

BEFORE THE PUBLIC UTILITIES COMMISSION OF NEVADA

In the matter of the Application of SOUTHWEST GAS)
CORPORATION for authorization to increase its natural)
gas rates and proposed tariff revisions to establish) Docket No. 01-7023
consistency between the southern and northern divisions)
and to account for changes in business practices.)
_____)

At a special session of the Public Utilities
Commission of Nevada, held at its offices on
January 14, 2002.

PRESENT: Chairman Donald L. Soderberg
Commissioner Richard M. McIntire
Commissioner Adriana Escobar Chanos
Commission Secretary Crystal Jackson

ORDER

The Presiding Officer makes the following findings and conclusions:

1. On July 13, 2001, an application, designated as Docket No. 01-7023, was filed with the Public Utilities Commission of Nevada (“Commission”) by Southwest Gas Corporation (“Southwest”) for authorization to increase its natural gas rates and proposed tariff revisions to establish consistency between the southern and northern divisions and to account for changes in business practices.
2. The application was filed pursuant to the Nevada Revised Statutes (“NRS”) and the Nevada Administrative Code (“NAC”), Chapters 703 and 704, including, but not limited to, NRS 704.100, *et seq.*, and NAC 703.2201 through 703.2491.
3. The Commission issued a public notice of this application in accordance with State law and the Commission’s Rules of Practice and Procedure.
4. The Bureau of Consumer Protection (“BCP”) and the Regulatory Operations Staff (“Staff”) of the Commission are participating in this docket as a matter of right. Sierra Pacific

Power Company (“Sierra Pacific”), the Nevada Energy Buyers Group (“NEBG”) and Kerr McGee Chemical (“Kerr McGee”) were granted full intervention status. The Nevada AFL-CIO (“AFL-CIO”) was granted conditional leave to intervene.

5. On August 22, 2001, a duly noticed prehearing conference was held.
6. On September 20, 2001, a duly noticed consumer session was held in Las Vegas, Nevada. On September 24, 2001, a duly noticed consumer session was held in Carson City, Nevada.
7. On November 16, 2001, the Parties filed a Stipulation with the Commission which resolved all of the issues in Docket No. 01-7023, except for cost allocation and rate design.
8. On November 19, 2001, a duly noticed hearing was held. The hearing was continued to December 3, 2001. Also on November 19, 2001, AFL-CIO and Kerr McGee filed letters indicating their non-opposition to the Stipulation.
9. On November 21, 2001, the NEBG filed a letter indicating its non-opposition to the Stipulation.
10. Sierra Pacific has indicated its non-opposition to the Stipulation.
11. On November 29, 2001, the Commission voted to approve the Stipulation, which resolved all of the issues except for cost allocation and rate design.
12. On December 3, 2001, the Commission resumed the hearing on the cost allocation and rate design issues.

Class Cost of Service Study

Distribution Mains

Position of the Parties

Southwest

13. Southwest classifies distribution mains as both customer costs and demand costs. Southwest classifies as customer costs the costs required to serve customers under minimal or no load conditions, including distribution mains. The remaining distribution main costs are classified as demand sensitive costs. Southwest's minimal system methodology results in approximately 75 percent of distribution main costs being classified as customer related costs and the remaining costs, approximately 25 percent, as demand related costs. The distribution main costs classified as customer costs are allocated to each customer class based upon the proportion of that customer class's number of customers to the total number of customers. Those costs classified as demand related costs are allocated to each customer class based upon that customer class's contribution to the system peak. (Exhibit No. 12 p. 5 through 7, Exhibit 27 p. 3 and 4, and Transcript Volume I at 61, 72, and 73.)

14. Southwest states that it relied upon a NARUC cost allocation manual, published in August 1981, as the basis for classifying distribution mains as a customer cost (Exhibit No. 7, p. 21 and 22 and Transcript Volume I at 62).

15. Southwest asserts that due to tremendous customer growth Southwest is experiencing, it is customer growth and not customer demand that is driving the installation of distribution mains. In support of its assertion, Southwest notes that since the 1993 general rate case its northern Nevada and southern Nevada operations have experienced a 34 percent and 100 percent increase in customers, respectively. Southwest states that the cost of service study should recognize this situation. (Exhibit No. 27, p. 5 through 8 and Attachment ABC-1.)

16. It is Southwest's opinion that any type of commodity-based allocation creates a cost shift with the large volume customers bearing a disproportional allocation of costs associated with both distribution and transmission mains. (Exhibit No. 27 p. 6.)

17. Southwest notes that the intent of the class cost of service study ("cost of service study") is to reflect how Southwest incurs its costs. Thus, the costs incurred to install pipe to serve its customers are fixed costs, and those costs change very little with changes in annual throughput. (Transcript Volume II at 34.)

18. Southwest acknowledges that, in the 1993 general case, Southwest proposed a similar classification of distribution main costs as customer costs and that the Commission rejected their proposal since the methodology used in that proceeding did not address the impact of customer density upon the class cost of service study. Southwest agrees that if isolated portions of its system were examined the same concern could possibly be raised. However, when the system is examined on the whole its minimum system reasonably reflects the minimum cost to serve a new customer. (Transcript Volume I at 65, 66, and 73.)

19. In response to criticism that its peak system demand allocation does not reflect the customers' usage obtained from the minimum system design capacity, Southwest could hypothetically eliminate this consumption by eliminating the cost of the two inch distribution main resulting in zero capacity. Elimination of the cost would remove \$0.614 per foot or 3 percent of the minimum system capacity cost. (Exhibit No. 27, p. 9.)

20. Southwest concurs with Staff that its system was designed to meet the customers' peak day demands and in doing so it provides customers access to Southwest's natural gas system. (Transcript Volume I at 71.)

