Case No. 80911

**IN THE SUPREME COURT OF THE STATE OF NEVADA**

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SOUTHWEST GAS CORPORATION,

Appellant,

v.

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

Respondents.

**APPEAL**

From the Eighth Judicial District Court. Clark County
The Honorable William Kephart, District Judge
District Court Case No. A-19-791302-J

# RESPONSE BRIEF

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## JURISDICTION

The Nevada Attorney General's Bureau of Consumer Protection ("BCP") responds to Southwest Gas Company's ("SWG") appeal from an order denying judicial review. Jurisdiction in the Supreme Court of Nevada and the Nevada Court of Appeals is proper pursuant to Section 4 of Article 6 of the Nevada Constitution, NRS 703.376; NRS 2.090; NRS 233B.150; and NRAP 3A(b)(1).

The District Court Order Denying SWG's Petition for Judicial Review was filed on June 23, 2020 in the Eighth Judicial District Court and is a final order. The Notice of Appeal was timely filed pursuant to NRAP 4(a)(1) in the Eighth Judicial District Court on July 2, 2020. This appeal is being taken from a final order in accordance with NRAP 3A(b)(1).

## ROUTING STATEMENT

This Court should retain this appeal to clarify that there is no presumption of prudence in Nevada general rate cases. This is a question of statewide importance pursuant to NRAP 17(a)(12), and will arise in every general rate case filed by a public utility. Clarity from Nevada's highest court on this issue is needed.

## ISSUES PRESENTED

1. Is a public utility entitled to a burden-shifting presumption of prudence in a general rate case in Nevada even though neither the U.S. Supreme Court nor the Nevada Courts have recognized such a presumption, and there is no statute or regulation mandating such a presumption in Nevada?

2. Is NRS 703.373(11) the standard of review for appeals from Public Utilities Commission of Nevada ("PUCN") decisions on issues of fact?

3. Were the PUCN's Findings on the pension expenses in the SWG 2018 general rate case based on substantial evidence that should not be disturbed on appeal?

4. Were the PUCN's Findings on the five work orders expenditures that were disallowed in the SWG 2018 general rate case based on substantial evidence that should not be disturbed on appeal?

5. Did the Commission set a reasonable rate of return on equity ("ROE") that should not be disturbed on appeal?

## STATEMENT OF THE CASE

The BCP responds to SWG's appeal from a final judgment entered on a petition for judicial review, over which the Honorable William Kephart, District Judge of the Eighth Judicial District Court, Clark County, presided. The District Court affirmed the Order of the PUCN on SWG's 2018 General Rate Application.

The primary contention in this appeal is whether the PUCN erred when it did not apply a presumption of prudence during the general rate case proceeding.

Nevada law is clear. There is no presumption of prudence in general rate cases in Nevada. Binding Nevada law is created in three ways – Nevada statute or regulation, Nevada Supreme Court decisions, or U.S. Supreme Court holdings regarding constitutional claims. These three sources have never mandated a presumption in general rate cases.

In its brief, SWG attempts to convince this Court to create a presumption of prudence in general rate cases. SWG cites to many nonbinding sources that have chosen to apply a presumption, and contorts rulings from this Court and the U.S. Supreme Court to mislead this Court into believing that there is a presumption of prudence mandate. SWG's assertions are false.

SWG is not happy with the PUCN's Order and the District Court's Decision on appeal because these rulings did not give SWG its desired result. Bear in mind that included in SWG expenditures, the subject of this appeal, were biweekly massages, bartending costs, golf memberships, a gas grill, and $94,000 in upgrades to a $6,100 per month rented office space. All expenses SWG wanted to pass on to Nevada ratepayers.

In this Response Brief, the BCP will untangle the snarl of SWG's argument to show that the issues on appeal are quite simple: First, we provide that the proper standard of review of PUCN decisions is based on NRS 703.373(11), which provides that this Court is to not substitute its judgment for that of the PUCN as to the weight of the evidence on questions of fact. Second, we make clear that there is no presumption of prudence in Nevada general rate cases because it is not the law in Nevada. Third, we quickly disprove SWG's baseless claims that its constitutional rights have been violated, including that the ROE does not amount to the heavy burden needed to claim confiscation. Fourth, we provide that the PUCN applied the correct standard and its decisions were based on substantial evidence in the record, which include a denial of SWG's request for a presumption of prudence.

The presumption of prudence would be detrimental to Nevada ratepayers and chaotic and expensive for all parties to a Nevada rate case. At the conclusion, the BCP will ask that this Court affirm the PUCN's Order in its entirety.

## STATEMENT OF FACTS

### A. The Parties

SWG is a public utility authorized to provide natural gas service in portions of Northern and Southern Nevada. (4 Joint Appendix 0940) ("JA"). SWG is a regulated monopoly – the need for government regulation in the electric utility industry has traditionally been premised on the notion that these utilities are "natural monopolies." Richard A. Posner, *Natural Monopoly and Its Regulation*, 21 STAN. L. REV. 548, 548 (1969).

Regulation of these monopolies are necessary to ensure satisfactory performance – over profits, specific rates, quality of service, extensions and abandonments of service and plant, even permission whether to enter the business at all. *See id.* at 548. This is where the PUCN comes in. In Nevada, the PUCN is charged with the following statutory purposes and policies in regulating public utilities such as SWG:

> 1. To confer upon the Commission the power, and to make it the duty of the Commission, to regulate public utilities to the extent of its jurisdiction;
> 2. To provide for fair and impartial regulation of public utilities;
> 3. To provide for the safe, economic, efficient, prudent and reliable operation and service of public utilities;
> 4. To 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."

NRS 704.001(1)-(4).

The BCP is a division within the Attorney General's Office, and its statutory mandate is to represent the public interest in public utility rate cases before the PUCN. NRS 228.360. The Regulatory Operations Staff ("Staff") of the PUCN is charged with providing an independent investigation/audit of all public utility filings and charged with balancing the interests of the of ratepayers and utility shareholders. It acts as an independent party in rate cases before the PUCN.

### B. The General Rate Case

On May 29, 2018, SWG filed a general rate application with the PUCN in which it sought a general rate increase for Nevada ratepayers, Docket No. 18-05031. (4 JA 0940.) In this case, SWG requested approval to increase its rates by $32.5 million, 3.8% in Southern Nevada and 1.9% in Northern Nevada. (2

JA 376.) Both the BCP and Staff were parties to this case. (*Id.*) A hearing was held in Docket No. 18-05031 in October 2018 and lasted six days. (*Id*.) The PUCN admitted 115 exhibits in the record. (*Id.*) SWG pre-filed direct and rebuttal written testimony. (*Id*.) The BCP, Staff, and other intervenors filed written direct testimony of their respective experts. (*Id*.)

### C. The PUCN's Order

The PUCN's Order was issued on December 23, 2018 granting in part and denying in part SWG's rate increase Application. (4 JA 0932 and 0940). SWG appealed from the following three PUCN findings: Pension expenses, Challenged Work Orders, and the ROE.

The PUCN did not apply a presumption of prudence in the general rate case and held that:

> ***[A] public utility must sustain the burden of proof regarding the prudence of expenditures that it wishes to recover in a general rate case . . . .[i]mplied within the requirement to establish that the proposed 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 and reasonable if it is established for the purpose of allowing the utility to recover costs that were not prudently incurred.

(4 JA 0945) (second emphasis added).

1. Pension Expenses

SWG requested a revenue requirement increases of $1.37 million for Southern Nevada District and $335.6k for Northern related to Pension and PBOP expenses. (5 JA 1069.) SWG stated that the Pension expenses were based on actuarial studies and test year employee counts. (*Id*.) SWG stated that pension expenses have been volatile since 2011. (*Id.*)

*a. Pension Discount Rate*

In the general rate case before the PUCN, SWG requested a reduction in the discount rate from 4.50% in 2017 to 3.75%, which equaled $11.7 million increase in pension costs for SWG in 2018 ($4 million of which was for SWG's Nevada jurisdiction). (5 JA 1069-1070.) A discount rate is used to estimate the existing liability for future pension benefits and a decrease in the discount rate will increase the following year's pension expense. (*Id*.)

Southwest Gas filed testimony on the discount rate which provided that the rate was determined using an actuary's proprietary yield curve that includes a portfolio of AA-related bonds. (*Id*.) According to SWG's testimony, its actuary recommends the annual discount rate, which is then discussed with senior management, who has some input on the selection of the discount rate. (*Id*.)

SWG's evidence provided that the annual discount rate from 2011 through 2017 averaged 4.75% and never dropped below 4.25% for the entire seven-year period. (5 JA 1071.) The 2018 discount rate was reduced from 4.5% to 3.75% in the test year for this general rate case. (*Id*.) SWG did not provide the Commission with evidence explaining the cause of the significant reduction in the discount rate for the 2018 test year, nor did it produce a witness during the hearing that could testify about the selection process for the rate reduction. (*Id*.)

At the hearing, the PUCN asked follow-up questions of SWG's expert witness regarding how a discount rate was determined and what influence SWG's management had on that discount rate, but the witness could not answer the questions and SWG did not provide another witness who could answer the questions. (*Id*.)

The PUCN denied SWG's requested reduction of discount rate because "SWG did not provide the Commission with evidence explaining the cause of the significant reduction in the discount rate for the 2018 test year, nor did it produce a single witness during the hearing that could testify about the selection process for the rate reduction." (5 JA 1071).

*b. Pension Tracker*

In the underlying case, SWG requested authority to implement a Pension Tracker to address the volatility. (5 JA 1072.) BCP recommended that the pension tracker be denied because it is not "prudent to review a single-issue such as pension expense via an annual filing as proposed by the Company without conducting a holistic review of the Company's operations which are performed during a general rate case." (*Id*.) Staff recommended the implementation of normalization over a 5-year period (2014-2018) instead of the tracker to address the volatility in pension expenses. (*Id*.) Applying normalization, Staff recommended reducing revenue requirement $1,387,087 for Southern Nevada and $339,132 for Northern Nevada to reflect normalization. (*Id*.) Staff requested that the pension tracker be denied and stated that creation of a comprehensive pension tracking mechanism is more complex than presented by SWG, and that its use would be appropriately addressed in an investigation and/or rulemaking docket. (*Id*.)

The PUCN rejected SWG's request to establish a tracking mechanism for the recovery of pension expenses, and instead adopted the normalization method proposed by Staff. (5 JA 1073.) The PUCN modified Staff's recommendation and opted to use a three-year period for normalization,

finding that 2018 was an outlier discount rate and a three-year average of 2016, 2017, and the corrected rate for 2018 represents a more appropriate period reflective of historical figures. (5 JA 1073-1074.) The Commission noted that SWG can address its concerns about managing pension costs by taking steps to revise the amount, type, and structure of pension related benefits offered to employees. (*Id.*)

2. Challenged Work Orders

The PUCN denied cost recovery for Work Order Nos. 0061W0001059, 006JW000J00J, 0061W0000511, 006JW0000888, and 0061W001120 (collectively, the "Challenged Work Orders"). (5 JA 1104.) Prior to filing the general rate case, Staff performed an audit of these work orders. (5 JA 1107-1108.) Staff issued numerous data requests and made on-site visits regarding these high-dollar projects, attempting to evaluate whether the inclusion of the costs in rates is just and reasonable. (*Id*.)

At hearing, during the testimony of the expert witness, SWG designated as the witness to sponsor testimony regarding these Work Orders, when asked whether she was involved in the execution of any of the non-GIR projects for which she sponsors testimony, she responded:

> To 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.

(5 JA at 1106.)

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 responded that she was "not involved in the execution of any of the projects." (*Id*.) The witness also 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" and that "[t]here was not an internal audit done on those work orders." (*Id.*)

Staff stated 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.

(5 JA 1131.)

Staff opined that SWG only provided it with a few paragraphs and an exhibit listing the projects and did not offer substantial testimony on the projects. (*Id*.) Staff recommended denying the Challenged Work Order expenditures because of the lack of evidence, stating that SWG was required to provide a witness 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." (5 JA 1107-1110.) The only evidence Staff received were invoices, names and budgets of projects, and internal memos regarding expenditures. (*Id*.)

The following gives this Court an idea of the type of items included in the Challenged Work Orders included a Casio Digital Piano; a Yamaha 7.2-channel home theater system; a Broil King natural gas grill; multiple Bose wireless speaker systems; multiple JBL Bluetooth headphones, $41,000 in non-travel meals to this program; $40,000 paid to NPL Construction Co. Cyber Risk Assessment that was erroneously booked to the FSM Program; $6,183 per month lease for office space, $94,000 in tenant improvements on the leased office space; $90,000 for a backhoe that Southwest Gas had previously agreed to remove as part of a civil penalty stipulation for a pipeline safety violation; bi-weekly or weekly massages from the European Massage Therapy School; bartender costs; and a golf course membership. (20 JA 4855-4857.)

The Commission found 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." (5 JA 1130.) The Commission disallowed

100% of the costs associated with the projects in the Challenged Work Orders, stating that the underlying evidentiary record 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. (*Id*.)

3. Return on Equity

SWG recommended an ROE of 10.3% within a range of 10-10.5%; Staff recommended 9.4% within a range of 9.1-9.7%; and BCP recommended 9.3% within a range of 9.1-9.7%. The PUCN ordered an ROE of 9.25, finding that it "balanced the interest of the ratepayers and the shareholders." (5 JA 1005).

In coming to the 9.25 ROE, the PUCN focused on the evidence of the model analyses, macroeconomic conditions, and the proxy group. (5 JA 1004). The PUCN looked at the "market risk premium," which is the difference between the market return and the risk-free rate. (5 JA 1006); *see generally* ROGER A. MORIN, NEW REGULATORY FINANCE 155 (Pub. Utils. Reports) (2006).[1] The PUCN found that Staff's and BCP's use of historical and published data to determine a "market risk premium" was more defensible than SWG's forecast

[1] The risk-free rate is the return that would be required by investors in the absence of risk.

approach. (*Id.*) SWG's "market risk premium" ("MRP") estimates were high (11.48-12.61%), compared to Staff's (6.88%) and BCP's (7.50%). (*Id*.) The PUCN replaced SWG's high estimate with Staff and BCP's estimates and found that the ROE in that model would be 9.1% and 9.3%, respectively. (*Id*.) The PUCN found that SWG's MRP were not adequately supported and adopted a range of reasonableness of 9.1%-9.7% in accordance with Staff and BCP's MRP estimates. (5 JA 1007).

