

Decision 99-02-086 February 18, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHWEST GAS CORPORATION for the Issuance of a Limited Exemption from the Affiliate Transaction Rules Adopted in D.97-12-088. (U-905-G)

Application 98-02-024
(Filed February 18, 1998)

OPINION ON SOUTHWEST GAS CORPORATION'S APPLICATION FOR A LIMITED EXEMPTION FROM THE AFFILIATE TRANSACTION RULES

Summary

By this application, Southwest Gas Corporation (Southwest Gas) seeks a limited exemption from the Commission's Affiliate Transaction Rules, adopted in Decision (D.) 97-12-088, and modified in D.97-08-035. This decision grants the application in part, and denies it in part.

Background

On February 18, 1998, Southwestern Gas filed this application which is unopposed. Southwest is a multi-state public utility the operations of which include intrastate transmission, distribution, and sale of natural gas in certain portions of California, Arizona, and Nevada pursuant to certificates of public convenience and necessity issued by the respective states' commissions. Within California, Southwest Gas provides natural gas distribution service to approximately 115,000 customers in portions of San Bernardino, Placer, Nevada, and El Dorado Counties.

Additionally, Southwest Gas conducts various regulated and non-utility operations through certain affiliate entities and wholly owned subsidiaries within

several states. Southwest Gas has provided a list of these entities in its application which is discussed more fully below.

Southwest Gas controls or operates two interstate pipeline affiliates which it states are considered "natural gas companies" within the meaning of the Natural Gas Act, subject to the jurisdiction of the Federal Energy Regulatory Commission (FERC). These interstate pipelines themselves own and operate transmission facilities for the transportation of natural gas into the Southwest Gas northern California and Nevada distribution systems.

The Requested Exemptions

The Affiliate Transaction Rules permit the utilities to apply for certain exemptions under defined circumstances. First, not every utility's affiliate is covered by the Rules. Therefore, the Rules adopt the common-sense observation that to the extent the utility does not have an affiliate as defined by the Rules, the Rules do not apply to that utility. (D.97-12-088, *slip op.* at 20.)

Rule II.G addresses this particular exemption. Rule II.G provides that a Commission-jurisdictional utility may be exempted from the Rules if it files an advice letter requesting the exemption. The utility is to make the advice letter filing within 30 days of the effective date of D.97-12-088 and should attest in the advice letter filing that: (1) no affiliate of the utility provides services as defined by Rule II.B of the Rules; and (2) the utility shall notify the Commission as provided by Rule II.G if it subsequently creates an affiliate covered by the Rules, and that it would agree in this notice to comply with the Rules.

Rule II.H also provides for a separate limited exemption for California utilities which are also multi-state utilities. Rule II.H states:

"Limited Exemption (Application): A California utility which is also a multi-state utility and subject to the jurisdiction of other state regulatory commissions, may file an application, served on all

parties to this proceeding, requesting a limited exemption from these Rules or a part thereof, for transactions between the utility solely in its capacity serving its jurisdictional areas wholly outside of California, and its affiliates. The applicant has the burden of proof.”

In D.97-12-088, *slip op.* at 19, we explained the rationale behind this limited exemption.

“As we state elsewhere in this decision, we are regulating the California utility here, not the affiliate. However, we recognize that in the case of a California utility which is also a multi-state utility and subject to the jurisdiction of other state commissions, the corporate structure of the utility may not be such that utility activities conducted wholly outside of California are separated into a separate corporate entity. Therefore, we provide that such a multi-state utility that is covered by these rules may file an application, served on all parties to this proceeding, requesting a limited exemption from these rules or a part thereof, for transactions between the utility solely in its capacity serving its jurisdictional areas wholly outside of California, and its affiliates. The applicant has the burden of proof. We stress that this is an opportunity for a limited, not wholesale, exemption to these rules.”

The Southwestern Gas application contains requests for exemptions under both Rules II.G and H, even though only requests for exemption pursuant to Rule II.H were to be filed by application. We note that Southwest Gas has also filed a timely advice letter (Advice Letter No. 564) requesting the same exemptions as requested by this application. For simplicity, we also address the Southwest Gas requests for exemption in Advice Letter 564 in this application, primarily because these requests are interrelated and overlap with the requests in this application.¹

¹ Southwest Gas has also filed Advice Letter No. 562 and 562 A which the Commission will address separately.

