018, Saguaro Power Company, a Limited Partnership ("Saguaro") filed comments addressing Staff's July 9, 2018, Letter.

• On August 24, 2018, the Presiding Officer issued Procedural Order No. 3, establishing a procedural schedule, rescheduling a continued prehearing conference, and setting the scope of the proceeding as it relates to negotiated rate contracts.

• On August 24, 2018, SWG filed its prepared certification testimony and applicable supporting schedules for its NND and SND.

• On August 30, 2018, Staff filed a letter correcting and addressing a mistake in its July 9, 2018, Letter. Staff requested confidential information of certain information contained in its letter pursuant to NAC 703.5274(2)(c).

• On August 31, 2018, SWG submitted its certification filing.

• On August 31, 2018, SWG filed a partially redacted copy of the prepared direct testimony of Brian T. Holmen.

• On August 31, 2018, SWG filed its prepared GIR certification testimony and supporting exhibits.

• On September 7, 2018, SWG filed its Summary of Operations and Rate of Return for Southern and Northern Nevada for calendar years 2013-2017.

• On September 11, 2018, the Commission conducted a consumer session at the Commission's office in Las Vegas, Nevada and via video-conference to Carson City, Nevada.

• On September 14, 2018, SWG filed its Prepared GIR Certification Testimony.

• On September 21, 2018, BCP and Staff filed Prepared Direct Testimony.

• On September 21, 2018, NCA filed a request to participate in the continued prehearing conference telephonically.

• On October 1, 2018, the Commission held a prehearing conference. SWG, BCP, and Staff made appearances. NCA also made an appearance telephonically.

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• On October 3, 2018, BCP and Staff filed Prepared Direct Testimony.

• On October 5, 2018, BCP and Staff filed Prepared Direct Testimony and SWG filed Prepared Rebuttal Testimony.

• On October 10, 2018, Staff filed Direct Testimony.

• On October 12, 15, and 16, 2018, SWG filed Rebuttal Testimony.

• On October 16, 2018, BCP filed an Errata to the Direct Testimony of David Lawton.

• On October 19, 2018, BCP filed an Errata and Notice of Adoption of Testimony.

• On October 22 through 25, 2018, and October 29 through 30, 2018, the Commission held a hearing. The Parties made appearances. Exhibit Nos. 1-115 and Confidential Exhibit Nos. 1-20 were accepted into the record.

• On October 25, 2018, SWG filed Late-Filed Exhibit 61.

• On October 29, 2018, SWG filed an Errata to the Direct Testimony of Randi Cunningham.

• On November 2, 2018, SWG filed Late-filed Confidential Exhibit No. 20.

• On November 9, 2018, the Presiding Officer issued Procedural Order No. 4, requiring that Parties submit legal briefs to the Commission on or before November 30, 2018.

• On November 9, 2018, SWG late-filed Exhibit No. 109.

• On November 13, 2018, the Presiding Officer issued Corrected Procedural Order No. 4.

• On November 30, 2018, SWG, BCP, Staff, and Nevada Cogeneration Associates #1 and #2 ("NV Cogen #1 and NV Cogen #2," respectively) filed post-hearing briefs.

IV. APPLICABLE LAW

The Commission must ensure just and reasonable rates.

1. The Commission's primary statutory responsibility in general rate case proceedings[1] is to ensure that rates charged for service by public utilities in Nevada are just and reasonable.[2] In carrying out this statutory responsibility, the Commission must "balance the interests of customers and shareholders of public utilities by providing public utilities with the opportunity to earn a fair return on their investments while providing customers with just and reasonable rates."[3] Moreover, "[i]f, upon any hearing and after due investigation, the rates, tolls, charges, schedules or joint rates shall be found to be unjust, unreasonable or unjustly discriminatory, or to be preferential, or otherwise in violation of any of the provisions of [Chapter 704 of the NRS], the Commission shall have the power to fix and order substituted therefor such rate or rates, tolls, charges or schedules as shall be just and reasonable."[4]

2. Notably, with regard to the Commission's statutory authority and duty to regulate utility rates, the Supreme Court of Nevada has described the Commission's power as "plenary,"

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[1] Pursuant to NRS 704.110, a public utility may file a general rate application to make changes to any rate or schedule.
[2] *See* NRS 703.150, 704.001, 704.110, 704.120.
[3] NRS 704.001.
[4] NRS 704.120.

meaning that it is "broadly construed."[5] Additionally, the Supreme Court of Nevada has emphasized the Commission's broad discretion in setting utility rates and practices, stating, for example, that "[t]he only limit on the [Commission's] authority to regulate utility rates is the legislative directive that rates charged for services provided by a public utility must be 'just and reasonable' and that it is unlawful for a public utility to charge an unjust or unreasonable rate."[6]

3. In addition to relevant Nevada law, the Commission relies upon two seminal United States Supreme Court cases for guidance in rate case proceedings: *Bluefield Water Works and Improvement Company vs. Public Service Commission, 262 U.S. 679 (1923)* and the *Federal Power Commission vs. Hope Natural Gas Company, 320 U.S. 591 (1944).*

4. In *Bluefield*, the United States Supreme Court addressed the concept of just and reasonable rates and set forth parameters that should be utilized to establish a fair return on public utility investments:

> A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding, risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties. A rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally.[7]

5. In *Hope,* the Court explained that a determination of whether a rate is just and reasonable is a result-oriented endeavor and involves "the making of 'pragmatic adjustments'."[8]

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[5] *See Nevada Power Co. v. Eighth Judicial Dist. Court of Nevada*, 120 Nev. 948, 957, 102 P.3d 578, 584 (2004); *Consumers League v. Southwest Gas,* 94 Nev. 153, 157, 576 P.2d 737, 739 (1978); NRS 704.040.
[6] *Nevada Power Co.* 102 P.3d at 584 (citing NRS 704.040).
[7] *Bluefield*, 262 U.S. at 692-693.
[8] *See Hope*, 320 U.S. at 602 (quoting *Federal Power Comm'n v. Natural Gas Pipeline Co.*, 315 U.S. 575, 586).

The Court provided that "[i]t is not theory but the impact of the rate order which counts" and even declared that the presence of "infirmities" in the "method employed" to effectuate just and reasonable rates in a rate order is unimportant.[9] Notably, the Court later reaffirmed these "teachings" in *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).[10]

A public utility must sustain the burden of proof regarding the prudence of the expenditures that it wishes to recover in a general rate case.

6. Nevada law instructs a public utility applicant as to the manner in which it should prepare for hearing regarding its proposal to change rates. Pursuant to NAC 703.2231, an applicant seeking to change rates "must be prepared to go forward at a hearing on the data which have been submitted and to sustain the burden of proof of establishing that its proposed changes are just and reasonable and not unduly discriminatory or preferential." NAC 703.2231 further requires that a utility seeking to change its rates must "ensure that the material it relied upon is of such composition, scope and format that it would serve as its complete case if the matter is set for hearing." Implied within the requirement to establish that the proposed rate changes are just and reasonable is a requirement for the utility to demonstrate that the expenses for which it is seeking recovery were prudently incurred. A rate cannot be just or reasonable if it is established for the purpose of allowing the utility to recover costs that were not prudently incurred. Thus, NAC 703.2231 requires the utility's GRC application to include all information necessary to demonstrate why incurred expenses are prudent and why proposed rate changes are just and reasonable.

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[9] *Id.*

[10] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 ("Today we reaffirm these teachings of *Hope Natural Gas*: '[i]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unreasonable, judicial inquiry ... is at an end. The fact that the method employed to reach that result may contain infirmities is not then important.'" (internal citations omitted)).

SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures.

7. During the proceedings in this case, SWG has offered conflicting statements regarding whether, and to what extent, it believes that it has an obligation to justify the expenditures that form the basis of its request to change rates. Initially, SWG stated that "[i]t has the burden of proof in every case" to show that its proposed changes are just and reasonable and that it "absolutely" understands that it carries the burden of justifying the prudence of its expenditures (Tr. at 371-72; 425-26.) Yet, later, SWG asserted that "a regulated utility is entitled to a rebuttable presumption that the expenses reflected in its rate applications are prudently incurred," shifting the burden "to opposing parties to produce evidence that raises serious doubt as to the prudency of such expenditures." (SWG Br. at 1-2.)

8. In support of its revised position that it does not have to sustain the burden of proof, SWG's counsel distributed to the parties and sought administrative notice of two decisions: (1) The Supreme Court of Nevada's decision in *Nevada Power Co. v. Pub. Utilities Comm'n of Nevada,* 122 Nev. 821, 138 P.3d 486 (2006); and (2) a 1986 Commission decision (*In re Nevada Power Company, 74* P.U.R.4th 703 (May 30, 1986)) that was relied upon by the Supreme Court of Nevada in the 2006 *Nevada Power* case. (Tr. 790-91.) SWG failed to inform the Commission that both decisions were superseded by statute in 2007.[11] NRS 704.185 now provides that "[t]here is no presumption of reasonableness or prudence for any transactions or recorded costs of natural gas included in the application, and the public utility has the burden of proving reasonableness and prudence in the proceeding." [12] As Staff explains:

[11] *See* Assembly Bill No. 7 ("AB 7"), 2007 Leg., 74th Sess. (Nev. 2007.)("The provisions of this act are intended to supersede the holding of the Nevada Supreme Court in *Nevada Power Company v. Pub. Utilities Commission of Nevada*, 122 Nev. Adv. Op. 72 (2006), to the extent that the Court determined that the rebuttable presumption of prudence is the controlling procedure in proceedings involving deferred energy accounting.")

[12] SWG's counsel should have complied with its obligations under Rule 3.3 of the Nevada Rules of Professional Conduct ("NRPC") and "correct[ed] a false statement of material fact or law previously made to the [Commission]…"

> ...the *Nevada Power case* was not only superseded by statute over a decade ago in 2007...but also is completely irrelevant to the instant SWG general rate case docket. While the *Nevada Power* case did discuss the circumstances under which a utility was entitled to a rebuttable presumption of prudence under the old statutes, the circumstances addressed were limited to energy or fuel costs incurred in a utility's deferred energy accounting adjustment ("DEAA") proceeding. *Nevada Power,* 122 Nev. at 834 (holding a utility enjoys a presumption of prudence of its energy costs when applying for recovery of losses documented by deferred energy accounting, and that the rebuttable presumption analysis is the controlling procedure in DEAA proceedings). The instant docket is a general rate case proceeding, not a deferred energy accounting proceeding, and therefore the rebuttable presumption analysis discussed in the *Nevada Power* case is completely irrelevant to the issues before this Commission, even if the case law had not been superseded by statute.

(Staff Br. at 6.)

9. Staff accurately notes that the decisions identified by SWG relate to DEAA proceedings, which are different from GRC proceedings. DEAA applications involve changes in rates to allow recovery of natural gas costs that are passed on to customers without a mark-up by the utility. Because the utility is not entitled to earn a profit on the purchase of natural gas, there is no incentive for the utility to imprudently inflate the costs associated with such purchases. Therefore, though the law has sinced been changed to clarify that there is no presumption of prudence in DEAA cases, the use of a reduced burden of proof for DEAA cases, compared to GRC proceedings, is at least understandable. It would be inappropriate, however, to presume the prudence of a utility's expenditures in a GRC proceeding.

10. Nevada law requires certain utilities to file with the Commission integrated resource planning applications through which the utilities are able to receive a determination of prudence outside of a general rate case. *See, e.g.*, NRS 704.661, NRS 704.741, and NRS 704.110. Only after the Commission has "pre-approved" certain projects through the resource planning process are the costs of carrying out those projects presumed to be prudent when a

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SWG not only cited to this case as precedent during hearing, but sought to question a witness on the witness's familiarity with this case and alleged precedent during cross examination.

utility seeks to recover the costs in a GRC. Nevada's natural gas utilities, however, are not subject to resource planning requirements, so they do not have the same opportunity to obtain a presumption of prudence. The absence of a statutory requirement to file a resource plan does not exempt a natural gas utility from proving that its costs and investments are prudent. NRS 704.001 requires that public utilities "provide for the safe, economic, efficient, prudent and reliable operation and service."

11. Furthermore, although SWG has no statutory requirement to file a resource plan, prior Commission decisions confirm that SWG must demonstrate prudence in a rate case. For example, in SWG's 2014 Conservation and Energy Efficiency ("CEE") plan filing, the Commission found that the expenditures included in the plan were "subject to [a] prudence review in the appropriate general rate case."[13] Notably, other areas of Nevada law are also illustrative of SWG's burden to prove prudence of expenditures in a rate case; for example, NRS 704.7984 specifically requires natural gas utilities to seek a determination of prudence with respect to Gas Infrastructure Replacement projects:

> 1. A Commission order approving or denying an advance application or a rate application is not a determination of prudency with respect to any replacement project set forth in such an application.
> 2. A gas utility shall seek a determination of prudency in the first general rate application filed pursuant to NRS 704.110 after the costs of each replacement project are accounted for in a replacement rate. In the general rate application, the gas utility shall submit evidence in support of the recorded cost for each replacement project completed since the last general rate application filed by the gas utility...

12. Similarly, for a gas utility's Solar Thermal Systems Demonstration Program costs, NRS 701B.339 holds that "[a] utility may recover its reasonable and prudent costs, including, without limitation, customer incentives, that are associated with carrying out and administering

[13] September 12, 2014, Order in Docket No. 14-04038, at paragraph 23.

the Demonstration Program within its service area by seeking recovery of those costs in an appropriate proceeding before the Commission pursuant to NRS 704.110."

13. SWG offers no controlling legal authority to support its claim that it enjoys a rebuttable presumption in this case regarding the prudence of its expenditures. SWG cites to a number of decisions that do not have precedential effect; are distinguishable from the instant case based on the nature of the requested relief and/or the applicable regulatory framework; or relate to other jurisdictions' regulation of intrastate utility service. The Commission therefore finds that no presumption of prudence exists and that SWG must bear and sustain the burden of proving the prudence of its expenditures, just as all other utilities in this State must do when they request Commission approval to increase their customers' rates.

V. COST OF CAPITAL

A. Capital Structure

SWG's Position

14. SWG requests that the Commission accept its consolidated corporate capital structure as of the end of the certification period on July 31, 2018, as follows:

~~**Component**~~	~~**Capital Ratio**~~
~~Long-Term Debt~~	~~47.62%~~
~~Short-Term Debt~~	~~2.19%~~
~~Customer Deposits~~	~~0.53%~~
~~**Total Debt**~~	~~50.34%~~
~~Common Equity~~	~~49.66%~~
~~**Total Equity**~~	~~49.66%~~
~~**Total**~~	~~100.00%~~

NND Debt Ratios	
Debt Components	***Certified Ratios***
Long-Term Debt	***45.50%***
Short-Term Debt	***2.37%***
Customer Deposits	***2.46%***
Total Debt	***50.34%***

SND Debt Ratios	
Debt Components	***Certified Ratios***
Long-Term Debt	*47.16%*
Short-Term Debt	*1.77%*
Customer Deposits	*1.40%*
Total Debt	*50.34%*

(Ex. 8 at ~~Certification~~ Statement F***, Northern Nevada,*** ~~Sheet 3 of 4~~ ***Sheet 1 of 4; Ex. 8 at Statement F, Southern Nevada, Sheet 1 of 4.***)

15. SWG states that in Docket No. 12-04005, the Commission adopted an unconsolidated, separate capital structure for Southwest Gas's NND and SND in order to address jurisdiction-specific debts (Industrial Development Revenue Bonds ("IDRBs") and customer deposits) that were a disproportionate share of SWG's proposed consolidated capital structure at the time. (Ex. 7 at 18.) SWG states that it has since remedied its jurisdiction-specific debts in a manner that makes use of a consolidated capital structure for its NND and SND appropriate. (*Id.* at 19.)

BCP's Position

16. BCP supports SWG's proposed capital structure contained in the certification filing. (Ex. 12 at 43.) Specifically, BCP states that, based upon value line equity level projections, the median of its group of comparable companies yields a 55-percent equity ratio between 2021-2023 compared to SWG's projected 2021-2023 equity ratio of 52 percent. (*Id.* at 44, DJL-4.)

Staff's Position

17. Staff states that it does not have any concerns with SWG's certified capital structure and recommends that the Commission accept it. (Ex. 15 at 7-8.)

Commission Discussion and Findings

18. The Commission finds that the consolidated certified capital structure, reflecting an equity-to-debt ratio of 49.66 percent to 50.34 percent, respectively, is appropriate. Accordingly, the Commission accepts the following capital structure provided by SWG in its certification filing:

~~Component~~	~~Capital Ratio~~
~~Long-Term Debt~~	~~47.62%~~
~~Short-Term Debt~~	~~2.19%~~
~~Customer Deposits~~	~~0.53%~~
~~Total Debt~~	~~50.34%~~
~~Common Equity~~	~~49.66%~~
~~Total Equity~~	~~49.66%~~
~~Total~~	~~100.00%~~

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NND Debt Ratios	
Debt Components	*Certified Ratios*
Long-Term Debt	*45.50%*
Short-Term Debt	*2.37%*
Customer Deposits	*2.46%*
Total Debt	*50.34%*

SND Debt Ratios	
Debt Components	*Certified Ratios*
Long-Term Debt	*47.16%*
Short-Term Debt	*1.77%*
Customer Deposits	*1.40%*
Total Debt	*50.34%*

B. Cost of Debt

SWG's Position

19. SWG proposes the following cost of long-term debt, cost of short-term debt, and cost of customer deposits:

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SWG Cost of Debt

Type of Debt	NND	SND
Long-Term Debt	4.96%	4.16%
Short-Term Debt	3.46%	3.46%
Customer Deposits	2.03%	2.03%

(Ex. 5 at F Sheet 1; Volume 2 at F Sheet 1.)

20. SWG notes that it has previously issued IIDRBs in its SND jurisdiction. (Ex. 7 at 23.) SWG states that, consistent with the IDRB indentures and financing agreements, "the proceeds from the issuance of such bonds must be restricted to funding qualified construction expenditures for additions and improvements in the specific distribution system to which the IDRBs relate." (*Id.*)

21. SWG states that it has historically excluded IDRBs from its cost of debt calculation in all regulatory jurisdictions, except for the specific jurisdictions to which the relevant IDRBs apply, consistent with previous Commission proceedings. (*Id.*) SWG provides that Internal Revenue Service ("IRS") rules require "that the benefits of the tax-exempt, lower cost IDRBs must accrue to customers in the specific jurisdiction to which the IDRBs apply." (*Id.*) SWG contends that "deviation from the requirements of the IRS rules could result in the loss of the IDRB tax-exempt status." (*Id.*)

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BCP's Position

22. BCP recommends that the Commission accept SWG's certified cost of debt. (Ex. 12 at 43.)

Staff's Position

23. Staff states that it does not have any concerns with SWG's certified cost of debt. (Ex. 15 at 7-8.) Staff notes that SWG correctly allocated the IDRBs solely to its SND, consistent

with the Commission's Order in Docket Nos. 12-02019 and 12-04005. (*Id.* at 8.) Staff recommends that the Commission accept SWG's certified cost of debt. (*Id.*)

Commission discussion and Findings

24. The Commission finds that SWG properly assigned its IDRBs to its SND. Accordingly, the Commission accepts SWG's certified cost of debt as follows:

Southwest Gas Cost of Debt

Type of Debt	**NND**	**SND**
Long-Term Debt	4.96%	4.16%
Short-Term Debt	3.46%	3.46%
Customer Deposits	2.03%	2.03%

C. Average Variable Interest Rate ("AVIR") – Variable Interest Expense Recovery Mechanism ("VIER") and IDRB Cost Benefit Analysis

SWG's Position

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25. SWG states that in Docket No. 04-3011, it received approval for a VIER mechanism as defined by NAC 704.210 through 704.222, inclusive, for $100 million (gross principal) of variable rate Clark County IDRBs. (*Id.* at 27.) SWG further states that in Docket No. 12-04005, it was authorized to include an incremental $50 million of variable rate IDRBs in the VIER mechanism. (*Id.*) SWG provides that the VIER mechanism adjusts the Base Tariff General Rate ("BTGR") for changes in the AVIR and accumulated deferred interest. (*Id.*) SWG further provides that, because a new BTGR will be established in this proceeding, a new authorized AVIR will be embedded in the new BTGR. (*Id.* at 28.) SWG states that its new authorized AVIR will also be used to calculate the deferred interest expense at the time rates from this proceeding go into effect. (*Id.*)

26. SWG states that "for the certification period ending on July 31, 2018, the updated 12-month weighted AVIR for the Clark County variable rate IDRBs was 0.2925 percent." (Ex. 9.

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at 3.) SWG further states that the variable rate 2003 Clark County Series A, 2008 Clark County Series A, and 2009 Clark Count Series A IDRBs had a 12-month average effective cost rate of 2.2654 percent for the above-referenced certification period." (*Id.*)

27. SWG states that in Docket No. 14-06004, it was directed to review its IDRBs to provide a cost/benefit analysis "regarding the retention of each issue of the variable interest IDRBs" in order to evaluate the benefits to ratepayers associated with "retaining the variable interest rate IDRBs" for each IDRB issuance.[14] (*Id.* at 28-29.) SWG states that it performed this analysis, which compared "current indicative fixed rate pricing for the IDRBs relative to the projected cost of retaining the IDRBs at the variable rate mode over the remaining life of the IDRBs of approximately 20 years." (*Id.* at 29.)

28. SWG states that, in its last Annual rate Adjustment proceeding in Docket No. 17-06002, which covered the period of September 2004 through April of 2017, it estimated that customers had saved approximately $54 million in revenue requirements for the variable rate IDRBs covered under the VIER mechanism. (*Id.* at 29-30.)

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29. SWG states that "[b]ased upon a comparison of indicative fixed rates and the various projected paths of variable rates and other associated expenses (credit facility costs, remarketing fees, and any applicable AMT premium), the results indicate that retaining the IDRBs in a variable rate mode is more likely to be the least cost alternative." SWG notes that given that certain variables and assumptions in its analysis were projected, with some inputs estimated as far as 20 years, its results are not definitive, and it will monitor the capital market for changes that could favor converting to a fixed rate mode. (*Id.* at 37.)

BCP's Position

[14] *See* the Commission's December 12, 2014, Final Order in Docket No. 14-06004 at ¶ 3-4.

30. BCP does not address this issue.

Staff's Position

31. Staff states that it reviewed SWG's cost/benefit analysis, does not have any concerns regarding it, and believes the analysis supports the company's conclusion. (Ex. 15 at 36.) Staff recommends that the Commission find that SWG provided a cost/benefit analysis regarding the retention of each issue of the variable interest IDRBs and satisfied the Commission's directive in Docket No. 14-06004. (*Id.* at 36-37.)

Commission Discussion and Findings

32. NAC 704.222 provides that changes in rates authorized by variable interest securities are effective at the same time as a change in rates resulting from a GRC. Accordingly, the Commission finds that it is appropriate to reset SWG's VIER mechanism consistent with its filing. The Commission further finds, consistent with Staff's review, that SWG satisfied the Commission's directive in Docket No. 14-06004 by providing a cost/benefit analysis regarding the retention of each issue of the variable interest IDRBs.

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D. Return on Equity ("ROE")

SWG's Position

33. SWG recommends an ROE in the range of 10.00 percent to 10.50 percent. (Ex. 11 at 55.) SWG states that such a range represents the range of investors' required rate of return for investment in natural gas utilities similar to SWG in today's capital markets. (*Id.*) SWG states that, within that range, an ROE of 10.30 percent is reasonable and appropriate. (*Id.*) SWG states that its revenue deficiencies in its SND and NND rate jurisdictions are based upon a requested ROE of 10.30 percent. (Ex. 1 at 4.)

34. SWG states that its recommended ROE was developed utilizing three widely accepted approaches: 1) the Discounted Cash Flow ("DCF") model, including the Constant Growth and Multi-stage forms; 2) the Capital Asset Pricing Model ("CAPM"), including both its traditional and empirical forms; and 3) the Bond Yield Plus Risk Premium approach. (Ex. 55 at 3.) SWG notes that, among other things, it also considered a proxy group of comparable companies, the regulatory environment in which SWG operates, the Tax Cuts and Jobs Act ("TCJA"), the changing market environment in which companies must compete for capital, and the effect of current capital market conditions on investors' return requirements. (*Id.* at 3-5, 55.)

35. The following tables summarize the range of ROEs calculated by SWG after applying the constant and multi-staged discounted DCF, CAPM, and bond yield plus risk premium estimation methodologies:

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Summary of Constant Growth DCF Results

	Mean Low	*Mean*	*Mean High*
30-Day Average	8.29%	9.69%	12.52%
90-Day Average	8.13%	9.52%	12.36%
180-Day Average	8.01%	9.40%	12.23%

Summary of CAPM Results

	Bloomberg Derived Market Risk Premium	***Value Line Derived Market Risk Premium***
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury (3.11%)	10.84%	11.60%
Near Term Projected 30-Year Treasury (3.52%)	11.24%	12.00%
Long Term Projected 30-Year Treasury (4.20%)	11.93%	12.69%
Average Value Line Beta Coefficient		
Current 30-Year Treasury (3.11%)	11.23%	12.03%
Near Term Projected 30-Year Treasury (3.52%)	11.63%	12.44%
Long Term Projected 30-Year Treasury (4.20%)	12.32%	13.12%

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Summary of Empirical CAPM Results

	Bloomberg Derived Market Risk Premium	Value Line Derived Market Risk Premium
Average Bloomberg Beta Coefficient		
Current 30-Year Treasury (3.11%)	11.78%	12.63%
Near Term Projected 30-Year Treasury (3.52%)	12.18%	13.04%
Long Term Projected 30-Year Treasury (4.20%)	12.86%	13.72%
Average Value Line Beta Coefficient		
Current 30-Year Treasury (3.11%)	12.07%	12.95%
Near Term Projected 30-Year Treasury (3.52%)	12.48%	13.36%
Long Term Projected 30-Year Treasury (4.20%)	13.16%	14.04%

Summary of Bond Yield Plus Risk Premium Results

Bond Yield Plus Risk Premium Approach	
Current 30-Year Treasury (3.11%)	9.93%
Near Term Projected 30-Year Treasury (3.52%)	10.00%
Long Term Projected 30-Year Treasury (4.20%)	10.19%

(*Id.* at 6-7.)

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36. SWG states that, "because the ROE is a market-based concept, and given that its jurisdictional operations within Nevada do not make up the entirety of its publicly-traded parent company, it is necessary to establish a group of companies that are both publicly-traded and comparable to SWG to serve as its "proxy" for purposes of the ROE estimation process." (*Id.* at 15.) Accordingly, SWG examined 11 companies that Value Line classifies as natural gas utilities and used criteria to narrow its proxy group to 7 companies. (*Id.* at 16-17.) SWG contends that such a proxy group is sufficiently large. (*Id.* at 18.)

DCF Analyses

37. SWG states that its DCF approach is based upon the theory that a given stock's current price represents the present value of its expected future cash flows. (*Id.* at 21.) SWG provides that its DCF model assumes that earnings, book value, and dividends all grow at the same, constant rate in perpetuity; the dividend payout ratio remains constant; the Price to

Earnings ("P/E") multiple and the calculated Cost of Equity remain constant in perpetuity; and the estimated Cost of Equity is greater than the expected growth rate. (*Id.* at 22.)

38. SWG states that it applied its DCF model to its proxy group of natural gas utility companies using the average daily closing prices for the 30, 90, and 180-trading days ending on March 29, 2018, and the annualized dividend per share as of March 29, 2018. (*Id.* at 25.) SWG provides that it then calculated its DCF results using the Zacks, First Call, and Value Line long-term earnings growth estimates, as well as retention growth estimates. (*Id.*)

39. SWG states that "it calculated the proxy group mean low, mean, and mean high DCF results by using the maximum Earnings Per Share ("EPS") growth rate reported by Value Line, Zacks, First Call, and the Retention Growth method for each of the proxy companies." (*Id.* at 27.) SWG provides that the proxy group mean high and low results reflect the average of the maximum and minimum DCF results, respectively, for the proxy group as a whole. (*Id.*)

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40. SWG provides that "the Constant Growth DCF model relies on several assumptions that are not consistent with current market conditions." (*Id.*) SWG further states that "the Constant Growth DCF model also assumes the return estimated today will be the same return required in the future, regardless of future capital market conditions. Because the Federal Reserve only recently has begun its move toward monetary policy normalization, that assumption is particularly concerning given the Federal Reserve's process of policy normalization. As interest rates increase, utility prices would fall, [and] all else remaining equal, the DCF result would increase." (*Id.* at 28.)

41. SWG contends that its Constant Growth DCF results are below a reasonable estimate of its cost of equity. (*Id.*) SWG states that, for example, "of the 1,082 natural gas utility rate cases provided by Regulatory Research Associates that disclosed the awarded ROE since

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1980, only two included an authorized ROE below 9.00 percent." SWG contends that on that basis alone, the Constant Growth DCF model mean low are highly improbable and should be given less weight than other methods in determining an ROE. (*Id.*)

CAPM and ECAPM Analysis

42. SWG states that its CAPM analysis "is a risk premium method that estimates the cost of equity for a given security as a function of a risk-free return plus a risk premium (to compensate investors for the non-diversifiable or 'systematic' risk of that security)." (*Id.* at 29.)

43. SWG states that it also applied an Empirical Capital Asset Pricing model ("ECAPM"), which "calculates the product of the adjusted Beta coefficient[15] and the market risk premium ("MRP"), and applies a weight of 75.00% to that result. The model then applies a 25.00% weight to the MRP, without any effect from the Beta coefficient. The results of the two calculations are summed, along with the risk-free rate, to produce the ECAPM result." (*Id.* at 30.) SWG provides that "ECAPM addresses the tendency of CAPM to underestimate the cost of equity for low-Beta coefficient companies, such as regulated utilities." (*Id.* at 31.)

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44. For both CAPM and ECAPM, SWG states that it utilized a forward-looking approach using data from Bloomberg and Value Line in order to estimate the MRP. (*Id.* at 33.)