The PUCN was persuaded by the BCP and Staff's expert testimony on the issue of market conditions. (*Id*.) BCP and Staff experts argued that the federal borrowing rate must be considered in a broader context than SWG's request to simply look at the Federal Reserve's decisions to increase rates on treasury bonds. (*Id*.) The BCP and Staff experts pointed out that the borrowing rate was at or near zero percent prior to the recent increase of just 25 basis points. The PUCN found that there is no evidence of a significant increase in federal interest rates that would justify SWG's ROE increase. (*Id*.)

The PUCN found that SWG does not have more risk than the other natural gas utilities in the proxy group. (5 JA 1009). For example, when looking at whether SWG holds more debt than the other utilities in the proxy group, BCP expert opined that a small increased adjustment would be

appropriate. (*Id*.) The PUCN disagreed, replying on the following evidence: 1) SWG's credit rating has improved since its last rate case in 2012; and 2) the credit agencies viewed SWG's regulatory environment as credit supportive, given the PUCN's approval of various rate mechanisms and infrastructure cost recovery programs, as well as the PUCN's approval of a holding company to create more separation between regulated and unregulated operations. (5 JA 1007-1009). Overall, the PUCN found that the substantial evidence did not support SWG's claim it was riskier than the other utilities in the proxy group. (*Id*.) Based on the evidence presented on the proxy group offered by SWG, the PUCN found that an ROE of 9.25% was commensurate with returns on investments in other enterprises having corresponding risks and is sufficient to assure confidence in the financial integrity of the enterprise to attract capital. (*Id*.)

### D. The Petition for Judicial Review

On May 22, 2019, SWG then filed a Petition for Judicial Review on PUCN's decision on these three findings, claiming that "the Commission has always applied a presumption that a utility has exercised prudent judgment when making expenditures." (19 JA 4735.)

The Honorable William Kephart heard oral argument on the petition after briefing. (21 JA 5110.) On March 6, 2020, the Eighth Judicial District Court issued an order denying the petition and affirming PUCN's Order because the Order did not violate NRS 703.373(11). (22 JA 5307, 5316). The District Court found that the proper standard of review to be applied to this case was NRS 703.373, requiring the court to not substitute its judgment for that of the PUCN as to the weight of the evidence on questions of fact. (22 JA 5308). The District Court declined to expand the standard of review to review both law and facts de novo, recognizing that the proper standard is clearly set forth in Nevada statutes and caselaw. (*Id*.)

The District Court held that the PUCN was not required to apply a presumption of prudence in the underlying case. (22 JA 5316.) The District Court correctly recognized that there is no Nevada statute or regulation establishing the presumption of prudence described by Southwest Gas. (*Id*.) The District Court also recognized that the U.S. Supreme Court and the Nevada Supreme Court has never found that a utility is entitled to a presumption of prudence in a general rate case. (*Id*.) The District Court affirmed the PUCN's Order on each of the challenged issues. (22 JA 5265-5270.)

SWG, being unhappy with the District Court's Order, now appeals to this Honorable Court and the BCP responds as follows.

## STANDARD OF REVIEW

In reviewing a final decision of the PUCN, the Supreme Court's role "is essentially the same as that of the district court . . . ." *State v. Zephyr Cove Water Co.*, 94 Nev. 634, 638, 584 P.2d 698, 700 (1978) (citation omitted). The standard of review for decisions issued by the PUCN is set forth in NRS 703.373(11). *See Silver Lake Water Distrib. Co. v. Pub. Service Comm'n of Nev.*, 107 Nev. 951, 953, 823 P.2d 266, 268 (1991) (citing NRS 703.373(6)(1983)). PUCN decisions will be upheld that are "'within the framework of the law' and based on substantial evidence in the record." *Nevada Power Co. v. Pub. Utilities Comm'n of Nevada*, 122 Nev. 821, 834, 138 P.3d 486, 495 (2006) (quoting *Silver Lake Water,* 107 Nev. at 954, 823 P.2d at 268 (1991)); *see id.* at 953–54, 823 P.2d at 268; *see also Nevada Power Co. v. Pub. Serv. Comm'n of Nevada*, 105 Nev. 543, 545, 779 P.2d 531, 532 (1989) (The Supreme Court "will not interfere with [PUCN] decisions other than to keep them within the framework of the law."). This Court reviews questions of law *de novo*. *Nevada Power Co.*, 122 Nev. at 834, 138 P.3d at 495 (citation omitted).

Here, the primary issue before this Court is whether a presumption of prudence is mandated in general rate cases in Nevada. Solely on this issue, this Court reviews the question of whether there is a presumption of prudence "without deference to the lower tribunal's rulings." *Marquis & Aurbach v. Eighth Judicial Dist. Court*, 122 Nev. 1147, 1155, 146 P.3d 1130, 1135 (2006) (citing *Appeal De Novo*, BLACK'S LAW DICTIONARY (8th ed. 2004)).

On every other issue in this case, the proper standard of review is prescribed in NRS 703.373(11).[2] Per NRS 703.373(11), the Supreme Court "shall not substitute its judgment for that of the Commission as to the weight of the evidence on questions of fact." *See also Nevada Power*, 122 Nev. at 838, 138 P.3d at 498 (citing NRS 703.373(6)(1983)). Substantial evidence is defined as "that which 'a reasonable mind might accept as adequate to support a conclusion.'" *Nevada Power*, 122NEV at 834, 138 P.3d at 495 (quoting *State, Emp. Security v. Hilton Hotels,* 102 Nev. 606, 608, 729 P.2d 497,

[2] NRS 703.373(11) provides that the PUCN's decision may be set aside, in whole or in part, if substantial rights of the petitioner have been prejudiced because the final decision is (a) in violation of constitutional or statutory provisions; (b) in excess of the statutory authority of the Commission; (c) made upon unlawful procedure; (d) affected by other error of law; (e) clearly erroneous in view of the reliable, probative and substantial evidence on the whole record; or (f) arbitrary or capricious or characterized by abuse of discretion.

498 (1986), *superseded by statute on other grounds as stated in Countrywide Home Loans v. Thitchener*, 124 Nev. 725, 192 P.3d 243 (2008)).[3] The burden is on Southwest Gas to show that the final decision of the PUCN is invalid pursuant to NRS 703.373(11). *See* NRS 703.373(9). The "rates, charges, classifications and joint rates" determined by the PUCN are "prima facie lawful." NRS 704.130(1). Further, this Court has stated the PUCN's power to regulate utilities is "'plenary,' meaning that it is 'broadly construed.'" *Nevada Power Co. v. Eighth Judicial Dist. Court of Nevada ex rel. Cty. of Clark*, 120 Nev. 948, 957, 102 P.3d 578, 584 (2004) (quoting *Consumers League of Nevada v. Sw. Gas Corp.*, 94 Nev. 153, 157, 576 P.2d 737, 739 (1978) and *Plenary*, BLACK'S LAW DICTIONARY (7th ed. 1999)).

As indicated below, there is no presumption of prudence in Nevada general rate cases and SWG has no valid constitutional claim. As such, other than the narrow question of whether a presumption of prudence is mandated in Nevada, this Court must give deference to the PUCN's Findings.

[3] SWG does not cite to NRS 703.373 despite it being the controlling law on appellate review of rate cases.

## SUMMARY OF THE ARGUMENT

Part I of this Response establishes that there is no presumption of prudence in Nevada general rate cases because A) there is no Nevada statute or regulation requiring a presumption; B) there is no Nevada Supreme Court decision mandating a presumption; C) there is no U.S. Supreme Court mandate that a presumption of prudence is constitutionally required in Nevada rate cases (and the general rate case does not invoke a constitutional confiscation claim); and D) practical problems inherent to the presumption of prudence make the adoption of the presumption unjust and unsound.

Part II unravels the case law and claims SWG jumbles together in its Brief and sets the record straight by explaining that the cited U.S. and Nevada Supreme Court cases do not mandate a presumption of prudence in Nevada general rate cases.

Part III provides an application of the proper standard, including NAC 703.2231, which provides that the utility bears the burden of proof in general rate cases, to the issues SWG challenges on the basis of the failure to apply a presumption of prudence: the Pension Expenses and the Challenged Work Orders.

Lastly, Part IV provides why the PUCN's Decision on ROE was lawful and based on substantial evidence.

## ARGUMENT

## I. THERE IS NO PRESUMPTION OF PRUDENCE IN NEVADA

There are three sources of binding law in Nevada: 1) statutes (NRS) and regulations (NAC); 2) Nevada Supreme Court decisions; and 3) the U.S. Supreme Court decisions. The premise of SWG's Brief ("Brief") is that there is a presumption of prudence in Nevada general rate cases. *See generally* Brief. In order for this to be true, one of the three types of binding law would have to exist. It simply does not. The BCP submits that there is no statute, regulation, Nevada Supreme Court case, or U.S. Supreme Court case mandating a presumption of prudence in Nevada rate cases. There is generally no presumption applied in the rate cases to which the BCP has been a party. Because there is no law mandating a presumption, and no presumption is applied as a matter of practice, SWG's claim that the PUCN "abandoned" the presumption in the underlying case is false and absurd.

### *A. Nevada Statutes and Regulations have Not Mandated a Presumption of Prudence*

#### 1. No Statute or Regulation Exists Mandating a Presumption of Prudence

SWG does not try to claim that there is any statute in existence mandating a presumption of prudence in Nevada. Thus, the parties are in agreement that there is no statute or regulation in Nevada mandating or otherwise concerning the presumption. The District Court, in holding that no presumption of prudence exists in Nevada, confirmed that there is in fact "no statute, regulation" identifying a presumption of prudence. (22 JA 5316).

#### 2. The Statutory Scheme Governing Rate Cases in Nevada is in Direct Conflict with a Presumption of Prudence

a. NRS 703.2231 Explicitly States that the Public Utility Bears the Burden of Proof in Rate Cases in Nevada

Nevada law is clear that the burden of proof in a rate case falls on the utility:

> An applicant 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**. To avoid delay by the Commission in its consideration of the proposed changes, the applicant 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.

*See* NAC 703.2231 (emphasis added).[4]

Agency regulations have the force and effect of law and such regulations should be interpreted like any other law. *Chrysler Corp. v. Brown*, 441 U.S. 281, 295 (1979) (citation omitted). If there is a conflict between a statute and common law, the statute prevails. *Davenport v. State Farm Mut. Auto. Ins. Co*., 81 Nev. 361, 364, 404 P.2d 10, 11 (1965) (citing NRS 1.030).

A presumption of prudence is a burden shift. SWG recognizes this: Under rebuttable prudence presumption framework, an 'intervener bears the initial burden of overcoming the prudence presumption by presenting evidence that creates a serious doubt as to the prudence of the utility's expenditure,' and burden only shifts back to the utility after the presumption is rebutted. Staff and intervenors opposing an application 'must accept a burden in commission proceedings.'" Brief at 38.[5]

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[4] Burden of proof is defined as "a party's duty to prove a disputed assertion or charge; a proposition regarding which of two contending litigants loses when there is no evidence on a question or when the answer is simply too difficult to find. The **burden of proof includes both the burden of persuasion and the burden of production**." *See Burden of Proof*, BLACK'S LAW DICTIONARY (11th ed. 2019) (emphasis added).

[5] SWG cites to *In Re Nevada Power Co., Util. Shareholders Ass'n of Nevada*, 74 Pub. Util. Rep. 4th 703 (Nev. Pub. Serv. Comm'n May 30, 1986) and *Gulf States Utilities Co. v. Louisiana Pub. Serv. Comm'n*, 578 So. 2d 71, 85 (La. 1991), which held the following: [A] utility's investments are presumed to be prudent and allowable. When, however, the Commission raises serious doubt about the

A burden shifting presumption of prudence would directly conflict with NAC 703.2231. *See* NRS 1.030. SWG conspicuously fails to make a single mention of NAC 703.2231 in its entire Brief. This is likely because NAC 703.2231 is detrimental to SWG's claim. NAC 703.2231 mandates that the utility must bear the **initial** burden of proof – "An applicant 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." *Id*. Because the utility must be ready to sustain the burden of proof based on the data it submits to the PUCN in its application, it is virtually impossible to simultaneously apply a presumption that requires the intervenors to bear the burden. *See Entergy Gulf States, Inc. v. Pub. Util. Comm'n of Texas*, 112 S.W.3d 208, 214 (Tex. Ct. App. 2003) (explaining that in order to raise the price of its product, the utility must participate in a rate case and bear the burden of proving that each dollar of cost incurred was reasonably and prudently invested.).

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prudence of a particular investment, a searching inquiry becomes necessary, and at that point, the burden shifts to the utility to prove that the expenditure was in fact necessary and appropriate, or resulted in no additional costs.

This Court is tasked with interpreting law or providing common law where there is not already statute on point. NRS 1.030. SWG has not asked this Court to interpret a law, and the presumption SWG incorrectly claims exists conflicts with current Nevada law. Therefore, this Court need not and should not make a determination on the burden shifting presumption of prudence because it would be to usurp the powers of the legislative branch and the executive branch's administrative agency (the PUCN through rulemaking). *Whitehead v. Nevada Comm'n on Judicial Discipline*, 110 Nev. 874, 909, 878 P.2d 913, 935 (1994). If SWG wanted a presumption of prudence, it should have asked the PUCN to change NAC 703.2231 through a rulemaking, or asked the Legislature to pass a law that there is a presumption of prudence in Nevada.

b. <u>The Entire Statutory Scheme is Built on the Reality that there is No presumption of Prudence in Nevada Rate Cases</u>

Not only does NAC 703.2231 provide the burden of proof is on the public utility, but the entirety of the statutory scheme of the NRS and NAC governing utilities (NRS 703, NRS 704, NAC 703, and NAC 704) shows that there is no presumption. *See generally* NRS 703; NRS 704; NAC 703; NAC 704.

The statutory purpose conferred upon the PUCN by the Nevada Legislature includes providing "efficient, prudent and reliable operation and

service of public utilities" and to balance "the interests of customers and shareholders of public utilities." NRS 704.001(2)-(3). To be sure, NRS 704.040(1) provides that "the charges made for any service rendered or to be rendered . . . must be just and reasonable." "Every unjust and unreasonable charge for service of a public utility is unlawful." NRS 704.040(2).