Staff

21. Staff recommends that the Commission accept Southwest's class cost of service study with one proviso; namely, distribution mains should be classified equally as customer costs and demand costs. Southwest's system was designed to meet three customer criteria: minimum load requirements, peak day requirements, and customer access. Since the commodity criteria is fully accommodated by the peak demand criteria, the remaining two criteria should be equally weighed in allocating distribution mains. (Exhibit No. 11 p. 1, 4, and 5.)

22. Further, Staff indicates that Southwest has not presented any evidence demonstrating that a direct ratio of distribution mains to the number of customers in a class is reasonable regardless of location. (Exhibit No. 11 p. 4.)

BCP

23. BCP disagrees with Southwest's classification of distribution mains as customer costs. The minimum system methodology does not recognize that the mains are sized for loads placed upon them, and not the number of customers, and customer density is ignored. In addition, BCP cites an excerpt from Professor Bonbright's text book titled *Principles of Public Utility Rates* which states in part:

“What this last-named cost imputation overlooks, of course, is the very weak correlation between the area (or mileage) of distribution system and number of customers served by the system. For it makes no allowance for the density factor (customers per linear mile or per square mile). Indeed, if Southwest's entire service area stays fixed, an increase in number of customers does not necessarily betoken any increase whatever in the costs of a minimum-sized distribution system.” (Exhibit No. 13 p. 7 through 9.)

24. BCP proposes that the distribution main costs be allocated between customer classes on a conservative basis of 50 percent annual demand and 50 percent peak demand. In order to properly implement the allocation principle of cost causality, BCP states that the fact that distribution mains are used to deliver natural gas throughout the year and not only on peak demand must be considered. Further, BCP notes that the additional cost associated with sizing the distribution mains to meet the elevated peak demands is only a small portion of the total mains installation costs. In fact the percentage of costs is significantly less than the 50 percent BCP is proposing be allocated on the basis of peak demand. (Exhibit No. 13, p. 11 through 13, and Transcript Volume I at 106 through 108.)

25. BCP acknowledges that Dr. Bonbright confirmed that the allocation or classification of distribution mains as a demand cost is equally indefensible and that some commissions allocate distribution investment to customers. (Transcript Volume I at 84.)

26. Regarding Southwest's peak demand allocation, BCP notes that Southwest's demand allocation ignores the fact that a significant amount of the residential customers' peak day load could be served by Southwest's minimum 2-inch distribution main system. BCP states that Southwest's oversight is detrimental to the residential customers whose total requirements are often met by the 2-inch distribution system. (Exhibit No. 13 p. 9, 10, and 16.)

AFL-CIO

27. AFL-CIO disagrees with Southwest's classification of distribution mains as customer costs. AFL-CIO notes that mains are installed for sustained usage and sized for peak day demand, not for the existence of customers. AFL-CIO states that Southwest's minimum system methodology relies upon a fiction that customers do not consume natural gas. AFL-CIO contends that natural gas is a discretionary service selected by consumers for economic reasons.

As additional support for its position, AFL-CIO notes that Southwest will not extend natural gas service to an area unless sufficient revenues are generated to support the facilities, which may require the assessment of a surcharge to the affected customers. (Exhibit No. 16, p. 18 through 20.)

28. AFL-CIO proposes that the cost of distribution mains be allocated to the various customer classes using both annual demand and peak demand allocation, weighted at 21.27 percent and 78.73 percent respectively. The annual demand allocation percentage was calculated by reducing 100 percent by the coincident peak load factor, excluding interruptible transportation customers. While the proposed weighted rates are those for southern Nevada, similar ratios were experienced in northern Nevada. (Exhibit No. 16, p. 20 and 21.)

NEBG

29. NEBG did not address this issue.

Commission Discussion and Findings

30. Southwest states that its proposed minimum system capacity allocation methodology complies with the NARUC manual and recognizes the tremendous customer growth being experienced by Southwest. Southwest's approach reflects that approximately 75 percent of the distribution mains cost should be allocated as customer costs, with the remainder based upon peak day demand. While the Commission recognizes that the NARUC manual is an important reference, it is not required to comply with it. In this instance, the Commission finds that the particular NARUC manual used by Southwest does not result in a reasonable allocation of distribution mains for the reasons cited below.

31. The northern and southern Nevada divisions of Southwest have experienced significant customer growth since the 1993 general rate cases, 34 percent and 100 percent

respectively. This increase lends credence to Southwest's position that customer growth should be considered in allocating distribution mains in this instance. As stated by Staff, Southwest does design its system to meet its customers peak day demand and customer growth.

32. By designing its system to meet its customers' peak day demand Southwest has incorporated all three designing criteria identified by Staff: annual throughput, peak day demand, and the number of customers. While allocating distribution main costs to the various customer classes based upon a customer class's contribution to the system peak would consider all three design components identified by Staff, it does not adequately recognize the significant increase in customer growth experienced by Southwest.

33. Specifically, Southwest's proposed minimum system design methodology inappropriately weights customer growth. Southwest does not provide any evidence demonstrating the reasonableness of allocating distribution main costs based principally upon the number of customers, regardless of location. Further, Southwest's methodology does not eliminate the capacity associated with the minimum system from the peak day demand allocation resulting in a misallocation of distribution main costs.

34. BCP and AFL-CIO proposals to allocate distribution mains between customer classes based upon a composite allocation of peak day demand and annual throughput do not recognize that peak day demand does include the level of capacity needed to meet the customers' annual throughput. Further, allocation of capacity based upon annual throughput would punish those customer classes that use their allocated peak day capacity more efficiently.

35. Staff's proposed 50/50 split between customer and demand classification of distribution main costs in this instance provides a reasonable acknowledgement that the system

design, in addition to meeting Southwest's existing customers peak day demands, incorporates a level of customer growth.

36. Accordingly, the Commission finds that Staff's position is reasonable and will be accepted.

Transmission Mains

Position of the Parties

Southwest

37. Since the transmission mains, which only exist in southern Nevada, were designed to meet peak day demands, Southwest classifies the transmission main costs as demand costs and allocates costs to the various customer classes based upon the customer class's contribution to the system's coincident peak day demand. (Exhibit No. 27 p. 3.)