45. SWG notes that for both its CAPM and ECAPM analyses, it used three different estimates of the risk-free rate, including the current 30-day average yield on 30-year treasury bonds (3.11%), the near-term projected 30-year treasury yield (3.52%), and the long-term projected 30-year treasury yield (4.20%). (*Id.* at 32.) SWG provides that the appropriate risk-free rate is that which terms best match the life of the underlying investment. (*Id.*) SWG, citing Morningstar, notes that "when valuing a business that is being treated as a going concern, the

[15] SWG states that the "Beta coefficient" represents both volatility of returns and the correlation in returns between the subject company and the overall market.

appropriate treasury yield should be that of a long-term treasury bond." (*Id.*) Accordingly, SWG argues that the 30-year treasury yield is the proper measure of the risk-free rate for its CAPM and ECAPM analyses because equity has a perpetual life and "natural gas utilities are going concerns that finance long-lived assets." (*Id.*)

Bond Yield Plus Risk Premium Model

46. SWG states that its Bond Yield Plus Risk Premium model is based upon "the basic financial tenet that equity investors bear the residual risk associated with ownership and therefore require a premium over the return they would have earned as a bondholder." (*Id.* at 36) SWG provides that risk premium approaches estimate the cost of equity as the sum of the equity risk premium and the yield on a particular class of bonds. (*Id.*)

47. In its analysis, SWG states that it performed its Bond Yield Plus Risk Premium analysis by first defining the Equity Risk Premium as the difference between the authorized ROE and the then-prevailing level of long-term treasury yield, gathering data for the ROE authorized in 1,082 utility rate proceedings between January of 1980 and March 29, 2018. (*Id.*) SWG states that, in order to reflect the prevailing level of interest rates during the term of the proceedings, it calculated the average 30-year treasury yield over the average lag period. (*Id.*) SWG states that it then subtracted the averaged lagged 30-year treasury yield from the authorized ROE for each of the 1,082 cases to determine the equity risk premium. (*Id.*)

48. SWG states that it utilized a regression analysis where the equity risk premium was the dependent variable, and the 30-year treasury yield was the independent variable, in order to model the relationship between interest rates and the equity risk premium. (*Id.* at 37.) SWG provides that, "relative to the long-term historical average, the analytical period includes interest rates and authorized ROEs that are quite high during one period (i.e., the 1980s) and that are

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quite low during another (i.e., the post-Lehman bankruptcy period)." (*Id.*) SWG states that, to account for that variability, it used a semi-log regression, in which the equity risk premium is expressed as a function of the natural log of the 30-year treasury yield. (*Id.*)

49. SWG states that its regression analysis shows that, "over time, there has been a statistically significant, negative relationship between the 30-year treasury yield and the equity risk premium. (*Id.* at 38.) SWG states that "[a]n important consequence of that relationship is that simply applying the long-term average equity risk premium of 4.63 percent would significantly understate the cost of equity." (*Id.*) SWG states that utilizing regression coefficients implies an ROE between 9.93 and 10.19 percent. (*Id.*)

Business Risk and Additional Considerations

50. SWG states that the mean model results for proxy results do not necessarily provide an appropriate estimate for its own cost of equity. (*Id.* at 38.) SWG contends that the mean model does not reflect the industry's more recent consolidation into fewer, larger companies. (*Id.*) SWG states that larger entities may be viewed by commissions as inherently less risky, leading to lower authorized ROEs. (*Id.*) SWG provides that "[s]uch results would show up in comparative proxy groups, which may impact the overall perception of even a smaller utility's riskiness." Accordingly, SWG states that additional factors must be taken into consideration when determining where its cost of equity falls within the range of results, including the regulatory environment in which SWG operates, and the effect of the TCJA. (*Id.* at 38-39.)

51. SWG states that "cost recovery mechanisms limiting regulatory lag are common amongst the proxy companies" and that "several of the proxy companies are able to use forecasted test years, and have other cost recovery mechanisms in place." (*Id.* at 40.) SWG also

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identifies alternative structures and incentive plans currently in effect for various proxy companies, such as "formula-based rate plans, which provide comprehensive adjustment mechanisms that automatically adjust rates in the event that the earned return is above or below an authorized range." (*Id.*) SWG contends that, to the extent that it does not have similar lag-reducing cost-recovery mechanisms, it faces additional risks relative to its peers. (*Id.*)

52. SWG states that it considered its regulatory risks when recommending its proposed ROE. (*Id.*) SWG further states that "[a]lthough [it] does have some rate mechanisms in place, many of those mechanisms are common throughout the proxy group, such as decoupling and infrastructure trackers, and would already be incorporated into the Proxy Group's authorized ROE." (*Id.*) Conversely, SWG states that it "is not able to take advantage of other regulatory lag-reducing mechanisms, such as forecast test years, which are available to many of the proxy companies." (*Id.*)

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53. SWG states that the TCJA decreased corporate income tax rates from 35 percent to 21 percent. (Ex. 7 at 9.) SWG provides that, while the reduction in tax rates will benefit customer rates, income taxes are also a material portion of a utility's revenue requirement. (*Id.*) Accordingly, SWG states that ratings agencies have viewed tax reform as credit-negative because it reduces a utility's cash flow. (*Id.*)

54. SWG states that shortly before the TCJA was put into law, natural gas utilities (as measured by the Proxy Group) have significantly underperformed the overall market. (Ex.11 at 41.) SWG states that from November 1, 2017, through March 29, 2018, the S&P 500 has gained approximately 2.38 percent in value compared to the Proxy Group, which has lost about 8.46 percent and underperformed the overall market by approximately 10.85 percent. (*Id.*) SWG asserts that it is reasonable to infer that investors have been evaluating natural gas utilities

relative to other market sectors. (*Id.* at 42.) SWG provides that, "[t]o the extent investors now view natural gas utilities as less attractive relative to alternative investments, the proxy companies' prices will fall, and the dividend yields will increase." (*Id.*) SWG further provides that "because rating agencies have discussed the consequences of the TCJA for utilities' cash flow, a reasonable conclusion is that equity investors recognize those consequences, and to allocate their capital to other market sectors." (*Id.*)

55. SWG states that the Proxy Group companies' dividend yields have increased coincident with the TCJA. (*Id.*) SWG further states that "the data suggests [that] the fall in price among natural gas utility stocks may be a matter of relative attractiveness, owing to the fact that non-regulated sectors will benefit from the TCJA in ways utilities cannot." SWG contends that "there is no question [that] dividend yields have increased significantly since the TCJA became law." (*Id.*)

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56. SWG states that "major rating agencies have observed that a reduction in utilities' revenue associated with lower income taxes and the potential return of excess accumulated deferred income taxes also may reduce utilities' cash flows." (*Id.*) SWG, citing Fitch Ratings, notes that "absent mitigating strategies on the regulatory front, this is expected to lead to weaker credit metrics and negative rating actions for issuers with limited headroom to absorb the leverage creep." (*Id.* at 43.) SWG notes that companies within the Proxy Group have experienced negative credit rating implications from the TCJA regarding their outlook, which could ultimately affect their credit ratings. (*Id.* at 44.) SWG notes that similar observations were made by Standard and Poor's and Moody's. (*Id.* at 43-44.)

57. SWG states that "there is little question that the TCJA has increased cash flow-related risks, and the potentially dilutive effects of additional equity issuances, for natural gas

utilities." (*Id.* at 47.) SWG states that "[t]hose risks are manifested in the sector's recent underperformance relative to the broad market and in the comments of financial participants such as Moody's, Standard & Poor's, and Fitch Ratings." (*Id.*) SWG contends that investors may have begun to see utilities as less attractive relative to other industry sectors because non-regulated companies might benefit from the TCJA in ways that utilities cannot. (*Id.*) Moreover, SWG argues that, to the extent that the TCJA accelerates economic growth and inflation, and increases the potential for federal budget deficits, investors might anticipate increased interest rates. (*Id.*)

58. SWG contends that, given that the Federal Reserve has raised the Federal Funds rate and begun the process of normalization, investors may perceive greater prospects of macroeconomic growth, resulting in an increase in the growth rates included in its DCF model. (*Id.* at 48.) SWG argues that, at the same time, higher growth and the absence of federal market intervention could allow interest rates to increase, reducing stock prices and increasing the dividend yield portion of the DCF model. (*Id.*) SWG provides that in that event, both terms of the Constant Growth DCF model would increase, resulting in higher ROE estimates. (*Id.* at 48.)

59. SWG states interest rates have recently risen and become increasingly volatile. (*Id.*) SWG further states that, given how those dynamics affect models in different ways, it would be inappropriate to rely on a single method to estimate SWG's cost of equity, and that a more appropriate and reasoned approach would include an understanding of the relationships among Federal monetary policy, interest rates, and measure of market risk, and how those factors may affect different models and their results. (*Id.*) SWG states that because the cost of equity is forward-looking, it is important to consider whether investors see the likelihood of increased interest rates during the period in which rates set in this proceeding will be in effect. (*Id.* at 49.)

SWG states that "[c]lassic valuation theory assumes investors trade securities rationally, with prices reflecting their perceptions of value." (*Id.*)

60. SWG notes that, although central banks "may set benchmark interest rates, they have maintained below-normal rates to stimulate economic expansion and capital market recovery. (*Id.* at 49-50.) SWG provides that "[i]t is therefore reasonable to conclude that the Federal Reserve and other central banks may have been acting as market-movers, thereby having a significant effect on the market prices of both bonds and stocks." (*Id.* at 50.) The presence of market-movers, such as the Federal Reserve, runs contrary to the PCCM hypothesis, which underlies traditional cost of equity models. (*Id.*) SWG provides that due to this, the results of those models should be considered contextually with both quantitative and qualitative information. (*Id.*)

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61. SWG states that "it is clear that interest rates have increased from the low levels experienced in early 2016", and "[a]lthough the Federal Reserve's market intervention policies have kept interest rates historically low over the past several years, rates have risen since July 8, 2016, when the 30-year Treasury yield hit an all-time low of 2.11 percent. (*Id.*) SWG states that as the Federal Reserve increased the Federal Funds target rate by 25 basis points between December of 2016 and March of 2018, short-term and long-term interest rates have increased correspondingly. (*Id.*) SWG states that current market data indicates a definitive likelihood of further rate increases by December of 2018, and that investors see a probability of increased interest rates, even after the six increases between December 14, 2016, and March 21, 2018. (*Id.* at 50, 52.) SWG contends that "[a]s interest rates continue to rise, it would be reasonable to expect lower utility valuations, higher dividend yields, and higher growth rates." SWG notes

that within the context of the DCF model, those variables would indicate increases in the cost of equity. (*Id.* at 53-54.)

62. SWG states that as interest rates have increased, utility valuations have fallen. (*Id.* at 54.) Specifically, SWG states that between July and December of 2016, the SNL Gas Utility Index lost approximately 9.00 percent of its value while the S&P 500 increased by 7.00 percent, indicating that the utility sector underperformed the market by approximately 16 percent. (*Id.*) SWG provides that, at the same time, the 30-year Treasury yield increased by approximately 95 basis points. (*Id.*) SWG further provides that, because investors see the strong likelihood of further rate increases, there is a continuing risk of losses in the utility sector. (*Id.*)

63. SWG states that "[o]n January 1, 2017, it reorganized and implemented a holding company structure to provide further separation from its regulated and unregulated lines of business, providing it financial flexibility." (Ex. 7 at 8.) SWG notes that rating agencies have viewed its reorganization as credit-positive and reduced the likelihood of credit contagion from its unregulated businesses. (*Id.*) Similarly, SWG notes that rating agencies have viewed its GIR mechanism as a positive regulatory support factor. (*Id.* at 12.)

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64. With regard to its regulatory environment, SWG cites Moody's, which stated:

> [i]n recent years, there have been meaningful improvements in the regulatory frameworks under which SWG operates. For example, infrastructure tracker mechanisms were approved in Arizona and Nevada and … [a] GIR advance application authorizing SWG $14.4 million of replacement work for 2015. Also, all three jurisdictions implemented decoupling mechanisms albeit the actual mechanism varies state-by-state. Constructive regulatory framework developments and signs of an improving regulatory environment are credit-positive.[16]

(*Id.* at 12-13.)

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[16] See *Moody's Investors Service, Credit Opinion Southwest Gas Corporation,* March 24, 2015, at 2.

BCP's Position

65. BCP recommends an overall ROE of 9.30 percent, with a range of reasonableness between 9.0 percent and 9.5 percent. (Ex. 12 at 39.) BCP does not disagree with the Proxy Group selected by SWG, but it included SWG in its analysis to for comparative purposes. (Ex. 12 at 24.) BCP's 9.30-percent ROE recommendation includes a 20-basis-point upward adjustment, which BCP suggests is merited as a result of SWG's higher financial risk compared to the proxy group companies given its lower projected equity level. (*Id.* at 45.)

66. With respect to its recommended 20-basis-point adjustment, BCP states that SWG's capital structure's equity level is below the equity capitalization of comparable groups of companies, indicating a higher financial risk for SWG relative to the comparable companies. (*Id.* at 43, DJL-4.) Specifically, BCP states that, based upon value line equity level projections, the median of its group of comparable companies yields a 55-percent equity ratio between 2021-2023 compared to SWG's projected 2021-2023 equity ratio of 52 percent. (*Id.* at 44, DJL-4.) BCP provides that based upon these figures, the proxy group companies' equity return estimates would be approximately 9.1 percent. (*Id.*) BCP contends that, given SWG's larger financial risk relative to the proxy group companies, it recommends an upward 20 basis point adjustment to arrive at its recommended 9.3 percent ROE. (*Id.* at 44-45, DJL-4.)

67. BCP states that SWG's recommended 10.30-percent ROE is overstated because it exceeds current capital market costs in light of the low cost of debt and equity returns currently authorized by regulatory authorities. (*Id.* at 47.) BCP further states that SWG's recommended ROE exceeds capital market costs for comparably risky utilities and that SWG's analyses failed to support any unusual risks that it faces that would justify its ROE. (*Id.* at 47-48.) BCP provides that SWG used an assortment of common models similar to BCP's analysis in estimating an

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ROE, but disregards DCF results in favor of higher results from other models. (*Id.* at 48.) BCP is critical of the weight that SWG gives to risk premium methods and states that SWG's contention that its DCF analysis should be given little weight is not supported. (*Id.* at 48-50.)

68. In its own analysis, BCP implemented a Constant Growth DCF model, two-stage non-constant growth DCF model, CAPM model, ECAPM model, and Risk Free Bond Yield Plus Premium analysis, which yielded the following results:

Summary of Constant Growth DCF Results

Model	***Range***	***Mid-point***
30-Day Average Stock Prices	9.47% - 9.73%	9.60%

(*Id.* at 32.)

Summary of Two-stage Non-constant Growth DCF results

Range	***Mid-point***
9.27% - 9.73%	9.50%

(*Id.* at 33-34.)

CAPM and ECAPM Results

Model	***Range***	***Mid-point***
CAPM	8.10% - 8.16%	8.13%
ECAPM	8.56% - 8.69 %	8.63%

(*Id.* at 38-39.)

Risk Free Bond Yield Plus Allowed ROE results

Range	***Mid-point***
9.52% - 9.56%	9.54%

(*Id.* at 36.)

DCF models

69. BCP states that its constant growth DCF analysis employed dividend yield data and growth estimates to determine the DCF for every proxy group company. (*Id.* at 32.) BCP further states that it utilized pricing data of the average of three months of closing prices ending in August of 2018[17] as an input to calculate the dividend yield for each proxy group. (*Id.* at 28.)

[17] BCP utilized data from Value Line's August 31, 2018, Investment Survey and Yahoo Finance Historical Stock Prices. *See* Ex. 12 at DLJ-5.

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BCP provides that relied upon analyst EPS forecasted growth rates. (*Id.* at 32.) BCP further provides that it did not rely on historical growth rates. (*Id.*) BCP states that its calculated Constant Growth DCF Analysis applied to the proxy group companies resulted in a range of 9.47 percent to 9.73 percent with a 9.60-percent midpoint. (*Id.* at 32, DJL-7.)

70. BCP states that Constant Growth DCF models are often adjusted to reflect several growth assumptions because the constant growth rate assumption is not always consistent with investor expectations. (*Id.* at 32-33.) BCP further states that short-term growth estimates are often inconsistent with long-term sustainable growth projections. (*Id.* at 33.) To address this circumstance, where more than one growth rate estimate is appropriate, BCP provides that multi-stage non-constant growth models can be used to determine a cost of capital estimate. (*Id.*)

71. BCP states that its Two-Stage Non-constant DCF model's first growth stage (years one through four) used Value Line's projected growth dividends through the year 2023. (*Id.*) BCP provides that the second stage in its model (for years five and beyond) employed an earnings growth estimate based upon the individual company in the proxy group's forecasted EPS average estimate. (*Id.*) BCP states that its two-stage non-constant DCF model produced an equity range of 9.27 percent to 9.55 percent with a 9.41 percent midpoint. (*Id.* at 33-34.)

72. BCP states that its combined DCF analyses produce a range of cost of equity estimates between 9.27 percent and 9.73 percent with a 9.5-percent midpoint. (*Id.* at 34.) Comparatively, BCP notes that SWG's Constant Growth DCF analysis yielded an average range of 9.40 percent to 9.69 percent with a midpoint estimate of 9.55 percent. (*Id.* at 48.) BCP provides that SWG's DCF analysis supports its own DCF results as well as its recommended ROE. (*Id.*)

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Risk Premium, CAPM and ECAPM models

73. BCP states that risk premium methods should be viewed with caution due to measurement uncertainties associated with selecting the proper time period to use in determining bond/equity return risk spread. (*Id.* at 34.) BCP further states that the CAPM analysis has similar measurement uncertainties regarding how to measure the equity risk premium, the proper selection of a time period for which the premium should be analyzed, and how to ensure a stable beta measure. (*Id.* at 35.)

74. BCP states that its risk premium analysis compares the authorized gas utility return on equity relative to 30-year Treasury bond yields from 1981 to 2017. (*Id.*) BCP provides that the resulting risk premium is combined with the current 30-year Treasury Bond average yield to calculate the risk premium estimate of equity costs. (*Id.* at 35-36.) BCP states that its risk premium equity return results range between 9.52 percent and 9.56 percent with a 9.54-percent midpoint. (*Id.* at 36.) BCP states that the midpoint of its risk premium analysis represents the high end of its equity cost range. (*Id.*)

75. BCP states that its CAPM analysis used the most recent three-month average of the 30-year Treasury Bond yields (3.03 percent) for its risk-free value, a Value Line beta estimate of each company in the proxy group, a historical MRP of six percent for the 1926 to 2015 period, and a more current MRP of 9.0 percent (measured from the difference between long-term equity returns on large stock companies and the current August 2018 Treasury yields). (*Id.* at 37-38.) BCP states that it then averaged the two MRPs to arrive at an MRP of 7.5 percent, which it found to be "well within the expected range of 5 percent to 8 percent found in a number of studies in the financial literature." (*Id.* at 38.) BCP also conducted an ECAPM analysis in

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order to correct for a potential biased beta estimate and utilized an adjustment to avoid understating the cost of equity (*Id.*)

76. BCP states that the range of CAPM results for the proxy group were between 8.10 percent to 8.16 percent with a midpoint of 8.13 percent. (*Id.*) BCP provides that its ECAPM analysis yielded a range of 8.56 percent to 8.69 percent with a midpoint of 8.63 percent. (*Id.* at 38-39.)

77. BCP states that SWG's CAPM model yielded an equity range between 10.84 percent and 13.12 percent, and it argues that such a range does not support SWG's conclusion of an equity range of 10.00 to 10.50 percent. (*Id.* at 48.) BCP further states that SWG's ECAPM model estimated an ROE range of 11.78 percent to 14.04 percent, which BCP argues is also significantly higher than SWG's estimated ROE range. (*Id.* at 49.) BCP provides that the key driver of SWG's CAPM and ECAPM model is the use of the DCF model to develop its forward-looking market risk premium. (*Id.*) BCP contends that SWG's use of the DCF model resulted in a substantially overstated MRP, which caused its "CAPM and ECAPM results to be overstated and outside the boundaries of [its] own conclusions in this case." (*Id.*)

Bond Yield Plus Risk Premium

78. BCP states that it conducted a bond yield risk premium analysis resulting in an estimated ROE of 9.55 percent. (*Id.*) BCP further states that SWG conducted the same analysis and concluded that a range of 9.93 percent to 10.19 percent was appropriate. (*Id.*) BCP provides that the difference between its model and SWG's was a result of SWG's use of unsupported forecasted interest rates. (*Id.*)

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Overall ROE Analysis

79. BCP states that the reasonable range of results for all of its models is 8.63 percent to 9.54 percent with an approximate midpoint of 9.1 percent. (*Id.* at 39.) BCP's recommended ROE of 9.3 percent reflects an adjustment to reflect additional risk in its capital structure relative to the proxy group companies. (*Id.*)

80. BCP states that it has no general disagreement with SWG's use of DCM, CAPM, ECAPM, and Bond Yield Plus Risk Premium models; however, it does disagree with SWG's analyses and assumptions for several reasons. (*Id.* at 49.) Specifically, BCP states that SWG's conclusion that its DCF analysis should be given little weight is unsupported and inconsistent with SWG's own use of the DCF to calculate its MRP for the CAPM and ECAPM estimates. (*Id.* at 49-50.) Moreover, BCP provides that SWG's CAPM and ECAPM do not support its own conclusions in its case. (*Id.* at 50.)

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81. BCP provides that SWG's low and mean DCF estimates support a range of results between 8.01 percent to 9.69 percent and its Bond Yield Risk Premium supports a 10.0-percent ROE. (*Id.*) BCP contends that such numbers are closer in line to its own ROE recommendation of 9.3 percent than its own recommendation of 10.3 percent. (*Id.*)

Current Capital Market Conditions

82. BCP states that current economic conditions do not warrant higher returns for companies. (*Id.* at 15.) BCP provides that an August 1, 2018, Federal Reserve monetary policy statement and June 13, 2018, economic projections indicate a "continuation of accommodative monetary policy and low interest rates." (*Id.*) BCP notes that while the Federal Reserve is expected to increase the Federal Funds rate in September of 2018 and again before the end of the year, such expectations are reflected in current market data. (*Id.*) BCP states that "cost of capital

remains at low levels as evidenced by a review of recent historical monthly bond yields" and equity cost lower than historic standards as demonstrated by the continued levels of authorized equity returns set by regulatory authorities around the country. (*Id.*)

83. BCP states that economic conditions are expected to slowly continue to improve in 2019 and 2020. (*Id.*) BCP provides that "while short-term Gross Domestic Product ("GDP") growth continues and appears to be increasing U.S. economy, the growth in economic activity is not increasing above earlier growth projections and the Federal Reserve has once again maintained its projections of moderate growth in longer-run GDP. (*Id.* at 16.)

84. BCP states that the Federal Reserve continues to target a low Federal Funds rate as part of its monetary policy and that from December of 2008 to December of 2015, "the Federal Funds targeted rate [was] between 0 and .25 percent, or nearly zero." (*Id.*) BCP further states that the current Federal Funds target rate has since increased to 1.75 percent to 2.0 percent. (*Id.* at 16-17.) BCP notes that there have been five increases in the Federal Funds rate since December of 2015 and there is a general expectation that the targeted range of federal funds will be raised again as part of monetary policy. (*Id.* at 17.)

85. BCP states that "interest changes in the short-term Federal Funds rate have been modest and the 30-year Treasury yields have changed very little since December 2015 levels." (*Id.*) BCP opines that any interest rate change in the Federal Funds rate will be "moderate and tempered" and "expect capital costs to remain low for the foreseeable future." Accordingly, BCP states that it expects capital costs to remain low for the foreseeable future. (*Id.*)

86. BCP states that "whatever the Federal Reserve decides in the coming months or next several years regarding monetary policy is currently priced into market data. (*Id.* at 17-18.) BCP further states that market evidence shows monthly trends in long term interest yields

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generally remaining low. (*Id.* at 18, DJL-3.) BCP provides that the Federal Reserve's stated policy of continued lower interest rates are reflected in market results. (*Id.* at 18.) BCP further provides that "the evidence of lower rates in the marketplace indicate that it is reasonable to expect further low yields for the foreseeable near-term future." (*Id.*)

87. BCP states that "as a general matter, capital costs remain low in comparison to historical levels." (*Id.* at 19.) BCP further states that current 30-year Treasury bonds are nearly at the same level as December of 2015 when the Federal Reserve began raising the Federal Funds rate. (*Id.*) BCP provides that average authorized equity returns for natural gas distribution utilities have remained at low levels, and that the continued modest economic growth will cause general investor expectations of growth to remain moderate. (*Id.* at 19-20.) BCP states that general economic data does not support increasing capital costs. (*Id.* at 20.)

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88. BCP states that regulatory authorities around the country have recognized the declining cost of equity and debt capital in setting rates, and the average authorized equity return is well below 10 percent. (*Id.*) BCP notes that "regulatory authority cost of equity decisions for electric utilities in 2018 averaged 9.72 percent for gas utilities." (*Id.*)

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89. BCP states the regulatory process in Nevada has provided a supportive regulatory framework that has enabled SWG to employ a variety of rate adjustment mechanisms to reduce the effects of regulatory lag, such as the GIR mechanism and a Customer-Owned Yard Line ("COYL") program in its NND, and a limited COYL program in its SND. (*Id.* at 20-21.) SWG provides that these mechanisms reduce SWG's risks by enhancing cash flow and changing the timing of cost expenditure and cost recovery. (*Id.* at 21.) BCP states that SWG has a lower risk due to these mechanisms but notes that many gas utilities have similar forms of rate adjustment mechanisms. (*Id.*) BCP notes that such rate mechanisms are viewed favorably by rating agencies

and Moody's concluded that "the more clauses a utility has in place, the lower the risk for the utility." (*Id.* at 22.)

90. BCP states that Moody's credit assessment for SWG concludes that it has a low business risk profile. (*Id.* at 23..) BCP further states that Moody's gave SWG a bond rating of A3 (low A) with a stable ratings outlook while S&P rated SWG's debt at BBB+ with a Stable Outlook. (*Id.* at 23-24.) Both Moody's and S&P's credit evaluations of SWG concluded low risk comparable to peer companies and favorable regulatory mechanisms to address regulatory lag. (*Id.* at 24.) BCP states that SWG's business risks are consistent with the average gas operation with cost recovery through supportive rate revenue recovery mechanisms, while its financial risks, due to its capital structure, are slightly higher than the comparable risk of other gas utility operations. (*Id.*) BCP states that SWG's contention that it faces "somewhat higher regulatory risks than its peers" is contrary to rating agency conclusions. (*Id.* at 50.)

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91. With respect to the TCJA, BCP states that that SWG only considered near-term effects of the law. (*Id.*) BCP notes that S&P concluded that it expects "the effects of the recently revised corporate tax code to be mostly manageable for SWG, in part reflecting cushion in the company's current financial measures." (*Id.* at 51.) BCP provides that SWG's conclusion on the effect of the TCJA and SWG's business and regulatory risk are unsupported by facts. (*Id.*)

Staff's Position

92. Staff states that its recommended range of reasonableness for an ROE is between 9.10 percent and 9.70 percent. (Ex. 15. at 2.) Within that range, Staff recommends an ROE of 9.4 percent; however, it notes that any number within its recommended range of ROE would be reasonable. (*Id.*, Tr. at 104.)

93. Staff states that it arrived at the recommendation using the Constant Growth DCF and Three-Stage DCF models, CAPM and ECAPM, and an Allowed ROE/Bond Yield Model. (Ex. 15 at 2, 10.) In conducting its analysis, Staff utilized the same proxy group as SWG. (*Id.* at 9.)

94. The following table provides a summary of Staff's ROE estimation results:

Summary of Staff's ROE Estimation Results

Method	***Average***	***Range***
Constant Growth DCF	9.54%	8.29% - 11.61%
Three-Stage DCF	8.44%	8.42% - 8.45%
CAPM & ECAPM	8.20%	7.61% - 8.78%
Allowed ROE/Bond Yield	9.61%	
Hevert Analysis with Staff Adjustments	9.70%	
Average (All Models)	9.10%	7.61% - 9.70%
Recommended ROE	9.40%	9.10% - 9.70%

(*Id.* at 3.)

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95. Staff states that its Constant Growth DCF model differs from SWG in that it used different data collection dates and observation periods. (*Id.* at 12.) Specifically, Staff utilized average stock prices for the 60-day and 90-day period ending July 31, 2018 from Yahoo Finance and dividend payments, which Staff subsequently annualized, from Q4 2017 to Q3 2018 from Value Line. (*Id.* at 11.) Staff notes that it did not use a sustainable growth model in its analysis and instead utilized earnings growth estimates from Value Line, Zacks Investment Research, and Yahoo Finance. (*Id.* at 11-12.)

96. Staff is critical of SWG's use of the sustainable growth model in its DCF analysis. (*Id.* at 26.) Staff contends that a sustainable growth model suffers from a logical trap that requires an analyst to estimate an ROE first in order to implement the model to estimate a fair ROE. (*Id.*) Accordingly, Staff states that the growth rate produced by SWG's model should be

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excluded. (*Id.*) Staff calculates that removing the sustainable growth rate from SWG's DCF model lowers its resulting ROE from 9.54 percent to 9.36 percent. (*Id.* at 26.)

97. Staff states that it also conducted a three-stage DCF model and notes that SWG did not conduct such an analysis. (*Id.* at 12, 16.) Staff states that "the three-stage DCF model is an extension of the Constant Growth DCF model, but enables an analyst to specify three varying growth rates instead of one constant long-term growth rate." (*Id.* at 12.) Staff contends that the three-stage DCF model is "theoretically superior, as investors' expectations on the short-run growth rate and long-run growth rate are likely to differ." (*Id.* at 12-13.)

98. Staff states that it modeled the first-stage growth rates (for years 1-5) using the average of expected earnings growth from Value Line, Zacks, and Yahoo Finance to arrive at an average growth rate of 6.75 percent. (*Id.* at 13.) For the second stage period (years 6-10), Staff utilized an average of the first and third stage periods. (*Id.*) Staff chose the expected growth rate of the economy for the third-stage growth rate and examined two additional growth rates to serve as a sensitivity test. (*Id.*)

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99. Staff states that the primary third-stage growth rate, which is based upon real historical growth of the national economy since 1929 and the expected inflation rate, is 5.43 percent. (*Id.*) Given the growth rate selection, Staff states that the proxy group utilities are expected to grow, on average, 6.75 percent from year 1 to year 5, 6.09 percent from year 6 to year 10, and 5.43 percent in year 11 and beyond. (*Id.* at 14.) Staff's alternative third-stage growth rate of 4.30%, which was based upon the U.S. Energy Information Administration's *Annual Energy Outlook 2018* (February 2018), yielded results that were incompatible with the expectation of 6.75 percent market growth in the first five years and were accordingly given no weight. (*Id.* at 14-15.)

100. Staff's CAPM analysis uses a risk-free rate of 2.99 percent, which is the average 20-year Treasury bond yield between May 1, 2018, and July 31, 2018. (*Id.* at 17.) Staff states that it used "the 20-year Treasury bond yield to match the duration of the bonds used to derive the MRP." (*Id.*) Staff's analysis also implemented a sensitivity test that used a higher risk-free rate of 3.60 percent to account for anticipated continuing rate increases from the Federal Reserve and ongoing reduction to its balance sheet. (*Id.*) Staff used the most recent available Value Line publication to determine its betas. (*Id.*) Comparatively, Staff states that SWG used three different measures of the 30-year Treasury yield, including the current 30-day average and the near and long-term projected 30-year Treasury yields from Blue Chip Financial Forecasts, as the risk-free rate. (*Id.*) Staff notes that SWG also utilized two betas from Value Line and Bloomberg. (*Id.*)

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101. Staff provides that it used a 6.88 percent MRP in its CAPM analysis, which was based on the historical MRP since 1926, and was comparably higher than other MRP figures that it had reviewed. (*Id.*) Staff states that SWG used two DCF-derived, forward-looking estimates of the MRP, which ranged from 11.48 percent to 12.61 percent. Staff provided the following comparative table of MRPs and Market Returns:

Comparison of MRPs & Market Returns

	IESE	**Duff & Phelps**	**Graham & Harvey**	**SWG**	**Staff**
MRP	5.4%[18]	5.0%	4.42%	11.48% - 12.61%	6.88%
Risk Free Rate	2.8%[19]	3.5%[20]	2.37%[21]	3.11% - 4.20%	2.99%
"Base" Market Return	8.20%	8.5%	6.79%	14.59% - 16.81%	9.87%

[18] Staff notes that the MRP of 5.4 percent is provided with a standard deviation of 1.7%.
[19] Staff states that the risk-free rate is provided with a standard deviation of 0.8%.
[20] Staff specifies that the risk-free rate of 3.5 percent is a normalized figure for 20-year Treasury bonds.
[21] Staff provides that the risk-free rate is based on 10-year Treasury bond yields.