These overarching policies provide a backdrop for the statutory scheme that governs ratemaking procedure. When a public utility such as SWG wants to change rates, they are required to submit to "the Commission an application to make the proposed changes and the Commission approves the proposed changes pursuant to NRS 704.110." NRS 704.100(1)(a). NRS 704.110 provides the detailed procedure for changing a rate schedule, including that a rate increase application must be accompanied by evidence to support the change:

> If a public utility files with the Commission a general rate application, the public utility shall submit with its application a statement showing the **recorded results of revenues, expenses, investments and costs of capital for its most recent 12 months** for which data were available when the application was prepared. Except as otherwise provided in subsection 4, in determining whether to approve or disapprove any increased rates, **the Commission shall consider evidence in support of the increased rates based upon actual recorded results of operations for the same 12 months, adjusted for increased revenues, any increased investment in facilities, increased expenses for depreciation, certain other operating expenses**

> **as approved by the Commission and changes in the costs of securities which are known and are measurable with reasonable accuracy at the time of filing and which will become effective within 6 months after the last month of those 12 months**.

NRS 704.110(3) (emphasis added).[6]

NAC 703.695(1) sets forth the order of proceedings, expressly providing that the public utility applicant present their evidence first at a hearing and then any parties of record opposing the application present their evidence after the utility. Additionally, the PUCN has the statutory right to question any witness in a hearing at any time in order to clarify testimony presented in the hearing in order to fulfill its statutory purpose. NAC 704.695(2). The PUCN has the authority to fix and order substituted rates if, upon any hearing and after due investigation, the rates, tolls, charges, schedules or joint rates are found to be unjust, unreasonable or unjustly

[6] NAC 703.2265 provide the filing requirements for utilities with annual gross operating revenues of $250,000 or more, and states as follows: Except as otherwise provided in NAC 703.22073, in filing its application, an applicant whose annual operating revenues are $250,000 or more must include statements A to E, inclusive, F and G with their respective schedules, H to J, inclusive, K, L and M with their respective schedules and N to P, inclusive, as these statements and schedules are described in NAC 703.2271 to 703.2451, inclusive.

discriminatory, preferential, or otherwise in violation of any of the provisions NRS 704.120(1).

The application of these laws provides the practical procedure of a general rate case: 1) the public utility submits its application for rate increase in compliance with NRS 704.110 and NAC 703.2265; 2) data requests are issued to the utility by the intervenors' experts; 3) direct and rebuttal testimony of the utility and intervenor experts are filed prior to the hearing; 4) the hearing takes place, during which the parties experts (first utility then intervenor then BCP per NAC 703.695) are questioned on the stand by the attorneys for the various parties and the Commissioners; 5) the Commission must issue a written order within 210 days of the filing to address the requests in the utility's application. NRS 704.110(2).

These statutes and regulations demonstrate that there is no presumption of prudence in rate cases. A utility cannot be simultaneously statutorily required to meet its burden of proof by providing sufficient evidence to show reasonableness while also claiming it does not need to provide evidence to show the prudence of its expenses unless and until serious doubt as to the

prudence has been shown by an intervenor.[7] Moreover, there is no statutory timeline for when a gas utility must bring a general rate case – it can take as much time as it needs to gather and submit the application and evidence to persuade the Commission that its increase request is just and reasonable. *See* NRS 704.110(3) (because subsections (3)(a)-(d) do not apply to natural gas utilities, such utilities may file a general rate application at their own discretion). As such, a presumption of prudence finding would contradict the statutory scheme governing rate cases in Nevada.

### *B. The Nevada Supreme Court Has Not Mandated a Presumption of Prudence in General Rate Cases*

This Court has never applied a presumption of prudence in general rate cases in Nevada. The only time this Court applied a presumption was in *Nev. Power Co. v. Pub. Utils. Comm'n*, 122 Nev. 821, 834-35, 138 P.3d 486, 495 (2006), and that was not a general rate case. SWG argues that this Court mandates a presumption of prudence in general rate cases. Brief at 35. In doing so, SWG goes to great lengths to attempt to explain to this Court non-

[7] "Prudence" is defined as "skill and good judgment in the use of resources." *Prudence*, MERRIAM-WEBSTER.COM, https://www.merriam-webster.com/dictionary/prudence (last visited February 25, 2021). "Reasonableness" is defined as "sound judgment." *Reasonableness*, MERRIAM-WEBSTER.COM, https://www.merriam-webster.com/dictionary/reasonableness (last visited February 25, 2021).

controversial points from *Nevada Power Co. v. Pub. Utilities Comm'n of Nevada*, 122 Nev. 821, 138 P.3d 486 (2006) ("*Nevada Power*") agreed to by the parties, only to then distort reality to support its flawed claim about a presumption that does not exist in Nevada law.

*Nevada Power* does not change the fact that there is no presumption of prudence in Nevada because a) it applied solely and specifically to deferred energy accounting cases ("DEAAs"), and b) *Nevada Power* was expressly superseded by AB 7. Assemb. B. 7, 2007 Leg., 74th Sess. (Nev. 2007) ("AB 7").

### 1. Nevada Power Purposely Applies a Presumption of Prudence in a Narrow Circumstance

*Nevada Power* applies specifically to DEAAs. *Id.* at 834, 138 P.3d at 495 (holding "[w]e hold that the rebuttable presumption analysis set forth in *Re Nevada Power Co.* is the controlling procedure in deferred energy accounting proceedings." (citation omitted)). This Court carved out a special standard for DEAAs because of the nature of such cases and the condition of the energy market at the time the decision was made. *Id*. This Court was intentional about making its application narrow, not because it wanted to leave a presumption in general rate cases (no such presumption exists), but because DEAAs contain less of a risk of imprudence compared to general rate cases.

a. What is a DEAA

This Court in *Nevada Power* provided the following summary of DEAAs:

> NRS Chapter 704, which governs the regulation of public utilities, provides for deferred energy accounting. Deferred energy accounting permits a public utility to "[record] upon its books and records in deferred accounts all increases and decreases in costs for purchased fuel and purchased power that are prudently incurred by the electric utility." Thus, deferred energy accounting documents the losses (or gains) resulting from any difference between wholesale purchase prices and the regulated retail consumer rates by authorizing a public utility to seek reimbursement from its customers through a rate increase (or to reimburse its customers through a rate decrease) at a later date.

*Nevada Power*, 122 Nev. at 824–25, 138 P.3d 486, 489.

Put simply, DEAAs are created by statute and are separate from general rate cases. *Id*. They allow utilities to seek repayment for amounts spent to purchase power on the market in order to meet demand. *Id*. These expenses are pass-through, which means any amounts allowed by the PUCN in these cases solely go to pay back the utility for money it already expended to purchase power. *Id*. This is unlike a general rate case in which all capital and

expenses incurred by the utility are included to seek rate changes and the utility is permitted to earn a return on equity on all approved expenses.[8]

b. Background of the *Nevada Power* Decision

By way of background, it is helpful to bring into focus the circumstances surrounding the *Nevada Power* decision. Specifically, this case was a result of extraordinary circumstances in the Nevada energy market. First, in the years before *Nevada Power* was heard by this Court in 2006, the Legislature was in the process of proposing deregulated energy in the electric utility market in the mid-1990s (to be in effect later), so Nevada Power Company ("NPC") was in the process of attempting to enter a deregulated market. *Id.*

Second, as part of the energy deregulation, SB 438 was enacted in 1999. S.B. 438, 1999 Leg., 70th Sess. (Nev. 1999) ("SB 438"); *id.* This new law impacted NPC by: 1) implementing a rate freeze through 2003, once the market was deregulated, which meant NPC was not able to increase rates during that time; 2) at the same time, SB 438 made NPC the "provider of last resort," meaning NPC was mandated to supply electricity to those customers who could not or chose not to buy electricity from a competitive supplier; and

[8] Coley Girouard, *How Do Electric Utilities Make Money*, ADVANCED ENERGY ECONOMY (Apr. 23, 2015, 10:55 AM), https://blog.aee.net/how-do-electric-utilities-make-money.

3) because the market was moving toward competitive selling, the Legislature abandoned deferred energy accounting as a method for recouping lost revenue associated with power purchases. *Id*.

Third, in 2000-2001, there was a western energy crisis, which caused dramatic price increases in wholesale power markets. In response, the Legislature, through AB 369. Assemb. B. 369, 2001 Leg., 71st Sess. (Nev. 2001) ("AB 369"), clawed back energy deregulation and reinstated regulation over electric utilities, including the deferred energy accounting mechanism. *Id*.

*Nevada Power* acted as a response to these circumstances. When the case came before this Court, this Court viewed the entirety of the circumstances in a holistic manner – the above circumstances, the nature of DEAAs, the fact that NPC in the below case was attempting to increase rates to pay for all of the power purchased during the deregulation period. As a result, this Court deemed it reasonable to apply a burden shifting presumption of prudence in this narrow context and only this context.

### 2. Nevada Power was Expressly Superseded by AB 7 (codified as NRS 704.185)

While the *Nevada Power* Court thought it reasonable to apply a presumption only in DEAAs, the Legislature disagreed and explicitly superseded the findings regarding the presumption in *Nevada Power* when it

enacted AB 7 in the 2007 Legislative Session. AB 7 makes clear that utilities are not entitled to a presumption of prudence: "The provisions of this act are intended to supersede the holding of the Nevada Supreme Court in *Nevada Power Company v. Public Utilities Commission of Nevada*, 122 Nev. Adv. Op. 72 (2006) . . . ." AB 7 § 1(3).

a. SWG Falsely Claims that AB 7 was Meant Only to Remove a Presumption in DEAAs and Leave the Common Law Presumption of Prudence

SWG goes to great lengths to argue the noncontroversial point that the parties agree on – that AB 7 "only appl[ies] to the expedited proceedings known as 'deferred energy accounting,' not to general rate case." Brief at 44-45. This is a true statement and is not contested. However, SWG then misrepresents this point to claim that the Legislature "surgically" removed a presumption in DEAA cases but purposely left the alleged common law presumption from *Pub. Serv. Comm'n v. Ely Light & Power Co.*, 80 Nev. 312, 393 P.2d 305 (1964) for general rate cases. Brief at 44-56.

This claim is baseless because, as provided above, the nonexistence of presumption of prudence in Nevada rate cases is the rule, not the exception. AB 7 applies only to DEAAs for two obvious reasons: 1) *Nevada Power* only ever applied a presumption in DEAAs, not general rate cases; and 2) the

presumption does not exist in other cases so there is no need to enact a law changing that.

This Court in *Nevada Power* stated the presumption of prudence application was "a matter of first impression." *Id.* at 834, 138 P.3d at 495. While this is true, it is not because it was the first time it applied a presumption specifically in DEAAs, but because it is the first time it EVER applied a presumption. For SWG to be correct, Speaker Barbara Buckley and the rest of the 2007 Legislature would have to have looked at *Nevada Power,* wanted to overturn it knowing that a presumption of prudence applied in general rate cases, and then said the following on the record:

> When we reinstated deferred cost accounting, we told the utilities that they could not use this to ask for rate increases unless it was to recover costs resulting from reasonable and prudent business practices. That is what we meant. **There is no presumption favoring a public utility when it files a rate change**. We do not burden Nevada consumers for mistakes. They must demonstrate that any cost they seek to recover was reasonably and prudently incurred. That is what this bill does.

*See* Minutes of the Meeting of the Assembly Committee on Commerce and Labor, March 7, 2007, at 8, Assem. B. 7, 2007 Leg., 74th Sess. (emphasis added).

To claim that the 2007 Nevada Legislature purposely left a presumption in general rate cases when it passed AB 7sounds absurd because it is. Speaker

Buckley made clear that a presumption of prudence is disfavored because it risks burdening customers with the costs of imprudent business decisions, not because the Legislature only wanted to remove the presumption in DEAAs. It is illogical to think that she would say this about the presumption in one context and not the other. AB 7 superseded the only presumption that existed in Nevada, the one set forth in *Nevada Power* that applied only to DEAAs.

b. <u>The Difference Between a DEAA and a General Rate Case is Precisely the Reason This Court Thought a Presumption Could Exist in DEAAs</u>

SWG next walks this Court through several uncontroversial claims about DEAA cases such as: 1) a general rate cases differs from a DEAA; 2) general rate cases cover all facets of a utility's operations; 3) DEAAs address the specific problem of recovering costs associated with wholesale market price swings; and 4) different statutes apply to the two proceedings. Brief at 44-56.

These points are not contested. But while the BCP agrees that DEAAs and general rate cases differ, it is critical to note the difference between the cases that is the precise reason the presumption of prudence could have been viewed as reasonable under the narrow circumstances in *Nevada Power*'s DEAA circumstance – applying a presumption in a DEAA case is far less

dangerous than applying a presumption in a general rate case. For a natural gas utility, DEAAs only involve changes in rates to allow recovery of natural gas costs, which are a pass-through costs to customers. (4 JA 0947.) On the other hand, in general rate cases, the PUCN reviews the entirety of the utility's expenditures from the test year, and the utility makes its profit in the form of the ROE on all of its approved investments – the more investments approved, the more profit the utility makes.

Regardless of the "simplicity" of a DEAA case, what is important is that only a case involving passthrough costs should ever even consider applying a presumption because the PUCN arguably could presume that a utility has (at least less of) a financial motive to spend imprudently or otherwise increase spending. A policy that makes it difficult to weed out imprudent costs and investments applied to cases in which the utility is incentivized to spend more should be avoided at all costs.

### 3. Other PUCN Cases Do Not Affect the Fact that there is No Presumption of Prudence in General Rate Cases

SWG refers to two past PUCN Decisions as "proof" that a presumption has always been applied in Nevada. While these decisions did apply the presumption, they do not change the fact that there is no presumption of prudence in rate cases in Nevada because 1) there is no *stare decisis* in

administrative decisions; 2) the PUCN simply applied an incorrect standard in these two cases; and 3) there are important differences between the two decisions and the general rate case herein.

a. In Re Nevada Power (1986)

In holding that a presumption of prudence applies to DEAAs in *Nevada Power*, the Court cites to a 1986 PUCN Decision: *In Re Nevada Power Co., Util. Shareholders Ass'n of Nevada*, 74 Pub. Util. Rep. 4th 703 (Nev. Pub. Serv. Comm'n May 30, 1986) ("1986 PUCN Decision"). *Nevada Power,* 122 Nev. at 834–35, 138 P.3d at 495-96. The 1986 PUCN Decision provided that the utility "enjoys a presumption that the expenses reflected in its deferred energy application were prudently incurred and taken in good faith."[9] 74 Pub. Util. Rep. 4th 703 (citation omitted).

b. There is No Stare Decisis for Administrative Decisions

The 1986 PUCN Decision is properly disregarded because it is not binding. Administrative agencies such as the PUCN in Nevada are not bound by *stare decisis*.[10] The PUCN and this Court are not bound by PUCN decisions

[9] Note that the 1986 PUCN Decision in no way affects the fact that the *Nevada Power* holding was narrowly tailored to apply to DEAAs and was superseded by AB 7, as discussed above.