38. It is Southwest's opinion that any type of commodity based allocation creates a cost shift with the large volume customers bearing a disproportional allocation of costs associated with both distribution and transmission mains. (Exhibit No. 27 p. 6.)

Staff

39. Staff did not address this issue.

BCP

40. The BCP did not address this issue.

AFL-CIO

41. AFL-CIO proposes that the southern Nevada transmission mains be allocated by using the same average demand and peak day demand methodology as that proposed for distribution mains, because the facilities are installed for sustained usage and sized for peak day demand, and not based on the existence of customers. While the ratio would be 68.5 percent and

31.5 percent, respectively, AFL-CIO proposes an equal weighting in this instance. The conservative 50 / 50 ratio is necessitated by elimination of the influence of several special contract customers who use the transmission mains but not the distribution system. (Exhibit No. 16, p. 21 and 22)

NEBG

42. NEBG did not address this issue.

Commission Discussion and Findings

43. AFL-CIO proposes to allocate transmission mains between customer classes based upon a composite allocation of peak day demand and annual throughput. (Exhibit 16 p. 21.) The proposal does not recognize the fact that peak day demand includes the level of capacity needed to meet the customers' annual throughput. (Exhibit 27 p. 3.) Further, AFL-CIO's allocation of capacity based upon annual throughput would punish the customer classes that use their allocated peak day capacity more efficiently. (Exhibit 27 p. 6.)

44. Therefore, the Commission rejects AFL-CIO's recommendation and finds that Southwest's methodology is reasonable; moreover, no other parties present any other objections.

Other Operating Revenues

Position of the Parties

Southwest

45. Southwest allocates all Other Operating Revenues, with the exception of rental income, to the various customer classes based on the level of distribution margin derived from each customer class. Southwest allocates rental income exclusively to the residential and general service classes based upon the number of customers. (Exhibit No. 27, p. 16.)

46. According to Southwest, AFL-CIO limits its proposed allocation adjustments to those that benefit the residential customer class. According to Southwest, allocation of gas plant rental revenues is an example of how a line by line examination of the allocation methods used in the class cost of service study may result in unfavorable adjustments to the residential customer class. For example, neither party takes exception to the allocation of gas plant rental revenues, which are payments made by affiliate entities (e.g., Paiute Pipeline Company) for the use of system allocable and district facilities. While the gas plant rental revenues are allocated to the residential and general service customers based upon the number of customers, the associated costs of the affiliate compensating Southwest were allocated on the basis of plant, customers, demand and commodity. This results in more revenues allocated to the residential customer class than if another allocation method were employed. Gas plant rental revenues accounted for \$230,799 of the \$5,370,086 in total Other Operating Revenues for southern Nevada and \$648,416 of the \$1,617,795 in total Other Operating Revenues for northern Nevada, respectively. (Exhibit No. 30 Statement J page 2 of 2; Exhibit No. 31, Statement J page 2 of 2; Exhibit No. 27, p.17; and Transcript Volume II at 37, 38, 54, 55, 58 through 61.)

47. Southwest notes that when evaluating the allocation methodology applied to an isolated cost the significance of the cost and the potential impact upon the final result must be evaluated prior to making a change to the allocation methodology to be employed. In certain circumstances the more accurate results due to a change in allocation may not significantly effect the final results. Further, when allocating costs to extremely large customers the specific customer situation must be considered in the selection of the allocation methodology or the results may be erroneous. (Exhibit No. 27, p. 18 and Transcript Volume II at 62 and 63.)

48. Southwest states that the AFL-CIO proposed allocation methodology would increase the Other Operating Revenues allocated to the residential customer class in southern Nevada and northern Nevada by \$1.0 million and \$0.161 million, respectively. However, Southwest notes the AFL-CIO proposal would have a minimal impact upon the average residential customer. The change in allocation reduces the southern Nevada residential rate by \$0.006, \$0.004 using AFL-CIO's proposed rate design, per therm or \$0.30 per month. (Exhibit No. 27, p. 17 and 18.)

Staff

49. Staff did not address this issue.

BCP

50. According to BCP, late charges and service connection revenues should be allocated to the customer classes that pay those revenues, not to distribution revenues as proposed by Southwest. While Southwest maintains records of late charge revenues by customer class, it does not maintain records of service connections by customer class. Therefore, BCP proposes that service connection revenues be allocated to the various customer classes in the same manner as the associated costs, which are primarily recorded in accounts 902 and 903. Further, since late charges and service connection charges account for approximately 90 percent of the Other Operating Revenues, excluding rents from gas property, all other revenues should be allocated using the weighted average of the late charge fee and the service connection revenue allocations. (Exhibit No. 13, p. 16 through 18.)

AFL-CIO

51. AFL-CIO proposes that Other Operating Revenues should be allocated to the various customer classes that pay this revenue rather than use a generic allocation ratio as proposed by Southwest. Specifically, AFL-CIO proposes that:

- late charge fees be directly assigned to the customer classes that pay these charges using the records maintained by Southwest;
- the basic customer accounting allocation factor, which is used to allocate the associated costs recorded in account numbers 902 and 903, should be used to allocate return item revenues, reconnect revenues and reread revenues; and
- the number of customers be used to allocate service connection revenues.

The effect would be to increase the residential allocation of Other Operating Revenues by \$1,013,000. (Exhibit No. 16, p. 25 and 26.)

NEBG

52. The NEBG did not address this issue.

Commission Discussion and Findings

53. While certain BCP and AFL-CIO proposed allocation methods may be superior to those used by Southwest, BCP and AFL-CIO adjustments appear to be limited to those benefiting the residential customer class. BCP and AFL-CIO accept Southwest's allocation of gas plant rental revenue, which significantly benefits the residential customer class, rather than propose a methodology that allocates these revenues in a manner more consistent with the allocation of the associated costs. Any potential mismatching of revenue with the associated costs could be significant in northern Nevada where the gas plant rental revenue accounts for approximately 40 percent of total Other Operating Revenues.

