

**REPORT TO THE  
ARIZONA CORPORATION COMMISSION**

**IN THE MATTER OF THE COMPETITION  
IN THE PROVISION OF ELECTRIC SERVICE  
THROUGHOUT THE STATE OF ARIZONA**

**DOCKET NO. U-0000-94-165**

**Submitted By**

**The Legal Issues Working Group**

**September 30, 1997**

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Exhibit A Maricopa County Superior Court Cases Involving Electric Restructuring

Appendix A List of Working Group Participants

Appendix B Chronology of Group Process

Appendix C Special Open Meeting Minutes

Appendix D Comments of Participants

**ARIZONA CORPORATION COMMISSION'S  
ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP  
EXECUTIVE SUMMARY**

**INTRODUCTION**

The following summarizes the attached final report of the Commission's Legal Issues Working Group (the "Working Group" or "group"). Appendix A is a list of the members of the Working Group.

Working Group participants prepared the report through a series of drafts compiled from oral comments at public meetings and from written comments from the participants. These participants are largely responsible for the focus and content of the final report.

The Working Group designated participants ("Reporters") to collect written comments and contributions from participants. The Working Group assigned Reporters by subject-matter and the Reporters incorporated material into a report format. The Reporters' work was collected into a single draft report and participants were given an opportunity to suggest changes and additional material for the final report. The Reporters are responsible for the balance and comprehensive nature of the work in the final report.

The Working Group's Reporters are as follows:

<b>Steven M. Wheeler</b>	<b><i>Nature of Restructuring in General and Stranded Cost Recovery.</i></b>
<b>Bradley S. Carroll</b>	<b><i>Rights and Duties of Public Service Corporations and Antitrust Issues</i></b>
<b>Lawrence V. Robertson, Jr.</b>	<b><i>Scope of Restructuring</i></b>
<b>Beth Ann Burns</b>	<b><i>Rates and Ratemaking</i></b>
<b>C. Webb Crockett</b>	<b><i>ACC Powers/Procedures</i></b>
<b>Jessica J. Youle</b>	<b><i>Non-PSC Issues</i></b>
<b>Patricia E. Cooper</b>	<b><i>FERC Issues and Federal Issues</i></b>
<b>Douglas C. Nelson</b>	<b><i>Taxation Issues</i></b>
<b>Michael M. Grant</b>	<b><i>Legislative Issues</i></b>

The Legal Division excised incorrect or redundant material from the draft and further summarized the Reporters' comments. Participants were given opportunity to comment on a second and third draft of the report. A chronology of the group's activities is attached to the Report as Appendix B. The minutes of the group's meetings are collected in Appendix C.

The report consists of Nine Parts, representing issues that the Working Group identified. The Working Group did not identify legal issues that may affect the matters discussed in the reports of other working groups involved in electric restructuring.

The attached Appendix D contains participants' separate comments regarding the Report.

### **PART 1: SCOPE OF THE COMMISSION'S AUTHORITY**

This part summarizes the legal arguments for and against the Commission's power to adopt the Rules. Part 1.2 contains comments for the Commission to consider in addressing electric utilities' obligations to serve customers in a competitive environment.

### **PART 2: RATES AND RATEMAKING**

This part identifies legal issues relating to cost allocation and confidentiality of information under competition.

### **PART 3: STRANDED COST RECOVERY**

This part identifies the issues to be decided in a stranded cost proceeding. It also identifies standards in the Rules that certain Affected Utilities have challenged as unreasonably vague. This part identifies legal arguments that may affect stranded cost recovery mechanisms and stranded cost "true up" proceedings.

### **PART 4: ACC POWERS/PROCEDURES**

This part identifies procedural issues that the Commission may face with respect to stranded costs, affiliated interests, non-public service corporations, antitrust, intergovernmental agreements, in-state reciprocity, and resource planning.

### **PART 5: NON-PSCs**

This part discusses the various entities that operate as public service corporations outside the Commission's jurisdiction. The part discusses the laws that affect the relationships between these entities and public service corporations.

## **PART 6: FERC ISSUES**

This part identifies the exclusive powers of the Federal Energy Regulatory Commission ("FERC") and the Arizona Corporation Commission. It identifies initiatives involving competition that may require FERC approval, such as establishment of an independent service organization ("ISO"). This part discusses the factors that may determine the jurisdictional separation of distribution and transmission.

## **PART 7: FEDERAL ISSUES**

This part explains tax-exempt financing under the "Two-County" rule. This part explains how FERC has addressed this rule with respect to open access for transmission services. This part discusses the potential effect of the Rural Electrification Act's upon electric cooperatives in a competitive environment. This part discusses what Arizona may require of out-of-state entities under the Commerce Clause of the U.S. Constitution.

## **PART 8: ANTI-TRUST ISSUES**

This part explains why utilities will not have state-action immunity from anti-trust laws to the extent the utilities provide competitive services.

## **PART 9: SUGGESTED CODE CHANGES**

This part identifies the arguments for and against the need for legislative changes to facilitate competition. It identifies the state statutes that the group discussed.

# REPORT OF THE ARIZONA CORPORATION COMMISSION'S LEGAL ISSUES WORKING GROUP

## INTRODUCTION

The Arizona Corporation Commission ("Commission") established the Legal Issues Working Group (the "Working Group") pursuant to A.A.C. R14-2-1616 to identify, analyze and provide recommendations to the Commission on legal issues relevant to Title 14, Chapter 2, Article 16 of the Arizona Administrative Code (the "Rules"). See A.A.C. R14-2-1601 to -1616, "Retail Electric Competition." This report ("Report") identifies and analyzes legal issues which the Commission should consider in evaluating modifications or additions to the Rules and relevant Arizona statutes.

This Report discusses regulatory policy regarding industry restructuring only to the extent policy explains or defines a legal issue that is relevant to the Rules. This Report does not recommend any policy over other policy choices that are available to the Commission.

The working group considered a number of amendments to the existing Rules, additional rulemaking as well as legislative and constitutional changes. Some participants believed that any amendments to the Rules were unnecessary. The working group did not reach unanimity for recommending any particular action. The working group's observations regarding legal issues in the Report are contained in sections entitled "Comment."

The Report refers to the Commission's Legal Division as "Staff." References to "Affected Utilities" are intended to encompass the utilities defined in A.A.C. R14-2-1601(1).<sup>1</sup> "Consumer" refers primarily to potential high-volume purchasers of electric generation services.

## PART 1

### SCOPE OF THE COMMISSION'S AUTHORITY

- 1.1 Whether the Commission may authorize "electric service providers" (as defined in the Rules) to offer generation, billing and collection, metering and meter-reading services and other information services on a competitive basis in areas where such services were previously exclusively provided by "Affected Utilities."

#### ANALYSIS

##### *SUMMARY OF ARGUMENTS REGARDING AUTHORITY AND "REGULATORY COMPACT"*

Certain Affected Utilities have filed actions in the Maricopa County Superior Court, alleging that the Commission does not have constitutional or statutory authority to adopt the Rules.<sup>2</sup> These Affected Utilities maintain that the Arizona Constitution and the Legislature, pursuant to its power under article XV, section 6, created a policy of "regulated monopoly" for electric utilities. These arguments also rely on judicial decisions that refer to Arizona's policy of "regulated monopoly" as being Legislative in origin or, alternatively, the result of a regulatory contract.

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<sup>1</sup> Two affected utilities, Morenci Water and Electric and Ajo Improvement Company, serve Morenci and Ajo. References to Affected Utilities throughout the report may not reflect these utilities' positions.

<sup>2</sup> Those cases are listed in the attached Exhibit "A" to the Report. The Residential Utility Consumer Office filed an action to challenge the Rules and has voluntarily dismissed the action.

Some Affected Utilities maintain that regulated monopoly for distribution and generation results in a "regulatory compact" between utilities and the state. These Affected Utilities maintain that their certificates of convenience and necessity, authorized pursuant to A.R.S. § 40-281, grant the Affected Utilities exclusive rights to deliver electric service, including generation and retail transmission, within their service territories.

Some participants maintain that competitive pricing unlawfully delegates to the market the Commission's duty to determine just and fair rates based upon the "fair value" of a public service corporation's assets. These utilities also maintain that the Rules violate the Arizona Constitution, article XV, § 14, which requires the Commission to determine "fair value" of a utility's assets. Other participants maintain that competitive pricing is within the Commission's constitutional powers to "prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected..." by public service corporations. Ariz. Const. art. XV, § 3.

Arguments in support of the Rules maintain that the State of Arizona has not entered into a regulatory compact favoring perpetual monopolies. These participants cite a decision of the Maricopa County Superior Court as denying a regulatory compact with respect to a telecommunications PSC, *U.S. West Communications, Inc. v. Arizona Corporation Commission, et al.*, Mar. Co. Sup. Ct. Cause No. CV95-14284 (May 6, 1997). These participants maintain that no Arizona case expressly uses the term "regulatory compact." These arguments maintain that Section 40-281 is intended to prevent unnecessary duplication of lines and facilities within distribution areas; it does not address competitive pricing of services, like generation, that are separable from distribution monopolies.

Participants in support of the Rules maintain that, in a monopoly setting, fair value is used to determine rates artificially, as if the rates were set in a competitive market. If rates are based upon a competitive market, then the Commission's fair value determination has been accomplished more directly and accurately than in the non-competitive setting.

The Working Group's consensus is that the Courts or perhaps the Legislature ultimately will determine whether the Commission must have legislative or constitutional authority to promulgate the Rules, although some participants recommended that the Commission should work with the Legislature to obtain authority to adopt and implement the Rules. In the meantime, the Commission should clarify that the Rules do not affect the exclusivity of distribution services under existing certificates of convenience and necessity. The Rules should also distinguish between certificates for distribution monopolies and certificates for other services that are unbundled or separated from distribution services.

#### ARGUMENTS BY AFFECTED UTILITIES

Affected Utilities maintain that the Arizona Supreme Court expressly recognized the existence of a regulatory compact in *Application of Trico Electric Cooperative, Inc.*, 92 Ariz. 373, 377 P.2d 309, wherein the court stated:

By the issuance of a certificate of convenience and necessity to a public service corporation the State in effect contracts that if the certificate holder will make adequate investment and render competent and adequate service, he may have the privilege of a monopoly as against any other private utility.

92 Ariz. at 380-381 (emphasis added). See also *City of Tucson v. Polar Water Co.*, 76 Ariz. 404, 265 P.2d 773 (1954) (CC&N recognized as a "contract" between the state and utility); *New England Coalition on Nuclear Pollution v. Nuclear Regulatory Comm'n*, 727 F.2d 1127, 1130 (D.C. Cir. 1984) ("the very nature of government rate regulation" is "a

compact whereby the utility surrenders its freedom to charge what the market will bear in exchange for the state's assurance of adequate profits.”).

These utilities maintain that “regulated monopoly” is Arizona’s legislative policy for regulating electric utilities. They maintain that this policy was created by, and therefore may only be modified by, the Arizona Legislature, not the Commission. In support of this position, the utilities cite cases such as *Tonto Creek Estates v. Arizona Corporation Commission*, 177 Ariz. 49, 56, 864 Ariz. 1081, 1088 (Ct. App. 1993), which states that “[t]he concept of regulated monopoly arose from the Legislature in granting the Commission authority to issue certificates of public convenience and necessity to public service corporations.”

The Utilities argue that Arizona courts have determined that the “contract” is one creating a constitutionally protected “vested property right” (*Trico*, 92 Ariz. at 381) and that the Corporation Commission is under a duty to protect the exclusive right to serve electricity in the region where the utility renders service, under its certificate (*Trico*, 92 Ariz. at 387). The court in *Trico* held as follows:

We hold that the Corporation Commission was under a duty to *Trico* to protect it in the exclusive right to serve electricity in the region where it rendered service, under its certificate.

92 Ariz. at 387 (emphasis added). Twenty years later, the Arizona Supreme Court strengthened and reiterated this view in *James P. Paul Water Company v. Arizona Corporation Commission*, 137 Ariz. 426, 671 P.2d 404 (1983). In that decision, the Supreme Court reaffirmed the exclusive right to provide service under a CC&N, 137 Ariz. at 429, and branded as clearly unlawful the Commission's attempt to certificate a competitor promising lower rates:

... the Commission lost sight of its obligation to respect *Paul's* expectation, as a certificate holder, of an opportunity to provide service as needed.

137 Ariz. at 431.

- Affected Utilities maintain that the elements of this regulatory compact are long-standing, clear and obvious. A public service corporation is required to serve those within its territory, to make extensions and improvements to meet future demands, to subject many of its business transactions to prior Commission approval and to limit its revenues and income to those established by the Commission.<sup>3</sup> In return, the utility is granted a monopoly for exclusive service rights therein and the constitutional guarantee of just and reasonable rates that allow it to recover its cost of service and earn a fair return on the fair value of its properties. Electric public service corporations in this state have committed billions of dollars of private capital to meet their collective obligations in reliance on this compact. *Cf. United States v. Winstar Corp.*, 116 S.Ct. 2432 (1996) (government financially responsible to regulated business for economic injury suffered by change in regulatory policy).

The Affected Utilities maintain that the history of the regulatory compact in America has been well chronicled. See, e.g., Sidak and Spulber, "Deregulatory Takings and Breach of the Regulatory Contract," 71 *N.Y.U. Law Review* 851 (1996); George L. Priest, "The

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<sup>3</sup> Pursuant to A.R.S. § 40-321, *et seq.*, the Legislature purports to give the Commission the authority to order a public service corporation to provide specified services in an approved manner to customers within the utility's service area. Moreover, A.A.C. R14-2-202(C) forbids a public service corporation from abandoning service within its territory without express Commission approval. Thus, once a utility becomes a regulated public service corporation, it apparently cannot "get out of the business" without Commission approval.

Origins of Utility Regulation and the 'Theories of Regulation' Debate," 36 *J.L. & Econ.* 289 (1993).

#### ARGUMENTS BY CONSUMERS AND STAFF

Potential consumers maintain that a certificate of convenience and necessity does not provide, in effect, that a public service corporation may "corner the market" on electric service. Arizona court decisions refer to regulated monopoly as a public policy, rather than as a contractual obligation. See *Ariz. Corp. Comm'n v. Superior Court*, 105 Ariz. 56, 59, 459 P.2d 489 (1969); *Winslow Gas Co. v. Southern Union Gas Co.*, 76 Ariz. 383, 385, 265 P.2d 442, 443 (1954); *Pacific Greyhound Lines v. Sun Valley Bus Lines, Inc.*, 70 Ariz. 65, 71, 216 P.2d 404, 408 (1950); *Corp Comm'n v. Pacific Greyhound Lines*, 54 Ariz. 159, 177, 94 P.2d 443 (1939).<sup>4</sup> The law does not recognize monopolistic pricing as a vested property right. See *Columbia Steel Casting v. Portland General Electric*, 103 F.3d 1446 (9<sup>th</sup> Cir. 1996); *F.T.C. v. Ticor*, 504 U.S. 621 (1992).

The Affected Utilities' interpretation of Section 40-281 also frustrates the Commission's authority, which is derived from the Arizona Constitution rather than from a legislative delegation. "Where the Constitution has said that public service corporations shall be governed by the Corporation Commission in a given respect, it is the last, the highest, and controlling fundamental law as to that matter." *State v. Tucson Gas, Electric Light and Power Co.*, 15 Ariz. 294, 301, 138 P.781, 784 (1914). In the event of a conflict between the Commission's constitutional authority and a state statute, the Constitution will

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<sup>4</sup> The Legislature recently added Section 40-281(D) to provide that Section 40-281 should not be construed as "granting or having granted" an exclusive franchise or monopoly to any telecommunications corporation. If Section 40-281 never granted exclusive rights to telecommunications companies, then it follows that the statute never granted the rights to other public service corporations.

prevail. *Ethington v. Wright*, 66 Ariz. 382, 394, 189 P.2d 209, 217 (1948); *Tucson Gas*, 15 Ariz. at 301, 138 P. at 784; *State ex rel. Corbin v. Ariz. Corp. Comm'n*, 174 Ariz. 216, 219, 848 P.2d 301, 304 (App. 1992).

The Commission's rate making power includes adoption of rules that prescribe the classifications and methods that will be used to determine rates and charges. See *Consolidated Water Util. Ltd. v. Ariz. Corp. Comm'n*, 178 Ariz. 478, 483-85, 875 P.2d at 137, 142-44 (App. 1994); *Woods*, 171 Ariz. at 294, 830 P.2d at 815; *Ethington*, 66 Ariz. at 392, 189 P.2d at 216 (Commission's "full and exclusive power" extends to "*making rules, regulations, and orders concerning such classifications, rates and charges by which public service corporations are to be governed....*" (emphasis added)).

Some participants maintain that Arizona's Constitution prefers competition and disfavors monopolies.<sup>5</sup> These participants cite a decision of the Maricopa County Superior Court as denying a regulatory compact with respect to a telecommunications PSC, *U.S. West Communications, Inc. v. Arizona Corporation Commission, et al.*, Mar. Co. Sup. Ct. Cause No. CV95-14284 (May 6, 1997). The Rules follow this principle and apply traditional rate regulation only to natural monopolies, such as companies that erect electric distribution lines, to prevent harm to the public from monopolistic pricing. Services that become separable from the natural monopoly, like electric generation, are eligible for pricing in the competitive market. The Commission's rate making function may change as a particular service becomes less essential or integral to the public service performed by

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<sup>5</sup> Article XV, § 15 provides, in pertinent part, that "[m]onopolies and trusts shall never be allowed in this State...."

the company. See *Mountain States Tel. and Tel. Co. v. Ariz. Corp. Comm'n*, 132 Ariz. 109, 116, 644 P.2d 263, 270 (App. 1982).

The changing nature of the electric industry has led one court to conclude that, while vertically-integrated electric monopolies may have been tolerated in the past, future generations should not be bound to a policy based upon the technological limitations of another time. See *Appeal of Public Service of New Hampshire*, 141 N.H. 13, 676 A.2d 101, 104 (1996). The same court, applying a state constitutional prohibition against monopolies similar to Arizona's, held that competition in electricity should be affirmed "with all doubt resolved against the perpetuation of monopolies." *Id.*, 676 A.2d at 105. The *New Hampshire* court upheld retail electric competition despite utilities' arguments that 80 years of statutes and court decisions granted them exclusive franchises.

#### COMMENT

None.

- 1.2 **Whether the Rules may require Affected Utilities to serve all customers as the "provider of last resort" if Affected Utilities no longer have the exclusive right to serve such customers?**

#### ANALYSIS

A.A.C. R14-2-1606 provides that Affected Utilities will provide electric service ("Standard Offer Tariffs") to all customers within a class in their utility service areas until the Commission has determined that (1) all consumers in the class have the opportunity to purchase power on a competitive basis and (2) all stranded costs pertaining to that class have been recovered. The Affected Utilities' obligation to supply electric generation will cease when stranded costs are fully recovered and competitive pricing is fully available to customers.

Affected Utilities maintain that A.A.C. R14-2-1606 requires incumbent utilities to continue providing electric services to all customers within their utility service areas even though they no longer possess the exclusive right to provide such services (e.g., generation, billing and collection, meter-reading, etc.). This obligation to serve will not terminate until some indefinite time in the future. The Affected Utilities maintain that no other "electric service provider" has a similar obligation. Several utilities have claimed that the traditional utility obligation to serve is legally dependent upon the concomitant *exclusive* right to serve. See, e.g., *James P. Paul Water Company and Tonto Creek Estates*, supra. Affected Utilities claim that the burden to plan for and serve (at regulated rates that do not explicitly provide for the recovery of associated costs) these customers is inconsistent with the free market regime envisioned by the Commission and unlawfully harms the Affected Utility's competitive position.

Affected Utilities maintain that the Rules should not impose an obligation to serve in situations where the exclusive right to serve no longer exists, or at least should establish more definite criteria for terminating an affected distribution utility's obligation to supply electric generation.<sup>6</sup> The Affected Utilities maintain that the Rules should explicitly provide for full recovery of all costs incurred in meeting this obligation.

For example, the Commission could classify customers by the size of their load. Customers purchasing 1MW or greater could be classified so that the obligation to serve

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<sup>6</sup> The "opportunity" to participate in competitive pricing does not mean that customers have actually availed themselves of the opportunity. The Rules probably require that the opportunity be available in a meaningful way. The FCC dealt with a similar issue in *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, Inter LATA Services in Michigan*, CC Docket No. 97-137, Memorandum Opinion and Order (Released August 19, 1997).

would cease when that customer is able to purchase generation from another supplier. If that customer returns to the affected distribution utility, the customer remains in the competitive marketplace notwithstanding the customer's decision not to choose another supplier. The obligation to provide competitive services may continue for customers purchasing lesser amounts during the transition until all customers in each class have the opportunity to receive competitive services such as generation.

The Commission could define the point at which all customers of a class have the opportunity to participate in the competitive market by using some presumptive time provisions. For example, customers of a class will presumptively have the opportunity to participate at least by a certain date, such as January 1, 2003, as provided in A.A.C. R14-2-1604(D). The Commission could extend the date upon a finding of extraordinary circumstances, including the Affected Utility's failure or inability to make all its customers available for competitive generation. The Working Group consensus is that clarification would be appropriate.

At least one Affected Utility suggests that linking the obligation to serve to "full" recovery of stranded costs might be too inflexible. This objection suggests that stranded cost recovery might extend beyond the time that all customers have the opportunity to purchase competitive power. Many participants maintain that the Commission should consider addressing this possibility in amendments to the Rules. See R14-2-1606(A).

The working group found that the Commission may not regulate entities that are not "public service corporations" as defined in article XV, § 2 of the Arizona Constitution. See *Rural/Metro Corp. v. Arizona Corporation Commission*, 129 Ariz. 116, 117, 629 P.2d 83, 84 (1981).

## COMMENT

- A. The Commission may consider clarifying the point at which all customers of a class have the opportunity to participate in the competitive market.
- B. The Commission may address whether the obligation to serve should be linked to stranded cost recovery that extends well beyond the point at which all customers of a class have the opportunity to participate in the competitive market.
- C. The Commission may explicitly state in the Rules that the reasonable costs of meeting the obligation to serve will be recoverable in rates.
- D. The Commission may not regulate corporations that do not conduct activities described in article XV, § 2, Arizona Constitution.

### 1.3 Whether the Commission may lawfully compel Affected Utilities to make their distribution and other facilities available to competitors on demand.

See the analysis and comments contained in Section 1.1.

The Rules contemplate that electric service providers (particularly generators) who desire to sell to customers within the existing certificated areas of electric utilities will have access to the distribution facilities of the Affected Utilities subject to terms and conditions and rates to be established by the Commission. Several of the utilities have argued that this provision represents an unlawful "taking" of a private utility's property (see *Loretto v. Teleprompter Manhattan CATV Corp.*, 450 U.S. 419, 102 S.Ct. 3164, 73 L.Ed. 2d 868 (1982); *GTE Northwest, Inc. v. Public Utility Commission of Oregon*, 321 Or. 458, 900 P.2d 495 (1995)) that is not authorized by any specific Arizona constitutional or statutory provision.

