Case No. 80911

In the Supreme Court of Nevada

SOUTHWEST GAS CORPORATION,

Appellant,

vs.

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

Respondents.

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Elizabeth A. Brown
Clerk of Supreme Court

APPEAL

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

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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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522. Staff recommends that the Commission disallow the City of Elko Franchise Fee payment, which is already a pass-through item on ratepayers' bills as "Local Taxes." (Ex. 72 at 5, 6.) Staff states that it found that a tax expense was erroneously included on Schedule M-5 as Franchise & Business Taxes for recovery through rates. (*Id.* at 5.) Staff provides that a July 2017 franchise fee payment of $6,177.00 made to the City of Elko was incorrectly included on the schedule for recovery. (*Id.* at 5-6.)

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BCP's Position

523. BCP does not address this issue.

SWG's Rebuttal Position

524. SWG states that the $6,771.00 franchise fee payment was properly remitted to the City of Elko and properly recorded as a business expense of SWG, but given that this is not an on-going expense, SWG does not oppose Staff's recommendation that it be removed from cost recovery. (Ex. 78 at 11.)

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Commission Discussion and Findings

525. In considering Staff's recommendation, the controlling question is whether the expense is appropriate to include in rates. The Commission agrees with Staff that the inclusion of the tax expense was erroneously included in the schedule for recovery as the fee is recovered on a pass-through basis on customer bills. Moreover, SWG has agreed to not seek recovery of the expense. Accordingly, the Commission accepts the adjustment proposed by Staff to reduce the revenue requirement by $6,177.00 for SWG's NND.

T. Commerce Substation Regulatory Asset

BCP's Position

526. BCP states that SWG has not complied with the Commission's prior rate case order in Docket No. 12-04005 regarding treatment of the Commerce Substation costs. (Ex. 59 at 7.) First, "the order contemplated that the Company would provide support for the reasonableness and prudence of the costs incurred associated with the loss, something the Company failed to provide in its direct case, where the information had to be provided." (*Id.* at 9.) Second, "the order contemplated that the Company would file its rate case in 2015, something the Company chose not to do for business reasons," and that "[a] rate case in 2015 would have most likely resulted in lower rates and a lower ROE for the Company, at least in Southern Nevada." (*Id.*)

527. BCP states that in 2015, SWG "should have either filed a rate case to include the deferred substation costs in rates, or it should have written-off those costs to income, more precisely, to the excess income it was enjoying at the time," and that "[i]t was inappropriate for the Company to continue deferring those costs through a period of over-earning in order to avoid a rate case that would have likely resulted in lower rates and a lower authorized ROE." (*Id.* at 10.) BCP therefore recommends that the Commission reduce SND rate base by $6,000,000.00 and annual amortization expense by $1,200,000.00. (*Id.*)

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Staff's Position

528. Staff recommends approval of the $6.0 million costs related to Commerce Substation regulatory asset over a six-year period. (Ex. 54 at 3 6, NL-2.) Staff states that it recommends the six-year amortization period considering SWG's last GRC was in 2012. (*Id.* at 4.) Moreover, NAC 703.276 requires that utilities file depreciation studies at least every six years, and NAC 704.7983 prohibits GIR advance applications in circumstances where a utility

has not issued a final order in a GRC during the immediately preceding six years. (*Id.* at 5.) Staff argues that such facts are suggestive of a six-year rate cycle. (*Id.* at 5.)

SWG's Rebuttal Position

529. SWG states that BCP's $6.0 million rate base adjustment is unreasonable. (Ex. 77 at 10.) SWG notes that in Docket Nos. 12-02019 and 12-04005, the Commission found that its request to adjust the rate base to reflect the $6.0 adjustment was appropriate. SWG provides that BCP's recommendation contradicts the Commission's previous order authorizing its inclusion. (*Id.*)

Commission Discussion and Findings

530. The Commission rejects BCP's recommendation to disallow recovery of $6 million in costs. As SWG noted, the Commission previously approved the establishment of the Commerce Substation Regulatory Asset in SWG's previous GRC, which was intended to delay its recovery to a future GRC until the Commission could gather sufficient information to determine the reasonableness of the costs. In the instant proceeding, the Commission finds that the costs were reasonable and accepts Staff's recommendation to allow the recovery of $6.0 million in costs over a six-year amortization period.

531. The Commission finds that a six-year amortization period is consistent with the most recent timing of SWG rate cases and depreciation cases. The six-year period also reduces the risk of over-recovery. In the event that SWG files a case prior to the conclusion of the amortization period, it can request to have the amortization period reset.

U. Repair Costs for Wigwam Parkway & Jessup Road Safety Incident

Staff's Position

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532. Staff recommends that the Commission approve its adjustment to SWG's SND O&M costs to remove approximately $112,000.00 to account for the response and repair costs associated with a grade one leak. (Ex. 60 at 2, 4.) Staff states that on September 27, 2017, SWG's contractor was performing a leak survey and discovered a grade one leak requiring the evacuation of two premises at the intersection of Wigwam Parkway and Jessup Road in Henderson, Nevada, which resulted in 2,092 customers losing service. (*Id.* at 2.) Staff provides that the cost of the incident, including emergency response and relight costs, exceeded $50,000.00 and was therefore a Federal Reportable incident as outlined by the Code of Federal Regulations ("CFR") 49 §§ 191.3 and 191.5. (*Id.* at 2-3.)

533. Based upon its investigation and summary report filed in Docket No. 17-01001, Staff states that it determined that in 1984, SWG failed to properly bed and shade the 4-inch M700/8000 Polyethylene ("PE") pipeline main during its installation, resulting in rocks having direct contact with the buried 4-inch PE pipeline, which later caused a crack in the pipe and the subsequent grade one leak. (*Id.* at 3.) Staff further states that failure to properly bed and shade the pipeline is inconsistent with SWG's Pipeline Main Construction Procedures as well as 49 CFR Part 192. (*Id.*) Staff provides that because the incident was caused by SWG's failure to follow its procedures and federal pipeline safety regulations, ratepayers should not bear the cost of the incident. (*Id.* at 3.)

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SWG's Rebuttal Position

534. SWG states that it does not oppose Staff's adjustment and agrees to not seek cost recovery related to the federal reportable incident. (Ex. 81 at 47.)

Commission Discussion and Findings

535. The Commission agrees with Staff's contention that ratepayers should not bear the costs associated with SWG's failure to follow its procedures and federal pipeline safety regulations. Moreover, SWG does not oppose Staff's adjustment and agrees to not seek cost recovery for this incident. Accordingly, the Commission accepts Staff's adjustment to SWG's SND O&M costs to remove approximately $112,000.00 to account for the response and repair costs associated with a grade-one leak.

V. Repair Costs for Hawk Springs / Mesa Park Safety Incident

Staff's Position

536. Staff recommends that the Commission approve its proposed adjustment to SWG's SND O&M costs to remove approximately $112,000.00 related to response and repair costs incurred as a result of a grade one leak. (Ex. 60 at 5, 6.) Staff states that on January 15, 2018, SWG discovered the grade one leak at the intersection of Hawk Springs and Mesa Park Drive in Las Vegas, Nevada through an odor complaint from a consumer. (*Id.* at 5.) Staff further states that it implemented a valve isolation plan resulting in approximately 1,766 customers losing gas service. (*Id.*) Staff provides that the cost of the incident, including emergency response and relight costs, exceeded $50,000.00 and was therefore a Federal Reportable Incident pursuant to 49 CFR §§ 191.3 and 191.5. (*Id.*) Staff notes that were no injuries or significant property damage. (*Id.*)

537. Staff states that its investigation determined that in 2005, SWG's construction contractor failed to perform a proper butt fusion joint on the 4-inch PE pipeline. (*Id.*) Staff states that the improper pipe jointing was inconsistent with Section 2.7 of SWG's pipe jointing procedures and the provisions of 49 CFR Part 192. (*Id.*) Staff provides that SWG's customers

should not bear the cost of the incident and is still determining whether to pursue a civil penalty against SWG for the incident. (*Id.* at 5-6.)

SWG's Rebuttal Position

538. SWG states that it does not oppose Staff's adjustment and agrees to not seek cost recovery related to the federal reportable incident. (Ex. 81 at 47.)

Commission Discussion and Findings

539. The Commission agrees with Staff's position that ratepayers should not bear the costs associated with SWG's failure to follow its own procedures and federal pipeline safety regulations. Moreover, SWG does not oppose Staff's adjustment and agrees to not seek cost recovery for this incident. Accordingly, the Commission accepts Staff's adjustment to SWG's SND O&M costs to remove approximately $112,000.00 related to response and repair costs incurred as a result of a grade one leak.

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W. Challenged Utility Work Orders

Supporting Testimony and Documentation for Work Order Nos. 0061W0001059, 0061W0001001, 0061W0000511, 0061W0000888, and 0061W001120 (collectively, the "Challenged Work Orders") - Expenditures Exceeding $1 Million

SWG's Position

540. SWG states that in Docket Nos. 12-02019 & 12-04005, it was directed to meet with Staff prior to filing its next GRC to determine the proper scope of testimony necessary to support work orders produced in response to MDR 106. (Ex. 42[40] at 20.) SWG provides that it met with Staff prior to filing the GRC, and pursuant to an agreement with Staff, it agreed to identify and summarize all non-GIR projects exceeding $1 million. (*Id.* at 20-21.)

[40] Ex. 42 is the prepared direct testimony of Randi L. Cunningham on behalf of SWG.

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541. SWG states that it is "providing support for all non-GIR projects over $1 million that are identified in MDR 106." (*Id.* at 21.) SWG states that Ex. 42 at RLC-4 "provides description, work order number, amount, and brief project summary for each item over $1 million placed in service since the last GRC." (*Id.*)

542. Regarding Ex. 42 at RLC-4, SWG confirms that the first 14 pages are a reproduction of MDR 106,[41] and that MDR 106 covers works orders for all system allocable Northern Nevada and Southern Nevada work orders that are over "$100,000 that have closed since the certification period in the last rate case." (Tr. at 366.) In response to Staff's question regarding where "a summary for any of the system allocable plant project that are greater than [$]1 million" is located within Ex. 42 at RLC-4, SWG states that "[t]hose appear to be missing" but that summaries had been "prepared." (Tr. at 367.)

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543. Additionally, when asked if Ex. 42 contains "project summaries for any of the system allocable [work order] greater than [$]1 million," SWG's witness states: "…I would have to go back and check. I don't know why they're not here [in Exhibit 42]. They were probably provided electronically. They should have been here." (*Id.*) SWG then agrees that Ex. 42 at RLC-4 contains 19 pages and that it was all that was provided. SWG further agrees that "even though Staff and [SWG] agreed that [SWG] would identify and summarize all MDR work orders, MDR work orders greater than ($)1 million, it appears [SWG] did not provide those summaries as requested." (*Id.* at 368.) SWG refers to the missing summaries as an "oversight," and mentions that it would have been "nice" had Staff informed SWG that its summaries for the worker orders greater than $1 million were missing because SWG "would have definitely

[41] Notably, Ex. 42 at RLC-4 contains 19 pages (referred to as "sheets").

provided them promptly." (*Id.*) However, SWG recognizes that, "in every case," it has the burden of proof to show that its proposed rate changes are just and reasonable. (*Id.* at 372.)

544. SWG confirms that one witness was "selected by the Company as the witness to sponsor testimony regarding the non-GIR projects over $1 million." (Tr. at 372.) However, when this witness was asked whether she was involved in the execution of any of the non-GIR projects for which she sponsors testimony, she responds: "[t]o the extent I was involved at the portfolio review board, the software projects came to us before they were launched. So from that perspective I was involved. But as far as the ongoing execution I was not, which is why we brought in a rebuttal witness to address the more finer [sic] details of what went on during those projects." (*Id.* at 373.) Moreover, when asked if she recalled SWG's response to a data request that asked whether she was involved in the execution of any of the projects, she agrees that SWG responded that she was "not involved in the execution of any of the projects." (Tr. at 373.) Significantly, despite being the company's sponsoring witness for the capital projects identified in the work orders, SWG's witness responds to a question regarding certain costs included in the capital work orders by stating, "I did not review the charges of any work order" (Tr. at 375.) and later proclaims that "[t]here was not an internal audit done on those work orders." (Tr. at 377.)

545. In response to a question from the Presiding Officer regarding whether the witness has responsibility for any of the work order projects that resulted in the costs documented by the witness in Ex. 42 at RLC-4, SWG's witness responds: "I don't. Typically the Company's approach when it files rate cases is to provide a limited number of witnesses focused on cost recovery, and then to the extent there is any issues raised through the discovery process, and that aren't addressed in direct, we may bring in additional subject matter experts on rebuttal to address those items." (Tr. at 416.)

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546. In response to a question from the Presiding Officer regarding whether SWG's witness could provide the "business case" for each of the projects listed in Ex. 42 at RLC-4, and other information that the Commission would receive from a project manager, like information how the request for proposals were handled and "the basis for the Company making the decision to incur these costs," SWG's witness responds: "Generally on direct we provide high level information. We have a rebuttal witness that can respond to all those questions, Mr. Murandu." (Tr. at 416-417.) SWG's witness then confirms that Mr. Murandu would be the proper witness to explain to the Commission whether "it was prudent to incur" the costs listed in Ex. 42 at RLC-4. (Tr. at 417.)

547. In response to a question from the Presiding Officer regarding whether she has "personal knowledge" to support the underlying cost data of any of the itemized work order projects included in the witness's testimony, SWG's witness responds that she has "knowledge of the cost data, but not the underlying, no." (Tr. at 420.) When asked to identify a company witness who does have personal knowledge of the underlying cost data, SWG's witness responds, "Mr. Murandu." (*Id.*)

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548. In response to a question from the Presiding Officer asking whether SWG understands that it is SWG's burden to justify the prudence of expenditures, SWG responds, "[a]bsolutely." (Tr. at 425-426.)

BCP's Position

549. BCP does not address this issue.

Staff's Position

550. Staff states that, generally, it "reviews all capital projects with expenditures over $1 million and reviews a sample set of capital projects with expenditures less than $1 million."

(Ex. 64 at 3.) Staff further states that "[f]or each project selected, Staff reviews the utility's business case (or justification) for the capital project, budget, and schedule, responses to request for proposals ('RFP's), executed contracts, any change orders, and major invoices charged to the project." (*Id.*)

551. Staff states that SWG did not provide any material information or documentation in its Application supporting the prudency of including the costs associated with the non-GIR plant SWG placed into service since its last GRS. (*Id.*) Staff explains that "SWG closed a total of approximately $366 million in non-GIR projects and approximately $294 million in GIR projects." Staff states that "SWG provided minimal and inadequate information for the non-GIR projects to support the prudency of the $366 million of expenditures associated with the non-GIR projects." (*Id.*) Staff states that "[o]ther than a few paragraphs and an exhibit listing the projects," SWG, through its testimony in Ex. 42, "does not offer substantial testimony on any of the non-GIR projects to support the reasons for the project prudency." (*Id.*) Staff opines that "[i]t appears that SWG believes that simply because SWG spent the money it should be automatically considered reasonable for inclusion in rates." (*Id.*)

552. Staff states that SWG's sponsoring witness for the costs associated with the non-GIR projects is "not the proper SWG personnel to sponsor direct testimony for capital projects" because this witness was "not involved in executing the projects" and does not "have direct knowledge of and did not have any approval authority over any of the projects...sponsored." (*Id.* at 4.) Staff opines that a "SWG Program/Project Sponsor and/or Officer who has the financial fiduciary responsibility of the project should be the individual to offer direct testimony supporting the prudency of the project." (*Id.* at 5.)

553. Staff explains that in order for the Commission to evaluate the reasonableness of the costs a utility incurs, "the Commission must be able to investigate and assess the decision-making of the utility at the time the costs were incurred." (*Id.*) Staff states that "[b]est practices in Nevada require the filing of testimony on behalf of individuals who actually worked on and supported the projects that customers are being asked to pay for, especially when those projects total well over $600 million in new expenditures." (*Id.*) As an example, Staff cites to the documentary evidence provided by other utilities in GRC proceedings. (*Id.*)

554. Staff states that SWG's "failure to provide adequate documentary and decision-maker support could reasonably cause the Commission to determine that none of the costs are reasonable for inclusion in rates." (*Id.* at 5-6.)

555. To assess whether the costs related to several capital projects were prudently incurred and thus just and reasonable to include in rates, Staff issued a number of data requests seeking SWG's justification, or business case, for these projects, including the Challenged Work Orders. (*See generally* Ex. 65; Ex. 64 at 6-11.) While Staff agrees that, during discovery, it gathered "a tremendous amount of information" regarding these project like invoices, names and budgets of projects, and internal memos regarding expenditures (Tr. at 810; *See generally* Exs. 65, 67, 68, and 69), Staff states that "even in that amount of data [SWG] has not demonstrated the prudency of these expenditures of these projects." (Tr. at 810.)

556. Moreover, in recognizing that the Commission does not have access to all of the data that is produced in response to discovery, Staff explains that SWG could have provided additional information on rebuttal to supplement this record and demonstrate the prudency and just and reasonableness of the costs associated with the challenged works orders and this GRC. (Tr. at 856-857.) However, Staff states that SWG's rebuttal similarly fails in this respect,

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explaining, for example, that SWG's rebuttal testimony also lacks descriptions of key decisions made regarding projects. (*Id.* at 857.) Instead, Staff opines that "it seemed like the rebuttal was more of a focus on [Staff] than the Company's actions of actually executing [these] projects." (*Id.*)

SWG's Rebuttal

557. As indicated during the presentation of its direct testimony at hearing, SWG offers a rebuttal witness to address whether "it was prudent to incur" the costs listed in Ex. 42 at RLC-4 (the costs incurred regarding the Challenged Work Orders). (Tr. at 416-417.) SWG witness Murandu states that the purpose of his rebuttal testimony "is to respond to specific aspects" of Staff's testimony regarding its "recommendations and comments concerning [the Challenged Work Orders]." (Ex. 80 at 2.) Specifically, SWG witness Murandu provides as follows:

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> "As the incoming [Chief Information Officer ('CIO')] starting in May 2017, I apprised myself of the programs and projects referenced in Staff's conclusions in this Docket. After reviewing the same materials referenced by Staff's witness...and developing a detailed knowledge of [SWG's] project governance and management guidelines, I came to a different conclusion. Staff's conclusions regarding each of the [Challenged Work Orders] and projects are incorrect. [SWG] provided extensive oversight for each of the referenced programs and projects. Furthermore, [SWG] was willing to recognize and take accountability for misclassifications identified through the auditing process in this current Docket."

(*Id.*)

558. SWG states that its projects are managed according to project governance guidelines within the Project Management Institute ("PMI") Standards. (*Id.* at 29.) SWG states that PMI "is globally recognized as a non-profit organization that creates the standards for project and portfolio management practices that are written in the Project Management Book of Knowledge ("PMBOK"), used to certify project management professionals." (*Id.*) SWG further

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states that it established the Portfolio Review Board ("PRB") and the Portfolio Advisory Council ("PAC") "to centralize the governance of processes, tools, and resources to maximize the business value of proposed projects." (*Id.*) SWG explains that "[t]he PRB serves the PAC as a technical resource" and that the primary purpose of "[t]he PAC is to instate portfolio governance and sustain it with disciplined oversight." (*Id.* at 30.)

559. SWG witness Murandu agrees that the projects included in the Challenged Work Orders all "closed to plant sometime between 2012 and 2016," that he did not start working for SWG until May 2017, and that, therefore, these projects were completed before he began working for SWG. (Tr. at 968-969.) While SWG witness Murandu states that he reviewed the records and documents associated with these projects to "ascertain the health of the projects, the genesis of the projects, the expenditures that had been spent to date on the projects, and the future direction and roadmap for these projects," he was not involved in the execution of these projects. (*Id.* at 969-970.)

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560. In recognition of Staff's difficulties obtaining the documented support for the projects in the Challenged Work Orders, SWG witness Murandu recognizes that he is the "first officer level representative" to provide testimony in this Docket and represents that SWG shares Staff's frustrations. (Tr. at 972.)

561. SWG witness Murandu states that while he was able to avail himself of the opportunity to learn about these projects after-the-fact in addition to familiarizing himself with SWG's governance structure for oversight of its projects (Tr. 973-978.), he agrees that this information should have been provided by SWG in its direct testimony and that SWG should not be permitted to "expand the scope of rebuttal beyond its proper function…" (Tr. at 979.)

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562. SWG witness Cunningham, recalled again on rebuttal after SWG filed a revised version of her direct testimony at RLC-4 to include the sheets that had been prepared containing the summaries for the projects associated with the Challenged Work Orders (Tr. at 367.), again confirmed that she was neither personally responsible for managing any of the projects listed in her testimony on those sheets, nor did she prepare SWG's business case, budget, schedule, RFPs, contracts, change orders, or invoice for these projects. (Tr. at 1546-1547.)

Work Order 0061W0001059 - Financial Applications Replacement

SWG's Position

563. SWG provides that the Financial Application Replacement cost a total of $18,146,654.00, with $5,105,334.00 allocated to its SND and $298,955.00 allocated to its NND. (Ex. 42 at RLC-4, Sheet 2 of 19, line 1.)

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BCP's Position

564. BCP does not address this issue.

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Staff's Position

565. Staff recommends disallowing 50 percent of the costs associated with SWG's System Allocable Pant Work Order No. 0061W0001059. (Ex. 64 at 1-2, Ex. 71 at 4.) Staff provides that such an adjustment would remove $9.051 million from rate base related to the work order ($2.546 million in its SND and $0.530 million in its NND). (Ex. 71 at 3-4.) Staff recommends corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2, pages 1-2, and CW-3, CW-13, CW-14.) Staff states that these work orders are the corporate level capital projects that SWG utilizes in all of its rate jurisdictions and subsidiaries. SWG's Southern

Nevada and Northern Nevada jurisdictions are allocated approximately 28 percent and 6 percent, respectively, of the total costs of SWG's System Allocable Plant. (Ex. 64 at 11-12.)

566. According to Staff, SWG states it initiated the Financial Applications Replacement Project, referred to as the Financial System Modernization Program ("FSM"), to modernize SWG's financial processes and supporting systems to better position SWG for the modern operating requirements associated with modern financial systems (Ex. 64 at 12-13.) Staff states that, on May 7, 2014, SWG's Board of Directors authorized the FSM Program to proceed with a budget of $19 million over a 22-month schedule. (*Id.* at 13.)