(*Id.* at 18.)

102. Staff states that it reviewed MRPs ranging from 4.42 percent to 5.40 percent and selected an MRP over 100 basis points higher. (*Id.*) Staff provides that SWG's "MRPs are exceptionally higher than all of the MRPs listed above – about 460 to 573 basis points higher than Staff's MRP and 600 to 800 basis points above the other estimates." (*Id.*) Staff contends that the difference between SWG's MRPs and the others appears to be due to its estimation method, which used a forward-looking MRP rather than an historical MRP. (*Id.* at 18-19.) Staff states that SWG's "figures do not fit current market expectations, even considering the environment of rising interest rates." (*Id.* at 19.)

103. Staff provides that SWG's estimated MRPs are flawed due to a reliance on DCF-derived MRPs and inflated forward-looking MRPs. (*Id.* at 27.) Staff states that SWG's "CAPM model relies on DCF derived MRPs, and thus is not really a CAPM analysis." (*Id.*) Staff asserts that by defining the MRP as the expected market return less the risk-free rate and estimating the expected ROE with DCF models, SWG's CAPM is the average of DCF-derived ROE and a risk-free weighted by beta. (*Id.*) Staff states that SWG's CAPM analysis relies heavily on its DCF analysis and argues that, if the value of beta is equal or very close to one, as is the case for the S&P 500, SWG's CAPM model is reduced to a simple DCF analysis. (*Id.*)

104. Staff states that SWG's forward-looking MRPs of 11.48% to 12.61% are inflated. (*Id.*) Comparatively, Staff states that SWG's MRPs are higher than the historical MRP based on Morningstar's Ibbotson 2018 SBBI,[22] in addition to other publications that it had reviewed (which ranged between 4.4 percent and 5.4 percent). (*Id.*) Overall, Staff states the MRP used in SWG's CAPM analysis was between 600 to 800 basis points higher than the numbers that it had

[22] Staff notes that it used Morningstar's Ibbotson 2018 SBBI for its MRP.

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reviewed. (*Id.*) Moreover, Staff provides that the MRPs used in SWG's CAPM analysis were inconsistent with the MRPs used in SWG's Bond Yield Plus Risk Premium, which ranged between 5.99 percent and 6.82 percent. (*Id.*) Staff notes that "while the MRP used in [SWG's] CAPM analysis were calculated using different methods and over different time periods, [Staff] would not except the estimates to be so vastly different." (*Id.*)

105. Staff notes that in its last rate case, SWG used MRPs that were also several hundred basis points higher than Staff's and other published estimates, which the Commission determined to be "unreasonably high."(*Id.* at 28.) Staff points to Commission's Second Modified Final Order in Docket No. 12-04005, which found that "SWG's use of overstated inputs appears to have produced results that are substantially higher than those calculated by BCP and Staff using the same proxy group companies" and that SWG was unable to successfully defend them. (*Id.*)

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106. Staff states that its CAPM analysis resulted in an estimate of 7.92 percent with a range between 7.61 percent and 8.22 percent (*Id.* at 19.) Staff notes that CAPM-based ROEs underestimate returns from low-beta stocks and overstates the return from high-beta stocks. (*Id.*) To address this issue, Staff states that it conducted an ECAPM analysis. that provides for a typical adjustment factor. (*Id.*) Staff's ECAPM analysis resulted in an estimate of 8.48 percent with a range of 8.18 percent to 8.78 percent. (*Id.*)

107. Staff provides that it conducted an Allowed ROE/Bond Yield analysis, "which is a simple regression model in which allowed ROEs for gas utilities are regressed on 20-year U.S. Treasury bond yields. (*Id.* at 20.) Staff states that "the model is based on the observation that while the long-term Treasury bond yields declined significantly in recent years, ROEs awarded by state regulators did not decline as much as predicted by risk premium models, including

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CAPM." (*Id.*) In its calculation, Staff "obtained data of allowed ROEs from Regulatory Research Associates ("RRA") *Regulatory Focus: Major Rate Case Decisions*, and averaged the bond yields over the previous four quarters with two quarters lagged." (*Id.*) Staff states that "applying the bond yield pertinent to Q4 2018 to the regression result produces an estimated ROE of 9.61 percent for the average gas utility. (*Id.* at 21.) Staff states that it also conducted a sensitivity analysis using both electric and natural gas industry data and another regression using the same data as SWG in its Bond Yield Plus Risk premium analysis. (*Id.* at 21-22.) Staff provides that using the regression from this data yields an estimated ROE of 9.46 percent for the average gas utility. (*Id.* at 22.)

108. Staff states that the regression results empirically confirm the idea that "allowed ROEs did not fall (or rise) as much as predicted by some risk premium models." Staff further states that "[r]egulators decreased (or increased) ROEs for gas utilities by 42 basis points, on average, when the long-term Treasury bond yield declined (or rose) by 100 basis points." (*Id.*) In other words, Staff states that "regulators grant ROEs in a range narrower than the movement of bond yields." (*Id.*)

109. Staff states that in SWG's last GRC, the Commission awarded the company an ROE similar to the industry average of the Allowed ROE/Bond Yield analysis. (*Id.*) Using the applicable inputs from 2012, the resulting industry average ROE for Q4 2012 was 9.64 percent. (*Id.* at 23.) As mentioned above, in the 2012 GRC, SWG was authorized an adjusted effective ROE of 9.68 percent. (*Id.*)

110. Staff states that it is important to consider that SWG's credit ratings have improved since its 2012 GRC. (*Id.* at 24.) Staff notes that Moody's, Fitch, and Standard and Poor's have since affirmed SWG's utility rating as A3, A-, and BBB+, respectively.

Additionally, Staff states that SWG has implemented its GIR mechanism which allows it to include the cost of certain projects in customer rates much more quickly than a GRC proceeding, which allows the company to "avoid the negative effects of regulatory lag" and serves as a risk and cash flow mitigation mechanism. (*Id.*) Staff states that "the major credit rating agencies have viewed this as a credit-positive development." (*Id.*)

111. Staff states that SWG underwent a holding company reorganization in January of 2017 "that further separated its unregulated operations, Centuri Construction Group ("Centuri") from its regulated operations, SWG, by making Centuri and SWG separate subsidiaries of a new publicly traded holding company, Southwest Gas Holdings, Inc." (*Id.*) Staff states that "major credit ratings agencies view SWG's change in organizational structure as a credit-positive due to the additional separation of SWG and Centuri, reducing the likelihood of credit contagion from the unregulated businesses." (*Id.* at 24-24.)

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112. Staff states that after taking out the retention growth estimate from SWG's DCF and excluding the CAPM analysis, Staff calculates that the average of SWG's ROE analysis would be 9.70 percent. (*Id.* at 28.) Without such adjustments, Staff provides that SWG's average ROE would be 10.66 percent. (*Id.*)

113. Staff states that SWG's requested ROE is significantly higher than what it was granted in its 2012 GRC and is not supported for several reasons. (*Id.*) Staff provides that SWG has experienced several positive changes that suggest SWG is less risky than it was during its 2012 GRC, in which it was authorized, adjusted for the debt ratio, an ROE of 9.68 percent (SND was authorized a 10.00-percent ROE, and NND was authorized a 9.30-percent ROE with separate capital structures). (*Id.* at 23, 28-29.) Staff notes that SWG identified that the average ROE awarded to gas utilities since 2013 has been 9.63 percent, showing a declining trend. (*Id.* at

28-29.) Staff contends that SWG's recommendation of 10.30 percent should be lower, not higher, than its currently-authorized ROE adjusted for the debt ratio. (*Id.* at 29.)

114. Staff states that it disagrees with certain factors that SWG used to determine its ROE. (*Id.* at 30.) With regard to regulatory risk, Staff states that SWG's claim of increased risk to the company due to a lack of lag-reducing cost-recovery mechanisms is unsupported by its own testimony and major credit rating agencies. (*Id.*) Staff states that SWG identified having the following adjustment clauses: full decoupling, a fuel and purchased power adjustment, a capital investment adjustment (its GIR provisions), and a Conservation and Energy Efficiency mechanism. (*Id.* at 31.) In contrast, Staff notes that most of the proxy group companies only have partial decoupling. (*Id.*)

115. Similarly, Staff notes that SWG's lack of an alternative regulation or incentive plan is belied by the fact that many of the proxy group companies also have no such alternative regulation or incentive plan. (*Id.*) Staff states that SWG demonstrated that its regulatory risk is not higher than the proxy group, and is either in line with, or potentially lower than the proxy group due to being one of the few companies that has full decoupling. (*Id.*)

116. Staff states that SWG's own testimony contradicts its claim that SWG faces increased regulatory risk. (*Id.*) Specifically, Staff notes that SWG stated that "[s]ince the last GRC, the company's credit ratings have improved. The improved ratings reflect the combined results from sound financing policies and strong operating results, which have been positively impacted by constructive regulatory treatment by the Company's regulatory commissions.[23]" (*Id.* at 31.)

[23] *See* Ex. 7 at 7-8.

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117. Staff states that since its last GRC in 2012, credit reports have viewed SWG's regulatory environments as credit supportive, specifically referencing that the company is fully decoupled and has infrastructure recovery programs in all of its jurisdictions. Staff specifically notes that Fitch ratings identified that "SWG's ratings reflect the low risk business profile of its regulated gas utility business. The ratings benefit from a relatively constructive regulatory environment. The utility's natural gas distribution business has revenue decoupling, purchased gas adjustment and infrastructure recovery mechanisms through its service territory. These rate mechanisms increase the stability and predictability of earnings and cash flows and provide for timely cost recovery." (*Id.* at 31-32.)

118. Staff state's that SWG's claim that natural gas utilities have underperformed compared to the overall market and that investors view natural gas utilities as less attractive investments, resulting in the allocation of capital to other market sectors assumes without evidence that the underperformance is a result of the TCJA and not some other factor specific to natural gas utilities. (*Id.* at 32.) Staff notes that this assertion contradicts an August 31, 2018, Value Line Investment Survey, which stated that stocks in the natural gas utility industry "have continued to increase in price in 2018," which the publication speculated was attributed to increased profits compared to the year prior, new rates, customer growth, and heightened consumption levels." (*Id.* at 33.) Staff notes that the publication states that the stocks have "generous dividends" and historically steady price movements. (*Id.*)

119. Staff states that it agrees with SWG that credit rating agencies have raised concerns regarding cash-flow related issues for utilities; however, Staff provides that such issues apply to all utilities, including the proxy groups. (*Id.*) Accordingly, Staff argues that "the effects and uncertainty related to the TCJA, if any, should have already been captured in the analysis

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because most, if not all, of the data used are from after the TCJA was passed." Moreover, Staff notes that there has not been a significant change in awarded ROEs for natural gas utilities in 2018, as the average awarded ROE in 2017 was 9.63 percent compared to 9.55 percent in the first half of 2018, indicating that regulators have not modified ROEs based upon the TCJA. (*Id.*)

120. Staff states that none of the credit agencies has changed SWG's credit rating or outlook, and that while major credit rating agencies "have warned about reduced cash flows as a result of the TCJA, the ultimate effect depends on the response of the regulators of the individual companies." Staff further states that SWG was not required to immediately reduce customer bills to reflect the tax law changes in Nevada and instead could have incorporated the effects of the TCJA in the instant GRC, where all other costs and revenue changes are being considered for the rates that will be effective on January 1, 2019. (*Id.*) Staff notes that prior to that date, SWG has retained the benefits of the TCJA as its current rates reflect the pre-TCJA environment from its last rate case. (*Id.* at 34-35.)

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SWG's Rebuttal Position

Overall ROE

121. SWG states that it updated its DCF, CAPM, and Bond Yield Risk Premium results based upon updated data through September 14, 2018. (Ex. 17 at 71.) SWG provides that based upon its results, it continues to recommend an ROE in the range of 10.00 percent to 10.50 percent, with an ROE of 10.30 considered reasonable and appropriate. (*Id.* at 75.)

122. SWG states that its key issues of concern regarding Staff and BCP's ROE recommendations relate to SWG's ability to continue to attract capital on a reasonable basis and how "the ROE recommendations and resulting overall rate of return will affect its ability to maintain its strong investment grade credit ratings." (Ex. 17 at 3.)

123. SWG states that in its last GRC, which resulted in two separate capital structures and ROEs for the NND and SND, it yielded an authorized ROE of 10.00 percent for SND based upon a common equity ration of 42.74 percent and a debt ration of 57.26 percent. (*Id.* at 4.) SWG further states that the Commission authorized an ROE of 9.30 percent for its NND based upon a common equity ratio of 59.06 percent and a debt ratio of 40.94 percent. (*Id.*) SWG provides that "[b]ased on the relationship of the ROE to the debt ratios utilized in calculating the authorized ROEs, the ROE changed 0.04289 percent for every 1 percentage point change in the debt to capital ratio." SWG states that given its debt percentage in this proceeding, the equivalent ROE would be 9.70 percent. (*Id.* at 5.) SWG contends that given the requested capital structure in this proceeding, Staff and BCP's ROE recommendations are 30 and 40 basis points below its current authorized ROE, respectively. (*Id.*)

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124. SWG states that Staff and BCP's ROEs are meaningfully below its authorized ROEs in California and Arizona. (*Id.*) SWG further states that its authorized ROEs in California and Arizona were awarded in conjunction with common equity ratios that exceed the ratio proposed in the instant Docket. (*Id.* at 6.)

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125. SWG states that Staff and BCP's ROE recommendations are below its current ROE despite changes in capital market conditions since its last GRC that SWG argues should have resulted in an increase. (*Id.* at 7.) SWG provides that both long-term and short-term interest rates have increased materially between the certifications for SWG's current and prior GRCs as follows:

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Interest Rate Series	Docket No. 12-04005 Certification Period May 31, 2012	*Interest rates* Docket No. 18-05031 Certification Period July 31, 2018	Change	2019 (Projected)	2020 (Projected)
		Long-term rates			
30-Year U.S. Treasury Yield	2.67%	3.08%	0.41%	3.54%	3.73%
10-Year U.S. Treasury Yield	1.59%	2.96%	1.37%	3.40%	3.56%
Moody's AA Utility Bond Yield	3.77%	4.13%	0.36%	4.79%	4.95%
		Short-term rates			
Customer Deposit Rate	0.05%	2.03%	1.98%	3.42%	3.61%
3-Month LIBOR	0.47%	2.35%	1.88%	3.38%	3.58%
Fed Funds Effective Rate	0.16%	1.91%	1.75%	3.16%	3.42%

(*Id.*)

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126. SWG states that "the projected long-term and short-term interest rates are expected to continue to increase, with yields on AA utility bonds projected to increase by 82 basis points from the current certification period until the end of 2020. (*Id.*) SWG contends that "the recommendations by Staff and BCP fail to comport with the actual and projected changes in capital market conditions as reflected in interest rate levels." (*Id.*)

127. SWG states that "the ROE from this proceeding should remain reasonable for the period in which the new rates will be in effect." (*Id.*) SWG further states that the use of projected capital market conditions as a relevant factor in determining an ROE is consistent with SWG's previous GRC, in which the Commission stated that "[t]he ROE needs to reflect current and future economic conditions."[24] (*Id.* at 8.) SWG argues that based upon actual and projected

[24] *See* the Commission's March 20, 2013, Second Modified Final Order in Docket No. 12-04005.

changes in interest rates, SWG's ROE in this proceeding should increase, not decrease, from its current equivalent ROE of 9.70 percent. (*Id.*)

128. SWG states that the ROEs suggested by Staff and BCP are significantly below the average authorized gas utility ROEs in other states. (*Id.*) SWG provides that BCP cited an averaged authorized gas utilities' ROE of 9.72 percent over a 12-month period ending on December 31, 2017, while Staff cited an average authorized gas utilities ROE of 9.63 percent over an 18-month period ending on June 30, 2018. (*Id.*) SWG notes that Staff removed an outlier ROE in its average that Staff deemed too high, while it did not remove or adjust for ROEs on the lower end of its range. (*Id.* at 8, footnote 5.) SWG states that the averages provided by Staff and BCP provide a range between 9.63 percent and 9.72 percent, with a mid-point of 9.68 percent. (*Id.*)

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129. SWG states that in order to attract capital, it must compete with other utilities in addition to alternative investment opportunities in fully competitive global markets and must also "demonstrate an ability to achieve a competitive risk-adjusted return on that capital." (*Id.* at 8.) SWG provides that the average and median historical ROE for the proxy group companies are 9.35 percent and 9.62 percent, respectively, with projected 2018 through 2022 average and median ROEs of 10.80 percent and 10.30 percent, respectively.[25] (*Id.* at 9.) SWG states that "approving an authorized ROE significantly below the level expected for other natural gas distribution utilities would send a negative signal to the financial community, as the authorized ROE on common equity is viewed as a key barometer of regulatory support." (*Id.*)

130. SWG states that "[g]iven the capital-intensive nature of the natural gas distribution business, it is important that SWG has sufficient access to capital and credit capacity

[25] SWG states that this information was derived from Value Line's August 31, 2018, Investment Survey. *See* Ex. 17 at 9, footnote 6.

at reasonable costs." (*Id.*) SWG further states that due to its significant projected capital expenditures, it will continue to require access to capital markets to fund those them. (*Id.*) SWG provides that for the 12 months prior to June 30, 2018, SWG and its parent company issued $300 million of senior notes in March 2018 and Southwest Gas Holdings, Inc. issued approximately 1.5 million shares of common stock generating $110 million in net proceeds, primarily through its Equity Shelf program. (*Id.* at 9-10.)

131. SWG states that "Staff and BCP's ROE recommendations are meaningfully below SWG's current authorized ROE, as well as the industry average authorized ROE, and do not square with the comparable earnings standard relative to the expected level of book returns of the proxy group companies." (*Id.* at 10.) SWG contends that the adoption of such ROEs would create uncertainty within the minds of credit rating agencies and investors with respect to the level of regulatory support that currently exists and can be anticipated in the future. (*Id.*)

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132. SWG states that, as cited by Moody's, the TCJA has increased financial risk for utilities. (*Id.* at 10.) Specifically, SWG states that with respect to the TCJA, "the loss of bonus depreciation for utilities beginning in 2018 coupled with a lower tax rate reduces the cash flow contribution from deferred taxes associated with capital investment." (*Id.*) SWG provides that the refunding of excess deferred taxes, over the long term, will also have a negative effect on cash flow. (*Id.*) SWG asserts that "rising interest rates and negative cash flow effects from the TCJA will create a more challenging financial environment going forward." (*Id.* at 11.)

133. SWG states that Staff's use of SWG's Arizona ROE of 9.5 percent as a factor to demonstrate the reasonableness of its own recommended ROE was not directly comparable. (*Id.* at 11-12.) SWG notes that its Arizona ROE is based upon a Fair Value Rate Base ("FVRB") compared to Nevada's applicable Original Cost Rate Base ("OCRB"). (*Id.* at 12.) SWG provides

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that applying the equivalent OCRB ROE for the ROE established in SWG's last Arizona rate case would be 10.15 percent. (*Id.*) Accordingly, SWG contends that on the basis of an equivalent OCRB methodology, Staff's recommended ROE of 9.40 percent is 75 basis points below SWG's Arizona GRC settlement ROE of 10.15 percent, which is also based upon a higher common equity ratio of 51.7 percent (compared to the 49.66 percent common equity ratio in this proceeding). (*Id.* at 13.)

SWG's Response to BCP's ROE Analysis and Criticisms

134. SWG states that it generally agrees with BCP's 20 basis point upward adjustment to account for SWG's financial risk. (Ex. 21 at 50.) SWG states that its projected capital structure includes a higher degree of financial leverage than its peers, and it is reasonable to compensate investors for bearing additional risk. (*Id.*)

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135. SWG states that BCP's 9.30 percent estimate of SWG's cost of equity is unreasonable. (*Id.* at 51.) SWG notes that the average ROE for natural gas utilities in 2017 was 9.72 percent. (*Id.*) SWG contends that BCP "has not provided any evidence that [SWG] is so less risky than other natural gas utilities that investors would require a return 42 basis points below the prevailing average. (*Id.*) Moreover, SWG states that "adopting [BCP]'s proposed ROE, including its financial risk adjustment, would rank it in the bottom 18th percentile of authorized ROEs over the past five years." (*Id.*)

136. SWG states that BCP's two-stage DCF analysis discounts dividends over two stages: 1) a four-year first growth stage in which Value Line's projected dividend growth is used; and 2) a 146-year stage, where the earnings growth rate from BCP's Constant Growth DCF analysis is used. (*Id.* at 52-53.) SWG states that it is concerned with the structure of BCP's two-

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stage DCF model, including its usage of only two stages and its assumed timing of dividend payments. (*Id.* at 53.)

137. SWG states that a common form of the multi-stage DCF model focuses on cash flow growth over three stages. (*Id.*) SWG provides that the first two stages define cash flow as projected dividends, while the third stage defines cash flow includes both dividends and the expected price at which the stock is sold at the end of the period. (*Id.*) SWG states that BCP's model differs from the common three stage model by assuming a year-end cash flow convention and constant payout ratio based upon the current level of dividends in its proxy group over the model's 150 year horizon. (*Id.* at 54.) SWG notes that BCP's model also assumes a terminal growth rate beginning in year five based on an earnings growth rate projection that ends in the fifth year of its study period. (*Id.*) Moreover, SWG states that BCP's model assumes that payout ratios will not change over the remaining 146 years of its projection period. (*Id.*) SWG provides that the effect of BCP's' assumption that "current comparatively low payout ratios (compared to the historical average) will continue in perpetuity" reduces projected dividend payments, and therefore the calculated ROE. (*Id.*)

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138. SWG is critical of the timing of dividend payments in BCP's analysis because it assumes that the entire dividend is paid at the end of the year which defers the timing of the cash flows. (*Id.*) SWG states that it is more reasonable "to assume that cash flow is received in the middle of the year, such that half the quarterly dividend payments occur prior to the assumed dividend payment date." (*Id.*) SWG provides that had BCP utilized such a convention, its median and mean results would be increased "by approximately 13 basis points, from 9.27 percent and 9.55 percent, to 9.38 percent and 9.68 percent, respectively." (*Id.* at 54-55.)

139. SWG states that BCP is too reliant on historical return data in its market risk premium. (*Id.* at 55.) SWG provides that "the relevant analytical issue in the application of CAPM is to ensure that all three components of the model ... are consistent with market conditions and investor perceptions." (*Id.* at 55-56.) SWG provides that its forward-looking MRP estimates in its CAPM analysis address this concern. (*Id.*)

140. With respect to BCP's Risk Premium analysis, SWG is critical of its reliance on historical Treasury yields. (*Id.* at 57.) SWG asserts that the cost of equity is forward looking and should accordingly include forward-looking parameters in determining it. (*Id.*) SWG provides that the 30-year Treasury yield is projected to steadily rise from 3.30 percent to 3.70 percent over the next six calendar quarters. (*Id.*) SWG further provides that had BCP used the 3.43-percent average near-term forecast of the 30-year Treasury yield over that period, its Risk Premium analysis would yield an estimate of 9.76 percent (compared to its 9.52 percent to 9.56 percent result). (*Id.*)

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141. With respect to BCP's criticisms of SWG's analysis, SWG disagrees with BCP's claim that SWG's recommendation ignores DCF results in favor of higher results from other modeling efforts. (*Id.* at 66.) SWG reiterates that its concerns with the Constant Rate DCF model relate to assumptions that are inconsistent with current market conditions, such as "the lack of alignment between current and long-term average payout ratios and utility sector P/E ratios. (*Id.*) SWG states that its Risk-Premium methods include direct measures of risk and consider future interest rates and market returns, which is why it argues that the mean low Constant DCF results should be given less weight. (*Id.*)

142. SWG states that it disagrees with BCP's contention that its CAPM and ECAPM analyses, which were higher than its overall recommended ROE range of 10.00 percent to 10.50

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percent, fail to support its recommendation. (*Id.* at 67.) SWG provides that its analyses recognize that determining the cost of equity is not entirely mathematical and also relies on both quantitative and qualitative information. (*Id.*)

143. SWG states that its DCF model was used to determine its MRP and that its model was applied to the S&P 500 companies instead of only natural gas utilities. (*Id.*) SWG further states that natural gas utility valuations tend to be strongly related to economic variables such as interest rates, which have only recently begun the process of normalization. (*Id.*) SWG provides that the Constant Growth DCF model assumes market conditions recently supporting utilities will remain a constant despite monetary policy is changing and interest rates are increasing. (*Id.*) SWG further provides that its MRP is consistent with historical experience while the Constant growth DCF model as applied to the proxy companies produce low results below recently authorized ROEs. (*Id.* at 67-68.)

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144. SWG states that the forecasted interest rates used in its Bond Yield Plus Risk Premium are supported, despite BCP's argument to the contrary. (*Id.* at 68.) SWG contends that current yields are not reasonable measures of future yields. (*Id.*) Moreover, SWG states that "as interest rates have begun to increase, Treasury yields have begun to under-project future yields. (*Id.* at 69.) SWG further states that "[t]o the extent that interest rates will continue to increase, the use of spot yields as a measure of expected future yields will systematically underestimate Treasury yields, and therefore systematically bias downward the cost of equity." (*Id.*)

SWG's response specific to Staff's ROE analysis and criticisms

145. SWG states that it disagrees with Staff's criticism that its Retention Growth model suffers from a logical trap that requires an analyst to estimate an ROE first in order to implement the model to estimate a fair ROE. (*Id.* at 13.) SWG notes that while its model

requires an estimate of the expected earned return on common equity, it also requires estimates of the expected retention ratio and the expected growth associated with the issuance of new shares of common equity. (*Id.*) Accordingly, SWG provides that the expected earned return on common equity is only one of multiple variables that the model considers. (*Id.*)

146. SWG contends that "its model provides insight into fundamental issues that drive utility valuations" and in that regard, the model derives from the structural form of the Constant Growth DCF model, "which itself is a condense form of the present value formula often used to measure intrinsic value." (*Id.*) SWG provides that to the extent elements of the Retention Growth Model are stable and internally consistent, it is a natural complement to the Constant Growth DCF model and is generally recognized as a method of establishing long term growth. (*Id.*)

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147. SWG states that it performed an analysis to determine the reasonableness of including the Retention Growth Estimate for natural gas utilities under current capital market conditions. (*Id.*) In doing so, SWG states that it examined the model's assumptions by analyzing the historical relationship between the retention ratios and subsequent earning growth rates. (*Id.* at 14.) Based upon its analysis, SWG provides that it determined that the components of the expected return were "generally consistent over time (although the expected profit margin does show a continuing trend of increases)." SWG further provides that "given that the results are general consistent with equity analysts' earnings growth rate projections, there is no reason to be concerned that the model is a "logical trap" that invalidates its use." (*Id.*)

148. SWG is critical of Staff's Three-Stage DCF results because its results are more than 200 basis points below the recently authorized returns that Staff identifies in other portions of its testimony. (*Id.* at 16.) SWG contends that the results are not compatible with current

market conditions including increases in treasury yields. (*Id.*) SWG argues that on those bases alone, Staff's Three-Stage DCF model should not considered. (*Id.*)

149. SWG disagrees with Staff on the proper risk-free rate to utilize. (*Id.* at 17.) SWG provides that "the maturity of the risk-free rate should approximate the life of the underlying investment." (*Id.* at 18.) SWG further provides that the 30-year Treasury yield is the most appropriate measurement of the risk-free rate because "as a practical matter, equity securities represent a perpetual claim on cash flows" and "30-year Treasury bonds are the longest-maturity securities available to match that perpetual claim." (*Id.*) SWG contends that because the 30-year Treasury bond is the longest duration risk-free security, it is the appropriate measure of a risk-free rate. (*Id.*) Moreover, SWG provides that it was able to calculate the equity duration of Staff's proxy group, and estimates that the average equity duration of 39 years. (*Id.* at 19.)

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150. SWG states that Staff's MRP estimate of 6.88 percent was based on the average of differences between the MRP and annual income return of the 20-year Treasury bonds for every year since 1926; however, SWG provides that the actual average MRP for the time period was 7.07 percent – 19 basis points above Staff's estimate." (*Id.* at 21.) SWG further provides that "even after correcting" Staff's analysis for the difference, three out of its four results fall below any authorized ROE for a natural gas utility and are all well below the industry's average awarded ROE" and for those reasons, SWG does not believe Staff's CAPM and ECAPM results are reasonable estimates of the company's ROE. (*Id.*)

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151. SWG states that Staff's exclusive reliance on historical data in estimating its MRP is inappropriate because it might produce results inconsistent with investor sentiment and current conditions in capital markets. (*Id.*) SWG provides that a historical MRP may not necessarily reflect investors' expectations or the relationship between market risks and returns. (*Id.*) SWG

further provides that "the relevant analytical issue in applying the CAPM is to ensure that all three components of the model (i.e., the risk-free rate, Beta, and the MRP) are consistent with market conditions and expectations. (*Id.* at 21-22.) Accordingly, SWG contends that a forward-looking MRP estimate is more appropriate for determining CAPM and ECAPM. (*Id.* at 22.)

152. SWG states that Staff assumes that the MRP does not change over time or with market conditions. (*Id.*) SWG states that, to the contrary, it conducted an analysis and found that the MRP is "time-varying" and moves inversely with the level of interest rates." (*Id.* at 23.) SWG provides that had it considered that, its CAPM result would have been between over 100 basis points above the top end of its CAPM results. (*Id.*)

153. SWG states that Staff's identification of a declining trend in authorized ROEs for natural gas utilities failed to consider whether the observed trend was statistically significant. (*Id.*) SWG provides that the trend is not statistically significant (representing a variation of approximately 1.40 percent of returns) and contends that the trend line does not support that SWG's ROE should be lower than its currently authorized level. (*Id.*)

154. SWG states that its Bond Yield Plus Risk Premium analysis considers the relationship between the 30-year Treasury yield and the Equity Risk Premium, not the MRP that Staff suggested. (*Id.* at 28.) SWG states that its MRP estimates in its CAPM and ECAPM analyses "represent the difference between the expected overall market return and the 30-year Treasury yield." (*Id.*) SWG provides that under the CAPM, the Equity Risk Premium is the product of the beta coefficient and the MRP. (*Id.*) SWG asserts that the Equity Risk Premium and the MRP are different measures of risk and should not be directly compared." (*Id.*)

155. SWG states that Staff's Allowed ROE/Bond Yield analysis relied on the projected Treasury yield from Blue Chip for Q4 of 2019 and that applying that number in its Allowed

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ROE/Bond Yield analysis results in an ROE of 9.96 percent, or four basis points below the lower end of SWG's recommended range. (*Id.* at 29.)