The Commission Staff maintains (1) the Affected Utilities will be compensated for access to their distribution lines and for the power produced through their generation plants; (2) a regulatory taking has not occurred since the Affected Utilities will continue to

use of their property, albeit under competition; and (3) a monopoly is not a property interest under the Takings Clause of the state or federal constitutions, see *Tennessee Electric Power Co. v. Tennessee Valley Authority*, 306 U.S. 118, 141 (1939); *Law Motor Freight, Inc. v. Civil Aeronautics B'd*, 364 F.2d 139, 144 (1st Cir. 1966) (“[F]reedom from competition is not constitutionally protected.”).

Some participants maintain that A.R.S. § 40-331 and/or A.R.S. § 40-332 authorize the Commission to compel Affected Utilities to “wheel” power from other sellers of generation to customers capable of being served from existing distribution facilities, upon a determination that the “public convenience and necessity.” These participants cite to article XV, § 10, which provides that “[a]ll electric, transmission...corporations, for the transportation of electricity,...for profit, are declared to be common carriers and subject to control by law.”

Working Group members disagree as to whether A.R.S. § 40-331 and/or A.R.S. § 40-332 apply only to circumstances in which an Electric Service Provider (“ESP A”) seeks to use the facilities of an Affected Utility (“Affected Utility B”) in order to serve ESP A’s own customers outside of Affected Utility B’s traditional service area. The Affected Utilities maintain that the statutes do not permit ESP A to use Affected Utility B’s facilities to directly compete for Affected Utility B’s customers. The participants also disagree as to whether these statutory provisions authorize the use of an Affected Utility’s facilities by non-public service corporations that are not and can not be regulated by the Commission.

#### COMMENT

None.

1.4 Whether the Commission may regulate entities as “Electric Service Providers” under the Rules that are not defined as “public service corporations” under the Arizona Constitution.

#### ANALYSIS

The Rules regulate as an “electric service provider,” any “company supplying, marketing, or brokering at retail any of the services described in R14-2-1605 or R14-2-1606.” A.A.C. R14-2-1601(V). The Arizona Constitution allows the Commission to regulate “public service corporations” which are defined, in relevant part, as “[a]ll corporations other than municipal engaged in furnishing... electricity for light, fuel, or power....” Ariz. Const. article 15, § 2. As the Commission moves toward competitive pricing, it may classify certain services as less essential to a public service. The Commission may eventually classify services or “electric service providers” as being outside the Commission’s regulatory authority. See analysis in Part 1.1. *See also, Rural/Metro Corp. v. Arizona Corporation Commission*, 129 Ariz. 116, 117, 629 P.2d 83, 84 (1981) (ACC may not regulate entities that are not “public service corporations” under article XV, § 2 of the Arizona Constitution.)

#### COMMENT

None.

1.5 Whether the Commission may streamline procedures for complying with statutes that regulate public service corporations.

#### ANALYSIS

The Rules provide that “electric service providers” may offer competitive generation and other services under less stringent rate procedures than for Affected Utilities that provide exclusive services in their existing territories. For example, rates for competitive generation service are deemed to be just and reasonable to the extent they are “market

determined.” See, e.g., R14-2-1612(A). Electric service providers file a tariff for each service that sets the maximum rate and terms and conditions that will apply. A.A.C. R14-2-1603(B).

Certain Affected Utilities maintain that the Rules should require an electric service provider for competitive generation to follow the established Commission procedures for rate filings and rate changes, including the extensive cost of service, financial and other information required by A.A.C. R14-2-103. These arguments maintain that the Constitution’s fair value provisions mandate such procedures for all services, including competitively priced services. Section 1.1 summarizes the “pro” and “con” arguments on this position.

Some Affected Utilities maintain that legislative changes should be made to streamline procedures in at least the following areas: confidentiality of utility information on file with the Commission (e.g., A.R.S. §§ 40-204 and 40-367), existing provisions regarding rate filings and tariffs (e.g., A.R.S. §§ 40-248, 40-250, 40-361, 40-365, 40-367), standards relating to rate discrimination and preferences (e.g., A.R.S. §§ 40-334, 40-374), requirements for Commission approval for financings and sale of assets (e.g., A.R.S. §§ 40-285, 40-301, *et seq.*), annual reports, etc.

Certain participants also maintain that the Commission should modify existing rules, particularly to the affiliated interest rules (A.A.C. R14-2-801, *et seq.*), the resource planning rules (A.A.C. R14-2-701, *et seq.*), the depreciation and rate filing rules (A.A.C. R14-2-102 and 103), and the customer service rules for electric utilities (A.A.C. R14-2-201, *et seq.*).

Staff and consumers maintain that the Commission may exercise its ratemaking powers and streamline procedures to facilitate competitive pricing. This includes

streamlining procedures for utilities to comply with statutes governing public service corporations.

**COMMENT**

None.

**PART 2**

**RATES AND RATE MAKING**

**2.1 Cost Allocation and Separation Issues.**

**ANALYSIS**

In the interest of leveling the playing field between non-regulated utility activities and small businesses, some participants suggested that the rules should (1) preclude utilities from cross-subsidizing their unregulated activities with funds received from ratepayers under Commission authorized rates; (2) establish accounting procedures and standards to prevent cross-subsidization by requiring the utilities to assign direct and indirect costs to the unregulated activities; and (3) require the unregulated activities to pay fair market value for the use of utility personnel, services, and equipment and to pay royalties for any intangible benefit gained through affiliation with the utility.

Some participants maintain that the existence of cross-subsidization would suggest that regulated rates are too high. The Commission could address cross-subsidization through orders to show cause. The consensus of the group is that the Commission has sufficient power to deal with cross-subsidization through rate making orders. These participants did not see a need to change the Rules at this time.

**COMMENT**

None.

## 2.2 Confidentiality.

### ANALYSIS

A participant suggests that A.R.S. § 38-431.02, *Notice of meetings*, be amended to provide that documents and other information related to a public body's discussions or consultations on negotiations, bids, or proposals for power and energy transactions, for the purchase or sale of fuel, or for the construction, ownership, or operation of generation or transmission facilities would not be public records, except that any contracts executed by the public body would be public records unless otherwise exempted by law.

The commenter also suggests amending A.R.S. § 40-204 to provide that information related to negotiations, bids, or proposals for power and energy transactions, for the purchase or sale of fuel, or for the construction, ownership, or operation of generation or transmission facilities would not be open to public inspection, unless ordered by the Commission for good cause shown.

The Working Group generally agreed that confidentiality procedures will have to be scrutinized at some time. The Working Group sharply disagreed over whether such a review should take place before or after competition commences.

### COMMENT

**The working group did not reach a consensus regarding what information should be confidential, although the group agreed that some confidentiality should be given to information that the Commission requires to be filed for regulatory purposes. In that regard, the Commission may provide by rule that commercially sensitive/proprietary information would be kept confidential unless, upon notice to the utility that would be affected by disclosure, extraordinary circumstances justify disclosure.**

## PART 3

### STRANDED COST RECOVERY

- 3.1 The legal procedures (hearing and/or utility filings) necessary to determine Affected Utilities stranded costs; legal procedures necessary to vary the annual level of stranded cost recovery, change the total amount of stranded cost recovery or change the mechanism by which stranded costs are recovered.

#### ANALYSIS

If a utility claims stranded cost recovery in conjunction with a rate case, the issue would be subject to the same general filing and/or hearing requirements attending other claimed costs. Similarly, the legal procedures associated with changes to total amounts of stranded costs, annual levels of recovery or mechanisms by which stranded costs are recovered may be subject to the same limitations as recovery of other costs in a rate case. If the Commission establishes a stranded cost recovery mechanism, subsequent *changes* to the recovery balance or other details of the plan may be resolved in an abbreviated proceeding similar to fuel or other adjustment clause mechanisms. See, e.g., *Scates v. ACC*, 118 Ariz. 531, 578 P.2d 612, *appeal after remand*, 124 Ariz. 73, 601 P.2d 1357 (1978). See also, A.A.C. R 14-2-1607(L).

The elements of proof for stranded cost recovery under the Rules would be generally as follows:

- A. Prove the value of jurisdictional asset or obligation which was:
  - I. prudent,

- ii. acquired or entered into<sup>7</sup> prior to adoption of the Rules under the traditional regulation of Affected Utilities.
- B. Prove that the market value of the asset or obligation
  - i. decreased,
  - ii. as a direct consequence of competition.
- C. Prove that the utility mitigated the stranded cost by every reasonable measure related to the provision of regulated electric service which was
  - i. feasible, and
  - ii. cost-effective.

The burden of proof with respect to "prudence" may, in many cases, already have been addressed in prior Commission proceedings. Moreover, many of the costs that would fit within the stranded cost category for Affected Utilities have been (a) explicitly approved by the Commission, in some cases after expensive prudence reviews<sup>8</sup>, (b) subject to review and not challenged by parties in previous rate cases, or (c) required by federal law or Commission order. Most Working Group participants agreed it would be unnecessary and unduly expensive and time-consuming to require a utility to "re-litigate" issues previously reviewed and/or resolved by the Commission. In addition to the presumption of prudence, the Commission may employ traditional principles of *res judicata*, *stare decisis*, and regulatory estoppel to prevent unwarranted re-litigation of previously decided matters. The Working Group's consensus is that the Commission may review prior

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<sup>7</sup> "Acquired" includes duties existing under law as of the date the Rules were adopted.

<sup>8</sup> One participant noted, as an example, that the prudence review of the planning and construction of the Palo Verde Nuclear Generating Station cost approximately \$40 million. The result of that review was reflected in a rate settlement agreement approved by the Commission in Decision No. 57649 (December 6, 1991).

prudence determinations that were materially influenced by extraordinary circumstances, such as fraud or concealment.

The Commission's regulations provide that "all investments shall be presumed to have been prudently made, and such presumptions may be set aside only by clear and convincing evidence that such investments were imprudent, when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, at the time such investments were made." See A.A.C. R14-2-103(A)(3)(I).

Certain Affected Utilities believe the standard for utility "mitigation" measures in the Rules is unlawful, unreasonable, and overly vague. The utilities maintain that the Rules may be interpreted as allowing the Commission to require utilities to expend potentially unlimited amounts of private capital and other resources to pursue ill-defined business ventures outside ACC jurisdiction. Other participants comment that Affected Utilities should be required to use any revenues that are generated by or from the use of personnel, assets or the credit of the utility to mitigate stranded costs. These participants maintain that ratepayers should receive the benefit of revenues generated by the regulatory assets, personnel or credit of the utility.

The consensus of the Working Group is that the Commission may inquire as to the efforts that utilities have undertaken to reasonably mitigate stranded costs through cost reductions, efficiency improvements, market expansion and/or the development of new products and services related to the provision of traditional utility service. Staff suggests that the Commission may clarify the level of mitigation that is "reasonable" by borrowing mitigation concepts from another body of law, like commercial lease law or public condemnation law.

## COMMENT

- A. The Commission may accept prior prudence determinations as binding for stranded cost proceedings absent extraordinary circumstances, such as fraud or concealment.
- B. Although some participants believe no change to the stranded cost recovery provisions is required, most participants agree that the Commission should clarify the mitigation standard in the Rules to define "reasonable" mitigation efforts that relate to the provision of regulated utility service.

### 3.2 The legal standards relevant to stranded cost recovery mechanisms.

## ANALYSIS

A.A.C. R14-2-1607(J) provides that stranded costs may only be recovered from "customer purchases made in the competitive market." Participants disagreed whether this provision means that stranded costs can only be recovered in the price for competitive services. These arguments maintain that such a construction is inconsistent with A.A.C. R14-2-1607(H). They maintain that "stranded costs" are, by definition, are costs that can not be recovered in the competitive generation market. Participants disagree whether A.A.C. R14-2-1607(J) conflicts with A.A.C. R14-2-1607(H).

The Working Group's consensus, with the exception of Consumers (who maintain that the Rules are sufficient to determine stranded costs), is that the Commission should more precisely define stranded cost recovery mechanisms. The Rules should be amended to the extent the first sentence in R14-2-1607(J) may be read as limiting the classes of customers or services that the Commission may designate for stranded cost recovery.

## COMMENT

See the discussion above.

- 3.3 The legal standards governing stranded cost recovery mechanisms (e.g., non-by passable CTC or exit fee).

#### ANALYSIS

The Rules provide that customers who are not eligible to receive competitive generation services do not, by definition, create "stranded costs" and therefore will not pay a stranded cost fee. Further, the Rules do not allow stranded cost recovery from purchases in non-competitive or monopolistic markets. These restrictions may require stranded costs to be recovered through an exit fee or some other non-usage-sensitive mechanism. The preferred mechanism for stranded cost recovery is outside the scope of the Working Group's review. Depending upon the Commission's interpretation of R14-2-1607(J), certain mechanisms may require amendment or waiver of the Rules.

#### COMMENT

See the discussion in Section 3.2 above.

- 3.4 The ACC's powers to "true-up" any initial stranded cost estimates to eliminate possible over/under recovery of stranded cost amounts.

#### ANALYSIS

The consensus of the Working Group is that the ACC is not legally required to "true-up" any reasonable initial stranded cost estimates any more than it is legally required to true-up reasonable estimates of other costs used in setting rates. However, the Commission may "true-up" stranded costs.

#### COMMENT

None.

**3.5 Legal standards for "securitizing" or using public funding mechanisms for the recovery of stranded costs.**

**ANALYSIS**

The participants did not study the legal issues associated with "securitizing" or public funding mechanisms for the recovery of stranded costs.

**COMMENT**

None.

**3.6 Whether Arizona recognizes a "regulatory compact" as a binding contract that affects the recovery of stranded costs or limits the ACC's power to amend regulations affecting public service corporations.**

**ANALYSIS**

This issue engendered considerable disagreement among the Working Group participants. The arguments regarding a "regulatory compact" are discussed in Part 1.1.

**COMMENT**

None.

**3.7 Whether the ACC has awarded stranded cost recovery for telecommunications providers or for gas LDC's in Arizona.**

**ANALYSIS**

The Commission traditionally prescribes rates to *avoid* stranded costs for any public service corporation, through rates charged to the utility's remaining customers (telephone) or recoupment of lost sales margins in rates (gas) or by a combination of both. With respect to gas LDCs, FERC Order No. 888-A, issued March 3, 1997 (starting at page 488, *et seq.*), and the Commission's 1990 Decision No. 50575 contain stranded cost recovery principles. FERC did not require a showing of prudence or mitigation and the ACC's decision did not interfere with this pattern.

## COMMENT

None.

## PART 4

### ACC POWERS/PROCEDURES

#### 4.1 Stranded Cost Proceedings.

See the analysis in Part 3.1.

The nature of a stranded cost proceeding will depend, in part, on (1) the methodology for determining the amount of recoverable stranded costs; (2) who will pay the stranded cost; and (3) the recovery mechanism (i.e., a surcharge on all ratepayers to be paid into a common fund, a meter charge, a rate surcharge, etc.).

Also, the Working Group's consensus is the Commission may implement automatic adjustment clauses in appropriate contexts to allow stranded costs to be adjusted based upon changed circumstances. Adjustment clauses have been approved in other contexts in the past and would obviate the need for utilities to make supplemental applications to the Commission to recoup their stranded costs. See, e.g., *Scates v. ACC*, 118 Ariz. 531, 578 P.2d 612, *appeal after remand*, 124 Ariz. 73, 601 P.2d 1357 (App. 1978).

## COMMENT

None. See comment to Part 3.1.

#### 4.2 Affiliated Interest Rules.

The Commission's rules relating to public utility holding companies and "affiliated interests" (See A.A.C. R14-2-801 through R14-2-806), apply to Class A investor-owned utilities under the jurisdiction of the Commission. A.A.C. R14-2-802(A). Although most utilities entering the competitive market will likely meet the definition of a "Class A investor-

owned” utility, some entities seeking to enter the competitive market in Arizona may not be Class A utilities. The Commission may revise the Rules to address the issues relating to the affiliated interests of companies not falling within the scope of the Commission’s existing affiliated interest rules. The Commission’s regulatory powers may be limited for entities that are not public service corporations.

#### COMMENT

None.

#### 4.3 Non-PSC’s.

The Commission may regulate only a “public service corporation” (“PSC”) as defined in article 15, § 2 of the Arizona Constitution. The same provision expressly excludes municipal entities from the Commission’s jurisdiction. Some participants maintain that intergovernmental agreements may be used to coordinate, but not regulate, competitive pricing for non-public service corporations. Certain participants maintain that the agreements may not allow the Commission to assert regulatory powers over such entities.

Alternatively, other participants maintain that existing rules, statutes and the Constitution must be amended to bring non-public service corporations, namely municipal corporations, under the jurisdiction of the Commission, or some other independent agency.

For-profit subsidiaries of non-PSCs may be subject to the Commission’s jurisdiction. Some question exists whether the Commission may, in such instances, use its affiliated interest rules to regulate the for-profit affiliate’s transactions with the non-PSC. The Commission regulates affiliated interest transactions of PSCs in A.A.C. R14-2-801 through -806. The Commission’s power to regulate affiliate transactions of a non-public service

corporation may be found in article 15, § 3 of the Arizona Constitution, which provides that the Commission may require a public service corporation to report information about, and obtain permission for transactions with, its parent, subsidiary, and other affiliated corporations. See *Arizona Corp. Comm'n v. State*, 171 Ariz. 286, 830 P.2d 807 (1992).

#### COMMENT

None.

#### 4.3.1 Antitrust Principles.

Non-PSCs and PSCs will be subject to the traditional oversight of the Federal Trade Commission ("FTC") and other federal and state agencies in the area of anti-competitive actions. The FTC is a law enforcement agency with statutory authority over a variety of industries, including the electric power industry. The FTC enforces the FTC Act (15 U.S.C. §§ 41-58) and the Clayton Act (15 U.S.C. §§ 12-27) which prohibit, among other things, "unfair methods of competition," "unfair or deceptive acts or practices," and mergers or acquisitions that may "substantially lessen competition or tend to create a monopoly."

In some instances the federal antitrust law's definition of "person" or "parties" embrace cities and municipalities, so that they will be subject to antitrust enforcement actions. 17 *McQuillin Municipal Corporations* (3rd Ed. 1990) 534, citing *Lafayette v. Louisiana Power & Light Co.*, 431 U.S. 963, 98 S. Ct. 1123. Generally, whether actions of a municipality violate the antitrust laws is a question of the extent to which the actions taken are authorized or directed by the state pursuant to state policy. *Id.* Thus, the Commission and the Courts may have jurisdiction over anti-competitive behavior affecting

PSCs, depending upon the activities undertaken and the nature of the entity which is the perpetrator of the anti-competitive behavior.

#### COMMENT

None.

#### 4.3.2 In-State Reciprocity.

The Rules address in-state reciprocity between non-PSCs and PSCs for purposes of competition. A.A.C. § 14-2-1611. Further, A.R.S. §§ 11-951 through 954 authorize the Commission and municipal subdivisions of this State to enter into intergovernmental agreements ("IGAs") to jointly exercise any powers common to the contracting powers. A.R.S. § 11-952(A). Some interested parties maintain that such IGAs could be used to facilitate competition between PSCs and non-PSCs by controlling some of the practices of the non-PSCs through contractual rather than regulatory means.

Some participants maintain that IGAs may not be used to limit the exercise of an entity's regulatory power. Some participants believe that IGAs could permit municipalities, or other "public agencies" as defined in A.R.S. § 11-951 to enter into agreements with the Commission so that the separate governmental agencies would agree to exercise their individual powers in a parallel and consistent manner. However, none of the participants addressed whether an Affected Utility, electric service provider, customer or other person may enforce such an agreement. The proposed form of such an IGA was not available for comment.

A.A.C. R14-2-1611(E) provides as follows:

If an electric utility making a filing under R14-2-1611(D) is an Arizona political subdivision or municipal corporation, then the existing service territory of such electric utility shall be deemed

open to competition if the political subdivision or municipality has entered into an intergovernmental agreement with the Commission that establishes nondiscriminatory terms and conditions for Distribution Services and other Unbundled Services, provides a procedure for complaints arising therefrom, and provides for reciprocity with Affected Utilities.

An IGA would generally address the respective operations of the Commission and the political subdivision or municipality, so that their efforts to establish competition in electric generation are coordinated. An IGA would be based on the general authority of A.R.S. § 11-952, and deal with the joint exercise of the parties or their respective authorities to regulate electric operations within their respective jurisdictions. Specifically, A.R.S. § 11-952(A) provides:

If authorized by their legislative or other governing bodies, two or more public agencies by direct contract or agreement may contract for services or jointly exercise any powers common the contracting parties and may enter into agreements with one another for joint or cooperative action . . . .

Staff maintains that an IGA between two governmental entities to agree to jointly exercise their respective authorities is authorized by A.R.S. §§ 11-951 through 11-954. An IGA will not be used to limit the exercise of an entity's regulatory power in the public interest. The IGA may "confirm that separate governmental entities will exercise their powers in a parallel and consistent manner." Some participants cite, as an example, the IGA entered into by the Commission with the Federal Power Commission that was approved by the Arizona Supreme Court in *Garvey v. Trew*, 64 Ariz. 342, 170 P.2d 845 (1946).

Staff maintains that the general provisions of an IGA "will consist of the powers of the respective state political subdivisions and will explain how the political

subdivisions will coordinate the exercise of their respective political powers.” One party agrees with the general scope of the agreement as described by the Commission. Another believes that the IGA should address whether there is “equal protection of the law for PSCs and non-PSCs.”

Another participant points out that an IGA will not create an independent regulatory entity with jurisdiction to assure fair and equitable treatment of PSC's and consumers' purchases in municipal corporations' territories.

Other participants maintain that the IGA statutes only permit public agencies to exercise jointly held powers. Therefore, so the argument goes, the Commission may only enter into IGAs with entities which have the same type of regulatory powers as the Commission. This group of interested parties take the position that non-PSCs do not have “joint power and authority” with the Commission; thus, no IGAs may be entered into with such governmental non-PSCs. There appears to be no dispositive case law in Arizona on the issue, although *Garvey v. Trew*, 64 Ariz. 342, 170 P.2d 845 (1946) and Op. Atty. Gen 184-135 shed some limited light on both sides of the issue. These participants also maintain that the IGA may not be used to give the Commission power over municipal corporations since it is specifically denied such power under article XV, section 2 of the Arizona Constitution.

Some participants claim that the Commission has used IGAs in the past when it agreed with the public utility commissions on some Indian reservations that the Commission should set the rates for telephone service on the reservation, even though the utility commission on the reservation had power to do so. In short, as with many of the issues facing the Commission, there is no bright-line answer to the issue of how to deal

with the in-state reciprocity issues, but the IGAs may be a viable mechanism to facilitate reciprocity, at least in part.