567. Staff states that SWG entered into a consulting contract with Mr. Biernacki on March 3, 2014, to perform professional services related to the FSM Program. (*Id.* at 14.) Staff states that Mr. Biernacki was paid an hourly rate of $155 for his services and a $10,000 relocation expense to move him from Hawaii to Las Vegas, Nevada. (*Id.*) Staff states that the final cost of the FSM Program was approximately $18.1 million. (*Id.*) Staff states that, in its review of the documentation associated with the FSM Project, it found "excessive consultant expenses, travel expenses, and numerous vouchers for frivolous items that caused [Mr. Danise] concern that SWG did not exert prior financial oversight over project costs." (*Id.*) For example, Staff reviewed one voucher from Power Promotions LLC, and found SWG had ordered a Casio Digital Piano, a Yamaha 7.2 channel home theater system, a Broil King natural gas grill, multiple Bose wireless speaker systems, and multiple JBL Bluetooth headphones, for a total of $7,568.39. (*Id.*) Staff states that numerous other vouchers included charges associated with food, gifts, birthday supplies, and other miscellaneous items. (*Id.* at 15.) Staff states that one example of miscellaneous other items from one voucher include charges for Pink Box donuts, a baby shower cake from Sam's Club, ice cream sundae supplies from Walmart for an employee

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appreciation day, and Popcorn Girl for St. Patrick's Day team morale. Staff finds it "extremely troubling that, based on the documents provided, SWG never questioned any charges, never questioned the booking of those costs as project costs for ratepayer recovery." (*Id.*)

568. Staff states that, once it discovered a lack of SWG oversight on the FSM Program, it began reviewing the amount of hours consultants were charging to the FSM Program. For example, one consultant billed an average of approximately 242 hours per month—over 80 hours of overtime a month. (*Id.*) Staff states that SWG has not provided any documentation or discussion as to why such excessive overtime was necessary or how it managed the consultant workload. As a result, Staff cannot agree that the amount of charges billed from consultants were reasonable. (*Id.*)

569. Staff states that it appears many consultants retained on the FSM Program were flown to Las Vegas each Monday and flown back home for the weekend. One example is Mr. Nauduri. Mr. Nauduri was paid on hourly rate of $130 an hour, $165 per diem per day he was on-site, and flown back home each weekend. (*Id.* at 16.) Staff states that during the Christmas week in 2015, SWG flew Mr. Nauduri out from Washington, D.C. to Las Vegas to work three days on-site, and during New Year's week in 2015, SWG flew Mr. Nauduri to Las Vegas to work three days on-site and then back to Washington, D.C. on a Wednesday in which Mr. Nauduri claimed to have billed 11 hours of work that day. (*Id.*) Staff states that SWG has not provided any supporting material as to why it was necessary for many consultants working on the FSM Program to fly home each weekend. (*Id.* at 17.)

570. Staff states that SWG provided rental cars for many consultants regardless of the need for a rental car. For example, one consultant submitted a rental car receipt for $135.58, when that consultant drove a total of 10 miles, which equates to $13.56 per mile. (*Id.*) In another

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example, a consultant rented a car for $184.72 during the week of June 1 through June 4, 2015, and drove a total of one mile. (*Id.*)

571. Staff states that it found other charges that appear to be incorrectly charged to the FSM Program. Staff found two vouchers from Deloitte and Touche LLP related to professional services rendered in connection with the NPL Construction Co. Cyber Risk Assessment for approximately $40,000. Staff states that it appears these charges should be allocated to SWG's wholly-owned construction company NPL Construction Co., not to SWG's ratepayers. (*Id.* at 17-18.)

572. Staff acknowledges that "there is no dispute" that the software needed to be replaced. (Tr. at 764.) However, Staff states that the FSM Program expenditures "could have been lower had SWG prudently managed the program" and that "[i]t is difficult to believe that a SWG employee was reviewing these costs and decisions and approving them as reasonable." (Ex. 64 at 18.) Accordingly, "[g]iven the extreme lack of oversight leading to the unreasonable expenditures…and SWG's lack of accountability with respect to those expenditures," Staff recommends the Commission disallow 50 percent of the costs associated with SWG's FSM Program. (Ex. 64 at 18; Tr. at 755-756.) Staff states that SWG failed to provide any alternatives or justifications for the timeline of the project or why it chose the contractor it chose. (Tr. at 765-766.) Staff states "SWG also must ensure that in future general rate cases it provides adequate justification supporting its project costs." (Ex. 64 at 19.)

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SWG's Rebuttal Position

573. SWG states that it requests a net plant of $13,283,718.00 for the FSM Program. (Ex. 81 at 12.) SWG further states that it removed $43,706.46 related to reasonable and necessary business expenses that were improperly characterized as capital instead of an

accounting expense, $266,239.00 in non-incremental labor costs, and $6,986.97 identified by Staff. (*Id.* at 12-13.)

574. SWG states that, prior to the implementation of the FSM Program, SWG used a software "implemented in 1986." (Ex. 80 at 2.) SWG states that "it needed to replace that system to leverage improvements made in the software industry with respect to financial systems for organizations of this magnitude." (*Id.*) SWG states that implementation of the FSM Program "resulted in improvements in the supply chain processes, invoice recording and reporting, improved contract management, and improved accounting processes and controls." (*Id.* at 3.)

575. SWG states that it disagrees with Staff's assertion that the FSM program suffered from an "extreme lack of oversight leading to unreasonable expenditures." SWG provides that Staff was provided all invoices from the FSM program and objected to 19 of 672 of them, representing 2.8 percent of all vouchers provided for review. (Ex. 80 at 3.) SWG further provides that it "cannot reconcile how the total amount of misclassified vouchers" identified by Staff ($93,514.74) could statistically justify a 50 percent disallowance from a project that totals $18.1 million. (*Id.*)

576. SWG states that that Staff's claim that it lacked accountability with expenditures related to the work order is simply not true. (*Id.* at 4.) SWG provides that after being made aware of certain expenditures were incorrectly classified in the FSM program, it removed them and informed Staff of the corrections. (*Id.*) SWG further provides that it also independently reviewed expenditures beyond what Staff questioned on its own accord and "made additional adjustments to appropriately reclassify misclassified expenses." (*Id.*)

577. SWG contends that its FSM program did not suffer from an extreme lack of oversight, noting that 1) the FSM program was sponsored by SWG's senior management and

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was authorized by its board of directors; 2) SWG's documentation shows that its FSM program had extensive oversight beginning at the executive level and throughout the program including activities such as the initial planning, staffing decisions, budget development, System Implementer selection, hiring of individual contractors, and all project deliverables through project completion; 3) the incurred charges were reviewed and compared to the budget and SWG kept extensive records (including 672 vouchers comprised of 2,280 pages of invoices and supporting documentation); 4) SWG held regular meetings with different committees overseeing the execution of the FSM program, kept minutes, and provided 510 pages of governance-related activities; and 5) records indicate that the FSM Program was completed on-time and under budget. (*Id.* at 4-5.)

578. SWG states that several invoices from the FSM Program that Staff was critical of were not inquired about in discovery. (*Id.* at 13.) SWG provides that it would have appreciated an opportunity to respond to specific questions regarding costs, but was not given an opportunity. (*Id.*) After reviewing the additional invoices questioned by Staff, SWG provides that it only supports $420.00 for costs considered "employee appreciation" expenses, and $41,035.00 for the Deloitte and Touche LLC invoices. (*Id.* at 13-14.) SWG further provides that it believes the remaining FSM Program costs are reasonable. (*Id.* at 14.)

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579. With respect to the Deloitte and Touche invoices, SWG states that it "did not charge its internal labor to the project since the costs of those employees are generally expensed and already included in rates." (*Id.*) SWG further states that it only billed incremental costs to the FSM program, which were included in the original budget for the project. (*Id.*) SWG provides that Deloitte and Touche were engaged as contract labor to provide services for its internal audit department on an incremental basis while several of its employees were dedicated

to the FSM Program; however, when internal audit employees perform audits for affiliates, such expenses are directly charged. (*Id.*) SWG further provides that because the services performed by Deloitte and Touche LLP were not for SWG audits, the company agrees that such audits should not have been included in the project. (*Id.*)

580. SWG states that the FSM Program did not suffer from an extreme lack of oversight; rather, it was sponsored by SWG's senior management and was authorized by the company's BOD. (Ex. 81 at 14-15.) SWG further states that the program had extensive oversight on a granular and executive level throughout the program, that the incurred charges were reviewed and compared to its budget, and the company held regular meetings with different committees that were overseeing the project. (*Id.* at 15.)

581. SWG states that it disagrees with Staff's recommendation to disallow 50 percent of the FSM Program costs and contends that Staff's reference to approximately 0.5 percent of costs for the FSM Program that were reasonable but misclassified did not demonstrate a lack of oversight. (*Id.*) SWG provides that Staff's claim of a lack of accountability is unsupported given that SWG acknowledged its error and removed costs that were incorrectly accounted for. (*Id.*) SWG provides that as Staff was provided all of the invoices for the FSM Program, it had all of the data required to calculate a specific cost disallowance. (*Id.*) Accordingly, SWG states it is not appropriate to use a projected disallowance. (*Id.*)

Work Order 0061W0001001 - Field Operations Management System ("FOMS"), Phase I

SWG's Position

582. SWG provides that FOMS, Phase I, cost a total of $13,313,529.00, with $3,745,595.00 allocated to the SND and $219,332.00 allocated to its NND. (Ex 42 at Exhibit RLC-4, Sheet 2 of 19, line 3.)

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BCP's Position

583. BCP does not address this issue.

Staff's Position

584. Staff recommends disallowing 50 percent of the costs associated with SWG's System Allocable Pant Work Order Nos. 0061W0001001 and 0061W0000511. (Ex. 64 at 1-2, Ex. 71 at 4.) With respect to Work Order No. 0061W0001001, Staff provides that the adjustment would remove $6.654 million from rate base related to the work order ($1.872 million in its SND and $0.390 million in its NND). (Ex. 71 at 4.) Staff recommends corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2, pages 1-2, CW-4, CW-13, and CW-14.)

585. Staff states that these work orders are the corporate level capital projects that SWG utilizes in all of its rate jurisdictions and subsidiaries. SWG's Southern Nevada and Northern Nevada jurisdictions are allocated approximately 28 percent and 6 percent, respectively, of the total costs of SWG's System Allocable Plant. (Ex. 64 at 11-12.)

586. Staff states that SWG initiated FOMS project to consolidate its field operations systems to automate and optimize field-related activities, increasing labor efficiencies for dispatch, customer service field processes and compliance procedures. (*Id.* at 19.) FOMS Phase I focused on the customer service related field operations. Staff states that the final cost of the FOMS Phase I project was approximately $13.3 million. (*Id.* at 20.) Staff states that there were "excessive SWG and consultant travel expenses and a lease for office space" associated with FOMS Phase I. (*Id.*) Staff states that there were approximately $68,000 in airfare, $160,000 in

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lodging, $42,000 in car rentals, $17,000 in meals, and $24,000 in seminar and/or conference fees. (*Id.*) Staff states "SWG has not demonstrated why these costs are reasonable." (*Id.*)

587. Staff states that on March 2, 2011, SWG rented a 6,192 square foot office space at 3110 South Rainbow Blvd. for a three-year term at $6,183 per month. (*Id.*) Staff states that SWG "has not justified the need to lease a specific office space for the FOMS Phase I Project, nor has SWG explained why its corporate buildings could not be used for the FOMS Phase I project." (*Id.*)

588. Staff states that given the "unreasonable" expenditures and "SWG's lack of accountability with respect to those expenditures," Staff recommends a 50 percent disallowance of the costs associated with SWG's FOMS Phase I. (*Id.* at 21.) Staff states that SWG must implement proper processes and procedures to ensure adequate oversight and control over project costs. (*Id.*)

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SWG's Rebuttal Position

589. SWG states that, in 2009, it "embarked on an effort to analyze what new options might be available in Work Management specifically the customer service arena" due to "limitations in the operation of the Company's legacy work management solution – Mobile Service." (Ex. 80 at 15.) Notably, SWG states that "[t]he asset management process had become cumbersome as a result of increasing requirements to collect compliance information related to work orders." (*Id.*) Ultimately, SWG states that it "determined that a single vendor, integrated solution for both Work Management/Compliance and Customer Service Dispatching would be in the best interest of process efficiencies for [SWG]....[and]....[a]s a result, Logica's Asset Resource Management ('ARM') suite of products was selected." (*Id.*)

590. SWG states that it "managed FOMS Phase I Project according to project governance guidelines within PMI Standards." (*Id.* at 17.) SWG states that "[p]roject expenditures were approved through a set channel of executive oversight and recorded in project documents…" (*Id.*) Moreover, SWG states that "[c]hange orders and deviation to budget required governance structure approval, and the recording of those expenditures into the accounting system required management sighn-off." (*Id.*)

591. SWG states that implementation of FOMS, Phase I, "addressed a key component of customer service by introducing a more efficient method of assigning and distributing work orders and customer service assignments to [SWG] field staff," as well as "providing an added benefit of linking asset records to compliance level activities performed on those assets" and "providing an integrated solution for work management and customer service dispatching." (*Id.* at 15-16.)

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592. SWG states that all of the expenditures referenced by Staff "were valid and necessary business expenses." (Ex. 80 at 16.) SWG contends that Staff merely identifies certain expenses and baldly asserts that they are excessive without providing reasoning. (*Id.*) SWG further states that Staff failed to seek an explanation from SWG regarding the reasonableness of costs identified in its testimony. (*Id.* at 16-17.) SWG provides that Staff does not need to seek an explanation, but contends that if it identifies expenditures as excessive, it would be appropriate for Staff to seek an explanation before making assertions without support. (*Id.*)

593. SWG states that as of its certification filing, it requests a net plant of $6,260,832.00 for FOMS Phase I. (Ex. 81 at 16.) SWG further states that prior to the certification period, it removed $4,758.00 related to meals related to FOMS, Phase I. (*Id.*) SWG notes that Staff identified and questioned various costs for consultant travel-related expenses,

conference fees, and the lease for additional office space and related improvements but did not conduct discovery on the related vouchers. (*Id.*) SWG provides it would have appreciated the opportunity to respond to specific questions regarding those costs. (*Id.*) SWG states that in reviewing the vouchers questioned by Staff, it determined that the costs were valid, reasonable, and associated with the implementation of the project. (*Id.* at 16-17.) Accordingly, SWG does not believe additional expenses should be removed. (*Id.* at 17.)

594. SWG disagrees with Staff's recommendation to disallow 50 percent of the project's costs. (*Id.*) SWG states that Staff's identification of a small percentage of costs related to the project that were mistakenly charged to the wrong account demonstrate a lack of oversight. (*Id.*) SWG provides that Staff's assertion of a lack of accountability on behalf of SWG is unsupported given that once it was apprised of misallocation of costs, it acknowledged the error and removed the costs. (*Id.*) SWG further provides that Staff was given all of the invoices for the project and could have calculated a specific disallowance for the project, making Staff's proposed projected disallowance inappropriate. (*Id.*)

Work Order 0061W0000511 - FOMS, Phase II

SWG's Position

595. SWG seeks recovery of the costs associated with FOMS Phase II, Work Management, cost a total of $9,786,464.00, with $2,753,299.00 allocated to its SND and $161,226.00 allocated to its NND. (Ex. 42 at Exhibit RLC-4, Sheet 2 of 19, line 4.)

BCP's Position

596. BCP does not address this issue.

Staff's Position

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597. Staff recommends a 50 percent disallowance for the costs associated with Phase II of the FOMS project. (Ex. 64 at 21-22.) Staff states that Phase II focused on SWG's work management system used to track its construction and technical processes. (*Id.* at 21) Staff states that the final cost of the FOMS Phase II project was approximately $9.8 million. (*Id.*) Staff states that given the expenditures it found unreasonable and SWG's lack of accountability with respect to those expenditures it is recommending the disallowance. (*Id.* at 22.)

598. More specifically, Staff recommends that the Commission accept an adjustment for Work Order No. 0061W000511, removing $4.892 million from rate base related to FOMS-II ($1.376 million from its SND and $0.287 million from its NND). (Ex. 71 at 5.) Staff recommends corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2, pages 1-2, CW-5, CW-13, and CW-14.)

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SWG's Rebuttal Position

599. SWG states the "FOMS Phase II Project was initiated to mitigate several issued in the lgacy Work Management System ('WMS') including components of the system that were becoming unsupported, the aging of the internally developed construction management scheduling tool, lack of functionality provide by the WMS system and the vendor's resistance to making necessary enhancements." (*Id.* at 19.) SWG states that the FOMS Phase II project was governed under the same PMI Standards which governed the FOMS Phase I project. (*Id.* at 21.)

600. SWG disagrees with Staff's claim that the FOMS Phase II project had unreasonable expenditures and that SWG had a lack of accountability regarding the expenditures. (Ex. 80 at 20.) SWG further states that Staff did not reference any particular costs or expenditures related to the work order that it claimed to be excessive or unsupported. (*Id.*)

SWG provides that Staff similarly did not provide an explanation for its claim that SWG lacked accountability relating to the FOMS Phase II project. (*Id.*) SWG contends that contrary to Staff's position, it "provided oversight for the FOMS Phase II Project and is accountable for the success of that project." (*Id.*)

601. SWG specifically disagrees with Staff's recommendation regarding the work order because, "like other projects, SWG managed the FOMS Phase II Project according to project governance guidelines within PMI Standards" and notes that the project had a Project Manager, Project Director, Oversight committee, Executive Steering Committee, and an Executive sponsor. (*Id.* at 21.) Moreover, SWG states that project expenditures were approved with executive oversight and recorded in project documents. (*Id.*) SWG provides that change orders and deviations to budget required governance structure approval and recoding of those expenditures required sign-off from management. (*Id.*) SWG contends that it successfully implemented the FOMS Phase II Project and states that it currently uses the system as part of its work management system. (*Id.*)

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602. SWG states that as of its certification filing, it requests a net plant of $5,897,108.00 for FOMS Phase II. (Ex. 81 at 16.) SWG states that prior to the certification period, it removed $2,160.00 related to meals from Phase II. (*Id.*) SWG notes that Staff identified and questioned various costs for consultant travel-related expenses, conference fees, and the lease for additional office space and related improvements but did not conduct discovery on the related vouchers. (*Id.*) SWG provides it would have appreciated the opportunity to respond to specific questions regarding those costs. (*Id.*) SWG states that it reviewing the vouchers questioned by Staff, it determined that the costs were valid, reasonable, and associated

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with the implementation of the project. (*Id.* at 16-17.) Accordingly, SWG does not believe additional expenses should be removed. (*Id.* at 17.)

603. SWG disagrees with Staff's recommendation to disallow 50 percent of the project's costs. (*Id.*) SWG states that Staff's identification of a small percentage of costs related to the project that were mistakenly charged to the wrong account demonstrate a lack of oversight. (*Id.*) SWG provides that Staff's assertion of a lack of accountability on behalf of SWG is unsupported given that once it was apprised of misallocation of costs, it acknowledged the error and removed the costs. (*Id.*) SWG further provides that Staff was given all of the invoices for the project and could have calculated a specific disallowance for the project, making Staff's proposed projected disallowance inappropriate. (*Id.*)

Work Order 0061W0000888 (GIS Mapping Migration Project)

SWG's Position

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604. SWG provides that the GIS Mapping Migration Project cost a total of $6,530,306.00, with $1,837,220.00 allocated to its SND and $107,587.00 allocated to its NND. (Ex. 42 at Exhibit RLC-4, Sheet 2 of 19, line 5.)

BCP's Position

605. BCP does not address this issue.

Staff's Position

606. Staff recommends disallowing 50 percent of the costs associated with SWG's System Allocable Pant Work Order No. 0061W0000888. (Ex. 64 at 1-2.) Staff states that these work orders are the corporate level capital projects that SWG utilizes in all of its rate jurisdictions and subsidiaries. SWG's Southern Nevada and Northern Nevada jurisdictions are

allocated approximately 28 percent and 6 percent, respectively, of the total costs of SWG's System Allocable Plant. (Ex. 64 at 11-12.)

607. More specifically, Staff recommends that the Commission accept an adjustment removing $3.259 million from rate base related to the GIS Mapping Migration Project ($0.917 million for its SND and $0.191 million for its NND). (Ex. 71 at 5.) Staff provides that the adjustment excludes 50 percent of the cost of the work order. (*Id.*) Staff recommends corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2, pages 1-2, CW-6, CW-13, and CW-14.)

608. Staff states that SWG initiated the GIS Mapping Migration Project to replace its existing electronic mapping and records system, which was implemented in the late 1980's to the early 1990's and had reached its useful life. (Ex. 64 at 22.) Staff states that the final cost of the GIS Mapping Mitigation Project was approximately $6.5 million. Staff states that there appear to be "excessive consultant expenses." (*Id.* at 23.) Staff states that it appears that for almost every meeting SWG held on its capital projects there was some sort of meal or refreshment provided. Staff states that SWG's shareholders, and not ratepayers, should pay free meals and refreshment costs for consultants. (*Id.*) Additionally, Staff states that SWG paid consultants to attend seminars and/or conferences. However, "since consultants are hired for their expertise and experience as represented in SWG's contract language, and are paid a premium wage for that expertise and experience, it seems unreasonable for SWG to also pay for consultants to attend seminars or conferences to receive training that benefits that particular consultant." (*Id.* at 23-24.)

SWG's Rebuttal Position

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609. SWG states that the GIS Migration Project replaced the existing GIS given that the legacy system "was highly distributed, inefficient, and challenging to sustain in its aged state." (Ex. 80 at 22.)