Regulatory Risk

156. SWG states that Staff argued that its risk is lower than it was in 2012 due to 1) SWG's upgraded credit rating; 2) SWG's implementation of the GIR mechanism and other cost mechanisms; and 3) SWG's reorganization as a holding company. (Ex. 21 at 42-43.) SWG provides that credit ratings do not fully measure the risk to SWG equity investors, the presence of SWG's cost recovery mechanisms does not mean SWG has lower regulatory risk than the rest of the proxy group companies, and SWG disagrees with Staff's contention that SWG's reorganization affects its level of risk. (*Id.* at 43-48.)

157. SWG states that credit ratings do not fully measure the risk to SWG equity investors. (*Id.* at 43.) SWG provides that while it agrees that credit ratings are "directionally related to the cost of equity," it does not agree that "changes in one is a direct measure of changes in the other." (*Id.*) Additionally, SWG contends that Staff did not present evidence to support its claim. (*Id.*)

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158. SWG states that the presence of its cost recovery mechanisms do not equate to lesser regulatory risk compared to the rest of the proxy group. (*Id.*) SWG further states that "the relevant analytical issue is whether [SWG] is so less risky than its peers as a direct result of the rate mechanisms that investors would specifically and measurably reduce their return requirements." (*Id.*) SWG provides that revenue stabilization and cost recovery mechanisms are common among the proxy group companies and that consequently, there is no reason to assume that SWG would be meaningfully less risky, or why its cost of equity would be lower than its peers, as a result of its rate mechanisms. (*Id.* at 43-44.)

159. SWG notes that the financial community has recognized the prevalence of revenue stabilization mechanisms among utilities; however, SWG argues that there is no reason to believe their adoption would reduce a utility's required return." (*Id.* at 44.) Further, SWG argues that Staff provided no empirical support for its claims that recovery mechanisms affect utility valuations or their respective cost of equity." (*Id.*)

160. SWG states that the idea that a reduction in volatility or timing of cash flows requires a reduction in the cost of equity is contrary to Modern Portfolio theory – the fundamental basis of CAPM. (*Id.* at 45.) SWG provides that that the theory, which defines risk as the uncertainty or variability of returns, recognizes that total risk is comprised of non-diversifiable and diversifiable risk. (*Id.*) SWG contends that in the context of CAPM, an investor would only be indifferent to a reduction in expected ROE if the reduction in volatility relates to reduced non-diversifiable risk. (*Id.*) SWG provides that "[i]f the rate structures mitigate increased systematic risk associated with the factors that drove a given company to implement them in the first place, there would likewise be no effect on the cost of equity." (*Id.*)

161. SWG is critical of Staff's claim that rating agency materials support its position that rate mechanisms have contributed to SWG's regulatory environment being credit-supportive. (*Id.* at 46.) SWG provides that comments from rating agencies are related, but do not directly correspond to equity investors, especially as it relates to marginal changes in capital cost rates. (*Id.*)

162. SWG also notes that if rate mechanisms materially reduced risks to bondholders, it would be reasonable to see bond rating upgrades as a result of those mechanisms; however, SWG provides that there is no indication that this is the case. (*Id.*) SWG distinguishes that some

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mechanisms may be viewed as credit-supportive in that they mitigate incremental risks, but such mechanisms are not necessarily credit enhancing. (*Id.*)

163. SWG contends that Staff also failed to provide any empirical support for the claim that SWG's rate mechanisms significantly reduce its risk relative to the other proxy companies. (*Id.*) SWG argues that in the 2012 GRC, the Commission found that it was not necessary to make an adjustment for revenue decoupling because "[a]ll of the companies in the proxy group have some form of rate stabilization mechanism in place; thus, the lower risk associated with revenue decoupling is accounted for in the results of the ROE study."[26] (*Id.*)

164. SWG disagrees with Staff's claim that SWG's cost recovery mechanisms are uniquely risk-reducing compared to companies in the proxy group. (*Id.* at 47.) SWG states that it is not rated more highly on various categories, including "Timeliness of Recovery of Operating and Capital Costs." (*Id.*) SWG provides that converting each letter rating from Moody's Investor Service Credit Opinion publications of each proxy group company to a numeric scale and averaging the numbers yields a score that is lower-rated than every other company in the proxy group but one.[27] (*Id.*) Accordingly, SWG argues that it is unreasonable to conclude that SWG's cost recovery mechanisms reduce its risk to a level below that of its peers. (*Id.*)

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165. SWG states that Staff incorrectly provided that the form of SWG's organization affects its level of risk. (*Id.* at 48.) SWG notes that all but two proxy group companies are structured as holding companies. (*Id.*) SWG argues that investors require levels of return commensurate with risk, and that two utilities identical in all respects except for their form of ownership should therefore have the same required returns. (*Id.*)

[26] *See* March 20, 2013 Second Modified Final Order in Docket No. 12-04005 at 149.
[27] *See* Ex. 21 at (RBH)-R14

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166. SWG states that it did not contradict itself in its direct testimony between Robert B. Hevert and Theodore K. Wood in discussing how SWG's improved credit ratings having been positively affected by constructive regulatory treatment by the company's regulatory commissions. (Ex. 17 at 13.) SWG provides that while Mr. Wood's testimony "discussed the constructive regulatory treatment received by SWG in its service territories, in no way did it provide a relative regulatory risk comparison to the proxy group companies used to estimate the cost of common equity, as asserted by Staff." (*Id.* at 13-14.) SWG further provides that the use of regulatory mechanisms are common among the proxy group companies; however, not homogenous in their construction or effectiveness for providing timely recovery of costs and/or revenues. (*Id.* at 14.) SWG states that what occurs in other state regulatory jurisdictions are important to SWG because it provides a benchmark in determining its relative risk, which in turn affects the cost of capital paid by its customers. (*Id.*)

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167. SWG states that other gas utilities in different jurisdictions have received infrastructure mechanisms that provide substantially more protection from the lag associated with infrastructure investments when compared to Nevada's GIR mechanism. (*Id.*) SWG notes that "Atmos Energy Corporation ("Atmos"), a utility within the proxy group companies, holds 70 percent of its rate base assets in Texas, which provides for an annual interim rate adjustment mechanism" that allows it to begin recovering its infrastructure investments in Texas on an expeditious and timely basis. (*Id.*) SWG provides that the mechanism allows for 100 percent of capital expenditures to be captured in the mechanism between rate cases compared to the approximately 28 percent of the capital expenditures included in SWG's Nevada regulatory jurisdictions. (*Id.* at 15.) SWG asserts that in addressing regulatory lag, the interim rate adjustment mechanism is far superior to Nevada's GIR mechanism. (*Id.*)

168. SWG states that Atmos has similar mechanisms in its other service territories. (*Id.* at 16.) Additionally, SWG notes that its credit ratings are higher than SWG for both Moody's and S&P. (*Id.*) SWG contends that while SWG's GIR mechanism in Nevada does mitigate the regulatory lag associated with qualifying investments, it may not provide the same level of risk reduction relative to other gas utilities. (*Id.*) SWG argues that it is inappropriate and counterproductive to implicitly reduce its ROE by assigning a below average ROE due to the GIR mechanism in Nevada. (*Id.*)

169. SWG states that its discussion of Atmos is relevant because SWG must compete with other utilities to attract capital. (*Id.*) SWG provides that a utility perceived as having a lower level of relative risk will be able to attract capital at lower rates, thus lowering the cost to serve over time. (*Id.*) SWG contends that it competes with Atmos to attract capital and that, "to the extent that Atmos is viewed to have a lower level of relative risk than SWG because of regulatory support (i.e., ROE of 10.50 percent, timely recovery of costs through interim rate adjustment mechanisms), then ultimately in the long-run, it will become more expensive on a relative basis for SWG to attract the capital needed to operate in Nevada. (*Id.* at 16-17.)

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Credit Ratings

170. SWG states that BCP's financial integrity analysis and claim that its recommendation preserves SWG's ability to maintain its bond rating is problematic. (*Id.* at 17.) SWG asserts that one such problem is that BCP's analysis is based on a static point in time. (*Id.*) BCP provides that credit ratings are "in part a forward-looking assessment of credit worthiness, which includes an assessment of the projected trend for [SWG]'s credit metrics, and not simply based on static credit measures." (*Id.*) SWG states that BCP's analysis "fails to provide any

impact from the return of excess deferred taxes, which will negatively impact cash flows and related credit metrics." (*Id.*)

171. SWG states that BCP's analysis also fails to include rating agency adjustments. (*Id.*) SWG provides that "rating agencies routinely make analytical adjustments to compute financial ratios in the course of the ratings process, which makes it difficult to replicate rating agency ratios." (*Id.*) SWG states that, for example, "such routine adjustments to debt and interest expense include adjustments for operating leases, pension obligations, securitizations, etc." SWG asserts that BCP's financial integrity analysis fails to account for such adjustments. (*Id.*)

172. SWG states that BCP's analysis also fails to include interest expense associated with deferred energy balances. (*Id.*) SWG provides that "part of its reported interest expense includes the carrying charges paid on deferred energy balances owned to customers, with interest rates being its authorized rate of return." (*Id.* at 17-18.)

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173. SWG states that BCP's analysis problematically assumes SWG earns its rate of return. (*Id.* at 18.) SWG further states that while it "continually seeks to improve its operating efficiencies and to prudently manage costs, [SWG] has routinely not earned its authorized rate of return in its Nevada service territories." SWG provides that a primary reason for this is related to the regulatory lag experienced with elevated capital expenditures, which far exceed [SWG]'s depreciation expense." (*Id.*) SWG further provides that "the financial attrition experienced from an elevated capital expenditure program is a well-recognized phenomenon in the utility industry." (*Id.*) Accordingly, SWG argues that the Commission should reject BCP's pro forma credit analysis in supporting the reasonableness of his recommended ROE. (*Id.* at 18-19.)

174. SWG states that BCP evaluated the reasonableness of its ROE recommendation by calculating the effect that its recommended ROE would have on several financial ratios to determine whether it would support an investor-grade bond rating. (*Id.* at 58.) SWG is critical of this approach and states that credit metrics are "not relied on in a rote fashion, nor are individual metrics reviewed in isolation, to the exclusion of information." (Ex. 17 at 59.) Moreover, SWG argues that maintaining an "investment grade" rating is an inappropriate standard, as only 6 of 221 utilities have had below investor-grade ratings. (*Id.* at 63.) SWG provides that BCP's standard would "frustrate the ability of SWG to raise capital under a variety of market conditions, and at reasonable costs and terms." (*Id.*)

175. SWG states that BCP's analysis suggests that ROEs as low as 5.19 percent for SWG's NND and 6.47 percent for its SND would be sufficient to achieve sufficient Cash Flow Coverage of Interest and Cash Flow as a percentage of Debt ratios in the A-rated financial risk range identified by BCP. (*Id.* at 64.) SWG contends that such ROEs are unrealistic estimates of the company's cost of equity. (*Id.*)

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TCJA Rebuttal Issues

176. SWG states that Staff's criticism of its assertion that the natural gas sector has materially under-performed the broad market since the approximate enactment of the TCJA is flawed. (*Id.* at 31.) Specifically, SWG provides that Staff's argument is problematic because it suggested that other variables could have caused the gas sector market underperformance, but did not identify or speculate to what those variables causing the underperformance might have been. (*Id.*) Moreover, SWG conducted an "abnormal returns" analysis, controlling for market-wide events, that determined that the TCJA had a "strong negative effect on the proxy company valuation levels." (*Id.* at 32-34.)

Commission Discussion and Findings

177. The Commission is legislatively mandated to ensure that established rates are just and reasonable.[28] The process of establishing rates for a utility requires that the Commission establish a rate of return based upon the equity portion of the utility's capital structure. In determining an appropriate ROE, the Commission relies upon frameworks contained in the NRS, NAC, and two seminal U.S. Supreme Court decisions regarding ratemaking, *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679 (1923) and *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), which are discussed in greater detail above in paragraphs 3-5. The Supreme Court of Nevada has held that utilities are entitled to be permitted to earn a reasonable rate of return which is "adequate, under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties."[29]

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178. In the *Hope* decision, the Court re-affirmed the *Bluefield* standard, finding that it is not the method for estimating the ROE that determines the reasonableness of the ROE, but rather, it is the result and effect of the result on the public utility.[30]

179. In establishing a zone of reasonableness and determining an ROE within that range, the Commission relies upon expert testimony and evidence which applies principles of finance, accounting, and economics to the cost of a particular utility's common equity. This evidence includes the results of each expert's ROE studies, the experts' judgement in assessing macroeconomic conditions, capital markets, SWG's particular circumstances (e.g., capital structure, risk profile, and regulatory environment), and each expert's critique of other experts'

[28] *Nevada Power Co. v. Pub. Serv. Comm'n*, 91 Nev. 816, 825, 544 P.2d 428, 434 (1975); *See also* NRS 704.040, 704.120.
[29] *Nevada Power Co. v. Pub. Serv. Comm'n*, 91 Nev. 816, 825, 544 P.2d 428, 434–35 (1975).
[30] *See Fed. Power Comm'n v. Hope Nat. Gas Co.*, 64 S. Ct. 281, 287–88 (1944).

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analyses. Based upon the evidence in the record, the Commission finds that the range or zone of reasonableness for SWG's ROE falls between 9.10 percent and 9.70 percent, as recommended by Staff.

ROE Model Analyses

180. In the instant Docket, the Parties relied upon a variety of models to arrive at their respective proposed authorized costs of equity. The application of those models utilized a proxy group of seven comparable utilities that were selected based upon criteria such as size, operations, and credit metrics. No parties challenged the proxy group utilized by SWG, and it was adopted by both BCP and Staff for use in their respective models and analyses.

181. The analyses provided by the parties generally relied upon standard financial models to estimate the appropriate ROE. The Commission considers a broad range of models and does not rely on any specific one in making a determination of the ROE; however, the Commission gives weight to each model and its respective inputs based upon the evidence in the record. The following table summarizes the parties' recommended ROE and range of reasonableness:

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Table 1

Summary of recommended ROE and range of reasonableness

Party	ROE Range	Recommended ROE
SWG	10.00% to 10.50%	10.30%
BCP[31]	9.00% to 9.50%	9.30%
Staff	9.10% to 9.7%	9.40%

182. As Table 1 notes, there is a 90- to 100-basis-point differential between the recommended ROE of BCP and Staff and the ROE proposed by SWG. The difference is largely

[31] BCP's recommended range of reasonableness and ROE included a 20 basis point upward adjustment that was considered and rejected by the Commission.

attributable to the results of SWG's application of the CAPM and ECAPM models as noted in Table 2 below:

Table 2

Modeling Method	SWG Mid ROE	BCP Mid ROE	Staff Mid ROE
Constant Growth DCF:	9.54%	9.60%	9.54%
Multi-Stage DCF		9.50%	8.44%
Capital Asset Pricing Model (CAPM)	**11.92%**	**8.13%**	**8.20%**
Empirical Capital Asset Pricing Model (ECAPM)	**12.86%**	**8.63%**	
Risk Free Bond Yield +Allowed ROE for Gas Utilities	10.04%	9.54%	9.61%
SWG DCF Model Adjusted by Staff			9.70%
Average	***11.10%***	***9.10%***	***9.10%***
Add BCP Capital Structure Risk Adjustment		.20%	
Recommended ROE	10.30%	9.30%	9.40%

183. As the testimony of Staff and BCP note, the key drivers of these models are the assumed "risk free" investment rate and the market risk premium over the risk-free investment that an equity investor requires. The reason for the wide variation amongst SWG and the other parties relates to the MRPs used by the witnesses. Staff and BCP relied upon analyses of historic MRPs. More specifically, Staff used an MRP of 6.88 percent based upon a historical analysis of MRPs since 1926 and compared the result to published data that is recognized and used by financial firms to generate MRPs for its clients. Similarly, BCP utilized a 7.50-percent MRP based upon an average of historical results, including the historical MRPs since 1926, for the proxy groups and the historical difference between long-term equity returns for large stock companies and the current August 2018 Treasury yields. The Commission finds that Staff and BCP both adequately defended their analyses and use of historic data.

184. In contrast, SWG did not rely on any historical analysis of MRPs, nor did it rely on published data regarding MRPs from recognized financial firms. Instead, SWG attempted to

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develop a forecast of MRPs. SWG's self-derived MRPs range from 11.48 percent to 12.61 percent and are significantly above historical data or current published data. The use of such MRPs was not adequately supported by SWG, and the Commission agrees with BCP that the MRP estimates resulting from SWG's method significantly overstate the ROE in SWG's CAPM and ECAPM models.

185. The Commission notes that, by replacing SWG's CAPM and ECAPM estimates with either Staff or BCP's CAPM and ECAPM estimates, SWG's average ROE modeling results in Table 2 would fall from 11.10 percent to 9.10 percent or 9.30 percent, respectively. The Commission cannot accept SWG's overstatement of MRP in its CAPM and ECAPM analysis, which was not adequately supported. Consequently, the Commission finds that a range of reasonableness between 9.10 percent and 9.70 percent should be adopted. Such a range is supported by Staff's testimony and only exceeds the high end of BCP's range by 20 basis points.

186. As Staff notes, any number in the range of reasonableness is appropriate for purposes of establishing an ROE. (Tr. at 104.) However, in identifying the most appropriate number, a variety of factors must be considered, including a comparison of SWG to the proxy group with respect to certain key metrics and overall macroeconomic conditions that affect its ability to attract capital investment.

Macroeconomic Conditions

187. With regard to macroeconomic conditions, SWG argues that the Commission must consider recent decisions by the Federal Reserve to increase the borrowing rate on Treasury bonds. Specifically, SWG provides that the Federal Reserve has increased the Federal Funds target rate by 25 basis points since December of 2016, with corresponding increases in short-term and long-term interest rates. However, the Commission agrees with BCP and Staff's

suggestion that increases in the federal borrowing rate must be considered in the proper context – the federal borrowing rate was at or near zero percent as the base prior to the recent increases.

188. Simply put, federal borrowing rates have been and remain at historic lows. The evidence on the record does not support or indicate the occurrence of significant increases in federal interest rates in the near term that would justify the prospective increase in ROE recommended by SWG. Moreover, any significant increase in long-term interest rates and/or the federal borrowing rate that occurs after the effective date of rates set in this GRC can be addressed in a subsequent GRC application by SWG.

Risk Relative to Proxy Group Companies

189. BCP recommends a 20-basis-point upward adjustment to SWG's ROE to compensate for expected changes in SWG's capital structure relative to similarly-forecasted changes to the proxy group. More specifically, BCP argues that SWG's equity level is indicative of higher financial risk relative to the proxy group companies and merits an adjustment. For the reasons discussed below, the Commission rejects BCP's recommendation as unnecessary and unsupported by the evidence on the record.

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190. As Staff notes, credit rating agencies have improved SWG's credit rating since its last GRC in Docket No. 12-04005. Additionally, all credit reports subsequent to its last GRC view SWG's regulatory environment as credit-supportive, citing its decoupling mechanisms and infrastructure cost recovery programs in its three jurisdictions. Notably, Moody's increased its rating from Baa1 to A3 on January 31, 2014, and Fitch upgraded its rating from BBB+ to A- on May 28, 2013.

191. Credit agencies have noted two actions taken by the Commission since SWG's last GRC that have been credit positive. Specifically, 1) Commission approval of the GIR

mechanism, which reduces the negative effects of regulatory lag on cost recovery; and 2) Commission approval of SWG's corporate restructuring to utilize a holding company, which provided more separation between the holding company's regulated and unregulated operations.

192. Staff and BCP also note the additional rate and cash flow mitigation resulting from the Commission's approval of full decoupling for SWG. Full decoupling guarantees the recovery of the margin per customer allowed in the most recent GRC proceeding. In SWG's provided summary of revenue stabilization mechanisms and cost tracks for each utility and subsidiary in the proxy group, only two of the eighteen companies listed had full decoupling.[32]

193. SWG also attempts to distinguish itself from the proxy group by asserting that it is not able to take advantage of certain mechanisms that other utilities have, such as forecasted test years and formula-based rate plans; however, as SWG provided in Ex. 11 at RBH-7, the majority of proxy companies do not have such mechanisms. Moreover, all of the rate mitigations identified by SWG in Ex. 11 at RBH-7 that apply to the majority of listed proxy group companies also apply to SWG, including the Cost of Fuel recovery mechanism; Decoupling – Margin Recovery mechanism; Accelerated Recovery of Infrastructure Investment (GIR); and Energy Savings and Conservation Program Cost Recovery.

194. The Commission finds that the evidence presented does not support a finding that SWG faces a higher regulatory risk than the proxy group of comparable companies. The Commission is not persuaded that there is sufficient evidence to support an upward adjustment of SWG's ROE based upon its risk relative to the proxy group. Indeed, given the evidence presented, the Commission finds that SWG's ROE is most appropriately set in the lower portion of the range of reasonableness.

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[32] *See* Ex. 11 at RBH-7.

195. The Commission therefore finds that an ROE of 9.25 percent balances the interests of the ratepayers and shareholders, and results in just and reasonable rates. Such an ROE falls directly in-between Staff's recommended ROE and BCP's proposed ROE adjusted for the denial of its recommended upward adjustment of 20 basis points. The Commission further finds that, based upon the evidence, an ROE of 9.25 percent is commensurate with returns on investments in other enterprises having corresponding risks and is both sufficient to assure confidence in the financial integrity of the enterprise and for SWG to attract capital.

VI. DEPRECIATION

196. SWG states that since its last GRC, its SND's direct depreciation and amortization expenses increased $11.3 million using the rates authorized in its last GRC, representing an increase of approximately 35 percent more than the $32.3 million authorized in its last GRC. (Ex. 42 at 11.) SWG further states that it used the proposed depreciation rates supported by its depreciation study, which increased its depreciation expense by $3.9 million to $47.5 million. (*Id.*) SWG also states that its NND's direct depreciation expense increased $1.3 million using the rates authorized in the last GRC, which represents 21.7 percent more than the $6.0 million authorized in its last GRC. (*Id.*) SWG states that its proposed depreciation rates would decrease the NND's depreciation expense by $0.1 million to $7.3 million. (*Id.*)

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A. Account 367 – Transmission Mains (SND)

SWG's Position

197. SWG requests an increase in the depreciation expense accrual rate to from 1.61 percent to 1.82 percent based on remaining life of 52.2, (R1.5-68 ASL) and increase in the net negative salvage rate from negative 15 percent to negative 30 percent. [33] SWG states that

[33] Detailed calculations of proposed depreciation rates can be found in the Direct Testimony of Dane Watson. (*See generally* Ex. 23.)

historical data suggests removal costs are increasing and that negative net salvage exceeds the current negative 15 percent amount in most of the 10-year moving averages back to 2008. (Ex. 4 at 41.) This results in an annual expense increase request of $231,975. (Ex. 4 at 49.)

BCP's Position

198. BCP does not propose a change to SWG's calculation for Transmission account 367-Mains. (Ex. 27, Attachment DJG 11 at 1.)

Staff's Position

199. Staff states that "[f]or Southern Nevada Account 367 Transmission Mains, the Depreciation Study recommends a doubling of the net salvage rate from negative 15 percent to negative 30 percent based on the fact that current historical data indicates that the negative net salvage is increasing." (Ex. 25 at 15.)

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200. Staff recommends an increase in the accrual rate from 1.61 percent to 1.72 percent based on a remaining life of 52.5 (R1.5-68 ASL) and a negative net salvage rate of negative 25 percent. (*Id.* at 16.) Staff states that this adjustment results in a reduction to SWG depreciation expense request of ($116,322). (*Id.*, Attachment POL 2 at 1.)

201. Staff also states that it does not disagree with increasing the negative net salvage value, but it is concerned by the doubling of the value in a single depreciation study and that the data employed by SWG contains data points that skew the results to a degree that may be abnormal and should not be relied upon. (*Id.* at 16.)

202. Staff concludes "that it is premature to select a greater negative net salvage amount beyond a negative 25 percent net salvage," and therefore recommends a negative 25 percent net salvage value, which is still a considerable increase from the current Commission-approved net salvage percentage for this account (negative 15 percent). (*Id.* at 17.) Staff also

states that any further movement should be deferred until SWG files its next depreciation study. (*Id.*)

SWG's Rebuttal Position

203. SWG states that"[a]ll parties agree Company specific experience is moving more negative," and that only Staff "raises an issue for this account." (Ex. 28 at 33-34.) SWG states that Staff "acknowledges that the current historical data indicates the negative net salvage is increasing and is recommending a negative 25%" net salvage rate. (*Id.* at 34.)

204. SWG states that while SWG "did discuss with Staff that there are known timing differences that occur, and that the 'edge-year data' should be given less weight," "SWG did not determine there were any abnormal data points, only timing differences (e g in 2017, removal cost was recorded but the retirements have not been unitized)." (*Id.*) SWG states that Staff " is correct about the timing difference seen in 2017, which is why [SWG] used 2016 and prior averages." (*Id.*)

205. SWG offers a table providing the last five years with the two-, four-, six-, eight-, and 10-year averages to illustrate that "even when you eliminate 2017 'edge-year' and move to 2016, the 10-year moving average for all four years (2013-2016) is more negative than -30%, except for 2013 In 2013, the 10-year moving average, a -27%, is still more negative than the value Staff is proposing." (*Id.* at 35.) SWG also provided a table showing net salvage for the past 5, 10 and 15 years to support its proposed negative 30 percent. (*Id.*)

206. SWG also states that while the Company and BCP agree on negative 30 percent, "Staff has moved more negative but proposes a negative 25 percent." (*Id.* at 36.) Staff concludes that "a -30% is the more reasonable and supportable position being experienced by the Company." (*Id.*)

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207. SWG continues that "[w]hile Staff believes it is premature to make such a large move and wants to see if further increases in negative net salvage occur, those have been realized already between the 2012 Study and this study." (*Id.*)

208. SWG states that "[t]he costs being incurred to safely retire assets is increasing and is not in dispute by any party," and therefore "[t]his Commission should… approve [SWG's] proposed negative 30 percent net salvage without further deferral and as a step toward the indications and actual Company experience. (*Id.* at 36-37.)

Commission Discussion and Findings

209. The Commission agrees with Staff's recommendation to increase the depreciation expense accrual rate from 1.61 percent to 1.72 percent based on a remaining life of 52.5 (R1.5-68 ASL) and increase in negative net salvage to negative 25 percent. The Commission finds that Staff's analysis regarding outlier data skewing SWG's net salvage data is reasonable, and that SWG failed to support its recommendation to double the net negative salvage rate at this time. The Commission also finds that all parties agree with an increase in the negative net salvage rate.

B. Account 376 – Distribution Mains (SND)

SWG's Position

210. SWG requests an increase in the depreciation expense accrual rate from 2.18 percent to 2.41 percent based on remaining life of 39.89, (R2.5-50 ASL) and an increase in the net negative salvage rate from negative 10 percent to negative 20 percent. SWG states that the most recent moving averages for net salvage are much more negative than the existing negative 10 percent. (Ex. 4 at 42.) This results in annual expense increase request of $2,059,663. (Ex. 4 at 49.)

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BCP's Position

211. BCP states that "[t]he Observed Life Table ("OLT") curve constructed from the Company's historical retirement data for this account is relatively well-suited for conventional Iowa curve-fitting techniques." (Ex. 27 at 21.) SWG selected the R2.5-50 curve for this account, and BCP selected the L2-55 curve. (*Id.*) BCP states that the "Iowa curve selected by [SWG] appears to be too steep and short to best describe the historical retirement pattern in this account, which indicates it may also not provide the best estimate of the remaining life." (*Id.* at 22.)

212. BCP also does not agree with SWG's proposed salvage rate of "-20% for Account 376 in the Southern Division; this is again a 100% increase (or double) the currently-approved net salvage rate of -10% for this account." (*Id.* at 27.)

213. BCP recommends "applying a net salvage rate of -13% to calculate the depreciation rate for this account," concluding that "[t]his rate is still greater than the averages of the nine and 10-year moving average rates." (*Id.* at 27.) BCP also states that "[c]onsidering a longer period of net salvage data such as this will help mitigate the large skew in the data imposed by the unusually large net salvage rate in 2017, and it will also help prevent large fluctuations in approved net salvage rates, such as would be the case if [SWG's] 100% increase were adopted." (*Id.*)

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Staff's Position

214. Staff states that the current approved net salvage rate is negative 10 percent and that SWG is recommending an increase to negative 20 percent "based upon decreasing salvage values and increasing removal costs for this account." (Ex. 25 at 17.)

215. Staff states that its analysis of the proposed net salvage gave less weight to edge-year data and excluded outlier data. (*Id.*) Staff also states that "[t]his approach is reasonable as it eliminates data from years that may still have unfinished retirement activity, as well as excludes

years where large fluctuations of annual net salvage data have skewed results and may in fact be corrected in later years." (*Id.* at 17-18.)

216. Staff therefore supports "increasing current the net salvage to negative 15 percent for both divisions, which is a reasonable mid-point to what SWG is proposing to move to, that being a negative 20 percent." (*Id.*)

SWG's Rebuttal Position

217. SWG states that "Southern Nevada Distribution Account 376 Mains is being contested by BCP," as BCP "is proposing the 55 L2," "[t]he existing life of Account 376 is 50 R2 5," and SWG's "proposal is to retain the existing 50 R2 5 which is also supported by Staff." (Ex. 28 at 26.)