[10] *See State, Dep't of Taxation v. Chrysler Group*, LLC, 129 Nev. 274, 279, 300 P.3d 713, 717 at n.3 (2013) (citing *Motor Cargo v. Public Service Comm'n*, 108

such as the 1986 PUCN Decision, so that decision in and of itself does not bind the PUCN. *Id*. The citation of the 1986 PUCN Decision in *Nevada Power* does not change its non-binding status. Only if this Court adopted its rule (and the rule was not superseded by statute) would it be binding. NRS 1.030. As discussed above, this Court held that the presumption applied in DEAAs, and purposely did not extend such a holding to general rate cases. As such, the 1986 PUCN Decision can be disregarded as a non-binding anomaly.

c. The Commission in the 1986 Decision Got it Wrong

The 1986 PUCN Decision should be called what it was – the 1986 PUCN incorrectly applied a presumption of prudence that did not, and does not now, exist in Nevada law. This becomes evident when the decision is read as a whole – the Commission in this case cites to NAC 703.2231 as the controlling burden of proof (the utility bears the burden), and then simultaneously states that the utility gets a presumption. *See generally* 1986 PUCN Decision. The Commission there even provides that the presumption means that the intervenors to a rate case sustain the burden of proof regarding prudence in a rate case. *Id*.

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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.").

This is contradictory. It is impossible, practically speaking, to simultaneously say that the utility has the burden of proof to establish that changes are reasonable but also hold that the utility does not have to present any evidence to support that the expenditures are prudent unless imprudence is proven first. This is especially true when the Commission states in the same breath that the utility "enjoys a presumption" but also the utility must file "explanatory supporting testimony" with its Application. *Id*.

While we may never know why the 1986 PUCN Decision contained a contradiction, we do know that in Nevada, the burden of proof falls on the utility and the standard of review includes that a Commission must have substantial evidence of unreasonableness to support its decisions if it is claiming an expenditure was imprudent. NAC 703.2231; *see also Nevada Power,* 122 Nev. at 834, 138 P.3d at 495. A presumption would create chaos in figuring out how to apply it. Lastly, the cases cited to in the 1986 PUCN Decision are both nonbinding FERC cases, which apply entirely different laws. The incorporation of the FERC cases shows that the Commission at that time applied the incorrect law in the 1986 PUCN Decision.

d. The 1986 PUCN Decision was Not a General Rate Case

As in *Nevada Power*, the 1986 PUCN Decision was also a DEAA. This is important because *Nevada Power* cited only to a DEAA when adopting the presumption only in DEAAs. General rate cases were never involved in the *Nevada Power* decision, nor the cases to which it cited, with good reason – a presumption of prudence did not, does not, and should not exist in general rate cases.

**4. The 2009 Decision**

While we would like to think that the 1986 PUCN Decision was the only time a rebuttable presumption was improperly applied, the PUCN improperly applied a rebuttable presumption in a rate case in 2009. *See generally Application of Nevada Power Co*., No. 08-12002, 2009 WL 1893687 (Nev. P.U.C. June 24, 2009), *clarified on denial of reconsideration*, 08-12002, 2009 WL 2482116 (Nev. P.U.C. Aug. 10, 2009) ("2009 Decision"). SWG tries to use this case as proof that Nevada law mandates a presumption of prudence. Brief at 57. In 2009, the Commission mentioned a "rebuttable presumption that the expenses reflected in its rate applications are prudently incurred." 2009 Decision, 2009 WL 1893687, at *75. The reasons behind the 2009 PUCN decision are unknown but the assertion is not an accurate account of the law.

Importantly, as mentioned above, there is no *stare decisis* in administrative decisions such as this one and so there is no binding effect of this erroneous decision.

Additionally, the cases in which the PUCN incorrectly mentioned a rebuttable presumption were not SWG cases. The PUCN has never applied a presumption of prudence in a SWG case. Therefore, SWG's claim that it was caught by surprise when the presumption was not applied is disingenuous because it has never been applied to SWG. Brief at 58.

Moreover, the PUCN has since made it abundantly clear to SWG that the presumption is not the law. Specifically, in the 2012 SWG general rate case, SWG raised the presumption of prudence as an issue and the PUCN provided that SWG bears the burden of showing that costs are prudently incurred. *See In re Southwest Gas Corp*., 12-02019, 2012 WL 7170426, at ¶ 45 (Nev. P.S.C. Dec. 19, 2012). Therefore, SWG should be estopped from raising this issue now. *LaForge v. State, Univ. & Cmty. Coll. Sys. of Nevada*, 116 Nev. 415, 419, 997 P.2d 130, 133 (2000).[11]

[11] Issue preclusion, or collateral estoppel, may be implicated when one or more of the parties to an earlier suit are involved in subsequent litigation on a different claim. Issues that were determined in the prior litigation arise in the later suit. If the common issue was actually decided and necessary to the judgment in the earlier suit, its relitigation will be precluded.

Lastly, while it is difficult to show because it is akin to proving a negative, the presumption is, as a matter of law and practice, not applied in general rate cases, as is evidenced by the fact that SWG can only cite to two PUCN cases where a presumption was improperly applied as was explained. In all other numerous rate cases before the PUCN over the years, the presumption was properly not applied, even when requested.

Cases before the PUCN unfold according to the statutes governing procedure – SWG provides evidentiary support of the prudence of its costs and requests in its application, and SWG presents first at the hearing to show reasonableness of its expenditures. The presumption of prudence is never mentioned or questioned in these cases, which is why SWG assertion that there has always been a presumption and it was abandoned in the general rate case herein is not only incorrect, but shocking.

### *C. The U.S. Supreme Court Has Not Mandated a Presumption of Prudence in General Rate Cases in Nevada*

#### 1. There is No Constitutional Basis in This Case

SWG agrees: "The U.S. Supreme Court, whose jurisdiction to review decisions of state regulatory commissions is limited to securing rights under the Fifth and Fourteenth Amendments—to determine "whether the action of the state officials in the totality of its consequence is consistent with the

enjoyment by the regulated utility of a revenue something higher than confiscation." Brief at 41, citing *W. Ohio Gas Co. v. Pub. Utils. Comm'n*, 294 U.S. 63, 70 (1935). The *W. Ohio Gas* Court provided:

> This court does not sit as a board of revision with power to review the action of administrative agencies upon grounds unrelated to the maintenance of constitutional immunities . . . .If this level is attained, and attained with suitable opportunity through evidence and argument to challenge the result, there is no denial of due process, though the proceeding is shot through with irregularity or error.

*Id*. (citations omitted).

Without a constitutional basis, the presumption of prudence cannot be invoked as a basis for overruling state utility regulators. Brief at 41. Whether a state applies a presumption of prudence according to the specific state laws is not a constitutional basis that would invoke the U.S. Supreme Court, and the U.S. Supreme Court has never mandated a presumption of prudence under its Constitutional jurisprudence.

### 2. SWG Failed to Meet the U.S. Supreme Court Standard for Confiscation

The U.S. Supreme Court review of state utility ratemaking decisions is invoked under the following circumstances set forth in the seminal cases, *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va*., 262 U.S. 679

(1923) and *Duquesne Light Co. v. Barasch,* 488 U.S. 299(1989). The *Bluefield* Court held:

> 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.

*Bluefield*, 262 U.S. at 692.

The U.S. Supreme Court in *Duquesne* provided that whether a rate is so low as to be confiscatory depends "to some extent on what is a fair rate of return given the risks under a particular rate-setting system, and on the amount of capital upon which the investors are entitled to earn that return." *Duquesne*, 488 U.S. at 310. The *Duquesne* Court further provided that in order to make a legitimate confiscation claim, the utility must show that the reduced rate:

> "**[J]eopardize[d] the financial integrity of the companies**, either by leaving them insufficient operating capital or by impeding their ability to raise future capital" or issued rates

> "**inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme**."

*Id*. at 312 (emphasis added).

In *Duquesne*, the Court rejected the utilities arguments concerning confiscation, stating that the utility did not "[allege] that the total effect of the rate order arrived at . . . [was] unjust or unreasonable." *Id*. The Court found that the appellants' attempts to make constitutional claims based upon a "piecemeal" examination of methodologies used was flawed because "[t]he Constitution protects the utility from the net effect of the rate order on its property." *Id*.

In the case at hand, SWG's District Court Petition for Judicial Review and Brief are replete of any effort whatsoever to provide evidentiary support to satisfy the standard for making a constitutional confiscation claim per *Bluefield* and *Duquesne*. *See* Brief at 39-44. SWG provides zero evidence or argument that PUCN's Order harmed it financially. Nor does it even try to show that the rates were "inadequate to compensate current equity holders for the risk associated with their investments." *Duquesne*, 488 U.S. at 312. Instead, it provides pages worth of conclusory statements and citations to case law taken out of context. To assert a claim as serious as a confiscation,

SWG needs to at least make a plausible argument rather than a desperate plea. It cannot prevail in a constitutional claim merely by citing to case law (that does not stand for what SWG asserts it stand for) while professing that the PUCN should have applied a presumption of prudence.

SWG would fail to meet this test because the rates set by the PUCN in the underlying case did not cause financial harm to the utility, and thus, were not confiscatory. As will be demonstrated below, the PUCN's Order was based on substantial evidence and in accordance with the controlling standards, including the constitutional requirement to set non-confiscatory rates. Moreover, there were no due process violations in the case and SWG was given ample opportunity, through evidence and argument to challenge the result. As such, there is no constitutional basis in this case that invokes the U.S. Supreme Court jurisprudence and no merit to SWG's claim that the U.S. Supreme Court mandates a presumption of prudence in Nevada general rate cases.

### 3. Ben Avon is Not the Applicable Standard of Review

As provided above in the "Standard of Review" section, the correct standard of review in appeals from Nevada general rate cases is provided in NRS 703.373(11) – the Court must not substitute its judgment for that of the

Commission on matters of fact. SWG argues that it is entitled to *de novo* review of facts and law based on its claim that the PUCN's rate-setting determinations were confiscatory.

SWG's assertions rest primarily on its flawed understanding and interpretation of *Ohio Valley Water Co. v. Borough of Ben Avon*, 253 U.S. 287, 289 (1920). The Court in *Ben Avon* provided that a utility receives *de novo* review on both law and facts under a constitutional confiscation claim. *Id*. Succeeding cases, including *Duquesne*,[12] have refined and narrowed the premise for which *Ben Avon* stood to such a degree that "the strength and substance of it has been dissipated." *New York Tel. Co. v. Pub. Serv. Comm'n*, 320 N.Y.S.2d 280, 285, *order modified and remanded*, 29 N.Y.2d 164 (1971). That is, *Ben Avon*, if it were to be applied in Nevada rate case appeals, would only conceivably apply in the event a valid confiscation claim was made under the *Duquesne* factors - either a showing by the utility of financial harm, or inadequacy of rates to compensate equity holders.

SWG made no attempt to satisfy this standard. Further, it failed to provide a single authority that has stated that a presumption of prudence is

[12] *See generally Fed. Power Comm'n v. Hope Nat. Gas Co*., 320 U.S. 591 (1944); *Fed. Power Comm'n v. Nat. Gas Pipeline Co. of Am*., 315 U.S. 575 (1942).

constitutionally mandated or that the absence of a presumption of prudence in a rate case is confiscatory. SWG also failed to provide a single authority that a presumption of prudence is mandated in Nevada. As such, SWG has not raised a confiscation claim. It necessarily follows that *Ben Avon* is not applicable.

Moreover, "[m]ost leading administrative law authorities agree that *Ben Avon* has been overruled *sub silentio*." *Pub. Serv. Comm'n v. Gen. Tel. Co. of Se*., 555 S.W.2d 395, 400 (Tenn. 1977).[13] Professor Kenneth Davis, referred to as the "foremost authority on administrative law" has concluded that the "*Ben Avon* doctrine in the Federal Courts is dead." *Michigan Consol. Gas Co. v. Michigan Pub. Serv. Comm'n*, 209 N.W.2d 210, 221 (Mich. 1973) (citing 4 Kenneth Davis, *Administrative Law* § 29.09 (2nd ed. 1978)). Numerous states, likewise, have declined to follow the "now dubious rule in the *Ben Avon*" for practical and policy reasons, determining that the substantial evidence test is

[13] This Court has never cited to *Ben Avon*, it has only referenced its predecessor once in *Steamboat Canal Co. v. Garson*, 43 Nev. 298, 185 P. 801, 806 (1919) (citing *Borough of Ben Avon v. Ohio Valley Water Co*., 103 A. 744 (1918), *rev'd*, 253 U.S. 287 (1920)). However, this Court in *Steamboat* also stated, "[i]f it were conceded that the courts of this state could fix or revise the rates a public utility could charge, would not the Legislature have performed a vain act in establishing another administrative body for the same purpose?" 43 Nev. 298, 185 P. 801, 806 (1919).

the appropriate test to apply and this Court should as well for these reasons. *Mount St. Mary's Hosp. of Niagara Falls v. Catherwood*, 260 N.E.2d 508, 517 (1970); *Tel. Co. of Se*., 555 S.W.2d at 402; *Michigan Consol*., 209 N.W.2d at 649.

Lastly, the "policy reasons for not recognizing [*Ben Avon*] are many and obvious." *Tel. Co. of Se*. 555 S.W.2d at 402. The premise of *Ben Avon* undermines the authority of the PUCN and, in effect, renders its legislatively-determined functions obsolete.[14] Adhering to the premise of *Ben Avon* creates a cumbersome and unnecessary burden on the reviewing court which, generally, has not benefited from constant exposure to the technical expertise rate making requires. *See New York Tel. Co. v. Pub. Serv. Comm'n*, 320 N.Y.S.2d 280, 286, *order modified and remanded*, 272 N.E.2d 554 (1971). Such re-litigation, without the benefit of the utility expertise, not only requires time and great expense, but results in "the loss of public confidence in administrative agencies[.]" *Id*. Moreover, the premise of *Ben Avon* effectively entitles the utility to a "do-over" by simply claiming the rate-making

[14] Even *St. Joseph Stock Yards Co. v. United States*, 298 U.S. 38, 53 (1936), the very case that Appellant cites in an effort to bolster its argument, emphasizes deference to agency expertise of the Commission when it stated "in a question of rate-making there is a strong presumption in favor of the conclusions reached by an experienced administrative body after a full hearing." (quoting *Darnell v. Edwards*, 244 U.S. 564, 569 (1936)).

determinations were confiscatory; such an underhanded opportunity undermines justice and flies in the face of "prior and subsequent decisions of the United States Supreme Court." *Tel. Co. of Se*. 555 S.W.2d at 399.