Southwest Gas states that the following affiliates are not engaged in the provision of a product that uses gas or the provision of services that relate to the use of gas, and are therefore outside the scope of the Affiliate Transaction Rules. (See Rule II.B.) These affiliates include the following:

- **Carson Water Company-** Southwest Gas states that this wholly owned affiliate of Southwest Gas operates as a land holding company and is not engaged in providing the type of energy products and services as set forth in Rule II.B. Southwest Gas also states that Carson Water does not conduct business operations or transactions with Southwest Gas or any third party within California.

- **Pataya Storage Company-** Southwest Gas states that this wholly owned subsidiary of Southwest Gas was initially formed to potentially own and operate a natural gas storage facility in Arizona. This project never materialized, and Pataya Storage remains an inactive corporate affiliate that is currently not engaged in any transactions with Southwest Gas or other third parties either within or outside of California.

- **Pataya Partnership-** Southwest Gas states that this company is a legal partnership controlled by Southwest Gas. This partnership was formed to develop natural gas storage facilities simultaneously with Pataya Storage. However, similar to Pataya Storage, this affiliate is inactive and is not currently engaged in any transaction with Southwest Gas or any other third party either within or outside of California.

- **Southwest Administrators-** Southwest Gas states that Southwest Administrators is a wholly owned subsidiary of Southwest Gas. Southwest Administrators is engaged in non-energy related marketing, non-utility water sales and in providing an insurance claim processing service. Southwest Gas

states that Southwest Administrators does not engage in any business activity or transaction identified by Rule II.B.

- **The Southwest Companies-** Southwest Gas states that Southwest Companies is a wholly owned corporate subsidiary holding company organized for the limited purpose of temporary possession of certain real estate subsidiaries retained after the sale of the prior financial subsidiary of Southwest Gas, the PriMerit Bank, including First Nevada Ltd. Southwest Gas states that none of these real estate venture subsidiaries have material assets remaining to liquidate, nor does Southwest Companies or its subsidiaries provide the type of products or services identified by Rule II.B as applicable to natural gas utility affiliates.

- **Southwest Gas Capital I-** Southwest Gas states that Southwest Gas Capital I is a wholly owned subsidiary trust of Southwest Gas formed solely to issue preferred securities and to invest proceeds in an equivalent amount of subordinated debt of Southwest Gas. Southwest Gas states that the sole assets of Southwest Gas Capital I are and will be certain subordinated notes, and that Southwest Gas Capital I does not provide the type of products or services identified by Rule II.B as applicable to natural gas utility affiliates.

- **Utility Financial Corporation-** Southwest Gas states that Utility Financial Corporation is a wholly owned subsidiary of Southwest Gas providing financing for the purchase, implementation, and installation of cogeneration systems and equipment. Southwest Gas states that Utility Financial Corporation currently has investments in two Arizona cogeneration projects, and that this subsidiary does not provide the type of products or services identified by Rule II.B as applicable to natural gas utility affiliates. Furthermore, this subsidiary does not conduct business operations or transactions within California.

- **Utility Partners, LC-** Southwest Gas states that Utility Partners, LC is a limited liability company that is an affiliate of Southwest Gas by way of a 40%

equity ownership. Southwest Gas states that Utility Partners, LC is involved in developing various computer software and does not directly or indirectly provide the type of products or services identified by Rule II.B.

Because the Southwest Gas verified application states that the above affiliates do not directly or indirectly provide the type of products or services identified by Rule II.B, and because some of these affiliates operate entirely outside of California and Southwest Gas is a multi-state utility, pursuant to Rule II.G and II.H, Southwest Gas is exempt from operation of the Affiliate Transaction Rules for transactions between itself and the above-listed affiliates, on the condition that it comply with Rule II.G.2 if the operations of any of the above affiliates, or any other circumstances, change from the information provided by Southwest Gas in this application.

Southwest Gas also believes that it should be exempted from the Affiliate Transaction Rules between itself and Northern Pipeline Construction Company (NPL). We do not agree. Southwest Gas states that NPL is a wholly owned subsidiary, and is a general construction contractor not engaged in the marketing of energy products or services delineated in D.97-12-088. Southwest Gas states that NPL is not involved in the distribution, sale, or marketing of natural gas, nor does it engage in a related business operation associated with any service appliances function or product that directly uses or consumes natural gas. Southwest Gas states that NPL provides the services of a full-service general contractor for construction projects that require specialized experience with underground facilities, including the trenching and installation, replacement, and maintenance of pipeline distribution systems. NPL contracts primarily with local distribution companies to install, repair, and maintain energy distribution systems from the town border stations to their end-use meter stations.