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218. SWG states that "[s]imilar to the other accounts, [BCP's] approach does not consider all the available information to arrive at a better life estimate," and " is not in line with authoritative guidance on multiple points, as previously noted for other accounts." (*Id.* at 27.) In addition, SWG states that Staff "is similarly not in agreement with BCP's proposal," and that "[a]fter performing [its] analysis, and considering all the information available, [Staff] supports the Company's proposal for Southern Nevada Account 376." (*Id.*)

219. SWG concludes that BCP's analysis does not take into account the significance of the other factors impacting this account, and that "the Company proposal at this time retains the existing life while the Company continues with the various pipe replacement programs either underway or planned." (*Id.* at 30.) SWG therefore states that "[f]or these reasons, the Commission should reject BCP's proposal and approve the retention of the existing 50 R2 5." (*Id.*)

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220. With respect to the net salvage rate for this account, SWG states that "[a]ll parties agree Company specific experience is moving more negative," but Staff proposes a net salvage of negative 15%, BCP proposes negative 13 percent, and SWG proposes negative 20 percent. (*Id.* at 37.) "[t]he existing is a -10% net salvage." (*Id.*)

221. SWG states that the basis for its negative 15 percent net salvage recommendation is that "Staff is reluctant to double the value of net salvage in a single study," and that Staff "has given less weight to edge-year data and has excluded outlier data." (*Id.* at 38.) While SWG acknowledges and agrees that the edge-year should be given less weight, "recent averages actually exceed [SWG's] recommendation and are definitely more negative than the values proposed by Staff and BCP." (*Id.*)

222. SWG provided a table that "provides the last five years with the 2, 4, 6, 8 and 10-year averages," which "illustrates that even when moving to 2016, eliminating the 2017 'edge-year,' the 10-year moving average for 2016 is a -26% and is more negative than the -20% net salvage [SWG] [is] proposing." (*Id.*) In addition, "[i]n 2015, the four-year moving average is a -23%, again, more negative than [SWG's] proposal for this account and more negative than what is proposed by Staff. (*Id.*)

223. SWG also provided a table illustrating net salvage for the past 5, 10 and 15 years. (*Id.* at 39.)

224. With respect to BCP's recommended -13% net salvage for this account, SWG states that BCP "objects to [SWG's] recommendation as it is double the currently-approved net salvage for this account," and "also discusses an averaging of the net salvage for the 10-year moving averages as being 12.18%." (*Id.* at 40.) SWG states that "[t]his averaging of the averages is not a standard analysis technique, and frankly, does not make sense." (*Id.*) BCP also

does not acknowledge that the 2017 edge-year issue has been given less weight in [SWG's] evaluation. (*Id.*)

225. SWG presented a table that "shows that the 2016 10- year moving average is -26%," and that "[c]ontrary to [BCP's] claims, a 10-year average is not relying too heavily on the most recent net salvage data. (*Id.* at 40-41.)

226. SWG also states that BCP's "concept of averaging the rolling average is unclear and is not an accurate reflection of how the analysis was performed to reflect the trends in net salvage." (*Id.*) "Looking at the 2016 4, 6, 8 or 10-year averages, they all exceeded [SWG's] recommended -20% net salvage." In addition, "[e]ven the 2015 4-year average exceeds [SWG's] recommendation, and the 6-year is more negative than Staff's -15% and BCP's -13%. (*Id.*)

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Commission Discussion and Findings

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227. The Commission agrees with BCP's recommended L2-55 Iowa curve. The L2-55 curve and longer life are a better mathematical fit to the OLT for account ~~367~~ ***376*** Mains. SWG states that BCP's analysis does not take into account the significance of the other factors affecting this account; however, the Commission agrees that the Iowa curve selected by SWG appears to be too steep and short to best describe the historical retirement pattern in this account. The Commission notes, and SWG acknowledges, that current pipe replacements under the GIR mechanism are likely affecting the OLT statistics by producing shorter lives in the current observed data and that the newer pipe replacements will eventually lead to longer lives. As a result of the accelerated GIR pipe replacements over the past six years, SWG distribution mains are getting younger with an overall longer average remaining useful life.

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228. With respect to the net salvage rate, the Commission agrees with Staff's recommendation to increase net salvage to negative 15 percent. The Commission finds that Staff's analysis regarding outlier data skewing SWG's net salvage data is reasonable, and that SWG failed to support its recommendation to double the net negative salvage rate at this time. The Commission also finds that all parties agree with an increase in the negative net salvage rate.

C. Account 385 – Industrial Maintenance and Repair Station Equipment (SND)

SWG's Position

229. SWG requests to lower the depreciation expense accrual rate from 3.06% to 2.90% based on remaining life of 21.25 (R4-34 ASL) and a change in net salvage from positive 2% to negative -2%. (Ex. 4 at 34, 44.) SWG states that this results in annual expense reduction of $13.573. (Ex. 4 at 49.)

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BCP's Position

230. BCP submitted a table showing that "[SWG] selected the R4-34 curve for this account, and [BCP] selected the R3-39 curve." (Ex. 27 at 23.) BCP states that "the R4 curve shape selected by [SWG] does not appear to track very well with the observed historical data," and that "[t]he OLT curve begins declining sooner than what would otherwise be described by the R4 curve for this account." (*Id.* at 24.) BCP concludes that the "R4-34 curve results in a remaining life that is too short for this account given the historical data." (*Id.*) Moreover, BCP states that the R3-39 selected by BCP for this account provides a better mathematical fit to the OLT curve than SWG's curve. (*Id.*)

Staff's Position

231. Staff does not propose a change to SWG calculation for Distribution account 385 Industrial M&R Station Equip. (Ex 25, Attachment POL 2 at 1.)

SWG's Rebuttal Position

232. SWG states that the existing life of this account is 33 R4, BCP proposes a 39 R3, and SWG's proposal is to move to 34 R4, which is supported by Staff. (Ex. 28 at 30.) SWG states that "[s]imilar to the other accounts, [BCP's] approach does not consider all the available information provided to arrive at a better life estimate," and "is not in line with authoritative guidance on multiple points, as previously noted for other accounts." (*Id.* at 31.) Moreover, "Staff is not in agreement with the BCP's proposal either as [Staff] has performed his own life analysis, considered all the available information and supports the Company proposal." (*Id.*)

233. SWG states that typically, the OLT demonstrates a more complete curve, and states that "[t]he Company and Staff agree on the life proposal for Southern Nevada Account 385, and that "[b]oth parties conducted independent analyses and used supplemental information provided by Company personnel." (*Id.* at 32.) SWG notes that "[t]he Company proposed life is only one year longer than existing but is a good fit to the upper and middle portion of the OLT curve. (*Id.*) BCP, on the other hand, "limits his analysis to a best mathematical fit and resulting SSD without considering any other information." (*Id.*) Therefore, the Commission should reject BCP's proposal and approve moving to SWG's proposed 34 R4. (*Id.*)

Commission Discussion and Findings

234. The Commission agrees with BCP's recommendation to lower the accrual rate from 3.06% to 2.31% based on remaining life of 26.7 (R3-39 ASL). The R3-39 curve and longer life are a better mathematical fit to the OLT for account 385 Industrial M&R Station. The Commission accepts SWG's request to increase the negative net salvage rate to -2%.

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D. Acccount 376 – Distribution Mains (NND)

SWG's Position

235. SWG requests an increase in depreciation expense accrual rate to from 2.09 percent to 2.12 percent based on remaining life of 39.87 (L2-54 ASL) and an increase in the net negative salvage rate from -10 percent to -20%. SWG states that the net salvage rate change is due to increasing costs of removal. (Ex. 4 at 97, 110.) SWG also states that this results in annual expense increase request of $37,078. (Ex. 4 at 117.)

BCP's Position

236. BCP states that SWG is "proposing a 100% increase (or double) the currently-approved net salvage rate of -10%," for this account, and that "[a]n examination of the historical data for this account shows that an average net salvage result of the 10-year moving average is only 12.4%." (Ex. 27 at 25-26.) In addition, "the same results produced from the four, five, six, seven, eight, and nine-year moving averages do not rise above -15%." (*Id.* at 26.)

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237. BCP states that SWG's claim that "the overall (as opposed to average) 10-year moving average is -26%," is incorrect because "a closer examination of the net salvage data shows that this result is heavily skewed by an extremely large net salvage rate of -683% in 2016." (*Id.*)

238. In addition, BCP states that "when looking at the actual dollar amount that contributed to this extremely large net salvage rate, the data shows that this net salvage rate is associated with only $15,228 of retirements, and that "[b]y comparison, in 2005 there was a much larger level of retirements ($776,713) and a much smaller (and in fact positive) net salvage rate of 0.18%." (*Id.*) Therefore, BCP recommends applying a net salvage rate of -15% to calculate the depreciation rate for this account. (*Id.*) Further, BCP states that this

recommendation is reasonable, "[g]iven the fact that only 3 of the last 24 10-year moving averages exceeded -15%. (*Id.*)

Staff's Position

239. Staff states that Distribution Mains account for NND is "the fourth largest account for SWG with over $123 million, or six percent, of all the assets of the Company," and that "[t]his account includes the cost of pipes that are used in the distribution of natural gas throughout the Company's service territory," and that these mains carry natural gas from the transmission system through to the customer's service line. (Ex. 25 at 6.)

240. For Northern Nevada, Account 376 Distribution Mains, Staff recommends that the Commission use a 55-L2 Average Service Life ("ASL") and life table and use a negative 15 percent net salvage rate. (*Id.* at 2.) Staff states that the ASL should be longer than 54 years because the actuarial life analysis provided in the Depreciation Study shows a range of 57 to 196 years with most observation bands fitting best within the 57 to 63-year range. (*Id.* at 8.)

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241. Staff states that further examination of the statistical output indicated that longer ranged observation bands support the use of a 63-year ASL, accounting for about half of the statistical output for this account. While Staff states that an increase is warranted, there are two primary reasons that Staff is only recommending a 55-year ASL and does not support moving as far as a 63-year ASL for this account. (*Id.* at 9.) "First, Staff believes it is reasonable to use the same ASLs for Account 376 Distribution Main and Account 380 Distribution Services, given that the Company's operational practices for the replacement and installation of material within these accounts in Northern Nevada are very similar. Second, Staff typically recommends ASL changes in five-year increments." (*Id.*)

242. Staff states that "[s]hould the statistical result in future depreciation studies support further increases in the ASL, Staff would support additional changes to the ASL for this account." (*Id.*)

243. Staff states that the current approved net salvage rate is negative 10 percent and that SWG is recommending an increase to negative 20 percent based upon decreasing salvage values and increasing removal costs for this account." (*Id.* at 17.)

244. Staff' states that its analysis of the proposed net salvage gave less weight to edge-year data and excluded outlier data. (*Id.* at 17.) Staff also states that "[t]his approach is reasonable as it eliminates data from years that may still have unfinished retirement activity, as well as excludes years where large fluctuations of annual net salvage data have skewed results and may in fact be corrected in later years. (*Id.* at 18.)

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245. Staff therefore supports "increasing current the net salvage to negative 15 percent for both divisions, which is a reasonable mid-point to what SWG is proposing to move to, that being a negative 20 percent." (*Id.*)

SWG's Rebuttal Position

246. SWG does not agree with Staff's recommendation. SWG states that "[w]hile one year may seem an insignificant difference, consider that out of the numerous (52 total) visual curve fits [SWG] performed across various bands, only 4 out of the total 52 fits had a life as long as 55 years and none with the agreed L2 dispersion pattern." (Ex. 28 at 7-8.) (*Id.*)

247. SWG concludes that, "[w]hile the 55 L2 is not an unreasonable fit, the 54 L2 is the better fit," and that the Commission should Commission should adopt SWG's recommended and better supported 54 L2 for this account." (*Id.* at 9.)

248. With respect to the net salvage rate for this account, SWG states that "[a]ll parties agree Company specific experience is moving more negative," however, Staff and BCP both propose a -15% compared to [SWG's]-20%," net salvage. (*Id.* at 41.) SWG notes that the existing net salvage is -10%. (*Id.*)

249. SWG states that "[b]oth Staff and BCP are reluctant to endorse doubling the net salvage value in a single study." (*Id.*) Staff uses the same rationale for NND as it did in the SND 367 and 376 Mains, and BCP "claims that only 3 of the last 24 10-year moving averages exceeded -15%. (*Id.* at 42.)

250. SWG does not agree with Staff's recommendation because it "gave less weight to edge year data but the fact is the 2017-2015 10-year moving averages are all more negative than [SWG's] -20% recommendation." (*Id.*)

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251. SWG states that it provides a table showing "the last five years with the 2, 4, 6, 8 and 10-year averages," that "illustrates that even when you give less weight to 2016, as a potential 'edge-year,' the 10-year moving averages for 2015 is a -25%, which is more negative than the -20% [SWG] [is] proposing." (*Id.*)

252. In addition, SWG states that "[i]n 2015, the 4, 6, and 8-year moving averages are all more negative than my proposal for this account and more negative than the value Staff is proposing." (*Id.*)

253. SWG states that "[a]ll parties agree net salvage is more negative and needs to be set at a new level," and that while "[t]he Company proposes a -20% ," "Staff and BCP have moved more negative but propose a -15%," net salvage. SWG states that "…a -20% is the more reasonable and supportable position being experienced by the Company." (*Id.*)

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254. SWG also states that "[t]he costs being incurred to safely retire assets is increasing and is not in dispute by any party," and that "[t]his Commission should therefore approve [SWG's] proposed -20% net salvage as a step toward the indications and actual Company experience." (*Id.*)

Commission Discussion and Findings

255. The Commission accepts Staff's recommendation to lower the accrual rate from 2.09 percent to 1.94 percent based on remaining life of 41.00 (L2-55 ASL). The Commission finds that employing an L2-55 life table will result in a match account 380 Services. With respect to the net salvage rate, the Commission agrees with Staff's recommendation to increase negative net salvage to negative 15 percent. The Commission finds that Staff's analysis regarding outlier data skewing SWG's net salvage data is reasonable, and that SWG failed to support its recommendation to double the net negative salvage rate at this time. The Commission also finds that all parties agree with an increase in the negative net salvage rate.

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E. Account 378 – Maintenance and Repair Station Equipment (NND)

SWG's Position

256. SWG requests an increase in its depreciation expense accrual rate to from 2.91% to 3.04% based on remaining life of 25.68 (R2-35 ASL). (Ex. 4 at 98.) SWG states that this results in annual expense increase request of $6,349. (Ex. 4 at 117.)

BCP's Position

257. BCP provides a table to show that the OLT curve from this account "is relatively well suited for standard Iowa curve fitting techniques in that its pattern is relatively smooth and there is a sufficient amount of retirement history." (Ex. 27 at 15.)

258. BCP states that "the R0.5-42 curve [it] selected results in a more reasonable service life and depreciation rate estimate for this account," than the Iowa curve selected by SWG because the R2-35 curve "is too steep in the middle portion of the curve and is ultimately too short to accurately describe the historical retirement characteristics in this account." (*Id.* at 16.) BCP also states that "the selected Iowa curve should first provide an accurate representation or "fit" to the historical retirement pattern," to provide an accurate estimate of future retirement patterns. (*Id.*) In addition, BCP states that the Iowa curve it selected is also a better mathematical fit to the OLT. (*Id.*) BCP therefore recommends a remaining life of 35.20 years. (*Id.* at 14.)

Staff's Position

259. Staff does not propose a change to SWG calculation for Distribution account 378-M&R Station Equipment (Ex. 25, Attachment POL 2 at 6.)

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SWG's Rebuttal Position

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260. SWG states that BCP performed its "analysis on only one band (placement band 1964-2017 and experience band 1972-2017)," and disregarded information obtained by interviews with the Company subject matter experts ("SMEs"). (Ex. 28 at 9.) SWG states that it "performed 62 different visual curve fits for this account using five different placement bands and four different experience bands in various combinations, not just one fit that was representative of a calculated mathematical best fit," and that in its fits, "only 1 of the 62 visual fits had an ASL equal to [BCP's] 42-year life and was with a different dispersion pattern." (*Id.* at 10.)

261. SWG states that the information provided by the Company SMEs is critical to understanding why [SWG] chose to retain the existing 35 R2." (*Id.*) Specifically, the Company "indicated there is a program to replace a number of regulator stations due to obsolescence," and

that the "Company also noted there has been a focus to bring stations up to current standards." (*Id.*) SWG states that this is meaningful information because the analysis across the bands indicated a decrease in life when compared to the existing life. (*Id.*)

262. SWG also states that "[b]y opting not to run multiple bands, [BCP] failed to recognize the trend in recent years toward a shorter life." SWG states that the "Company information is a key data point that explains the lower life indications," and that SWG's "recommendation to hold the life at the approved level takes into consideration the program's tendency to depress the life. (*Id.* at 11-12.) SWG also stares that nothing in the analysis would suggest a longer life as proposed by BCP. In addition, SWG states that "this information explains and fully supports [SWG's] proposal not to lower the life, but retain the existing 35 R2, despite the fact it may not be the best fit as [BCP] claims. (*Id.* at 12.)

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263. SWG states that BCP relies solely on the results of the mathematical fitting and fails to take into account other information, and that "[a]uthoritative guidance cautions depreciation analysts against such an approach." (*Id.* at 13.)

264. SWG further states that "35 R2 reflects a balance of Company specific historical data analysis and information provided by Company personnel," and that SWG has "provided authoritative depreciation citations that support this approach in formulating life proposals." (*Id.* at 15.)

265. Finally, SWG states that Staff agrees with the Company's proposed parameter for this account, and that performed the same actuarial analysis and evaluated information from Company personnel in arriving at its agreement on this account. Staff concludes that "[f]or all of these reasons, this Commission should reject [BCP's] proposal in favor of [SWG's] proposal to retain the existing 35 R2 for Northern Nevada Account 378. (*Id.*)

Commission Discussion and Findings

266. The Commission accepts BCP's recommendation to increase the remaining life to 42 years versus retaining the 35-year life as proposed by SWG. The Commission finds that the R0.5-42 curve and longer life are a better mathematical fit to the account. The Commission notes that while the M&R station replacement and rebuilds program is nearly complete and SWG expects life to increase, SWG itself recommends retaining the 35-year life at this time. (*See supra* para. 261.)

F. Account 380 – Services (NND)

SWG's Position

267. SWG requests to lower the depreciation expense accrual rate to from 2.72% to 2.11% based on remaining life of 27.86 (L2.5-45) and reduce the net negative salvage rate from -35% to -25%. (Ex. 4 at 99, 111.) SWG states that this results in annual expense reduction of ($438,807). (Ex. 4 at 117.)

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BCP's Position

268. BCP states that SWG selected the L2.5-45 curve for this account, and BCP selected the L1.5-53 curve. BCP notes that both Iowa curves fall within the range of reasonableness for this account, however, the L1.5-53 curve [BCP] selected "provides a closer fit to the observed data, particular for relevant age intervals from years 43-52, as well as earlier age intervals," and provides a better mathematical fit." (Ex. 27 at 17-19.)

Staff's Position

269. Staff states that "[t]he Distribution Services account for the NND is the sixth largest account for SWG with nearly $72 million or 3.49% of all assets of the Company," and that "[t]he account includes the cost of the small pipes (typically 1/2-inch to 1-inch)

used to provide service to a customer, and it is comprised of the pipes that connect the distribution main to the customer's meter." (Ex. 25 at 10.) Staff also states that the current life for this account is 43 years with an L2.5 dispersion. (*Id.*)

270. Staff states that it agrees with SWG that there should be a longer service life for this account, but based on Staff's review of the data, a much longer ASL is more appropriate than the 45 years proposed by SWG. (*Id.* at 10.)

271. In Staff's evaluation of Northern Nevada Account 380, Staff found that "the Company's statistical and graphical outputs derived from the OLT of the account provided support for longer lives." (*Id.*) Additionally, Staff states that the physical characteristics of the pipe included in this account further support an increase to the ASL. (*Id.*)

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272. Staff states that the statistical analyses for this account as set forth in SWG's Depreciation Study shows a range of 48 to 258 years with most observation bands fit best within a 56-year ASL, and that a closer look at the shrinking band least squares function supports the use of a 56-year ASL over most other observations. (*Id.* at 11.)

273. Staff also states that "the material used in the replacement/installation program for the Northern Nevada Account 380 Distribution Services is akin to the same material used in the replacement/installation program for the Northern Nevada Account 376 Distribution Mains, with pipe diameter size being the only major difference. As such, it would be reasonable to assume that the ASL for each of those accounts would be similar or the same. As noted above, since Staff proposes to increase the ASL for Northern Nevada Account 376 Distribution Mains to 55 years, it further supports Staff's recommendation to use a 55-year ASL for this services account as well. (*Id.*)

274. Given the above and that Staff typically recommends ASL increases/decreases in five-year increments, Staff recommends that the ASL be increased to 55 years. (*Id.*)

275. Staff recommends that the Commission reject SWG's proposed 45-year average service life ("ASL") for Account for Account 380 in its NND and instead adopt its own proposed ASL of 55 years. (Ex. 24 at 6.) Staff states that the account's current ASL for its NND is set at 43 years and that SWG proposes maintaining its 50-year approved ASL for the account in its SND. (*Id.* at 2.) Staff notes that Account 380 accounts for approximately 30 percent of the total distribution plant investment in its NND and 27 percent of the total distribution plant investment in its SND. (*Id.*)

276. Staff states that SWG' SND has a heat degradation issue in its M7000/8000 PE pipelines but has not seen any evidence of such degradation in its NND. (*Id.* at 6.) Staff further states that although SWG's NND's service pipeline leak rate is 4 to 5 times lower than that of its SND, it still requests an ASL for its NND that is five years shorter than its SND. (*Id.*) Staff provides that it is not aware of any information that supports SWG's position that service pipelines in its NND will have a significantly shorter ASL than the pipelines in its SND, and that operational and engineering information actually supports SWG's NND pipelines having longer ASLs. (*Id.* at 5.) Staff further provides that if the 45-year ASL was approved, the Commission would face a significant theoretical reserve imbalance in future depreciation filings. (*Id.* at 6.)

SWG's Rebuttal Position

277. With respect to BCP's claims that a 53 L1 5 provides a closer fit to the OLT in the relevant age intervals at the earlier ages and from years 43-52 and that BCP's proposal has a better mathematical fit, SWG states that BCP makes its one fit (best mathematical fit) "to a single band and relies on the best statistical result (the SSD) to the OLT," and ignores any

information from Company personnel and the supporting information provided in SWG's workpapers. (Ex. 28 at 16.) SWG states that BCP's "recommendation increases the existing life by 10 years, which is a 23% increase in the life of this account." (*Id.*)

278. SWG states that because BCP "does not follow accepted depreciation guidance as it pertains to performing multiple band analysis, obtaining and considering Company information, while placing too much reliance on mathematical fitting," the Commission should reject BCP's life proposal for this account. (*Id.* at 17.)

279. With respect to Staff proposal to move the life of Services longer to match the life of Account 376 Mains and to be more consistent with the life of Southern Nevada, SWG states that Staff "provides testimony that supports the concept that the life of Services in Southern Nevada is being impacted by several issues," which "supports that the life should be lowered in Southern Nevada and the life of Services in Northern Nevada should remain at SWG's proposal. (*Id.* at 18.)

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280. SWG states that Staff's "support for the lower life of Southern Nevada Distribution Account 380 is based on heat degradation, leak data, and known issues with the M7000/8000 PE pipe," and that while SWG does not disagree with Staff's findings, if properly taken into account, the life of the Southern Nevada Services should be decreased rather than increasing the life of Northern Nevada Account 380 Services. (*Id.*)

281. SWG states that it did not lower the life of Services in Southern Nevada in the study because at the time, "Company operations personnel indicated these issues existed for Southern Nevada, but there was not a Commission-approved program in place yet and the timing for the program was unclear." (*Id.*) SWG states that, instead, it held the life of Services in Southern Nevada at the approved level until the extent and effect of program was known

contemplated program will have the effect of lowering the life of Southern Services — not increasing the life of Services in the North." (*Id.* at 18-19.)

282. In addition, SWG states that it disagrees with Staff's "perceived desire to match the life with that of Distribution Account 376 Mains." (*Id.* at 19.) SWG states that "the Company and the industry as a whole believe that Services have more factors affecting their retirement than do Mains," and therefore does "not agree that lives for Mains and Services should be the same." (*Id.*) Instead, SWG states that Service lives are slightly shorter (from 5-10 years) than Mains given the additional forces acting to cause the retirement of Services." (*Id.*)

283. SWG concludes that "[w]hen visually comparing all the proposals, in the full band, against the Company's recommendation, it is clear that the Company's selection is a closer match to the actual history of the account." (*Id.* at 21.) Moreover, "[t]he proposals advanced by BCP and Staff do match better toward the end (tail) of the OLT curve, but those points are not as meaningful for determining the life," and "[t]he reason for discounting this part of the OLT curve in this account is that there are limited retirements, only four (4) totaling $408, occurring between the ages of 55-100 years." (*Id.*)

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284. In summary, SWG states that it has "combined a rigorous analysis with consideration of all of the factors related to these assets in making a sound, rational and reasonable life recommendations for this account and it should be approved by this Commission." (*Id.* at 22.)

Commission Discussion and Findings

285. The Commission accepts Staff's recommendation to lower the accrual rate from 2.72 percent to 1.59 percent based on remaining life of 37.04 (L2.5-55)***, which reflects Staff's proposed 55-year ASL for this account and SWG's proposal to reduce the negative net salvage***

on this account from -35 percent to -25 percent. The Commission finds that the NND Services should not have an ASL 5 years shorter than the SND and five years shorter than the NND Distribution Mains because, as Staff points out, operational and engineering information support longer ASLs for SWG's NND pipelines than for its SND pipelines, and the material used for NND Services is similar to the material used in the replacement/installation program for the NND Distribution Mains for which Staff has recommended a 55-year life.

G. Account 381 – Meters (NND)

SWG's Position

286. SWG requests an increase in the depreciation expense accrual rate from 2.91% to 3.04% based on remaining life of 20.42 (L1.5-29). (Ex. 4 at 101.) SWG states that this results in annual expense increase request of $309,374. (Ex. 4 at 117.)

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BCP's Position

287. With respect to the NND, BCP states that SWG " (*Id.*) BCP states that "the Iowa curve selected by [SWG] appears to disregard significant and relevant portions of the OLT curve for this account, particularly between age intervals 30-50.," and that "[t]his results in a smaller area under [SWG's] Iowa curve than is otherwise indicated by the OLT curve." (*Id.* at 20.) BCP states that the "smaller area under Mr. Watson's curve results in a shorter average life and a higher proposed depreciation rate for this account. (*Id.*)

Staff's Position

288. Staff states that "Northern and Southern Nevada Account 381 Distribution Meters account for a combined $213 million or 10.3% of the Company's total assets," and that "this account includes the cost of meters used in measuring the gas sold to customers." (Ex. 25 at 12-13.) Staff also states that [t]he current, approved Iowa curve for the Northern Nevada account is

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a 34-L1.5 with SWG proposing to decrease the ASL to 29 years using an L1.5 life table, and that "[t]he current, approved Iowa curve for the Southern Nevada account is a 33-S1 with SWG proposing to change it to be consistent with Northern Nevada to 29-L1.5." (*Id.* at 13.)

289. Staff states that "[g]iven the anomalies with various families of meters within this category for both Northern and Southern Nevada, Staff recommends approving the 29-L1.5 for both Northern and Southern Nevada as proposed by SWG," even though the Northern Nevada account shows better fits with a 36-year ASL. (*Id.*)

290. Staff notes, however, that the ASL in Account 381 Distribution Meters may need to decrease further in the Company's subsequent depreciation study. (*Id.*)

SWG's Rebuttal Position

291. SWG states for this account, Staff and SWG are in agreement with the 29 L1 5. (Ex. 28 at 22.) However, BPC proposes a 36 RO 5, where the current life is 34 LI 5. (*Id.*) SWG states that consistent with the other accounts on which BCP and SWG disagree, BCP makes its "one fit (best mathematical fit) to one band and then relies on the best statistical result (the least SSD) to the OLT," and "again ignores any information from Company personnel or supporting information [SWG] provided in [its] study workpapers." (*Id.*) Finally, SWG states that BCP's "recommendation to increase the life of meters beyond its existing life is not reasonable based upon the known issues affecting the life." (*Id.* at 23.)

292. SWG states that "it typically would see around 1,000 replacements but saw 8,000 last year and 5,000 the year before," and that "[t]here has also been a change in the handling of meters when it is returned to the manufacturer." (*Id.* at 23-24.) "The higher level of failures and the change in handling returned meters both have the effect of lowering the life of meters, not increasing the life as suggested by BCP." (*Id.* at 24.)

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293. SWG states its 29 L1 5 is a superior fit to the entire OLT when compared to that of BCP. (*Id.* at 26.)

294. SWG concludes that "[t]he Commission should therefore reject BCP's proposal as it is not considering the changing technology, does not reflect recent specific experience of Southwest Gas, and ignores pertinent information provided by Company SMEs on existing issues and the handling of meters." (*Id.* at 25.)

Commission Discussion and Findings

295. SWG itself notes that the fuller bands indicate a life in the 30s. BCP's actuarial analysis supports a 36-year life. Staff is not recommending a change to SWG calculation, but notes meter account shows better fit with a 36 year life. Therefore, based on Staff's and BCP's testimony, the Commission rejects SWG's proposal of a 29-year ASL and retains the current ~~33-year~~ ***34-year*** ASL for this account.

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H. System Allocable – Account 390.10 – Structures Owned (NND and System Allocable Division)

SWG's Position

296. SWG requests an increase in the depreciation expense accrual rate from 2.30% to 2.41% based on remaining life of 34.46 (R3-45) and an increase in the negative net salvage rate from 0% to negative -5%. (Ex. 4 at 161.) SWG states that this results in annual expense increase request of $39,425. (*Id.* at 166.)

BCP's Position

297. BCP does not propose a change to SWG calculation for System Allocable account 390.10 – Structures Owned. (Ex. 27, Attachment DJG 3 at 1.)

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Staff's Position

298. Staff states that "[f]or the NND, this account includes the cost of general structures and improvements used for utility service," and that "[f]or the System Allocable Division, this account contains property that support the operations of SWG's corporate operations, which includes support for both the NND and SND." (Ex. 25 at 18.) In addition, Staff states that "[t]hese accounts are mainly comprised of office and operations buildings, such as the SWG corporate office located on Spring Mountain Road in Las Vegas, and the new 5 million Elko operations center that was just closed to plant as part of the certification filing in this Docket." (*Id.*)

299. Staff also states that "Account 390.10 Structures-Owned for the NND and System Allocable Division are both currently set to 0 percent net salvage, and that "SWG proposes to move the net salvage for the NND and System Allocable Division to negative 5 percent." (*Id.* at 18-19.)

300. Staff states that "the Company has not produced any evidence that shows assets in this account losing value over time, whether in SND, NND or the System Allocable Division. (*Id.* at 18.) Staff also states that "SWG just placed into service, during the certification period, a new $5 million operations center in Elko, Nevada," and that "[i]t would be inappropriate to begin charging ratepayers negative 5 percent on the value of a brand new building before SWG has even moved into the facility and begun using it." (*Id.* at 20.) Staff therefore recommends retaining the existing approved zero percent net salvage rate for the structures accounts across all divisions. (*Id.*)

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SWG's Rebuttal Position

301. SWG states that "[t]he Company and BCP agree on a -5% net salvage," but "Staff is proposing to retain a 0% net salvage." (Ex. 28 at 44.) SWG states that Staff "has not taken into account that there are assets included within this account such as roofs, HVAC equipment, roads, fences and other assets that will wear out and be retired," and that "[t]hese items do and will incur more cost of removal at retirement than salvage." (*Id.* at 44.)