Because SWG failed to make a valid confiscation claim, and because *Ben Avon* is effectively obsolete (as it should be for serious reasons), *Ben Avon* is inapplicable and is not the standard of review.

### *D. A Presumption of Prudence Would be Unjust and Detrimental to Nevada Ratepayers from a Policy Perspective*

If this Court were to be inclined to adopt a presumption of prudence in general rate cases in Nevada for the first time, the BCP would strongly urge this Court to refrain from such adoption because the presumption of prudence contains inherent practical problems, and the application would lead to chaos and unjust and unreasonable rates for Nevada ratepayers. A few of the practical problems are as follows:

- **Profit Bias**: Public utilities in general rate cases make profit on their investments in the form of the ROE. The more money they spend and get approved, the more profit they make. The utility is incentivized to spend more in order to make more profit. That is why safeguards such as the burden of proof being on the utility is necessary to

prevent the utility from potentially approving costs that are not the most efficient, reasonable, and prudent options available.

- **Impractical in Practice**: It does not make sense to require the utility to present only its expenditures without support as to their reasonableness, while requiring the other party prove the imprudence of these expenses. This burden shift is akin to a defendant in a criminal case being presumed guilty until proven innocent. Any rate hearing must involve evidence presented by the party requesting the change that can be thoroughly tested by the opposing parties and the court. A utility cannot convince the PUCN to raise rates without requiring supporting evidence to be produced (without an intervenor first creating "serious doubt" as to the "prudence").
- **More Expensive**: Staff and intervenors know that there is 210 days before a rate order is issued. *See* NRS 704.110(2). In order to meet the nearly impossible burden of proving imprudence within that timeframe, the intervenors and Staff would need to perform more audits, hire more experts, perform more testing, use more lawyers to work on each case, conduct more discovery disputes, and require

lengthier hearings in order to pry the evidence establishing the imprudence of expenses away from the utility.

- **Stonewalling**: A clear issue with the application of the presumption of prudence is the potential of SWG filing as little information as possible. Under the presumption, the utility could properly submit the bare minimum and then, relying on the presumption, only provide evidence to support the reasonableness of the expense if and when another party created serious doubt about the prudence of the expense.[15]
- **Hiding the Ball**: If SWG is the holder of the evidence in a rate case, the intervenors may have a difficult time getting the utility to produce sufficient evidence for the intervenors to even attempt to ascertain prudence of expenses. Under a presumption, the intervenors have to work with very little evidence to meet a high burden.

[15] *In re: Petition of Mississippi Power Co.*, No. 2013UA189, 2013 WL 6044209, at *2-3 (Miss.P.S.C. Oct. 15, 2013) ("[S]imply demonstrating that costs were incurred is insufficient to establish a prima facie case for prudency which would shift the burden of production to the intervenors."). *See generally Coalition of Cities for Affordable Util. Rates v. Pub. Util. Comm'n of Texas*, 798 S.W.2d 560 (Tex. 1990).

- **Unjust and Unreasonable Outcomes**: Many discovery disputes and drawn-out cases are reasonably foreseeable if a presumption were to be applied. But because the PUCN only has 210 days from the date the application is filed to issue its order, it would still need to make decisions, regardless of whether adequate, thorough, and accurate evidence concerning the prudency of each expense was uncovered. *Id*. The PUCN's proverbial hands would be tied if Staff and the intervenors were not able to "prove" imprudence. This would result in rates that were not necessarily just and reasonable, and certainly not ones that balance the interests of the ratepayers with the shareholders.

## II. SWG CONFLATES OR OTHERWISE CONFUSES COURT HOLDINGS AND, AS A RESULT, INCORRECTLY CLAIMS THERE IS A PRESUMPTION OF PRUDENCE MANDATE

SWG in its Brief cherry-picks quotes from various court decisions and throws them all together to sell you the lie that the U.S. Supreme Court has mandated a presumption of prudence in rate cases. It has not. The following provides what the U.S. Supreme Court and this Court have actually held, including that A) the U.S. Supreme Court has never, even arguably, held that a

presumption of prudence is mandated in rate cases, and B) this Court did not mandate a presumption of prudence in *Ely Light*.

### *A. SWG Incorrectly Conflates Three Separate Concepts to Argue that the U.S. Supreme Court has Mandated a Presumption of Prudence*

The U.S. Supreme Court's handling of ratemaking issues involves complex concepts that are often difficult to parse apart. Without knowing better, it would be easy to jumble concepts concerning prudence together, as SWG has done. However, looking at the history of the concepts, and context of each case to which SWG refers in its Brief, it becomes clear that there are separate and distinct ideas concerning prudence: 1) the Prudent Investment Rule; 2) the Arbitrary Substitution of Judgment Rule; and 3) the Burden-shifting Presumption of Prudence.

#### 1. The Prudent Investment Rule

The primary idea involving prudence discussed by the U.S. Supreme Court is the "prudent investment rule," first set forth by Justice Brandeis in his concurrence in *State of Missouri ex rel. Sw. Bell Tel. Co. v. Pub. Serv. Comm'n of Missouri* 262 U.S. 276, 287–88 (1923) (Brandeis, J., concurring) ("Sw. Bell").

To understand this rule, it is necessary to look at the cases leading up to Brandeis's Concurrence in *Sw. Bell.* First, a controversy arose regarding the

proper methodology of valuing public utility investments in *Smyth vs. Aymes*, in which the Court held that "the basis of all calculations as to the reasonableness of rates to be charged by a corporation maintaining a highway under legislative sanction must be the **fair value of the property** being used by it for the convenience of the public." 169 U.S. 466, 546 (1898), *overruled by Fed. Power Comm'n v. Nat. Gas Pipeline Co. of Am*., 315 U.S. 575, 62 (1942) (emphasis added). Next, in *Willcox v. Consolidated Gas Co*. the Court amplified the *Smyth vs. Aymes* rule when it held that:

> [T]here must be a fair return upon the reasonable value of the property at the time it is being used for the public. . . .**[T]he value of the property is to be determined as of the time when the inquiry is made regarding rates**. If the property, which legally enters into the consideration of the question of rates, has increased in value since it was acquired, the company is entitled to the benefit of such increase.
>
> 212 U.S. 19, 52 (1909) (emphasis added).

This was the beginning of the fair market rule, which provided that the methodology for valuing the utility's investments is to be based on fair market value. *Willcox v. Consol. Gas Co. of New York*, 212 U.S. 19, 41 (1909).

The fair market rule was the methodology for the valuation of investments until the 1923 case *SW. Bell.* While the majority in *Sw. Bell* reiterated the fair market rule for valuation of property, Justice Brandeis, in

his concurrence, set forth a new methodology to compete with the fair market value rule for the valuation of public utility investments. *Id*. at 290. In Justice Brandeis' opinion, "the utility [should be] compensated for all prudent investments at their actual cost when made (their historical cost), irrespective of whether individual investments are deemed necessary or beneficial in hindsight." *Id*. Thus, as of 1923, there were two competing methodologies for the valuation of public utility investments – fair market rule and prudent investment rule. *Id*.

Then, in 1944, the U.S. Supreme Court in *Fed. Power Comm'n v. Hope Nat. Gas Co*., 320 U.S. 591 (1944) declared that the Constitution did not mandate a single rate-making formula, rather, it merely required that fair, non-confiscatory rates be the end-result of the rate making process. *Hope*, 320 U.S. at 602, stated as follows:

> It is not the theory but the impact of the rate order which counts . . . .The fact that the method employed to reach that result may contain infirmities is not then important. Moreover, the Commission's order does not become suspect by reason of the fact that it is challenged. It is the product of expert judgment which carries a presumption of validity.

While the *Hope* Court clearly removed itself from the role of referee over rate arguments, it was not specific about what is considered confiscatory. *Id*. Most recently, in 1989, the Court unequivocally adopted the *Hope* end-

result test in *Duquesne at* 488 U.S. at 312. The *Duquesne* Court refused to recognize the prudent investment/historical cost methodology as a constitutional standard and also gave guidance on what constituted a confiscation claim. *Id*.

This historical understanding is important because, in its Brief, SWG makes inaccurate and misleading assertions by lifting quotes from these cases without context from the cases. For instance, SWG cites *Duquesne* to make it seem as though the Court in *Duquesne* adopted the prudent investment rule when it did not. Brief at 27. In reality, the quote is taken from a cite to the Brandeis Concurrence, which the *Duquesne* Court cites to explain the history of the methodologies. *Id*. The current rule of the U.S. Supreme Court, after considering the prudent investment rule, is that there is no constitutionally mandated methodology in ratemaking hearings as long as the end-result is not confiscatory. *Id*.

**2. Arbitrary Substitution of Judgment Admonishment**

The second concept concerning prudence is repeatedly conflated with a presumption of prudence throughout SWG's Brief. Brief at 26-75. This concept is the U.S. Supreme Court's admonishment of commissions not to substitute their judgment with that of the utility's management unless there is

substantial evidence to support such a substitution (hereinafter referred to as "Arbitrary Substitution of Judgment Rule"). SWG cites to two U.S. Supreme Court cases to inaccurately claim that this concept mandates a presumption of prudence. The first is *Sw. Bell* and the second is *W. Ohio Gas Co. v. Pub. Util. Comm'n of Ohio* 294 U.S. 63, 72 (1935).

a. Sw. Bell

SWG claims that the U.S. Supreme Court established the presumption of prudence in *Sw. Bell* – not in the Brandeis Concurrence, but in the majority decision. Brief at 26. SWG cites to the following language to support this claim:

> The commission is not the financial manager of the corporation, and it is not empowered to substitute its judgment for that of the directors of the corporation; nor can it ignore items charged by the utility as operating expenses, unless there is an abuse of discretion in that regard by the corporate officers.

*Sw. Bell,* 262 U.S. at 289.

These words, this holding, is not a presumption of prudence. As the District Court in this case explained, "the U.S. Supreme Court found only that the 'applicable general rule' is that a regulatory commission is not 'empowered to substitute its judgment for that of the directors of the corporation.'" (22 JA 5317, citing *Sw. Bell*, 262 U.S. at 289). The language SWG

cited in *Sw. Bell* does not refer to who makes the initial showing of evidence. *Id*. It does not mention who carries the burden. The language simply states what we already know to be true under the standard of review the Commission must apply when reviewing a public utility's application: the PUCN decisions must be "'within the framework of the law' and based on substantial evidence in the record." *Nevada Power*, 122 Nev. at 834, 138 P.3d at 495 (quoting *Silver Lake Water*, 107 Nev. at 954, 823 P.2d at 268 (1991)); *see id.* at 953–54, 823 P.2d at 268.

The Arbitrary Substitution of Judgment Rule is an inherent part of the Commission's standard of review and is applied in every case – the PUCN must recognize each expense made by the utility and cannot disallow or deny a request or expense without substantial evidence of inefficiency or improvidence to support such a decision. *See Nassiri v. Chiropractic Physicians' Bd*., 130 Nev. 245, 249, 327 P.3d 487, 490 (2014) ("[A]ppellant seems to confuse "standard of proof" with "standard of review.") In claiming this language means a presumption of prudence, SWG has taken a giant irrational leap in logic, especially when Nevada law provides that the utility bears the burden to prove its case.

Moreover, as mentioned above, the origin of the prudent investment rule (and the concept of the presumption of prudence, discussed below) is in the Brandeis Concurrence to this very case. *Sw. Bell*, 262 U.S. at 290. It is illogical to claim that the presumption of prudence is set forth in the majority decision of the case, the concurrence to which is accredited with the origin of the concept of the presumption. There are two separate and distinct concepts in *Sw. Bell's* majority decision and its concurrence and SWG conflates the two.

Lastly, it is critical to note that the *Sw. Bell* language applies to the Missouri case – which applied Missouri law and Missouri procedure to the specific facts in that case to reach its conclusion. Through that lens, it is easy to see, not only that the *Sw. Bell* Court did not mandate a presumption of prudence, but also that that case is entirely different than the matter herein. In *Sw. Bell*, the Court reversed the Missouri commission's order that arbitrarily disallowed much of the utilities costs and set the amount it would allow the utility to recover based on its appraisal of the property. *Sw. Bell,* 262 U.S. at 288-289. This left the utility with inadequate revenue on top of being contradictory to the substantial evidence in the case. *Id*. The specific disallowance to which the *Sw. Bell* Court refers when it provides the Arbitrary Substitution of Judgment Rule was the disallowance of an amount actually

paid by the utility to a third-party for telephone and rental services, that was reasonable and comparable to the going rate for such services, and for which the commission did not have any evidence to support its unreasonableness. *Id*. The Court provided appropriate relief for that utility, the same relief SWG would receive if the law and facts of Missouri were at play in this case. However, the facts in this case are very different than that of *Sw. Bell*.

b. W. Ohio Gas

SWG also claims the following language in *W. Ohio Gas* is the U.S. Supreme Court mandating a presumption of prudence in all state rate cases:

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

*W. Ohio Gas,* 294 U.S. at 72 (citation omitted).

It is critical to understand the circumstances and context of this language, which demonstrates that this Court did not mandate a presumption of prudence. In addition to the fact that this language makes no mention of a burden-shifting presumption, it also does not even relate to the standard of review the PUC is to apply, particularly in general rate cases. Specifically, the

*W. Ohio Gas* Court was deciding facts and state laws that were materially different and procedural opposite from the matter herein.