Rule II.B provides that the Rules apply to all utility transactions with affiliates engaging in the provision of services that relate to the use of gas. In D.98-07-031, which addressed an application by Southwest Gas to modify the terms and conditions of the certificate of public convenience and necessity granted in D.95-04-075, to provide natural gas service in El Dorado, Nevada, and Placer Counties in California, the Commission stated with respect to certain cost overruns:

"The cost overruns alleged in the application have not been investigated to determine whether they were reasonably incurred. It is not known if they were the result of changes in governmental regulations, or unforeseen changes in construction practices, or excusable clerical errors in excess of the 10% contingency, or simply errors in Southwest's judgment. It is not known what level of profit, if any, was made by Southwest's wholly owned subsidiary construction firm which received millions in revenue from the expansion project to date." (D.98-07-031, *slip op.* at 14-15.)

D.98-07-031 does not state the name of the Southwest Gas wholly owned subsidiary construction firm. Since NPL is the only listed affiliate of Southwest Gas that most closely meets the description of the affiliate described in D.98-07-031, and since Southwest Gas has listed all of its affiliates in this application, it appears that NPL is providing construction service in the service territory of Southwest Gas, so that Southwest Gas itself can provide natural gas service. As such, it falls within the definition of Rule II.B (engaging in the provision of services that relates to the use of gas), and transactions between Southwest Gas and this affiliate are not exempted from our Affiliate Transaction Rules.

Southwest Gas also requests an exemption for LNG Energy, Inc. (LNGE) due to the Southwest Gas multi-utility status. Southwest Gas states that LNGE is a subsidiary engaged in the business of marketing liquefied natural gas as an

alternative energy source to small communities or for industrial and commercial applications. LNGE's underlying purpose is to provide an energy source to customers located in geographic areas that cannot and will not be provided basic natural gas distribution service from Southwest Gas or any other local distribution company. LNGE also provides liquefied natural gas supplies for fuel use in self-propelled vehicles that is considered "Vehicular Natural Gas" as defined by 15 U.S.C. § 717(a)(10). Southwest Gas states that the operations relating to the marketing of Vehicular Natural Gas are exempt from federal and state economic regulation pursuant to 15 U.S.C. § 717(d).

Southwest Gas states that LNGE is currently involved in only small and minor business operations within California. LNGE has delivered liquefied natural gas to three separate commercial customers in California, including one client using Vehicular Natural Gas for a motor vehicle fleet. LNGE transacts business exclusively with third-party customers and has never conducted energy service transactions with the Southwest Gas natural gas operations in California or any other state. Because Southwest Gas does not conduct any energy marketing transactions with LNGE either inside or outside of California, and because the affiliate has a limited presence in California, Southwest Gas believes it should be exempted from our rules.

Southwest Gas has not made a case for a full exemption from our rules for this affiliate. LNGE provides marketing services that relate to the use of gas in California. The point is not that LNGE does not conduct any energy marketing transactions with Southwest Gas. The rules are applicable to all transactions between Southwest Gas and an affiliate such as LNGE, that provides services that relate to the use of gas in California.

In D.97-12-088, we recognized that in the case of a California utility which is also a multi-state utility and subject to the jurisdiction of other state

commissions, the corporate structure of the utility may not be such that utility activities conducted wholly outside of California are separated into a separate corporate entity. Therefore, we provided that such a multi-state utility could request a limited exemption from these Rules or a part thereof, for transactions between the utility solely in its capacity serving its jurisdictional areas wholly outside of California, and its affiliates. However, this opportunity for an exemption was to be narrow, and did not necessarily encompass both activities within and outside of California. Southwest Gas has not narrowly tailored its requested exemption to encompass activities of LNGE solely outside of California. Therefore, its requested exemption for transactions between Southwest Gas and LNGE is denied.²

Southwest Gas also requests exemptions for Southwest Gas Transmission Company (SGTC) and Paiute Pipeline Company (Paiute). Southwest Gas owns or controls 100% of SGTC, which is a FERC jurisdictional interstate pipeline that owns an 8.9-mile pipeline which transports natural gas from an interconnection with El Paso Natural Gas Company's facilities to the Southwest Gas southern Nevada distribution system that serves the Las Vegas, Nevada area. El Paso operates and maintains the pipeline. Southwest Gas states that SGTC is subject to FERC's exclusive jurisdiction and does not conduct any business activity or transactions within California.