302. Moreover, SWG states that "the concept of depreciation is to allocate the costs ratably over the entire service life, negating the argument that the buildings are new," and that both Northern Nevada and System Allocable Plant have already incurred some level of negative net salvage." (*Id.*)

303. SWG states that the primary difference between the SND Account 390.10 and the other 390.10 Accounts is that SND "had a 10-year moving average of -1 32% in 2017, which is unlike the other two jurisdictions." (*Id.*) SWG also states that Staff "is correct in that the assets and functions of the account are similar and ultimately should be the same," and that if consistency is desired, recognizing that the cost to retire assets will exceed salvage in the future is reasonable, and the proposed -5% net salvage for Northern Nevada and System Allocable Plant could be applied to Southern Nevada." (*Id.*)

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Commission Discussion and Findings

304. The Commission accepts Staff's recommendation to lower the accrual rate from 2.30 percent to 2.25 percent based on remaining life of 34.80 (R3-45) and to ~~set~~ ***retain*** a net salvage rate of 0 percent ***for System Allocable Plant. The Commission also accepts Staff's recommendation to retain a net salvage rate of 0 percent for SWG's NND plant.*** The Commission rejects SWG proposal of negative five percent net salvage for NND, as the

operations centers in both the SND and NND are relatively new and SWG has not produced evidence supporting a negative five percent net salvage for NND buildings versus zero percent for SND.

VII. REVENUE REQUIREMENT

A. Regulatory Liability Account for Tax Rate Reduction

Establishment of Regulatory Liability Account for reduction in tax rates

BCP's Position

305. BCP recommends that the Commission "order a regulatory liability to record the excess federal income tax amounts collected by Southwest Gas from Nevada consumers during calendar year 2018 as a result of the January 1, 2018 effective date of the TCJA, which in plain language reduced the federal income tax burden for large corporations such as Southwest Gas from capturing the vast majority of income at a 35% tax rate to the now enacted flat tax rate of 21%." (Ex. 53 at 2.) In addition, "BCP recommends that the Commission direct Southwest Gas to begin amortization of the regulatory liability for 2018 current income tax to ratepayers benefit over a three (3) year period beginning January 1, 2019 and to be reflected in the gas utility rates arising from this instant docket." (*Id.* at 3.) BCP states that, "[g]enerally, when an unusual event occurs during the test year, its unusual level of costs, or in this case, savings, can be captured and passed on to ratepayers without triggering retroactive ratemaking problems." (*Id.*) Therefore, because the TCJA was passed in December, during the test year, and became effective in January, during the certification period, its impacts can be captured and amortized into future rates without any retroactive rulemaking issues. (*Id.*)

306. In the alternative, if the Commission is concerned about going beyond the end of the certification period, BCP recommends that the Commission "cut-off the accrual of the

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liability at July 31, 2018, the end of the certification period, rather than January 1, 2019, the beginning of the rate-effective period in this case." (*Id.* at 32.)

Staff's Position

307. Staff does not address this issue.

SWG's Rebuttal Position

308. SWG states that BCP's proposed adjustment to 2018 income taxes collected through rates constitutes retroactive and single-issue ratemaking. (Ex. 81 at 38.) SWG states that in Docket No. 18-02018, the Commission's Investigation into the TCJA, Staff filed comments stating that "single-issue ratemaking is generally disfavored and may be prohibited because doing so runs the risk of understating or overstating the cost of service; this may, in turn, allow the company to raise or decrease rates to cover the change in one component without consideration for counterbalancing costs/savings from a different component, and thereby result in unjust and unreasonable rates." (*Id.*) SWG also provides that retroactive ratemaking is unlawful.[34] (*Id.*)

309. SWG states that it disagrees with BCP's recommendation to establish a regulatory liability of $8.4 million and amortize the balance over three years because the federal income rate tax was reduced to 21 percent on January 1, 2018. (*Id.* at 39.) SWG provides that its filing used the 21-percent rate in calculating its cost of service for the test period and, as a result, the effects of the TCJA are accounted for in the current revenue requirement calculation for rates effective January 1, 2019. (*Id.*) SWG contends that it did not over-collect in 2018 because it charged its customers according to its authorized rate of return at the time. (*Id.*) SWG notes that many other expenses were different in 2018 than other time periods since its last GRC, and

[34] *See Southwest Gas Corp. v. Public Serv. Com'n*, 86 Nev. 662, 474 P.2d 379, 380 (1970).

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selecting only the 2018 tax expense to adjust the rates would be single-issue ratemaking. (*Id.*) SWG further contends that a regulatory liability going back to January 1, 2018, would be retroactive ratemaking. (*Id.*)

310. SWG states that its rate base should not be reduced for a proposed regulatory liability related to its 2018 tax rates. (*Id.*) SWG provides that, even if the Commission were to establish such a mechanism, it would not be a reduction in rate base; rather, it would be a 2018 operating expense. (*Id.* at 39-40.) SWG further provides that the Commission's investigation into the TCJA found that any changes to the cost of service to address the TCJA should be done on a prospective basis (e.g. a GRC) and not retrospectively. (*Id.*)

Commission Discussion and Findings

311. The issue before the Commission is whether a regulatory liability should be established by SWG to include the TCJA tax savings from 2018 as a result of the reduction in corporate federal income tax from 35 percent to 21 percent, effective January 1, 2018, as proposed by BCP. The Commission notes that all aspects of cost of service for a regulated utility in Nevada are subject to change between the effective date of rates established in the most recent GRC and the effective date of rates established in the next GRC. Under a historical test year approach, as in Nevada, the utility is generally at risk for all changes in the cost of service that occur in between GRCs. Cost of service changes between GRCs can reduce or increase the utility's earnings.

312. The Commission finds that SWG's savings since the effective date of the TCJA of January 1, 2018, do not rise to a material circumstance justifying special regulatory treatment in the instant proceeding. The Commission further finds that the benefit to ratepayers from the

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TCJA will be reflected in rates on a going-forward basis once new rates from this proceeding take effect. Accordingly, the Commission denies BCP's recommendation.

B. EDIT

Amortization of Unprotected EDIT resulting from the TCJA

SWG's Position

313. SWG proposes to amortize the non-plant related excess deferred taxes resulting from the TCJA over a five-year period. (Ex. 38 at 5.)

BCP's Position

314. BCP "recommends that the unprotected excess ADIT balance be amortized over three (3) years or one rate-cycle," and that the amortization period of the unprotected ADIT is a Commission decision in accordance with NAC 704.6526(4) and (5)." (Ex. 53 at 4.)

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Staff's Position

315. Staff recommends a reduction "in income tax expense by $64,191 for the SND and increase income tax expense by $17,121 for the NND, in order to reflect a six-year amortization period," for non-plant excess or deficient accumulated deferred income tax. (Ex. 56 at 2.) Staff states that "[t]he six- year period is consistent with the six-year rate case cycle used by Staff in calculating other regulatory amortization expenses." (Ex. 54 at 4.) Staff also states "SWG's proposal to begin amortization on January 1, 2019, is reasonable." (Ex 56. at 8.)

SWG's Rebuttal Position

316. SWG recommends that all amortizations of regulatory assets and liabilities be amortized consistently (Ex. 81 at 41.) SWG provides that five years represents the most appropriate estimate of SWG's rate cycle. (*Id.*) SWG notes that it does not entirely agree with Staff's rationale for recommending a six-year rate cycle; however, SWG states that selecting an

appropriate period based on an estimated cycle requires a balancing of many considerations. (*Id.* at 45.) SWG provides that with respect to any regulatory liabilities, such as non-plant EDIT in its SND, SWG "would over-return the value of the regulatory liability if it stayed out beyond the stated estimated rate case cycle." (*Id.*)

317. SWG contends that the three-year period proposed by BCP would exacerbate over-recovery of regulatory assets and over-returns on regulatory liabilities. (*Id.* at 45.)

Commission Discussion and Findings

318. The Commission finds that the amortization period for unprotected excess ADIT should approximate SWG's historic rate cycle in order to avoid any material over-refunding of regulatory liabilities. The Commission further finds that Staff's proposed six-year rate reflects the most recent GRC cycle and a therefore, a six-year amortization period should be used. Accordingly, the Commission rejects BCP's recommendation to amortize the unprotected excess ADIT balance over its proposed three-year rate cycle.

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Protected EDIT Amortization Tracker

BCP's Position

319. BCP recommends including "the amortization of the protected excess ADIT balance to consumers' benefit as a reduction to cost of service beginning with the rates effective January 1, 2019 at the completion of this instant docket." (Ex. 53 at 3.)

320. BCP states that "a tracker mechanism should be set up to track any over or under recoveries of these costs between rate cases," as this "will ensure that ratepayers will be reimbursed in full for the over-paid taxes related to these depreciable assets." (Ex. 59 at 24.)

Staff's Position

321. Staff does not address this issue.

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SWG's Rebuttal Position

322. SWG states that it does not oppose evaluating a tracking mechanism to track any over or under recoveries of costs associated with the protected excess accumulated deferred income taxes. However, if the Commission determines that the Commerce Tax should be embedded in general rates, as recommended by BCP, this same reasoning dictates that a tracking mechanism should be authorized for the Commerce Tax. (Ex. 78 at 12.)

Commission Discussion and Findings

323. The Commission rejects the proposed tracking mechanism for the amortization of the EDIT proposed by BCP. The Commission finds that the evidence presented by BCP does not raise a significant concern or demonstrate a need to adopt a tracking mechanism for the approximate 40-year amortization of EDIT under the Average Rate Assumption Method. The Commission notes that this decision is consistent with its recent decisions in Docket No. 18-02010 for Nevada Power Company d/b/a NV Energy ("NPC") and Docket Nos. 18-02011 and 18-02012 for Sierra Pacific Power Company d/b/a NV Energy ("SPPC").

Regulatory Liability Account and Amortization for protected EDIT in 2018

BCP's Position

324. BCP states that "the protected EDIT that could have been amortized in 2018 using the Average Rate Assumption Method should be placed in a regulatory liability account and amortized to ratepayers over a 3-year period," to coincide with SWG's 3-year rate cycle period. (Ex. 59 at 24, 33.)

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325. BCP proposes the following adjustments:

Table 3: 2018 Protected EDIT		
Description	Northern NV	Southern NV
Regulatory Liability	$579,059	$1,640,742
3-Year Amortization	$193,020	$546,914

(*Id.* at 34.)

Staff's Position

326. Staff does not address this issue.

SWG's Rebuttal Position

327. SWG states that it created a regulatory liability on December 31, 2017, for all of its protected EDIT balance and therefore any additional regulatory liability would result in double counting and could result in IRS penalties. (Ex. 78 at 13.)

Commission Discussion and Findings

328. The Commission finds that the amortization for the full amount of the regulatory liability for the protected EDIT shall begin January 1, 2019, using the Average Rate Assumption Method. Any additional amortization adjustment would result in double-counting. BCP's additional hypothetical amortization of protect EDIT for 2018 is therefore denied.

C. Management Incentive Plan ("MIP")

SWG's Position

329. SWG requests recovery through customer rates all of the requested Company costs associated with its MIP. (Ex. 40 at 24.)

330. SWG states that "[t]he MIP is an annual incentive program that provides Executives and other participating employees with an opportunity to receive variable, at-risk pay based upon the achievement of specific benchmarks that are critical to the short-term and long-

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term success of the Company and that reward superior performance for the Company's customers."[35] (*Id.* at 5-6.)

331. SWG explains that for each participating employee, the MIP includes the five performance metrics: Net Income (40% of target MIP weighting)[36], Operation & Maintenance Expense (O&M) per Customer (20% of target MIP weighting); Customer Satisfaction (20% of target MIP weighting); Safety — Damage per 1,000 Tickets (10% of target MIP weighting); and Safety — Incident Response Time within 30 Minutes (10% of target MIP weighting). (*Id.* at 6.)

332. SWG states that "[t]he Company updated the MIP in 2017 to better align the program with peers," and that as part of that update, SWG provided for the payment of any earned MIP awards in the form of cash following the performance year. (*Id.* at 7-8.) In addition, SWG "amended the MIP in 2017 to add the threshold 'gate' requirement of achieving 80% of Company's targeted earnings for the performance year for any payment to be made under the MIP." (*Id.*)

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333. SWG asserts that "[t]he MIP design is consistent with the peer group incentive plans and includes market-competitive terms." (*Id.* at 17.) SWG further asserts that "[t]he MIP's narrower payout range is not a material difference in design relative to the peer group and, to the extent that the maximum potential payout under the MIP is lower relative to target than prevalent

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[35] "[F]or each metric actual performance may vary from 70% to 140% of the target incentive opportunity based on performance relative to the target. No MIP award is paid in any year unless the Company achieves a minimum 80% of the Company's targeted earnings for the performance year." (Ex. 40 at 7.)

[36] "The Net Income metric is calculated on a consolidated basis for the Corporate Strategy Executives; for the remaining Executives, Net Income is calculated with respect to the organization's gas segment by backing out Net Income allocable to Centuri Construction Group. For all participants, the Net Income metric is measured without regard to Company-Owned Life Insurance (COLI) returns." In addition, for each metric actual performance may vary from 70% to 140% of the target incentive opportunity based on performance relative to the target. No MIP award is in any year unless the Company achieves a minimum 80% of the Company's targeted earnings for the performance year. (*Id.*)

practice in the peer group, [it] represents a more conservative design in that potential payouts under the plan are capped at a lower level." (*Id.*)

334. SWG states that, in the instant Docket, it addressed the Commission's adjustment to the MIP in the last general rate case. (*Id.* at 19.) SWG explains "[t]he Commission made two adjustments to the MIP in the Company's last general rate case." (*Id.*) "First, the Commission used a three-year average to determine the MIP award," and "[i]n this docket, consistent with that order, Southwest Gas used a three-year average to calculate the MIP award." (*Id.*) SWG states that "[s]econd, the Commission adjusted the MIP award in the last general rate case to take out the amounts awarded based on the ROE metric," and consistent with that adjustment, SWG "has modified the design of the MIP and removed the ROE metric an implemented," metrics that are designed to incentivize decisions that benefit the customers. (*Id.*)

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BCP's Position

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335. BCP states that in SWG's prior rate case, Docket No. 12-04005, the Commission made two adjustments to the MIP: (1) one adjustment to normalize the test year levels to a 3-year average of targeted levels and (2) an adjustment to remove 25% of the MIP plan to exclude that portion of the plan tied to financial performance measures, in that case ROE. (Ex. 59 at 35.)

336. BCP states that while SWG "makes an adjustment to the short-term incentive plan costs to normalize the test year levels in these plans using a 3-year average percentage award level," the adjustment "does not remove incentives tied to financial performance, such as net income, capital expenditures, or O&M expense goals, all of which could be considered financial performance measures." (*Id.* at 34-35.)

337. BCP states that, when SWG amended the MIP in 2017, SWG added a financial funding mechanism to the MIP, and that "even though the Company's performance measures

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include both financial and non- financial factors, the actual funding of SWG's incentives is tied to the financial performance of the Company." (*Id.* at 36.) BCP further states that "[u]nder the Company's plans, regardless of how well employees may perform in nonfinancial performance measures, such as safety, the awards will only be paid to the extent the Company meets its," Earning Per Share ("EPS") goals. Therefore, BCP concludes that "under the Company's incentive compensation plans, financial measures are the controlling factor in determining to what extent incentive compensation will be paid." (*Id.*)

338. BCP states that "Net Income is, without question, directly related to financial performance," and that "[t]his performance metric is the same type of financial metric the Commission excluded in the last rate case, return on equity, with a slightly different name." (*Id.* at 37.) BCP concludes that "at least 40% of the MIP is directly related to financial performance through the Net Income measure and 100% of the Company's MIP plan is indirectly related to financial performance through the EPS funding mechanism."

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Table 5: MIP Performance Measures

Incentive Plan Performance Measures	Goal %
Net Income	40%
O&M per Customer	20%
Customer Satisfaction	20%
Safety — Damage per 1,000 Tickets	10%
Safety — Incident Response Time	**10%**
EPS Funding Mechanism Trigger (80% of Targeted EPS)	100%

(*Id.*)

339. Based on the above, BCP recommends that "40% of the MIP plan be excluded because it is directly tied to financial performance through the Net Income goal," and further recommends that "50% of the remaining costs of the MIP be excluded because of their indirect tie to financial performance through the EPS funding trigger." (*Id.* at 37-38.) In total, BCP

recommends that "70% of the MIP be excluded from rates, which is the 40% tied to Net Income plus 30%, which is 50% of the remaining 60%. (*Id.*)

340. BCP states that "[w]hen incentive compensation payments are based on financial performance measures," the compensation agreement between shareholders and employees is intended to benefit the shareholders and the employees," and "[r]atepayers have no stake in this agreement; therefore, they should bear none of the costs that result from such an agreement." In contrast, when incentive compensation its ties to customer satisfaction metrics, "then, ratepayers would have a stake in the agreement, and could share in a portion of the costs." (*Id.* at 42.)

341. BCP also states that a clear majority of the 24 Western states included in the Incentive Compensation Survey taken by the Garrett Group in 2007 follow the financial-performance rule, "in which incentive payments associated with financial performance are excluded from rates." (*Id.* at 42-43.)

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342. BCP disagrees with SWG's assertion that the company would run the risk of not being able to retain key personnel if it did not offer an overall compensation package that is comparable to compensation offered by other companies. (*Id.* at 52.) BCP further states that, "when incentive payments are based on financial performance goals, there should be a financial benefit to the company that comes from achieving these goals and this financial benefit should provide ample additional funds from which to make the incentive payments." Therefore, "a utility is not placed at a competitive disadvantage when incentive payments tied to financial performance are not collected through rates." (*Id.* at 52-53.)

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Staff's Position

343. Staff states that "[t]he MIP format has undergone several changes since the 2012 GRC," and that "of the five current MIP metrics, only three metrics were in place in prior years. (Ex. 58 at 10.) Staff also states that those three metrics' targets were tightened for 2017. (*Id.*)

344. Staff states that it has concerns with the thresholds for the customer service and damages per 1,000 tickets metrics." (*Id.* at 11.) Specifically, Staff states that "[i]n regard to the customer service metric, while the 2017 target was increased 2 percentage points and the minimum was increased 5 percentage points to encourage increased customer service efforts, the maximum was decreased by two points to 95 percent, which makes it easier for employees to realize a 140 percent payout in this metric category while achieving less than the maximum required in 2016. No information was provided as to why the threshold maximum was lowered." (*Id.*)

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345. In regard to the damages per 1,000 tickets metric, Staff states that "where a lower ratio means fewer damages and a higher MIP payout, the target is consistently set at what appears to be an easily achievable level," and that "[i]t appears the damages per 1,000 tickets no longer provides an at-risk bonus but instead provides a guaranteed payout at the maximum amount." (*Id.* at 11-12.)

346. Staff is also concerned that not all of the metrics can be directly correlated to benefit customers, and that the MIP performance scores are not specific to the employees who work in and/or provide service to the Nevada operating divisions. (*Id.* at 12.)

347. Staff states that a companywide MIP is potentially problematic because "[s]everal of the MIP metrics are related to customer interactions with local SWG employees." (*Id.* at 13.) For example, "[t]he damages per ticket and the response time metrics are very localized,

meaning that they require an in-person action and are not problems that can be handled remotely over the phone, possibly by an out-of-state SWG employee, or through the SWG website." (*Id.*)

348. Staff also states that "[b]y combining the performance of every operating division Nevada ratepayers are paying for the performance of SWG employees in other operating divisions in other states," and that "due to the proclivity of smaller towns scattered among a larger geographic service territory in the NND as compared to the SND, the MIP metric target of 1.80 is wholly unrealistic for NND employees who are unquestionably depending on the actions of employees in other operating divisions to meet the metric target so that a bonus can be paid." (*Id.* at 14.) Accordingly, Staff recommends removing 100 percent of the revenue requirement allocated to the Nevada ratemaking jurisdictions for the damages per 1,000 tickets metric. (*Id.*)

349. Accordingly, Staff recommends that the Commission: (1) disallow "the revenue requirement allocated to the Nevada ratemaking jurisdictions created by the net income metrics;" and (2) reduce "the revenue requirement allocated to the Nevada ratemaking jurisdictions for the damages per 1,000 tickets metric by 100 percent;" and that "SWG create [an] operating division specific targets for the two safety metrics, the damages per 1,000 tickets and incident response time, in its next MIP." (*Id.* at 17.)

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SWG's Rebuttal Position

350. SWG states that it normalized MIP based on a three-year average of awarded percent of target in Adjustment No. 19 to address payment uncertainty, consistent with the order in the company's last GRC. (Ex. 81 at 28.)

351. SWG further states that it does not benefit from favorable weather due to its margin decoupling mechanism, nor does it benefit from customer growth because there are both costs and revenues associated with growth. (*Id.* at 28-29.) SWG further states that growth and

what the utility is authorized to collect from new customers is regulated from the Commission. (*Id.* at 29.)

352. SWG states that, with respect to BCP's claim that earnings-based plans can discourage compensation, the company states that it has a margin decoupling mechanism "that breaks the link between consumption and margin, leaving the utility no incentive to discourage conservation." (*Id.*) Moreover, SWG provides that it has Conservation and Energy Efficiency Programs. (*Id.*)

353. With respect to BCP's assertion that the utility and its stockholders do not assume any financial risks associated with incentive payments, SWG states that if it retained amounts collected through MIP whenever incentive payments were not reached, it would have a detrimental effect on future requests for recovery of MIP costs due to its basis on a normalization of costs over multiple years. (*Id.*)

354. With regard to BCP's contention that incentive payments based on financial performance should be made out of increased earnings, SWG states that it does not have discretion to raise revenue given that it is rate-regulated. Accordingly, SWG provides that it can only increase earnings by controlling costs between rate cases in a paradigm where if cost control is sustained, customers benefit from lower rates in the company's next GRC. SWG further provides that it cannot sustain higher earnings without cost control. (*Id.*)

355. With respect to BCP's criticism that incentive payments embedded in rates shelter the utility from the risk of earnings erosion through attrition, SWG notes that if the amounts embedded in rates for MIP did not pay out, it would affect future recovery of the cost. (*Id.*) Accordingly, SWG provides that BCP's rationale for disallowing incentive payments based upon financial performance are not applicable or without merit. (*Id.* at 29-30.)

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356. In response to Staff's comments that MIP performance scores are not necessarily specific to the employees who work in and/or provide service in Nevada, SWG states that, while the company's headquarters are in Nevada, the majority of MIP-eligible employees work in every state in its service territories and it is more appropriate to have company-wide measures of MIP. (*Id.* at 31.) SWG provides that the base salaries of most MIP-eligible employees are allocated to each of its ratemaking jurisdictions rather than being tracked individually by each jurisdiction for administrative efficiencies. SWG contends that "MIP costs should be treated in the same fashion." (*Id.*)

357. SWG states that Staff did not calculate its adjustment for MIP Correctly. (*Id.* at 32.) SWG provides that Staff's stated MIP amount of $7,500,000.00 was not what the company requested for recovery in Adjustment No. 19, which was based on three-year normalization assuming a 40 percent payout for the net income metric for an amount of $6,608,299.00, and 40 percent of that amount for the net income metric. (*Id.*)

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358. SWG states that all expenses related to the MIP, Energy Solutions Plan, and Special Incentive Plans are just and reasonable, and SWG should be authorized full recovery of them in rates. (*Id.* at 33.) SWG further states that Staff's division-specific MIP metrics recommendation and related adjustment to remove costs related to safety metrics are inappropriate and should be rejected. (*Id.*)

Commission Discussion and Findings

359. The Commission agrees with Staff's contention that performance metrics applied to Nevada employees should be measured based upon performance in Nevada as opposed to measurement based upon the consolidated performance of SWG's operations in Nevada, Arizona, and California. Accordingly, the Commission adopts Staff's recommended

disallowance for MIP payouts related to damages per 1,000 tickets, which was based upon consolidated operation results instead of Nevada-specific results.

360. With respect to the MIP, the Commission finds that the amount of incentive compensation included for rate recovery in a GRC should be commensurate with the benefits to customers from achievement of the specific performance metrics of the plan. Payouts for performance metrics tied to ROE and Net Income should be assigned to shareholders since they are the beneficiary of the achievement of those metrics. Accordingly, the Commission finds that payments under the MIP that are directly related to an ROE or Net Income metric must be excluded from cost recovery in rates.

D. Restricted Stock Unit Plan ("RSUP")

SWG's Position

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361. SWG states that "[t]he RSUP is a long-term incentive program designed to reward sustained performance over a three-year period with each grant made under the plan." (Ex. 40 at 8.) SWG further states that such grants include Performance Share Units ("PSU") and time-vested Restricted Stock Units. (*Id.*) SWG provides that executives are eligible to receive PSU awards and both executives and Director-level employees are eligible to receive RSUP awards. (*Id.*) SWG requests rate recovery of the costs associated with its RSUP. (Ex. 40 at 24.)

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362. SWG states that the RSUP design has changed since its last general rate case. (*Id.* at 9.) Previously, "the determination of whether to grant an RSUP award each year and the value of RSUP grants was based upon the average MIP payout for the three years immediately preceding the RSUP award determination date," and "[t]he target RSUP award was set at an average MIP payout percentage of 100%, with a threshold award of 50% of target and maximum award of 150% of target, in each case depending on the average MIP payouts for the last three

fiscal years relative to the target payouts under that plan." (*Id.*) In addition, "[n]o RSUP award was granted in a plan year unless the average MIP payout for the prior three years was at or above 90%." (*Id.*) SWG states that, under the current design, the RSUP is not based on the average MIP payout and is better aligned with the Long Term Incentive design of the Company's peers. (*Id.* at 9-10.)

363. SWG concludes that "[t]he RSUP design, like the MIP, is consistent with the peer group incentive plans and include market-competitive terms," and that "[t]he Company's RSUP is in line with prevalent practices among the Company's peer group subject to a few non-material variations." (*Id.* at 20.)

364. SWG states that, in its last general rate case, the Commission disallowed 100 percent of the its RSUP costs for the following reasons: "(i) the duplication of metrics under the MIP and RSUP; (ii) the rise in RSUP expenses; and (iii) the fact that equity awards are intended to align management with shareholders, which is a benefit to shareholders." (*Id.*)

365. SWG states that the RSUP expenses should be recoverable in this Docket because: (i) following SWG's update to the RSUP and MIP metrics, the duplication of metrics concern no longer applies; (ii) SWG's RSUP expenses are in line with the competitive market and any increases in these expenses are consistent with market practice; (iii) the RSUP not only aligns the interest of high level management with that of shareholders, but also aligns participants with and provides a significant benefit to SWG's customers; (iv) disallowing 100% of the Company's RSUP expenses disregards the significant benefits that the Company's overall (including MIP) incentive plan design provides to customers and; (v) SWG should not be penalized for making allocation decisions regarding how to structure its pay program, as long as overall compensation is reasonable, which SWG states it is. (*Id.* at 21-22.)

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BCP's Position

366. BCP states that in SWG's last rate case, Docket No. 12-04005, the Commission excluded 100% of SWG's long-term stock-based incentive. (Ex. 59 at 59.) BCP also states that the results of the Garrett Group Incentive Survey reveal that "20 of the 24 western states tend to exclude all or virtually all long-term stock-based incentive pay, either through an outright ban on stock-based incentives or through applying the financial performance rule, which has the effect of excluding long-term earnings-based and stock-based awards." (*Id.*)

367. BCP argues that because "most states exclude executive incentive pay as a matter of course, SWG would actually be given an unfair advantage if its long- term equity plans were included in rates." (*Id.* at 58.)

368. BCP also states that the Commission should not allow stock-based incentives to be included in rates because, "[t]here is no cash expense associated with stock-based incentive awards, such as restricted stock units," therefore, "if these awards are included in rates, the utility will collect cash from ratepayers to cover a cash expense that does not exist. (*Id.* at 60.) BCP recommends an adjustment that removes the long-term incentive expense in the amount of $1,132,890.00 for SND and $235,828.00 for NND. (*Id.* at 61.)

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Staff's Position

369. Staff states that it "does not find any of the factors for including RSUP costs in customer rates cited by SWG compelling and recommends removing 100 percent of the employee RSUP costs from revenue requirement for several reasons." (Ex. 58 at 21.) First, Staff states that "SWG has not provided information to show that the benefits of the RSUP accrue to the ratepayers rather than the shareholders." (*Id.*) Second, Staff states that "SWG has not provided any evidence that including the RSUP revenue requirement in rates creates executive

employee retention." (*Id.* at 22.) Third, Staff states that "while the Hay Group report shows that SWG's RSUP offering and design is in line with its peers' offering and design, it does not state if any of the peer group company's regulators allow for partial or full RSUP cost recovery in rates. (*Id.*) Fourth, Staff states that the total direct compensation ("TDC") "was changed in 2017 to better align with the TDC offered to SWG's peer group and that these changes also increased the total target TDC payout without providing any additional benefits for ratepayers to account for those additional costs." (*Id.*)

370. Staff states that "because the TDC is more closely aligned with shareholders' interests, Staff does not believe the RSUP costs should be borne by the ratepayers." (*Id.*)

SWG's Rebuttal Position

371. SWG states that the Commission should reject BCP and Staff's recommendations to disallow 100% of the Company's RSUP expenses. (Ex. 75 at 15.) SWG states that "[a]cknowledging that shareholders benefit from management's success under the RSUP (for example if stock price increases both management and shareholders will benefit) does not mean that utility customers do not also benefit from the program," and that "long-term incentive plans serve two functions: incentivizing management (aligning them with the organization's long-term strategic objectives) and retaining management." (*Id.*)

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372. SWG states that "[r]etention is facilitated by the fact that long-term awards are typically granted every year with multi-year vesting terms. In any given year a participant has several outstanding, unvested tranches of the awards, each of which would be forfeited upon a voluntary termination to join a competitor," and that "[r]etaining a stable, high-performing executive team is clearly a benefit to customers and, at a minimum, long-term incentive expenses such as those associated with the RSUP should be shared by customers and shareholders." (*Id.*)

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373. SWG also states that Staff notes that this retention incentive does not depend on whether shareholders or customers incur the associated expense. SWG argues that this is not the relevant issue in determining whether these expenses are recoverable through customer rates. (*Id.* at 15-16.) SWG states that the relevant inquiry "is whether the expenses associated with the program are reasonable and whether the program aligns management's interests with those of the Company's customers," and that each of those criteria are satisfied here. (*Id.* at 16.)

374. SWG states that BCP's assertion that RSUP expenses represent a non-cash expense for the Company that it is seeking to recover through cash, is incorrect. (*Id.*) SWG argues that "[w]hen a company grants equity awards to employees, it must expense those awards under the principles set forth under FASB Accounting Standards Codification Topic 718, Compensation—Stock Compensation," and that "[t]hus, contrary to [BCP]'s assertion, the Company's financial position does change when the parent organization grants equity awards as the Company must recognize an expense associated with those awards over the vesting period of those awards." (*Id.* at 16-17.) SWG concludes that "[i]n seeking to recover the expense associated with those awards the Company is in essence seeking to increase its revenue to offset its associated expense." (*Id.* at 17.)

Commission Discussion and Findings

375. The Commission finds that the inclusion of the cost of the RSUP would not result in just and reasonable rates. In arriving at this conclusion, the Commission considers and balances the interest of ratepayers and shareholders. The Commission notes that the evidence on the record supports a conclusion that the purpose of the RSUP is to align top-level executives with shareholder interests. Both metrics under the plan (three-year Consolidated EPS in Nevada, Arizona, and California and three-year Utility ROE/Net Income) incentivize employees to

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maximize shareholder earnings at the consolidated gas operations level and the Nevada jurisdiction level. As the beneficiaries of achieving such metrics, it is appropriate that shareholders bear the cost for the RSUP.