54. The Commission finds that while the Other Operating Revenues cost of service allocations should be re-evaluated it is inappropriate to accept an adjustment in this instance. Therefore, the Commission finds that Southwest's allocation of Other Operating Revenues is reasonable.

55. Further, to the extent the overall allocation of Other Operating Revenues is in error the affect upon the final rate design should be minimal because 1) the component only represents approximately 5 percent of the total stipulated divisional margin; 2) the class cost of service study is but one item the Commission uses in the development of rates (NAC 704.6675); and 3) the Parties generally agree, that to the extent rates differ from those supported by the class cost of service, the Commission should gradually move towards cost based rates.

56. Therefore, the Commission finds that BCP and AFL-CIO's proposed adjustments should not be accepted. However, BCP and AFL-CIO have raised reasonable concerns as to the allocation methods used by Southwest, here and later in this order. Therefore, the Commission also finds that Southwest shall re-evaluate all the allocation methodologies it uses in its class cost of service study and shall use the results of the re-evaluation in the preparation of the cost of service study filed in its next general rate case application. It is expected that the allocation methodology re-evaluation will incorporate the effect of including special contract customers in the class marginal cost of service study and the use of a marginal cost of service study.

Uncollectible Accounts Expense

Position of the Parties

Southwest

57. Southwest allocates the uncollectible accounts expense to the various customer classes using the number of customers as the allocation methodology. (Exhibit No. 16, p. 22 and

23.) Southwest notes that when evaluating the allocation methodology applied to an isolated cost the significance of the cost and the potential impact upon the end result must be evaluated prior to making a change to the allocation methodology to be employed. In certain circumstances the more accurate results from a change in allocation may not significantly affect the final result. Further, when allocating costs to extremely large customers the specific customer situation must be considered in the selection of the allocation methodology, or the results may be erroneous. (Exhibit No. 27, p. 18 and Transcript Volume II at 62 and 63.)

Staff

58. Staff did not address this issue.

BCP

59. BCP did not address this issue.

AFL-CIO

60. While Southwest allocates uncollectible account expenses based upon the number of customers, AFL-CIO proposes to allocate uncollectible accounts expense to the various customer classes by allocating 50 percent based upon the number of customers and 50 percent based upon the class revenue. AFL-CIO states that its proposed allocation methodology acknowledges that while the preponderance of uncollectible expenses are incurred by the smaller customers, the large customers are still a significant portion of the uncollectible expense. AFL-CIO notes that their proposal would increase the uncollectible account expense charged to large customers from 4 percent to 15 percent. As an example of the disparity in using the number of customers as the allocation ratio, AFL-CIO notes that while the large commercial class uncollectible account expense has averaged approximately \$10,000 for the last five years, Southwest proposes to only allocate \$152 to this customer class. (Exhibit No. 16, p. 22 and 23.)

NEBG

61. The NEBG did not address this issue.

Commission Discussion and Findings

62. AFL-CIO raises a valid concern that the allocation methodology employed by Southwest does not accurately reflect the occurrence of uncollectible expenses. For the reasons cited for the proposed adjustments in the allocation of Other Operating Revenues, the Commission finds Southwest's allocation of uncollectible expense in this proceeding to be reasonable. Further, as previously noted Southwest has been ordered to re-evaluate all the allocation methods it uses in a class cost of service study.

Sales and Marketing for Large Commercial Customers**Position of the Parties**Southwest

63. Southwest disagrees with AFL-CIO's proposed allocation methodology as it fails to properly match costs associated with large commercial sales department to the department's benefits which Southwest identifies as special contract customer revenues. The special contract revenues are allocated to various other customer classes as revenue credits. The large commercial sales department is responsible for maintaining Southwest's relationship with special contract customers. Southwest notes that the special contract customer revenues allocated to the residential customer class for both southern Nevada and northern Nevada exceed the cost of the large commercial sales department allocated to these two operations. Specifically, the special contract revenues allocated to the southern Nevada residential class were \$6.3 million compared to the large commercial sales department which was allocated costs of \$0.6 million. The special contract revenues allocated to northern Nevada residential customer class were

\$0.250 million compared to the large commercial sales department which was allocated costs of \$0.178 million. The residential customer allocation of special contract revenues represent 75 percent and 71 percent of that operation's special contract revenue, respectively. (Exhibit No. 27, p. 19 and 20.)

64. Further, Southwest notes that when evaluating the allocation methodology applied to an isolated cost the significance of the cost and the potential impact upon the final result must be evaluated prior to making a change to the allocation methodology to be employed. In certain circumstances the more accurate results from a change in allocation may not significantly affect the final results. Further, when allocating costs to extremely large customers the specific customer situation must be considered in the selection of the allocation methodology or the results may be erroneous. (Exhibit No. 27, p. 18 and Transcript Volume II at 62 and 63.)

Staff

65. Staff did not address this issue.

BCP

66. BCP did not address this issue.

AFL-CIO

67. The AFL-CIO proposes to directly assign the costs associated with the large customer sales department to the large customer class in lieu of the weighted customer allocation methodology used by Southwest. However, the costs assigned to the interruptible transportation customers are allocated to the other customer classes using the methodology employed by Southwest. Southwest uses this methodology to allocate the associated revenues from these customers to the other customer classes. Southwest bases the allocation of associated revenues upon customer class contribution to gross margin. Southwest reported that the large customer

sales department costs for southern Nevada and northern Nevada were \$600,487 and \$178,734, respectively. Of this amount, the AFL-CIO notes that Southwest only allocated \$3,508 to the southern Nevada large general service customers. The AFL-CIO proposal would allocate \$129,145 of the department's costs to the southern Nevada large general service customers.

(Exhibit No. 16, p. 27 and 28.)