610. SWG disagrees with Staff's claim that the GIS Migration Project had unreasonable expenditures or that SWG had a lack of accountability with respect to the expenditures. (Ex. 80 at 23.) SWG provides that "notwithstanding the total number of objections not exceeding $31,664.00 that [Staff] cites, this represents less than 0.5 percent of the total investment in the GIS Migration Project." (*Id.*)

611. SWG states that all of the expenditures on the project were reasonable. (*Id.*) With respect to Staff's specific criticisms, SWG provides that meals included in the expenditures were reasonable because they occurred during times that were inconvenient or where self-provided meals would have resulted in inefficient use of time. (*Id.*) SWG further provides that expenditures related to conferences and training for the project team and its project manager were reasonable because it minimized the risk of extended implementation durations and cost overruns due to inexperience and lack of knowledge. Accordingly, SWG asserts that all of the expenditures on the project were valid and reasonable, and that a 50 percent disallowance of a $6.5 million project based upon $31,664.00 contested expenditures is punitive and not justifiable. (*Id.* at 24.)

612. SWG states that the requested gross plant amount after the certification period for the GIS Mapping Migration Project was $6,517,032.00, which excludes $13,274.00 in meals related to the project, which were removed at certification. (Ex. 81 at 17-18.) SWG further states that the vouchers that Staff critiqued regarding the project, such as the cost of seminars and conferences, were appropriate and associated with the implementation of the project. (*Id.* at 18.)

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SWG states that it does not support removing additional costs charged to the GIS Mapping Migration Project. (*Id.*)

613. SWG provides that Staff's identification of 0.5 percent of the total costs of the project being mistakenly charged to the wrong account does not demonstrate a lack of oversight. (*Id.*) Moreover, SWG provides that Staff's assertion of a lack of accountability is not supported given SWG's acknowledgement of the error and removal of incorrect costs. (*Id.*) SWG contends that, considering Staff was provided all invoices related to the project, it was able to calculate a specific recommended disallowance, making its projected disallowance inappropriate. (*Id.*)

Work Order 0061W001120 (Web Content Management)

SWG's Position

614. SWG provides that its Web Content Management ("WCM") cost a total of $3,479,565.00, with $978,932.00 allocated to its SND and $57,324.00 allocated to its NND. (Ex. 42 at Exhibit RLC-4, Sheet 2 of 19, line 6.)

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BCP's Position

615. BCP does not address this issue.

Staff's Position

616. Staff recommends disallowing 50 percent of the costs associated with SWG's System Allocable Pant Work Order No. 0061W0001120. (Ex. 64 at 1-2.) Staff states that these work orders are the corporate level capital projects that SWG utilizes in all of its rate jurisdictions and subsidiaries. SWG's Southern Nevada and Northern Nevada jurisdictions are allocated approximately 28 percent and 6 percent, respectively, of the total costs of SWG's System Allocable Plant. (*Id.* at 11-12.)

617. More specifically, Staff recommends that the Commission accept an adjustment removing $1.737 million from rate base related to WCM ($0.489 million from its SND and $0.102 for its NND). (Ex. 71 at 5-6.) Staff provides that the adjustment excludes 50 percent of the cost of the work order. (*Id.* at 6.) Staff recommends a corresponding adjustment to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2, pages 1-2, CW-7, CW-13, and CW-14.)

618. Staff states that the final cost of the WCM Project, phase II, was approximately $3.5 million. Staff states that there were "excessive consultant expenses" associated with this project. (Ex. 64 at 25.) Staff states that there were many vouchers with team meals billed and, additionally, many instances where multiple consultants billed in excess of 100 hours for the same two-week period. (*Id.* at 25-26.) Staff states that SWG did not provide any documentation that the project was a time-sensitive project requiring hundreds of hours of overtime by multiple consultants. (*Id.* at 26.) Staff states it additionally found vouchers for the purchase of an Apple Mac computer, and multiple iPads, totaling approximately $4,000. (*Id.*) Staff states that SWG failed to provide any documentation to support the purchase of these Apple products for this project. (*Id.*)

SWG's Rebuttal Position

619. SWG states that "[t]he primary objective of the WCM project is to allow [SWG] to publish content in a timely and efficient manner." (Ex. 80 at 25.) SWG states that it managed this project similar to FOMS, and in accordance with PMI Standards. (*Id.* at 26.)

620. SWG states that its gross plant amount requested at the end of its certification period was $3,473,492.00, which was $6,073.00 less than its initial filing to account for the removal of the cost of meals related to the project. (Ex. 81 at 19-20.) SWG further states that it

does not support removing additional costs charged to the project. (*Id.* at 20.) SWG provides that Staff's 50 percent disallowance is justifiable, as Staff's identification of a small percentage of costs mistakenly charged to the wrong account does not demonstrate a lack of oversight. (*Id.*) Moreover, SWG further provides that Staff's assertion of a lack of accountability is unsupported given that the company acknowledged the misallocated costs and removed them from the project. (*Id.*) SWG contends that Staff's 50 percent disallowance is not appropriate given that it was provided all of the invoices related to the project and could have calculated a specific cost disallowance. (*Id.* at 21.)

Commission Discussion and Findings

621. The Commission finds that SWG failed to sustain its "burden of proof of establishing that its proposed [rate] changes" associated with the projects in the Challenged Work Orders "are just and reasonable and not unduly discriminatory or preferential."[42] Accordingly, the Commission disallows 100 percent of the costs associated with the projects in the Challenged Work Orders.

622. ***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. In fact, based on the evidence presented, there***

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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. ~~As discussed in the Applicable Law section of this Order, SWG does not enjoy a rebuttable presumption of prudence regarding its expenditures in GRC proceedings,~~[43] ~~and given that there has been no proceeding in which the Commission could address the prudence of the costs associated with these Challenged Work Orders other than this proceeding, the Commission cannot satisfy its responsibility to set just and reasonable rates if it includes these costs which lack evidentiary support.~~

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623. To sustain its burden of proof of establishing that its proposed rate changes are just and reasonable, SWG is required to "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."[44] As the evidentiary record reveals, the total support provided by SWG for the Challenged Work Orders in its direct case is presented in the testimony included under Exhibit 42, which is the prepared direct testimony of SWG witness Cunningham.[45] However, despite

[43] Notably, SWG initially understood that it is its burden to carry to justify the prudence of its expenditures. (Tr. at 425-426.)
[44] NAC 703.2231.
[45] SWG states that Ex. 42 at RLC-4 "provides description, work order number, amount, and brief project summary for each item over $1 million placed in service since the last GRC." (*Id.*)

being the one witness "selected by the Company as the witness to sponsor testimony regarding the non-GIR projects over $1 million,"[46] this sponsoring witness was not involved in the execution of any of the projects included in the Challenged Work Orders,[47] "did not review the charges of any work order,"[48] and does not possess any personal knowledge to support the underlying cost data of any of the itemized work order projects included in her testimony.[49] In fact, SWG's sponsoring witness for the Challenged Work Orders was unable to even provide the Commission with information demonstrating "the basis for the Company making the decision to incur these costs" associated with the Challenged Work Orders.[50] SWG was not even aware during hearing that its testimony supporting the expenditures for the Challenged Work Orders omitted the summaries it agreed to provide for these work orders.[51]

624. In contrast, Staff offers substantial evidence regarding SWG's failure to provide adequate documentary support showing that the costs associated with the Challenged Work Orders were prudently incurred and just and reasonable, in addition to SWG's lack of oversight regarding the costs it seeks to recover.[52] Based upon this evidence and SWG's response to the challenges made regarding the prudence of its expenditures over the course of these proceedings, the Commission is troubled by SWG's lack of oversight and its continuous implication that it is Staff's responsibility to not only identify the deficiencies in SWG's filing,[53] but to issue discovery to determine the reasonableness of the costs that SWG seeks to recover from ratepayers.[54] To be clear, the Commissions finds that SWG cannot shift its burden of proof

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[46] Tr. at 372.
[47] Tr. at 373.
[48] Tr. at 375.
[49] Tr. at 420.
[50] Tr. at 416-417.
[51] Tr. at 368.
[52] *See Generally* Ex. 64
[53] Tr. at 368.
[54] *See for example* Tr. 751-753, 770-773, 819-824, 858.

regarding the prudence of its expenditures to any party, including Staff – this is SWG's burden to sustain.[55]

625. Similarly, the Commissions finds that SWG cannot establish the prudence of its expenditures through the discovery process given that, legally, it 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,"[56] and as a matter of course, the Commission simply does not have access to all of the data that is produced in response to discovery.[57] While this record includes discovery responses received by Staff,[58] those responses were introduced during hearing and not in SWG's Application, and similarly fail to establish the prudence of SWG's expenditures related to the Challenged Work Orders given that the sponsoring witness was not involved in the execution of the projects, did not have direct knowledge of the manner in which the projects were overseen, and could not even explain the company's basis for incurring the costs associated with the projects.[59]

626. Moreover, after representing to the Commission that it had a witness who would be able to explain to the Commission whether "it was prudent to incur" the costs associated with the Challenged Work Orders,[60] SWG offered a witness who did not start working for the Company until May 2017, which means that the witness could not have been directly involved in the execution of any of the projects included in the Challenged Work Orders because each of the projects "closed to plant sometime between 2012 and 2016."[61] Therefore, similar to SWG witness Cunningham, SWG witness Murandu was unable to provide the Commission with any

[55] NAC 703.2231
[56] *Id.*
[57] Tr. at 856-857.
[58] *See for example* Ex. 65-69,
[59] Tr. at 373, 375, 416-417, 420.
[60] Tr. at 417.
[61] Tr. at 968-969.

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evidence regarding the prudence of the expenditures associated with the Challenged Work Orders.

627. Finally, while Staff recommends a 50-percent disallowance for the costs associated with these Challenged Work Orders, the Commission finds that Staff's proposal is arbitrary and unsupported by the record given SWG's inability to offer sufficient evidence establishing the prudence of any of these costs. Therefore, instead, 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 is reasonable for inclusion in rates.[62] Accordingly, as established above, the Commission disallows 100 percent of the costs associated with the projects in the Challenged Work Orders in this Docket, but SWG may again seek recovery of the costs associated with these Challenged Work Orders in a future GRC.

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X. Work Order No. 0026w1423077 (Winnemucca Cyanco MSA/Regulator Project)

SWG's Position

628. SWG states that the cost of this project was $223,306.00. (Ex. 42 at Exhibit RLC-4, 4 of 19, line 58.)

BCP's Position

629. BCP does not address this issue.

Staff's Position

630. Staff recommends disallowing all of the costs associated with Work Order No. 0026W00000877, the Winnemucca Cyanco MSA/Regulator project. (Ex. 64 at 2.) More

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[62] Ex. 64 at 5-6.

specifically, Staff recommends that the Commission remove $0.208 million from rate base for SWG's NND related to Work Order No.0026W1423077. (*Id.* at 7.) Staff recommends corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2, page 2, CW-10, CW-14.)

631. Staff state that SWG initiated Work Order No. 0026W142307 to relocate and replace the meter set assembly for the Cyanco plant in Winnemucca, Nevada. The Cyanco MSA Replacement Project cost approximately $223,306, all of which SWG allocated to its Northern Nevada jurisdiction. (Ex. 64 at 31.) Staff states that SWG initiated this project primarily due to Cyanco's plant expansion and corresponding increase in its gas demand. (*Id.*) Therefore, a new MSA with greater capacity needed to be installed. (*Id.*) Staff states that SWG indicated that it utilized NPL Construction for the Cyanco/MSA Regulator Project; however, Staff states that in NPL's vouchers, NPL notes that the MSA/Regulator was used to assist Paiute Pipeline, not Cyanco. (*Id.*)

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632. Staff states that, in fact, the payment authorization for NPL's vouchers also came from Paiute Pipeline. (*Id.*) Staff further states that it does not believe that SWG's retail customers should pay for all or some portion of the facilities used to serve Cyanco. (*Id.* at 31.) Staff states that Cyanco is a contract customer of SWG who pays negotiated rates to SWG and does not pay a full margin rate. (*Id.*) Thus, Staff states that any upgrades to SWG's system that alone benefit Cyanco should be paid for by Cyanco, not SWG ratepayers. (*Id.*)

633. Staff states that "[f]rom a policy standpoint, [it] does not believe that [the] Commission should support retail ratepayers paying any portion of these costs that SWG incurs to serve customers who pay something less than a full margin or full retail rate. Moreover,

neither Schedule No. ST-1/NT-1 nor SWG's Rule 9 state explicitly that SWG may adjust or reduce the costs it incurs to build facilities to serve contract customers." (*Id.* at 32.)

634. Staff states that SWG's Northern Nevada ratepayers should not have to pay for the costs associated with the Cyanco MSA/Regulator Project. (*Id.*) Staff states that, additionally, since the vouchers from NPL Construction are from Paiute Pipeline, it appears that SWG may have incorrectly allocated the costs of the project to SWG's NND. (*Id.*)

SWG's Rebuttal Position

635. SWG states that it allocated the costs of the project to the correct company. (Ex. 81 at 24.) SWG further states that the project's costs "are justified by the additional margin and allowable investment provided solely by Cyanco's plant expansion project and forecasted gas usage at their current (negotiated) gas service rates. (*Id.*) SWG provides that it ran an Incremental Contribution Model to determine the allowable investment, and that the Cyanco margin is included in the current GRC. (*Id.*) SWG further provides that the project will pay for itself in less than a year. (*Id.*)

Commission Discussion and Findings

636. The Commission finds that SWG's economic analysis adequately demonstrates that the cost of the project was justified given the increased margins at the facility. Moreover, as SWG notes, the project will pay for itself in less than a year. In this instance, the Commission is not persuaded by the concerns raised by Staff regarding whether the upgrades solely benefit Cyanco. Accordingly, the Commission rejects Staff's recommendation to disallow the costs associated with Work Order No. 0026W00000877, the Winnemucca Cyanco MSA/Regulator project.

Y. Change Order No. 4 regarding Contract No. 205579

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BCP's Position

637. BCP does not address this issue.

Staff's Position

638. Staff recommends disallowing all of the incremental costs associated with the price increases contained in Change Order 4 in SWG's Contract Number 205579 with Arizona Pipeline Company ("APL"), that were greater than the consumer price index adjustment of 2.1 percent. (Ex. 64 at 2, 37.) More specifically, Staff recommends that the Commission exclude the incremental costs of $0.595 million for SWG's SND related to price increases contained in Change Order 4 of SWG's Contract No. 205579 with APL from rate base. ~~(*Id.* at 7-8.)~~ ***(Ex. 71 at 7-8.)*** SWG recommends a corresponding adjustment to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.* at 8, Attachments CW-2 page 1, CW-11, and CW-13.)

639. Staff states that SWG entered into a contract with APL on November 17, 2015, for the five-year term January 1, 2016 through December 31, 2020 for the installation, abandonment, replacement, relocation, and building of early vintage plastic pipe ("EVPP"), and mains and services. (Ex. 64 at 34-35.) Staff states that SWG did not bid this contract. (*Id.* at 35.) In an October 9, 2015 email from Jo Taylor to Shane Thacker, SWG provided justification for renegotiating the APL EVPP contract, stating that renegotiating the contract would capitalize on the advances that had been made during the previous contract. (*Id.*) However, Staff states that SWG noted that its justification was contingent upon the pricing APL offered; that is, if APL's pricing were to increase greater than SWG anticipated, SWG would consider bidding the contract. (*Id.*) Staff states that SWG's justification for not bidding the contract was reasonable. (*Id.*) Staff states that, while SWG was able, by continuing to contract with APL, to maintain the

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efficiencies and experience already in place, SWG payments to APL of price increases greater than the Consumer Price Index ("CPI") adjustments outlined in the contract were excessive, especially in view of past problems with APL's performance under the contract. (*Id.* at 26, 35.)

640. Staff states that APL has had multiple incidents due to the lack of effective quality and safety plans in place, which has resulted in pipeline damages, APL employee disqualifications and revocations, notice of probable violations from Commission Staff, and disruption of service to SWG's customers. (*Id.* at 36.)

641. Staff states that in Change Order 4, dated January 18, 2018, SWG authorized APL to receive price increases between 10 and 70 percent, much greater than CPI adjustment of 2.1 percent contained in sections 2.1, 3.1, 4.1, 10.1, and 10.1A of the contract. (*Id.*) Staff further states that it was not reasonable for SWG to authorize the price increases contained in Change Order 4. (*Id.* at 37.) Staff states that SWG provided no valid justification for the price increases contained in Change Order 4. (*Id.*)

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642. Staff states it understands that prices in the Las Vegas Valley are increasing, and could warrant adjustments to the APL EVPP contract higher than the generic CPI adjustment; however, no justification was provided by SWG for its "generous, above-CPI price increases." (*Id.*) Furthermore, Staff states that given APL's performance issues that resulted in SWG issuing work stoppages to APL, the price increases above the CPI adjustment were not warranted and are "frankly, a surprising reward for poor performance." (*Id.*) Finally, Staff states that SWG's own justification for not rebidding the contract when it expired at the end of 2015 was that APL was offering attractive pricing with just the CPI adjustment. (*Id.*) "SWG acted inconsistently with its own justification for not rebidding the work and the contract itself. As such, SWG's ratepayers

should not be required to pay for the increased costs associated with SWG changing the contract terms for the benefit of APL." (*Id.*)

SWG's Rebuttal Position

643. SWG states that it disagrees with Staff's recommendation to disallow all incremental costs associated with the price increases contained in Change Order 4 in Contract Number 205579 above the CPI adjustment. (Ex. 73 at 2.)

644. SWG states that increased quality and safety standards, construction activity increasing to pre-recession levels, the strength and growth of the local economy, and upward pressure on wages, [63] have resulted in increased operating costs for APL since the contract was executed, which justified an adjustment to contract prices. (*Id.* at 3-4.)

645. SWG states that in determining the price adjustment for the contract, it determined that regardless of installation methods, the expense that contractors realized were consistently the same due to set up costs. (*Id.* at 4.) Accordingly, SWG provides that it normalized the prices of the service installation in the contract in order to gain efficiencies and allow its contractor to establish the best installation method, and in turn reduce overall costs. (*Id.*)

646. SWG states that it conducted a post-adjustment analysis that determined APL had the lowest cost per foot, represented a fair and reasonable cost to SWG customers, and also proved to be below market rates. (*Id.*)

647. SWG states that it compared the existing APL EVPP contract inclusive of the January 18, 2018, Change Order ("Above CPI") to what the price impact would have been if the "CPI-only" increase had been applied to the contract and found that the difference between the

[63] *See* Direct Testimony of Paul Maguire in Docket No. 18-06004 at 9.

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Above CPI and CPI Only to be a 12.7 percent increase. (*Id.* at 6.) SWG contends that the overall difference of 12.7 percent is more reflective of the actual price increase than to broadly characterize the increase as "between 10 percent and 70 percent" because the "70 percent" items are infrequently utilized on projects. (*Id.*)

648. SWG states that even after the "Above CPI" increase in January of 2018, APL has approached the company to assert that they require additional price adjustments given market conditions. (*Id.* at 7.) SWG provides that the contractor has expressed that it has been taking months of financial losses and that if SWG doesn't agree to additional increases or rebid the entire contract, the contractor will be forced to discontinue it after January 1, 2019. (*Id.*)

649. SWG states that it agrees with Staff's position that prices in the Las Vegas Valley are increasing and could warrant adjustments to the APL EVPP contract higher than the generic CPI adjustment. (*Id.*) SWG contends that it "has demonstrated sufficient justification to warrant the price increases granted to the APL EVPP contract "Above CPI." (*Id.*)

650. Accordingly, SWG provides that Staff's recommendation to disallow the incremental costs associated with the price increased contained in Change Order 4 in Contract Number 205579 above the CPI adjustment should be rejected. (*Id.* at 7-8.)

Commission Discussion and Findings

651. The Commission adopts Staff's proposed adjustments to 1) disallow costs associated with the price increases contained in Change Order 4 in SWG's Contract Number 205579 with APL; and 2) disallow all incremental costs associated with the price increases that were greater than the consumer price index adjustment of 2.1 percent. The resulting disallowance excludes incremental costs of $0.595 million for SWG's SND related to price increases contained in Change Order 4 from rate base, in addition to a corresponding adjustment

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to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base.

652. The Commission notes that, in adopting Staff's position, the Commission finds that SWG failed to demonstrate that such costs are justifiable in the current economic environment. Specifically, the costs above CPI indicate that a competitive solicitation might have yielded lower costs. While SWG asserts that current costs have risen above the CPI, it failed to demonstrate why it was prudent to continue its contract with APL.

Z. Battle Mountain Lateral Project

BCP's Position

653. BCP does not address this issue.

Staff's Position

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654. Staff recommends that the Commission approve an adjustment to exclude $200,000.00 in costs for SWG's NND related to the Battle Mountain Lateral Project." (Ex. 60 at 8-9.) More specifically, Staff recommends that the Commission remove $0.200 million from rate base for SWG's NND related to the Battle Mountain Lateral Project. (Ex. 71 at 8.) Staff recommends corresponding adjustments to remove the costs and related accumulated depreciation, depreciation expense, and ADIT from rate base. (*Id.*, Attachments CW-2 page 2, CW-12, CW-14.)

655. Staff states that the project, which was approved in SWG's GIR Advance Application in 17-05027, involved replacement of an existing 6-mile, 1960s vintage 4-inch pipeline serving Battle Mountain, Nevada, with a new higher grade 6-inch pipeline. (*Id.* at 6.) Staff provides that after the pipe was welded, installed, and pressure-tested, it ultimately determined that a 40-foot section of the pipe was defective. (*Id.* at 7.) Staff contends that it is

inappropriate for ratepayers to fund the defect, and that SWG should pursue a claim against its pipe manufacturer. (*Id.* at 8.) Moreover, Staff is critical of SWG for failing to identify a visible pipe defect issue considering that it conducted on-site inspections at the pipe mill to have its personnel inspect the pipe that it was purchasing for the project. (*Id.* at 8.)

SWG's Rebuttal Position

656. SWG recommends that the Commission deny Staff's proposed Battle Mountain adjustment as the costs occurred outside the Company's certification filing at July 31, 2018, and are not part of SWG's filing and not at issues in this docket. (Ex. 62 at 1.) SWG suggests that any discussion related to the prudency of costs incurred after July 31, 2018, are for a future GRC proceeding and it is inappropriate to discuss the possible disallowance of costs that have not occurred as of the certification date of this proceeding. (*Id.* at 2.)

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Commission Discussion and Findings

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657. The Commission rejects Staff's proposed adjustment to exclude $200,000.00 in costs for SWG's NND related to the Battle Mountain Lateral Project. In rejecting Staff's recommendation, the Commission notes that the incurred costs associated with the adjustment occurred outside of the certification period and are therefore inappropriate to address in the instant Docket.