In *W. Ohio Gas*, the authorities of the city of Lima, Ohio, had unilaterally passed an ordinance declaring the maximum price a gas consumer could be charged. *Id*. at 65. The utility, *W. Ohio Gas*, challenged this ordinance by filing a complaint with the PUC of Ohio in compliance with the procedural statutes at that time, which provided that the utility had the burden of proving the ordinance was unlawful. *Id*. During the hearing, there was absolutely no evidence or argument concerning the utility's negligence or inefficiency. *Id*. at 72. Thus, in providing the above language concerning good faith, the U.S. Supreme Court, on appeal, was referring to its standard of review – that it would presume good faith of the utility and not substitute its judgment for the utility's unless there was evidence to show otherwise, which the Court had previously noted there was not.[16] *Id*. Importantly, this language was not related to the PUC's standard of review it was to apply to the utility. *Id*. Rather,

[16] The commission said it was disallowing the costs because they were "unnecessary and wasteful." *W. Ohio Gas*, 294 U.S. at 72. The Supreme Court responded that this decision had no basis in evidence, either direct or circumstantial, for such a finding and there was no evidence of "inefficiency or improvidence." *Id*.

it was the deference the *W. Ohio Gas* Court, the appellate court, was to give to the plaintiff, the utility, in the underlying case. *Id*.

These cases represent a standard different than the prudent investment rule and certainly different than a burden-shifting presumption. The language in both cases make no mention of the words "presumption of prudence." If the U.S. Supreme Court meant to make something the law of the land, it surely would use the actual words of the rule in the decision. *See Trinity Cty. Lumber Co. v. Ocean Acc. & Guarantee Corp*., 228 S.W. 114, 116 (Tex. Comm'n App. 1921)("The intention sought is not the secret unexpressed intention . . . but the intention which finds expression in the language used." (citation omitted)) Moreover, the U.S. Supreme Court, in reviewing utility ratemaking cases, applies the laws of that state and reviews the arguments solely based on constitutional issues. Thus, if the U.S. Supreme Court were reviewing this case, it would apply Nevada law, including the law that declares the utility bears the burden of proof, and would further review the matter for constitutional claims to inevitably reach its determination that the PUCN's Order is constitutionally sound.

### 3. The Burden-Shifting Presumption of Prudence

The third concept is the burden-shifting presumption of prudence – the concept SWG claims is mandated in Nevada. The Brandeis concurrence has been acknowledged as the origin of this concept. 2 Leonard Saul Goodman, *The Process of Ratemaking* 860 (1st ed. 1998) Specifically, footnote 1 in the concurrence provides:

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

*Sw. Bell,* 262 U.S. at 290 n. 1 (Brandeis, B., concurring).

In providing this language as the prudent investment rule is discussed, the Brandeis concurrence provides guidance for how the prudent investment rule should work. *Id*. That is, in proposing that utilities should be compensated for prudent investments made based on their actual (historic) cost, the Brandeis concurrence provides the footnote to clarify that the compensation should be only for those costs that are prudent and the prudence should be assumed unless there is evidence that they are not reasonable. *Id*.

While other courts – not the U.S. Supreme Court – have taken this footnote and turned it into a full-blown burden shift – the presumption of prudence, none of these cases are binding law.[17] Moreover, a review of these cases provide that the law of the states in these cases are vastly different than Nevada law governing utilities – namely that the entire statutory scheme in those states are not build on the foundation that the utility has the burden of providing evidence in its case-in-chief that its requests are reasonableness (and prudence as part of reasonableness).[18]

It is unclear exactly how the evolution to a burden shift took place. It is plausible that the presumption evolution originated in ROBERT E. BURNS ET AL,

[17] States that apply a presumption of prudence often have statutes or regulations that explicitly provide for such presumption. *See e.g*., Ariz. Admin. Code § R14-2-103(A)(3)(1) (1992).

[18] SWG string cites over two pages of other state or federal cases that it claims stands for the application of the presumption of prudence. However, when reviewing these cases, it becomes clear that 1) many of the cases actually quoted for the Arbitrary Substitution of Judgment Rule (For example, *Pac. Tel. & Tel. Co. v. Whitcomb*, 12 F.2d 279, 288 (W.D. Wash. 1926), holding that in the absence of evidence to the contrary, investments may reasonably be assumed to have been made in the exercise of reasonable judgment; and 2) the cases that apply the burden-shifting presumption are FERC cases or cite to FERC cases (For example, *Gulf States Utils. Co. v. Louisiana Pub. Serv. Comm'n*, 578 So. 2d 71, 85 (La. 1991), citing to *Union Electric Co*., 40 F.E.R.C. 61,046 (FERC 1987) for the holding that prudence is presumed until the commission raises serious doubt about the prudence, at which point, the burden shifts to the utility.).

THE PRUDENT INVESTMENT TEST IN THE 1980S 34-35 (The National Regulatory Research Institute 1985) ("Burns Report").[19] The thesis of the Burns Report provides that "four guidelines for successful use of the prudent investment test…are, first, that there should exist a presumption that the investment decisions of utilities are prudent." Burns at iv. However, this was not a statutory or common law interpretation of the Brandeis Concurrence, this was an opinion in a law article. *Id*.

Regardless of its origin, the burden shifting presumption of prudence is not synonymous with the prudent investment rule and certainly is not the same as the Arbitrarily Substitution of Judgment rule. SWG has cherry-picked quotes from cases concerning the Prudent Investment Rule and the Arbitrary Substitution of Judgment Rule and jumbled them all together to make it seem as though the U.S. Supreme Court mandated that if all state utility cases do not require intervenors to bear the burden of first proving imprudence before the utility must provide evidence to support that its expenditures were prudent and reasonable, then there is a constitutional violation. *Nevada Power*, 122 Nev. at 835, 138 P.3d at 495-96. SWG inserts words and meanings that are not in the actual standard to assert that the prudence must be presumed, when in

[19] SWG cites the Burns Report throughout its Brief at 32, 66, 71.

fact, the Commission still needs to assess the reasonableness and prudency of the utility's request, with the evidentiary burden being on the utility.

What can be gleaned from a historical review of the Supreme Court cases is that 1) the U.S. Supreme Court rule regarding the methodology a state commission may apply is the end-result test; and 2) the Court has never mandated a presumption of prudence. Per *Hope* and *Duquesne*, as long as the end-result of the methodology applied in a case is not confiscatory, a commission may apply different methodologies in determining just and reasonable rates.

### ***B. <u>This Court in Ely Light Did Not Mandate a Presumption of Prudence</u>***

SWG claims that this Court recognized "the presumption in this state nearly six decades ago." Brief at 28. This is patently untrue. A review of *Ely Light* provides that 1) a presumption of prudence is not and has never been mandated in general rate cases in Nevada, and 2) it adopts the *Hope* end-result test as the standard for determining a constitutional confiscation claim in a rate case.

When claiming *Ely Light* mandated a presumption, SWG cites to the following language:

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

*Ely Light*, 80 Nev. at 324, 393 P.2d at 311 (citation omitted)(emphasis added).[20]

SWG takes this language (hereinafter referred to "Subject Paragraph") and completely contorts it to assert that the language mandates a burden shifting presumption of prudence. Brief at 28. This argument is a complete distortion of the case for the following reasons.

### 1. Looking at the *Ely Light* Court Decision in Context Shows that It Did NOT Apply a Presumption of Prudence

When reviewing the entire Subject Paragraph in context, it becomes clear why the Court provided the above language. Immediately prior to the Subject Paragraph, the *Ely Light* Court spoke in disdain about the Commission's argument to the appellate court (for why its disallowance of certain costs should be affirmed) because there is a "presumption of the legality of [the Commission's] orders." 80 Nev. at 324, 393 P.2d at 311. In

[20] In SWG's Petition for Judicial Review, when citing this *Ely Light* language, SWG conspicuously left out the word "reasonable" in the quote. (19 JA 4747).

other words, there is a presumption on review that the commission got it right, and the commission in *Ely Light* was pointing out that this was the only reason it needed to provide for the Court to affirm its decision. *Id*. The *Ely Light* Court appeared concerned that the Commission was solely relying on the appellate court's deferential standard of review instead of showing the evidence on which it relied, and consequently addressed that concern noting that, while the deferential standard of review does apply, it does not give the Commission carte blanche authority to draw conclusions without supporting such conclusions with evidence. *Id*.

The *Ely Light* Court then authored the Subject Language to point out that the deferential standard of review only applies "if the order finds substantial support in the evidence." *Id*. The Subject Language, however, is <u>not</u> a presumption of prudence. There is a difference between the standard under which the PUCN reviews management decisions versus who has the initial burden of proof in general rate cases before the PUCN. One is a standard for how the PUCN is to review the evidence in a general rate case, and the other is a procedural mandate dictating which party is initially required to present its case-in-chief before the PUCN in general rate cases. As illustration of the Subject Paragraph, when a PUCN hears a general rate case, and is determining

whether to allow a utility's expenditure as a rate, it must first review the evidence to see if there is a reason to disallow the expense. If there is evidence that shows that there was an abuse of discretion, or bad faith, or inefficiency, or improvidence on the part of the utility, or if the amounts spent by the utility were unreasonable, then the PUCN should disallow that expenditure in compliance with its duty to order just and reasonable rates. If there is no evidence that any of the above occurred, then the utility should refrain from making a decision to disallow the expense simply because it would have made another decision.[21]

Assuming *arguendo*, we can contrast this example with a theoretical application of a presumption of prudence – which mandates that the intervenor, not a utility, sustains the initial burden of proving imprudence in a general rate case. However, these are entirely different concepts and should not be conflated. The *Ely Light* Court makes no mention of the procedure of a rate case or a burden-shifting presumption. The Subject Paragraph is about the standard of review the Commission is to apply, not a procedural change shifting the burden of proof away from the utility.

[21] Note that this is different than if the utility fails to provide any or insufficient evidence, as in that case, the utility would disallow the request for failure to meet its evidentiary burden under NRS 703.2231.

Moreover, the context of the Subject Paragraph in *Ely Light* shows that the *Ely Light* Court was not applying a presumption. In *Ely Light*, the Court found that the commission's decision to disallow a pension plan by 50% was completely arbitrary and there was no evidential support to make this decision. *Id*. That is, the Commission under the *Ely Light* Court substituted its judgment regarding whether it thought the pension plan was a good idea. *Id*. This is different from a commission disallowing a cost because the utility failed to provide evidence sufficient to meet its burden of proof, or where evidence on the record shows that the cost was not reasonable (analysis of the PUCN's decisions discussed below in Part III).

**2. The *Ely Light* Court Adopted the *Hope* End-result Test**

SWG's claims that *Ely Light* stands for the presumption of prudence in Nevada is patently false particularly when, as described above, *Ely Light* stands for the adoption of the *Hope* standard– the very U.S. Supreme Court case that held that there is no constitutionally mandated methodology for ratemaking. Specifically, this Court in *Ely Light* declared that Nevada does not mandate one single ratemaking methodology:

> We need not trace the tendency of the United States Supreme Court, through a number of decisions, to wean itself from Smyth v. Ames. This it finally and conclusively did in Federal Power *Commission v. Hope Natural Gas Co*., 320 U.S. 591, 64 S.Ct. 281, 88

> L.Ed. 333. Citing the *Hope* case in Bell Tel. Co. of Nevada v. Public Service Commission, 70 Nev. 25, 253 P.2d 602, this court said: '[I]t is not our province to quarrel with methods used by the commission or with methods approved by the district court, no matter how faulty they may have been as means or guides in arriving at sundry determinations involved either in evaluating the property or determining the net return if the end result of the orders made is to permit the company a just and reasonable return.'

*Ely Light,* 80 Nev. at 322, 393 P.2d at 310 (citing *Bell Tel. Co. v. Pub. Serv. Comm'n,* 70 Nev. 25, 253 P.2d 602 (1953)).

This adoption of the *Hope* standard is what the *Ely Light* decision is known for, not for the asserted adoption of a presumption of prudence. *See* Richard G. Campbell & John C. Walley, *Legislative and Judicial History of the Regulation of Public Utilities in Nevada*, NV LAW 31, 37 (1997). To argue that the *Ely Light* Court held that only the presumption of prudence is mandated by the Nevada Supreme Court only a couple paragraphs after it declared no single methodology is mandated is irrational and contrary to the law. Nevertheless, SWG takes the Subject Paragraph and conflates it with the concept of the presumption, trying to pass it off as a mandate of a burden-shift.

### 3. SWG's Logic Regarding Ely Light is Flawed

The following is a summary of SWG's flawed reasoning and assertion that *Ely Light* mandated a presumption of prudence: According to SWG, the *Ely*

*Light* Court used the phrase "proper exercise of judgment" and Brandeis used the phrase "exercise of reasonable judgment." Brief at 32. The Brandeis concurrence (in footnote 1 discussed above) is treated as the first articulation of a presumption of prudence. *Id*. Therefore, SWG asserts, because there is a similar phrase in the *Ely Light* decision and the Brandeis concurrence, and because Brandeis talked about presuming prudence when applying the prudent investment rule– ipso facto – *Ely Light* mandated a presumption of prudence in Nevada. This argument, crafted over several pages in the SWG brief, takes several leaps in logic that are not supported by the actual meaning of the words used in the two separate opinions and should be resoundingly rejected by this Court.[22]

#### 4. Nevada Power, in Adopting a Presumption of Prudence in DEAAs Never Cited to Ely Light

SWG attempts to brush off the glaring fact that the *Nevada Power* Court never cites to *Ely Light* to stand for the existence of a presumption of

[22] The Subject Paragraph in *Ely Light* cites to *West Ohio Gas* and *SW Bell*. As previously discussed, these two cases do not mandate a presumption of prudence. If this Court in *Ely Light* intended to mandate a presumption of prudence, it would have cited to a case that adopted the Brandeis concurrence or another case that clearly stood for a burden-shifting presumption. It did not.

prudence by saying that "instead of debating whether *Ely Light* itself extended to such proceedings" *Nevada Power* cited to another matter. Brief at 53. This reality, that *Nevada Power* makes no mention of *Ely Light* in its comprehensive analysis of the presumption of prudence, should provide this Court with the nail for the coffin on SWG's claim that *Ely Light* mandated a presumption of prudence in rate cases. A presumption does not and has not been mandated in rate cases in Nevada, which is why *Nevada Power* and AB 7 never addressed it – common law and statutes are generally enacted to change an existing law or practice, not to declare again that something is the law.

### 5. This Court has Not Applied Ely Light to Mean a Presumption of Prudence

#### a. Zephyr Cove

SWG inaccurately asserts that this Court "reinforced and even expanded the presumption" in *State v. Zephyr Cove Water Co*. by reversing the exclusion of certain expenses because "nothing in the record to support a finding that such expenses would be unreasonable." 94 Nev. at 639 n.1, 584 P.2d at 701 n.1. *Zephyr Cove* has nothing to do with a presumption of prudence. The two issues in *Zephyr Cove* were 1) the district court's improper actions and standard of review, and 2) the commission in that case's failure to base its decision on substantial evidence.