NEBG

68. The NEBG did not address this issue.

Commission Discussion and Findings

69. AFL-CIO raises a valid concern that the allocation methodology employed by Southwest does not accurately reflect the nature of costs associated with the large customer sales department. For the reasons cited above, the Commission finds Southwest's allocation of the large customer sales department costs in this proceeding to be reasonable. Further, as previously noted Southwest has been ordered to re-evaluate all the allocation methods it uses in a class cost of service study.

Special Contracts

Position of the Parties

Southwest

70. Southwest contends that the unique characteristics of special contract customers (i.e. size, location, and alternative fuel capability) create challenges to including these customers into a class cost of service study. (Exhibit No. 27, p. 11.) In addition, since most of the special contract customers are located in close proximity to interstate pipelines serving Southwest, these customers take service from Southwest's transmission system and not its distribution system. (Exhibit No. 27, p. 11 and 12.) Further, Southwest notes that if these customers are included in a

class cost of service study and either a commodity or demand based allocation methodology were used, the special contract customers would be assigned a significant portion of the costs even though these customers do not take distribution service. (Exhibit No. 27, p. 11 and 12.)

71. According to Southwest, the BCP class cost of service study provides inconsistent treatment to the special contract customer class. BCP also excludes those special contract customers that take service from only the transmission system from its class cost of service study. However, unlike Southwest, BCP does include in its class cost of service study the remaining special contract customers. According to Southwest, BCP proposes to allocate system costs to the special contract customer class using the same allocation methodologies as applied to the other customer classes. Since the BCP class cost of service study's special contract customer class excludes the subclass of special contract customers taking only transportation service, it inappropriately weights the special contract class category. The result is to create two subclasses within a customer class and not allow the revenue from one subclass to offset the other subclass. (Exhibit No. 27, p. 12 and 14.)

72. According to Southwest, if the special contract customers are included in a class cost of service study it is necessary to use the proper allocation methodologies that reflect the unique characteristics of these customers or an unreasonable result will occur. For example, while BCP's allocation of plant investment using its average demand and peak day demand allocation methodology results in \$153 million in plant allocated to the special contract customer class, a customer by customer examination would disclose this amount to be significantly overstated. (Exhibit No. 27, p. 11 and Transcript Volume II at 47 through 49.)

73. Further, Southwest states one could not apply the allocation methodologies used in its class cost of service study because the allocation methodologies do not consider the unique

characteristics of these customers. If Southwest's class cost of service allocation methodologies were applied to this customer class the results would be erroneous. (Transcript Volume II at 52.) Southwest should be able to develop the proper allocation methodologies for the special contract customer class by the time Southwest files its next general rate case application. (Transcript Volume II at 49 and 50.)

74. Southwest notes that it has filed with the Commission several of the special customer contracts, and the Commission has approved these contracts, including the economic analysis. In addition to these contracts, several have been filed with the Commission for informational purposes and those filings may have included the associated economic analysis. (Exhibit No. 27, p. 15 and Transcript Volume II at 56 and 57.)

Staff

75. Staff recommends that the Commission require Southwest to file a marginal class cost of service study in its next general rate case application and that the study include separate columns for special contract customers. (Exhibit No. 11, p. 1 and 7.)

76. Staff notes that, absent a class cost of service study, Southwest's presumption that revenues received from the special contract customers are fully compensatory is not verifiable. (Exhibit No. 11, p. 7.)

BCP

77. BCP notes that, while the special contract customer class accounted for 30 percent of northern Nevada's annual throughput and 70 percent of southern Nevada's annual throughput, Southwest has excluded this customer class from its class cost of service study. Inclusion of this customer class in the class cost of service study would reveal the actual costs to serve the remaining customer classes. In that light, BCP recommends that the Commission include the

special contract customers in the class cost of service study and that the costs be allocated in the same manner as that used to allocate costs to all other customer classes. (Exhibit No. 13, p. 18.)

78. BCP contends that after adjusting Southwest's class cost of service study for improper reliance on customer costs and the misallocation of other revenues, inclusion of the special contract customer class in the class cost of service study would eliminate any revenue deficiency that needs to be corrected through a disproportional rate increase. (Exhibit No. 13, p. 19 and Attachment RAG-1.)

79. BCP eliminates the entities that use no portion of the distribution system from the special contract customers to be included in the class cost of service study. (Exhibit No. 13, p. 19.)

80. BCP acknowledges that the price charged to the special contract customers for service has very little to do with the costs developed in a cost of service study. For those customers that have competitive alternatives the customer's incremental cost must be used when developing the price to charge for services. If the price that may be charged exceeds the incremental costs to provide service, the customer will provide revenues to cover some of the fixed costs. (Transcript Volume I at 100 and 101.)

81. If special contract customers were to leave the system the embedded costs associated with these customers should not automatically be recovered from the remaining customers but should be evaluated on a case-by-case basis. (Transcript Volume I at 105, 109, and 110.)

AFL-CIO

82. AFL-CIO did not address this issue.

NEBG

83. NEBG did not address this issue.

Commission Discussion and Findings

84. While including both the revenues and associated costs in its cost of service, Southwest does not include the special customer class as a separate class of customers in the cost of service study. Southwest allocates the special contract customer class revenues and the associated costs to the other customer classes. The revenues are allocated as a revenue credit that is used to offset the other customer classes' cost of service. The associated costs are not separated from the pool of costs allocated to the other customer classes which results in those costs being allocated in the same manner as all other costs. Southwest's proposed method assumes that the special customer class revenues are sufficient to compensate for the cost of providing service to these customers. Further, Southwest's methodology assumes that the special contract customers' revenue is allocated to each of the other customer classes at the same ratio as the composite allocation ratio for all the special contract customer costs. To the extent the allocation ratios differ a misallocation would have occurred.

85. As justification for this assumption, Southwest states that it has provided to the Commission and the Commission has approved several of these contracts, including the associated economic analysis.