VIII. RATE DESIGN

A. Class Cost of Service ("CCOS") Study

SWG's Position

658. SWG provided two CCOS studies in response to compliance items set forth in Docket Nos. 12-02019 and 12-04005. (Ex. 84 at 4.) SWG states that the first CCOS study excluded negotiated rate customers and was to be used in setting rates. (*Id.*) SWG provides that

the second CCOS study includes all of the negotiated rate customers and is intended to provide the Commission with information to determine whether negotiated rate customers, as a class, provide the average rate of return. (*Id.*) SWG states that it prepared both CCOS studies as directed by the Commission. (*Id.*)

659. SWG states the purpose of a CCOS study is to allocate the revenue requirement to the appropriate customer rate classes and determine the resulting rate of return for each customer class identified in the study. (*Id.* at 2.) SWG provides that the results of the CCOS study are used as a guide to establish proposed class revenues and proposed class rates for each customer class. (*Id.*) SWG states that it utilized a three-step process to develop its CCOS study wherein costs are functionalized, classified, and then allocated to the customer classes included in SWG's proposed rate design. (*Id.* at 3.)

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660. SWG provides that the functionalization process assigned plant investment costs and expenses to the appropriate operating functions; the classification process identified whether plant investment costs and incurrence of expenses are related to providing capacity, annual volume of gas actually delivered, or providing customers with access; cost allocation process apportioned costs as demand, commodity, or customer to each rate class based on the characteristics of class demand, class consumption, and number of customers associated with each class. (*Id.*)

661. SWG states that its certification filing updated the number of bills and monthly throughput by rate schedule to reflect certification period amounts through July 31, 2018, and to reflect contract Customer 6 switching from a negotiated customer to a full margin transportation customer in March of 2018. (Ex. 85 at 1.) SWG states that the revenues associated with

Customer 6's service were re-allocated to rate schedule SG-G3 and removed from the negotiated customers, as reflected in the updated CCOS Study and Statement J schedules. (*Id.*)

662. SWG provides that its certification filing CCOS study differs from what it had originally filed in that it adjusted the allocation of Other Gas Supply Expenses (Account No. 813) to reflect the number of customers served on each rate schedule, and to more closely represent costs incurred on SWG's system. (*Id.* at 2.) SWG contends that the change will have "a de Minimis impact on proposed rates, since these expenses only represent approximately 0.3 percent of the proposed revenue requirements for both its SND and NND. (*Id.*)

663. SWG states that, as a result of the changes in its certification filing, revenues in the NND fell by approximately $1,700,000.00 and revenues in the SND fell by $1,230,000.00. (*Id.*)

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664. SWG states that it initially added Allocation 15, KAM Direct Allocation, and inadvertently failed to reference it in its direct testimony. (*Id.* at 3.) SWG provides that the allocation is related to all labor and materials expenses associated with the Key Account Management department. (*Id.*) SWG states that the department manages the full-margin transportation customers and contract customers. (*Id.*) SWG notes that prior to separating the money associated with these larger customers, the expenses were rolled into Customer Records & Collections Expenses and allocated to every customer class. (*Id.*)

BCP's Position

665. BCP recommends the Commission accept SWG's CCOS studies with three proposed changes for both the SND and NND. (Ex. 90 at 45, 47-48.) Specifically, BCP recommends that SWG's SND CCOS study include NCA 1 and NCA 2 in its study; classify the costs recorded in FERC Account No. 813 as commodity-related costs; and classify the costs

recorded in FERC Account No. 871 as commodity-related costs. (*Id.* at 46.) For the NND, BCP recommends that SWG's CCOS study include Customer 1; classify the costs recorded in FERC Account No. 813 as commodity-related costs; and classify the costs recorded in FERC Account No. 871 as commodity-related costs. (*Id.* at 47.)

666. BCP states that it recommends including NCA 1 and NCA 2 for the SND in the CCOS study because it states the contracts are non-conforming, were never filed with the Commission, and either negotiated or renegotiated after the adoption of the Transmission Management Program final rule on December 15, 2003 by the Pipeline and Hazardous Materials Administration. (*Id.* at 31-32.) Similarly, BCP recommends including Customer 1 for the NND in the CCOS study. (*Id.* at 36.) BCP states that it was imprudent for SWG to not seek approval for these contracts, and that the difference in the revenues from the inclusion of the three contracts in the CCOS study and the present contract revenues should be subsequently imputed in the revenue requirement. (*Id.* at 34, 36.)

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667. BCP states that SWG reclassified the costs recorded in FERC Account No. 813 from commodity-based to customer-based in its certification filing in violation of NAC 703.2461. (*Id.* at 41-42.) BCP argues that "[t]he CCOS is not included in Statement I and therefore the Commission's regulations do not provide for the reclassification of costs as a customer-related cost from a commodity-related cost in the CCOS. (*Id.* at 42-43.) BCP also argues that "presenting a new classification of costs in the certification filing does not afford parties the time necessary to investigate whether the reclassification was proper." (*Id.*)

668. BCP states that FERC Account No. 813 (Other Gas Supply Expenses) should be classified as commodity-related costs in the CCOS allocating it as customer-related would have an adverse and non-trivial effect on single-family residential customers. (*Id.* at 41.) BCP notes

that the total expenses recorded to the account in the SND during the certification period was $709,908.00 and that classifying the cost as customer-related allocates 77.7509% of the cost to single-family residential customers, or $551,960.00 in total compared to 35.9192% or 254,993.00, when classifying the cost as commodity-related. (*Id.*)

669. BCP states that the costs in FERC Account No. 871 should be classified as commodity-related costs, consistent with the definition of the account in the Uniform System of Accounts. (*Id.* at 45.) BCP provides that the definition includes "expenses related to distribution system operating pressures and British Thermal Units content of the natural gas in the distribution system." (*Id.*) BCP further provides that those "costs are related to the volumes of gas flowing through the distribution system – including those volumes for transportation customers – not the number of customers of the natural gas utility." (*Id.*)

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670. BCP recommends that SWG file a compliance filing with the same terms as those in Ordering Paragraph 30 of the Commission's March 20, 2013, Second Modified Final Order in Docket No. 12-04005, which stated:

> SWG shall file tariffs implementing the Commission's findings in this Order showing the resulting rates for each customer class in each division within 15 calendar days of the issuance of this Order. These tariffs shall be supported by the following schedules: (a) Statement I incorporating all of the Commission's ordered adjustments; (b) Schedule N-2 and associated workpapers detailing the allocation of the Commission ordered revenue requirement to each customer class; (c) Statement O showing the derivation of the rates contained in the compliance tariffs; (d) Statement J showing the increase and decreases in the compliance tariff rates from the certification present rates; (e) Statement F showing the cost of capital; and (f) Depreciation Study per Commission Order.

(*Id.* at 4.)

Staff's Position

671. Staff states that it does not propose any modifications to either of SWG's CCOS studies. (Ex. 103 at 15.) Staff further states that the Commission should find that SWG has

satisfied its compliance from Docket No. 12-04005 requiring it to file the two separate CCOS studies. (*Id.* at 11.)

672. Notwithstanding the aforementioned, Staff states that it questions the reasonableness of certain allocation factors used in the CCOS studies filed by SWG and recommends that the Commission issue a directive requiring that SWG addressing issues related to the allocation factors in its next GRC. (*Id.* at 12, 16.) More specifically, Staff is critical of SWG's use of a single critical peak ("CP") (January) in its CCOS studies, as well as its allocation factors for its distribution investments and transmission investments, "which are allocated to customer classes by a 50 percent demand / 50 percent Customer Count allocation factor, and by a 100 percent demand allocation factor, respectively." (*Id.* at 12.)

673. Staff states that it agrees with SWG that January is a peak month for its SND and NND; however, Staff contends that its SND is not a single-peaking system. (*Id.*) Staff provides that monthly consumption data for SWG's SND shows a relatively flat load and more closely resembles a three-CP or four-CP for allocation purposes. (*Id.*) SWG further provides that separating full margin transportation customers and contract customers from other customer classes shows that the majority of consumption during the summer months come from ST-1 customers. (*Id.*) Staff suggests "that the use of a single CP (in the month of January) unreasonably allocates the costs away from large customers such as ST-1, and modifying the allocations in the CCOS studies to a 3 CP or 4 CP could significantly reduce the amount of costs allocated to the residential customer class." (*Id.* at 12-13.)

674. Staff states that SWG's NND does not exhibit the same consumption pattern; however, Staff notes that it could find a two-CP or four-CP appropriate. (*Id.* at 13.) Staff further states that "demand may not be the only deciding factor in allocating expenses" and that the

"NT-1 customer class exhibits a fairly flat load shape wile residential customer class load is still peaking in winter months." (*Id.*) Staff provides that the NT-1 customer class represents approximately 70 percent of the total consumption during summer months, yet the costs for the facilities are only based on January. (*Id.*) Staff further provides that for the consumption during the test period from February 2017 to January of 2018, the NT-1 customers consumed approximately 42.4 percent while the Residential Customer class consumed 31.6 percent. (*Id.*)

675. SWG states that the total load in SWG's SND and NND are relatively flat and a significant portion of the loads, particularly in the summer months, come from larger customers such as the ST-1 customers. (*Id.*) Staff provides that such patterns call into question whether SWG's allocation factors for Distribution and Transmission investments are appropriate. (*Id.*)

676. Staff states that there is merit in allocating some costs based on customer count as well as basing some allocation costs on peak periods. (*Id.* at 14.) Staff further states that some customers receive value from the ability to consume during all times of the year. (*Id.*) Accordingly, Staff states that it is reasonable to allocate a portion of costs based upon consumption. (*Id.*) With that under consideration, Staff conducted a modified CCOS study allocating Distribution investments based upon a 33.3 percent factor based on Demand, Customer Count, and Consumption, and allocated Transmission investments based on a 50 percent demand and 50 percent commodity allocation factor. (*Id.*) Staff provides that the results show that contract customers do not provide SWG with enough revenues to cover the costs to serve the customer class in the SND or NND. (*Id.*)

677. Staff states that it is concerned with SWG's allocation of O&M expenses based on a Customer Count and Demand allocation factor because O&M occurs year-round, not just during peak time. (*Id.*) Staff further states that O&M expenses "are incurred mostly in the

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summer months and are not tied to the peak amount served or the amount of customers served." (*Id.* at 14-15.) SWG provides that SWG conducts leak surveys for business areas every year and leak surveys for residential customers every three years; however, based on SWG's CCOS studies, the majority of these costs are allocated to residential customers despite receiving fewer benefits. (*Id.* at 15.)

678. Staff states that additional costs are caused by ST-1 and NT-1 customers that could potentially be shifted to sales customers. (*Id.*) Specifically, Staff notes that in certain instances, SWG occasionally has to procure gas supplies to cover its sales customer needs, as well as the needs of its transportation customers. (*Id.*) Staff notes Docket No. 18-08016, where SWG stated "[s]ince those gas supply costs are solely the responsibility of the sales customers, and flow through the Company's PGA mechanism, there is potential for gas costs incurred due to the actions of transportation customers to be shifted to sales customers." (*Id.* at 15; Application at 3 in Docket No. 18-08016.) Given the potential cost shift above, Staff is critical of SWG's CCOS study, which it states does not allocate additional costs to the cost causer. (Ex. 103 at 15.)

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SWG's Rebuttal Position

679. SWG states that it complied with the Commission's March 20, 2013, Second Modified Final Order in Docket No. 12-04005. (Ex. 107 at 2-3.)

680. SWG states that BCP inaccurately claims that peak month usage was not properly represented for all negotiated rate contracts in the illustrative CCOS study. (*Id.* at 12.) SWG provides that it properly allocated transmission based on January peak volumes for all negotiated rate customers in both of its jurisdictions. (*Id.*)

681. SWG states that "the labor, materials, and expenses associated with dispatching and controlling the supply and flow of gas through the distribution system (Acct. No. 871) and

for purchasing gas supply (Acct. No. 813) vary more based on variations in customer demand than customer size. (*Id.* at 13.) SWG states that allocating FERC Account Nos. 813 and 871 based upon annual throughput results in large volume customers bearing a substantial amount of the costs for these accounts. (*Id.* at 14.) Accordingly, SWG provides that the cost allocation for FERC Account Nos. 813 and 871 in the CCOS study is appropriate on a customer, rather than commodity basis. (*Id.*)

682. SWG states that NAC 703.2461 does not preclude a utility from incorporating a correction to an allocation within its CCOS certification. (*Id.*) Moreover, SWG notes that in past GRC proceedings, both BCP and Staff have not objected to modifications to FERC Account No. 871 in certification filings. (*Id.*) SWG contends that BCP's proposed allocation for FERC Account No. 813 does not appropriately reflect the cost to serve customers and should not be approved. (*Id.*)

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Commission Discussion and Findings

683. The Commission declines to modify SWG's CCOS as recommended by BCP or to direct SWG to incorporate the changes discussed by Staff. However, the Commission stresses to SWG that each and every cost allocation and allocation methodology is subject to review and potential modification in every CCOS study filing. Such items include, but are not limited to, the evaluation of the need for any new or revised customer classes. The CCOS study is the foundation for just and reasonable rate design, and the position that a certain cost has been allocated the same way for years carries less weight than the underlying basis for that allocation. SWG, BCP, and Staff are encouraged to continue robust discussions and analysis of SWG's CCOS studies in order to provide the Commission with the most information available to ensure

just and reasonable rates. Additional evaluation of the CCOS study and its components may be required in future filings.

684. The Commission finds that SWG shall file tariffs implementing the Commission's findings in this Order showing the resulting rates for each customer class in each division within 15 calendar days of the issuance of this Order. These tariffs shall be supported by the following schedules: (a) Statement I incorporating all of the Commission's ordered adjustments; (b) Schedule N-2 and associated workpapers detailing the allocation of the Commission ordered revenue requirement to each customer class; (c) Statement O showing the derivation of the rates contained in the compliance tariffs; (d) Statement J showing the increase and decreases in the compliance tariff rates from the certification present rates; (e) Statement F showing the cost of capital; and (f) Depreciation Study per Commission Order.

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685. In addition, the Commission directs SWG, in its next GRC application, to file two CCOS studies. The first CCOS study shall exclude negotiated rate customers ("NRCs") and shall be used to set rates. The second CCOS study shall include all of the NRCs and shall be used to provide information to the Commission regarding whether the NRCs, as a class (or classes), provide the average rate of return.

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B. General Revenues Adjustment ("GRA")

SWG's Position

686. SWG requests authority to continue its GRA provision originally approved by the Commission in Docket No. 09-04003 without any modifications. (Ex. 36 at 17, Ex. 1 at 4.) SWG provides that the GRA provision has performed as designed, benefitted customers by providing credits during times of colder-than-normal weather, and has ensured that SWG has recovered no more or less than its Commission-authorized revenues. (Ex. 36 at 17.) SWG seeks

approval, consistent with NAC 704.9716, to continue tracking and balancing "the margins for Single-Family Residential, Multi-Family Residential, and the General Service rate classes (SG/NG-1, SG/NG-2, and SG/NG-3)." (*Id.* at 17-18.)

BCP's Position

687. BCP does not address this issue.

Staff's Position

688. Staff recommends the Commission approve SWG's request to continue its GRA provision for Single-Family Residential, Multi-Family Residential, and the General Service classes, as originally approve in Docket No. 09-04003 and more recently in Docket No. 12-04005. (Ex. 95 at 2.)

Commission Discussion and Findings

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689. NAC 704.9716 provides that in a GRC filing, a gas utility may elect to utilize general revenue decoupling methodology in lieu of an "equity adder" methodology in order "to remove financial disincentives that discourage a public utility which purchases gas for resale from planning and implementing substantive conservation and energy efficiency programs." General revenue decoupling allows a gas utility to recover the base tariff general rate revenue without regard to the difference in the quantity of natural gas actually sold.[64] SWG received approval to implement a full decoupling mechanism in Docket No. 09-04003 and was authorized to continue the mechanism in Docket No. 12-04005.

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690. The Commission agrees with SWG that the GRA provision has provided benefits to ratepayers and finds that SWG also receives a substantial benefit from full revenue decoupling by reducing risk to the utility. Moreover, Staff also recommends continuation of the GRA

[64] *See* NAC 704.9563.

mechanism, and BCP does not contest its use. Accordingly, the Commission approves SWG's request to continue its GRA provision, as originally approved by the Commission in Docket No. 09-04003, without any modifications.

C. Basic Service Charge

SWG's Position

691. SWG states that it does not propose any adjustments for its existing Basic Service Charge in its SND or NND and is only proposing to update rates based upon the cost of service and the results of the CCOS study. (Ex. 36 at 18.) SWG provides that it proposes an updated Delivery Charge of $0.39366 per therm for single family residential customers and $0.42205 per therm for multi-family residential customers for its SND. (*Id.*) SWG further provides that it "proposes an updated Delivery Charge for its NND of $0.037594 per therm and $0.43143 per therm for single and multi-family residential customers, respectively." (*Id.* at 18-19.)

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BCP's Position

692. BCP does not address this issue.

Staff's Position

693. Staff recommends that the Commission approve SWG's proposal to keep the Basic Service Charge and Demand Charges at the current rates for all customer classes and approve modifications to the volumetric Delivery Charge therm rate. (Ex. 103 at 16-17.) Staff notes that SWG is proposing to maintain its current rate structure for residential customers by maintaining the current basic service charge and modifying the delivery charge therm rate to recover the revenue requirement change. (*Id.* at 17.) Staff further notes that SWG requests to maintain the basic service charge for all General Service customers and modify the delivery

charge therm rate for all general service customers to recover the revenue requirement change. (*Id.*)

Commission Discussion and Findings

694. SWG requests to maintain its basic service charges ~~and demand 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 ~~with an updated Delivery Charge of $0.39366 per therm for single family residential customers and $0.42205 per therm for multi-family residential customers for its SND. The Commission also grants SWG's request to maintain its existing basic service charge in its NND with an updated Delivery Charge of $0.037594 per therm for single family residential customers and $0.43143 per therm for multi-family residential customers.~~ ***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.***

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D. Biogas and Renewable Natural Gas Tariff

SWG's Position

695. SWG proposes a Biogas and Renewable Natural Gas Tariff (Schedule No. SG-RNG/NG-RNG). (Ex. 36 at 21, Ex. 1 at 5.) SWG states that "the Biogas and Renewable Natural Gas ('RNG') industry is a developing industry representing potential new supply sources stemming most commonly from waste-water treatment facilities, dairies, and landfills." (*Id.*) SWG further states that this proposed schedule "is intended to provide potential customers the general terms and conditions relevant to interconnections with SWG facilities, dependent upon the type of RNG activity proposed." (*Id.*)

696. SWG provides that, "[b]ecause each project would be unique, the proposed tariff describes multiple agreements that can be developed according to the type of activity ranging from RNG Transportation to gathering systems dedicated to RNG. (*Id.*) SWG further provides that the tariff will specify applicable rates, identify customer and utility responsibilities, as well as identify definitions specific to the proposed schedule. (*Id.*)

BCP's Position

697. BCP does not address this issue.

Staff's Position

698. Staff recommends that the Commission approve SWG's proposed Biogas and Renewable Natural Gas Tariff with additional language. (Ex. 95 at 3.) Staff states the tariff language is vague and general in nature, and does not include some components that are normally contained in a utility tariff outlining service provisions such as specific costs or rates applicable to the customer. (*Id.* at 4.) Moreover, Staff notes that while the applicant is intended to cover all costs of a project under the tariff, it would be appropriate to have the Commission ensure that each contract properly falls under it. (*Id.*)

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699. Staff recommends the tariff include additional language that is currently in SWG's Arizona Biogas and Renewable Natural Gas Tariff: "Contract agreements qualifying for service under this Rate Schedule, shall be subject to review and approval by the Commission." (*Id.*) Staff states that the language would be added to the end of the first paragraph under the rates section on page 53A. (*Id.*)

700. Staff states that it also recommends revising a provision under the "Applicability" heading on sheet 53A. (*Id.* at 5.) Specifically, Staff recommends that the first sentence read "Applicable to non-residential suppliers of Biogas and suppliers of Renewable Natural Gas

(RNG) ("Applicant")." (*Id.*) Staff states that it recommends this addition for clarity and to align it with the language of Biogas and Renewable Natural Gas tariffs in other states that Staff reviewed. (*Id.*)

SWG's Rebuttal Position

701. SWG states that agrees with Staff's proposal. (Ex. 108 at 4; Tr. at 1375.)

Commission Discussion and Findings

702. The Commission finds that SWG has demonstrated the need for the Biogas Renewable Natural Gas tariff to provide customers with a specific service while addressing an emerging customer need. The Commission further finds and agrees with Staff that certain proposed tariff language is vague and requires additional language to ensure adequate oversight. Notably, SWG agreed with Staff's recommended changes to address Staff's concerns. The Commission approves the Biogas and Renewable Natural Gas Tariff Schedule Nos. SG-RNG/NG-RNG in accordance with Staff's recommendations.

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E. Compression Service Tariff

SWG's Position

703. SWG proposes a Compression Tariff (Schedule No. SG-CGS/NG-CGS). (Ex. 36 at 20.) SWG states that it has identified opportunities to provide high pressure compression service through facilities owned and operated by SWG and located on a customer's property. (*Id.*) SWG notes that "[b]ecause each potential project would be unique, the proposed tariff describes the specific components of the rate structure which will be designed to recover the depreciation, return on capital investment, income taxes, property taxes, and operating expenses associated with the high-pressure equipment." (*Id.*) SWG provides that "[i]n addition to specifying applicable rates, the proposed Compression Tariff identifies both customer and utility

responsibilities, as well as definitions specific to the proposed Schedule No. SG-CGS/NG-CGS." (*Id.*)

704. SWG states that typical types of customers that need high pressure compression facilities include enterprises with large vehicle fleets that could use natural gas as a transportation fuel and require natural gas fueling stations. (*Id.* at 21.) SWG provides that the Compression Tariff is not intended for residential applications. (*Id.*)

BCP's Position

705. BCP does not address this issue.

Staff's Position

706. Staff recommends that the Commission approve SWG's proposed Compression Gas Service Tariff with additional language recommended by Staff. (Ex. 95 at 6.) Staff states that it recommends the same Commission approval and "Applicability" language that it recommended for the Biogas and Renewable Natural Gas Tariff. (*Id.*) Specifically, Staff recommends that language be added to the Compression Gas Service tariff "Rates" section to include a provision that states "Contract agreements qualifying for service under this Rate Schedule, shall be subject to review and approval by the Commission." (*Id.*)

707. SWG also recommends that under the "Applicability heading on sheet 47A, the first sentence be revised to read "Applicable to qualified non-residential Applicants requiring compressed natural gas (CNG)." Staff states that it proposed this modification for clarity and to align the language with similar tariffs in other states that Staff reviewed. (*Id.*)

SWG's Rebuttal Position

708. SWG states that it agrees to Staff's recommended modifications to the tariff language. (Ex. 108 at 4.)

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Commission Discussion and Findings

709. The Commission finds that SWG's proposed tariff would enable the utility to expand its services to address additional customer needs. The Commission agrees with Staff's recommendation and further finds that the tariff requires additional language to ensure adequate Commission oversight and more closely conform with language from similar tariffs. Moreover, SWG agrees with Staff's proposed modifications. Accordingly, the Commission approves SWG's proposed Compression Tariff Schedule Nos. SG-CGS/NG-CGS as modified by the recommendations made by Staff.