E. Supplemental Executive Retirement Plan ("SERP") and Executive Deferred Plan ("EDP")

SWG's Position

376. SWG requests recovery through customer rates all of the requested Company costs associated with its executive retirement programs (EDP and SERP), as reasonable business expenses." (Ex. 40 at 24.)

377. SWG states that "[t]he Company maintains a tax-qualified defined contribution (401(k)) plan that is available to all of its employees, the SWG Employees' Investment Plan ("EIP")." (*Id.* at 10.) "The EIP permits participants to contribute between 2 and 60 percent of their base salaries to the plan and receive a corresponding Company matching contribution up to 3 5% of a participant's annual salary." (*Id.*) SWG notes that executives are not eligible to receive Company matching contributions under the EIP. (*Id.*)

378. SWG explains that "[t]he EDP provides salary deferral opportunities for Executives by permitting them to defer annually up to 100% of base salary and non-equity incentive compensation," and that "[t]he EDP is a non-qualified plan under which participating Executives are general unsecured creditors of the Company with respect to benefits payable under the plan." (*Id.* at 10-11.) SWG states that it provides matching contributions under the EDP that parallel the contributions it makes to other participants under the EIP to address the ineligibility of Executives to receive Company matching contributions under the EIP. (*Id.* at 10.)

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379. In addition, SWG states that "base salary deferred under the EDP is not included in the formula used to calculate an Executive's pensionable benefit under the Company's tax-qualified defined benefit retirement plan." (*Id.* at 11.)

380. SWG states that "[t]he Company maintains a tax-qualified defined benefit retirement plan ("Retirement Plan"), which is available to all Company employees and under which benefits are based on an employee's years of service, up to a maximum of 30 years, and the 12-month average of the employee's highest five consecutive years' salaries, excluding bonuses, within the final 10 years of service." (*Id.*) "The SERP is designed to supplement the Retirement Plan for participating Executives by providing an opportunity for Executives to receive a comparable retirement benefit at a level of 50% to 60% of base salary without regard to the Internal Revenue Code ("IRC") limits that apply to the Retirement Plan." (*Id.*)

381. SWG explains that "[t]o qualify for a normal retirement benefit under the SERP, an Executive must have reached age 55 with 20 years of service or age 65 with 10 years of service." (*Id.*)

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382. SWG states that it "maintains the EDP and SERP to attract and retain qualified executives in a competitive marketplace in which the majority of the Company's peer companies offer executive retirement programs," and to "provide participating Executives with an opportunity to receive retirement benefits that are available to other Company employees under the Retirement Plan and EIP that are not otherwise available to the Executives due to applicable IRC limits." (*Id.* at 12.) SWG concludes that, "[t]he SERP and EDP therefore help put Executives on par with other Company employees with respect to the level of benefits they receive at retirement," and that the "SERP and EDP also align the Executives' interests with the long-term interests of the Company as general unsecured creditors of the Company with respect to their benefits under those plans." (*Id.*)

383. SWG states that in evaluating the reasonableness of the compensation levels and the competitiveness of the Company's compensation programs, SWG used several sources, including: a public company peer group, Willis Towers' 2016 CDB Energy Services survey, and Hay Group's 2016 Total Direct Compensation Database. (*Id.* at 13.) In addition, with respect to the EDP design and benefit levels, SWG included the Hay Group's 2014 Executive Benefits Survey and Willis Tower's 2013 Executive Retirement Survey. (*Id.*)

384. The public-company peer group employed in SWG's analysis included the following utility companies: Atmos Energy Corp; Avista Corporation; Black Hills Corp; Great Plains Energy, Inc.; New Jersey Resources Corp; Northwestern Corporation; One Gas, Inc.; Pinnacle West Capital Corp.; PNM Resources Inc.; Portland General Electric Co.; Spire Inc.; Vectren Corp.; and Westar Energy Inc. (*Id.*) SWG states that "[t]he companies within the peer group represent regulated utilities that are of a similar size to the Company in the aggregate and that represent a conservative peer group in that eight of the thirteen peers included in the peer group had lower annual revenue than Southwest Gas in their most recent fiscal year." (*Id.* at 13-14.)

385. SWG further states that "[t]he Company's annual revenue in its most recent fiscal year was at the 63rd percentile of the proxy peer groups' fiscal year-end revenues (i.e., well above median)," which "results in a conservative approach to evaluating the reasonableness and competitiveness of Southwest Gas' executive compensation amounts due to Southwest Gas' positioning above median in revenues within the peer group." (*Id.* at 14.)

386. SWG concludes that "[t]he Company's SERP is in line with competitive practices in terms of benefit levels and design relative to its peer group companies." (*Id.* at 22.) SWG states that, with respect to the EDP, "survey data indicates that a majority of participating companies in each survey provide an employer matching contribution in executive non-qualified deferred

compensation plans, and a majority of those plans permit deferrals of base salary plus annual incentives," which are "consistent with Southwest Gas' EDP. (*Id.* at 23.)

BCP's Position

387. BCP states that SWG included in pro forma operating expense, $41,113 in the revenue requirement for the SND SERP and $10,265 for the NND SERP, and included $579,568 for the SND EDP and $144,712 for the NND EDP. (Ex. 59 at 62.) BCP notes that the total non-qualified retirement plan expenses for SND is $620,681 and $154,977 for NND. BCP recommends that these costs be disallowed. (*Id.* at 63.)

388. BCP states that the costs should be disallowed because, "[w]hen these supplemental costs are excluded from rates this results in a sharing of the overall pension costs: ratepayers pay for all of the benefits included in the regular pension plans, and shareholders pay for the supplemental benefits included in the non-qualifying plan." (*Id.*) BCP also states that "[f]or ratemaking purposes, shareholders should bear the additional costs associated with supplemental benefits to highly compensated employees, since these costs are not necessary for the provision of utility service but are instead discretionary costs of the shareholders designed to attract, retain and reward highly compensated employees." (*Id.*)

389. Moreover, BCP states that "because officers of any corporation have fiduciary duties of loyalty and care to the corporation, these individuals are required to put the interests of the Company first," which "creates a situation where not every cost associated with executive compensation is presumed to be a cost appropriately passed on to ratepayers. (*Id.*) BCP also states that, "[m]any regulators are inclined to exclude management and executive bonuses, incentive compensation and supplemental benefits from utility rates, understanding that these costs would be better borne by the utility shareholders." (*Id.*)

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390. BCP therefore recommends an adjustment to remove both the SERP and the EDP expenses is $620,681 for SND and $154,977 for NND. (*Id.* at 65.)

Staff's Position

391. Staff states that it agrees that the "SERP provides participating executives with a similar retirement opportunity that is available to other SWG employees, but the SERP benefits should match the benefits provided by the otherwise applicable retirement plan to truly provide comparable plans for all employees." (Ex. 58 at 25.) Staff states that it "acknowledges that offering some type of SERP seems to be a standard industry practice, full cost recovery is not," and therefore recommends that the benefits that are eligible for cost recovery be equal to the non-executive employee's benefits by removing the portion related to retirement benefits that exceed the restoration benefit. (*Id.* at 25-26.)

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392. Staff therefore recommends that the SERP expenses for the NND and SND be decreased in the amounts of ~~$57,844~~ ***59,747.00*** and ~~$273,916,~~ ***282,574.00,*** respectively, to remove costs that are in excess of the restoration amount of SERP from the revenue requirements. (Ex. 63 at 11.)

SWG's Rebuttal Position

393. SWG states that the full SERP amount included in its initial filing is appropriate; however, if the Commission determines that an adjustment to the SERP benefits for the non-restorative amount is necessary, then SWG suggests that Staff's calculation should be corrected to reflect a decrease of $274,612 for SND and $58,804 for NND. (Ex. 62 at 3.)

394. SWG states that it agrees with Staff's "recommendation regarding the Company being allowed to recover EDP and SERP restoration benefits through customer rates," disagrees with Staff's recommendation "to disallow SERP expenses beyond the restoration benefits," and

disagrees with BCP's recommendation" regarding the disallowance of all Company expenses associated with these programs." (Ex. 75 at 18.)

395. With respect to BCP's recommendation to disallow 100% of SWG's expenses under the EDP and SERP, SWG states that while BCP cites to a few jurisdictions that have denied recovery of these expenses, it failed to "cite to prior Nevada rulings that permitted the Company to recover a portion of these expense." (Ex. 75 at 17-18.)

396. SWG notes that "SERP benefits are calculated by reference to length of service, which facilitates retention of participating Executives," and that "[r]etention of a high-performing team clearly benefits the Company's customers." (*Id.* at 18.) SWG further notes that "each of these programs are components of the Company's market-competitive compensation and benefit programs and as such help the Company attract and retain top talent by offering these programs, which also benefits the Company's customers," and therefore "recovery of the Company's full SERP and EDP expenses through customer rates is warranted." (*Id.*)

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Commission Discussion and Findings

397. The Commission accepts Staff's recommendation to exclude from cost recovery of all SERP benefits exceeding the restoration benefit. In making this determination, the Commission notes that the IRS limits the annual payout under a tax-qualified defined benefit pension plan to $220,000 per retiree. The normal SWG pension plan benefit allows employees who retire with service up to a maximum of 30 years to receive an annual benefit equal to 50 percent to 60 percent of their base salary up to the $220,000 annual IRS maximum benefit, while higher-paid employees receive a benefit equal to an amount which is less than 50 percent to 60 percent of base salary as a result of the $220,000 IRS maximum benefit under a normal pension plan.

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398. The Commission further notes that the SERP provides an additional retirement to higher-paid retired employees which allows them to receive a retirement benefit equal to the same 50 percent to 60 percent of base salary available to employees under the normal pension plan whose annual benefit does not exceed the IRS maximum of $220,000. This supplemental benefit is referred to as the "restoration benefit."

399. The Commission also notes that if SWG decides that a limited number of its highest-paid employees should receive a maximum retirement benefit, as a percentage of base pay which exceeds the level available to all other employees, shareholders should be assigned the additional cost.

F. Payroll Expense

SWG's Position

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400. SWG states that Schedule No. I-C2, Labor and Benefits "reflects the estimated overall general wage increase of approximately 2.9 percent to be effective during the certification period. (Ex. 37 at 3.) SWG further states that since the effective date for these changes in expenses occurred after the end of the January 31, 2018, test year but prior to the certification date of July 31, 2018, the adjustment was included as a certification adjustment. (*Id.*)

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BCP's Position

401. BCP states that while the adjustment for SWG's NND appears reasonable, the SND adjustments total 5.29 percent, and that a 5.29 percent increase is high for a one-year period. (Ex. 59 at 66.) BCP notes that "[m]ost of the increase came from within the test year," and that "SWG began the test year with 2,231 employees on the payroll, and ended it with 2,299,

the highest number of employees at any time during the five-year period from June 2013 through July 2018. (*Id.* at 67.)

402. BCP further states that, similar to the test year period, "the Certification period started with 2,280 employees, dropped to 2,269 in March, before increasing to 2,282 by the end of July," and that "[p]rior to the test year, SWG did not have more than 2,246 employees, and that was in December 2016." (*Id.*) BCP argues that the "increase in employee levels results in a loss of productivity for SWG that it should try to reverse, and the Commission should not accept a reduced level of labor productivity for SWG." (*Id.*)

403. BCP recommends that SWG payroll cost increase for the SND be limited to 3.0 percent based on data provided by the Bureau of Labor Statistics ("BLS"), which showed that "the average increase in salaries from June 2017 to June 2018 was 2.5 percent." (*Id.*) This results in a recommended adjustment to reduce the payroll expenses in the amount of $840,593.00. (*Id.* at 68.)

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Staff's Position

404. Staff recommends that the Commission approve SWG's requested base salary and wage levels for all employees. (Ex. 58 at 5.) However, Staff notes that "SWG needs to provide justification for all employee compensation in future rate cases, not just the 19 members of the executive employee group. SWG has over 400 employees designated as either SND or NND, and almost 900 employees designated as corporate employees who work companywide." (*Id.* at 8.) Staff further states that "SWG must make available justification for including their salary in revenue requirement to the Commission in the initial filing, instead of having it pieced together through data requests." (*Id.*)

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SWG's Rebuttal Position

405. SWG states that "BCP's analysis and recommendation is based on a misleading calculation that compares the Company's percentage increase in annualized payroll expense adjustments to a one-year average in salary increases and that BCP mischaracterizes the Company's proposed adjustments to payroll expense as a request that equates to a one-year wage increase of 5.29% in Southern Nevada. BCP's analysis fails BCP's analysis and recommendation is based on a misleading calculation that compares the Company's percentage increase in annualized payroll expense adjustments to a one-year average in salary increases. BCP mischaracterizes the Company's proposed adjustments to payroll expense as a request that equates to a one-year wage increase of 5.29% in Southern Nevada. BCP's analysis fails to offer an apples to apples comparison and ignores the administrative aspect of employee compensation resulting in a flawed recommendation." (Ex. 74 at 1-2.)

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406. SWG states that "due to the timing of the test year and certification period, the Company experienced employee wage increases for 2017 and 2018 resulting in payroll expense adjustments, and that consistent with the Company's long history of issuing its employee wage adjustments mid-year (with Board approval generally obtained in May and the increase taking effect in June), these payroll expenses were known and measurable and appropriate for inclusion by SWG as test year and certification adjustments." (*Id.* at 3.)

407. SWG also states that using BCP's calculation of 5.29% for the increase in payroll expense adjustments would result in average annual wage increases of 2.64%, which is in line with the BLS 2.5% average for annual salary increases. (*Id.* at 4.) SWG further states that the BLS is merely a single economic indicator that may be considered in evaluating appropriate wage increases or the reasonableness of payroll costs in any given year but is inappropriate for

determining reasonableness of annualized payroll expenses that include costs over an extended period." (*Id.* at 4.)

Commission Discussion and Findings

408. The Commission rejects BCP's recommendation to limit SWG's payroll cost increase for SND to 3.0 percent. The Commission notes that SWG addressed its concerns raised by BCP's testimony by clarifying that the 5.29-percent increase relates to a two-year period rather than an annual period. Given the clarification, the annual increase over the last two years would amount to approximately 2.65 percent. The Commission finds that such an increase is not excessive, and a reduction to SWG's annual payroll cost would not be justifiable.

409. The Commission agrees with Staff's recommendation that SWG provide justification for all employee compensation in future rate cases instead of merely the 19 members of the executive employee group. Accordingly, the Commission directs SWG to meet with Staff prior to its next GRC to determine a satisfactory manner for how SWG will provide benchmarking for all employees similar to what it provided for executives regarding salary and/or wage levels.

G. Perquisites ("Perks") and Vehicle Stipends

BCP's Position

410. BCP does not address this issue.

Staff's Position

411. Staff recommends that the Commission remove "the Perks and vehicle stipend costs," from the revenue requirement because "SWG has not provided any information to indicate that the perquisites benefit the ratepayers who are expected to pay for the costs, or to

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indicate that the costs further the goal of providing adequate, safe and reliable service." (Ex. 58 at 27.)

SWG's Rebuttal Position

412. SWG states that the perks that it seeks recovery for are physical exams, life insurance, and financial and estate planning. (Ex. 81 at 33.) SWG provides that the physical exams help SWG minimize medical expenses and reduce medical absences while ensuring its highest-level executives are able to perform their duties. (*Id.*) SWG further provides that the benefits help attract and retain key employees, are relatively low cost, and allow employees to focus their duty to provide adequate, safe, and reliable service. (*Id.* at 33-34.)

413. SWG states that vehicle stipends are reasonable to include in rates and should be viewed within the context of total cash compensation, as a vehicle stipend is another form of base pay. (*Id.* at 34.) SWG provides that "it addressed the Commission's concerns of including luxury vehicles in its revenue requirement by changing its policy of providing certain employees with a vehicle owned by the company" and "removed all vehicles that were not fully amortized from the revenue requirement for director level and above." (*Id.*) SWG further provides that such actions eliminated the Commission's concerns. (*Id.*)

414. SWG states that the vehicle stipend is a fixed amount, and provided the employee meets the conditions for the vehicle as specified by the company, it may use the vehicle for both business and personal reasons, with no additional reimbursements for work use. (*Id.*) SWG further states that the stipend is another form of cash compensation. (*Id.*) SWG recommends that perks and vehicle stipends be authorized for full recovery. (*Id.*)

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Commission Discussion and Findings

415. The Commission finds that the inclusion of requested perks and executive vehicle stipends in SWG's revenue requirement will not result in just and reasonable rates. In making this determination, the Commission considers the evidence on the record and how that evidence balances the interests of ratepayers and shareholders. The Commission is not persuaded by SWG's rationale that the inclusion of physical exams, life insurance, financial and estate planning, and vehicle stipends are necessary for the successful operation of the utility.

416. The Commission agrees with Staff that SWG failed to adequately justify how the perks and vehicle stipends benefit ratepayers and did not identify how such costs further the goal of providing adequate, safe, and reliable service. Instead, SWG focused on the manner in which the benefits are given to employees and how they benefit the employees. Accordingly, the Commission accepts Staff's recommendation to remove costs associated with the perks and vehicle stipends from SWG's revenue requirement.

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H. Board of Directors ("BOD") Compensation

BCP's Position

417. BCP does not address this issue.

Staff's Position

418. Staff recommends a disallowance of 50 percent of the BOD's compensation. (Ex. 58 at 28.) Staff states that the "Board's legacy compensation was not aligned with its peer group in regards to total compensation."(*Id.*) Thus, Staff states that SWG reviewed "the non-employee Board compensation and compar[ed] it to the peer group compensation, and that "[i]n 2017, the Board's compensation was changed to provide a more equal distribution between cash and equity compensation." (*Id.*) Staff concludes that because the changes were implemented in 2017, "it is

impossible to know at this point in time if the Board's compensation amount is now aligned with its peers" and that "the ratepayers should not bear 100 percent of the risk." (*Id.*)

SWG's Rebuttal Position

419. SWG states that Staff's adjustment does not represent a 50 percent disallowance of the board of director costs. (Ex. 81 at 35.) SWG further states that to align with previous Commission orders, Adjustment No. 12 removed $1,082,245.00 of BOD costs, allocating $291,072 to its SND and $60,584.00 to its NND. (*Id.*) SWG provides that removing an additional $331,081.00 for its SND and 68,911.00 for its NND, results in a 65.3 percent disallowance of BOD-related expenses. (*Id.*) SWG further provides that it is required to have a BOD, Staff did not express concerns about unjust compensation, and its Board of Director's compensation is aligned with SWG's peers. (*Id.*) Accordingly, SWG contends that its Board of Director costs are reasonable, necessary, and Staff failed to provide objective information supporting excluding the associated costs from rates. (*Id.*)

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Commission Discussion and Findings

420. The Commission accepts Staff's proposal to disallow 50 percent of the BOD compensation costs in order to share the costs equally between ratepayers and shareholders. The Commission finds that the evidence on the record supports benefits to both ratepayers and shareholders. A competent BOD provides value to SWG through increased earning and market value, while ratepayers benefit from safe, reliable service. Accordingly, it is appropriate that the costs be shared between shareholders and ratepayers.

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I. Pension Expenses and Tracker

Pension Expenses

SWG's Position

421. SWG requests a revenue requirement increases of $1.37 million for SND and $335.6k NND related to Pension and PBOP expense. (Ex. 36 at 7.) SWG states that Pension and PBOP expenses are based on current actuarial studies and test year employee counts. (*Id.*) SWG further states that since 2011, pension costs have fluctuated due to the discount rate and mortality rates used in calculating the pension cost. (*Id.* at 13.) SWG provides that the reduction in the discount rate from 4.50 percent in 2017 to 3.75 percent in 2018 resulted in an increase in total gas operation pension costs (including its Arizona, California, and Nevada jurisdictions) of $11.7 million, with 28.13 percent and 5.86 percent allocated to SWG's SND and NND, respectively. (Ex. 36 at Attachment CMB-3, Tr. at 946.)

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422. SWG states that the discount rate is used to estimate the existing liability for future pension benefits and is determined through the utilization of an actuary's proprietary yield curve that includes a portfolio of AA-rated bonds. (*Id.* at 14.) SWG further provides that the discount rate has been the driving force in changes in pension costs. (*Id.*) SWG states that its actuary recommends the annual discount rate, which is then discussed with senior management, who has some input on the selection of the discount rate. (Tr. at 948.) SWG was not able to provide specifics about what information was utilized by the actuary and senior management in determining recommendations for the appropriate annual discount rate. (Tr. at 948-950.)

BCP's Position

423. BCP's witness, a Certified Public Accountant with both public and private experience, opines that upper-level management has some control over the two biggest factors

affecting volatility and pension costs – discount rates and the expected rate of return. (Tr. at 444-445, Ex. 53 at JDK-1.) BCP contends that a pension tracker does not provide an incentive to control pension costs. (Tr. at 441.)

Staff's Position

424. Staff does not address this issue.

SWG's Rebuttal Position

425. SWG does not address this issue in its rebuttal testimony.

Commission Discussion and Findings

426. The issue before the Commission is whether Nevada's allocated share of an $11.7-million increase in pension cost, resulting from a reduction in the discount rate used in calculating the annual pension cost, should be included for cost recovery. The Commission notes that the discount rate is used to estimate the total future pension liability to date, as well as the level of pension expense charged to annual financial results. Selection of the annual discount rate is a result of a recommendation from SWG's actuarial firm and input from senior management. SWG put forth evidence that indicates that the annual discount rate from 2011 through 2017 averaged 4.75 percent and never dropped below 4.25 percent for the entire seven-year period.

427. The 2018 discount rate was reduced from 4.50 percent in 2017 to 3.75 percent in the test year for this GRC, resulting in an approximate increase in pension cost to SWG's SND and NND of $3,291,000.00 and $686,000.00, respectively. SWG did not provide the Commission with evidence explaining the cause of the significant reduction in the discount rate for the 2018 test year, nor did it produce a witness during the hearing that could testify about the selection process for the rate reduction.

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428. The Commission finds that SWG failed to provide evidence justifying an increase of approximately $4.0 million in pension costs to its Nevada gas operations. SWG is directed to recalculate its 2018 pension cost, allocated to Nevada, excluding the reduction in the discount rate of 3.75 percent in 2018. The Commission further finds that the annual pension cost to be reflected in the cost of service in this proceeding will be based upon a three-year average of 2016, 2017, and the revised calculation for 2018. The Commission's decision to use a three-year average for determining annual pension cost is addressed in paragraphs 435-437 of this Order.

Pension Tracker

SWG's Position

429. SWG requests authority to implement a Pension Tracker in order to "track the difference between pension expenses included in base rates and the level of expense incurred between GRC proceedings through a regulatory asset that is adjusted annually in the company's Annual Rate Adjustment filing." (Ex. 1 at 5.) SWG states that a pension tracker is appropriate for SWG's pension expense because 1) the amount of pension expense typically fluctuates from year-to-year and can significantly deviate from the expense levels set in base rates; and 2) management has limited managerial discretion over the components or volatility of the expense. (*Id.* at 13.)

BCP's Position

430. BCP recommends that the Commission deny SWG's request for Pension Tracker, because "BCP does not agree it is prudent to review a single-issue such as pension expense via an annual filing as proposed by the Company without conducting a holistic review of the Company's operations which are performed during a general rate case, such as in this instant docket. (Ex. 53 at 4.)

Staff's Position

431. Staff states that due to volatility in pension expense the 5-year average periodic pension expense from 2014-2018 should be used to set the reasonable level of expense for inclusion in rates. (Ex. 63 at 8.) Staff also states that normalization of expenses is a common practice in ratemaking. (*Id.* at 6.) Therefore, Staff recommends that the Commission reduce revenue requirement $1,387,087 for SND and $339,132 for NND to reflect normalization. (*Id.*)

432. Staff states that the Commission should deny implementation of a pension tracker in the instant docket. (Ex. 63 at 5.) Staff states that creation of a comprehensive pension tracking mechanism is more complex than presented by SWG, and that if the Commission determines a pension tracker is may be appropriate it should be addressed in an investigation and/or rulemaking docket. (*Id.*)

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SWG's Rebuttal Position

433. SWG states that a pension tracker provides a straight forward mechanism with comparing the amount in base rates with the pension expense incurred for the annual period. (Ex. 77 at 2.)

434. SWG also states that consideration of pension tracker in the instant docket is administratively efficient and that other utilities interest or not in a pension tracker is not relevant. (*Id.* at 5.) SWG also states that BCP provides no support that pension tracker is too complicated to address in annual filing, and that BCP's position on trackers is inconsistent with its support for implementing a tracker for ARAM amortization. (*Id.* at 6.)

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Commission Discussion and Findings

435. The Commission rejects SWG's request to establish a tracking mechanism for the recovery of pension and PBOP expenses. In rejecting SWG's request, the Commission finds that normalization of expenses is a more appropriate means to address volatility.

436. The Commission finds that expense normalization is a common practice in ratemaking for addressing costs that can vary from year to year. Accordingly, the Commission accepts the premise of Staff's proposal to address volatility in pension expense by normalizing the amount for recovery using an average of a number of historical years. However, in doing so, the Commission modifies Staff's recommendation to utilize an average of the last three years. More specifically, the Commission finds that SWG shall use an average of the 2016, 2017, and 2018 (as corrected in accordance with Paragraph 442) pension expenses.

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437. The Commission finds that, after the effects from the outlier reduction in the discount rate have been removed from pension expense for 2018, a three-year average of 2016, 2017, and the corrected rate for 2018 represents a more appropriate period reflective of historical figures. The Commission notes that utilizing the above-referenced three-year average addresses volatility without the risk of dis-incentivizing cost management by the utility between rate cases that could otherwise occur with the pension tracker mechanism proposed by SWG. The Commission also notes that SWG can address its concerns about managing pension costs by taking steps to revise the amount, type, and structure of pension-related benefits offered to employees.

J. Winnemucca Home

BCP's Position

438. BCP does not address this issue.

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Staff's Position

439. Staff recommends disallowing all of the costs associated with the Winnemucca District Manager's house. (Ex. 64 at 2, Tr. 843.) Staff states that SWG initiated Work Order No. 026W0000877 to purchase a home in Winnemucca, Nevada for approximately $307,753 in 2012 for the Winnemucca District Manager. (Ex. 64 at 27, Ex. 71 at 6.) Staff recommends an adjustment to remove the costs and related accumulated depreciation, depreciation expense, and ADIT associated with this property from rate base. (*Id.*, Attachments WC-2, page 2, CW-8, CW-14.) Staff states that it disputes the appropriateness of both the company's decision to purchase the home and the rent that SWG charges. (Tr. at 843.)

440. According to Staff, SWG stated that it needed to purchase the prior Winnemucca District Manager's home when he transferred to a new position within SWG. (Ex. 64 at 27.) Staff states that SWG stated it retained the home because the incoming District Manager was unable to find suitable available housing in the area. (Ex. 64 at 27-28.) Staff further states that the District Manager does not pay SWG rent for the purchased home; however, SWG imputes a monthly rent of $1,368, which is included as additional income in the Winnemucca District Manager's taxable earnings. (Ex. 64 at 28.)

441. Staff provides that "[i]f SWG wants to offer free housing for its employees as part of its compensation plan, its shareholders should pay for those costs, not ratepayers, unless SWG can show that this Perk is part of a below-normal salary package." (Ex. 64 at 29.) Staff notes that it is aware of other utility personnel that work in Winnemucca, and that those other utilities don't pay for homes. (Tr. at 842.)

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SWG's Rebuttal Position

442. SWG states that Staff did not provide a reason for disallowing this cost. (Ex. 81 at 25.) SWG further states that the employees occupying the home are typically in developmental positions and the company-owned housing enables the company to move people in and out of these positions while minimizing relocation costs. (*Id.*) SWG states that in lieu of salary adjustments, the company provides a home, with imputed earnings, as part of the employee's compensation package. (*Id.*) SWG states that the cost of the home is reasonable and essential to providing safe and reliable service. (*Id.*)

Commission Discussion and Findings

443. The question before the Commission is whether costs associated with the Winnemucca home should be included in rates. In assessing whether its inclusion in rate base would result in just and reasonable rates, the Commission weighs the benefits to both ratepayers and shareholders. The Commission is persuaded by Staff's testimony that other utilities have employees who live and work out of Winnemucca and do not receive housing benefits. The Commission is not persuaded by SWG's contention that providing a benefit to an individual employee is essential to providing safe and reliable service. Moreover, while SWG provides that the employees occupying the home are typically in developmental positions, the Commission distinguishes this from employees that might require short-term housing when relocating.

444. SWG has failed to show how employees of SWG and other utilities can find suitable housing in Winnemucca while SWG's District Managers uniquely cannot. Based on the evidence presented, the Commission finds that SWG did not adequately justify how the home will benefit ratepayers or result in just and reasonable rates. Accordingly, the Commission

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accepts Staff's adjustment to remove all costs and related accumulated depreciation, depreciation expense, and ADIT associated with the Winnemucca home from rate base.

K. Incline Village Home

BCP's Position

445. BCP does not address this issue.

Staff's Position

446. Staff recommends that the Commission disallow and make an adjustment removing from rate base $0.830 million from the NND rate base all of the costs associated with of the Lake Tahoe District Manager's house in Incline Village owned by SWG, including accumulated depreciation, depreciation expense, and ADIT. (Ex. 64 at 2, Ex. 71 at 6-7, Attachments CW-2, page 2, CW-9, CW-14.)

447. Staff disputes the appropriateness of both the company's decision to purchase the home and the rent that SWG charges. (Tr. at 843.) According to Staff, SWG stated it owns a home in Incline Village, Nevada, for the Lake Tahoe District Manager. (Ex. 64 at 28.) Staff SWG purchased this home from a different SWG employee for over a quarter of a million dollars in 2004. (*Id.*) Staff states that the Lake Tahoe District Manager does not pay rent and that SWG imputes a monthly rent of $1,621, which is included as additional income in the Lake Tahoe District Manager's taxable earnings. (*Id.*) However, because the home value is close to one million dollars, it does not appear to Staff that the imputed rent even covers the property tax for the home. (*Id.*) Staff provides that "the fair market rent value [of the home] is $2,360.00, well above, some $700.00 more than what the utility is imputing as income." (Tr. at 841.)