Specifically, the district court on appeal in that case "authorized directly the collection of revenues from the utility's customers, without either approval by the Commission or compliance with statutory provision . . . [when there was ] statutory authorization for such a procedure." *Zephyr*, 94 Nev. at 637–40, 584 P.2d at 700–02. As a result, the *Zephyr* Court reversed that portion of the district court's order.

The second issue in *Zephyr* was the lack of evidence the commission had to support its approved rate of return, which this Court held was not a "just and reasonable return." 94 Nev. at 639, 584 P.2d at 701. There, the evidence in the underlying hearing had shown that the utility had not "enjoyed a reasonable rate increase in almost 20 years; ha[d] not paid its stockholders a dividend in 20 years; ha[d] consistently been unable to generate operating income sufficient to meet current and deferred expenses." *Id.* The *Zephyr* Court found that the commission's rate of return was unreasonable. *Id*.

*Zephyr* makes no mention of the presumption of prudence and cites to *Ely Light* in a footnote as another example of a past commission denying a utility request when the Commission did not have substantial evidence to support its decision. The quote SWG uses in this appeal to insinuate that *Zephyr* cites *Ely Light* for a presumption of prudence is actually the *Zephyr*

Court simply stating that a commission must have evidence to support a claim that an expense is unreasonable.

b. Southwest Gas Curtailment Case

SWG also inaccurately relies on this Court's holding in *Sw. Gas Corp. v. Pub. Serv. Comm'n*, that for purposes of a curtailment case the Commission could not prohibit a utility from curtailing a high-priority gas, for the flawed assertion that it applied a presumption of prudence. 98 Nev. 404, 407, 651 P.2d 95, 97 (1982). Again, the only reason *Ely Light* was cited in *Sw. Gas Corp.* is for its discussion on it being inappropriate to substitute its judgment without evidence.

c. Idaho Case

SWG then cites to *Boise Water Corp*., 555 P.2d 163 (Idaho 1976) to again falsely assert that *Ely Light* held that there is a burden-shifting presumption of prudence because the *Boise Water* Court cited to it when it held "that a utility establishes a 'prima facie case for the reasonableness of its operating expenses to non-affiliates by showing actual incurrence.'" Brief at 33. *Boise Water*, a non-binding Idaho state case, determined, based on applicable Idaho laws, that the utility has the initial burden, but that burden is met simply by showing the incurrence of costs instead of bearing the burden of proof. *Id*. at

169. *Boise Water* determined how the burden shift works in Idaho rate cases, which is unlike the way Nevada rate cases work. NAC 703.2231. *Ely Light* makes no mention of SWG's proposition that all that the utility needs to show in order to sustain its burden is that the expenses were actually incurred. *Ely Light* at 324. Arguably, the *Boise Water* Court may have cited to *Ely Light* for the part of its holding that mentions inefficiency and lack of good faith, which is also mentioned in *Boise Water*. However, other than those terms, the referenced portions of the two cases are entirely different. As such, *Boise Water* should be discarded as inapplicable and irrelevant.

SWG's failed assertion that these cases stand for this Court's application of the presumption of prudence shows just how patently improper and convoluted their understanding is. All three cases, *Zephyr*, *Sw. Gas Corp*., and *Boise Water,* are not related to the presumption – and notably these cases reinforce the conclusion that *Ely Light* does not recognize, let alone mandate, a presumption of prudence. *Ely Light* represents the idea that the commission must have evidence and legal authority to make its decisions, otherwise the commission is arbitrarily substituting its judgment for that of the utility. This is entirely different from a burden-shifting presumption of prudence, which would allow utilities to include potentially imprudent expenditures, not have

to explain their inclusive expenses in their case-in-chief, but only need to provide evidentiary support of reasonableness if "serious doubt" is made as to the prudence, and then have Nevada ratepayers foot the bill. This is not the process or rule this Court held in *Ely Light* and this Court has an opportunity to soundly reject that proposition now.

## III. THE PUCN APPLIED THE PROPER STANDARD AND CORRECTLY DENIED THE PENSION EXPENSES AND WORK ORDER IN THIS CASE

SWG challenges the following PUCN findings in the underlying general rate case: 1) PUCN's denial of a pension tracker and application of normalization (Subsections C and D); 2) denial of a discount rate from 4.5% to 3.75%; and 3) the disallowance of the Challenged Work Orders (Subsection E). In addition to these findings being proper as sustained by the District Court, because there is no presumption of prudence in Nevada, these findings were also proper as sustained by the District Court because A) the PUCN's decisions on these issues had no reliance or application of the question of whether there was a presumption of prudence; and B) because the PUCN relied on substantial evidence to come to its decisions.

### *A. <u>This Court Need Not Decide on the Presumption of Prudence because the Underlying PUCN Decision Did Not Rely on It</u>*

The singular argument SWG makes for its assertion that this Court should reverse the District Court's findings in support of the PUCN's decision on the Challenged Work Orders and Pension Expenses is that of an inaccurate assertion that the presumption of prudence was not applied.[23] However, the PUCN's findings do not turn on whether a presumption of prudence was applied. That is, assuming *arguendo*, if a presumption of prudence had been applied, also assuming SWG provided the same evidence, the outcome would have been the same. The District Court correctly sustained the PUCN's decision wherein the PUCN applied the correct procedural and substantive standards as reflected in its Modified Order, weighed the evidence provided, recognized the lack of evidence provided by SWG on these issues, gave SWG multiple opportunities to provide adequate evidence, and made its decision based on the evidence before it to issue just and reasonable rates.

[23] "If the Commission had properly applied the presumption of prudence, it would have approved the work orders and pension expenses. No evidence demonstrated that those expenses were imprudent." Brief at 59.

### *B. The PUCN Applied the Proper Standard in Denying the Pension Expenses and Work Orders*

In reviewing rate cases, the PUCN must comply with a certain standard of review. That is, the PUCN is responsible for ensuring that any charges imposed on Nevada utility customers (the ratepayers) are "just and reasonable," *see* NRS 704.001(4); NRS 704.120(1). The PUCN must "[p]rotect, further and serve the public interest." NRS 703.151(1). The PUCN is also legally required to balance the public interest with the interest of shareholders of a public utility to ensure that the utility has "the opportunity to earn a fair return on their investments . . . .". NRS 704.001(4).

PUCN decisions must be "within the framework of the law'" and based on "substantial evidence in the record." *Nevada Power*, 122 Nev. at 834, 138 P.3d at 495 (quoting *Silver Lake Water,* 107 Nev. at 954, 823 P.2d at 268 (1991)); *see id.* at 953–54, 823 P.2d at 268.

The presumption of prudence is not part of the PUCN's standard of review. However, the PUCN's duty to rely on substantial evidence as provided in *Nevada Power* and *Ely Light* is included in this standard. The PUCN's Order, as sustained by the District Court in the underlying case, was based on substantial evidence, as the following section illustrates.

### *C. The PUCN Applied the Correct Standards and Came to the Correct Decisions on Denying the Use of a Pension Tracker and Instead Using a Normalization Method*

SWG argues that the PUCN wrongfully denied the use of SWG's proffered pension tracker and instead implemented the normalization method because it did not apply a presumption of prudence; the accuracy of the pension expenses was not questioned; and the use of the normalization method for the pension costs violated "not just the presumption of prudence, but also Southwest Gas's due process rights." Brief at 74. The District Court sustained the PUCN's findings and SWG's arguments fail for the following reasons:

#### 1. The PUCN's Finding on Normalization is based on Substantial Evidence in the Record

The use of a pension tracker was SWG's recommendation to address the issue of volatility of pension expenses. (5 JA 1072.) The PUCN denied the use of the tracking mechanism and instead found that normalization is a more appropriate means for addressing volatility.[24] (*Id.* at 1073.)

[24] Insofar as SWG claims the presumption of prudence should have been applied to this issue, assuming *arguendo* a presumption of prudence existed, the use of a tracker was a tool suggested to be used in the future and the presumption applies to expenditures already incurred.

SWG's incorrectly asserts that the pension tracker recommendation was never challenged and that the PUCN's decision to deny the tracker was a direct result of witness testimony. Brief at 73. The BCP and Staff both recommended denying the tracker because it was imprudent and not properly assessed in a general rate case. (5 JA 1072.) Evidence supporting Staff's recommended denial of the pension tracking mechanism was submitted in testimony that was filed nine days prior to Southwest Gas submitting pre-filed rebuttal testimony and approximately three weeks before the hearing. (*Id*.) Part of this testimony was the recommendation of a 5-year average normalization method as the best method to reach a reasonable level of pension expenses. (*Id*.)

SWG was questioned on the reasonableness of the tracker and was apprised of the alternative method of normalization prior to the hearing. (*Id*.) Therefore, SWG had ample opportunity, both through pre-filed testimony and at hearing, to address this issue, and consequently its denial was not unconstitutional. *See generally W. Ohio Gas*, 294 U.S. 63. Pursuant to NAC 704.2231, SWG had the burden of establishing that the pension tracker was just and reasonable. If SWG did not adequately prepare for or address the normalization method issue, it is not because it was not given the opportunity.

SWG's failure to rebut BCP and Staff's concerns with the tracker is its own oversight which should not now be held against ratepayers.

Moreover, the PUCN's application of a normalization method for addressing pension cost volatility did not violate SWG's due process rights. Brief at 74. Based on substantial evidence in the record – namely, Staff and BCP testimony – the PUCN rejected SWG's request to establish a tracking mechanism, not because SWG was not given the opportunity to provide evidence as to the reasonableness of the method, and not because the PUCN presumed the tracker was imprudent, but because the evidence submitted by Staff and the BCP convinced the PUCN that normalization was a more reasonable and accurate method for addressing volatility of pension expenses. (5 JA 1072); *see Robertson Transp. Co. v. Pub. Serv. Comm'n*, 159 N.W.2d 636, 638 (Wis. 1968.) ("There may be cases where two conflicting views may each be sustained by substantial evidence."). Moreover, SWG's sweeping constitutional arguments that its due process rights were violated have no evidentiary support. Brief at 74. SWG's due process allegation lacks any meaningful analysis and should be summarily discarded as a result.

### 2. This Case is Entirely Different than the Situation in Ely Light

SWG cites to *Ely Light* to claim that the accuracy of the pension expenses were unquestioned and so the Commission's decision was "arbitrary, confiscatory and erroneous, requiring reversal." Brief at 73, citing *Ely Light* at 80 Nev. at 324, 393 P.2d at 311. SWG's comparison of PUCN's denial of pension expenses to the decision in *Ely Light* is without merit. First, *Ely Light* does not apply a presumption of prudence, as previously discussed. Second, SWG insinuates that, because the topic in *Ely Light* was also pension expenses, the analysis is the same. But it is not.

In *Ely Light*, the pension expense issue was a denial by the Commission of 50% of the utility's pension cost because the commission thought half should be paid for by ratepayers and half by stockholders. *Id.* at 323, 393 P.2d at 311. This Court reversed this decision because there was "no competent evidence before the Commission to support its finding that the cost of the pension plan was unreasonable, to delete 50% of such cost from the rate base computations was arbitrary . . . and . . . search of the record finds nothing to support the Commission's decision." *Id*. at 323-324, 393 P.2d at 311. In this matter, the Commission based its pension expense findings on substantial evidence in the record, and so the comparison to *Ely Light* is without merit.

### D. ***The PUCN's Denial of SWG's Requested Discount Rate is Proper***

SWG also vaguely argues that the PUCN violated SWG's due process rights in denying its discount rate recommendation in one sentence.[25] Again, SWG fails to present any argument, binding law, or analysis of the facts to support this conclusory assertion, and as a result, this argument should be rejected as without merit. In support of its recommendation that the Court reject this argument, BCP will still explain why the PUCN's denial of SWG's discount rate was proper.

In the general rate case, SWG provided expert testimony stating that an actuary recommended a 3.75% discount rate (without providing any specifics about what information the actuary used in arriving at its recommendation). (5 JA 1069-1070.) At the hearing, when the SWG witnesses assigned to address this issue were questioned regarding how the discount rate recommendation was reached, the witnesses could not speak on the issue at all. (*Id*.) The Commission gave SWG the opportunity to provide support for the actuary's discount rate determination, questioning how the senior manager makes the decision, why the discount rate decreased so significantly, how the

[25] "The Commission also violated Southwest Gas's due process rights by requiring it to justify a 3.75% discount rate without prior notice" is the only argument SWG makes concerning the discount rate. Brief at 74.

rate was determined, etc. (*Id*.) This provided SWG with the opportunity to explain and justify the pension expense, but SWG could not or did not avail itself of the opportunity.

Accordingly, the PUCN denied SWG's requested reduction of discount rate because "SWG did not provide the Commission with evidence explaining the cause of the significant reduction in the discount rate for the 2018 test year, nor did it produce a single witness during the hearing that could testify about the selection process for the rate reduction." (5 JA 1071.)

SWG failure to provide sufficient evidence to support its request was a failure to meet its burden of proof and is proper grounds for denying the request. *See* NAC 703.2231.[26] SWG's due process rights were not violated as SWG was given notice regarding the discount rate issue when it was mentioned in BCP's pre-filed testimony, when its witness on the issue asked multiple questions on the stand, and when the PUCN provided SWG an opportunity to provide such evidence. As such, the PUCN properly decided

[26] If there were a presumption of prudence, it would have been rebutted by the parties and PUCN when the witnesses were questioned on the prudence of the actuary's recommendation. At that point, the presumption would have fallen off and SWG would be required to show prudence, but failed to do so. *Re Minnesota Power & Light Co*, 11 FERC ¶ 61312, 61645 (1980).

this issue based on the lack of evidence available and found that there was no basis to make SWG's suggested significant increase to the discount rate.

### E. ***The Challenged Work Orders Were Denied as a Result of SWG's Failure to Meet its Burden of Proof***

SWG next argues that its "work orders on software projects should have been approved" and would have been approved if the presumption of prudence had been applied. Brief at 67-72. The issue on appeal to which SWG refers is the PUCN's denial of five of SWG's nine capital projects work orders ("Challenged Work Orders"). SWG now claims that the Commission's finding that there was a lack of oversight is not supported by substantial evidence. Brief at 70. This argument fails, not only because there is no presumption of prudence, but also because the record shows that SWG failed to meet its burden of proof regarding the reasonableness of the Challenged Work Order expenses. Moreover, PUCN's denial of the complete Challenged Work Orders and not just individual expenses in it was proper given the circumstances.