F. Tariff No. 7, Rule 2, and Rule 2D

SWG's Position

710. SWG requests changes to Tariff No. 7, Rule 2, and the addition of Rule 2.D. (Ex. 1 at 156-158.)

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BCP's Position

711. BCP does not address this issue.

Staff's Position

712. Staff recommends that the Commission approve SWG's proposed change to Tariff No. 7, Rule 2 and the addition of Rule 2.D. (Ex. 94 at 2.) Staff states that the proposed language clarifies that only the language in the tariff or Commission rules are considered agreed upon. (*Id.*) Staff states that the additional proposed inclusion of Rule 2.D is consistent with the language in SWG's Arizona Gas Tariff No. 7, Provision of Service Rule 7.1.D.1. (*Id.*)

Commission Discussion and Findings

713. The Commission finds that the proposed modifications to Tariff No. 7, Rule 2, and the addition of Rule 2.D, clarify the scope of SWG's contractual relationship with its

customers. Staff reviewed the proposed changes and additions and recommended their approval. Moreover, BCP did not dispute the proposal. Accordingly, the Commission approves SWG's proposed changes to Tariff No. 7, Rule 2, and the addition of Tariff No. 7 Rule 2.D as filed.

G. Tariff No. 7, Rule 3 - Easements

SWG's Position

714. SWG requests to modify Rule 3 of Tariff No. 7 to include Rule 3.F.1 and 3.F.2. (Ex. 1 at 161-162.)

BCP's Position

715. BCP does not address this issue.

Staff's Position

716. Staff states that the proposed changes are reasonable. (Ex. 94 at 3.) Staff contends that customers that have applied for a service should reasonably expect to provide the access necessary for SWG to provide that service. (*Id.*) Staff provides that the language clarifies that "the cost of a needed easement on private property will not be borne by other ratepayers and that the easement must be satisfactory to install and maintain gas pipelines and appurtenances." (*Id.*) Staff notes that the proposed change to Rule 3 is consistent with SWG California Tariff No. 19.D, 19.E, and 19.F. Services and Facilities on Customer's Premises. (*Id.*)

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Commission Discussion and Findings

717. The Commission finds that the proposed changes are reasonable and should ensure that the utility, as part of its agreement to provide a customer with service, may access the customer's property in furtherance of the provision of service. Moreover, the Commission finds that the language protects ratepayers by clarifying that ratepayers will not be responsible for the

cost of a needed easement. Accordingly, the Commission accepts SWG's additions Tariff No. 7, Rule 3, to include sections 3.F.1 and 3.F.2, as filed.

H. Tariff No. 7, Rule 5 – Third-Party Electronic Billing

SWG's Position

718. SWG states that it proposes to implement changes related to Rule No. 5 – Electric Billing in order to provide more flexibility and update the tariff in a manner that is more consistent with current industry business practices. (Ex. 36 at 21.)

BCP's Position

719. BCP does not address this issue.

Staff's Position

720. Staff recommends that the Commission approve the proposed change to Rule No. 5. (Ex. 94 at 4.) Staff notes that "[w] the removal of the requirement to use a third-party Electronic Billing Provider, customers will have more options, such as paying bills through the SWG website. (*Id.*) Staff provides that the change will also help SWG to streamline its electronic billing process. (*Id.*)

Commission Discussion and Findings

721. The Commission finds that the proposed modifications to Rule No. 5 – Electric Billing will provide ratepayers with more payment options while providing internal administrative benefits to SWG. Accordingly, the Commission approves SWG's changes to Tariff No. 7, Rule 5 as filed.

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I. Tariff No. 7, Rule 8.C.2.i

SWG's Position

722. SWG requests that the Commission approve changes to Tariff No. 7, Rule 8.C.2.i. (Ex. 1 at 185.)

BCP's Position

723. BCP does not address this issue.

Staff's Position

724. Staff recommends that the Commission approve SWG's proposed change to Tariff No. 7, Rule 8.C.2.i. (Ex. 94 at 4.) Staff states that the revision removes references that are no longer applicable and should be removed to provide clarity and accuracy within the tariff. (*Id.*)

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Commission Discussion and Findings

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725. The Commission agrees with Staff's analysis that the proposed revision to Tariff No. 7, Rule 8.C.2.i updates the tariff to remove inapplicable references and provides more clarity and accuracy. Accordingly, the Commission approves SWG's changes to Tariff No. 7, Rule 8.C.2.i as filed.

J. Tariff No. 7, Rule 8.E

SWG's Position

726. SWG proposes the addition of Rule 8.E – Limitation of liability. (Ex. 36 at 22.) SWG provides that the "change adds greater certainty to the obligations between SWG and its customers." (*Id.*) SWG further provides that the provision's intent is to avoid overly broad liability exposure that could create upward pressure on its cost of service. (*Id.*)

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BCP's Position

727. BCP does not address this issue.

Staff's Position

728. Staff recommends that the Commission reject SWG's proposed addition of Rule 8.E. (Ex. 94 at 6.) Staff states that proposed language is broad and fails to address the possibility of gross negligence or willful misconduct of the utility. (*Id.*) Moreover, Staff is critical of the manner in which the provision is written, as there is no recourse for the customer in the event of gross negligence or willful misconduct of the company. (*Id.*)

SWG's Rebuttal Position

729. SWG states that it does not agree with Staff's concern that Rule 8.E may remove an incentive for it to behave in the most prudent manner possible because SWG is obligated to behave prudently as a highly regulated entity. (Ex. 108 at 3.) SWG provides that its failure to act prudently could result in significant disallowances or penalties. (*Id.* at 3-4.)

730. SWG states that, provided that the Commission does not accept its original language, the following language would be acceptable and an improvement over existing tariff language:

> The Utility's liability, if any, for its gross negligence or willful misconduct is not limited by this Tariff. With respect to any claim or suit, by a customer or by any others, for damages associated with the establishment, interruption, resumption, and termination of service to a customer, the Utility's liability shall not exceed an amount equal to the proportionate charge for the service for the period during which service was affected. The utility shall not be liable for any special, indirect, or consequential damages whatsoever including, but not limited to, loss of profits or revenue, loss of use of equipment, cost of capital, cost of temporary equipment, overtime, business interruption, spoilage of goods, claims of customers of the customer or other economic harm.

(*Id.*)

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Commission Discussion and Findings

731. The Commission agrees with Staff's contention that SWG's proposed language is overly vague, fails to consider the possibility of gross negligence by SWG, and does not provide an avenue for customer recourse in the event of such negligence. Moreover, the Commission finds that the record does not adequately support acceptance of SWG's alternative proposed language. Accordingly, the Commission rejects SWG's proposed modifications to Tariff No. 7, Rule 8.E. In rejecting the provision, the Commission notes that SWG is able to address the Commission's concerns and file an updated tariff outside of a GRC.

K. Tariff No. 7, Rule 14

SWG's Position

732. SWG proposes modifying Tariff No. 7, Rule 14 – Claims against the Company. (Ex. 36 at 22.) SWG provides that "the modifications are intended to clarify that billing and service complaints should be adjudicated by the Commission." (*Id.*) SWG states that the proposed language is consistent with current practice and Commission policy to resolve disputes with the Commission and avoid the judiciary. (*Id.*)

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BCP's Position

733. BCP does not address this issue.

Staff's Position

734. Staff recommends that the Commission approve the proposed change to Rule 14. (Ex. 94 at 7.)

Commission Discussion and Findings

735. The Commission agrees with SWG that the Commission is the appropriate venue for resolving billing and service complaints that cannot be remedied at the company level. The

Commission finds that SWG's proposed modification to Tariff No. 7, Rule 14 – Claims against the Company provides clarity that benefits both ratepayers and the company. Accordingly, the Commission approves SWG's modifications to Tariff No. 7, Rule 14 as filed.

L. Tariff No. 7, Rule 16.B

SWG's Position

736. SWG requests approval of modifications to Tariff No. 7, Rule 16.B. (Ex. 1 at 206-207.)

BCP's Position

737. BCP does not address this issue.

Staff's Position

738. Staff recommends that the Commission approve the proposed change to rule 16.B. (Ex. 94 at 8.) Staff notes that the modification would remove Rule 16.B.3, which allowed SWG to install automatic meter reading or offsite meter reading devices on a customer's premises and to assess a charge when such an installation is requested and for the convenience of a customer. (Ex. 36 at 7.) Staff states that because company policy now dictates the installation of an AMR or OMR device on all customer premises, there will not be any circumstances where a customer would request an installation of such a device for customer convenience. (*Id.* at 7-8.)

Commission Discussion and Findings

739. The Commission approves the proposed changes to SWG's Tariff No. 7, Rule 16.B as filed. The Commission agrees with Staff that the current language is unnecessary and finds that removal of the language eliminates an outdated provision.

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M. Tariff No. 7, Rule Nos. 3.F 16.C.1

SWG's Position

740. SWG requests to modify Rule Nos. 3.F and 16.C. (Ex. 36 at 22.) SWG states that the modifications are intended to "clarify the customer's obligation to provide access to the company for its gas facilities whenever the company provides service through gas facilities that are installed on the customer's property." (*Id.*)

BCP's Position

741. BCP does not address this issue.

Staff's Position

742. Staff recommends that the Commission approve the proposed change to rule 16.C.1. (Ex. 94 at 8.) Staff provides that it is necessary for SWG "to have access to properties to provide service, maintain facilities, move facilities when needed, and remove facilities when no longer providing service." (*Id.*) Staff states that the "Grant of Easement" form required by SWG from the customer clarifies that SWG "will only use the easement for the purpose of providing gas service, will work with due care, and will be responsible for leaving the property in the same condition as before the work was performed." (*Id.*)

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Commission Discussion and Findings

743. The Commission finds that the proposed modifications to Tariff No. 7, Rule 3F and 16.C.1 are practical and ensure that SWG can provide adequate, safe and reliable service. The Commission further finds that the proposed changes memorialize that SWG will limit the scope of accessing customer property to providing service while further ensuring that it will respect the condition of customer property. Accordingly, the Commission approves SWG's proposed changes to Tariff No. 7, Rule 3F and 16.C.1 as filed.

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N. Tariff No. 7, Rule 16.C.2

SWG's Position

744. SWG requests changes to Tariff No. 7, Rule 16.C.2. (Ex. 36 at 22.) SWG states that the proposed changes are intended to clarify the customer's obligation to provide access to the company for its gas facilities whenever SWG provides service through gas facilities that are installed on the customer's premises. (*Id.*)

BCP's Position

745. BCP does not address this issue.

Staff's Position

746. Staff recommends that the Commission approve the proposed change to Rule 16 to add Rule 16.C.2. (Ex. 94 at 10.) Staff states that the rule provides that when a customer is currently receiving service, it is the customer's responsibility to, within ten days of SWG's request, provide a non-exclusive perpetual easement at no cost to SWG. (*Id.* at 9.) Staff states that "[t]he easement must be in a form that is satisfactory to the installation and maintenance of a gas pipeline" and that the company has rights to ingress and egress. (*Id.*)

747. Staff states that the addition also describes circumstances where easements or other property rights may be deemed unsatisfactory. (*Id.*) Staff states that the changes do not prohibit the customer from requesting additional time or prohibit SWG from granting additional time to provide the easement if a good faith attempt is made. (*Id.*) Staff notes that if a request is not made, SWG may initiate the termination process, which gives the customer a ten-day notice. (*Id.*)

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Commission Discussion and Findings

748. The Commission finds that the addition of Rule 16.C.2 is reasonable and ensures that the utility should be able to access customers' premises and provide adequate service upon request to receive such service. The Commission agrees with Staff's contention that the language provides SWG and its customers with flexibility to seek additional time to make good-faith efforts, as necessary, to procure a perpetual non-exclusive easement. Further, Staff supports the language, and BCP did not oppose it. Accordingly, the Commission approves modifications and additions to SWG's Tariff No. 7, Rule 16.C.2 as filed.

O. Tariff No. 7, Rule 16.D

SWG's Position

749. SWG requests to modify Tariff No. 7, Rule 16.D. (Ex. 36 at 22.)

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BCP's Position

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750. BCP does not address this issue.

Staff's Position

751. Staff states that it recommends that the Commission approve the proposed change to Rule 16.D. (Ex. 94 at 11.) Staff states that the proposed change provides that "the customer will be solely responsible for any injury, damage, or loss resulting from the gas or its use loss after such gas passes beyond the point of delivery, and that the company shall not be responsible for any loss, injury, or damage" from the negligence of the customer." (*Id.* at 10.) Staff states that an additional sentence was included to clarify that SWG has the right, but not the responsibility, to refuse service to a customer if the company believes that the facilities beyond the point of delivery present a hazardous condition. (*Id.*)

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Commission Discussion and Findings

752. The Commission finds that the proposed language protects SWG from events that are outside of the control of the utility by clarifying that SWG is not responsible for damages occurring from gas after it has passed the point of delivery. Staff supports the language and BCP did not oppose the modification. Accordingly, the Commission approves SWG's request to modify Tariff No. 7, Rule 16.D as filed.

P. Tariff No. 7, Rule 16.E

SWG's Position

753. SWG proposes changes to Tariff No. 7, Rule 16.E in order to clarify SWG's service obligations and to provide a clear expectation of the scope of services that SWG provides to customers as it relates to a customer's responsibility for equipment. (Ex. 36 at 22.)

BCP's Position

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754. BCP does not address this issue.

Staff's Position

755. Staff recommends that the Commission approve the proposed change to Rule 16.E. (Ex. 94 at 11.) Staff states that the proposed changes language in Rule 16.E from the company "performing a safety inspection upon connection" to "performing a leak check upon connection." (*Id.*) Staff further states that the change clarifies that while SWG has the right to refuse service if it detects a leak, it doesn't have the obligation to inspect, maintain, repair or warn of any condition that it might observe. (*Id.*) Staff provides that the revision also puts customers on notice that they are responsible for the "upkeep and safety standards of anything on the premises outside the scope of gas service." (*Id.*)

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Commission Discussion and Findings

756. The Commission finds that the proposed language is reasonable and clarifies the obligations of the utility and customer. Moreover, Staff recommends approval of the tariff modification and BCP did not oppose it. Accordingly, the Commission approves SWG's proposed changes to Tariff No. 7, Rule 16.E as filed.

Q. Modifications to SWG's Nevada Gas Tariff No. 7 – Service Territory

SWG's Position

757. SWG submitted late-filed Ex. 109, which contains modifications to SWG's Nevada Gas Tariff No. 7, PUCN Sheet Nos. 128-133. (Ex. 109 at 1-9.) SWG requests acceptance of the tariff and states that it merely clarifies SWG's Description of Service Area. (*Id.* at 1.)

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BCP's Postion

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758. BCP does not address this issue.

Staff's Position

759. Staff does not address this issue.

Commission Discussion and Findings

760. NRS 704.390 provides that "it is unlawful for any public utility to discontinue, modify or restrict service to any city, town, municipality, community or territory theretofore serviced by it, except upon 30 days' notice filed with the Commission, specifying in detail the character and nature of the discontinuance or restriction of the service intended, and upon order of the Commission, made after hearing, permitting such discontinuance, modification or restriction of service." Accordingly, a utility's service territory cannot be modified except by a properly filed notice to allow other parties to thoroughly vet and intervene as necessary.

761. Here, SWG submitted its tariff modification as a late-filed exhibit to its GRC application. The Commission appreciates that the filing may not, by its nature, seek to modify SWG's service territory. However, the manner in which it was filed did not provide current parties and other potentially interested parties with sufficient notice to examine the proposed changes to its tariff and ensure due process. Accordingly, the Commission rejects the proposed tariff modification. In rejecting the proposed tariff modification, the Commission notes that SWG may properly re-file it in a separate proceeding in accordance with NRS 704.390 and other applicable laws and regulations.

IX. DOCKET NO. 17-08020

A. Request to Recover Cost of Backhoe

Commission Discussion and Findings

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762. In Docket No. 17-08020, the Commission accepted a Stipulation between SWG and Staff regarding a series of incidents where SWG was implicated in violating Nevada's One Call Law and/or the Federal Pipeline Safety Regulations in multiple significant incidents. (*See* the Commission's October 18, 2018, Final Order in Docket No. 17-08020.) The utility paid significant administrative fines totaling $300,000.00 as a result of the incidents. (*Id.* at para. 10.) Relevant to this proceeding, the aforementioned order prohibited SWG from seeking "cost recovery for the replacement backhoe associated with the one destroyed" in one of the incidents. (*Id.* at Ordering Paragraph 6.)

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763. In the instant Docket, SWG originally sought cost recovery of the backhoe contrary to the Stipulation in Docket No. 17-08020. SWG's own witness testified that she was aware, prior to filing its GRC Application, of the Stipulation in Docket No. 17-08020. (Tr. at 994.) Whether the backhoe's inclusion in rate base in its original application was the result of an

oversight as SWG states,[65] the result of negligent or careless record keeping and filing practices, or intentional conduct in blatant disregard or defiance of the Commission's authority, such an occurrence is unacceptable. A utility that received a substantial $300,000.00 regulatory fine should have taken corrective and preventative measures to ensure that it remained in compliance with all aspects the Commission's order. As a regulated utility in the State of Nevada, SWG has a solemn obligation to provide safe and reliable service. The public's trust is violated when a utility breaches its duty to comply with state and federal safety laws, as was the case in the above-referenced incidents.

X. NEGOTIATED RATE CONTRACTS

A. Negotiated Rate Contracts

SWG's Position

764. SWG does not address this issue in its Application.

BCP's Position

765. BCP recommends that the Commission find that SWG's Schedule No. ST-1/NT-1 generally only allows contract rate discounts to the volumetric demand and delivery charge and does not provide for adjustments to the Basic Service Charge or Transportation Service Charge. (Ex. 90 at 2, 8.) Moreover, BCP states that SWG's tariff does not allow SWG to apply rates with a different rate structure than those listed in SWG's Nevada Gas Tariff No. 7. (*Id.* at 8.)

766. BCP acknowledges that SWG may negotiate contract rates including discounts to terms other than the volumetric demand and delivery charge, as well as rates inconsistent with SWG's tariff rate design; however, such contracts require prior Commission approval. (*Id.* at 10.) BCP testifies that SWG has not obtained approval for nine of the twelve contracts at issue

[65] SWG Witness Randi Cunningham stated that the inclusion of the costs in the Application "was inadvertent." *See* Tr. at 995.

in this proceeding. (*Id.*) BCP notes that the Commission's Order in Docket No. 09-04003 found that contracts that conform to SWG's tariff do not require Commission approval, but contracts that do not conform to SWG's tariff require Commission approval before they go into effect. (*Id.* at 25-26.)

767. BCP states that none of SWG' twelve negotiated rate contracts comply with SWG's tariff. (*Id.* at 15.) SWG provides a detailed analysis to support this conclusion. Due to SWG's claim of confidentiality, BCP assigns each contract customer a numeric designation. (*Id.* at 16.)

768. BCP notes that "five of six contract customers in SWG's NND pay only a Basic Service Charge of $1,000.00 per month and Transportation Service Charge of $500.00 per month." (*Id.* at 11.) BCP provides that SWG essentially eliminated or waived all volumetric charges and demand charges for these customers. (*Id.*) BCP further provides that "none of the other seven contract customers pay a reduced or discounted Demand Charge per therm consistent with the rate structure in the Statement of Rates." (*Id.*)

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769. BCP states that SWG's tariff allows SWG to "reduce" rates to specify allowable adjustments to the Volumetric and Demand charges for a contract rate; however, it does not allow SWG to eliminate or waive these charges. (*Id.*) Accordingly, BCP argues that SWG's tariff does not allow SWG to apply a rate of $0.00 per therm for the volumetric demand and delivery charges for contract customers. (*Id.* at 12.)

770. BCP identifies the following violations of SWG' tariff in its contracts with customers in SWG SND:

a. Contract Customer 1 in SWG's SND does not pay the Basic Service Charge or the Transportation Service Charge; and does not pay the fixed Monthly Demand Charge; (*Id.* at 16.)

b. Contract Customer 2 in SWG's SND pays a Basic Service Charge of $750.00 a month instead of the SWG tariff rate for a customer with two meters, of $2,000.00 a month; and does not pay the fixed Monthly Demand Charge; (*Id.* at 17, 18.)

c. Contract Customer 3 in SWG's SND pays a Basic Service Charge of $1,000.00 instead of the SWG tariff rate for a customer with two meters, of $2,000.00 per month; receives a $0.00 per therm volumetric rate and does not pay the fixed monthly Demand Charge; (*Id.* at 18.)

d. Contract Customer 4 in SWG's SND receives a $0.00 per therm volumetric rate; and does not pay the fixed monthly demand charge. (*Id.* at 19.)

e. Contract Customer 5 in SWG's SND receives discounts to the Basic Service Charge and Transportation Service Charge; receives a $0.00 per therm volumetric rate; and does not pay the fixed Monthly Demand Charge; and (*Id.* at 20.)

f. Contract Customer 6 in SWG' SND receives a $0.00 per therm Demand Charge. (*Id.* at 20-21.)