448. Staff states "Nevada ratepayers should not be asked to pay for the cost of a District Manager to live in a million-dollar home in Incline Village, Nevada." (Ex. 64 at 29.) "If

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SWG wants to offer free housing for its employees as part of its compensation plan, its shareholders should pay for those costs, not ratepayers, unless SWG can show that this Perk is part of a below-normal salary package." (*Id.*)

SWG's Rebuttal Position

449. SWG states that "company-provided housing is an essential element of operational effectiveness and emergency response in the Lake Tahoe area." (Ex. 81 at 25.) SWG further states that the employees occupying the home are typically in developmental positions and the company-owned housing enables the company to move people in and out of these positions while minimizing relocation costs. (*Id.*) SWG states that in lieu of salary adjustments, the company provides a home (with imputed earnings) as part of the employee's compensation package. (*Id.*) SWG provides that the cost of the home is reasonable and essential to providing safe and reliable service. (*Id.*)

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Commission Discussion and Findings

450. The question before the Commission is whether costs associated with the Incline Village home should be included in rates. In assessing whether its inclusion in rate base would result in just and reasonable rates, the Commission again weighs the benefits to both ratepayers and shareholders. The Commission again agrees with Staff's criticism of SWG's business decision to both purchase the house and provide the District Manager with rent, regardless of whether it is imputed from the District Manager's salary. As Staff notes, the rent charged to the District Manager is approximately $700.00 below monthly fair market rental value for the area and may even be inadequate to cover the property tax on the home.

451. Moreover, the Commission is not persuaded that the home is essential to providing safe and reliable service. As Staff also notes, SWG has field offices in the area and

has the capacity for employees to work out of those offices. It is unclear how providing the District Manager with this home is essential or ensures safe and reliable service. The evidence before the Commission does not adequately demonstrate a benefit to ratepayers, and as a result, this expense should fall to the shareholders.

452. Accordingly, the Commission accepts Staff's adjustment to remove $0.830 million from the NND rate base related to the entire cost of the Lake Tahoe District Manager's house in Incline Village owned by SWG and to make corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT related to the home from rate base.

L. Las Vegas Apartments

BCP's Position

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453. BCP does not address this issue.

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Staff's Position

454. Staff recommends disallowing all of the costs associated with the two apartments SWG rents in Las Vegas. (Ex. 64 at 2.) Staff states that SWG rents two apartments in Las Vegas, Nevada for temporary use by select employees. (*Id.* at 28.) According to Staff, SWG stated that it rents two apartments in Las Vegas that are used for new hires while they obtain permanent housing, and for temporary housing of employees attending training, or other short-term activities at a monthly cost of $2,350. (*Id.* at 30.) Staff states that SWG did not provide any analysis showing whether the apartment rents were more cost effective than individual hotel costs for the test period. (*Id.*)

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SWG's Rebuttal Position

455. SWG states that the apartments were utilized by new hires who relocated from other areas of the state and country. (Ex. 81 at 27.) SWG further states that the monthly cost for the two apartments is $2,350.00 with a daily rate of less than $40.00. (*Id.*) SWG provides that the apartments are conveniently located, provide temporary housing for new-hires, and are more cost-effective and convenient than placing employees in hotels. (*Id.*)

Commission Discussion and Findings

456. The issue is whether the costs associated with the two apartments in the Las Vegas area should be allowed in rates. The Commission rejects Staff's recommendation to disallow the costs of the apartments. In rejecting Staff's recommendation, the Commission distinguishes the apartment expenditures from the costs associated with the District Manager homes in Incline Village and Winnemucca, Nevada. First, SWG clearly demonstrates that the cost of the apartments, less than $40.00 per day, are cost-effective compared to other options. Second, the Commission differentiates between the need to provide short-term housing for relocating employees and the prudence of providing housing to District Managers for the duration of their position in those roles. Accordingly, the Commission accepts SWG's position and finds that the cost of the Las Vegas apartments should be allowed.

M. Vdara Hotel Expenses

BCP's Position

457. BCP does not address this issue.

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Staff's Position

458. Staff recommends disallowing all of the costs associated with Vdara Hotel lodging expenses. (Ex. 64 at 2.) Staff states that SWG paid approximately $7,800 to reserve hotel rooms at the Vdara Hotel. (Ex. 64 at 30.)

SWG's Rebuttal Position

459. SWG states that it agrees with Staff's recommendation to disallow costs related to lodging at the Vdara Hotel. (Ex. 81 at 49.) SWG states that it had intended to remove all charges related to employee events from its operating expenses. (*Id.*)

Commission Discussion and Findings

460. The Commission agrees with and accepts Staff's recommendation to disallow costs related to employee events at the Vdara Hotel.

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N. Leasehold Improvements to Former Elko Office Building

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BCP's Position

461. BCP does not address this issue.

Staff's Position

462. Staff recommends that the Commission approve adjustments to retire $375,170.00 of leasehold improvements from SWG's NND rate base related to the previously leased Elko office building, resulting in an annual $8,741.00 in revenue requirement for annual depreciation expense. (Ex. 70 at 4.) Staff states that otherwise including the amounts in rate base would result in earning a return on the improvements as well as a return of investment through annual depreciation expense. (*Id.* at 2.)

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SWG's Rebuttal Position

463. SWG states SWG states that "it does not oppose an adjustment to retire the leasehold improvements made on its formerly leased Elko office." (Ex. 81 at 48.)

Commission Discussion and Findings

464. The Commission accepts Staff's recommendation to remove $375,170.00 in costs associated with leasehold improvements to the retired office in Elko, Nevada, ~~from rate base~~ ***in the calculation of depreciation expense***. As Staff notes, allowing these costs to remain in rate base would result in SWG earning a rate of return on the improvement as well as a return on investment through the annual depreciation expense. Moreover, SWG does not oppose Staff's adjustment. Accordingly, the Commission finds that the ***depreciation*** expense is not acceptable and accepts Staff's adjustment to remove $375,170.00 ~~from the NND rate base~~ ***in costs from the calculation of the depreciation expense***.

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O. Directors and Officers (D&O) Liability Insurance

SWG's Position

465. SWG states that quality individuals will not risk their personal assets to serve as a corporate director or officer without mitigating risks associated with certain positions, especially when other comparable positions with other companies mitigate such risk. (Ex. 3 at Statement P, Sheet 8.) SWG provides that indemnification creates a liability for the company that is prudent to cover through D&O insurance. (*Id.*) SWG further provides that D&O insurance "is a reasonable and necessary expense that is incurred by publicly traded companies. (*Id.*) SWG states that D&O liability insurance increases its revenue requirement by approximately $30,278.00. (*Id.*)

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BCP's Position

466. BCP does not address this issue.

Staff's Position

467. Staff recommends that the Commission reduce ***SWG's requested revenue requirement by $145,363.00 for the SND and $30,256.00 for the NND, and reduce*** rate base by $40,321.***00*** for SND and $8,393.***00*** for NND for costs related to D&O liability insurance. (Ex. 70 at 4.) Staff argues that these costs should be shared 50-50 as was ordered in Docket No. 12-04005. (*Id.* at 6.)

468. Staff states that while it is likely that ratepayers derive some benefit from D&O liability insurance, there are direct benefits that accrue to shareholders. (*Id.*) Staff further states that both SPPC and NPC split such costs between shareholders and ratepayers. (*Id.*) Accordingly, Staff contends that the costs associated with the D&O liability insurance should be split equally between ratepayers and shareholders, as was ordered in SWG's previous GRC. (*Id.*)

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SWG's Rebuttal Position

469. SWG states that D&O liability insurance is a necessary and reasonable cost that should be included in rates. (Ex. 81 at 37.) SWG further states that the expenses are not discretionary or optional and that no party claimed that D&O insurance costs "are unjust, unreasonable, or imprudent." (*Id.*) SWG contends that such an adjustment would constitute an implicit reduction in its rate of return and return on common equity because if the company continues to incur reasonable, required expenses and cannot recover them in rates, the company is effectively earning a lower return on equity than what the Commission authorizes. (*Id.*)

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Commission Discussion and Findings

470. The issue before the Commission is how to apportion the costs associated with the D&O Liability Insurance for inclusion in rates. The Commission notes that in SWG's previous GRC, the Commission ordered a 50/50 sharing of the expense between ratepayers and the company.

471. As noted by Staff, D&O insurance covers claims against the company resulting from misconduct or breach of fiduciary duties. The Commission notes that without such insurance, SWG might request recovery of the costs associated with such claims from ratepayers; however, it should be noted that there is no guarantee that such a request would be granted. The Commission agrees with Staff that D&O insurance benefits both shareholders and ratepayers, and consequently, those costs should be shared. Based on the foregoing analysis, the Commission finds that a 50/50 apportionment of the cost of D&O Liability Insurance between ratepayers and SWG is just and reasonable. Accordingly, the Commission accepts Staff's recommendation to disallow 50 percent of D&O liability insurance expenses ***in the amount of $145,363.00 for SWG's SND and $30,256.00 for SWG's NND*** by reducing SWG's SND rate base by $40,321.00 and reducing SWG's NND rate base by $8,393.00.

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P. Rate Case Expenses

Amortization of rate case expenses

BCP's Position

472. BCP does not address this issue in testimony.

Staff's Position

473. Staff recommends amortizing the new regulatory asset for general rate case expenses incurred in this proceeding over a six-year period for the reasons discussed *infra* paras.

487-491. Staff states that "changing the amortization period from five years to six years for this asset will result in amortization expense adjustments in the amounts of ($3,480) for the SND and ($724) for the NND." (Ex. 54 at 15.) Staff also states that "if the Commission approves SWG's requested five-year amortization period for SWG's regulatory asset, SWG will collect an additional year of amortization expense that was not calculated into rates and over-recover the value of the regulatory asset." (*Id.* at 15-16.)

SWG's Rebuttal Position

474. SWG states that it continues to recommend a five-year amortization period; however, SWG provides that its primary concern is that all amortizations based on a rate case cycle be treated consistently. (Ex. 81 at 41.)

Commission Discussion and Findings

475. The Commission accepts Staff's proposal to amortize SWG's rate case expense over a six-year period. The six-year period is consistent with the most recent duration between SWG GRCs and depreciation cases. Moreover, the six-year period reduces the risk of over-recovery. In the event SWG files a GRC prior to the completion of the amortization period, it can request to have the amortization period reset.

Rate Case Cost Discrepancies

BCP's Position

476. BCP does not address this issue.

Staff's Position

477. Staff states that as of SWG's certification period, it requested a combined rate case expense recovery of $126,147.00 for its SND and NND; however, after Staff inquiry, SWG discovered that the total expenses should have reflected $331,998.00 upon the conclusion of its

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certification period. (Ex. at 17.) Staff contends that such oversight problems and failures to properly update certification materials are demonstrative of a pattern of SWG failing to adequately prepare and defend its Application. (*Id.* at 17.)

478. Staff states that "SWG is requesting expense recovery of $126,147 (combined SND and NND), as of the certification date, relating to rate case expenses for this current proceeding." (Ex. 54 at 16.) Staff states that SWG claimed this represented actual amounts incurred to the certification date, and that $475,250 represented estimated amounts SWG expected to incur at the certification. (*Id.*)

479. However, Staff states that through review of SWG's "13 Month Average" balance, it came to Staff's attention that "SWG had included this regulatory asset in rate base as 'Nevada Rate Case 2018' (account 182303044) with a thirteen-month average balance of $238,563, and a July 2018 ending balance of $331,998." (*Id.*) In addition, Staff states that "[a]fter discovering that the regulatory asset's balance at July 2018 was $331,998 ($205,851 more than the $126,148 requested at certification), [it] issued DR Staff-387 requesting clarification for the discrepancies between SWG's request and that workpaper." (*Id.*) Staff states that in response, SWG stated 'In preparing this response, it was discovered that the total expenses should have reflected $331,998, rather than $126,148, as that was the ending balance at July 31, 2018.'" (*Id.*)

480. Staff states that "it is SWG's responsibility to ensure that its applications and certification filings are correct and adequately supported when filed" and that "Staff has not determined the reasonableness of the $331,998 figure, since SWG only provided invoices for 'professional services' supporting the lower figure and there is no time to further investigate this issue before this testimony." (*Id.* at 17.)

481. Staff states that "this rate case expense error is but one of many instances, uncovered during Staff's investigation, in which SWG has failed to adequately prepare and defend the instant GRC filing" and that "given the extent of the problems that Staff has experienced during its investigation, Staff believes it is not reasonable for SWG to recover these additional, unvetted rate case expenses from ratepayers." (*Id.*)

482. Therefore, Staff recommends that the $126,147 requested at the time of certification in Schedule I-C3, and subsequently confirmed to Staff in the response to DR Staff-352 be recovered in rates by SWG. (*Id.*) Additionally, Staff recommends that the value of the regulatory asset in rate base be set to the $126,147 represented in the certification filing and confirmed by the response to DR Staff-352 (with a corresponding adjustment to ADIT and then allocated to the SND and NND). Staff states that this results in the net amount of ($73,071), which is then allocated to the SND ($60,482) and the NND ($12,589). (*Id.*)

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SWG's Rebuttal Position

483. SWG states that it regrets that this error was not identified prior to the filing and that it responded to Staff with the corrected amounts. (Ex. 77 at 9.) SWG also states that Staff's recommended write-off is extreme, given that it was the result of an unintentional oversight and that Staff "had ample time to ask any additional follow up questions to verify the reasonableness of the expense." (*Id.*) SWG concludes that because "the costs incurred are valid business expenses incurred processing this general rate case," SWG should be afforded full cost recovery of the expenses. (*Id.*)

Commission Discussion and Findings

484. The Commission rejects Staff's proposal to deny recovery of $205,851.00 in GRC costs related to SWG's error in reporting the correct regulatory asset certification balance. While

the Commission agrees with Staff that SWG has exhibited certain failures to provide adequate documentation and information that have resulted in problems in this proceeding, the Commission finds that this particular error was the result of an unintentional oversight. In this circumstance, denying recovery of the corrected amount would be an excessive response and could create a chilling effect on applicants identifying and correcting their own inadvertent errors in filings.

Q. Regulatory Amortization Adjustments related to Schedule I-C7

Amortization Period Adjustment

SWG's Position

485. SWG requests a regulatory amortization adjustment increase of $1,064,802.00 for its SND and a decrease in operating expenses of $7,405.00 for its NND related to various regulatory assets on schedule H-C7. (Ex. 36 at 9-10.)

BCP's Position

486. BCP does not address this issue.

Staff's Position

487. Staff recommends a six-year amortization period for the six regulatory assets requested by SWG between the SND and NND. (Ex. 54 at 4.)

488. Staff's states that "SWG's last general rate case was filed six years ago, which is a six-year rate cycle (ideally, a six-year amortization period would have been used in the last rate case)." (*Id.*)

489. Secondly, Staff states that "SWG is required by NAC 703.276 to file depreciation studies 'not exceeding 6 years or as otherwise directed by the Commission,'" and that "[b]ecause SWG submitted a depreciation study in this current proceeding, it could be up to another six

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years before they are required to file a new depreciation study, which is also suggestive of a six-year rate cycle." (*Id.* at 5.)

490. In addition, Staff states that "according to NAC 704.7983, regarding cost recovery of the replacement of existing pipeline and related infrastructure, it is [Staff's] understanding that the utility 'is not eligible to file another gas infrastructure replacement advance application' until the utility has filed a GRC, and that '[t]he Commission shall not approve a request for a waiver if the Commission has not issued a final order on a general rate application' filed by SWG 'during the immediately preceding 6 years,' which is also suggestive of a six-year rate case cycle." (*Id.*)

491. Staff states that "[i]f the Commission approves amortization periods of five years for the majority of these regulatory assets, SWG will collect from ratepayers an additional year of amortization expense and will over-recover the value of the regulatory assets." (*Id.* at 5-6.)

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SWG's Rebuttal Position

492. SWG states SWG states that it continues to recommend a five-year amortization period; however, SWG provides that its primary concern is that all amortizations based on a rate case cycle be treated consistently. (Ex. 81 at 41.)

Commission Discussion and Findings

493. The Commission accepts Staff's proposal to amortize various regulatory assets included on HC-C7 over a six-year period. The Commission finds that the six-year period is consistent with the most recent SWG rate cases and depreciation cases. The Commission further finds that the six-year period also reduces the risk of over-recovery. In the event that SWG files a rate case before the amortization is complete, SWG can request to have the amortization reset.

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Updated Regulatory Asset Certification Values

SWG's Position

494. SWG requests a regulatory amortization adjustment increase of $1,064,802.00 for its SND and a decrease in operating expenses of $7,405.00 for its NND related to various regulatory assets on schedule H-C7. (Ex. 36 at 9-10.)

BCP's Position

495. BCP does not address this issue.

Staff's Position

496. Staff states that not all of the regulatory assets listed in certification Schedule I-C7 are stated at the assets' value as of the certification date. (Ex. 54 at 6.) Staff further states that "[i]f the value of a regulatory asset that was initially estimated in Schedule H-C7 is not updated in Schedule I-C7 to reflect the balance as of the end of certification (July 31, 2018), SWG will potentially over-recover amortization expenses related to those assets." (*Id.* at 7.)

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497. Staff therefore recommends, to prevent double-recovery of amortization expense, that the Commission order SWG to adjust the following regulatory assets in Schedule I-C7 to reflect the value at the certification date:

a. "The new regulatory asset for 'Gas Lamps: Post —May 2012 to July 2018' (account 182303087) in the amount of $750,00023 is in rate base and needs its starting amortization balance to be equal to the ending balance on certification (July 31, 2018) in the amount of $737,876;" (*Id.* at 8.)

b. "The existing regulatory asset for 'Pre-May 2012 Incr. Pipe Repl' for $150,15026 (account 182303017)," needs to be updated because " the $150,150 figure in Schedule I-C7 was, the same estimate included in the precertification Schedule H-C7 and was not subsequently updated to reflect the July 31, 2018 balance in the certification;" (*Id.* at 9.)

c. "The existing regulatory asset for 'Gas Lamps: Pre-May 2009' (account 182303086) that is in rate base in the amount of $246,30829," needs to be updated because "the $246,308 figure in Schedule I-C7 was the same estimate included in the precertification Schedule H-C7 and was not subsequently updated to reflect the July 31, 2018 balance in the certification filing;" (*Id.*)

d. The "existing regulatory asset found in Schedule I-C7 'Balance of Pre-May 2012 Incr. Pipe Repl at 7/31/18' for $28,05035 (account 182303017)," needs to be updated because "the $28,050 figure in Schedule I-C7 was the same estimate used in the precertification Schedule H-C7 and was not subsequently updated to reflect the July 31, 2018 balance in the certification filing." (*Id.* at 10.)

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498. Staff states that other utilities before the Commission that project their regulatory assets forward to the rate effective date and notes that NPC was authorized to do so in Docket No. 06-11022.[37] (*Id.* at 10-11.) Staff states that NV Energy has since projected all of its regulatory assets forward to their rate effective dates. (*Id.* at 11.)

SWG's Rebuttal Position

499. SWG states that it is not appropriate to update the regulatory asset balances consistent with the rate-effective period because doing so "would be analogous to making an Expected Change in Circumstance ("ECIC") adjustment, but with a limited scope." (Ex. 77 at 7-

[37] *See* May 24, 2007, Order in Docket No. 06-11022 at Paragraphs 349-351.

8.) SWG argues that "the NRS does not require a utility to file a statement of ECIC adjustments, nor does it permit a utility to make an ECIC adjustment for a single cost of service item. (*Id.* at 8.)

Commission Discussion and Findings

500. The Commission accepts Staff's adjustment. The Commission is not persuaded by SWG's analogy and finds that such an adjustment is not precluded by the NRS. The Commission notes that updating a regulatory asset to the correct certification date balance is the routine, accepted, and correct practice for Nevada utilities in GRC proceedings in order to reflect the correct amount for cost recovery.

Updated Regulatory Asset Values for Rate-Effective Date

SWG's Position

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501. SWG requests a regulatory amortization adjustment increase of $1,064,802.00 for its SND and a decrease in operating expenses of $7,405.00 for its NND related to various regulatory assets on schedule H-C7.[38] (Ex. 36 at 9-10.)

BCP's Position

502. BCP does not address this issue.

Staff's Position

503. Staff states that, if the net book value ("NBV") "of a regulatory asset is not updated to the rate effective date, SWG will double-recover five months of amortization expense (August 1, 2018 through December 31, 2018) on the asset," and that therefore "to prevent over-recovery of amortization expense, certain regulatory asset accounts requested in the certification

[38] Schedule H-C7 is SWG's pre-certification schedule, whereas Schedule I-C7 represents H-C7 after SWG's certification period.

schedule need their balances ... projected forward to the rate effective date in this proceeding." (Ex. 54 at 7.)

504. Staff therefore recommends, to prevent double-recovery of amortization expense, that the Commission order SWG to adjust the following regulatory assets in Schedule I-C7 to bring the NBV of these assets to the rate effective date:

a. "The existing regulatory asset for 'Pre-May 2012 Incr. Pipe Repl' for \$150,15026 (account 182303017) is not in rate base but needs to be adjusted to the rate effective date (*Id.* at 9.) Staff calculated its "adjustment by taking the July 2018 balance of \$162,16227 and amortizing this asset for five months at \$6,006 per month to achieve the rate effective date balance of \$132,132;" (*Id.* at 9.)

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b. "The existing regulatory asset for 'Gas Lamps: Pre-May 2009' (account 182303086) that is in rate base in the amount of \$246,30829 needs to be adjusted to the rate effective date." (*Id.*) Staff calculated its "adjustment by taking the July 2018 balance of \$284,2083 and amortizing this asset over five months at \$18,950 per month to the rate effect date balance of \$189,458;" (*Id.*)

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c. "The regulatory asset titled 'existing regulatory amortizations' that consists of \$513,984 (account 182303085) in annual amortization expense is currently in rate base," and should be "adjusted to the rate effective date." (*Id.*) Staff calculated this adjustment "by taking the July 2018 balance and amortizing this asset five months at \$42,832 per month to achieve the rate effect date balance of \$1,970,243; and" (*Id.* at 10.)

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d. The "existing regulatory asset found in Schedule I-C7 'Balance of Pre-May 2012 Incr. Pipe Repl at 7/31/18' for $28,05035 (account 182303017) is not in rate base but needs to be adjusted to the rate effective date." (*Id.*) Staff calculated this adjustment "by taking the July 2018 balance of $30,292 and amortizing this asset over five months at $1,122 per month to achieve the rate effective date balance of $24,684." (*Id.*)

SWG's Rebuttal Position

505. SWG states that it is not appropriate to update the regulatory asset balances consistent with the rate-effective period because doing so "would be analogous to making an ECIC adjustment, but with a limited scope." (Ex. 77 at 7-8.) SWG argues that "the NRS does not require a utility to file a statement of ECIC adjustments, nor does it permit a utility to make an ECIC adjustment for a single cost of service item. (*Id.* at 8.)

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Commission Discussion and Findings

506. The Commission accepts Staff's proposal to update various regulatory assets on Schedule I-C7 to reflect the additional amortization up to the rate-effective date. The Commission is not persuaded by SWG's analogy and finds that such an adjustment is not precluded by the NRS. The Commission finds that the cost adjustments and amortization updates proposed by Staff are routine GRC adjustments that are necessary to prevent the double-recovery of costs. As Staff notes, other utilities, such as SPPC and NPC, have consistently projected its regulatory assets forward to the rate-effective date since 2007.

R. Commerce Tax Treatment

BCP's Position

507. BCP recommends that the "Commission require SWG to establish a regulatory liability for the Commerce Tax collections from July 2015 through December 2018, and refund those taxes back to ratepayers over a 3-year period." (Ex. 59 at 21.)

508. BCP argues that, although the Commission at one time allowed SWG to surcharge certain state taxes, SWG did not have the authority to use the surcharge mechanism to collect the Commerce Tax. (*Id.* at 17.) BCP states that in SWG's last rate case, Docket No. 12-04005, the Commission required SWG to stop surcharging the Mill Tax and the Modified Business Tax ("MBT") and instead embed these taxes in base rates." (*Id.* at 18.)

509. BCP acknowledges that, in Docket No. 12-04005, SWG was allowed to continue surcharging Franchise Taxes, but Staff distinguished Franchise Taxes from the Mill Tax in that the Mill tax is a fixed amount based on revenues from the previous year and the Franchise Tax is collected by SWG from ratepayers and passed on the appropriate government entity. (*Id.* at 18.) BCP states that the Commerce Tax is similar to the Mill Tax because it is also based on revenues from the previous year and is not a dollar for dollar pass through to ratepayers like the local franchise tax. (*Id.* 18-19.) Thus, BCP states that SWG should have "known that it had no authority to surcharge the Commerce Tax." (*Id.* at 19.)

510. Further, BCP states that, unlike the Modified Business Tax, there was never any statutory authority that allowed SWG to collect this tax through a surcharge. (*Id.* at 19-20.) BCP states that both SPPC and NPC "waited for the next rate case, after the tax was implemented, to embed the tax in their respective base rates," and that SWG should have done the same in its 2015 rate case, which it chose not file "apparently to take advantage of the opportunity to over-earn throughout 2015 and into 2016." (*Id.* at 20-21.)

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511. BCP recommends that the Commission "require SWG to establish a regulatory liability for the Commerce Tax collections from July 2015 through December 2018, and refund those taxes back to ratepayers over a 3-year period." (*Id.* at 21.) BCP's recommended adjustment "includes a 3-year amortization of the taxes collected from July 2015 through July 2018 plus an estimate of the taxes that will be collected through December 2018." (*Id.*) BCP states that [t]he estimated amounts through December should be subject to a true-up adjustment when the Company has actual numbers." (*Id.*)

Staff's Position

512. Staff recommends that the Commission direct SWG to cease charging the Commerce Tax on ratepayers' bills, and instead include the tax as an expense in its revenue requirement and rates, and approve a corresponding adjustment to SWG's tax expense. (Ex. 72 at 2.) Staff states that the Commerce Tax is an annual assessment that was passed by the Nevada Legislature during the 2015 Legislative Session which is imposed on businesses with gross state revenue exceeding $4,000,000.00 in taxable year. (*Id.*) Staff notes that for utilities, the current tax rate is 0.136 percent. (*Id.*)

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513. Staff states that SWG currently passes its Commerce Tax through to its ratepayers through an add-on rate, expressed as a percentage of what the ratepayer would otherwise pay for natural gas service. (*Id.* at 3.) Staff contends that the Commerce Tax should be embedded in rates as opposed to a pass-through item on customers' bills because the tax is an annual, rather than monthly charge. (*Id.* at 3-4.) Moreover, Staff states that SWG currently bills customers at the full tax rate of 0.136 percent, which doesn't account for the exclusion of SWG's first $4,000,000.00 of annual revenue or other adjustments applied in the calculation of its Nevada

taxable revenue. (*Id.* at 4, Tr. at 891.) Staff states that treating the Commerce Tax as a revenue requirement item would be consistent with how NV Energy collects its tax. (Ex. 72 at 4.)

514. Staff states that based upon the foregoing analysis, it recommends that the Commission "direct SWG to change its Commerce Tax billing and collection methodology, and embed this tax in its rates on a going-forward basis." Staff states that its recommendation corresponds with a similar Commission-approved Staff recommendation in SWG's previous rate case concerning the treatment of the Mill Tax and its inclusion for recovery in rates.[39] Staff notes that if the Commission directs SWG to include the Commerce Tax in the revenue requirement, it will be necessary to adjust SWG's recorded tax expense in the test period by increasing the "Taxes Other than Income" expense by $444,435.00 and $129,090.00 for the SND and NND, respectively. (*Id.* at 5.)

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SWG's Rebuttal Position

515. SWG states it relied on the Commission's Order in Docket No. 00-1028, when, on July 1, 2015, it submitted to the Commission notice of Adjustment No. 44 to its "Taxes and Assessments Not Included in Rates" schedule to reflect the implementation of the Commerce Tax. (Ex. 78 at 4.) SWG states that it provided a copy of the notice to Staff and BCP and updated customer invoices consistent with the change. (*Id.* at 4-5.) SWG states that neither Staff nor BCP raised concerns with the proposed treatment of the Commerce Tax following the July 1, 2015, filing. (*Id.* at 5.)

516. SWG states that the Commerce Tax is very different from both the MBT and the Mill Assessment in that it is based solely on revenues and can therefore be traced to customer bills. (*Id.* at 7.) SWG states that the Commerce Tax is similar to both the Franchise Fees and

[39] *See* March 20, 2013 Second Modified Final Order in Docket No. 12-04005 at 114-115.

Business License Taxes, which are included on the "Taxes and Assessments Not Included in Rates" schedule, in that it is directly derived from current revenue charged to each customer's bill. (*Id.*) Given that the Commerce Tax is based on revenue from customers, SWG believes it is appropriate to continue its current treatment of recovery. (*Id.* at 7-8.)

517. SWG states that neither Staff nor BCP consider the accuracy and efficiency that is inherent to SWG's surcharge methodology. (*Id.* at 8.) SWG states that by treating the Commerce Tax as a surcharge, each customer is assured that it only bears the Commerce Tax expense for which it is directly responsible. (*Id.*)

518. SWG states that if the Commission determines that the Commerce Tax should be embedded in general rates, it would only be appropriate to do so in conjunction with the establishment of a tracking mechanism, similar to the one suggested for the protected EDIT, to track both over-collections and under-collections to ensure customers are paying no more, or no less, as it relates to the Commerce Tax. (*Id.* at 9.) SWG suggests that if the Commission does not agree that a tracking mechanism is appropriate, the amount to be recovered should be determined on a prospective basis by multiplying the approved revenue in the instant docket by the current Commerce Tax rate for utilities (0.136%). (*Id.*) SWG states that using a historical amount is less appropriate and does not match the customer bill to the associated Commerce Tax; however, if a historic amount is used, SWG recommends that the amount of expense from the most recently ended fiscal year of June 30, 2018, would be most appropriate. (*Id.*)

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519. SWG states that it does not agree with BCP's recommendation to establish a regulatory liability for Commerce Tax collected since enactment with amounts refunded to customers over a three-year period. (*Id.* at 9.) SWG says that the regulatory liability amounts to nothing more than an unwarranted and unsubstantiated penalty against SWG and that there is no

evidence that SWG acted improperly in determining how to treat the Commerce Tax. (*Id.* at 9-10.) SWG also states that it has remitted the dollars collected for the Commerce Tax to the State of Nevada as required by statute. (*Id.*)

Commission Discussion and Findings

520. The Commission accepts the proposal by Staff and BCP directing SWG to recover the Commerce Tax in its revenue requirement in lieu of a surcharge included on customers' bills. ***The amount included in the revenue requirement should reflect the amount of Commerce Tax that SWG paid in its test period.*** The Commission rejects SWG's argument that the Commerce Tax is similar to the local franchise tax applied monthly to certain customers' bills. The Commission notes that the Commerce Tax is an annual tax on SWG's gross annual revenue for a given July 1 through June 30 period and is subject to various exclusions and deductions. The Commerce Tax is not a tax on the individual customer that is collected by SWG and subsequently remitted to the taxing authority by the utility. The Commission's decision on this matter is consistent with the rationale in SWG's last GRC, Docket No. 12-04005, where SWG was directed to recover the Mill assessment and MBT in revenue requirement in lieu of a surcharge on customers' bills.

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521. The Commission rejects BCP's proposal to establish a regulatory liability account for the Commerce Tax surcharge amounts collected from customers between 2015 and 2018. The Commission agrees with SWG that such an action would be disproportionately punative. Morever, SWG represents that it remitted the taxes to the proper taxing authority, as required.

S. City of Elko Franchise Fee

Staff's Position