86. Although the Commission has approved several of these contracts, Southwest must still demonstrate that the special contract customer class revenues are adequately compensating Southwest for the cost of providing these customers service. The Commission is not re-evaluating any previously approved contract, since it is expected that any cost of service study would incorporate the specifics of these contracts. Further, if the cost of service study

indicates that this customer class revenue is deficient it does not preclude Southwest from justifying any deficiency by using the criteria set forth in NAC 704.6675.

87. The BCP proposal to require the use of the same allocation methodologies used to allocate costs to the other customer classes is inappropriate because it does not reflect the specific characteristics for each of the special contract customers. Therefore, the Commission finds Southwest's treatment of special contract customers in this proceeding to be reasonable. Further, the Commission finds that in its next general rate case application Southwest shall include the special contract customer class in its class cost of service study.

Marginal Cost of Service Study

Position of the Parties

Southwest

88. Southwest believes that an embedded class cost of service study is the appropriate guide for establishing both a class revenue requirement and rates. Southwest cites testimony filed by Mr. Feingold, a Southern California Gas Company witness, in a Southern California Gas Company biennial cost allocation proceeding before the California Public Utility Commission. In that proceeding Mr. Feingold cites one difficulty and two reductions in benefits associated with the use of a marginal cost of service study:

- theoretical debate over the development of the marginal unit costs;
- using the marginal cost study to allocate the embedded cost revenue requirement distorts the marginal price signal; and
- other rate setting considerations, such as, gradualism, further dilute the marginal cost study's impact upon rates.

(Exhibit No. 27, p. 21 and 22.)

Staff

89. Staff recommends that the Commission order Southwest to perform a marginal cost study and a class cost of service study in its next general rate case application. (Exhibit No. 11, p. 1 and 8.)

BCP

90. BCP did not address this issue.

AFL-CIO

91. AFL-CIO did not address this issue.

NEBG

92. NEBG did not address this issue.

Commission Discussion and Findings

93. While citing some difficulties it has with a marginal cost of service study, Southwest acknowledges that a marginal cost price signal is better than an embedded cost price signal. While the Commission agrees with Southwest that the cost of service study should act as a guide for the development of rates, other considerations may also be appropriate (NAC 704.6675). In order to make sound decisions, the Commission should have the most accurate guide possible.

94. Further, as indicated by Southwest, it has experienced, and may continue to experience, tremendous customer growth. The use of an embedded cost of service study may not give appropriate weight to each customer class, vis-à-vis the incremental cost of providing service to that class.

95. While NAC 704.6671 and NAC 704.6675 allow the natural gas utility to use either an embedded or a marginal cost of service study in the establishment of general rates, the

Commission finds that Southwest shall file a marginal cost of service study in its next general rate case application which incorporates the pertinent findings of this Order.

Rate Design

96. While Southwest proposes several changes to its existing rates and tariffs (e.g., extension of the winter season to include April) the parties disagreed with the following items: margin deficiency allocation, customer charge, and the extension of declining block rates. Other than the issues previously discussed, the Commission finds Southwest's requested rate and tariff changes to be reasonable.

Margin Deficiency Allocation

Position of the Parties

Southwest

97. Southwest believes that a gradual change in rates is more reasonable than a significant shift as evidenced by its allocation of the margin deficiency among the various customer classes. (Exhibit No.30 statement O page 6 of 8 and Exhibit No. 31 statement O page 6 of 8.)

98. Southwest allocates the increased cost of operations to the various customer classes while giving consideration to the rate of return contributed by the various customer classes. If a customer class provided a rate of return in excess of the system average it was allocated a smaller level of the system revenue deficiency than customer classes that were not earning the average system rate of return. Southwest contends, that while the various customer classes gradually move toward the system average rate of return, all customers share in the increased costs of operation. Southwest opines that the embedded class cost of service study

should be used as a guide in the development of rates. (Exhibit No. 26, p. 6 and 7 and Exhibit No. 27, p. 22.)

Staff

99. Staff agrees with Southwest that a gradual change in rates is more reasonable than a significant change in rates. Thus, Staff recommends that the Commission accept Southwest's margin deficiency allocation methodology. (Exhibit No. 11, p. 5 and Transcript Volume I at 148 and 149.)

BCP

100. While BCP did not directly address this issue, BCP supports the concept of gradualism, as indicated by its expressed concern of rate stability and rate continuity. Further, BCP notes that a significant number of regulatory commissions use the class cost of service as a guide. (Exhibit No. 13, p. 28 and Transcript Volume I at 84 and 85.)

AFL-CIO

101. AFL-CIO agrees with Southwest that a cost of service study should be used as a guide and that gradualism while "not proposing any mathematical exactitude" is the appropriate movement towards equalized rates of return between customer classes. (Exhibit No. 16, p. 32.)

NEBG

102. While supporting the concept of gradualism in rate design, NEBG believes that the southern Nevada large general service customer class's payment of \$4.2 million in inter-class subsidies is excessive and should be reduced by half, considering that the total estimated margin at the proposed system average rate of return is \$3.5 million. (Exhibit No. 19, p. 3 and 4, Transcript Volume I at 140.)

Commission Discussion and Findings

103. Southwest's proposed margin deficiency allocation promotes the rate design concept of gradualism and recognizes that the cost of service study is but one tool the Commission uses in the development of rates. Implementation of NEBG's recommendation would subject the classes with rate of returns in excess of the system average to a disproportionate increase. The Commission believes that in this instance all parties should participate in the rate increase. However, the Commission notes that the increase to the typical large commercial customer is less than 1.5 percent (Exhibit No. 26, p. 7). Further, the marginal cost of service study ordered by the Commission will reflect what the actual cost allocation should be for the large commercial customers.

104. The Commission finds that Southwest's methodology used to allocate costs to large service customers is appropriate.

Customer Charge

Position of the Parties

Southwest

105. Southwest proposes to change the monthly customer charge for the residential, medium general service, master-meter mobile home park, and the water pumping customer classes. Southwest notes that an increase in the monthly customer charge will enhance its revenue stability and better match the fixed costs associated with the cost of providing gas service. Southwest opines that its proposed customer charge comports with the National Association of Regulatory Utility Commissioners's "customer-only" accounts method for designing the monthly customer charge. (Exhibit No. 7, p. 21 through 23 and Transcript Volume I at 38.)

106. While the residential customer monthly charge in northern Nevada should be greater than that for southern Nevada, Southwest proposes that the same rate be applied in the two areas to maintain consistency between the two divisions. In addition, Southwest notes that an increase in the monthly customer charge provides greater stability in customers' energy bills. (Exhibit No. 7, p. 22 and Transcript Volume I at 38.)

107. Regarding the revenue requirement stipulation in this proceeding, Southwest has not changed its request to modify the monthly customer charge rates (e.g., raise the residential rate from \$6 to \$10 per month) as Southwest still believes the rates are cost based. Further, Southwest notes that the increase in monthly customer charge would help protect consumers against the effects of colder than normal weather. (Exhibit No. 26, p. 8 and Transcript Volume I at 26 and 27.)

108. Southwest acknowledges that its proposed changes in the monthly customer charge will increase that category of revenues in southern Nevada by \$20.6 million while the total stipulated increase in southern Nevada is \$13.5 million. The difference in revenues will come from a reduction in the current commodity rates. In northern Nevada the increase in the monthly customer charge is \$3.5 million while the stipulated revenue increase is \$5.9 million. The northern Nevada increase in the customer charge is approximately 59 percent of the stipulated increase in revenues. (Transcript Volume I at 26 through 29 and Exhibit No. 11, Attachment AMB-4.)

109. Under cross-examination by Commissioner McIntire, Southwest acknowledged that its rate design proposal would cause a large swing in rates within a customer class. Southwest states that this could be addressed by moving towards cost based rates on a gradual basis and acknowledges that this was proposed by Staff. (Transcript Volume I at 49 and 50.)

110. Southwest acknowledges that implementation of its proposed rate design during the winter could create the potential for Southwest to receive revenues in excess of that assumed in its rate design. The potential transitional problem caused by the current rate design, which is more commodity oriented, weights cost recovery to the winter period whereas the proposed rate design, which is more a fixed charge oriented, shifts more costs to the non-winter months for recovery. Assuming the sales presumed by Southwest, the implementation of the new rate design during the transitional period could result in an over-recovery in the millions of dollars. (Transcript Volume I at 32 through 34 and Exhibit No. 25.)

Staff

111. While Staff agrees that an increase in the monthly customer charge would increase Southwest's revenue stability, Staff recommends that the Commission limit any increase in the monthly customer charge to a rate slightly greater than the overall requested revenue increase. Staff's proposed method implements a more gradual approach than Southwest's. Specifically, Staff recommends a maximum increase of 33 percent in the customer charge, the overall requested revenue increase for southern Nevada and northern Nevada is 22 percent and 32 percent, respectively. (Exhibit No. 11, p. 1, 6, and 7 and Exhibit No. 30 Statement O sheet 6 of 8 and Exhibit No. 31 Statement O sheet 6 of 8.)

112. Further, Staff's proposed monthly customer charge is a reasonable rate to recover the customer costs as adjusted by Staff to reflect its proposed distribution main allocation methodology and Staff's lower anticipated rate of return. (Transcript Volume I at 148.)

BCP

113. BCP recommends that the Commission not change the monthly residential customer charge. The monthly customer charge should reflect the costs that would be avoided if

the customer were to leave the system, variable operating and maintenance expenses. Since the current \$6.00 per month residential customer charge exceeds the southern Nevada residential customer's avoided costs of \$4.21 and is about equal to that for the northern Nevada residential customer's avoided costs of \$6.26, BCP recommends that the Commission not change the monthly customer charge. (Exhibit No. 13, p. 27 and Attachment RAG-3.)

AFL-CIO

114. AFL-CIO recommends that the Commission not increase the monthly residential customer charge. Based upon its adjustments to Southwest's cost of service study, AFL-CIO states that little or no increase in the monthly residential customer charge is warranted, since the monthly residential customer costs for southern Nevada and northern Nevada are \$6.23 and approximately \$9.00 per month. AFL-CIO notes that Southwest's increase in the monthly customer charge reduces the variability in its revenues caused by weather and changes in consumption. (Exhibit No. 16, p. 35, 36, 42, 43.)

Commission Discussion and Findings

115. Southwest's proposal to increase the monthly customer charge would increase its revenue stability and provide the consumer with energy cost stability.

116. No Party disagrees with Southwest's request to continue to apply the same monthly residential customer charge in southern and northern Nevada even though various parties' own analyses indicated different costs for the two operations.

117. The Commission's acceptance of Staff's proposed 50/50 customer and peak day demand split of distribution mains, which account for 41 percent of net plant in southern and 43 percent of plant in northern Nevada (Exhibit No. 11, p. 2) would significantly reduce the monthly residential customer costs.

118. The Commission-approved stipulated revenue requirement decreases monthly customer costs. The Commission approved a stipulated revenue requirement that was less than Southwest's requested amount thus reducing the total costs to be allocated in the cost of service study. The Commission authorized revenue requirement was \$7 million, or 6.1 percent less in the south and \$1.8 million, or 5.2 percent less in the north. (Exhibit No. 1 Exhibit I sheets 3 and 7 of 8, Exhibit 30 Schedule N-2 sheet 4 of 4, and Exhibit 30 Schedule N-2 sheet 4 of 4.)

119. Staff's proposal to increase the customer charge to a maximum of 33 percent of the existing rate implements the concept of gradualism in the movement of rates to cost of service based rates when a significant difference exists between the rate and the actual cost of service.

120. Southwest acknowledges that its proposed increase in the monthly customer charge would cause a significant swing in bills within a customer class.