771. BCP identifies the following violations of SWG tariff and NAC 704.518 in its contracts with customers in SWG' NND:

a. Contract Customer 1 in SWG' NND pays a Volumetric Charge of $0.01442 per therm, which is higher than the Volumetric Charge of $0.01129 per therm

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in the Statement of Rates. (*Id.* at 22.)[66]; and receives a rate of $0.00 per therm for the Demand Charge; and (*Id.*)

b. Contract Customers 2 through 6 in SWG' NND receive a rate of $0.00 per therm for the Volumetric Demand and Delivery Charges. (*Id.*)

772. BCP recommends that the Commission find that there is no authority in SWG's tariff to waive the volumetric demand and delivery charges by applying a rate of $0.00 per therm. (*Id.* at 10-11.)

773. BCP recommends that the Commission find that SWG was required to obtain Commission approval of three of the negotiated rate contracts for Contract Customers in SWG's SND and six of the negotiated rate contracts for Contract Customers in SWG's NND, because they do not comply with SWG's Gas Tariff No. 7. (*Id.* at 24.)[67]

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774. BCP states that NAC 704.518(3) requires that SWG file contracts and supporting documentation of a bypass alternative for Commission approval if the terms of the contracts do not conform to SWG's tariff. BCP further states that the Commission's Order in Docket No. 93-3003 did not exempt SWG from filing contracts with the Commission for approval. (*Id.* at 25.) BCP provides that the Order in Docket No. 93-3003 only applied to contracts executed pursuant to SWG's Schedule No. SG-OS/NG-OS (Optional Gas Service) and still required that they be filed with the Commission pursuant to NAC 704.516 through 704.528. (*Id.*)

775. BCP takes issue with the manner in which SWG calculated its informative CCOS study. (*Id.* at 28.) BCP states that SWG' CCOS calculations show annual revenues of $14,997,

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[66] BCP points out that SWG's tariff "does not provide for rate terms that are higher than the tariff rates." (Ex. 90 at 22.)

[67] BCP notes that the Commission approved three of the negotiated rate contracts for contract customers in its SND: Saguaro, NPC, and Desert Star Energy. (*Id.*)

567.00 and annual rate of return of 18.45 percent from contract customers in its SND, and $403.467.00 and 296.61 percent from contract customers in its NND. (*Id.* at 28-29.)

776. BCP points out that "the peak month allocator is a key driver of the allocation of revenues to customer classes in the CCOS study", and that allocators used in the CCOS study must be consistent for all customer classes to fairly assign revenues. (*Id.*) BCP provides that SWG' CCOS calculations do not meet these standards. (*Id.*)

777. BCP states that SWG's informative CCOS study used the peak month therms for only two of its six contract customers in SWG's NND, which accounts for only 18 percent of total therms transported through SWG's SND distribution system that month. (*Id.*) BCP further states that SWG's informative CCOS study used the peak month therms for only 21.3 percent of the total therms transported in SWG's NND distribution system that month. (*Id.*)

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778. BCP states that it conducted its own CCOS study that fully included the peak month volumes for SWG's contract customers. (*Id.* at 29.) BCP provides that for SWG's SND, it calculated a $15,320,517.00 class net operating margin when all contract customers are grouped as a class, compared to SWG's estimated $14,997,567.00 – an annual deficiency of $322,950.00 when all peak month volumes of contract customers are included. (*Id.* at 29-30.) BCP further provides that it calculated SWG's NND net operating margin to be $2,201,381.00 when all contract customers are grouped as a class compared to the $403,467.00 in present contract revenue – an annual revenue deficiency of $1,797,914.00 when all peak month volumes of the contract customers are included in the CCOS study. (*Id.* at 30.) Accordingly, neither SWG's SND nor NND contract customers pay their average rate of return. (*Id.*)

779. In addition to its concerns regarding whether SWG's contract customers pay rates which generated revenues paying SWG's authorized rate of return, BCP states that it was

imprudent for SWG to not file its NCA 1 and NCA 2 contracts with the Commission. (*Id.* at 33.) BCP provides that the contract issue has been raised in every GRC proceeding since 2001 – eight years prior to SWG renegotiating the contracts with NCA 1 and NCA 2. (*Id.*) BCP further provides that given the concerns raised in previous proceedings regarding whether rates from contract customers and the flow-back of contract revenues in the CCOS study resulted in just and reasonable rates for full margin tariff customers, it would have been prudent for SWG to seek Commission approval of the contracts prior to renegotiating them. (*Id.*)

780. To address these two concerns, BCP recommends that the Commission find that the contract revenue from the rates paid by SWG's contract customers do not provide the average rate-of-return when grouped as a customer class, and that that the difference in revenues from the inclusion of NCA 1 and 2 in the CCOS study and the present contract revenues from NCA 1 and NCA be imputed as a reduction to SWG's revenue requirement in its SND. (*Id.* at 31.)

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781. BCP also recommends that the difference in revenues from the inclusion of SWG's NND Customer 1 in the CCOS study and the present contract revenues from that customer should be imputed as a reduction to SWG's NND revenue requirement. (*Id.* at 31, 34, 35.) BCP provides that the reduction in annual revenue requirement based upon SWG's requested certified revenue requirement is $659,045.00; however, if the Commission accepts BCP's recommendation to classify costs recorded in FERC Account Nos. 813 (Other Gas Supply Expenses) and 871 (System Load Dispatching) as commodity-related costs, the reduction in annual revenue requirement increases to $798,739.00. (*Id.* at 35.) BCP notes that "to the extent that the Commission reduces SWG's certification requested revenue requirement, the reduction to the annual revenue requirement would be less because the calculated CCOS study net

operating margin for [SWG's NND] Customer 1 would decrease and therefore the differential to the contract revenues would decrease." (*Id.*)

782. BCP does not recommend imputation of revenues from SWG's SND contracts with Saguaro Power Company, NPC, and Desert Star, because these contracts were previously approved by the Commission. (*Id.* at 32, 32)

783. Furthermore, BCP does not recommend imputation of revenues from Las Vegas Generating Station II's contract, because it does not support imputation of revenues from contracts executed prior to the implementation of PHMSA's Transmission Integrity Management Program ("TRIMP") rule in 2003. (*Id.* at 31-32.) [68]

784. Additionally, BCP recommends that the Commission direct SWG to provide notice to Contract Customers 2 through 6 in its NND to terminate their contracts to allow the customers to become direct connect customers of SWG's affiliate – Paiute Pipeline Company ("Paiute"). (*Id.* at 36, 38.) BCP provides that if the customers are truly direct connect customers of Paiute, they should become direct customers of Paiute. (*Id.*) BCP further provides that the five direct connect customers are only paying a Basic Service Charge of $1,000.00 a month, and a $500.00 Transportation Service Charge – an insignificant contribution the margin paid by all full margin customers. (*Id.*) BCP contends that if the above-referenced customers "are not making a sufficient contribution to pay for distribution plant investment, general plant investment, depreciation expenses, and non-gas operations & maintenance expenses, then there is little value to full margin tariff customers to have these five direct connect customers as retail customers of SWG." (*Id.*)

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[68] NCA 1 and NCA 2 were renegotiated subsequent to the implementation of PHMSA's TRIMP. (*Id.*)

Staff's Position

785. Staff states that SWG offers two broad types of service: "1) bundled, full-service natural gas commodity deliveries and 2) unbundled transportation service that allows customers to purchase their own natural gas commodity and use SWG's infrastructure to schedule, balance and deliver gas to the customer's location." (Ex. 98 at 3.) Staff further states that SWG offers full margin transportation service under tariff schedules ST-1 or NT-1 for customers in SWG's SND and NND, respectively. (*Id.*) Staff provides that not all transportation customers are full-margin, and that there are a subgroup of customers who receive service under contracts. (*Id.* at 4.)

786. Staff states that there are three types of contracts that have distinct characteristics and regulatory requirements: 1) discounted contracts; 2) contracts for special services; and 3) legacy contracts that pre-date current regulations governing SWG's transportation service contracts. (*Id.*)

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787. Staff states that discounted transportation contracts are used for customers that operate under Section 3.1 (g)-(h) of SWG's ST-1 or NT-1 tariff. (*Id.*) Staff further states that these customers may pay a lower volumetric and/or demand rate if they can demonstrate that their requirements can be served by alternate fuels or other natural gas pipelines. (*Id.*) These customers pay a rate that may be lower, but their rates otherwise follow the rate design of SWG's tariff. (*Id.* at 5.) Staff states that because the discounted contract rates retain the overall rate design in SWG's Commission-approved tariff, SWG may simply file the executed contracts with accompanying supporting documentation of bypass alternative with the Commission, without seeking pre-approval from the Commission. (*Id.*)

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788. By contrast, Staff states that contracts for special services are used for customers that operate under NAC 704.518(3)-(7) and incorporate certain provisions of SWG's ST-1 or NT-1 tariff by reference. (*Id.*) Staff provides that these customers may receive rates which are different from the rates set forth in SWG' tariff and may not follow the tariff's rate design. (*Id.*) Staff further provides that a customer seeking a contract for special services must demonstrate its ability to bypass SWG's system and pay a negotiated contract rate to SWG that is different from SWG' tariff rate. (*Id.*) For example, Staff notes contracts for special services can include a high, fixed demand charge in exchange for not paying a volumetric rate based on usage. (*Id.*) Staff states that because contracts for special services do not need to comply with SWG's tariff rate design, such agreements must be individually approved by the Commission pursuant to NAC 704.518(3)-(5) in order to be made effective. (*Id.*)

789. Staff states that legacy contracts are agreements that pre-date current regulations and tariff provisions outlined in NAC 704.518, incorporate contract rates largely unrelated to otherwise applicable tariff rates, and have been separately approved by the Commission. (*Id.* at 5-6.)

790. Staff states that during discovery, SWG provided that the nine above-referenced contracts are "discounted contracts" subject to its tariff ST-1/NT-1 provisions, including the demonstration of bypass alternative. (*Id.* at 6.) Staff notes that three other contracts, NPC, Saguaro, and Desert Star, were identified and found to not be at issue. (*Id.*)

791. Staff states that SWG is not complying with its tariff because it reduced its Basic Service Charge ($1,000.00 per meter) for certain customers, which is not provided for, and thus violates its tariff. (*Id.* at 9.) Staff further states that SWG "appears to be stretching the meaning

of a rate "adjustment" by allowing fixed and $0.00 per therm charges in certain contracts because the volumetric charge in SWG's tariff contemplates a charge per therm. (*Id.* at 10.)

792. Staff states that SWG is also "inconsistently complying with its contract filing requirements by filing negotiated rate contracts late or not at all." (*Id.* at 10.) Staff notes that SWG's inflation adjustment for Cyanco filed in Docket No. 18-06016 showed that the contract was renegotiated in 2016; however, SWG did not file the 2016 contract with the Commission until Staff issued data requests regarding the inflation adjustment due to a reference to a new contract that was not on file with the Commission. (*Id.*)

793. Staff states that if the contracts in violation of SWG's tariff are properly classified as "contracts for special services" pursuant to NAC 704.516 through 704.528, the contracts would still not be fully compliant with Commission regulations because the agreements never received the Commission approval required for these types of contracts. (*Id.* at 11.)

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794. Staff states that if the nine contracts at issue are classified as "contracts for special services," they must comply with the provisions of NAC 704.516 through 704.528. (*Id.*) Staff notes that, in particular, NAC 704.518(3) provides that a "utility shall file with the Commission an application for approval of a contract for special services between the utility and the generating, industrial, or large customer… A utility shall not provide service to a generating, industrial, or large customer pursuant to a contract of special services until the contract is approved by the Commission." (*Id.* at 12.)

795. Staff provides that, with respect to contracts for special services, "NAC 704.518(4)(b) & 7(a) requires a customer who seeks a contract for special services to demonstrate that a bona fide alternative is available, and that SWG, in establishing the rates and charges under a contract for special services, must ensure the customer has a "bona fide

alternative." (*Id.* at 16.) Staff contends that the regulations require the demonstration of "a bypass alternative. (*Id.*) Staff further contends that providing "some form of an economic bypass study is an integral part of an application requesting Commission approval of a contract for special services." (*Id.*)

796. Staff further provides that discounted contracts require the economic bypass study pursuant to Section 3(g) of SWG's transportation tariff, Schedule No. ST-1/NT-1, which states that "[p]rior to initiating service under this provision, the company shall file the executed service agreement and supporting economic studies with the Commission." (*Id.*)

797. Staff states that under the terms of SWG's tariff, SWG must file an executed service agreement and documentation satisfying the 3-prong test of bypass alternative with the Commission before operating under the terms of a discounted contract. (Ex. 96 at 2-4.)

798. Staff states that SWG has not filed the supporting documentation of bypass alternative with the Commission as required by its tariff Schedule ST-1/NT-1 and that on many occasions, Staff has had to file data requests to obtain copies of contracts and studies that should have been filed with the Commission. (*Id.* at 19.) Staff contends that SWG has failed to adhere to the filing requirements of its tariff, which has made Staff's assessment of the contracts and supporting studies more difficult. (*Id.* at 19-20.)

799. Staff states that its confidential analysis shows that none of the four contracts reviewed by Staff complied with the requirement to document a bypass alternative. (*Id.* at 20.) Staff further provides that such a demonstration requires that the customer "demonstrate that the alternative is economically and operationally feasible and that the cost to the customer to bypass the system of the utility is less than the marginal cost needed for the utility to serve the customer" as delineated in NAC 704.518(7) (a). (*Id.* at 20-21.)

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800. Staff further states that SWG has not filed supporting documentation of bypass alternative for its contracts with LV Cogen II, EP #1, EP #2, Premier Magnesia, Newmont Gold (Carlin), and Newmont Twin Creeks. (*Id.* at 18). Staff further states that SWG has indicated that it did not have documentation of bypass alternative for its EP #1, EP #2, Premier Magnesia, Newmont Gold (Carlin) and Newmont Twin Creeks contracts. (*Id.*) Staff provides that the Commission does not have an economic bypass study for LV Cogen II on file. (*Id.*)

801. Staff recommends that the Commission find that SWG's contracts with Cyanco, EP #1. # 2, Newmont Gold (Carlin) & Twin Creeks, Premier Magnesia, LV Cogen II and NCA #1 and #2 are not fully compliant with SWG's tariff, Schedule No. ST-1/NT-1, including the demonstration of bypass alternative, and that the rate designs in the aforementioned contracts are most appropriately characterized as contracts for special service. (*Id.* at 8.)

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802. Staff recommends that the Commission confirm that SWG is required to file documentation of bypass alternative for all contracts, including contracts for "directly connected customers" executed under Section 3(g) of ST-1/NT-1 or under NAC 704.518, with the Commission. (*Id.* at 14-17.)

803. Staff recommends that the Commission order SWG to file supporting documentation of bypass alternative for its contract with LV Cogen II, and renegotiate and file new contracts and supporting economic studies for the expired contracts with EP #1, EP #2, Newmont Gold (Carlin), Newmont Twin Creeks, and Premier Magnesia within nine months of the date of the issuance of the Commission's final order. (*Id.* at 17.)

804. Staff states that SWG is still providing transportation service pursuant to expired contracts to EP #1, EP #2, Premier Magnesia, Newmont Gold (Carlin), and Newmont Twin Creeks and notes that some of them expired decades ago. (*Id.* at 19.) Staff provides that SWG

has been providing service under these contracts pursuant to an evergreen clause contained in its tariff, and "these contracts were neither renegotiated nor have they ever been filed with the Commission." (*Id.*)

805. Staff states that in SWG's 2009 GRC, the Commission directed the utility to renegotiate expired contracts and file the new agreements with the Commission. (*Id.* at 20.) Staff acknowledges that it had previously testified that SWG had complied with the Commission's request, but notes that SWG had not actually filed new contracts to replace the old agreements, and instead provided Staff with updated price sheets that were signed subsequent to the 2009 Commission order. (*Id.*) Staff states that while it previously found that sufficient, Staff's current recommendation is based upon a better understanding and appreciation for supporting economic studies. (*Id.* at 20-21.) As Staff explained at hearing, while Staff has performed some review of SWG contracts previously, "to the best of my knowledge a review of this level of detail has not previously been conducted." (Tr. at 1279).

806. Staff contends that "such [economic bypass] studies are essential to assess the reasonableness and justification for a contract and the rates contained within it, regardless of whether the customer is directly connected to an alternative pipeline." (*Id.* at 21.) Staff further contends that, "without such studies, the Commission would be left without any means to ensure the reasonableness of a contract, whether it is executed under SWG's tariff" or governing regulations for special services. (*Id.*) Staff also notes that absent further Commission action, the expired contracts may continue to operate in perpetuity pursuant to evergreen clauses. (*Id.*)

807. Accordingly, Staff recommends that the Commission order SWG to "renegotiate and file new contracts and supporting economic bypass studies for the expired contracts with EP

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#1, EP #2, Newmont Gold (Carlin), Newmont Twin Creeks, and Premier Magnesia, within nine months of the date of the issuance of the Commission's final order in this Docket." (*Id.* at 21-22.)

808. Staff states that SWG has not updated the price lists for its NND customers since SWG's 2012 rate case for the contracts with EP #1, EP #2, Premier Magnesia, Newmont Gold (Carlin), and Newmont Twin Creeks. (*Id.*)

809. Staff states that in CCOS studies, revenues from contract customers are used to offset the amount of revenues paid by other customer classes, which SWG refers to as "full margin customers." (Ex. 103 at 2, 8.) Staff provides that the revenues from contracts are used to offset the revenues to be collected from full margin customers because, but-for the negotiated contracts, the loss of these entities as customers would have meant the loss of the transportation customers' billing determinants, requiring SWG's remaining customers to pay a greater portion of costs. (*Id.* at 2-3, 8-9.) Accordingly, Staff provides that, by retaining the customers on SWG's system, it helps reduce the costs borne by the remaining customers. (*Id.* at 3, 9.)

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810. Staff questions "the reasonableness of some of the allocations and allocation factors used in the CCOS studies filed by SWG", including but not limited to SWG's use of a single critical peak, and SWG's allocation of distribution investments and transmission investments. (*Id.* at 12.).

811. Staff ran the CCOS study using alternative allocation factors and found that SWG' contract customers "do not provide SWG with enough revenues to cover the costs to serve this customer class in the SND or the NND." (*Id.* at 14.).

812. Staff also provides that SWG' recent filing in Docket No. 18-08016 identified costs that are being incorrectly "spread to all customer classes and not to the transportation customers, even when such costs were caused by the NT-1/ST-1 customers." (*Id.* at 15.).

813. Staff states that it is concerned with SWG's alleged violations of its own tariff and the Commission's regulations. (*Id.* at 5, 8.) Staff provides that SWG's tariff and the Commission's regulations provide SWG with tools to retain customers, provided that customer's bypass is physically, operationally, and economically feasible and imminent, while ensuring that those rates and services do not impose a burden or cause a harm to ratepayers. (*Id.* at 5, 8-9.) Staff's concern relates to the possibility that the costs associated with serving the contract customers may be shifting to remaining ratepayers without justification, which Staff contends would be inappropriate and unreasonable. (*Id.* at 5, 9.)

814. Staff recommends that the Commission impute the revenues into the cost of service that SWG would have received had the contract customers taken service under the otherwise applicable class in lieu of the revenues actually received by the customers. (*Id.* at 5-6, 9.) Staff recommends that the Commission impute up to $3,590,356.00 for rate making purposes in SWG's NND. (Ex. 103 at 2.) For SWG's SND, Staff recommends that the Commission impute up to $13,031,780.00 for rate making purposes. (Ex. 103 at 8.)

815. Staff provides that it would be unreasonable for remaining SWG customers to absorb costs associated with SWG violating its own tariff and Commission regulations. (*Id.* at 6, 9.)

816. Staff states that SWG's CCOS study lists the contract customers as rate class NG-G4 for SWG' NND and SG-G4 for its SND. (*Id.* at 6, 10.) Staff states that using the proposed certification rates for the NG-G4 and billing determinants for those customers would lead to an imputation of revenue of up to $3,590,356.00 for the NND; however, that tariff applies to customers that utilize SWG's distribution facilities to receive service. (*Id.*) Staff notes that SWG indicated that all of the contract customers in the NND are direct connect customers of Paiute

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and have minimal, if any distribution facilities associated with their service. (*Id.* at 6-7.) Accordingly, Staff contends that the use of the NG-G4 rates could result in overstating the revenues that SWG should have received from the customers of those noncompliant contracts. (*Id.* at 7.), noting that SWG states that it does not have a tariff available for direct access customers served by SWG. (*Id.*)

817. Staff states that utilizing the proposed certification rates for the SG-G4 and billing determinants for the relevant customers in SWG' SND leads to a revenue imputation of up to $13,031,780.00. (*Id.* at 10.) Staff provides that it does not have the same concern about direct access customers that it does for the NND because the contract customers in SWG' SND use SWG's distribution system to move their gas supplies, and without the contract customers, would be subject to the SG-G4 rates. (*Id.*)

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818. Staff states that the Commission has broad authority in setting rates and could impute whatever amount it deems appropriate or impose a civil penalty in a separate proceeding. (*Id.* at 6, 7, 10.) Staff states that the imposition of a penalty would go to the State's general fund and would not address the problem with respect to SWG's customers. (*Id.* at 7, 10-11.)