#### COMMENT

None.

#### 4.4 Resource Planning Issues.

The Commission provides for resource planning and oversight. See A.C.C. R14-2-701, *et seq.* The need for full, formal generation resource planning will likely decrease once competition is implemented and fully underway. As with any competitive market, supply and demand factors may provide optimum market efficiency, and an equilibrium will be reached at some point in the future.

Resource planning ensures that the public is not left without adequate supply, even for a short period of time. Historically, construction of generation and distribution facilities required far-reaching resource planning. Advances in technology has progressively reduced lead-time, thereby permitting quicker response to changes or shifts in demand. Competitors want an adequate supply, as well as facilities, to meet the anticipated demand. Competitors want their resource planning information to be confidential.

Resource planning is monitored by federal (such as FERC) and state (such as the Commission) authorities. As competition commences, the Commission may consider additional rulemaking to deal with confidentiality concerns or to protect Arizona's public from periodic shortages. Oversight may be provided by an independent system operator as well as consumer organizations.

#### COMMENT

None.

## PART 5

### NON-PSC'S

#### 5.1 Municipal Corporations, Non-PSCs with Federal Interests.

##### ANALYSIS

Within Arizona, many different kinds of "non-PSCs" operate as electric utilities. These include municipal utilities (owned/operated by a city or town), electrical districts, irrigation districts, agricultural improvement districts and power districts. General governing authority for the municipalities and the districts is found in Article 13 of the Arizona Constitution, A.R.S. Title 48 (districts) and A.R.S. Title 9 (municipalities). Tribal utilities are non-PSCs that are not generally regarded as municipal corporations. Some non-PSCs provide electric service within a defined and exclusive service territory; others provide electric service within the service territories of existing PSCs and other non-PSCs.

A variety of federal interests affect PSCs and non-PSCs. For example, cooperatives' (PSCs) and municipal corporations' (non-PSCs) contract for federal preference power; the federal government has a considerable interest in Tribal activities; federal proprietary interests exist for facilities used by certain districts under federal reclamation law; and the federal government guarantees, funds or otherwise authorizes financing obligations of certain PSCs, cooperatives and municipal corporations.

Two parties commented that federal interests might complicate Commission jurisdictional issues and should be researched. The ACC Staff believes a federal interest in a non-PSC does not preclude the non-PSC's ability to offer a competitive generation supply.

## COMMENT

None.

### 5.2 Relations Between Non-PSC's and PSC's.

## ANALYSIS

Some participants maintain that the new Rules allow both non-PSCs and PSCs to provide competitive generation (but not distribution) service to customers within each other's service territories, subject to certain conditions. One commenter believes the Rules do not allow such competition. In the context of non-PSC, certain statutes were identified by parties as potentially restricting the authority of PSCs and non-PSCs to compete with each other. No participant identified any Arizona law that would preclude non-PSCs from providing access to their distribution systems and service area customers. (One commenter cited A.R.S. § 9-516 as preventing the Commission from granting CC&Ns over a municipality's service area under certain circumstances.) Another participant maintained that the Commission can authorize PSCs to provide competitive generation to customers in non-PSC territories. Four parties pointed out that Arizona law does not require non-PSCs to provide access to their distribution facilities.

Three parties raised issues relating to the impact of Title 9 on the ability of the Commission to authorize competition among PSCs and non-PSCs. One of these parties asserts that A.R.S. § 9-516 prohibits the Commission from authorizing a PSC to compete with "municipal corporations." However, by its express terms, A.R.S. § 9-516 is applicable only to cities and towns, not the full panoply of municipal corporations or other non-PSCs. A second commenter believes Title 9 gives cities and towns the exclusive right to provide electricity within their boundaries. Several commenting parties believe A.R.S. § 9-516

imposes a condemnation requirement on cities and towns in order for them to compete with PSCs. Commission Staff believes this statute does not require such condemnation to offer "competitive generation supply."

One party identified A.R.S. § 48-1515 and "similar statutes" as possibly having an anti-competitive effect on certain special taxing districts (non-PSCs) if improperly construed as restricting expansion of an existing district, rather than limiting creation of new districts. A.R.S. § 48-1751 also may limit an electric district to selling only surplus energy outside its service area.

Title 40 (relating to PSCs generally), Title 10 (relating to PSC cooperatives) and franchising statutes were raised by various parties as limitations on the general ability of PSCs to compete with each other, as well as with non-PSCs. The impact of these statutes is more fully addressed in Section 12 of this report.

#### COMMENT

None.

## PART 6

### FERC ISSUES

#### 6.1 ACC's Exclusive Jurisdiction.

- 6.1.1 In view of FERC Orders 888, 888-A, 889, 889-A, FERC decisions, case law, the U.S. Constitution and the various Federal acts, what exclusive (or concurrent) jurisdiction may the ACC exercise in the context of competitive electric energy services, whether in wholesale and/or retail transactions considering the interstate nature of the transmission lines?

## ANALYSIS

FERC's jurisdiction is limited by its enabling law and only includes public utilities. It has indirect jurisdiction over transmitting utilities through complaints which may be brought pursuant to §211 of the Federal Power Act. It has no jurisdiction over municipals, PMA's or RUS borrowers who were brought into open access only through reciprocity concepts.

The Energy Policy Act of 1992 forbids FERC from ordering "retail wheeling" or direct access to power supply by retail customers, leaving such orders to the states' discretion. See 16 U.S.C. § 824k(h). FERC has affirmed that it is a state decision to permit or require retail wheeling and has left it to state regulatory authorities to deal with any stranded costs or stranded benefits occasioned by retail wheeling on facilities or services used in local distribution. (62 FR 12274, 12409). Further, in 888-A FERC clarified that "states have the authority to determine the retail marketing areas of the electric utilities within their respective jurisdictions" along with the authority to determine the end user services those utilities provide. (62 FR 12274, 12279).

Additionally, exclusive jurisdiction has been reserved to the states (and therefore the ACC) over the following matters: the provision and pricing of retail sales of electric energy (as opposed to unbundled transmission) and the siting of transmission and distribution lines. While states retain jurisdiction over local distribution lines, FERC claims to be the final arbiter of their definition (see discussion in §8.4 below).

FERC and state commissions each have jurisdiction over separate aspects of a retail wheeling transaction: FERC has jurisdiction over rates, terms and conditions of unbundled retail transmission in interstate commerce by public utilities while state

commissions have jurisdiction over local distribution facilities, the rates for services using those facilities to make a retail sale, and the service of delivering electric energy to end users (62 FR 12274, 12279, 12372) even if there are no identifiable local distribution facilities. Thus, in all cases, states have the means to ensure that customers do not avoid their responsibility for stranded costs or benefits.

Nevertheless, FERC has further indicated in 888-A (and the Federal Power Act supports such interpretation) that FERC and a state have concurrent jurisdiction to order stranded cost recovery when retail customers obtain retail wheeling in interstate commerce from public utilities in order to reach a different generation supplier.

If the state regulatory authority is not authorized to order stranded cost recovery for direct retail access, FERC may permit a utility to seek a customer-specific surcharge to be added to an unbundled transmission rate. (Order 888, FERC Stats. & Regs. at 31,824-26; and 18 C.F.R. 35.26). FERC will not interfere if the state agency has such authority and has, in fact, addressed such costs, regardless of whether it has allowed full, partial or no recovery.

FERC will be the primary forum for recovery of stranded costs caused by "retail-turned-wholesale" customers, such as the creation of a municipal utility system to purchase wholesale power on behalf of retail customers who were formerly bundled customers of the historical utility power supplier (e.g., by annexing retail customers of another service territory). 18 C.F.R. 35.26. FERC will not intercede in every instance of municipalization, but only in cases where the new wholesale entity uses FERC-mandated transmission access to obtain a new power supply on behalf of retail customers that were formerly supplied power by the utility.

Additionally, FERC in 888-A deems transmission line siting as a state-exclusive function and will not interfere in a state's decision and jurisdiction over such issues. FERC will not encroach on the following areas: state authority over local service issues including reliability of local service; administration of integrated-resource planning and utility buy-side and demand-side decisions, including DSM; authority over utility generation and resource portfolios: generation siting; and authority to impose non-by passable distribution or retail stranded cost charges along with charges for social or environmental programs. (Order 888 and 18 C.F.R. 35.27)

#### COMMENT

None.

#### 6.2 FERC's Exclusive Jurisdiction.

6.2.1 In view of Rules 888, 888-A, 889, 889-A FERC decisions, case law, the U.S. Constitution and the various Federal acts, what exclusive (or concurrent) jurisdiction may FERC exercise in the context of competitive electric energy services, whether in wholesale and/or retail transactions within Arizona considering the interstate nature of the transmission lines?

#### ANALYSIS

FERC appears to have staked out exclusive jurisdiction in unbundled state retail transactions and requires utilities to implement any state retail access experiments under the Order 888 pro forma wholesale tariffs. Where specific provisions are inapplicable for service to unbundled retail customers, e.g, filing of individual service agreements and requirements for customer deposits, public utilities must seek a waiver of those tariff provisions. (New England Power Company, et al., 75 F.E.R.C. P61,008 (1996).

FERC rejected retail transmission tariffs filed by Portland General Electric ("PGE") and Washington Water Power ("WPP") to implement retail competition experiments in Washington, Idaho and Oregon. WPP's tariffs had been approved by the Washington and Idaho state regulatory commissions and PGE's were submitted to Oregon's. However, FERC noted that no state authority had requested FERC approval of any of the separate retail tariffs or variations from the 888 pro forma tariff (to accommodate any special needs of a state retail access program) and so rejected the tariffs without prejudice. FERC left the door open to the state commissions for such requests, instructing that the separate retail tariff or variations from the pro forma tariff sought should still be consistent with FERC's open access and comparability principles.

WPP argued that the retail experiments did not constitute unbundling within the meaning of Order 888, because WPP had simply removed the energy component from its current bundled retail tariff and included non production costs for transmission, distribution and general expenses. FERC disagreed and found instead that the tariff included the "separation of products that we have determined creates unbundled retail transmission of power that is within our exclusive jurisdiction." Citing Order 888, FERC noted. "When a retail transaction is broken into two products that are sold separately,...we believe the jurisdictional lines change.....When a bundled retail sale is unbundled and becomes separate transmission and power sales transactions, the resulting transmission transaction falls within the Federal sphere of influence." *The Washington Water Power Company*, Docket No. ER97-960-000 (Issued Feb. 25, 1997); 78 F.E.R.C. P61,178; 1997 FERC LEXIS 306.

In its proposed retail tariff, PGE had used the pro forma tariff adding stranded cost recovery charges, service agreements and local distribution provisions to it. Nevertheless, it was rejected since the Oregon Commission had not made a specific request that PGE be allowed such variance from the open access compliance tariff.

FERC uses *PGE* to explain that absent FERC approval of a specific state commission request, the open access tariff must be used for all unbundled retail transmission, including pilot or experimental programs. In such programs, state commissions may "determine the rates jurisdictional to them by establishing a bundled delivery price (including stranded costs) and then subtracting the utility's open access tariff rates for transmission and ancillary services." *Portland General Electric Company*, Docket No. ER97-1112-000 (Issued March 3, 1997); 78 F.E.R.C. P61,219; 1997 FERC LEXIS 579.

FERC casts "buy-sell" transactions in a similar jurisdictional model. Where "an end user arranges for the purchase of generation from a third party supplier and a public utility transmits that energy in interstate commerce and resells it as part of a 'nominal' bundled retail sale to the end user," FERC says the retail sale is actually the functional equivalent of two unbundled sales (one transmission, and the other the sale of power) and that FERC has exclusive jurisdiction over the transmission component. FERC has acknowledged that in such a transaction there would also be an element of local distribution which would be subject to local jurisdiction. (Fed. Reg. Vol. 61, No. 92, p. 21,620).

FERC will also assert exclusive jurisdiction in a holding company or other multi-state situation where a state regulatory agency decision, e.g. on stranded cost recovery, could

result in an inappropriate shift of disallowed costs to affiliated operating companies in other states. (62 FR 12,274, P12,409)

In short, FERC claims that "matters of interstate commerce, including the vast integrated electric system that supply the nation's industrial, commercial and residential customers are the responsibility of the Federal government." (Statement by Elizabeth A. Moler, Chair, FERC, before the Energy and Natural Resources Committee, United States Senate, March 30, 1997.) As made clear by FERC Orders 888 and 888-A, 889 and 889-A, this includes all transmission transactions, coordination services and agreements, independent system operators, regional power pools, and power exchanges.

#### COMMENT

None.

#### 6.3 FERC Approvals.

- 6.3.1 What actions taken in Arizona or involving Arizona public utilities to move to retail competition in the electric industry (including any formation of an ISO) will require FERC approvals and what criteria will FERC apply?

#### ANALYSIS

The majority of the current rules will not require FERC approval. A commenter indicated that FERC cooperation would only be needed in delineation of transmission and distribution lines and perhaps for stranded costs imposition. However, FERC's very recent decisions in *PGE* and *WPP*, as discussed in §8.2.1 above, provide that the ACC and public utilities must, in conformance with those decisions, detail and seek FERC pre-approval of all unbundled retail tariffs that deviate in any way from the Order 888 open access compliance tariffs filed, including those which add stranded cost recovery charges,

distribution charges, service agreements, etc. Further, the ACC and public utilities must propose and seek approval of the delineation of transmission and distribution lines as discussed below.

Additionally, any proposal for ISO creation (whether state or regional), relevant ISO procedures (including transfer of operational control of FERC jurisdictional facilities), transmission pricing, access fees, tariffs, expansion, or enforcement will also require FERC pre-approval. *Pacific Gas and Electric Company, et al.*, Docket Nos. EC96-19-000 and ER96-1663-000 (Issued November 26, 1996).

In Orders 888 and 888-A, FERC has issued specific guidance for formation of an ISO which apply only if the ISO is also a control area operator. These FERC principles include:

1. The ISO's governance should be structured in a fair and non-discriminatory manner.
2. An ISO and its employees should have no financial interest in the economic performance of any power market participant. An ISO should adopt and enforce strict conflict of interest standards.
3. An ISO should provide open access to the transmission system and all services under its control at non-pancaked rates pursuant to a single, unbundled, grid-wide tariff that applies to all eligible users in a non-discriminatory manner.
4. An ISO should have the primary responsibility in ensuring short-term reliability of grid operations. Its role in this responsibility should be well-defined and comply with applicable standards set by NERC and the regional reliability council.
5. An ISO should have control over the operation of interconnected transmission facilities within its region.
6. An ISO should identify constraints on the system and be able to take operational actions to relieve those constraints within the trading rules

established by the governing body. These rules should promote efficient trading.

7. The ISO should have appropriate incentives for efficient management and administration and should procure that services needed for such management and administration in an open competitive market.
8. An ISO's transmission and ancillary services pricing policies should promote the efficient use of and investment in generation, transmission, and consumption. An ISO or an RTG of which the ISO is a member should conduct such studies as may be necessary to identify operational problems or appropriate expansions.
9. An ISO should make transmission system information publicly available on a timely basis via an electronic information network consistent with the Commission's requirements.
10. An ISO should develop mechanisms to coordinate with neighboring control areas.
11. An ISO should establish an ADR process to resolve disputes in the first instance.

FERC has not issued specific guidance for non-control area operator ISO's. Presumably, their hallmark would be independence with respect to governance and financial interests to ensure that the ISO is independent and would not favor any class of transmission users.<sup>9</sup>

FERC does not require ISO's. In Rule 888-A, FERC said it does not believe it "appropriate to require public utilities or power pool to establish ISO's, preferring instead to allow time for functional unbundling to remedy undue discrimination."

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<sup>9</sup> In an order on the proposed PJM ISO FERC stated: "The principle of independence is the bedrock upon which the ISO must be built if stakeholders are to have confidence that it will function in a manner consistent with this Commission's pro-competitive goals." Order 888-A, FN219, citing *Atlantic City Electric Company, et al.*, 77 F.E.R.C. P61,148 (1996).

## COMMENT

None.

### 6.4 Jurisdictional Separation of Distribution-Transmission Lines.

- 6.4.1 The FERC has issued criteria and decisions to assist in determining what is a distribution line and what is a transmission line so as to assert appropriate FERC jurisdiction over transmission lines. What are the criteria, how should they be applied, and what FERC actions are required to confirm that determination?

The answer is unclear. FERC recognized in Order No. 888 that once retail service was unbundled, there would be a need to draw a distinction between facilities used for transmission and those used for local distribution<sup>10</sup> so as to leave states with authority over the service of delivering electric energy to end users. Toward that end, FERC has adopted a case-by-case methodology in delineating between "transmission" and "distribution" facilities regulated by FERC and those left to the States. FERC has not established a "bright line" test. Guidance will develop as FERC issues decisions.

Order 888 requires public utilities to consult with state regulatory agencies before filing any transmission distribution classifications and/or cost allocations (for such facilities to be included in rates) with FERC. If those classifications and/or cost allocations have state regulatory support, if the state regulators have specifically evaluated the seven indicators and any other relevant facts, and if the state's recommendations are consistent with the principles of Order 888, the Commission will defer to them. FERC has said it hopes to use this mechanism to take advantage of state regulatory authorities' knowledge and expertise concerning the facilities of the utilities they regulate. (Order 888 Introduction/Summary, Fed. Reg. Vol. 61, No. 92, P21541).

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<sup>10</sup> *Washington Water Power Company*, FN8.

In Order 388, FERC provided seven local distribution indicators for states to use in the evaluation process:

1. Local distribution facilities are normally in close proximity to retail customers.
2. Local distribution facilities are primarily radial in character.
3. Power flows into local distribution systems; it rarely, if ever, flows out.
4. When power enters a local distribution system, it is not reconsigned or transported on to some other market.
5. Power entering a local distribution system is consumed in a comparatively restricted geographical area.
6. Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.
7. Local distribution systems will be reduced voltage.

FERC added that it would consider jurisdictional recommendations by states that take into account other technical factors that the state believes are appropriate in light of historical uses of particular facilities. Order 888-A reaffirmed that approach and the tests to distinguish between state and Federal jurisdiction (Fed. Reg. Vol. 62, No. 50, P12,372). The order also recognized that the test does not resolve all possible issues, but is designed for flexibility to include unique local characteristics and usage. (Rule 888-A, 62 Fed. Reg. 12,274, P12279).

FERC approved such a specific state recommendation in *Pacific Gas and Electric Co., et al.*, Docket No. EL96-48-000 (Issued October 30, 1996); 77 F.E.R.C. P61,077; 1996 FERC LEXIS 1975. *Pacific Gas* accepted a delineation of certain lines of three major California utilities as part of that state's electric industry restructuring. The

utilities reserved the ability to change the initial delineation as uses of the facilities change, since it may have multiple uses.

The "existing uses" method accommodated state regulatory settlements, the peculiarities of each system, the historic facts relating to the unique design of each utility's integrated transmission system. Consequently, different results were reached for each utility's system.

The delineation between transmission and distribution is important, not just for determining state or Federal jurisdiction, but also, to ensure each company's appropriate recovery of stranded costs from retail customers, for allocation of administrative and general and operation and maintenance expenses, as well as for development of any access charges (and associated cost support) for use of a utility's ISO grid facilities.

#### COMMENT

None.

## PART 7

### FEDERAL ISSUES

#### 7.1 Two-County Rule.

- 7.1.1 What is it, how does it affect a utility in a competitive environment, and what resolution is possible?

#### ANALYSIS

While one commenter noted "there is no reason to segregate this particular element for separate consideration and treatment," others who have raised it believe it important to discuss because it may, like other Federal issues presented herein, be an impediment

to a utility's participation in the competitive environment contemplated by the Rules. Certainly, FERC, in Rule 888 recognized the threat of open access requirements to continued use of two-county financing and provided some solutions.

Two-County financing or "local furnishing" bonds provide financing in the form of tax-exempt bonds for "facilities for the local furnishing of electric energy or gas" if such facilities are part of a system "providing service to the general populous not exceeding the larger of two contiguous counties or one city and a contiguous county." Internal Revenue Code §142(a)(8). The Internal Revenue Service has added two additional conditions for such tax exempt bond status: (i) generally, the total amount of electricity generated by facilities connected directly to the local grid together with the amount generated by that utility's remote generating facilities, cannot exceed in any year the total amount of electricity consumed in the local service area; or (ii) actual metered flows of electricity at each interconnection point are at all times inbound to the local system. A utility with such financing that ceases to meet these conditions loses the favorable interest rate on such financing. The utility's bondholders lose the tax-exempt status of the bonds which have been sold to them and must be made whole by the utility according to the terms of the bonds.

Competitive generation may impact this financing. FERC's solution in Order 888 was to exempt a utility from reciprocal service if providing such service would jeopardize the tax-exempt status of the bonds. Order 888, mimeo at 376-377. The IRS also amended its rules to accommodate a mandatory FERC wheeling order issued under §211 of the Federal Power Act and retain the tax exempt status. I.R.C. §142(f)(2).

The ACC rules do not disturb two county financing as long as no changes are made which specify an obligation for such a financed entity to serve outside of the two-county area. Parties have argued earlier in this Docket that this could happen if the utility became obligated to serve a customer outside of its existing two-county service territory under the proposed retail wheeling provisions. The solution is for the rules to clearly limit the obligation to serve outside of a local furnishing utility's existing service area. Another solution is for the Commission to include in its definition of recoverable stranded costs, any increase in financing costs or the stranded cost of any assets because of local furnishing requirements.

In 888 A, FERC clarified that all costs associated with a loss of tax-exempt status, including the costs of defeasing, redeeming and refinancing tax-exempt bonds are properly considered costs of providing transmission services. FERC explained that "a customer that takes service, understanding that such service will result in the loss of tax-exempt status, shall be responsible for such costs to the extent consistent with Commission policy and a transmission provider may include in its tariff a provision permitting it to seek recovery of such costs...If the transmission customer is not willing to pay the costs associated with the transmission provider's loss of tax-exempt status, the transmission provider will not be required to provide the requested service." (Order 888-A; 78 F.E.R.C. P61,220; 1997 FERC LEXIS 463).

An alternative solution is to provide local furnishing utilities with a mechanism to modify the schedules described in A.A.C. R14-2-1604(A-D) until such time as a Federal solution can be found. FERC has told Congress it needs to find a solution. (Statement by

Elizabeth A. Moler, Chair. FERC, before the Energy and Natural Resources Committee, United States Senate, March 30, 1997.)

Some commenters state that the Rules should not be amended to encourage use of two-county financing for the benefit of some, but not all, utilities. These participants suggest that consumers should not pay costs of financing that have been increased due to a corporation's decision to extend its service territory.

#### COMMENT

None. See the above discussion.