121. As indicated earlier in this order, the parties including Southwest promote a gradual change in rates when the rate may be significantly different than that indicated by the cost of service study.

122. BCP's proposal to limit the costs to be considered in the calculation of the monthly residential customer charges to those avoided if the customer were not to take service (i.e., variable operation and maintenance expenses) is unreasonable since it ignores the fact that significant fixed costs are incurred to serve the customer.

123. Since the AFL-CIO recommendation for no change in the residential customer charge is based upon significant changes to the cost of service study which the Commission rejected, this recommendation is also inappropriate.

124. Based upon the forgoing, the Commission finds that Staff's proposal to limit the increase to the monthly customer charge to 33 percent should be accepted, resulting in an increase to the residential customer charge of \$2.00. Further, the Commission finds that Southwest's request to apply the same residential monthly customer charge in both northern and southern Nevada is reasonable.

Declining Block Rates

Position of the Parties

Southwest

125. Southwest requests authorization to implement declining block rates in northern Nevada for residential service and to expand its application in southern Nevada to include the winter season. The first tier of the block consumption is calculated separately for northern Nevada and southern Nevada and for the summer and winter seasons. The first tier block consumption equals that division's average residential consumption. The rate to be applied to the second tier consumption in southern Nevada is the existing approved summer season rate of \$0.15605 per therm and will be applied to all second tier consumption regardless of the season. In northern Nevada, the second tier rate would be developed to include the same difference between the two tiers as that existing in southern Nevada. Southwest states that its declining block rate design recovers, to the maximum extent possible, the fixed costs for the provision of service to the residential customer class from non-usage sensitive rate design components. (Exhibit No. 7, p. 16 through 18. and Transcript Volume I at 54 and 55.)

126. Southwest notes that its proposed two-tier rate design aids in the stabilization of a residential customer's energy bill and Southwest's revenues. (Transcript Volume 1 at 54.)

Further, Southwest notes that its proposed two-tier rate design mitigates a residential customer's exposure to colder than normal weather. (Exhibit No. 26, p. 5 and 6.)

127. In addition, Southwest represents that the Arizona Commission recently reaffirmed Southwest's declining block rate design, stating that abandoning the declining block rate design may lead consumers toward increased electricity usage which would impose upon the state the detrimental externalities associated with the incremental generation. (Exhibit No. 26, p. 5)

128. Southwest notes that the AFL-CIO's arguments for an increase in variable rates ignores the fixed nature of the costs associated with the provision of service to the residential customer class. (Exhibit No. 26, p. 4.)

129. Regarding conservation, Southwest opines that its proposed two-tier declining block rate design does not impede energy efficiency and conservation in that it provides for economic efficiency. (Transcript Volume II at 24.)

Staff

130. Staff recommends that the Commission accept Southwest's proposed declining block rate design. However, that recommendation is predicated upon the basis that Southwest use both a Commission approved revenue requirement and cost of service study. (Exhibit No. 11, p. 5 and Transcript Volume I at 149.)

131. In response to Commissioner McIntire's questions, Staff explained that, lacking an explicit conservation goal, it supported the proposed declining block rate design as it will temper seasonal changes, and it provides the proper price signal. Further, Staff notes that the smoothing out of seasonal variations would provide a measure of benefit to those consumers who

are unable to change their circumstances, for example renters, while still providing the appropriate price signal. (Transcript Volume I at 150, through 153.)

BCP

132. BCP recommends that the Commission deny Southwest's implementation of the proposed declining block rate design in northern Nevada and its expansion of the declining block rate design in southern Nevada to the winter season. BCP notes that Southwest's cost of service studies contained no information supporting their proposal. (Exhibit No. 13, p. 29 and Transcript Volume I at 77, 78 and 98.)

AFL-CIO

133. AFL-CIO recommends the Commission deny Southwest's proposal to implement declining block rate design in northern Nevada and its proposed expansion to the winter season in southern Nevada. AFL-CIO argues that the use of a declining block rate design does not encourage conservation. AFL-CIO is particularly opposed to winter declining block rate design due to its disproportionate impact upon "apartment dwellers". (Exhibit No. 16, p. 39 through 42, and Transcript Volume I at 125.) However, AFL-CIO did note that the use of declining block rate design enhances revenue stability. (Exhibit No. 16, p. 43 and Transcript Volume I at 127.)

NEBG

134. NEBG did not address this issue.

Commission Discussion and Findings

135. Implementation of the declining block rate design with the second tier rate, the lower rate, being applied to above average residential customer consumption would increase Southwest's revenue stability. Also, implementation of the proposed declining block rate design could temper seasonal variations, thus enhancing a customers' energy stability and providing a

proper price signal. However, Southwest does not provide cost justification for the second tier rates. The second tier rates are based upon the southern Nevada division's existing summer second tier rate. Without proper cost justification, the Commission is unable to ascertain the reasonableness of the proposed tiered rates.

136. Due to the lack of cost justification, the Commission finds that Southwest's request to expand the block rate design to the winter season in the south and to both seasons in the north is inappropriate. However, the Commission finds that expansion of the winter season to include April is reasonable.

THEREFORE, based on the foregoing findings of fact and conclusions of law, it is hereby ORDERED that:

1. The Application of Southwest Gas Corporation, designated as Docket No. 01-7023, is APPROVED with regard to cost allocation and rate design in accordance with the findings contained in this Order.

//
//
//
//
//
//
//
//
//
//

2. The Commission retains jurisdiction for the purpose of correcting any errors that may have occurred in the drafting or issuance of this Order.

By the Commission,

DONALD L. SODERBERG, Chairman

RICHARD M. MCINTIRE, Commissioner

ADRIANA ESCOBAR CHANOS, Commissioner
and Presiding Officer

Attest: _____
CRYSTAL JACKSON, Commission Secretary

Dated: Carson City, Nevada

1/25/02
(SEAL)