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819. Staff recommends that the Commission find that four of SWG's current contracts are non-compliant with SWG' tariff because SWG has failed to demonstrate that bypass is economically, operationally, and physically feasible and imminent with respect to those contracts (also referred to as the "three-prong bypass feasibility test"). (Ex. 96 at 2.) Staff provides that, as noted in SWG' tariff (Schedule No. ST-1/NT-1 § 3.1(g)), the demonstration of eligibility "shall include engineering studies, cost estimates, economic feasibility analyses, the ability to obtain all necessary right-of-way, and the ability to obtain upstream transportation capacity sufficient to supply the customer's requirements." (*Id.*)

820. Staff also recommends that the Commission open an investigation and rulemaking to address issues identified by Staff and other parties in the pre-hearing briefs, as well as consideration of potential revisions to SWG's tariff, Schedule No. ST-1/NT-1. (Ex. 98 at 23.) Staff provides that addressing SWG's contracts in a separate rulemaking will enable the Commission to propose clarifications to the tariff and regulations while ensuring that the contracts are appropriately addressed in other proceedings going forward, such as the GIR or expansion proceedings. (*Id.*)

821. Regarding SWG's CCOS study of the costs of its contract customers, Staff states that it does not request immediate modifications of SWG's CCOS study, because Staff believes that a higher priority should be placed upon other issues regarding SWG's contract customers. (Ex. 103 at 16.) However, Staff recommends that the Commission direct SWG to address Staff's concerns in revisions to the CCOS study it will file with SWG' next general rate case. (*Id.*)

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SWG's Rebuttal Position

822. SWG states that Staff and BCP's recommendations contradict Staff's testimony in Docket 12-04005, where Staff found SWG to be in compliance with its contracts and found that their contracts were reasonable and provided a positive rate of return/net income. (Ex. 113 at 2.) SWG provides that since Docket No. 12-04005, no material changes have been made to its Nevada Gas Tariff No. 7, the NRS, or the NAC regarding the approval or execution of contracts. (*Id.*) SWG further provides that since its last GRC, it has not entered into any additional contracts and only one contract customer, Cyanco, has been renegotiated. (*Id.* at 2-3.) Accordingly, SWG contends that all of the other contracts that Staff and BCP claims to be non-compliant have been previously reviewed and found to be reasonable and compliant. (*Id.* at 3.) SWG further contends that, notwithstanding other issues raised in this docket regarding

contracts, Staff and BCP's recommendation would represent an extreme and punitive disallowance of its authorized revenue of up to approximately $3.5 million in its NND and $13 million in its SND. (*Id.*)

823. SWG states that calculating its rates for full-margin customers requires 1) determining the calculation of the annual revenue requirement; 2) deducting revenue derived from service to the contract customers from the total revenue requirement; and 3) determining the amount of revenue collected through rates for each of the full-margin rate schedules. (*Id.*) SWG provides that "imputing additional revenue to the NRCs reducing the amount of revenue collected from SWG full-margin rate schedules." SWG contends that in order to recover the lost revenue resulting from the proposed imputation, it would need to break its current negotiated contracts, which could result in costly litigation. (*Id.* at 3-4.) SWG further contends that "there is no cost-of-service basis to charge contract customers more than they currently pay as their rates already produce greater than the system rate of return." (*Id.* at 4.)

824. SWG states that its contracts have been addressed in previous dockets. (*Id.*) SWG notes that in Docket No. 01-7023, the Commission ordered SWG to include contract customers as a class in its CCOS study and noted that using the same allocation methods as other classes in the study would be inappropriate because it would not reflect the characteristics of each contract customer. (*Id.*)

825. SWG states that pursuant to the order in Docket No. 01-7023, SWG included the contracts as a customer class in its CCOS study to enable the Commission, Staff, and BCP to review whether the customer provided a positive benefit to the system. (*Id.*) SWG provides that its CCOS study analyses showed that its rate of return from the contract customer class was greater than its proposed system rate of return and that the contract customers benefitted the

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other customers in the system, and summarizes its view of the results of the embedded CCOS study filed in Docket No. 04-3011. (*Id.* at 4-5.).

826. SWG states that in Docket No. 04-03011, the Commission "did not allocate any costs or impute any revenue to the NRC class." (*Id.*)

827. SWG notes that the number of contract customers has dropped from 23 customers to 12 customers. (*Id.*) SWG notes that three of the remaining customers operate under approved contracts for special services, while only four have executed new contracts (Cyanco (2016), Premier Magnesia (2010), NCA #1 (2010), and NCA #2 (2010). (*Id.*) SWG provides that all other customers have been operating under the same contracts since 2004. (*Id.* at 5-6.)

828. SWG states that it filed all of its executed service agreements and supporting economic studies and renegotiated its expired contracts as required in Docket No. 09-4003. SWG states further that in Docket No. 12-04005, it included an allocation of costs for Premier Magnesia, NCA #1, and NCA #2 and an additional allocation of costs for every other contract in existence except the three Commission-approved contracts for special services. (*Id.* at 6.)

829. SWG states that the CCOS study in Docket No. 12-04005 showed that the rate of return for the contract class was greater than the proposed system rate of return, with SND contracts providing a rate of return ranging from 21.69 percent to 82.18 percent, and NND contracts providing a rate of return ranging from 156.59 percent to 292.13 percent. (*Id.* at 7.)

830. SWG also states that, in Docket No. 12-04005, Staff and BCP testified that SWG was in compliance regarding its contracts, and the Commission did not allocate any additional costs or impute any revenues to the contract customer class. (*Id.*)

831. SWG states that in Docket No. 14-06004, it provided copies of all contracts in its SND and NND to BCP and Staff. (*Id.* at 9.) SWG further states that its contracts have been

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addressed in multiple GIR dockets because NAC 704.7985 requires that all customers, except for contract customers, pay the GIR rate for the cost of GIR projects, and that contract customers only pay a GIR rate if the replacement of a pipeline benefits that contract customer. (*Id.*) SWG notes that in those proceedings, no contracts were identified as non-compliant and thus subject to the full GIR rate. (*Id.*)

832. SWG states that its CCOS study analyses do not support the revenue adjustments proposed by Staff or BCP. (*Id.* at 11.) SWG provides that imputing additional revenue to contract customers would only increase the interclass rate subsidy that contract customers provide to other customers and would be contrary to establishing cost-of-service based rates. (*Id.*) SWG argues that a case can be made that in seeking cost-of-service based rates, the Commission could correct the interclass subsidy these customers are currently providing with the addition margin the contract customers provide to the benefit of other customers. (*Id.* at 11-12.)

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833. SWG disagrees with Staff and BCP's assertion that its contracts are non-compliant with its tariff, and notes that in previous proceedings its contracts (with the exception of the Cyanco contract) have been either not contested or found to be in compliance. (*Id.* at 12, 13.)

834. SWG contends that "it is more important the totality of each contract rate design than to focus on individual components that could potentially have been included in a customer's rate structure." (*Id.* at 13.) SWG asserts that when contracts are accounted for in a CCOS study, "there is no difference if the revenues are collected as a demand rate, commodity rate or basic service charge – it is the total dollars that matter." (*Id.*) SWG further asserts that the allocation of payment between various rates is secondary to ensuring that its contracts meet the minimum annual margin needed to cover the costs to serve the contract customers. (*Id.*)

835. SWG states that it did not bring its contracts to the Commission for approval as special contracts because there was nothing unique about the service being provided and the revenues for each customer exceeds the rate of return. (*Id.* at 14.) Given that, SWG states that the agreements did not need to be filed for Commission approval. (*Id.)* Moreover, SWG states that the Commission indicated that it does not desire that all contracts be brought before the Commission for approval. (*Id.*) SWG points to the Commission's November 3, 2009, Order in Docket No. 09-04003, which stated "the Commission finds that it would not be appropriate to require the filing for approval by the Commission of all service agreements between SWG transportation customers under ST-1 and NT-1 tariffs. The requirement would require deviation from NAC 704.518 and would likely violate NRS 704.075." (*Id.* at 14-15.)

836. SWG argues that Staff and BCP "attempt to manipulate the company's CCOS study to provide support for the extreme recommendation that revenue should be imputed." (*Id.* 15.)

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837. SWG asserts that Staff's allocation of costs to contract customers in its CCOS study adjustments are contrary to previously approved studies, and that Staff and BCP both fail to acknowledge that the contract customers are not served from low pressure distribution facilities. (*Id.* 15-16.)

838. SWG compared the net plant allocated by Staff, BCP, and SWG to the contract customers in their respective CCOS studies to the net book value of SWG's facilities installed to serve the customers and found that Staff and BCP's calculations are "extreme and unsupported." (*Id.* at 16.) SWG provides that Staff allocated 33 percent of SWG's distribution facilities on commodity, which it contends violates the 50 percent customer and 50 percent demand allocation of the facilities used in previous dockets. (*Id.*) SWG further provides that Staff

allocates Gas Transmission system facilities 50 percent on commodity in violation of the 100 percent coincident peak demand allocation approved in previous proceedings. (*Id.* at 16-17.)

839. SWG states that Staff and BCP's analyses are also problematic because they allocate substantial amounts of low-pressure distribution facilities although none of the contract customers receive service from such facilities. (*Id.* at 17.) SWG further states that LV Cogen II, NCA #1, and NCA #2 are each served from a pipeline connected directly to Kern River, and that such contractors do not require 11.6 percent or 6.9 percent of SWG's SND total net plant to be served. (*Id.*)

840. SWG provides that "Staff's allocation of net plant to the NRCs of $156.8 million exceeds the total value of SWG net transmission plant of $95.0 million by over 60 percent, while BCP's allocation of net plant to the NRCs essentially equals SWG net transmission plant." (*Id.*) SWG contends that, effectively, Staff and BCP's analyses would not charge SWG's remaining customers anything for SWG's SND transmission plant, which is sized and built to meet all customers' peak winter demands. (*Id.*) SWG presents a similar analysis for NND. (*Id.* at 18.)

841. SWG provides that CCOS studies can diverge from measuring cost-of-service when manipulated to use commodity-based allocation factors to measure value of service, when it inappropriately includes all contractors in the allocation of distribution costs. (*Id.* at 18.)

842. SWG states "[w]hen dealing with very large and uniquely situated customers, like the NRCs, each customer's location and specific facilities must be considered for the CCOS study to be of any real value as a tool for rate design and/or determining whether customers are contributing a positive rate of return to the system." (*Id.* at 19.) Accordingly, SWG contends that Staff and BCP's respective studies are unreliable for use in rate design. (*Id.*)

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843. SWG states that it is not appropriate to assume that contract customers would be charged G-4 rates in lieu of their respective contract rates. (*Id.* at 20.) SWG provides that "the facilities used to serve the NRCs are identifiable, limited in scope, and do not include any low-pressure distribution facilities, and therefore, NRCs should not be allocated/pay for the corresponding system costs." (*Id.*) Moreover, SWG further provides that the "NRCs are much larger on average than SWG G-4 customers." (*Id.*) SWG notes that in its NND, contract customers use 15 times more gas annually than G-4 customers, and in the SND, contract customers use 67 times more gas annually when compared to G-4 customers. (*Id.*) SWG asserts that the acceptance of its CCOS study "shows the NRCs are generating revenues greater than the system rate of return" and that if any adjustment is made, it should be to reduce contract revenues. (*Id.*)

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844. SWG disagrees that recent PHMSA rules have resulted in making bypass a non-viable option for any customers. (Ex. 110 at 5.) SWG states that current contract customers are large and sophisticated companies that have the ability to construct and operate their own pipeline facilities or contract for the services. (*Id.*) SWG notes that six of the existing contract customers "operate utility-scale power plants are experienced in the energy industry, well versed complying with safety regulations and have the expertise to safely operate an underground pipeline." SWG also argues that given Cyanco's experience in safety and complex manufacturing, it also has the technical expertise to construct and operate a bypass pipeline and connect directly to Paiute. (*Id.* at 5-6.)

845. SWG states that its tariffs are designed in consideration of each individual bypass option. (*Id.* at 6.) SWG further states that in all cases, it establishes a floor in setting the rate that is the equivalent cost for the customer to construct new gas pipeline facilities to bypass SWG's

system and connect directly to the nearest interstate pipeline or alternate fuel source. (*Id.* at 6.) SWG provides that, at a minimum, the rates must earn a rate of return that won't cause other customers to subsidize the cost of the service for contract customers. (*Id.*)

846. SWG distinguishes between "Direct Connect" customers and Cyanco, Desert Star, LV Cogen II, NCA #1, NCA #2, NPC, and Saguaro. (*Id.* at 6-7.) SWG states that for Direct Connect customers, it does not make sense to conduct a bypass study because the customers have already bypassed SWG's system through direct connections to Paiute and are not served by SWG facilities. (*Id.* at 15.) SWG provides that, even without any analysis, it can be concluded that the cost for these customers to bypass would be zero. (*Id.*) SWG asserts that the Direct Connect customer contracts conform to its tariff. (*Id.* at 15.)

847. SWG states that in Docket No. 09-04003, it was required to review contracts operating subject to an evergreen clause. (*Id.* at 16.) SWG provides that Direct Connect customers are allowed to continue in evergreen status because the customers were already connected to Paiute and therefore SWG did not have much leverage to negotiate higher rates. (*Id.*) SWG further provides that the only value it provides the customers related to the convenience of balancing gas deliveries under SWG's tariff compared to Paiute's tariff. (*Id.*) SWG notes that continuation of the contracts under evergreen clauses were important because the contracts enable SWG to curtail service in accordance with Rule No. 8. (*Id.* at 16-18.) SWG provides that if the NT-1 agreements were terminated, it could not curtail them to protect higher priority residential customers. (*Id.*)

848. SWG states that the need to curtail Direct Connect customers is an important aspect of allowing the evergreen provisions of certain contracts to continue. (*Id.*) SWG notes that Elko is downstream of Newmont Gold (Carlin) and Newmont Twin Creeks on Paiute's Elko

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lateral and that, during the winter, Newmont Gold (Carlin) was frequently curtailed by SWG to ensue service to residential customers in Elko, Nevada. (*Id.*) SWG provides that since 2013, Newmont Gold (Carlin) has been curtailed 137 times. (*Id.*)

849. SWG states that it determined, to its satisfaction, that bypass for Cyanco was economically, operationally, and physically feasible, and imminent. (*Id.* at 8.) SWG provides that Cyanco is located in a remote area outside of Winnemucca, Nevada, and near Paiute, and owns or could reasonably obtain the required land along the alignment that could be used to construct a bypass pipeline. (*Id.*) SWG notes that it acquired such rights for a rejection line it intended to build to Paiute. (*Id.*) SWG contends that Cyanco is familiar with the equipment needed for precise measurement and pressure regulation of natural gas and has the financial means/technical ability to operate a pipeline or contract with a third party. (*Id.*)

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850. SWG states that it filed the Cyanco contract and supporting economic bypass analysis with the Commission, albeit in an untimely manner due to an administrative error. (*Id.* at 9.) SWG also states that the contract conforms with the provisions of its NT-1 tariff and provides a benefit to other customers in its NND. (*Id.* at 9.)

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851. SWG states that it determined that LV Cogen II's bypass was economically, operationally, and physically feasible and imminent when it executed the contract in 2001. (*Id.* at 10, 11.) SWG further states that it timely filed the contract and analysis with the Commission and refiled it in Docket No. 09-04003. (*Id.*) SWG provides that the basic service charge in the agreement was set to $750.00 because it was the basic service charge set at the time that the contract was written. (*Id.*) SWG provides that the transportation rate was set on a fixed basis to ensure that SWG recovered the cost of the facilities installed to serve LV Cogen II. (*Id.*) SWG further provides that the adjustment provided to LV Cogen II conforms with its tariff. (*Id.* at 10.)

SWG notes that the contract has been reviewed in multiple dockets, and that it was not aware of any claim that the contract was in violation of any regulation or tariff over the 17 years of its existence. (*Id.* at 11.)

852. SWG states that it does not agree with Staff's position that SWG violated its tariff by not having NCA #1 and NCA #2 conduct a bypass analysis because, given the volume of gas used by the customers and its proximity to the Kern River Pipeline, SWG knew that bypass alternatives were available. (*Id.* at 12.)

853. SWG disagrees with Staff's position that SWG would have been willing to allow another public utility to set up business within its service territory to serve NCA #1, NCA #2, PABCO, and Georgia Pacific. (*Id.*) SWG f states that "PABCO and Georgia Pacific are full margin transportation customers served by existing SWG facilities" and that in its analysis, "SWG assumed that NCA #1 and NCA #2 would build separate pipelines to serve the gas needs for each generating facility." SWG states that "[i]ncluding PABCO or Georgia Pacific in its analyses would have created a scenario in which multiple customers would have been served by the same pipeline" which "would essentially create a public utility on an intrastate pipeline." SWG contends such a scenario was not likely and was therefore not considered. (*Id.*)

854. SWG states that it determined to its own satisfaction that the bypass of NCA #1 and NCA #2 was economically, operationally, and physically feasible and imminent. (*Id.* at 13.) SWG further states that a bypass analysis was conducted at the time of the contract's execution, timely filed with the Commission. (*Id.*) SWG provides that the contracts have been reviewed in additional dockets, and that Staff testified that the contracts "generate a positive rate of return on rate base and that they are reasonable." (*Id.*)

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855. SWG states that it chose the flat rate structure in NCA #1 and NCA #2's contracts to ensure monthly margins irrespective of whether NCA #1 and NCA #2 operate. (*Id.*) SWG further states that it was able to contract 10 years of a "predictable margin at rates greater than what was needed to recover the cost of service" to serve the customers. (*Id.*) SWG contends that it would not have likely guaranteed ten years of margin if NCA #1 and NCA #2 were full margin G-4 customers because there would have been no incentive on the customers' end to agree to a minimum annual volume or minimum annual margin if it was paying the full G-4 margin rates. (*Id.*)

856. SWG states that the rates for NCA #1 and NCA #2 conform with the provisions of its tariff Schedule No. ST-1. (*Id.* at 14.) SWG contends that the rates were tailored to address the customers' bypass alternative and provide a rate of return exceeding what is necessary to cover the cost of the dedicated SWG facilities serving it, which in turn provides benefits to other SND customers. (*Id.*)

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Commission Discussion and Findings

857. Like other utilities, SWG is required to provide its services, and apply rates, terms and conditions to its provision of services, in compliance with the requirements of NRS 703 and 704 and its tariff approved by the PUCN.

858. A tariff is a collection of rules that define the relationship between a utility and its customers.[69] Tariff modifications require Commission approval. Specifically, NRS 704.100(1)(a) states that "[e]xcept as otherwise provided in NRS 704.075 and 704.68861 to 704.68887, inclusive, or as may otherwise be provided by the Commission pursuant to NRS 704.095 or 704.097, [a] public utility shall not make changes in any schedule, unless the public

[69] *See* NAC 703.375 through 703.410, inclusive.

utility: Files with the Commission an application to make the proposed changes and the Commission approves the proposed changes pursuant to NRS 704.110; or files the proposed changes with the Commission using a letter of advice…"

859. SWG serves the majority of its customers on a bundled commodity and delivery basis. As Staff states, "only a small subset of SWG customers purchase their own commodity gas and purchase transportation service from SWG." (Exhibit 98, at 3.)

860. Gas transportation customers that purchase service pursuant to contracts under Tariff Schedule No. ST-1/NT-1 include:

a. Limited discount gas transportation customers

b. Special contract gas transportation customers

c. Legacy power plant contracts[70]

d. Desert Star contract for special gas transportation services[71] (Exhibit 98, at 4.)

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861. In this proceeding, Staff and BCP challenged SWG's use of limited discounts and special contracts. In summary, Staff and BCP assert that SWG has misused its contracting authority under NAC 704.518 and tariff pages NT-1 and ST-1 by including unauthorized discounts in the contracts, failing to document risk of bypass, and failing to file contracts or obtain Commission approval of the contracts prior to their effective dates. Staff and BCP ask the Commission to remedy these violations by imputing to ratepayers the value of the discounts

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[70] Legacy power plant contracts: SWG has contracts with NPC and Saguaro Power Company ("Saguaro"), both of which pre-date current regulations and tariff provisions set forth in NAC 704.518, which were approved by the Commission in Docket No. 95-3052 and Docket No. 94-4050, respectively, and are not at issue here. (Exhibit 98 at 6.)

[71] Desert Star contract for special services: SWG has a contract with Desert Star, which was approved by the Commission in Docket No. 98-4013, which is not at issue here. (Exhibit 98 at 8.)

SWG provided to contract customers under contracts which do not comply with NRS 704.100, NAC 704.518 and SWG tariff pages ST-1/NT-1.

862. On the other hand, SWG defends the challenged contracts, and asserts that the fact that the Commission has not previously rejected these contracts or made specific findings that the contracts violate applicable laws should limit the scope of the Commission's actions on these contracts in this proceeding. (Ex. 113, at 2-3.)

863. SWG claims that it complied with the filing requirements, stating that it provided copies of all contracts to BCP and Staff in Docket No. 14-06004. (*Id.* at 9.)

864. SWG also opposes the imputation remedies proposed by Staff and BCP, stating that its CCOS demonstrates that its rate of return from contracts is higher than the proposed system rate of return and that contractors benefit other SWG customers. SWG adds that it has reduced its number of contract customers from 23 to 12, and that 3 of the remaining 12 customers operate under special contracts approved by the Commission. (*Id.* at 4-5.)

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865. Throughout this proceeding, various witnesses have asserted that there may be some confusion regarding the Commission's view of what SWG may or may not do in contracting with gas transportation customers. The time has come to clarify these matters.

866. NAC 704.518 and SWG Tariff Schedules NT-1 and ST-1 provide SWG with two options in contracting with gas transportation customers once it satisfies the threshold requirement of demonstrating that the customer has an opportunity to bypass SWG's system: 1) SWG may enter into limited discount contracts under NAC 704.518(2) which only discount volumetric demand and delivery charges and which follow the rate design set forth in NT-1 and ST-1, file these contracts with the Commission along with documentation demonstrating the risk of bypass, and execute them without prior Commission approval; or 2) SWG may enter into

special contracts under NAC 704.518(3) which offer discounts in addition to volumetric demand and delivery charge discounts, and which do not follow the rate design set forth in tariff pages NT-1 and ST-1. However, SWG may only utilize this second type of contract, which offers terms inconsistent with SWG's tariff, if SWG files the proposed contract and documentation demonstrating the risk of bypass, and obtains Commission approval of the contract before it goes into effect. As NAC 704.518(3)(c) states, "a utility shall not provide service to a generating, industrial or large customer pursuant to a contract of special services until the contract is approved by the Commission."