We do not agree with Southwest Gas that FERC's jurisdiction over SGTC precludes the application of the Affiliate Transaction Rules to Southwest Gas with respect to its transactions with SGTC. However, pursuant to Rule II.H, we

² Southwest Gas argues that 15 U.S.C. § 717(d) prevents us from economic regulation of LNGE. However, under the Affiliate Transaction Rules, we regulate the utility, not the affiliate.

exempt transactions between Southwest Gas and SGTC from the Affiliate Transaction Rules because Southwest Gas is a multi-state utility, and SGTC does not conduct any business activity or transactions within California. If the operations of SGTC, or any other circumstances change from the information provided by Southwest Gas in this application, Southwest Gas should file a Petition for Modification of this decision justifying why the exemption we grant today should be continued under the new set of circumstances.

Southwest Gas also addresses its transactions with Paiute, an interstate pipeline affiliate which provides interstate natural gas transportation service to, *inter alia*, WP Natural Gas for its local distribution company resale operations in South Lake Tahoe, California, and to Southwest Gas, for its local distribution company resale operations in North Lake Tahoe and in Truckee, California. Southwest Gas believes these transactions should be exempted from our Rules. Southwest Gas so argues, on the grounds that (1) all natural gas transportation transactions, and the information exchanged between Southwest and Paiute relating to such transactions, are governed by FERC's standard of conduct for interstate pipelines with marketing affiliates (18 C.F.R. § 161), and (2) Paiute is governed and controlled by a specific list of Operating and Structure Guidelines included with Paiute's formal certification order issued by FERC.

We do not grant the Southwest Gas requested exemption based on FERC's standards of conduct for interstate pipelines with marketing affiliates, which are not specific to the Southwest Gas affiliate but apply to all interstate natural gas pipelines that transport natural gas for others under defined circumstances. In D.97-12-088, *slip op.* at 22, we recognized that other utilities argued that we should exempt FERC-regulated affiliates from the ambit of the Rules. These parties argued that FERC has established standards of conduct for these affiliates, and further regulation is unnecessary, and that the information disclosure

standards adopted in the Rules would interfere with the flow of information to the pipeline necessary to transport natural gas.

In D.97-12-088, we did not adopt that requested exemption. We clarified that the standards of conduct adopted apply to the Commission-regulated utility, not to the FERC-regulated pipeline. We also adopted an exemption in Rule II.D to allow the utility to exchange certain operating information with these affiliates without the necessity of disclosure in Rule II.D.

Southwest Gas also argues that it should be exempt from the Rules with respect to its transactions with Paiute because FERC has adopted additional case-specific standards of conduct controlling the interrelationship between Southwest Gas and Paiute, and that these procedures have the preemptive effect of controlling the following types of relationships and transactions between Southwest and Paiute: (1) disclosure of information; (2) access to transportation capacity; (3) non-discriminatory application of transportation service; (4) rate discounts; (5) exchange of information between operating personnel; (6) joint support services; and (7) shared corporate officers.

Paiute's formal certification order which FERC issued did not mandate these standards, but merely permitted a set of guidelines governing the relationship between Paiute and Southwest Gas, which guidelines were part of a settlement. As such, these guidelines do not have a "preemptive effect." However, under the guidelines,

"Paiute will not disclose to Southwest any third-party requests for transportation; Paiute will apply its tariff in a uniform manner to affiliates and non-affiliates; and Paiute's determinations of transportation rate discounts will be made independently of Southwest. The guidelines provide that Southwest will perform 'umbrella' functions for Paiute in such areas as accounting, administration, engineering, construction, financing, legal, rates and regulatory affairs, pipeline operations, and gas supply. Further, Southwest and Paiute will share corporate officers such as President,

Secretary, and Treasurer, and Paiute's Vice President-General Manager will report to Southwest's Executive Vice President, 'who may initiate coordination between the companies for the purpose of efficient and economic operation.'" (43 FERC ¶61,257 at 61,707.)

Given the facts that Southwest Gas is a multi-state utility, that Paiute has a small presence in California, and given the guidelines set forth above which are permitted by FERC, we exempt the Southwest Gas transactions with Paiute from our Affiliate Transaction Rules. However, if the operations of Pauite, or any other circumstances change from the information provided by Southwest Gas in this application, Southwest Gas should file a Petition for Modification of this decision justifying why the exemption we grant today should be continued under the new set of circumstances.

In Resolution ALJ 176-2998, dated March 12, 1998, the Commission preliminarily categorized this proceeding as ratesetting, and preliminarily determined that hearings were not necessary. No protests have been received. Given this status, a public hearing is not necessary, nor is it necessary to alter the preliminary determination in ALJ 176-2998.