#### 7.2 Federal Rural Electrification Act (and resulting mortgages, interlocking all-requirements contracts, and related issues).

##### 7.2.1 What is it, how does it affect a cooperative in a competitive environment, and what resolution is possible?

The U.S. Congress in 1936 through the Rural Electrification Act (RE Act), 7 U.S.C. 901 *et seq.*, and again in 1993, through the Rural Electrification Loan Restructuring Act, determined that the national interest would be served by support of rural electric service through low cost loans to rural electric cooperatives to enable them to provide affordable and dependable electric service in sparsely populated areas with loads, which although vital to a rural economy, cost more to serve. Delivering energy costs more in rural areas and the capital investment on a per customer basis is substantially higher. Including areas with more dense population (the small towns) in such systems helps to spread those costs and keeps rates lower.

The Rural Utilities Service (RUS), an agency of the U.S. Department of Agriculture, makes or guarantees and administers RE Act loans and regulates certain cooperative activities. Further, most cooperatives are member owned non-profit entities

which use a tax exemption, embodied in §501(c)(12) of the Internal Revenue Code (26 U.S.C. §501(c)(12)) to further reduce the higher than normal rural costs.

RUS requires as a condition to making or guaranteeing any loans to power supply borrowers (G&T cooperatives), that the borrower enter into RUS all-requirements wholesale power contracts with its distribution members and assign and pledge such contracts as security for the repayment of those loans or any other loans which RUS has permitted to be secured pursuant to the RUS mortgage. The RUS wholesale power contract requires that the rates charged for power and energy produce sufficient revenues to enable the power supply borrower (the G&T) to timely pay the principal and interest on all its debt. RUS relies on the wholesale power contracts and its oversight of cooperatives to certify to the Federal government that "the security for the loan is reasonably adequate and the loan will be repaid within the time agreed." 7 C.F.R. §1717.301.

Most of these loans are amortized over a 35 year period (currently a period that extends about 20 years beyond the target date for full retail choice) and most RUS financed systems obtain a new loan or loan guarantee every three or four years in order to maintain and improve service quality and reliability. In Arizona, five of the affected utility distribution cooperatives and AEPCO are bound together by an all-requirements wholesale power contract that does not expire until December 31, 2020. A sixth affected utility, Navopache Electric Cooperative, is bound until December 31, 2025 by a similar contract to a New Mexico G&T.

RUS finances, at least in part, eight electric systems in Arizona; six are affected utilities and two are tribal utility authorities. RUS financed systems make sales to about 6.6 percent of all electric consumers in Arizona. Federal taxpayers through RUS

hold more than \$382 million in outstanding debt to electric utilities in Arizona. The Federal agency has said that a sudden loss of load from these Arizona systems would not only have disastrous effects on the ability of the cooperatives to serve residential consumers in sparsely populated or less profitable areas, it would also compromise RUS efforts to improve the quality of life in rural Arizona. Letter by Blaine D. Stockton, Jr., Assistant Administrator, RUS, September 12, 1996 to the ACC.

The competitive generation supply and resulting termination of exclusive Certificates of Convenience and Necessity inherent to the ACC rules creates a tension with the federal regulatory scheme outlined above and intrudes on the all-requirements contract, the security for the Federal debt, and the mortgages held on that debt. The mandated use of RUS financed delivery facilities by non-RE Act beneficiaries is also problematic. Such use may cause the cooperatives: (i) to lose their tax-exempt status since revenues flowing to the cooperatives from non-members may well exceed 15 percent of a cooperative's total revenues; (ii) to have problems with either current or future financing under the RE Act; and (iii) due to the retail rate cap under the Order, create tension between the distribution cooperative and its G&T, which is obligated to increase rates to the distribution cooperative as load is lost to competition.

RUS has recommended establishment of a customer specific pricing mechanism: (i) that considers the distribution-G&T structure of non-profits; (ii) that imputes a rate of return on rate base for sales to nonmembers; (iii) that includes in rates charged to non-members any tax liability imposed by ACC ordered retail choice<sup>11</sup>; and, (iv) that

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<sup>11</sup> This pricing mechanism was specifically adopted by FERC in Order 888 for non-jurisdictional transmitting utilities providing open access pursuant to reciprocity or §211 requests. As well, FERC exempted such utilities from the reciprocity

does not divert the RUS subsidy away from its intended beneficiaries in Arizona. *Stockton Letter*, p.9.

RUS also asks the Commission to consider through the process the impact of partial stranded cost recovery on the ability of the utility to repay RUS loan and the results of that on RUS ability to continue low cost financing in Arizona in the future. *Stockton Letter*, p.10.

No solution is yet apparent to the Rule's conflict with the RUS system of interlocking all-requirements wholesale power contracts/mortgage security other than the schedule modification offered by the Rules themselves or a total exemption from the Rules.

One commenter raised these issues and noted that while the G&T could probably sell and has sold excess power (at wholesale) to other entities, the "anti-competitive feature is at the distribution level" because of the all-requirements contracts. The commenter adds that G&T financing has been based on those contracts. Another comment noted only that these are "level playing field issues related to competition among PSC's and non-PSC's". The cooperatives, however, are subject to ACC jurisdiction even though they are not investor owned utilities.

Some participants maintain that solutions to the cooperatives' problems include (1) not selling power to non-members or (2) making membership in the cooperative a condition of service; or (3) match the FERC mechanism that is used to handle this financing tool. These participants are concerned that REA financing does not benefit

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requirement if it would threaten their tax exempt status. Order 888, FN499. RUS has proposed the other pricing mechanisms to FERC; no Orders or decisions have yet been made by FERC as to that proposal. Some cooperatives have open access tariffs which incorporate these pricing principles, but they have not been tested at FERC.

competitors on an equal basis. They maintain that the Rules should not encourage this type of financing to the detriment of other competitors.

#### COMMENT

None. See the above discussion.

#### 7.3 Western Area Power Administration.

7.3.1 What affect will its presence, system, contracts, policies and Federal constraints have on the adoption of retail competition in electric supply?

#### ANALYSIS

Western Area Power Administration (Western), a Federal agency and transmission provider, is a member of the Southwest Regional Transmission Association, a FERC approved Regional Transmission Group. Additionally, it is voluntarily complying with FERC's open access concepts through a modified open access tariff. Consequently, its presence should not impede implementation of competition in Arizona.

#### COMMENT

None.

#### 7.4 Interstate Reciprocity.

7.4.1 In view of the Commerce Clause of the U.S. Constitution, what can Arizona require of out-of-state entities to compete in Arizona markets?

#### ANALYSIS

The sale and delivery of electricity affects interstate commerce. However, historically, it has been subject to local regulation, in large part due to the necessity of such regulation to protect the public health and safety of local citizens and the administrative burden of economic regulation of largely in-state monopolies. As well, this local character

has been preserved in federal legislation which has specifically left certain regulation to the states. see Order 888 and the Federal Power Act.

State regulation of interstate commerce is subject to certain limitations: (i) it may not discriminate against interstate commerce; (ii) it may not regulate subject matter which inherently requires uniform national regulation; and, (iii) the state intent underlying the regulation may be of more importance than is the burden on interstate commerce, i.e, the balance of interests must favor state as opposed to national interests. *Southern Pacific Co, v. Arizona*, 325 U.S. 761 (1945).

Concerns have been raised in this docket that an early mandate of competitive generation supply, before other states have acted, will unnecessarily subject Arizona's utilities to cutthroat competition from market entrants located nationwide who would not have entered the Arizona market if other markets were available. Sensing a threat to Arizona's economic and tax base, certain participants asked whether Arizona could limit participation here to foreign entities from states which also have retail competition – a true reciprocity requirement. That may be unlikely, given the three-prong test of *Southern Pacific*, but the Working Group has not achieved a consensus on this point.

A state may not create economic barriers to out of state products in order to protect local interests. *Dean Milk Co. V. City of Madison*, 340 U.S. 349 (1951). Instead, the purpose or benefits of the law, e.g., public health or welfare must outweigh the burdens on interstate commerce. Reciprocity agreements between states for the sale of products are not *per se* a violation of the Commerce Clause of the U.S. Constitution. However, mandatory reciprocity requirements prohibiting the sale of products from another state unless that state reciprocates is such a violation unless there is a substantial state interest

which can not be achieved by other means. *Great Atlantic & Pacific Tea Co. V. Cottrell*, 424 U.S. 366 (1976).

Arizona may exert regulatory jurisdiction over entities that: (i) meet the definition of jurisdictional entities in the Arizona Constitution. Arizona statutes and the rules; (ii) are doing business within the State of Arizona; and, (iii) have sufficient minimum contacts within the state to support the exercise of jurisdiction. Such entities may also be amenable to jurisdiction by Arizona courts.

In *General Motors Corporation v. Tracy*, 197 U.S. Lexis 692; 65 USLA 4068 (Feb. 18, 1997), the U.S. Supreme Court left in place an Ohio two-tiered tax system, saying Ohio may tax interstate sellers of natural gas at a different and higher rate than it taxes local distribution companies. The Court did not arrive at this result as a legal proposition. Instead, court employed a balancing test to determine the economic harm that the system posed for interstate commerce. After describing the developing natural gas industry and making a distinction between bundled and unbundled service, the Court found that it was unsuited to gathering facts upon which economic decisions could be made. "The most we can say is that modification of Ohio's tax scheme could subject LDC's to economic pressure that in turn could threaten the preservation of an adequate customer base to support continued provision of unbundled services to the captive market." 197 U.S. Lexis at \_\_\_\_.

*General Motors* notwithstanding, the Commerce Clause generally prohibits state policies that amount to economic protectionism for in-state utilities. Nevertheless, the Commission can and should avoid policies and rules which put in-state jurisdictional utilities at a competitive disadvantage to electric service providers located out-of-state or

out of ACC's jurisdiction. Examples include grafting an additional renewables mandate from previous integrated resource planning orders onto the solar portfolio for affected utilities and continuing an Affected Utility's obligation to serve into the competitive phase-in and beyond.

#### COMMENT

None.

### PART 8

#### ANTI-TRUST ISSUES

##### 8.1 State Action Immunity Doctrine.

Some participants were concerned about the State-Action Immunity Doctrine ("State Action"). State Action, generally provides an exemption from antitrust laws providing that actions that are taken: i) pursuant to a clearly articulated state policy to displace competition in favor of regulation; and ii) actively supervised by the state, do not violate that antitrust statutes. The Arizona legislature as codified this principle in A.R.S. § 40-286 which provides:

The provisions of title 44, chapter 10, article 1, shall not apply to any conduct or activity of a public service corporation holding a certificate of public convenience and necessity granted pursuant to this article, which conduct or activity is approved by a statute or this state or of the United States or by the corporation commission or an administrative agency of this state or of the United States having jurisdiction of the subject matter.

Affected Utilities will not have a State Action exemption to the extent they are engaging in competitive, as opposed to monopoly, services.

## COMMENT

See discussion above.

### 8.2 Application of Traditional Antitrust Principles.

## COMMENT

The working group reviewed antitrust issues and decided that the ACC does not have jurisdiction to enforce violations of the antitrust laws. Antitrust principles may need to be considered to the extent the Commission is concerned about market power and monopolistic pricing.

## PART 9

### SUGGESTED CODE CHANGES

#### 9.1 Federal Statutes.

Work Group participants generally agreed that federal statutes may need to be changed, among other things, to harmonize FERC and ACC jurisdiction, address potential antitrust issues and recognize generally the increasingly interstate nature of electricity sales and deliveries. Certain of these issues have been addressed in other portions of this report. No specific federal statutory changes were recommended in relation to this section of the report.

Work Group participants disagreed whether changes to federal statutes are necessary to implement the Rules. Some participants maintained that no amendments were required to implement the Rules. These participants also maintain that amendments should not be undertaken, if at all, until the impact of competition has been reviewed and assessed.

Some participants maintain that federal statutes should be changed to, among other things, harmonize FERC and ACC jurisdiction, address potential antitrust issues and recognize generally the increasingly interstate nature of electricity sales and deliveries. Certain of these issues have been addressed in other portions of this report. No specific federal statutory changes were recommended in relation to this section of the report.

## 9.2 The Arizona Constitution.

### 9.2.1 Whether Constitutional amendments are required either to allow or facilitate competition in generation supply and other electric services.

## ANALYSIS

The Working Group did not achieve a consensus whether constitutional amendments are required to implement competition. The Working Group debated three principal issues on this subject:

- (1) the ACC's authority to require municipal utilities to open their territories to competition and regulate their sales to others and their implementation of retail access (Ariz. Const. art. 15, § 2);
- (2) the ACC's power to exercise varying degrees of control over non-PSCs given the provisions of art. 15, § 2; and
- (3) the ACC's power to determine just and reasonable rates in the competitive market rather than through traditional rate-of-return, fair value rate cases. See art.15, §§ 3 and 14).

## THE ACC'S POWER OVER MUNICIPAL UTILITIES

Affected Utilities maintain that if municipal utilities are to be permitted to serve in the service areas of Affected utilities, the ACC must have constitutional authority to compel

municipalities to open their own service territories to competition and to regulate the terms and conditions for opening those territories. The Affected Utilities maintain that even if the ACC and a municipal utility have authority to open the municipality's service territory pursuant to an IGA, the ACC will not have the power to regulate the municipality's conduct. The Affected Utilities maintain that the ACC will be powerless to enforce the IGA, respond to consumer complaints or enforce complaints by competitive providers regarding unbundled rates or other terms and conditions of service that may be unfair or not cost-justified. The Affected Utilities argue that the governing body of the municipal utility will be the final arbiter of such complaints (subject to an uncertain standard of judicial review), not an independent regulator.

Other participants maintain that municipalities are "regulated" via the ballot box. The municipalities are governed by elected representatives who are responsive to voters. Municipalities do not have an incentive to increase investor returns at the expense of ratepayers. The lack of a profit motive is a disincentive for predatory or anti-competitive practices.

Affected Utilities maintain that the ACC may not enforce its rate setting powers or rules upon municipalities' sales of electricity in other utilities' service territories. According to the Affected Utilities, these differences in regulatory supervision will create significant variations in costs and flexibility for regulated and non-regulated market participants. Some Work Group participants raised several alleged advantages which municipal utilities enjoy over investor-owned PSCs, such as freedom from various taxes and the ability to issue tax-exempt debt.

Other participants point out that California looked at comparative advantages among municipalities and investor-owned utilities and determined that the issue was a non-starter. These participants also maintain that no competitive advantage can be established between the tax advantages enjoyed by investor-owned utilities and the governmental exemptions that are available to municipal utilities.

One municipal utility proposed to form public service subsidiaries or affiliates that would be regulated by the ACC control. Formation of regulated subsidiaries may partially address the Affected Utilities' concerns about the ACC's lack of jurisdiction over sales by municipal utilities in the Affected Utilities' territories. The Affected Utilities maintain that the Rules do not require formation of a subsidiary and do not, in any event, address ACC's lack of jurisdiction over their sales in and access to municipal utilities' service territories.

#### RATE REGULATION OF PSCs

Affected utilities maintain that the Constitution establishes a single definition of PSC as any corporation engaged in furnishing electricity for light, fuel, or power. Article 15, Section 3 then requires the ACC to prescribe rates for all PSCs. Article 15, Section 14 requires the ACC to ascertain the fair value of all PSCs and use that as the basis for determining rates. Some Affected Utilities maintain that Arizona courts have consistently ruled that these duties are mandatory, and the ACC must exercise this level of supervision over PSCs. See the discussion in Section 1.1.

Affected Utilities maintain that the Competition Rules essentially envision two kinds of PSCs and two systems of rate setting - ACC prescribed, fair value cost based rates for distribution-monopoly "wires service" and market determined rates for competitive electricity supply and, in some cases, other distribution related services.

Other participants maintain that the ACC already has the power to regulate distribution monopolies differently from competitive generation supply. These participants maintain the ACC is empowered by the Constitution to make such distinctions based upon its power to prescribe "just and reasonable classifications to be used" by PSCs pursuant to Article 15, Section 3. Distribution monopolies are "natural monopolies" that continue to be rate-regulated to protect the public from monopolistic pricing. Technology exists to separate distribution monopolies from generation. Generation supply therefore is eligible for competitive pricing without the risk of monopolistic pricing that exists for distribution monopolies. The United States Supreme Court has recognized a market distinction between local gas distributors and competitive gas suppliers in *General Motors v. Tracy*, \_\_\_ U.S. \_\_\_ (1997).

Affected Utilities maintain that state constitutional mandates prohibit the transition to a competitive market as envisioned by the Competition Rules. Additionally, these requirements impose needless or burdensome regulatory restraints on the desired goal - a fully flexible, free market. For example, these participants maintain that the ACC still must require the filing of tariffs and the Constitution requires rates that are prescribed by the ACC and that are based upon fair value. To the extent that the tariff rates are prescribed by or based upon the market, all tariffs will be suspect. As the market determines rates either below or above a "fair value" premised rate, consumers or competitors may raise these constitutional requirements to invalidate the market based price and to demand refunds of collected monies.

Other participants maintain that the Commission's power to prescribe just and reasonable rates is exclusive and may not be abridged by any other branch of government.

*Consolidated Water Utilities, Ltd. v. Arizona Corp. Comm'n.* 178 Ariz. 478, 875 P.2d 137 (Ct. App. 1993). These participants maintain that article XV, section 14 of the Arizona Constitution authorizes the ACC to use the fair value of a utility's assets to artificially determine just and reasonable rates as if they were set in a competitive market. The same goal is achieved, albeit more accurately, through pricing in a competitive market. They maintain that tariffs are not a barrier to competition. For example, the ACC uses competitive tariffs for services in the telecommunications industry. These participants maintain that traditional rate regulation may be required for the transition to competition, and will continue for the foreseeable future for transmission and distribution of electricity.

#### COMMENT

None.

#### 9.3 Arizona Statutes.

This portion of the report will focus principally on the Working Group's debate regarding possible changes to the Public Utilities statutes (Title 40).

##### 9.3.1 A.R.S. § 40-281

This statute and A.R.S. § 40-282 require utilities to obtain certificates of convenience and necessity ("Certificates") prior to constructing facilities and providing electric service to the public.

#### ANALYSIS

The debate regarding certificates of convenience and necessity is found in Part 1.1 of this Report.

#### COMMENT

See the Comment to Part 1.1.

9.3.2 A.R.S. §§ 40-201 and 40-202

ANALYSIS

Affected Utilities maintain that these statutes must be amended to draw distinctions between the level of regulation to be applied to the "wires" distribution function and all other competitive generation and distribution related services. The Affected Utilities maintain that more definitions should be added to A.R.S. § 40-201 to distinguish between competitive generation and distribution services, including definitions for "affected utilities," "electric service providers," "aggregators" and "brokers."

Other participants maintain that the ACC already has the power to classify additional entities as competition is observed. These participants maintain that legislative classifications are unconstitutional to the extent the classifications interfere with the ACC's rates and classification functions.

Affected Utilities and some other participants maintain that, at a minimum, the Legislature should amend A.R.S. § 40-202 to state the public policy of this state as to competition and to mandate or allow different regulation for competitive providers, similar to the statute's provisions relating to telecommunications services.

Other participants agreed that a statement of policy, consistent with article XIV, §15 of the Arizona Constitution, would be desirable. Other participants maintain that the state constitution does not allow statutory mandates for "different regulation" of competitive rates or competitive services.

9.3.3 Rate Statutes

Affected Utilities maintain that A.R.S. §40-203, A.R.S. §§ 40-246 to 40-251 and A.R.S. §§ 40-365 and 40-367 assume a fully regulated monopoly. According to the

Affected Utilities, the statutes give the ACC full power and obligation to establish rates, follow certain procedures in allowing changes to rates and require the posting or publication of all rates. The Affected Utilities maintain that these statutes must be reevaluated, amended and possibly repealed before implementing competition. The Affected Utilities maintain that although the ACC should retain a certain level of jurisdiction over monopoly services, reduced regulation is appropriate for competitive services. If not, they maintain that deregulation will not be achieved and the market will not be allowed to operate.

Other participants maintain that reduced statutory regulation should not be enacted until the effectiveness of existing and potential competition become known. In the case of natural monopoly, regulation will continue to assume the role of a substitute for competition. Markets that are not fully competitive (e.g., oligopolies) require the ACC to balance its rate control function with a role as a facilitator of competition. In effectively competitive markets, they argue that the ACC must secure the prerequisites to competition, such as open access to distribution systems, subsidy-free pricing of services, non-discriminatory pricing, and efficient market entry. These are ratemaking functions that the ACC must exercise before one can understand the implications of a proposed statutory change. This may explain, to some degree, why Working Group participants have not come forward with specific statutory changes to Title 40.

#### 9.3.4 A.R.S. § 40-204

Affected Utilities maintain that this statute should distinguish between monopoly and competitive service providers and relieve competitive providers from the statute's extensive information and regulation requirements. Affected Utilities maintain that

proprietary information for competitive PSCs should be protected to a greater extent than fully regulated, monopoly PSCs. Affected Utilities maintain that similar confidentiality amendments should be added to A.R.S. § 40-360, the state's public records law and Open Meeting statutes (Titles 38 and 39).

Other participants suggest that restricted or closed access to information may discourage or even prevent competition. Lack of competition will continue the current monopolistic pricing and prevent the ACC from reducing the level of regulation for utilities. These participants maintain that such statutory changes should be scrutinized carefully and only after competition has commenced.

**9.3.5 A.R.S. §§ 40-221 and 40-222**

These statutes authorize the ACC to establish accounting systems and depreciation standards for PSCs. Affected Utilities maintain that this level of regulation will be inconsistent with and unnecessarily burdensome on a competitive marketplace.

Other participants oppose immediate changes for the reasons stated in Sections 12.3.2 to 12.3.4.

**9.3.6 A.R.S. § 40-284**

Some Affected Utilities maintain that this statute may prohibit or restrict the transaction of utility business within Arizona by a foreign corporation and may need needs to be reexamined in the context of the competitive market. These Affected Utilities maintain that this statute might be the appropriate forum to address concerns about interstate reciprocity. These arguments maintain that, with the exception of California, no other western state has opened its electric market like Arizona and Arizona utilities may

need to seek replacement markets and mitigate stranded costs in other states' markets that will be closed to them.

Other participants maintain that foreign corporations already conduct utility business in Arizona. These participants refer to annual reports of the large Affected Utilities as proof that Arizona utilities have found replacement wholesale markets in other states, including California. These participants maintain that closing or restricting Arizona markets to out-of-state entrants may violate the U.S. Constitution's Commerce Clause ("Commerce Clause"). The state may not discriminate against interstate commerce nor may it unduly burden interstate transactions. *Arkansas Electric Cooperative v. Arkansas PSC*, 461 U.S. 375 (1983). Discriminatory state laws and regulations are "per se" invalid under the Commerce Clause. *Philadelphia v. New Jersey*, 437 U.S. 617 (1978).

#### 9.3.7 A.R.S. § 40-285

This statute provides that ACC approval must be obtained before any PSC may sell, lease, assign, mortgage or otherwise dispose of or encumber its system. Transfers or other dispositions without an order of the ACC are void. Affected Utilities maintain that in a competitive marketplace such a statute is antiquated and inconsistent with the flexibility that utilities need to respond to the demands of the marketplace.

Other participants maintain that these arguments presume the existence of meaningful competition. Meaningful competition will not be realized until after the Rules take effect and the competitive market has been assessed. In any event, protections must be in place to address merger and acquisition activities that may result in monopolistic activities.

Some participants point out that the Rules affect generation, not the state's extensive distribution and transmission systems. These participants further maintain that A.R.S. § 40-285 applies only to systems that are "necessary" to provide a public service. These participants maintain that in a competitive setting facilities would not be "necessary" when alternative providers are available to provide a public service.

9.3.8 A.R.S. § 40-301 et. seq.

These statutes give the ACC power to supervise the utilities' authority to issue stocks, bonds, notes and other evidences of indebtedness and to create liens on their property. The statutes void any loan or stock issuance that was not approved by the ACC. Affected Utilities maintain that these statutes assume that a sole-source provider of a basic utility service should be subject to public interest regulatory jurisdiction. For example, issuance of too much debt may endanger the utility's ability to provide service. Affected Utilities question the need for these statutes if consumers have the right to choose competitive generation supply and other distribution related services. Affected Utilities maintain that these statutes restrict their ability to function effectively in a competitive marketplace and, unless amended, would call into question the validity of all stock and financing issues for competitive service providers.

Other participants maintain that the Commerce Clause prevents these statutes from applying to out-of-state entrants. These participants oppose changes for the reasons set forth in Sections 12.3.2 to 12.3.4 and 12.3.8.

9.3.9 A.R.S. §§ 40-321, 40-322, 40-331, 40-332 and 40-334

These statutes pertain generally to regulation of services and facilities provided by electric utilities. Affected Utilities maintain that these statutes assume a "one

size fits all" standard as to these subjects and assume continued regulation is required. These arguments maintain that the statutes are inappropriate in a competitive market that determines adequate rates, allocates resources and dictates differing levels of service.

Other participants oppose changes for the reasons set forth in Sections 12.3.2 to 12.3.4 and 12.3.8.

**9.3.10 A.R.S. § 40-341 et. seq.**

This Article establishes a system for conversion of overhead electric facilities. Affected Utilities maintain that, although the need for such statutes may continue, their purpose and function should be reexamined in light of the separation of regulated distribution "wires" services from competitive generation and other distribution related services.

Other participants maintain that the state should retain jurisdiction over overhead electric facilities. These involve legitimate state property and environmental concerns.

**9.3.11 A.R.S. § 40-360 et. seq.**

This Article establishes the Power Plant and Transmission Line Siting Committee. In general, it requires any person contemplating construction of electric power plant and transmission facilities within the state to file a ten-year plan with the ACC and vests authority over siting and environmental compatibility issues in the Committee and ACC. Affected Utilities question the need for or desirability of a ten-year generation plan that is subject to regulatory review. Other Affected Utilities suggest that the size of facilities covered by the statutes should be reevaluated.

Other participants oppose these changes for the reasons set forth in Sections 12.3.2 to 12.3.4.

9.3.12 A.R.S. § 40-401 *et. seq.*

These statutes assess charges on PSCs to finance the regulatory expense associated with the operation of the ACC and the Residential Utility Consumer Office. Affected Utilities maintain that the annual assessment provisions may require adjustment since, for example, the assessment is levied upon revenues from intrastate operations of entities holding certificates. Affected Utilities maintain that significantly higher or lower revenues will result from changes in the number of entities holding certificates and in the total of revenues derived from intrastate operations.

Other participants oppose these changes for the reasons set forth in Sections 12.3.2 to 12.3.4.

9.3.13 Title 10

The Rules require most Arizona cooperatives to open their service territories to competition. A.R.S. §§ 10-2072 and 10-2138 prohibit competition by cooperatives. Thus, the cooperatives maintain that they are required to open their territories to competition but under current law are unable to seek replacement customers. Most participants agree these statutes should be repealed. Also, most of Arizona's cooperatives are formed pursuant to A.R.S. § 10-2021 *et seq.* (Non-profit Generation and Transmission Cooperatives) or A.R.S. § 10-2051 (Non-profit Distribution Cooperatives). In general, cooperatives maintain that these are limited purpose statutory structures adequate for the regulated monopoly system for which they were crafted but too restrictive for the increased and varied demands of a competitive market. Affected Utilities and Staff

maintain the statutes should be amended to facilitate the cooperatives' participation in a competitive marketplace.

#### 9.3.14 Non-Regulated Activity by Utilities

Certain Working Group participants suggested either additional legislation or regulations controlling the ability of utilities to compete in non-regulated activities. These participants expressed concern about the utility's ability to participate at all in these businesses or to cross-subsidize such non-regulated activities with revenues from regulated activities. A majority of Work Group participants felt that the ACC has sufficient jurisdiction currently to prohibit any unfair cross-subsidization and/or that prohibition of non-regulated activities would be inconsistent with the move generally to competition.

#### 9.3.15 A.R.S. § 48-1515

One Working Group participant suggested possible repeal or amendment of this statute to remove its arguable limitation on expansion of an existing special district.

#### COMMENT

None.

EXHIBIT A

MARICOPA COUNTY SUPERIOR COURT CASES  
INVOLVING ELECTRIC RESTRUCTURING

*Tucson Electric Power Company, an Arizona corporation v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03748*

*Citizens Utilities Company, a Delaware corporation v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-04176*

*Arizona Public Service Company, an Arizona corporation v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03753*

*Arizona Electric Power Cooperative, Inc., a nonprofit Arizona generation and transmission cooperative, v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03920*

*Graham County Electric Cooperative, Inc., a nonprofit Arizona distribution cooperative v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03921 [Consolidated with Case No. CV97-03920]*

*Duncan Valley Electric Cooperative, Inc., a nonprofit Arizona distribution cooperative v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03922 [Consolidated with Case No. CV97-03920]*

*Trico Electric Cooperative, Inc., an Arizona nonprofit corporation v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03928 [Consolidated with Case No. CV97-03920]*

*Sulphur Springs Valley Electric Cooperative, Inc., an Arizona cooperative, non-profit membership corporation v. The Arizona Corporation Commission, an agency of the State of Arizona, Case No. CV97-03942 [Consolidated with Case No. CV97-03920]*

LEGAL ISSUES WORKING GROUP  
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Douglas A. Oglesby	Vantus Energy Corporation
Cory Prochaska	Wellton-Mohawk Irrigation and Drainage District

**LEGAL ISSUES WORKING GROUP  
CHRONOLOGY OF GROUP PROCESS**

***January 8, 1997***

Legal Division sends letters of invitation to participate to a service list prepared by Chief Economist.

***January 10-February 3, 1997***

Fifty-one companies, municipalities, public interest groups or their attorneys accept 1-8-97 invitation to participate in Working Group.

***February 27, 1997***

Public Notice and Agenda for first meeting of the Group are posted and mailed.

***March 5, 1997***

First meeting of Working Group; 42 persons excluding staff attend.

***March 13, 1997***

Public Notice and Agenda for second meeting of the Group are posted and mailed.

***March 19, 1997***

Second meeting of Working Group; 30 persons excluding staff attend. Ken Sundlof of the Public Power/Governmental Entities Subgroup and Steve Wheeler of the Stranded Cost Subgroup distribute to the Group lists of issues to consider. Participants discuss issues. Legal Division requests participants' written comments on both lists of issues by March 25, 1997 and promises staff's written responses at the next meeting, April 1, 1997.

***March 13-April 1, 1997***

Comments received from participants.

***March 28, 1997***

Public Notice and Agenda for third meeting of the Group are posted and faxed to participants.

***April 1, 1997***

Third meeting of the Working Group; 35 persons excluding staff attend. Legal Division distributes staff's responses to issues raised at March 19, 1997 meeting by the Public Power/Governmental Entities and Stranded Cost Subgroups. Participants discuss responses.

***April 4, 1997***

Comments received to date on legislative issues are faxed to participants.

***April 4-April 17, 1997***

Comments received from participants. Additional individuals and entities join Working Group.

***April 16, 1997***

Public Notice and Agenda for fourth meeting of the Group are posted and faxed to participants.

***April 17, 1997***

Fourth meeting of the Working Group; approximately 30 persons excluding staff attend. Utilities Director Carl Dabelstein makes a presentation on stranded costs and distributes its outline to participants. The Stranded Cost, Public Power/Governmental Entities and Federal Issues Subgroups report to the other members of the working group. Participants discuss the issues raised by the Legislative Issues Subgroup.

***April 18-May 21, 1997***

Comments received from participants and distributed to Working Group. Additional individuals and entities join Group.

***May 7, 1997***

Public Notice and Agenda for fifth meeting of the Working Group are posted and mailed to participants.

***May 16, 1997***

Complete set of staff and participant comments received to date are mailed to all members of Working Group.

***May 21, 1997***

Fifth meeting of the Working Group; approximately 40 persons excluding staff attend. Legal Division distributes its outline of the draft report to the Commission and discusses it with participants. Individual participants are selected to act as "reporters" for outline topics. The Group also establishes a tentative timetable for filling out the outline using participant comments.

***May 22, 1997***

Comments received from participants and mailed to all members of Working Group. Additional individuals and entities join Working Group, which now has 92 persons on its service list.

***May 29, 1997***

List of reporters for each outline topic and revised timetable are mailed to participants.

***May 30-June 29, 1997***

Participant comments on outline topics are submitted to reporters and Chief Counsel. Legal Division disseminates copies of comments to all participants.

***June 30, 1997***

First draft of report is mailed to participants; deadline for comments is July 17, 1997.

***July 17, 1997***

Notice and agenda for July 24, 1997 meeting are posted and mailed to participants, together with copies of comments received since the July 7 comments mailing.

***July 18, 1997***

Additional participant comments are mailed to Group members.

***July 24, 1997***

Sixth meeting of the Working Group; 30 persons excluding staff attend. Participants review first draft of the report, discuss possible edits, Table of Contents and Executive Summary.

***July 25, 1997***

Reporters meet to edit second draft of report. Revised timetable and new comments received are mailed to participants.

***July 28, 1997***

Second draft of the report is mailed to participants; deadline for comments is August 18, 1997.

***July 29, 1997, August 21, 1997***

Comments on second draft of the report are mailed to participants. The August 21, 1997 mailing includes announcement of next meeting date for Working Group.

***August 25, 1997***

Notice and agenda for August 28, 1997 meeting are posted and mailed to participants.

***August 28, 1997***

Seventh meeting of the Working Group. Twenty persons excluding staff attend. Participants discuss the comments received to date and the format, Executive Summary and presentation of the final report.

***August 29, 1997***

Revised timetable is mailed to participants.

***September 5, 1997***

Proposed final draft of report is mailed to participants; comments are due by September 12, 1997. Mailing includes announcement of final meeting of Working Group on September 26, 1997.

***September 8-September 29, 1997***

Participants submit editorial comments on the proposed final draft of the report and overviews of their individual substantive comments to be appended to the report submitted to the Commission.

***September 19, 1997***

Notice and agenda for September 26, 1997 meeting are posted and mailed to participants.

***September 26, 1997***

Eighth meeting of the working group; 15 persons excluding staff attend. Legal Division distributes Executive Summary which is discussed by the participants. Deadline for submission of final individual comments is the morning of September 30, 1997. Participants are requested to provide disk of their comments for posting to the Commission's web page.

***September 30, 1997***

Report to the Arizona Corporation Commission by the Legal Issues Working Group is filed with ACC's Docket Control.

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: March 5, 1997

TIME: 9:00 a.m.

PLACE: Arizona Corporation Commission  
1200 West Washington Street  
Phoenix, Arizona

ATTENDANCE:

Chairman Carl Kunasek  
Commission Renz Jennings  
Members of Commission Staff

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP

MATTERS DISCUSSED:

Commission Chief Counsel Lindy Funkhouser opened the meeting. Representatives from staff, electric utilities, consumer groups, potential market entrants, and other groups discussed how to identify and address legal issues affecting the Commission's rules on electric competition. Several issues were identified as requiring additional investigation at this time: political subdivisions and intergovernmental agreements; stranded cost legal issues; legislative issues; and federal issues. Subgroups were organized to investigate these issues.

ASSIGNMENTS FOR NEXT MEETING:

With the exception of the Legislative Issues Subgroup, these subgroups are to meet to discuss these issues and report back to the Working Group at the next meeting of the group.

The Legislative Issues Subgroup is to identify and provide to staff by Friday, March 21, the legislative issues they believe need to be addressed to implement the electric competition rules.

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES  
March 5, 1997  
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These issues will be disseminated among the members of the Working Group, who will have the opportunity to respond to them by April 4.

The Working Group will meet again sometime in early April, at a time and place to be determined.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: March 19, 1997

TIME: 1:00 p.m.

PLACE: Arizona Industrial Commission Auditorium  
800 West Washington Street  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Public Power/Governmental Entities Subgroup  
Members of Stranded Cost Issues Subgroup

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP  
PUBLIC POWER/GOVERNMENTAL ENTITIES SUBGROUP  
STRANDED COST ISSUES SUBGROUP

MATTERS DISCUSSED:

Kenneth C. Sundloff opened the meeting of the Public Power/Governmental Entities Subgroup. Mr. Sundloff reviewed a list of issues for the subgroup to consider. Representatives from interested parties discussed the issues. Commission Chief Counsel Lindy Funkhouser requested participants' written comments on the list of issues by March 25, 1997 and agreed to prepare responses to the issues, through the Commission's staff, at the next meeting scheduled for April 1, 1997.

Steven M. Wheeler opened the meeting of the Stranded Cost Issues Subgroup. Mr. Wheeler reviewed a list of issues for the subgroup to consider. Representatives from interested parties discussed the issues. Commission Chief Counsel Lindy Funkhouser requested participants' written comments on the list of issues by March 25, 1997 and agreed to prepare responses to the issues, through the Commission's staff, at the next meeting scheduled for April 1, 1997.

Participants discussed a timetable for participants to submit legislative comments.

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES  
March 19, 1997  
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ASSIGNMENTS FOR NEXT MEETING:

Participants will send their comments on the lists of both issues to the Commission's Legal Division by March 25, 1997.

The Commission's Legal Division will prepare responses to the issues for the next meeting scheduled for April 1, 1997.

The next meeting of the Public Power/Governmental Entities and Stranded Cost Issues Subgroups was set for April 1, 1997.

Legislative comments will be submitted for review by mid-April, 1997. Staff will advise participants of a due date for the comments.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: April 1, 1997

TIME: 1:00 p.m.

PLACE: Arizona Corporation Commission, Administration Offices  
1300 West Washington Street  
Third Floor Conference Rooms A & B  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Public Power/Governmental Entities Subgroup  
Members of Stranded Cost Issues Subgroup

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP  
PUBLIC POWER/GOVERNMENTAL ENTITIES SUBGROUP  
STRANDED COST ISSUES SUBGROUP

MATTERS DISCUSSED:

The Commission's Chief Counsel, Lindy Funkhouser, opened the joint meeting of the Public Power/Governmental Entities and Stranded Cost Issues Subgroups. Mr. Funkhouser reviewed the Legal Division Staff's comments on the list of issues for the subgroups to consider. Representatives from interested parties discussed the issues. Commission Chief Counsel Lindy Funkhouser advised participants that the Commission's Utilities Director, Carl Dabelstein, will be invited to the meeting of the Legislative Subgroup in mid-April, 1997.

ASSIGNMENTS FOR NEXT MEETING:

Participants will meet to discuss legislative issues in mid-April, 1997.

The Commission's Legal Division will advise participants of the date and location of the meeting of the Legislative Issues Subgroup.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: April 17, 1997

TIME: 1:00 p.m.

PLACE: Arizona Industrial Commission Auditorium  
800 West Washington Street  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Legal Issues Working Group

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP

MATTERS DISCUSSED:

Commission Director Carl Dabelstein presented an overview of stranded cost recovery for electric utilities. Director Dabelstein distributed an outline of his presentation.

The participants discussed member comments on legislative issues that may apply to electric restructuring. The group also discussed the future role of the Stranded Cost Issues and Public Power/Governmental Entities subgroups.

ASSIGNMENTS FOR NEXT MEETING:

The Legal Division will prepare an outline of the issues raised by participants to date, and will advise the group of the date and place of the next meeting.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: May 21, 1997

TIME: 1:00 p.m.

PLACE: Arizona Hall of Fame Museum  
1101 West Washington Street  
Basement Conference Room  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Legal Issues Working Group

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP

MATTERS DISCUSSED:

The chairman distributed an outline of the draft report and discussed it with participants. Individual participants were appointed to act as "reporters" for selected outline topics. The group established a tentative timetable for filling out the outline using participant comments.

The following participants agreed to serve as Reporters on the following topics:

Steven M. Wheeler	<i>Nature of Restructuring in General and Stranded Cost Recovery.</i>
Bradley S. Carroll	<i>Rights and Duties of Public Service Corporations and Antitrust Issues</i>
Lawrence V. Robertson, Jr.	<i>Scope of Restructuring</i>
Beth Ann Burns	<i>Rates and Ratemaking</i>
C. Webb Crockett	<i>ACC Powers/Procedures</i>
Jessica J. Youle	<i>Non-PSC Issues</i>

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES  
May 21, 1997  
Page 2

Patricia E. Cooper	<i>FERC Issues and Federal Issues</i>
Douglas C. Nelson	<i>Taxation Issues</i>
Michael M. Grant	<i>Legislative Issues</i>

ASSIGNMENTS FOR NEXT MEETING:

Participants will submit comments to reporters regarding the topics and reporters will incorporate the comments in separate summaries for their assigned topics.

The Legal Division will prepare a first draft of the report based upon Reporters' summaries by June 30, 1997.

Participants will deliver comments on the draft report by mid-July, 1997 and the group will meet in late July, 1997 to discuss edits to the first report.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: July 24, 1997

TIME: 1:00 p.m.

PLACE: Arizona Industrial Commission Auditorium  
800 West Washington Street  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Legal Issues Working Group

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP

MATTERS DISCUSSED:

The participants discussed the first draft of the Legal Issues Working Group Report. Reporters were instructed to edit the first draft and assist in preparation of a second draft of the report.

ASSIGNMENTS FOR NEXT MEETING:

A second draft of the report will be mailed to participants and a second round of comments will be submitted in August, 1997. Participants will meet in late August, 1997 to discuss edits to the second report.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: August 28, 1997

TIME: 9:30 a.m.

PLACE: Arizona Department of Revenue  
Room B-1  
1600 West Monroe Street  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Legal Issues Working Group

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP

MATTERS DISCUSSED:

The participants discuss the second draft of the Legal Issues Working Group Report. Participants will submit comments to the proposed final report, together with a position statement not exceeding 5 pages prior to issuance of the final report. The position statements will be attached to the final report as appendices.

ASSIGNMENTS FOR NEXT MEETING:

A final meeting will be scheduled for late September, 1997 to finalize the report.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

ARIZONA CORPORATION COMMISSION  
SPECIAL OPEN MEETING MINUTES

DATE: September 26, 1997

TIME: 2:00 p.m.

PLACE: Arizona Department of Revenue  
Room B-1  
1600 West Monroe Street  
Phoenix, Arizona 85007

ATTENDANCE:

No Quorum  
Members of Commission Staff  
Members of Legal Issues Working Group

TOPIC: ELECTRIC RESTRUCTURING LEGAL ISSUES WORKING GROUP

MATTERS DISCUSSED:

The participants discussed the Executive Summary and the presentation of the final report. Commission Chief Counsel Lindy Funkhouser reminded the Working Group that final comments on the report must be submitted no later than the morning of September 30, 1997. He requested that the comments also be presented on a disk for posting on the Commission's webpage. He thanked the participants, especially the Reporters, for their cooperation in the process and for their valuable contributions to the report.

ASSIGNMENTS FOR NEXT MEETING:

No future meetings have been scheduled.

The meeting adjourned.

Lindy Funkhouser  
Chairman, Legal Issues Working Group  
Chief Counsel, Arizona Corporation Commission

## LEGAL ISSUES WORKING GROUP

### PARTICIPANT COMMENTS

- Aguilá Irrigation District  
The City of Safford  
Electrical District No. 8  
Harquahala Valley Power District  
McMullen Valley Water Conservation & Drainage District  
Tonopah Irrigation District
- Arizona Consumers Council
- Arizona Electric Power Cooperative, Inc.  
Duncan Valley Electric Cooperative, Inc.  
Graham County Electric Cooperative, Inc.
- Arizona Public Service Company
- Arizona Utility Investors Association
- ASARCO, Inc.  
Cyprus Climax Metals  
ENRON Corp.  
Arizona Association of Industries
- Irrigation and Electrical Districts' Association
- PG&E Energy Services
- Residential Utility Consumer Office
- Salt River Project Agricultural Improvement and Power District
- Southern Arizona Mechanical Contractors Association
- City of Tucson
- Tucson Electric Power Company

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September 16, 1997

By Facsimile (542-4870) and U.S. Mail

Lindy P. Funkhouser, Esq.  
Chief Counsel  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85004

Re: Comments to Proposed Final Draft Report of Legal Issues Working Group

Dear Mr. Funkhouser:

On behalf of the following "non-Affected Utility" municipal corporation electric providers, we are submitting these additional comments on the Proposed Final Draft Report to the Commission:

Aguila Irrigation District  
The City of Safford  
Electrical District No. 8  
Harquahala Valley Power District  
McMullen Valley Water Conservation & Drainage District  
Tonopah Irrigation District

We express our commendation for the tremendous amount of work that has obviously been devoted to this final draft. Much improvement has been made since the earlier versions, and we congratulate you on the balanced, thorough, and enlightening presentation of the significant issues with which the working group has grappled.

Our first comment is that the very absence of a consensus among the various stakeholders on these legal issues, to which numerous lawyers have contributed their expertise, evidences the state of uncertainty (or, at best, flexibility) of the law regarding certain aspects of the Rules. That may suggest that many of the important legal issues may ultimately need to be resolved by the courts, and that the Commission should proceed very cautiously before concluding that any major changes to the constitution or the relevant statutes are needed at this juncture.

We note the particular choice of words for defining "Consumer" in the introduction section of the report, *viz.*, "*high volume purchasers* of electric generation services." (emphasis added) This definition evidences what we think is an unfortunate, subtle (but real) bias in this entire process. The interests of the small, individual residential and agricultural users of electricity throughout Arizona, and particularly the rural regions, are being subordinated to the interests of the major utilities already here, the out-of-state utilities who want to be here, and the major industrial customers --the *high volume purchasers*--who want to see a price war between the other two. The economic impacts

Lindy Funkhouser, Esq.  
September 16, 1997  
Page 2

upon the small, individual consumers of electricity, and especially those served by remote transmission facilities in sparsely populated service areas, are too easily being ignored. Those *low volume* consumers are expected to buy into the magic words "competition will save money for everyone," which are being repeated constantly by the proponents of competition, who often act as if simply saying the mantra often enough will make the assertion a reality. From the vantage point of the rural interests I represent, I remain concerned that there may, indeed, be some economic losers among the consumers in this game, not just "big winners and little winners" as we are being told.

Until more experience is gained, in other states as well as Arizona, with the real economic fallout of competition, the Commission should keep its focus limited to deregulation of the retail sales within those entities over which it clearly has jurisdiction under existing law. If the results of that are as wonderful for *all consumers* as we are being promised they will be, no time will be wasted by the not-for-profit municipal and district utilities joining into the full competition game, because their own governing bodies -- their taxpayers and customers -- will insist upon it without the need of any mandate from the State.

We offer one editorial suggestion, with respect to the very last item of the report. It was our understanding that, even though it was once mentioned in a list of possible statutes for which the Rules could have some implications, the repeal or amendment of A.R.S. 48-1515 was not being suggested or argued by any participant. We would ask you to consider deletion of the last section, 9.4.15, from the report.

Finally, we refer again to my comment letter of June 11, 1997, and the fundamental positions asserted therein. Only minimal changes in Arizona statutes, and no constitutional amendments, are necessary or advisable in order to implement the Rules. Changes, if any, must be motivated by protection of Arizona's *citizen* consumers, not national economic interests. Ongoing debates by investor owned utilities aimed at the demise of public power should not be allowed to obfuscate the basic issues and processes necessary for the Commission to go about its business of implementing competition for electric generation within its jurisdiction.

Your report is very well done, and will advance the appropriate progress of this process; and we appreciate the hard work that has made it possible.

Respectfully,



Jay I. Moyes

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June 12, 1997

By Facsimile (542-4870) and U.S. Mail

Lindy P. Funkhouser, Esq.  
Chief Counsel  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, AZ 85004

Re: Comments to Legal Issues Working Group

Dear Mr. Funkhouser:

I represent the following non-PSC municipal corporation electric providers with regard to the ACC electric competition rules proceedings and resulting working group processes:

The City of Safford  
Aguila Irrigation District  
Electrical District No. 8  
Harquahala Valley Power District  
McMullen Valley Water Conservation & Drainage District  
Tonopah Irrigation District

I have participated in certain meetings of, and reviewed comments of other participants in, the legal issues working group. On behalf of the above-named entities, these general comments are submitted to emphasize three fundamental positions, without reiterating in detail supporting points presented by other commentators or citing the supporting legal authority. We anticipate providing more detailed comments after review of the forthcoming summary reports of the "recorders" and your draft report to the Commissioners.

1. Changes in Arizona law should be minimal, motivated only by legal necessity in order to benefit Arizona citizens, not national economic powers.

All of our comments are founded upon the following principle: *Changes in Arizona law in order to implement electric competition are acceptable only if absolutely necessary for the benefit and protection of the electricity consuming citizenry of Arizona.*

Lindy Funkhouser, Esq.

June 12, 1997

Page 2

Economic and institutional dislocation will inevitably follow full competition in the electric industry, just as it has in every other "so-called de-regulation" process and jurisdiction. That dislocation is a defensible price for Arizona to pay only if the electric consumer citizens of Arizona are truly benefitted thereby. Simply because major, national financial and industrial powers seek private economic advantage and *increased profits* for their worldwide shareholders is *not* adequate justification for dismantling the current reliable and broadly affordable (though not fully competitive) integrated electric generation, transmission and distribution system serving Arizona's citizens.

Not just coincidentally, almost all of the district/municipal electric utilities are small, and serve primarily the sparsely populated regions of rural Arizona, heavily dependent upon agricultural economies. These are not the markets sought by the national and regional giants currently hovering over Arizona and pressing the ACC at every turn to hastily impose full competition regardless of the unresolved issues and unknown costs. The major PSCs, in and out of Arizona, are lining up only the fattest and ripest cherries to be picked among the large industrial users and densely populated, easily aggregated load centers. Rural Arizona and the logistically expensive-to-serve agricultural and residential customers must not be left alone to hold the bag of reallocated and dislocated facilities and costs, "stranded" or otherwise, that will no longer be shouldered by the major industrial customers who will enjoy prime economic bargaining leverage in an open marketplace. For the protection of the rural Arizona citizens and economies, the small, publicly owned district/municipal utilities will need every possible protection from unnecessary regulatory costs, and every possible advantage from preference resources once the free marketplace is at work statewide.

## 2. Constitutional amendment is ill-advised and unnecessary.

Municipal/district electric utilities exist *solely* to benefit their constituent Arizona citizenry, and they have always been adequately governed by that same citizenry. Their every act must be conducted under the broad light of open public scrutiny. They enjoy no guaranteed return on their investments, and must answer directly to their constituency if they do not operate in the best economic interests of that *local* constituency. Most are able to serve power at substantially lower rates, compared to PSCs, largely *because* they are governed by the people who pay the rates (avoiding the enormous costs, proportionate to their small size, that ACC regulatory compliance would impose,) and because they are not required to deliver profits to non-customer investors. There is no need for an additional layer of costly bureaucratic oversight of these publicly owned, governed and operated, *not-for-profit* entities.

In contrast, the framers of the Arizona Constitution wisely distinguished the need for careful oversight of the activities of the *private investor*-owned utilities, whose policies are devised behind closed doors and whose goals must necessarily make the economic interests of

Lindy Funkhouser, Esq.  
June 12, 1997  
Page 3

their *international shareholder and creditor constituency* paramount over the interests of their Arizona customers.

None of my district clients enjoys an exclusive monopoly service territory. Both APS and those districts serve accounts (some for the same customer) on the same distribution wires. Customers in those districts have always been able to exercise the choice to take service from APS instead, and they base that choice solely upon comparative rates and related economic considerations. Predictably, if open competition does what its proponents say it will, customer-driven market forces will, in due course, politically force open the territories of those few municipals that presently have monopoly service territories. That process will occur *without the aid of, or need for, constitutionally mandated ACC jurisdiction, if there are real economic benefits from allowing those citizens access to competing generation markets*. Current contractual wheeling and supply arrangements between the municipals and the PSC transmission and generation utilities can be augmented by intergovernmental agreements. They can provide appropriate treatment of stranded costs, if any, and the practical enforcement of fair, reciprocal competitive practices as a condition of allowing municipals competitive access to customers outside their current service areas.

Implementation of competition does not require amendment to the well-reasoned constitutional distinction between PSCs and non-PSCs; and any such tinkering by the legislature and the voters could have many unintended consequences for historical utility regulatory alignments.

### 3. The "level playing field" argument is a red herring.

The recently increased volume level of clamor by the large investor-owned PSCs for a state and federal regulatory "level playing field" is simply another chorus of their perennial whining for help to escape the inescapable -- their economic dilemma of trying to sell affordable power to Arizona customers while lining their investors' pockets with profits. In contrast, public power is able to "pay its shareholders" -- its local customer citizenry -- by keeping costs and rates as low as possible consistent with sound management for longevity and reliability. It has no other master to serve. Public power cannot be blamed and should not be penalized because of that fundamental difference.

Recent independent studies, of which you are aware, demonstrate that there are as many, if not more, "tilts" of the playing field in favor of the investor-owned utilities as for the publicly-owned. APS, as the lead singer in this chorus, only points out those items which support their aim of depriving the municipals of "preferences" to federal power resources, tax-exempt financing, and other historical benefits. But their complaints are only diversionary tactics, hiding the equally broad array of special tax, economic and political benefits enjoyed by PSCs. *The real objective of their complaint is not a level field; it is the total demise of public power as a*

Lindy Funkhouser, Esq.

June 12, 1997

Page 4

*competitor, leaving them the only player on the field.*

Federal preference power is a product of federal legislation, not state. And its allocations are based upon long-standing public policy, *historical* load and need (not future competitive market opportunities.) Debates about federal power preferences have no place in this process of opening Arizona to competition, and we refer to the comments of Sheryl Taylor on this issue. (It must be noted, however, that if the more radical environmental groups, purporting to protect endangered species with no regard for human costs, have their way, then the costs of federal preference power will continue its rate escalation spiral such that the PSCs will soon celebrate their exemption from the burdens of take-or-pay federal power contracts, and all power consumers will be the losers.)

In summary, we reiterate our basic principle that changes in law are acceptable only if they provide benefit to all the citizens of Arizona, not just the major, national industrial and financial institutions who are politically and economically driving this competitive process. And any such changes should be and can be minimal. We will vigorously contend against efforts to constitutionally impose new ACC jurisdiction upon district and municipal electric providers, or to legislatively destroy the vital ability of rural public power consumers to rely upon federal preference resources. Neither of these objectives of the PSCs is necessary to effectively implement electric competition in a manner that will broadly benefit the citizens of Arizona.

Thank you for the opportunity to comment on behalf of the above-named public entities.

Respectfully,



Jay I. Moyes

JIM/dmn

205772

To: Lindy Funkhouser, Legal Issues Working Group, Draft RP3  
From: Barbara Sherman, for the Arizona Consumers Council  
Date: 7/22/97

- The purpose of the Arizona Corporation Commission regulation and oversight of electric industry has been to protect the interests of the residential, low income and small business customers. The federal and state move toward electric competition will not eliminate the need for protection of these customers. Changes in electricity regulation must take this into account. After the changes, a revised legal and regulatory framework must ensure that electricity is reliable, safe, and available at affordable prices to the majority of the customers -- the small residential, the low income, and business consumers.
- We note with significant concern that the definition of "consumer" in the report only refers to one type of consumer, namely, the "high-volume purchasers of electric generation services." See position above about the role of the Arizona Corporation Commission.
- With relation to the changes in the Arizona Constitution and Arizona State statutes or FERC, the Arizona Consumers Council concurs with those who would keep a close eye on potential problems and minimize changes until they are necessary. Again, the constitution and statutes offer many tools for protecting consumers. In particular, it is critical that the Arizona Corporation Commission always has the ability to oversee electric utility operations to prevent price gouging and fraud as well as to oversee minimum standards for safety and reliability. For example, the needs for business confidentiality must not overshadow the residential and small business consumers need for protection, i.e., for Arizona Corporation Commission oversight of financial business information.
- The question has been posed as to whether or not the staff at the Arizona Corporation Commission should express its own opinion in the working reports. Perhaps the working reports are not the right vehicle for staff opinions, since they are intended as a compilation of the opinions, needs and positions of the many differing stakeholders in the process. However, it would be a disservice to the public if the staff did not specify its recommendations. The ACC staff is knowledgeable, experienced, and has done a good job of protecting the interests of the low income, the residential and the small business consumers in Arizona, overall. Most of the staff have many years of expertise that should not be lost in the critical change in electric regulation. The Arizona Consumers Council recommends that a separate staff report be prepared with staff recommendations re electric restructuring for the Arizona Corporation Commission and made public so that informed decisions are made in the rules.

page 2, Barbara Sherman to Lindy Funkhouser, September 22nd.

The staff has a duty to represent the public's interest and not just to tell the commissioners what they want to hear.

\* One of the most important issues regarding the restructuring of electricity is the stranded costs/benefits issue. The price tag for generation plants loom large for the industry and all the consumers, but especially the residential and small business consumers. Electric consumers should not have to pay for "stranded costs" except as they receive the benefits of competition. Regulated electricity rates and bundled rates already include the costs of the generation plants. "Stranded benefits" should be distributed among all customers.

- Prior to decisions on rules changes, it would be wise to quantify the rules change impacts on the electricity rates of low income, residential and other small consumers. It is important to retain customer classes and classes of service insofar as they are necessary to evaluate whether small consumers are getting their fair share of the benefits of competition. Tax impacts also need to be quantified. We should be moving into competition with our eyes open, knowing the probable impacts, so that we can prevent problems.

- Provisions need to be made—even with competition—for social programs re hardship cases whether low income or health.

- Also, integrated resource planning has consumer protection and national defense implications that must be taken into account even though electricity is moving into competition.

- The obligation to serve will change with competition, however; small consumers will need a reliable electricity source.

\* Consumer interests demand some continuation of legal constraints against cross-subsidization of other business ventures with electricity.

- All electric service providers need to meet minimum standards of service. New and foreign providers should meet similar requirements to those of Arizona's long term service providers.

- As for the "fairness" issues and "level playing field" issues, it must be remembered that there have been and will continue to be a need for rural areas of Arizona to receive adequate, safe and reliable electricity at affordable rates. Much of the tax and loan infrastructure that create differences between investor owned utilities and municipals or cooperatives arose from the need to provide electricity in areas where population density is low.

Thank you for the opportunity to share our views. Barbara Sherman

AEPCO, Duncan and Graham's (the "Cooperatives")

Minority Report

Legal Issues Working Group

The most significant failing of the Report of the Arizona Corporation Commission's Legal Issues Working Group (the "Report") is its political rather than legal nature. This is driven by two major factors: (1) the currently pending litigation concerning the Rules and (2) the upcoming Legislative session. Both elements have transformed what should be a thoughtful analytical road map on legal obstacles to competition and how to address them into a mishmash of policy pronouncement and legal obfuscation that, at best, confuses and, at worst, actively misleads the reader.

For example, because the Rules are being challenged in court, notably absent from the Report are meaningful recommendations as to who has what jurisdiction and how should it be exercised to achieve the desired goal of a competitive electric marketplace. Understandably, the Commission's attorneys can't concede that the Courts long ago decided the Legislature controls the competition issue because that would damage the ACC's litigation defense.

The SRP and other municipals are so concerned about any opening of the Constitution which might lead to an examination of their non-regulated status that they oppose necessary Article 15 amendments. Similarly, prospective providers and large industrial consumers are so fearful of any legislative debate which might delay the January 1, 1999 start date that they oppose any examination of Title 40 - even change which would produce a more flexible market for competitors and a more competitive market for consumers.

The Report, therefore, finesses these issues by offering pro and con and avoiding conclusions on settled matters. For example, a Report reader does not know that:

- More than 50 years ago, the Supreme Court decided the Legislature's control of the Certification process does not conflict with the ACC's rate-making power.
- Since that time, Arizona's courts have ruled repeatedly that a regulatory compact exists and the Commission may administer but may not change the policy of regulated monopoly.
- More than 40 years ago, the Supreme Court ruled that the Commission can only use "fair value" as the basis for prescribing just and reasonable rates.

- Since that time, Arizona's courts have ruled repeatedly that ACC rate orders and tariffs not based on "fair value" are void and the rates collected are subject to refund.

Instead, the best the Report can muster on these critical, settled legal issues is the following tepid statement:

The Working Group's consensus is that the Courts or perhaps the Legislature ultimately will determine whether the Commission must have legislative or constitutional authority to promulgate the Rules . . . (Report, p. 3).

Report readers should first view Rod Serling's televised admonition many years ago: "There's a signpost up ahead. You just crossed over into the Twilight Zone."

The Cooperatives disagree in many areas with the Report's analyses, conclusions and, most importantly, its lack of recommendations on key subjects. In the interests of brevity, we will highlight five major Constitutional and Legislative subjects most in need of better focus:

#### The Constitution.

Several constitutional hurdles stand between today's regulated market and competition. The two most critical are:

- Article 15, Sections 3 and 14. No one disagrees that the Constitution gives the Commission exclusive ratemaking authority. However, like most power offered by that document, it is not unfettered. As to rates, (1) the Commission, not the provider nor consumer, must set them and (2) they must be based on "fair value", not some other standard including the market. Since statehood, every time the ACC has tried to ignore either mandate the courts have ruled the rate invalid. As importantly, in at least one case, they also ordered a refund of all dollars collected under it. If these Constitutional requirements aren't changed, no supplier and no consumer will have a market based rate on which they can rely. This issue must be resolved by the Legislature and the people.
- Article 15, Section 2. The ACC Rules seek to regulate non-electric supply services, i.e. metering, billing and collection, etc. However, since these functions are not included in the definition of activities ascribed to a public

service corporation, several cases dictate the ACC can't exercise this power and can't be given it by the Legislature. If regulation of these services is desired, a Constitutional change is required.

#### Title 40.

The Cooperatives feel that many revisions to Title 40 are necessary to allow competition to work. We refer to this subject as "De-regulate, don't re-regulate." The three most important areas are:

- A.R.S. § 40-281. Placing the debate about what the Certificate statute currently requires to one side, no one can seriously argue that the Legislature shouldn't take action to clarify what the State's public policy on competition should be in the future. This is a critical issue because failure to act will leave, unnecessarily, the entire foundation of competition in jeopardy.
- A.R.S. §§ 40-285 and 40-301 et seq. These statutes require a utility to seek ACC approval before selling assets or issuing stock or notes. Violations render the sales, stock or notes void. They burden a competitive market, slow decisions and cause providers, potential or current, to wonder if Arizona's market is worth the peril. They were created by the Legislature for another time and must be re-examined by the Legislature to see if they still fit.
- Rate Statutes. The statutes in Title 40 - A.R.S. §§ 40-250 and 40-367 among them - assume a highly regulated monopoly market where tariffs, standard terms and conditions, rate hearings and regulatory filings are required to assure customer satisfaction, not consumer choice. Thus, the Legislature, pursuant to its Constitutional power, has imposed on the Commission a variety of filing, hearing and process requirements. They are paternalistic and antithetical to the goal of a competitive marketplace. The ACC can't de-regulate and its Rules don't purport to. Only the Legislature can deal with this issue.

The nature of a minority report is to poke at the core product. This memorandum is no exception to that general rule. However, we do not by these comments minimize nor denigrate the considerable effort devoted to the Report by all participants.

# Snell & Wilmer

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Steven M. Wheeler (602) 382-6327

September 19, 1997

HAND DELIVERED

Lindy Funkhouser  
Chief Counsel  
ARIZONA CORPORATION COMMISSION  
1200 West Washington  
Phoenix, AZ 85004

*RE: Final Report of the Legal Issues Working Group*

Dear Mr. Funkhouser:

Thank you very much for the opportunity to participate in the Legal Issues Working Group. You are to be congratulated for your management of this exceedingly difficult process. Although I am disappointed that the Final Report utilized a standard of "unanimous consensus" for determining whether recommendations would be presented to the Commission (a process which allows one participant to "blackball" a recommendation otherwise supported by a clear majority of those present), I nonetheless commend you for the "inclusiveness" of your workshops and the opportunity for all to present their views, comments and concerns.

The purpose of this letter is to present an overview of the substantive comments of Arizona Public Service Company to the Final Report, as your September 5, 1997 memo invites. These comments are designed to promote, not retard, the movement toward responsible retail access as quickly as possible. And, as in the past, Tom Mumaw and I stand ready to work with you and the other parties to revise the Competition Rules to cure their many obvious deficiencies.

The summary comments set forth below will concentrate solely on legal issues associated with the Competition Rules.<sup>1</sup> The many policy issues raised by the Competition Rules<sup>2</sup> will be

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<sup>1</sup> This summary is not intended to be a complete presentation of all of APS's views on the Competition Rules. Those views have been expressed in previous pleadings and written comments to the Commission and in part are the subject of an APS legal challenge to the rules. Nothing in these comments shall serve as a waiver of any argument APS has or may have with respect to the Competition Rules.

<sup>2</sup> Such issues include the calculation and recovery mechanisms for stranded cost, failure of the rules to address reliability concerns or industry structure, the impact of competition on local and state tax revenues and the plethora of technical and administrative implementation issues.

Lindy Funkhouser  
September 19, 1997  
Page 2

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left to APS comments made in other forums and working groups. With that introduction, and without repeating the extensive legal analysis and argument we have provided during the workshop process, the following represent the significant legal issues APS believes must be addressed by the Commission in connection with the Competition Rules:

1. Lack of Commission Authority.

The Commission simply has no jurisdiction, even if adequate compensation is paid, to (a) grant CC&N's to competitive generation service providers or (b) force incumbent Affected Utilities to make their distribution facilities available to competitors. The fact that APS, and virtually all other parties, favor retail access in one form or another cannot cure this obvious lack of Commission authority. The cases cited by APS make it perfectly clear, and no party has cited any direct precedent to the contrary, that it is the legislature, not the Commission, that must establish the foundational authority for retail access in the electric utility industry. Only then can the Commission begin the implementation task. We urge the Commission to work with APS to remedy this defect as soon as possible.

2. Mitigation Standard Related to Recovery of Stranded Costs.

The mitigation standard in R14-2-1607 is clearly unlawful, unreasonable and overly vague. The Commission cannot legally require utilities to expend potentially unlimited amounts of private capital and other resources to pursue ill-defined business ventures not subject to ACC jurisdiction solely to qualify for compensation to which the utility is otherwise lawfully entitled as a result of the Commission's actions. Therefore, Section A of R14-2-1607 should delete the phrase "every feasible" and add "reasonable" and add "that are directly related to its regulated business" so that the subsection would now read:

The Affected Utility shall take reasonable, cost effective measures to mitigate or offset stranded costs by means such as expanding wholesale or retail markets, or offering a wider scope of services for profit, among others, that are directly related to its regulated business.

3. Regulation of Non-Public Service Corporations.

R14-2-1611(A) states "... nor shall Arizona electric utilities which are not Affected Utilities be able to compete for sales in the service territories of the Affected Utilities."

Lindy Funkhouser  
September 19, 1997  
Page 3

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Notwithstanding this unambiguous pronouncement, numerous working group participants continue to argue about the extent to which non-PSCs are able to compete in investor owned utility service areas, either directly under the Competition Rules or through some as yet unproduced intergovernmental agreement. Given the confusion this debate has engendered, the Commission should clarify and further reconfirm that R14-2-1611 does not permit non-PSCs to compete within the service territories of Affected Utilities. If such competition is sought by a non-PSC, then appropriate legislative changes must be implemented to insure that such competition is authorized, fair, conducted on a reciprocal basis, and provides for such compensation as may be required for any "takings" of utility property (e.g., under A.R.S. § 9-516).

4. Obligation to Serve.

Affected Utilities are required to provide a bundled "standard offer" service to end-users that are under no reciprocal obligation to take such service. The Final Report acknowledges the lack of legal support for this unilateral burden on Affected Utilities but, although proposing some minor changes to the Competition Rules, it does nothing to either lift that burden or to equalize it by imposing such an obligation to serve on other ESPs.

5. Recovery of Stranded Costs in Rates for Non-Competitive Services.

A.A.C. R14-2-1607(J) is, at best, ambiguous and arguably in direct conflict with Subsection H of the same regulation. The Final Report is needlessly "soft" in its recommendation for an amendment to this part of the Competition Rules to clarify from whom stranded costs can be recovered. At a minimum, the first sentence of Subsection J should be deleted.

6. "Streamlined" Regulation of Competitive Services and Competitive Service Providers.

The Final Report seemingly accepts the notion that the Commission has the authority to excuse compliance by certain ESPs with specific statutory provisions. There is absolutely no authority cited for such a proposition. Moreover, several of the statutes in question (e.g., A.R.S. §§ 40-285; 40-301, *et seq.*; and 40-360.02) require or at least authorize severe penalties for non-compliance. Thus, it is unlikely that any ESP could reasonably rely on the Commission's unilateral waiver or modification of these statutes.

Lindy Funkhouser  
September 19, 1997  
Page 4

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The only prudent course of action to recommend to the Commission would be to seek legislative modification of those statutes that are no longer necessary or which would restrict competition. APS has already proposed such modifications to the Joint Legislative Study Committee currently evaluating electric industry competition issues.

Thank you for the opportunity to present these additional comments. I hope the Commission Staff will carefully consider these views and support these changes to the Competition Rules that are so clearly required to provide meaningful customer choice in an efficiently and lawfully restructured industry.

Sincerely,



Steven M. Wheeler  
for SNELL & WILMER LLP.  
Attorneys for Arizona Public Service Company

SMW:DN



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Investors Association

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September 29, 1997

Lindy Funkhouser, Esq.  
Chief Counsel  
Arizona Corporation Commission  
1200 W. Washington  
Phoenix, AZ 85007

DELIVERED BY U.S. MAIL, E-MAIL & FAX

Dear Lindy:

As you are aware, the Arizona Utility Investors Association believes that the Corporation Commission's rule establishing electric competition leaves a gaping hole in the regulatory oversight of the transition to competition with regard to municipal aggregation.

The final draft of the report of the Legal Issues Working Group in Sections Four and Five purports to address issues involving non-public service corporations. However, those sections deal only with municipal electric utilities and are silent about other municipalities which may choose to offer the same services as those reserved for Electric Service Providers under the provisions of R14-2-1601, 1605 and 1606.

The rule itself ignores municipal corporations unless they are operating electric utilities, but the Commission's Legal Division has asserted that municipalities may offer services that have been defined as competitive by the Commission, i.e., electric generation, ancillary services, metering, meter reading and billing and collection.

This creates a serious dichotomy which should be expressed as an unresolved legal issue. The dichotomy is as follows:

1. The foundation of the Commission rule is that the transition to competition will be regulated by the Commission and that market entrants which choose to compete as Electric Service Providers must submit to Commission jurisdiction.

Indeed, all of the pertinent language in the rule anticipates that electric competitors will be regulated, as in R14-2-1605 which says, "A *properly certificated* Electric Service Provider may offer any of the following services under bilateral or multilateral contracts with retail consumers:" (Emphasis added)

2. However, the Commission is barred by the Arizona Constitution from regulating municipal corporations and has no apparent authority to compel a municipality to obtain a Certificate of Convenience & Necessity or submit in any other way to Commission rules and regulations.

3. As a result, cities and towns throughout Arizona will be able to aggregate thousands of retail electric customers without following the same rules imposed on other Electric Service Providers. They will be able to set prices, aggregate electric loads, install and read meters, bill customers and establish their own protocols without regulatory oversight from anyone who knows anything about the electric industry.

4. While it's not possible to predict precisely the effect of creating a potentially large unregulated segment of the industry, the consequences could be severe for system reliability, consumer understanding and the conduct of a competitive marketplace.

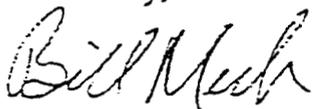
5. Members of the staff of the Utilities Division who were instrumental in drafting the competitive rule say it was always their intention to require regulation of Electric Service Providers and not to create an unregulated segment of the industry during the transition to full competition.

In our view, municipal corporations should either a) be excluded from competing in the service territories of Affected Utilities until the Commission has relinquished its regulation of competitive services or b) be required by legislation to follow Commission rules and regulations governing the transition to competition.

In R14-2-1611, the Commission purports to exclude Arizona electric utilities which are not public service corporations from competing for sales in the service territories of Affected Utilities. Therefore, it may be possible to amend the rule to apply a similar prohibition to municipalities which do not succumb to Commission jurisdiction. The other option is a statutory enactment described previously.

In any case, the report of the Legal Issues Working Group should at least recognize the prospect of unregulated municipal aggregation as a significant unresolved legal issue.

Sincerely,



Bill Meek  
President

MEMORANDUM

TO: Lindy Funkhouser, Chief Counsel, Legal Division  
ARIZONA CORPORATION COMMISSION

FROM: Webb Crockett, Lou Stahl 

DATE: September 15, 1997

RE: Final Comments on the Report to the Arizona Corporation Commission  
Regarding Electric Industry Competition

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The following represents final comments on the Report to the Arizona Corporation Commission ("Report").

It should be noted that many of the comments previously made by the Consumers represented herein, ASARCO, Incorporated, Cyprus Climax Metals, ENRON Corp. and the Arizona Association of Industries, with respect to the various Drafts of the Report were not included in the Final Draft of the Report. The Consumers are again providing their position on issues, as the representatives of a major segment of the interested parties, as well as specific citations to relevant authority which should have been included in the Report in order for the Commission to have a more complete understanding of the constitutional, statutory and legal basis for any decisions the Commission makes regarding electric industry competition.

It is respectfully submitted that the following comments be considered by the Commission in connection with its review of the Report:

Introduction:

The Introduction does not reflect that there was often not a consensus on whether any action should be taken at all, as well as many areas where a consensus could simply not be reached on any particular action. For example, with respect to the proposed Constitutional and statutory amendments requested by the Affected Utilities, some participants believe that no amendments are necessary, and, therefore, believe no action is necessary.

The term "Consumer" should be construed more broadly than to "refer primarily to high-volume purchasers of electric generation services." Other consumers who would not be considered high-volume purchasers are also involved in the deregulation process.

Scope of the Commission's Authority:

The Affected Utilities argue that the incumbent utilities have the right to a monopoly position due to an alleged regulatory compact with the State of Arizona. The position of many of the consumers of electricity, as well as other parties, is that mere acquisition of a certificate of convenience and necessity in a given area does not give a public service corporation the exclusive right to provide electric service, and

no property right to a monopoly may be claimed. Absent from the discussions in the Report, however, is any citation to the approval of the consumers' viewpoint by the Superior Court of Arizona as set forth in the recent decision of the Honorable Steven D. Sheldon in *U.S. West Communications, Inc. v. The Arizona Corporation Commission, et al.*, CV 95-14284 (May 6, 1997). This is an important decision in this area of which the Commission should be aware and which should be followed as it progresses through the appellate system. The disposition of the *U.S. West* case on the regulatory compact and takings arguments will undoubtedly have a significant impact on the Affected Utilities' arguments. Thus, the citation to the *U.S. West* case should be noted at each juncture where the regulatory compact is discussed or referenced, as well as in the sections where the Affected Utilities raise the takings arguments. (Sections 1.1, 1.2, 1.3, 1.4, 1.5, 2.1, 2.2.)

It should have been made clear in the Report that A.R.S. § 40-281 does not provide for an exclusive and indefinite monopoly. There are no perpetual rights under Arizona law. The Arizona Constitution makes it very clear that monopolies are disfavored, stating "monopolies and trusts shall never be allowed in this State..." (Ariz. Const. Art. 14, § 15) (emphasis added). This cornerstone Constitutional principle is set forth in footnote 4 on page 7 of the Report, but should be stated in the text rather than relegated to a footnote. This principle should be reiterated in Sections 1.1, 1.2, 1.3, 1.4, 1.5, 2.1, 2.2.

**Section 1.1:**

Page 3, bottom paragraph – There was not a consensus of the Working Group that (1) the Commission must have additional legislative or constitutional authority to promulgate the Rules; (2) the Commission should clarify that the Rules do not affect the exclusivity of distribution services; or (3) the Rules need to distinguish between certificates for distribution and certificates for other services.

Page 6 – Footnote number 3 should not be relegated to a footnote but should be included in the text of the Report.

**Section 1.2:** It is incorrectly stated on Page 10 that "The Working Group consensus is that the Commission should consider addressing this possibility in amendments to the Rules." The consumers who have been actively participating in the Working Group do not agree that the Rules need to be amended. Thus, it should be noted that "no consensus" was reached on this section. Comments A and C should be eliminated to the extent they state or imply that the Rules need to be amended or augmented. The goals of Comment B, and even A and C, may be reached without amendments to the Rules. Further, with respect to Comment B, the consumers take the position that the obligation to serve should and does continue so long as Affected Utilities are recovering stranded costs because until such costs are fully recovered, Affected Utilities are being paid for their investment and for the costs of implementing competition. Affected Utilities should not be allowed to pass on additional costs to consumers.

Section 1.3: The text of Article 15, Section 10 of the Arizona Constitution should also be included in this section. Section 10 provides: "All electric, transmission, . . . corporations, for the transportation of electricity, . . . for profit, are declared to be common carriers and subject to control by law." Further, under the provisions of A.R.S. § 40-332, the Commission has the power to order joint use of facilities.

Section 1.5: In the final paragraph of this section on page 14, the words "and consumers" should be inserted after the word "Staff" in order to alert the Commission that others share Staff's views on this issue.

Section 2.1: On page 14, first paragraph, it should be noted that more than a single participant agrees that the Affected Utilities should be precluded from cross-subsidizing their unregulated activities with funds received from ratepayers, that accounting methods and procedures to prevent cross-subsidization should be implemented, and that they should be required to pay fair market value for the use of utility personnel, services, and equipment used, as well as royalties for any intangible benefit gained, through affiliation with the regulated utility. These directives should be extended to encompass any use of the personnel, assets or credit of the utility to benefit the unregulated activities.

Section 3.1: In response to the statements in this section that utilities should be required to expend resources in mitigation of stranded costs, some parties believe there should be no limitations on such mitigation requirements. Rather than limit mitigation efforts to only the use of funds generated by "traditional utility service" the Affected Utilities should be required to use any revenues that are generated by or from the use of personnel, assets or the credit of the utility to mitigate stranded costs. Consumers should receive the benefit of all revenues generated by the assets, personnel or credit of the utility. Those assets, personnel and credit of the utility were traditionally devoted to serving the public, with the ratepayers returning the investments to the corporation through rates, and any continuing revenues from such assets, personnel and credit should be utilized to complete the return of that portion of the investment rendered stranded by competition.

Footnote number 6 on page 17 should have the word "duties" stricken and replaced with the words "legal obligations".

Sections 3.2 and 3.3: It should be noted that there is a disagreement as to whether there is a conflict between R14-2-1607(J) and R14-2-1607(H). Also, the Commission should be aware that the Consumers take the position that stranded costs should be recovered from all who benefit from competition. Under the "comment" on page 20, the words "see the discussion above" should be stricken and replaced with "no consensus".

Section 7.1: It should be noted in this section that some participants take the position that the availability of two county financing is a benefit which will not be available to all participants in a

competitive market. Recognizing this fact, the Commission should not draft specific rules or make changes to the Rules which will affirmatively foster the use of this benefit by some participants to the detriment of other participants. More particularly, if a corporation chooses to extend its service territory in such a manner as to increase its costs of financing, these costs should not be passed through to consumers as costs. The last sentence in the second full paragraph on page 43 ("Another solution is for the Commission to include in its definition of recoverable stranded costs, any increase in financing costs or the stranded cost of any assets because of local furnishing requirements.") should be deleted. If corporations wish to take advantage of beneficial financing, they should also recognize that they must live within the parameters of that financing in order to accept it. Corporations should be required to weigh the benefits of the financing against its possible burdens prior to accepting it, even if some of those burdens mean foregoing some market share.

Section 7.2: Here again, the Consumers' viewpoint was never incorporated into the Final Draft of the Report. To accurately reflect the participants' positions, it should be noted that some participants believe that solutions to the issues raised in this section are possible without amendments to the Rules. Possible solutions may include that co-operatives simply not sell to non-members, or make membership in the co-operative a condition of service. Still another possibility is to match the FERC mechanism put in place to handle this financing tool. Companies should not be able to utilize this type of favorable financing without being required to recognize that benefits and burdens must be weighed, even if some of those burdens require a lesser market share or more limited service areas in the competitive market. As discussed with respect to the two county financing, REA financing is beneficial financing which is not available to all participants in a competitive market. That fact should be noted in reviewing the Report, as well as the position that no Rules should be adopted which will foster the use of this financing by some, to the detriment of others in a competitive environment.

Section 9.3: Further comment on this section relates to the ability of the Commission to permit the market to determine fair and reasonable rates for services. The Commission's power to prescribe rates is exclusive and cannot be interfered with by the legislature, the courts or the executive branch of the state government. *Pueblo Del Sol Water Co. v. Arizona Corp. Comm'n*, 160 Ariz. 285, 772 P.2d 1138 (Ct. App. 1988); *Southwest Gas Corp. v. Arizona Corp. Comm'n*, 169 Ariz. 279, 818 P.2d 714 (Ct. App. 1991); *Consolidated Water Utils., Ltd. v. Arizona Corp. Comm'n*, 178 Ariz. 478, 875 P.2d 137 (Ct. App. 1993). The Commission, in operating in the regulated monopoly arena, sets rates as a surrogate for the market because, in the case of natural monopolies or regulated monopolies, there is no market. Regulation is an attempt to artificially duplicate the market and market rates. The Commission is permitted wide latitude in setting rates and, by allowing the market to set reasonable rates, those rates, by all estimations, will be lower than regulated monopoly rates. Regulation in the

traditional form may still be required, and may continue under the present statutory and constitutional scheme, for the operations of, and the setting of rates, charges, fees, etc. for the transmission and distribution of electricity.

Section 9.4: The Commission should note at the outset of this section that there is substantial disagreement over whether statutes and/or the Constitution need to be amended, and if so, what those amendments should be, as well as the scope of the amendments, if any. Specifically, it is the position of many interested parties that statutory and Constitutional amendments are not necessary.

Section 9.4.1 A.R.S. §§ 40-281 and 282: Since distribution and transmission services have not been deregulated, these statutes are required to remain in force and effect for those services. The Rules draw a sufficient distinction between distribution, transmission and generation.

Section 9.4.6 Foreign corporations already do business in Arizona. This fact contradicts the arguments and hypothetical issues raised by the Affected Utilities with respect to this statute and necessary amendments thereto.

Sections 9.4.7 and 9.4.8 A.R.S. §§ 40-285 and 40-301 et seq.: The Report should have made it clear that it is only generation which is being deregulated and that distribution and transmission will remain subject to regulation and control by the Commission. Additionally, reference should be made back to the recommended statement of policy noted in Section 9.4.2, which could be designed to adequately address the applicability and the scope of these statutes in the generation area. In addition, A.R.S. § 40-285 would not apply to competitors since facilities would not be "necessary" in the performance of duties to the public when there are alternative providers available to the public. It is, however, necessary to retain the limitations set forth in A.R.S. § 40-285 when "necessary" facilities are involved.

Section 9.4.10 It should be reiterated that it is only generation which is being deregulated, not distribution or transmission. Thus, it is still necessary to retain the provisions set forth in A.R.S. § 40-341, et seq. in order to allow consumers to convert overhead facilities to underground.

Section 9.4.11 It should be reiterated in this section that it is only generation which is being deregulated, not distribution or transmission. Thus, it is still necessary to retain the limitations set forth in A.R.S. § 40-360, et seq. with reference to siting generating plants and high voltage lines.

Robert S. Lynch

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HAND DELIVERED

September 12, 1997

Lindy Funkhouser, Chief Counsel  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007-2996

Re: Comments on the Proposed Final Draft of the Report of the  
Legal Issues Working Group to the Arizona Corporation  
Commission

Dear Mr. Funkhouser:

By memorandum of September 5, 1997, you submitted the proposed final draft report of the Legal Issues Working Group to its participants. You asked for individual final comments to be returned to you no later than September 12, 1997.

I want to congratulate you on pulling together a report that gives a clear picture of the major issues that the Legal Issues Working Group confronted during its deliberations. I think the Commission should be greatly aided by your editing effort. I have only two observations.

First, the discussion in Section 1.1 of the "monopoly" status of Certificates of Convenience and Necessity issued under A.R.S. Section 40-281 can easily be remedied by a clarification to that statute similar to that done for the telecommunications industry. Of the various possible statutes in Title 40 discussed in the report, this is, in my view, the one statute that clearly deserves consideration for legislative change. Other problems that have been raised probably can be more effectively addressed after Arizona benefits from watching California implement its program beginning in January.

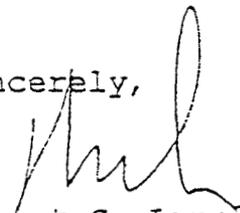
Second, the unresolved discussions mentioned in several parts of the report concerning utilities that are regulated by the

Lindy Funkhouser  
September 12, 1997  
Page 2

Commission and those that are not can also be left for another time. It is important to note the lack of agreement on whether a problem exists and what actions may or may not be necessary. Effective implementation of this program will require all of the Commission's resources. Being sidetracked by entering into this area will not help. California saw no reason to change its current scheme and Arizona need not either. When the Commission is finished deregulating retail electric sales, it will by then have evidence of whether that portion of the distribution business that remains within its jurisdiction has problems or not. There will be plenty of time then to consider cures to any real problems that can be demonstrated through experience rather than speculation.

Again, congratulations on the excellent effort that has gone into this report.

Sincerely,



Robert S. Lynch

RSL:psr  
cc: IEDA Members

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September 11, 1997

Mr. Lindy Funkhouser  
Chief Counsel, Legal Division  
1200 West Washington  
Phoenix, Arizona 85007

Re: Report of the Arizona Corporation Commission's Legal Issues  
Working Group ("Report")

Dear Mr. Funkhouser:

Pursuant to the agreement reached at the August 28, 1997 meeting of the Legal Issues Working Group, as reflected in Constance J. Fitzsimmons September 5, 1997 transmittal memorandum, PG&E Energy Services ("Energy Services") hereby submits its individual "final comments."

THE REPORT

As you are aware, a representative of Energy Services has participated as both a member of the Legal Issues Working Group and a "reporter" during the period of time when the Report was being developed. At various times that individual has made substantive observations, suggested editorial changes and offered written text where believed appropriate in support of the collaborative effort contemplated by R14-2-1616. Recognizing that a consensual process by its very nature cannot fully accommodate the views of all concerned, Energy Services nevertheless believes that the form of Report transmitted on September 5, 1997, on balance, represents an inclusive and fair presentation of the issues addressed and arguments advanced by the participants. Accordingly, it has nothing to suggest by way of addition or modification as of this juncture.

THE REOPENED PROCEEDING

As you are also aware from its active participation as an Intervenor in the Maricopa County Superior Court litigation resulting from the Commission's issuance of Decision No. 59943 and

its adoption of R14-2-1601 et seq., Energy Services believes that the Commission's actions in that regard were within its constitutional and statutory powers and jurisdiction.<sup>1</sup> In addition, Energy Services believes such actions were consistent with and in furtherance of the public interest of the State of Arizona and its residents. What is crucial for all concerned is for the Commission to continue to act in this manner during the transition to a competitive environment in the provision of electric services.

Through its issuance of Decision No. 60351 on August 29, 1997, the Commission has determined to reopen the electric competition proceeding (Docket No. U-000-94-165) in order to (i) receive presentations and recommendations from representatives of each working group established by R14-2-1601 et seq., and (ii) consider proposed additions and/or modifications to the previously adopted electric competition rules. Energy Services will continue to be an active participant in the reopened proceeding; and actively supports the Commission's indicated intention to conduct that proceeding in an expeditious manner. Significant in this regard is the following statement of the Commission:

"Because the Rules phase in competition according to an established schedule, the Commission believes that the rule making process should commence as early as possible to meet that schedule." (Decision No. 60351 at page 2, lines 1-3) (emphasis added)

By its issuance of Decision No. 59943 and its adoption of R14-2-1601 et seq., the Commission established a framework by which Arizona's retail electric markets could transition to competition. That transition is now under way. Through the reopened proceeding provided for by Decision No. 60351, the Commission will be in a position to adopt such additional measures, if any, as may be necessary to assure that such transition is fair, equitable and orderly. But, as the Commission has correctly concluded, such "fine tuning" does not require that the previously adopted schedule for implementing competition be disturbed or delayed. To the contrary, the public interest requires that it not.

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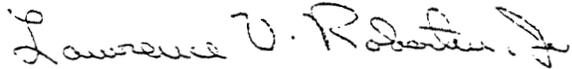
<sup>1</sup> Energy Services also believes that no constitutional or statutory changes are necessary to support or rationalize the Commission's actions. Certain parties have suggested certain "clarifying" amendments to various provisions of Title 40 of the Arizona Revised Statutes. Energy Services believes such changes are unnecessary, and would oppose any proposals of that nature if they entail a risk of undercutting or restricting the Commission's authority to provide for competition in the retail electric industry.

Page 3  
September 11, 1997

CONCLUSION

Thank you for the opportunity to submit these "final comments" in connection with the September 5, 1997, version of the Report.

Very truly yours,

A handwritten signature in cursive script that reads "Lawrence V. Robertson, Jr." with a stylized flourish at the end.

Lawrence V. Robertson, Jr.  
Attorney for PG&E Energy Services

LVR: mbd

Residential Utility Consumer's Office

Comments on Draft of Legal Issues Working Group

September 15, 1997

The following are the preliminary comments of the Residential Utility Consumer Office (RUCO) to the Report of the Arizona Corporation Commission's Legal Issues Working Group ("Report"). RUCO will have additional comments as to legal matters as more specific proposals are made and the reports of the various other working groups are published.

A. Purpose of Comments

The legislature established the RUCO for the following purpose:

"The purpose of the residential utility consumer office is to represent the interests of residential utility consumers, critically analyze proposals made by public service corporations to the corporation commission, develop its own recommendations and present them to the commission."

Laws 1987, Ch. 222, Sec. 1.

The statute expands on the purpose of RUCO by giving its Director the power to participate in utility rate cases and other proceedings of the Arizona Corporation Commission ("ACC") affecting residential consumers. The statute states:

"A. The director may:

1. Research, study and analyze residential utility consumer interests.

2. Prepare and present briefs, arguments, proposed rates or orders and intervene or appear on behalf of residential utility consumers before hearing officers and the corporation commission as a party in interest and also participate as a party in interest pursuant to Secs. 40-254 and 40-254.01 in proceedings relating to rate making or rate design and involving public service corporations . . ."

A.R.S. § 40-464.

The following comments are tendered as a result of the determination of the Director that the prospect of a major change in the regulation of electric utilities may have a tremendous impact on residential consumers.

## B. General Comments

The Report continually discusses issues and concerns of the "Consumer." On page 1 of the Report, "Consumer" is defined as referring "primarily to high-volume purchasers of electric generation services." While RUCO is concerned with this "Consumer," RUCO's primary concern is on behalf of residential utility consumers.

The Report does not directly address issues of primary importance to the residential consumer of electricity. The major issue to residential consumers is the provision of uninterrupted, universal electric power at the lowest possible rates.

The introduction of the salutary concept of competition in the provision and sale of generation of electricity cannot be allowed to leave even a moments gap in the assurance of uninterrupted, universal electric power at the lowest possible rates.

The Report has not addressed the legal aspects of providing uninterrupted, universal electric power at the lowest possible rates, or the legal mechanisms which might allow residential consumers to participate in the market for lower cost generation, billing and collection, metering and meter-reading services. These issues remain to be resolved. RUCO is advocating evidentiary hearings prior to any additional rule making so all parties may present their positions on a "level playing field." It is clear from the Report that little consensus was reached by the legal working group; a similar situation exists with the other working groups. An evidentiary record will provide the commission with a solid basis for any modifications, additions or corrections that may need to be made to the Electric Retail Competition Rules. Such evidentiary hearings are compelled by the omission of any meaningful legal analysis in the Report related to the assurance of uninterrupted, universal electric power at the lowest possible rates.

## C. Sections 1.2, 1.4 and 6.5

Sections 1.2 and 1.4 address legal issues related to the ACC's ability to require utilities to be the "provider of last resort" and the ability to regulate providers of generation services who are not currently regulated.

For residential consumers, there must be a provider of last resort. Certain areas of the State, by virtue of an area's rural character, topography, low densities or other reasons, may not be attractive to providers of generation services. Again, there can be no doubt that each residential consumer in Arizona shall be served in an efficient and low cost manner with electricity at that consumer's home.

Section 6.5 addresses resource planning issues. The availability of low cost, uninterrupted, universal service applies to any discussion of future planning to ensure that the generation resources are available to handle the future needs of the residents of Arizona. While the natural equilibrium of the marketplace will likely satisfy the availability of generation resources in the long term, it is necessary that continual review be undertaken in the short term to insure that residential consumers have resources available.

Various mechanisms should be examined to encourage competition among providers for the residential consumers as customers. These mechanisms are the province of other working groups. The ACC will be required to make a final determination on these mechanisms following recommendations from working groups. Presentation of evidence may also be necessary for the ACC to make a reasoned determination as to the mechanisms that will be available to the residential consumer.

#### D. Sections 5.1 and 6.1, Stranded Costs

A broad examination of the existence and quantification of stranded costs must be undertaken. The parties to such an inquiry must be required to examine and quantify any such costs which might be attributable to the residential consumer. No levy of stranded costs on the residential consumer can be allowed without a process that allows residential consumers to meaningfully participate. The residential consumer must have the opportunity to advocate for its position in an evidentiary proceeding.

RUCO agrees with Staff that concepts such as "mitigation" are well defined in bodies of law such as commercial lease law and such bodies of law should be examined to determine precise analogies to the anticipated proceedings when stranded costs are alleged. Two examples point out availability of such other bodies of law. In *Corrigan v. City of Scottsdale*, 149 Ariz. 538, 720 P.2d 513 (1986), certiorari denied 107 S.Ct. 577, 479 U.S. 986, 93 L.Ed.2d 580, the Arizona Supreme Court set out a standard for measuring damages which may have accrued as a result of a temporary taking, a concept quite similar to a stranded cost. Such a test, which looks to the overall economic consequences of the action in question, is an analogous situation which assists in understanding a stranded cost issue or claim.

\*Recognizing this problem, we feel the best approach is not to require the application of any particular damage rule to all temporary taking cases. Instead we hold that the proper measure of damages in a particular case is an issue to be decided on the facts of each individual case. It is our intent to compensate a person for the losses he has actually suffered by virtue of the taking. . . . The damages awarded and the way to measure those damages thus may be adapted to compensate the party . . . for his actual losses.

We emphasize, however, that no matter what measure of damages is appropriate in a given case, the award must only be for actual damages. Such actual damages must be provable to a reasonable certainty similar to common law tort damages. (Citation omitted) This approach will compensate for losses actually suffered while avoiding the threat of windfalls . . . .

149 Ariz. at 543-4.

The concept of mitigation is likewise well documented in Arizona law:

"The party injured by a breach of contract has a duty to take reasonable steps to avoid the consequences of known injuries. *Coury Bros. Ranches, Inc. v. Ellsworth*, 103 Ariz. 515, 518, 446 P.2d 458, 461 (1968); *Fairway Builders, Inc. v. Malouf Towers Rental Co., Inc.*, 124 Ariz. 242, 255, 603 P.2d 513, 526 (App. 1979); *Sames v. Lopez*, 25 Ariz.App. 477, 481, 544 P.2d 694, 698 (1976). The party in breach has the burden of showing that mitigation was reasonably possible, but was not reasonably attempted. *Fairway Builders*, supra, 124 Ariz. at 255, 603 P.2d at 526. Whether the duty is violated is a question of fact. 124 Ariz. at 256, 603 P.2d at 526.

*Northern Arizona Gas Service, Inc. v. Petrolane Transport, Inc.*, 145 Ariz. 467, 477, 702 P.2d 696 (App. 1984).

Other applicable concepts and law will apply to the stranded cost analysis.

#### E. Conclusion

RUCO is hopeful that the advent of competition in generation, billing and collection, metering and meter-reading services will be a benefit to the residential consumers of Arizona. RUCO, however, is concerned that the competition to provide electricity to large users may harm the residential consumer. All legal analysis should commence with the premise that the provision of uninterrupted, universal electric power at the lowest possible rates is the cornerstone of the new competitive market and the regulations of that market.

The lack of a consensus shown in the Report and the indefinite nature of many of the proposals coming from the various working groups, points to the need to be ever mindful of the interests of the residential consumer. It is RUCO's position that evidentiary hearings are essential for the ACC to resolve the numerous issues for which no consensus can be reached. The protection of universal, low cost electric service for the residential customers will best be effectuated through a process that

allows all parties, including the consumer advocates, to provide the complete record upon which the ACC can base the difficult decisions it must make.

# SRP

## Supplement to

### Report of the Arizona Corporation Commission's

### Legal Issues Working Group

The Salt River Project Agricultural Improvement and Power District ("SRP") submits this supplement to the Legal Issues Working Group report for the purpose of addressing specific legal issues which may apply to the participation of public power entities such as SRP in a competitive market.

#### Introduction

SRP is a governmental entity (an Arizona agricultural improvement district) which provides electric power to its customers and, through the Salt River Valley Water Users Association, water delivery services to shareholders. As a public body, SRP represents the interest of its constituents and makes its various comments in this regard. SRP and its customers support the transition to competition and are committed to bringing competition to Arizona quickly and effectively.

As a governmental entity, SRP is not regulated by the Corporation Commission and is not subject to the competition rules. However, SRP has actively participated in these proceedings in order to lend its expertise in a positive manner and to coordinate SRP's transition to a competitive market with the efforts of the Corporation Commission.

In the spirit of promoting a fast and effective transition to a competitive market SRP makes these specific comments to the sections of the report:

1.1 No comment.

1.2 No comment.

1.3 Under the Rules distribution systems will remain regulated. Under the Rules the distribution utility will receive a just and reasonable return on distribution system investment, probably using traditional rate making principles. There is no issue of a taking where prices are properly set. The Commission has always had the authority to order a regulated utility to wheel the power of another provider. *See e.g. Arizona Constitution, Art. 15, § 10; A.R.S. § 40-332.*

1.4 No comment.

1.5 SRP supports any reasonable step to "streamline" or eliminate unnecessary elements of regulation.

2.1 This point addresses utility and non-utility activities by the same Affected Utility, and deals with the argument the utility status somehow gives the utility an advantage in competing in other markets (e.g. heating and air conditioning). SRP opposes any new regulation which would limit competition.

2.2 SRP agrees that in a competitive market place there may be certain proprietary information which should be kept confidential, as long as the public has full access to that information which remains relevant to those aspects of the industry which remain regulated.

3.1 A number of methodologies have been suggested to recover stranded costs. SRP continues to work with other participants to explore the various methodologies.

3.2 No comment.

3.3 SRP supports a future charge, per kWh or per kW, levied on all customers. SRP does not support an exit fee. SRP believes that this is a fair way to assess the costs of a transition to competition to those customers who will benefit from competition. SRP also advocates a rate cap so that prices should be no higher than they are now, with no "dampening" of demand and reliability.

3.4 - 3.7 No Comment

4.1 No Comment

4.2 SRP supports the elimination of unnecessary regulation, including aspects of the affiliate interest rules which do not directly relate to unregulated parts of a business.

4.3 In general terms this section deals with the irrational fear of the investor-owned utilities that public power entities such as SRP will be more effective competitors. Called the "level playing field" argument, this is a non-issue.

Historically customers have always had the choice of public power. In other words, customers could always have chosen (either through local governments or with legislative authority) to "municipalize" the provision of electricity. This "competition" has always acted as a "market" control on the businesses of the investor owned utilities<sup>1</sup>.

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<sup>1</sup> As has the option of private power served as a competitive force on public power.

As we move toward greater customer choice, it would be counter-intuitive to limit the choice of public power. As before, public power will be a market force in pushing the market toward greater efficiencies and innovation.

In making their arguments the investor-owned utilities fall into the trap of assuming that public power has their same motivations. Public power is owned and controlled by its customers. It has no stockholders demanding greater profits. Thus, public power is not motivated to expand its profits by taking the business of the investor owned utilities. Its motivation is to serve its customers by operating its business rationally and efficiently.

Under competition, prices will be set by the market. The historic cost structure of any competitor, and there are many differences, will have no relevance to market price. Instead, the market will set prices based on marginal cost, as in any other industry.

4.3.1 No comment

4.3.2 Public power, and SRP in particular, does not need an intergovernmental agreement to participate in competition. The purpose of the IGA is to provide a coordinating mechanism between deregulation by the Corporation Commission and the voluntary transition to market competition in the service territories of public power entities. The IGA will not subject SRP to Corporation Commission regulation, nor will it subject the Corporation Commission to SRP regulation. The entities will simply agree to coordinate their respective activities, basically to promote consumer understanding and acceptance, statewide, during the transition process.

4.4 No comment.

5.1 No comment

5.2 The relationship between public power and investor owned utilities is addressed under paragraph 4.3 above.

6.1 - 6.4 No comment

7.1 The "two county rule" provides advantages to certain investor owned utilities. As with the other "level playing field" arguments, it is irrelevant to the issues at hand.

7.2 - 7.4 No comment

8.1 - 8.2 No comment

9.1 No comment

9.2 No comment

9.3.1 There is no need to amend the Arizona Constitution. Those advocating amendment are simply promoting delay in the transition to competition.

The suggestion that the customers of governmental, public power, entities should be subjected to additional regulation through the Corporation Commission is silly. We are in the process of deregulation, not more regulation. The sole reason for Corporation Commission regulation of investor owned utilities is to keep the investors (shareholders) from abusing the monopoly position granted to them. This concept is recognized in the constitution of Arizona, as it is in almost every other state.

The real motivation for this suggestion is that the investor owned utilities wish to protect themselves against competition by subjecting other utilities to their same regulatory burdens. The answer is not to increase regulation of others, but to reduce unnecessary regulation by the Commission.

9.4 SRP strongly advocates a minimalist approach on legislative change. The goal should be to implement competition quickly and effectively. Any activity which might slow down the process should be avoided. For this reason SRP advocates only two legislative items at this time. These are to solidify the Commission's general authority to implement its rules, and to deal with the changes in state tax revenues which might happen in competition. SRP is also receptive to changes that would, in general, streamline or eliminate unnecessary elements of regulation. Any other change should await the implementation of competition, where the need and details of the change will be better known and understood.

FINAL COMMENTS OF  
SOUTHERN ARIZONA MECHANICAL CONTRACTORS ASSOCIATION TO  
PROPOSED FINAL DRAFT OF LEGAL ISSUES WORKING GROUP REPORT

This document constitutes the Southern Arizona Mechanical Contractors Association's ("SAMCA") final comments to the proposed final draft of the Legal Issues Working Group report to the Arizona Corporation Commission, and is presented by SAMCA's legal counsel undersigned. SAMCA's final comments are specifically addressed to Section 9.4.14 of the Working Group Report.

I. WHAT IS SAMCA

SAMCA was formed in 1987 to provide representation and mutual assistance to air conditioning, heating and refrigeration contractors in Tucson in identifying and preventing unfair competition from utilities. SAMCA currently is 86 members strong and its members derive from every facet of the mechanical contracting industry. The majority of SAMCA members are Arizona-licensed contractors. Those contractors compose 68% of SAMCA's total membership. An additional 18% of SAMCA members are suppliers of air conditioning, heating and refrigeration equipment. The remaining members are various service companies who provide support to the mechanical contracting industry.

2. THE PROBLEM OF CROSS-SUBSIDIZATION

Even though the electric utility industry in Arizona may be "deregulating," the distribution of electricity to retail customers will remain a monopoly created and protected by state law and regulated by the Arizona Corporation Commission ("Commission"). The Commission will continue to determine both the rates the utilities are to charge for distribution and the profits to be derived from such distribution.

There has been much discussion within the Working Group about recovery of the "stranded costs" of the utilities which will result from deregulation. While the utilities must make reasonable efforts to mitigate those stranded costs, some stranded costs will necessarily exist. Some members of the Working Group have expressed their belief that one of the preferred methods of stranded cost recovery is to allow the utilities to compete freely in nonregulated markets, such as appliance retailing and servicing. When the utilities enter such businesses, they find themselves in head-to-head competition with small and locally-owned independent businesses.

The entry of utilities into markets traditionally dominated by

locally-owned, small, independent proprietors has the distinct possibility of creating unfair competition in which such businesses are unable to effectively compete against the larger, better-financed utility or utility-affiliated competitor. This situation is compounded further if utilities are allowed to subsidize and aid their nonregulated activities with profits, services and advantages obtained and acquired through their regulated activities. Such "cross-subsidization" enables the utility affiliates to offer products and services below their real market value. Unchecked cross-subsidization will eventually force the locally-owned, independent businesses out of the market.

Cross-subsidization can take many forms. Several examples are as follows:

(1) A utility's nonregulated affiliate can at no little or no cost enclose promotional materials in the monthly utility bill. By so doing, the nonregulated business has immediately and substantially reduced its operating costs and received an enormous competitive advantage in the market.

(2) A utility maintains a wealth of information on consumer needs, requests and other market characteristics which may be readily available to its nonregulated affiliate to be used as a valuable marketing tool. Small, independent businesses do not have access to such important marketing information.

(3) A utility may offer its nonregulated affiliate or the customers thereof below-market interest rates and extended payment plans on products and services. Such financing arrangements are usually cost prohibitive to small businesses, thereby placing them at a competitive disadvantage.

(4) A utility may provide loans, loan guarantees or other financial subsidies to assist the business venture of its nonregulated affiliate in getting off the ground. Small businesses do not have such a ready source of financing.

(5) Because of economies of scale, a nonregulated utility affiliate may be able to bypass the normal distribution channels and buy direct from manufacturers at favorable prices, placing the independent businesses at a competitive disadvantage.

(6) By using the utility's name and logo, the nonregulated utility affiliate has instant recognition in the marketplace, which is something competitors must work for many years to achieve. Moreover, such name recognition may lead to unjustified consumer confidence.

(7) A utility's nonregulated affiliate may use fully-trained employees transferred from the regulated utility. However, the competitors of the utility affiliate may spend a great deal of time, effort and money to provide comparable training for its employees.

(8) Nonregulated affiliates may share office space with the utility either rent free or at a discount to the fair market rental rate. Rent or ownership payments constitute a substantial overhead expense for small businesses.

(9) An array of utility-developed computer and office technology may be available to subsidize the efforts of the nonregulated utility affiliate.

(10) The nonregulated affiliate may have the use of utility vehicles, tools, equipment, accounting and legal departments, and managerial talent at no cost, while such services are very costly to independent businesses.

Thus, small, independent service providers in the competitive market stand to be severely prejudiced and ultimately harmed if nothing is done to prohibit or control cross-subsidization. If utilities are to be permitted to engage in nonregulated activities, they should be required to do so on a level playing field, without the many competitive advantages which may be gained through their utility affiliations.

### 3. PREVENTION OF CROSS-SUBSIDIZATION

Arizona has no existing legislation which prevents unfair cross-subsidization. The Commission's affiliated interest rules are inadequate to prevent cross-subsidization and its devastating effects on small businesses. Those rules merely prohibit utilities from entering into transactions with their affiliates unless they open up their books to the Commission for review. There is nothing contained within said rules which actually prevents cross-subsidization by utilities. Under the current rules, utilities and their nonregulated affiliates may share costs, marketing information, employees and equipment; and the affiliates may enjoy the benefits of the utilities' financing capabilities, economies of scale and name recognition.

The easiest and most effective way of preventing cross-subsidization is to enact a new rules to replace the affiliated interest rules which would completely separate utility and nonutility business activities. SAMCA submitted a draft of its proposed rules to the Working Group. This separation of activities

would avoid the problems of identifying and properly allocating costs which are associated with different and unrelated activities. A complete separation also prevents utility affiliates from receiving unfair competitive advantages, such as name recognition, logo use, customer base and a readily-available technical expertise. Separating activities is the simplest and surest way to avoid these problems. A complete separation would ensure that utilities pursue competitive ventures on a stand-alone basis. Utilities should only be permitted to provide utility service, and all nonutility activities should be conducted by affiliates without the advantages of cross-subsidization.

#### 4. THE WORKING GROUP'S REPORT

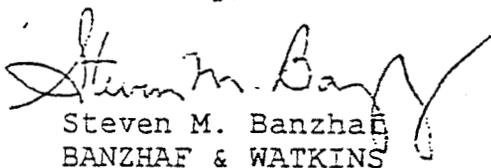
Section 9.4.14 of the report states, in part, that a majority of the Working Group believes that the Commission has "sufficient jurisdiction currently to prohibit any unfair cross-subsidization and/or that prohibition of non-regulated activities would be inconsistent with the move generally to competition." As SAMCA has repeatedly brought to the attention of the Working Group, such a statement about the beliefs of a "majority" of the working group contradicts the written record in this matter. Therefore, in SAMCA's view, the proposed final draft of Section 9.4.14 of the report does not accurately reflect the views expressed by concerned members of the Working Group.

#### 5. CONCLUSION

The restructuring of the Arizona electric utility industry involves issues of vital importance to SAMCA. SAMCA believes the Working Group's report fails to address important issues which will seriously affect the competitive market. New Commission rules or legislation, or both, will be necessary to adequately protect third party victims, such as SAMCA and its members, from harmful fallout emanating from the deregulation process.

I respectfully submit these comments on behalf of SAMCA this 10th day of September, 1997.

Sincerely,



Steven M. Banzhaf  
BANZHAF & WATKINS  
Attorneys for Southern Arizona  
Mechanical Contractors Association



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*The Sunshine City*

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September 11, 1997

Lindy P. Funkhouser, Esq.  
Arizona Corporation Commission  
Legal Division  
1200 W. Washington, Room 230  
Phoenix, AZ 85007-2927

Re: Legal Issues Working Group -- Final Draft Report

Dear Lindy:

Again, I want to thank you very much for the opportunity to participate in the Legal Issues Working Group and to review the Final Draft Report. The City of Tucson offers the following comments to the report.

The report seems balanced in that it presents the points of view that the various participants expressed without making judgments regarding the correctness or incorrectness of such points. Several of the issues will undoubtedly be affected by the determinations of the pending lawsuits and we do not believe comments on these issues would be helpful at this time.

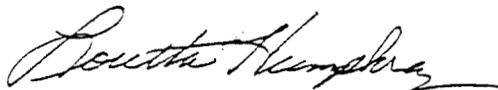
The City agrees with those participants who oppose any amendment to the Constitution that would impact or compromise the municipalities' rights to regulate their own municipally owned utilities. All avenues to implement the spirit of the rules should be explored before any such constitutional amendment is suggested.

The sections relating to FERC and federal issues illustrate the complexity of this area and although the City has no specific recommendations, it is felt that many of these issues will be sorted out as the rules become implemented.

Lindy Funkhouser  
September 11, 1997  
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The City looks forward to working with the Commission, the Commission staff, and other participants in the implementation of these rules and any consequent changes and modifications.

Sincerely,



Loretta Humphrey  
Principal Assistant City Attorney

LH:lr

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## *Tucson Electric Power Company*

Mail Stop D6203  
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Bradley S. Carroll  
Counsel  
Regulatory Affairs

September 23, 1997

(520) 884-3945  
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Mr. Lindy Funkhouser  
Chief Counsel  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85004

Re: Legal Issues Working Group Final Report

Dear Mr. Funkhouser:

At your invitation, Tucson Electric Power Company ("TEP"), by this letter, provides an overview of its comments to the Final Report of the Legal Issues Working Group that has met regarding issues related to competition in the retail electric industry in Arizona. TEP recognizes that the Final Report is the product of many hours of coordination and correlation by you, your staff, the Reporters and other members of the Working Group. During the Working Group sessions many viewpoints were expressed and debated, and as the Final Report reflects, little agreement was reached. You and your staff are to be commended for providing the environment where these discussions could occur and for developing the Final Report document.

TEP's substantive legal concerns with the Competition Rules are well documented. TEP has stated its position on these matters in the record of the Competition Rules' docket and during the workshop sessions. Without repeating each of those concerns in detail, TEP notes that none of them are resolved by the Final Report. TEP believes that given the time and effort that has been devoted to the legal workshops, the Final Report should set forth recommendations to amend the Competition Rules.

Specifically, there were no recommendations proposed on such matters of legal significance as: (a) the Commission's authority to enact the Competition Rules and redefine certificates of convenience and necessity; (b) an Affected Utility's obligation to serve customers in a competitive environment; (c) legal standards for the mitigation and recovery of stranded costs; (d) rewrites of the sections of Title 40 that are necessary in a competitive environment; and (e) the regulation of non-public service corporations (such as SRP and the tribal utilities) that indicate an intent to compete with public service corporations. Without a resolution of these important issues, the Competition Rules will continue to deny Affected Utilities the due process that they are entitled to.

Now that reports from other working groups will be filed in the near future, TEP would recommend that the Legal Issues Working Group be continued to study the legal ramifications of such reports and the recommendations therein. Perhaps in this context, specific legal recommendations could be made as the Competition Rules are interpreted and/or amended.

As always, TEP is willing to work with the Commission and Staff to address and implement positive changes to the Competition Rules. TEP continues in its support of competition and in its commitment that any such competition must be equitable and fair. TEP believes that by including sound recommendations for appropriate changes to the Competition Rules in subsequent reports, all of the parties will be aiding in the implementation of competition in Arizona.

Sincerely,

A handwritten signature in cursive script, appearing to read "Bradley S. Carroll".

Bradley S. Carroll  
Counsel, Regulatory Affairs