#### 1. The PUCN's Decision was Based on Substantial (Lack of) Evidence

Issues with the Challenged Work Orders initially arose after SWG's application was filed and Staff did a run-of-the-mill audit of five of nine

projects.[27] Specifically, Staff issued numerous data requests and made on-site visits regarding the audited projects, attempting to analyze and ascertain whether the costs were just and reasonable and proper to be included in Nevada rates. (5 JA 1107-1108.) Staff was not able to get responses to its inquiries from SWG, despite multiple efforts to do so. (*Id*.) Staff found the Challenged Work Orders involved SWG's complete failure to present evidence to support that these costs were just and reasonable. (*Id*.) The only evidence provided to Staff regarding the Work Orders was 1) the names of and budgets for the projects; 2) invoices or estimates for purchases made; 3) the name and/or signature of the employee or consultant authorizing the expenditures; 4) memos identifying individuals in charge of various projects; and 5) organizational charts for the projects. (5 JA 1107-1110.)[28]

Some of the items included in the Challenged Work Orders that reasonably raised serious doubt about their prudence include, but are not limited to: a piano, home theatre system, gas grill, Bluetooth headphones,

[27] It is the normal course of action and within Staff's investigatory authority in a general rate case for Staff to audit high-dollar projects that a utility requests to be placed in rates.

[28] The support of expenditures for five capital projects consisted of one exhibit without any further explanation, and the exhibit referenced in testimony, Exhibit No. RLC-4, provides only a brief description of each of the work orders.

dozens of t-shirts, bartender costs, biweekly massages, golf memberships, and a $90,000 backhoe it was legally prohibited from including in expenses (civil penalty in a separate civil case). (*Id*.)

SWG failed to provide evidence indicating that the projects' authorized budgets or expenditures were reasonable investments, the least-cost option, the best available alternative projects, or reasonable under the circumstances. (*Id*.) Moreover, there was insufficient evidence to show why certain costs were incurred, including costs for consultants, expert fees or services, personnel overtime, rental car fees, and daily meals or refreshments. (*Id*.) SWG claims that the PUCN ignored evidence SWG provided that substantiated the expenses but does not point to any of this alleged evidence. That is likely because such evidence was not provided to the PUCN. Staff made several attempts to obtain evidence from SWG, but to no avail.

Not surprisingly, the PUCN found that SWG failed to sustain its burden of proof for establishing that the proposed rate changes associated with the Challenged Work Orders were just reasonable and not unduly discriminatory or preferential, citing NAC 703.2231. (5 JA 1130.) As a result, the PUCN correctly disallows 100% of the Challenged Work Orders. (*Id*.)

The issues regarding the Challenged Work Orders were raised by Staff and the PUCN and Staff gave SWG many opportunities to provide evidence to resolve its concerns. SWG completely failed to prove that these costs were just and reasonable during the Hearing. A utility failing to provide evidence to support its request for approval of expenses is grounds for denial of the request per NAC 703.2231. As such, SWG's argument that the denial was improper is without merit.

### 2. *Assuming Arguendo* there was a Presumption, the Decision Would have Been the Same

For arguments sake, even if a presumption of prudence existed in Nevada, when Staff raised issues bringing into question the prudence of the work order expenses, thereby rebutting the presumption, SWG would have had the burden of showing that the Challenged Work Order expenses were reasonably and prudently incurred. SWG would have failed to meet this burden by failing to provide evidence. SWG cannot stonewall or otherwise fail to present evidence to support the inclusion of the Challenged Work Orders and then claim the decision should be reversed. SWG failure would have resulted in a disallowance regardless of the application of a presumption.

### 3. The PUCN Approving Some of the Challenged Work Order Expenditures in a Refiled Case is Irrelevant

SWG argues that the PUCN conceded that the PUCN incorrectly disallowed SWG's requests in the 2018 rate case when it allowed some of the disallowed costs in a subsequent refiling, *Application of Sw. Gas Corp. for Auth. to Increase Its Retail Nat. Gas Util. Serv. Rates for S. & N. Nevada*, Order, Docket No. 20-02023, 2020 WL 6119350 (Nev. P.U.C. Sept. 25, 2020) ("2020 rate case"). This argument should be rejected. In the 2020 rate case, the PUCN did not make a finding that the Challenged Work Orders were imprudent or prudent in the 2018 Rate Case. The PUCN's decision in the 2018 rate case was based on SWG's failure to produce evidence and meet its burden of proof, even after Staff and BCP repeatedly attempted to get the necessary information. The fact that SWG filed a subsequent rate case and met its burden of proof on some of the requests previously denied is irrelevant.

If anything, the 2020 rate case outcome, in which SWG provided evidence found to be sufficient of its expenditures demonstrates: 1) that it failed to do so in the 2018 general rate case; and 2) the typical general rate case proceeds without a presumption of prudence, which was not called into question in the 2020 rate case. The PUCN maintains that it properly

disallowed the Challenged Work Orders in the underlying case based on the evidence on the record there.

### 4. PUCN was Not Required to Disallow on an Expense-by-Expense Basis

SWG incorrectly asserts that, even if the PUCN was allowed to deny any of the expenses, the expenses were required to be evaluated on an expense-by-expense basis, so only a small portion of the expenses should have been disallowed. Brief at 68-69. This is wholly untrue, primarily because there is no presumption of prudence. But also, again, SWG is ignoring the fact that it failed to provide sufficient evidence of the reasonableness of the entirety of the Challenged Work Orders – through sufficient answers to Staff's data requests, through testimony of a witness personally involved in the projects, through expert testimony justifying the expenses – not just some of the expenses. SWG denied the percentage of the Challenged Work Orders of which SWG failed to meet its burden of proof – 100%.[29] Moreover, SWG argues that the disallowance was confiscatory because "no one asked the

[29] *See Popowsky v. Pennsylvania Pub. Util. Comm'n*, 674 A.2d 1149, 1153 (Pa. Commw. Ct. 1996)(holding that although there were some services for which evidence was provided, because the utility failed to meet its burden of proof in showing the value of all of the services, the PUC was correct in denying the entire claim for the expense).

Commission to disallow 100%." Brief at 68. Pursuant to NRS 704.120(1), SWG has the authority to make its own decisions in order to meet its legal duty to provide just and reasonable rates.

## IV. THE PUCN'S DECISION ON RETURN OF EQUITY WAS BASED ON THE CONTROLLING STANDARDS FOR FAIR RETURNS AND ON SUBSTANTIAL EVIDENCE

### *A. Standard for Determining Whether an ROE is Confiscatory*

A utility's ROE is the amount a utility can earn on the equity spent by the utility on investments and infrastructure. That is, it is the rate of profit based upon ratepayer assessments the utility can make, and the more it spends on investments, the more profit it make. When the Commission determines an ROE, it must apply the proper standards of review – ensuring just and reasonable rates, balance the interests of the shareholders and the ratepayers, and refraining from substituting its judgment for that of management's without substantial evidence to support its reason. In addition, the Commission must comply with the two seminal U.S. Supreme Court cases when making decisions on return on equity: *Bluefield Waterworks and Hope.* Further, in a just and reasonable ROE, the Commission is free to fix a rate within a "zone of reasonableness" which is thus higher than a confiscatory rate. *Nat. Gas Pipeline Co. of Am*., 315 U.S. at 585–86.

The Court in *Hope* confirmed *Bluefield* and stated that there is no constitutionally mandated method for determining ROE, rather, it is the end-result on the public utility that matters. *Hope* at 603. The Court in *Hope* added that an ROE should be commensurate with the returns of investments in other enterprises having corresponding risks and be sufficient to ensure confidence in the financial integrity of the utility such that the utility can maintain is credit and attract capital. *Id*. *Hope* further provided that the presence of infirmities in the method employed to arrive at a just and reasonable rate is not important; it is the impact of the rate-setting order that matters. *Id*. This Court held in *Nevada Power Co. v. Pub. Serv. Comm'n*, 91 Nev. 816, 825, 544 P.2d 428, 435 (1975) that the Commission in determining the ROE must conform with *Bluefield* and *Hope*.

### ***B. PUCN's Application of the Controlling Standards to Reach the ROE in the Underlying Case***

In general rate cases, each party submits its recommended ROE within a recommended zone of reasonableness and then the PUCN sets a zone of reasonableness based on the parties' recommendations in which the ROE must be set. (5 JA 1005.) In this case, SWG recommended an ROE of 10.3% within a range of 10-10.5%; Staff recommended 9.4% within a range of 9.1-9.7%; and BCP recommended 9.3% within a range of 9.1-9.7%. The PUCN

determined and ordered an ROE of 9.25%, finding that it "balanced the interest of the ratepayers and the shareholders." (*Id*.)

SWG's argues that the ROE was confiscatory in that the 9.25% rate "was lower than what anyone requested." Brief at 77. This argument is irrelevant because it is not the standard per *Hope*, *Bluefield* and *Natural Gas*. The Commission set the 9.25% ROE based on substantial evidence in the record. Specifically, the evidence that it considered included 1) the results of each expert's evaluation of various return on equity models; 2) the experts' judgment in assessing macroeconomic conditions, capital markets, SWG's circumstances (e.g., capital structure, risk profile, and regulatory environment); and 3) each expert's critique of other experts' analyses. *Id*.

SWG makes no attempt at arguing or demonstrating that the ROE was insufficient to ensure confidence in the financial integrity of SWG or that it caused SWG to struggle to maintain its credit or attract capital. This is the standard and SWG did not, likely because it cannot, show that the ROE did not meet the controlling standard for confiscation. As such, its confiscation argument should be summarily rejected.

The only argument SWG makes concerning the ROE that is part of the standard is that SWG further states that "the Commission ignored the

undisputed proxy group rate of return of 10.23%, and evidence of an industry average rate of return of 9.68%." Brief at 77. However, the Commission used a proxy group tool that was offered by SWG to comply with *Hope*'s guidance to set an ROE commensurate with similar enterprises. The proxy group had a group of seven comparable natural gas utilities, having the same size, operations, and credit. The BCP and Staff provided expert testimony using SWG's proxy group to form their opinions. No party challenged the proxy group. (5 JA 1009.)

Moreover, SWG's 10.23% was not a figure presented in the underlying case. It was new evidence presented for the first time in the petition for reconsideration proceedings, which is not permitted under the PUCN's regulations.[30] (7 JA 1590.) Even though this figure was not presented by SWG in the underlying case, it should be disregarded as irrelevant regardless.[31]

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[30] NAC 703.801(1)(b) states that a petition "may not contain additional evidentiary matter or require submission or taking of new evidence."

[31] This figure came from one of its witnesses' exhibits.[31] But the 10.23% is not explicitly identified in the referenced exhibit. (*Id*.) Rather, the exhibit contains a list of the ROEs for *all* natural gas utilities across the country since 1980. (*Id*.) The BCP assumes that the 10.23% was be derived from the average ROE that the seven proxy gas companies have had since 1980. (*Id*.) But this is meaningless because an average ROE over the last 40 years cannot be relied upon for rate-setting because it does not reflect the current economic conditions, including historically low risk-free rates. Similarly, SWG's cite to 9.68% as the industry's average ROE is meaningless. An industry-average

This claim falls short of the heavy burden SWG has to demonstrate that the ROE is arbitrary or capricious under the deferential appellate standard of review, let alone confiscatory.

### C. ***The PUCN Relied on Substantial Evidence in Determining that a Just and Reasonable ROE is 9.25***

In coming to the 9.25% ROE, the PUCN focused on the evidence of the model analyses, macroeconomic conditions, and the proxy group. The PUCN looked at the "market risk premium" ("MRP").[32] The PUCN found that Staff's and BCP's use of historical and published data to determine an MRP was more defensible than SWG's forecast approach. (CR at 369-70.) SWG's MRP estimates were high (11.48-12.61%), compared to Staff's (6.88%) and BCP's (7.50%). (*Id*.) The PUCN replaced SWG's high estimate with Staff and BCP's estimates and found that the ROE in that model would be 9.1-9.3%. (*Id*.) Further, the PUCN was persuaded by the BCP and Staff's expert testimony on the issue of market conditions. (5 JA 1007.) Lastly, the PUCN found that SWG

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return on equity does not consider any of the careful deliberation based on the thorough evidence and analyses of all of the party's experts and instead looks at one single data point to claim confiscation.

[31] The MRP is the difference between the market return and the risk-free rate. (5 JA 1006.); *see also* Roger A. Morin, NEW REGULATORY FINANCE 155 (Pub. Utils. Reports) (2006). The risk-free rate is the return that would be required by investors in the absence of risk. (*Id*.); *See id*. at 37, 151. 34.

does not have more risk than the other natural gas utilities in the proxy group. (5 JA 1009.)

In this case, the PUCN relied on substantial evidence – testimony of several experts on ROE submitted by the parties during a multi-day hearing, extensive discovery and investigation by the BCP and Staff. The PUCN's decision does not need to disprove that SWG's 10.30% does not have evidence to support it. It matters only that the 9.25% ROE is supported by substantial evidence in compliance with NRS 703.373(11). Such is the case here.

SWG's argument concerning the ROE boils down to the fact this it did not like the ROE the PUCN ordered. A lower ROE means less profit. However, it does not mean that the decision is unconstitutional or in violation of NRS 703.373(11).

## CONCLUSION

The PUCN followed the applicable Nevada and U.S. Supreme Court standards in determining the subject findings in the underlying Order. The PUCN reached a result that was not a constitutional confiscation or a violation of due process rights, and SWG's claims fail to invoke a constitutional analysis. Further, importantly, there is no requirement in Nevada to apply a presumption of prudence in general

rate cases before the PUCN. For these reasons, this Court should affirm the decision of the District Court to affirm PUCN's Modified Order on the Challenged Work Orders, the Pension Expenses, and the Return on Equity.

Dated this 1st day of March, 2021.


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## CERTIFICATE OF COMPLIANCE

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3. I certify that I have read this brief, that it is not frivolous or interposed for any improper purpose, and that it complies with all applicable rules of appellate procedure. I understand that if it does not, I may be subject to sanctions.

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## CERTIFICATE OF SERVICE

I certify that I am an employee of the Office of the Attorney General, State of Nevada, and that on March 1, 2021, I submitted a true and correct copy of the foregoing RESPONSE BRIEF for filing, via this Court's electronic filing system. Electronic notification will be sent to the following:

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