~~867. The Commission finds that SWG violated NAC 704.518 and tariff pages ST-1/NT-1 by failing to file information demonstrating that the customer has a "bona fide alternative" to receiving fully-bundled gas services from SWG, with regard to the following customers: EP#1 and #2, Newmont Gold (Carlin) and Twin Creeks, Premier Magnesia[72], and LV Cogen II.~~

~~868. The Commission rejects SWG's assertion that the existence of a direct physical connection to Paiute eliminates the need for an economic bypass analysis for Premier Magnesia or for any other customer connecting directly to its gas supplier. As BCP states, there is no provision in SWG's tariff, or in regulation or statute, that relieves SWG from the duty to satisfy the threshold showing of bypass for direct-connect customers.[73] And, as Staff explains, the direct physical connection only satisfies one of the three prongs of the bypass feasibility test, and~~

[72] ~~The Commission rejects SWG's assertion that the existence of a direct physical connection to Paiute eliminates the need for an economic bypass analysis for Premier Magnesia (See SWG response to Staff Data Requests 314, 318, and 319, provided for the record as Exhibit CJP-9 to Exhibit 98), or for any of the other customers connecting directly to their gas supplier.~~

[73] ~~TR at 1111, 1112.~~

~~it does not eliminate the need for the customer to also satisfy the operational and economic prongs of the test.~~[74]

~~869. The Commission finds that SWG violated NAC 704.518 and tariff pages ST-1/NT-1 by including a complete waiver of the volumetric demand and delivery charges in its contracts with all nine of the contracts in dispute.~~

~~870. The Commission finds that SWG violated NAC 704.518 and tariff pages ST-1/NT-1 by failing to obtain prior Commission approval for its contracts with the following customers: Cyanco, EP #1 and #2, Newmont Gold (Carlin) and Twin Creeks, Premier Magnesia (2010 contract)~~[75] ~~and LV Cogen II.~~

~~871. Recognizing that SWG may not be exclusively responsible for the lack of complete filed documentation of the NCA #1 and NCA #2, contracts,~~[76] ~~the Commission finds that the records of the Commission do not contain complete documentation for these contracts.~~

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~~872. Prior Commission approval for all of these nine contracts is required because each of them includes discounts other than the volumetric demand and delivery charges, or waivers to those charges, and because each of these contracts fails to conform to the rate design approved by the Commission in its approval of SWG's tariff.~~

~~873. The Commission rejects SWG's notion that it can comply with its obligations to file proposed contracts and supporting documentation, and, where appropriate, obtain prior Commission approval of contracts, by sharing such documents informally with Commission Staff and BCP.~~[77] ~~As BCP explains, in 2009, the Commission ordered SWG to file all of its~~

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[74] ~~*See* SWG response to Staff Data Requests 314, 318, and 319, in Exhibit CJP-9 to Exhibit 98~~

[75] ~~Staff provides evidence that this contract was never filed with the Commission, although it was provided to staff in discovery in this proceeding. (Exhibit 98 at 18.)~~

[76] ~~Staff concedes that SWG submitted contracts for NCA #1 and NCA #2 to Commission personnel in 2010, but "they were never docketed due to an unknown administrative error." (Exhibit 98 at 18.) Apparently, these contracts were never reviewed or approved by the Commission.~~

[77] ~~Exhibit 98 at 19~~

~~contracts in Docket 09-04003 because the Commission recognized that "nobody had in one place all of the contracts."[78] Despite this clear directive, SWG has mostly provided copies of the contracts in a piecemeal fashion – leading all the way up to a closed session of the hearing in the instant Docket – and in many instances, the contracts had limited supporting documentation.~~

~~874. Therefore, and in order to comply with NAC 704.518, SWG must file the required documents with the Commission.~~

~~875. The Commission also rejects SWG's position that it does not need to comply with the filing and approval requirements of NAC 704.518 and the tariff sheets NT-1/ST-1 if the company has a belief that a contract's changes to rate design are insignificant or not "unique."[79] NAC 704.518 does not allow these items as bases for non-compliance with the tariff and does not delegate to SWG the responsibility of determining which discounts comply with its tariff. Changes to contract terms must be limited to the items which are specifically permitted under NAC 704.518 and the tariff sheets NT-1/ST-1, unless the Commission reviews and approves the contract prior to its effective date.~~

~~876. The Commission rejects SWG's argument that the Commission's ability to take action against the violations cited here is limited because prior Commissions have not taken action against the same, or similar, violations in the past. While prior decisions of the Commission often provide useful guidance for addressing contemporary challenges, they are not subject to the doctrine of *stare decisis*, and do not have the weight of precedent.*~~[80]

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[78] ~~TR at 1109.~~

[79] ~~Exhibit 113 at 12-14.~~

[80] ~~*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.")~~

~~877. Notably, in this proceeding, the Commission has received much more detailed evidence of SWG contracting practices in violation of applicable regulations and its tariff,than was provided in previous Commission proceedings.~~

~~878. Moreover, the Commission now knows that the Commission's earlier efforts in Docket Nos. 09-04003, 12-04005, 14-05042, 15-06001 and 17-1108, to call the attention of SWG to the need to bring its contracting practices into compliance with applicable laws and tariff provisions, have not resulted in SWG reforming its contracting practices.~~

~~879. The Commission is convinced by the evidence of this record that SWG's contracting practices violate applicable laws and tariff requirements. The Commission is most concerned 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. (*Id.* at 5, 8-9.)~~

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~~880. Moreover, the Commission has clear authority to utilize imputation to address tariff violations, as it did in Docket No. 07-12001. In that proceeding, Staff identified a Rule 9 line extension contract between SPPC and the Tahoe Reno Industrial Center ("TRIC") that did not require TRIC to pay any advance or contribution in aid of construction. The agreement, which was in clear violation of SPPC's Rule 9 tariff, was addressed by adjusting the rate base to account for the cost of the violations.~~

~~881. However, the Commission is not convinced that it is appropriate at this time to implement the imputation remedies proposed by Staff and BCP. There are difficulties with quantifying the precise amount of revenues that should be imputed for the benefit of ratepayers based upon the record in this proceeding. In this Order, the Commission makes a number of findings that affect overall revenue requirement. That, in turn, affects the calculation of imputed~~

~~revenues under either BCP's or Staff's methodologies. In addition, while SWG has itself identified NG-4 and SG-4 as the otherwise applicable rate class, it appears that the negotiated rate customers could more appropriately be placed in a different (if not currently existing) rate classification. Imputing revenues based upon the NG-4 and SG-4 rates may unduly skew the calculation. A reasonably imputed revenue impact would require modifications to the CCOS to add one, if not two, rate classes for these customers and more specific allocation of plant and expenses related to those customer classes.~~

~~882. The Commision will provide SWG one final opportunity to bring its contracting practices into compliance with applicable law and tariff provisions.~~

~~883. The Commission directs SWG to file with the Commission in this Docket, no later than 60 days from the date of this Order, its contracts and supporting documentation sufficient to meet Staff's proposed "three-prong bypass feasibility test" for the following contracts: Cyanco, EP #1 and #2, Newmont Gold (Carlin) and Twin Creeks, Premier Magnesia (2010 contract), LV Cogen II, NCA #1 and NCA #2. The Commission recognizes that SWG may have filed some of this documentation in the past or have shared it informally with Staff or BCP in the context of other proceedings. However, in view of the extreme difficulty experienced in this proceeding with obtaining the complete package of documents for each contract, the Commission deems it appropriate to ensure materials arrive in a single, organized location by directing SWG to file the contacts. SWG may seek confidential treatment of such documents pursuant to NAC 703.527-703.5282, to the extent it deems appropriate, within 20 days of the issuance of this Order.~~

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~~884. The Commission directs Staff to review SWG's filings pursuant to the preceding paragraph and report to the Commission regarding SWG's compliance with its requirements, no later than 105 days from the issuance of this Order.~~

~~885. In the event that Staff determines SWG has not complied with the requirements of the prior paragraph, Staff shall file with the Commission a Petition to Show Cause pursuant to NAC 703.540, itemizing SWG's violations of these requirements, and specifying Staff's recommendations regarding civil penalties and other sanctions.~~

~~886. Regarding SWG's CCOS study, the Commission finds that Staff and BCP have raised substantial concerns regarding whether SWG's CCCOS study accurately shows SWG's costs of serving its contract customers and and whether the contracts are fair to all customers.~~

887. ~~The Commission will open an investigation regarding SWG's contracting practices to: 1) determine the changes to be made to SWG' CCCOS study prior to the study being submitted in the Application in SWG's next GRC; and 2) evaluate whether changes need to be made to SWG contracting practices which are not directly related to violations, but which are not prudent practices.~~ ***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***

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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.

XI. GIR MECHANISM

A. GIR Rates

SWG's Position

888. SWG requests, pursuant to NAC 704.7984, that its revenue requirement associated with GIR projects that have been previously approved be included in its GIR mechanism. (Ex. 1 at 4.) SWG provides that the resulting rate increase in base rates for its SND will be $17,072,082.00 or approximately 5.2 percent, and the increase in base rates for its NND will be $1,086,278.00 or approximately 1.1 percent. (*Id.*) SWG also requests a determination of prudency for the GIR projects. *(Id.*)

889. SWG proposes to reset its GIR rates, effective January 1, 2019, in order to account for the deferred revenue requirement accrued through August of 2018 for previously approved GIR projects. (Ex. 1 at 9.) SWG states that the net deferrals for the GIR projects through August of 2018 are $14,300,989.00 ($0.02609/therm) for the SND, and $426,950.00 (0.00384/therm) for the NND. (Ex. 35 at EEP-1.)

BCP's Position

890. BCP does not address this issue.

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Staff's Position

891. Staff states that the Commission should accept SWG's GIR rates as filed in its GIR Certification filing. (Ex. 57 at 4.) Staff states that it verified the calculations in SWG's GIR certification filing and supporting schedules. (*Id.* at 3.) More specifically, Staff provides that it selectively reviewed a variety of GIR costs that were provided in the Prudency Packages for SND and NND, as contained in the Prepared GIR Certification (*See* Ex. 35 at EEP-1), in addition to invoices, charges for labor, and labor loadings. (*Id.*) Staff further provides that "in all material respects, the Prudency Packages seemed to be in order and well-supported" and only found discrepancies for amounts that Staff considered de minimus. (*Id.*)

Commission Discussion and Findings

892. The Commission approves SWG's proposed GIR rates as filed in its GIR Certification filing. In approving SWG's proposed GIR rates, the Commission notes that the GIR is distinct from the GRC and has different evidentiary thresholds. The Commission still maintains its ability to oversee and audit GIR projects placed into rate base in this proceeding to ensure compliance and prudency.

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THEREFORE, it is ORDERED:

1. The Application of Southwest Gas Corporation, designated as Docket No. 18-05031, is GRANTED in part and DENIED in part, as MODIFIED by this Order.

2. Southwest Gas Corporation's GIR Mechanism rates are APPROVED.

3. Southwest Gas Corporation shall use the capital structure designated by the Commission in Paragraph 18 of this Order.

4. Southwest Gas Corporation shall use the cost of debt designated by the Commission in Paragraph 24 of this Order.

5. Southwest Gas Corporation's return on equity shall be set at 9.25 percent for both its Southern Nevada Division and Northern Nevada Division as established in Paragraph 195 of this Order.

6. Southwest Gas Corporation's Variable Interest Expense Recovery Mechanism shall be reset, consistent with its filing and Paragraph 32 of this Order.

7. Southwest Gas Corporation's basic service charge and updated delivery charges are approved as filed, consistent with Paragraph 694 of this Order.

8. Southwest Gas Corporation's General Revenues Adjustment is approved as filed, consistent with Paragraph 690 of this Order.

9. Southwest Gas Corporation shall remove from its revenue requirement 100 percent of Management Incentive Plan payouts related to the damages per 1,000 tickets metric, consistent with Paragraph 359 of this Order.

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10. Southwest Gas Corporation shall remove from its revenue requirement all Management Incentive Plan payouts allocated to the Nevada ratemaking jurisdictions created by the net income metrics or Return on Equity metrics, consistent with Paragraphs 359-360 of this Order.

11. Southwest Gas Corporation shall remove from its revenue requirement 100 percent of Restricted Stock Unit costs, consistent with Paragraph 375 of this Order.

12. Southwest Gas Corporation shall remove from its revenue requirement all Supplemental Executive Retirement Plan and Executive Deferred Plan benefits exceeding the restoration benefit, consistent with Paragraphs 397-399 of this Order.

13. Southwest Gas Corporation shall remove from its revenue requirement all perquisites and vehicle stipend costs, consistent with Paragraphs 415-416 of this Order.

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14. Southwest Gas Corporation shall exclude from its revenue requirement 50 percent of the Board of Director compensation costs, consistent with Paragraph 420 of this Order.

15. Southwest Gas Corporation shall remove from is revenue requirement all costs and related accumulated depreciation, depreciation expense, and ADIT associated with the Winnemucca, Nevada home, consistent with Paragraph 444 of this Order.

16. Southwest Gas Corporation shall remove from its revenue requirement all costs and related accumulated depreciation, depreciation expense, and ADIT associated with the Incline Village, Nevada home, consistent with Paragraph 452 of this Order.

17. Southwest Gas Corporation shall remove from its revenue requirement all costs related to employee events at the Vdara Hotel, consistent with Paragraph 460 of this Order.

18. Southwest Gas Corporation shall remove from its ~~revenue requirement~~ ***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.

19. Southwest Gas Corporation shall exclude 50 percent of costs associated with its Directors and Officers Liability Insurance, consistent with Paragraph 471 of this Order.

20. Southwest Gas Corporation shall update regulatory asset values identified by Staff for Schedule I-C7 as of the Certification Date of July 31, 2018, consistent with Paragraph 500 of this Order.

21. Southwest Gas Corporation shall update regulatory asset values identified by Staff for Schedule I-C7 to reflect the additional amortization up to the rate effective date, consistent with Paragraph 506 of this Order.

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22. Southwest Gas Corporation shall modify its Commerce Tax billing collection and methodology to embed the tax in revenue requirement on a forward-basis, consistent with Paragraphs 520-521 of the Order.

23. Southwest Gas Corporation shall remove $6,177.00 from its revenue requirement in its Northern Nevada Division to exclude costs associated with its City of Elko franchise fee, consistent with Paragraph 525 of the Order.

24. Southwest Gas Corporation shall remove $112,000.00 from its SND's operation and maintenance costs related to the Wigwam Parkway and Jessup Road safety incident, consistent with Paragraph 535 of this Order.

25. Southwest Gas Corporation shall remove $112,000.00 from its Southern Nevada Division's Operation and Maintenance costs related to the Hawk Springs / Mesa Park safety incident, consistent with Paragraph 539 of this Order.

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26. Southwest Gas Corporation shall remove 100 percent of the costs associated with the projects in the Work Order Nos. 0061W0001059, 0061W0001001, 0061W0000511, 0061W0000888, and 0061W001120, consistent with Paragraphs 621-627 of this Order.

27. Southwest Gas Corporation shall remove costs associated with the price increases contained in Change Order 4 in Southwest Gas Corporation's Contract Number 205579 with Arizona Pipeline Company, consistent with Paragraphs 651-652 of this Order.

28. Southwest Gas Corporation shall remove all incremental costs associated with the price increases that were greater than the consumer price index adjustment of 2.1 percent associated with Change Order 4, consistent with Paragraph 651 of this Order.

29. ***The Assistant Commission Secretary SHALL 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.

Compliances

30. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 702 regarding its Biogas and Renewable Natural Gas Tariff within 30 days of the date of issuance of this Order.

31. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 709 regarding its Compression Service Tariff within 30 days of the date of issuance of this Order.

32. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 713 regarding the clarification of the scope of Southwest Gas' contractual relationship with its customers within 30 days of the date of issuance of this Order.

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33. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 717 regarding changes to easement provisions within 30 days of the date of issuance of this Order.

34. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 721 regarding third-party electronic billing within 30 days of the date of issuance of this Order.

35. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 725 regarding the removal of certain inapplicable tariff language within 30 days of the date of issuance of this Order.

36. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 735 regarding claims against the company within 30 days of the date of issuance of this Order.

37. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 739 regarding the removal of unnecessary meter reading device installation language within 30 days of the date of issuance of this Order.

38. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 743 regarding a customer's obligation to provide access to their property in certain instances within 30 days of the date of issuance of this Order.

39. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 748 regarding the utility's access to customer's premises within 30 days of the date of issuance of this Order.

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40. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 752 regarding liability within 30 days of the date of issuance of this Order.

41. Southwest Gas Corporation shall file new tariff sheets reflecting the Commission's findings in Paragraph 756 regarding leak checks within 30 days of the date of issuance of this Order.

42. Southwest Gas Corporation shall file shall file tariffs implementing the Commission's findings in this Order showing the resulting rates for each customer class in each division within 15 calendar days of the issuance of this Order. These tariffs shall be supported by the following schedules: (a) Statement I incorporating all of the Commission's ordered adjustments; (b) Schedule N-2 and associated workpapers detailing the allocation of the

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Commission ordered revenue requirement to each customer class; (c) Statement O showing the derivation of the rates contained in the compliance tariffs; (d) Statement J showing the increase and decreases in the compliance tariff rates from the certification present rates; (e) Statement F showing the cost of capital; and (f) Depreciation Study per Commission Order, consistent with Paragraph 684 of this Order.

~~43. Southwest Gas Corporation shall file all of its negotiated rate contracts and supporting documentation sufficient to meet the "three-prong bypass feasibility test" described by Staff within 60 days of the issuance of this Order, consistent with Paragraph 883 of this Order.~~

~~44. Within 105 days of Southwest Gas Corporation's filing, filed pursuant to Ordering Paragraph 43, Staff shall file with the Commission a review and analysis of Southwest Gas Corporation's compliance with its "three-prong test," consistent with Paragraph 884 of this Order.~~

45. Southwest Gas Corporation shall file a recalculated 2018 pension cost in this Docket within 30 days of the issuance of this Order, consistent with Paragraph 428 of this Order.

Directives

46. Prior to its next General Rate Case filing, Southwest Gas Corporation shall meet and coordinate with Staff to determine a satisfactory manner for Southwest Gas Corporation to provide benchmarking for all employees, consistent with Southwest Gas Corporation's current practice for executives and Paragraph 409 of this Order.

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47. In its next General Rate Case application, Southwest Gas shall file two Class Cost of Service studies, consistent with Paragraph 685 of 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

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EXHIBIT 2

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EXHIBIT 2

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 C. Pongracz
Commissioner C.J. Manthe
Assistant Commission Secretary Trisha Osborne

MODIFIED ORDER

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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.*)

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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.

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• 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,"

[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).

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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)).

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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:

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[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

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.

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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.

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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

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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:

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 Statement F, Northern Nevada, 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:

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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.*)

BCP's Position

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

Staff's Position

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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.*)

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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

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.*)

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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. 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

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

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.)

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.)

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BCP's Position

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.)

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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.

D. Return on Equity ("ROE")

SWG's Position

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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:

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%

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%

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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.)

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

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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.*)

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.)

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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 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.)

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 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

[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.

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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.*)

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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 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.)

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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 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.*)

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.*)

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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.*)

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

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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

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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.*)

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

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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.)

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.)

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.)

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

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 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:

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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.) 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

[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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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.*)

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.)

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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 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

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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.*)

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.*

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at 49-50.) Moreover, BCP provides that SWG's CAPM and ECAPM do not support its own conclusions in its case. (*Id.* at 50.)

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

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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 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.*)

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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.)

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.*)

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.)

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%

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(*Id.* at 3.)

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 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.)

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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.*)

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.)

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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.*)

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%

(*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

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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.

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 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.*)

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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

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

BCP and Staff using the same proxy group companies" and that SWG was unable to successfully defend them. (*Id.*)

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 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.)

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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

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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.)

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

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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.)

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.)

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

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 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.*)

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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.)

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.*)

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.)

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 rates			
Interest Rate Series	**Docket No. 12-04005 Certification Period May 31, 2012**	**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.*)

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

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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.*)

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

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 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

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

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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.*)

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 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

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structure includes a higher degree of financial leverage than its peers, and it is reasonable to compensate investors for bearing additional risk. (*Id.*)

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

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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.*)

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.)

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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.*)

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 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.*)

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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

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growth DCF model as applied to the proxy companies produce low results below recently authorized ROEs. (*Id.* at 67-68.)

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

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Growth DCF model and is generally recognized as a method of establishing long term growth. (*Id.*)

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.*)

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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-

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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.)

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.*)

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.*)

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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.*)

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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 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.*)

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

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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.*)

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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 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.*)

[26] *See* March 20, 2013 Second Modified Final Order in Docket No. 12-04005 at 149.

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.*)

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.*)

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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

[27] *See* Ex. 21 at (RBH)-R14

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.*)

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.*)

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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

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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.)

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.*)

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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.)

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.)

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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.*)

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.)

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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

[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.

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]

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' 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.

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[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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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:

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%

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

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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%

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

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.

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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 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.

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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.

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.

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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]

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

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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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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.

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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.*)

A. Account 367 – Transmission Mains (SND)

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SWG's Position

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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 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

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

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.)

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.)

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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.*)

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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.*)

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.*)

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

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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.)

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.*)

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

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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.)

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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.*)

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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

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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.*)

Commission Discussion and Findings

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 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.

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.

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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.)

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.*)

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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.*)

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Commission Discussion and Findings

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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%.

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.)

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

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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.)

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.*)

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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.)

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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.)

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

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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.*)

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.*)

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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.*)

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.

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

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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.)

SWG's Rebuttal Position

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.)

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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.)

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.*)

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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.)

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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.)

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.)

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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.*)

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

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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.)

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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

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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.)

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.*)

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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.*)

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.)

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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.)

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 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.)

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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 <u>lowering</u> the life of meters, not increasing the life as suggested by BCP." (*Id.* at 24.)

293. SWG states its 29 Ll 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 34-year ASL for this account.

H. System Allocable – Account 390.10 – Structures Owned (NND and System Allocable Division)

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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.)

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.*)

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.)

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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 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.

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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 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

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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.*)

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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 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.*)

[34] *See Southwest Gas Corp. v. Public Serv. Com'n*, 86 Nev. 662, 474 P.2d 379, 380 (1970).

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 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.

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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.)

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.)

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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.

Protected EDIT Amortization Tracker

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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.

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").

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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.)

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.

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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-term success of the Company and that reward superior performance for the Company's customers."[35] (*Id.* at 5-6.)

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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.)

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.*)

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 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

[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.*)

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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.*)

BCP's Position

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.)

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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 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."

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.)

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.*)

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.)

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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.)

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.)

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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.*)

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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.)

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.*)

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.*)

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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

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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

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.)

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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.)

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

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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

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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

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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.*)

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.)

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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 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.)

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.*)

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

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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.)

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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.*)

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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.*)

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.)

392. 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. (Ex. 63 at 11.)

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SWG's Rebuttal Position

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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.*)

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

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.)

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.*)

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

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