Public Utilities (PU) Code § 311(g)(1) provides that this decision must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. The draft decision of ALJ Econome in this matter was mailed to the parties and to the service list of the Affiliate Transaction proceeding, R.97-04-011, I.97-04-012 in accordance with PU Code § 311(g) and Rule 77.1 of the Rules of Practice and Procedure. No parties filed timely comments.

Findings of Fact

1. The Affiliate Transaction Rules permit the utilities to apply for certain exemptions under defined circumstances.

2. For simplicity, we also address the Southwest Gas requests for exemption in Advice Letter 564 in this application, primarily because these requests are interrelated and overlap with the requests in this application.

3. Southwest Gas is a multi-state utility subject to the jurisdiction of other state regulatory commissions as well as to this Commission's jurisdiction.

4. The Southwest Gas application states and verifies that the following affiliates do not directly or indirectly provide the type of products or services identified by Rule II.B, and some of these affiliates operate entirely outside of California: Carson Water Company; Pataya Storage Company; Pataya Partnership; Southwest Administrators; The Southwest Companies; Southwest Gas Capital I; Utility Financial Corporation; Utility Partners, LC.

5. NPL is providing construction service in the Southwest Gas service territory, so that Southwest Gas itself can provide natural gas service. As such, it falls within the definition of Rule II.B (engaging in the provision of services that relates to the use of gas).

6. LNGE provides marketing services that relate to the use of gas in California. Southwest Gas has not narrowly tailored its requested exemption for LNGE to encompass activities of LNGE solely outside of California, as required by D.97-12-088.

7. SGTC does not conduct any business activity or transactions within California.

8. Paiute has a small presence in California, and FERC has permitted a set of guidelines governing the relationship between Paiute and Southwest Gas.

Conclusions of Law

1. Pursuant to Rules II.G and II.H of the Affiliate Transaction Rules as set forth in D.97-12-088, as modified by D.98-08-035, Southwest Gas should be exempt from the operation of the Affiliate Transaction Rules between itself and

the following affiliates, on the condition that it comply with Rule II.G if the operations of any of the listed affiliates, or any other circumstances, change from the information provided by Southwest Gas in this application: Carson Water Company; Pataya Storage Company; Pataya Partnership; Southwest Administrators; The Southwest Companies; Southwest Gas Capital I; Utility Financial Corporation; Utility Partners, LC.

2. Transactions between Southwest Gas and NPL, and Southwest Gas and LNGE, should not be exempted from our Affiliate Transaction Rules.

3. Pursuant to Rule II.H, transactions between Southwest Gas and SGTC, and Southwest Gas and Paiute should be exempted from the Affiliate Transaction Rules. If the operations of SGTC or Paiute, or any other circumstances change from the information provided by Southwest Gas in this application, Southwest Gas should file a Petition for Modification of this decision justifying why the exemption we grant today should be continued under the new set of circumstances.

4. This proceeding is designated a ratesetting proceeding; no protests have been received. No hearing is necessary.

O R D E R

IT IS ORDERED that:

1. The Southwest Gas Corporation (Southwest Gas) application for the issuance of a limited exemption from the Affiliate Transaction Rules as set forth in Decision (D.) 97-12-088, as modified by D.98-08-035, is granted in part and denied in part, as more fully set forth in the following ordering paragraphs.

2. Pursuant to Rules II.G and II.H of the Affiliate Transaction Rules, Southwest Gas is exempt from the operation of the Affiliate Transaction Rules between itself and the following affiliates, on the condition that it comply with

Rule II.G if the operations of any of the listed affiliates, or any other circumstances, change from the information provided by Southwest Gas in this application: Carson Water Company; Pataya Storage Company; Pataya Partnership; Southwest Administrators; The Southwest Companies; Southwest Gas Capital I; Utility Financial Corporation; Utility Partners, LC.

3. Transactions between Southwest Gas and Northern Pipeline Construction Company, and Southwest Gas and LNG Energy Inc. are not exempted from our Affiliate Transaction Rules.

4. Pursuant to Rule II.H, transactions between Southwest Gas and Southwest Gas Transmission Company (SGTC), and Southwest Gas and Paiute Pipeline Company (Paiute), are exempted from the Affiliate Transaction Rules. If the operations of SGTC or Paiute, or any other circumstances change from the information provided by Southwest Gas in this application, Southwest Gas shall file a Petition for Modification of this decision justifying why the exemption we grant today should be continued under the new set of circumstances.

5. This proceeding is closed.

This order is effective today.

Dated February 18, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners