

EXCEPTION



0000036114

Arizona Corporation Commission

BEFORE THE ARIZONA CORPORATION COMMISSION



Arizona Utility Investors Association

2100 N. Central, Ste. 210
P. O. Box 34805
Phoenix, AZ 85067

Tel: (602) 257-9200
Fax: (602) 254-4300

Email: info@auia.org
Web Site: www.auia.org

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

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AZ CORP COMMISSION
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IN THE MATTER OF ARIZONA PUBLIC SERVICE)	DOCKET NO.
COMPANY'S REQUEST FOR A VARIANCE OF)	E-01345A-01-0822
<u>CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606</u>)	
IN THE MATTER OF THE GENERIC PROCEEDINGS)	DOCKET NO.
<u>CONCERNING ELECTRIC RESTRUCTURING.</u>)	E-00000A-02-0051
IN THE MATTER OF TUCSON ELECTRIC POWER)	
COMPANY'S APPLICATION FOR A VARIANCE OF)	DOCKET NO.
<u>CERTAIN ELECTRIC COMPETITION RULES</u>)	E-01933A-02-0069
<u>COMPLIANCE DATES.</u>)	
IN THE MATTER OF THE APPLICATION OF)	DOCKET NO.
TUCSON ELECTRIC POWER COMPANY FOR)	E-01933A-98-0471
<u>APPROVAL OF ITS STRANDED COST RECOVERY.</u>)	
IN THE MATTER OF THE GENERIC PROCEEDING)	DOCKET NO.
<u>CONCERNING THE ARIZONA INDEPENDENT</u>)	E-00000A-01-0630
<u>SCHEDULING ADMINISTRATOR</u>)	

AUIA'S EXCEPTIONS TO THE RECOMMENDED OPINION AND ORDER IN THE TRACK A PROCEEDING

The Arizona Utility Investors Association (AUIA) hereby files its exceptions to the Recommended Opinion and Order (Order) issued July 23, 2002, in the above-captioned proceeding by the Chief Administrative Law Judge (CALJ).¹

A Perception of Fairness

In arriving at the key decision in this Order, regarding divestiture, the CALJ writes:

"We find that due to circumstances outside our control or the control of any party, and in order to protect the public interest, we must take further action to regulate the transition to competition. We want to take action in a manner that is fair to all parties and that protects ratepayers." (See Order, P. 22. L. 20)

Yet, there is little in this Order that is "fair" to Pinnacle West Capital Corporation and its shareholders.

1. Although this Order would affect both APS and TEP, its terms are more closely aligned with the TEP Request for Variance. Further, the Track A proceeding and the Order puts APS in far greater jeopardy than TEP. Therefore, these Exceptions will be directed primarily at the provisions affecting APS and its affiliates.

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1 By the terms of this Order, the Commission would unilaterally discard the
2 1999 Settlement Agreement and leave \$1 billion of Pinnacle West generation assets
3 at risk in financial and economic limbo.

4 For the record, AUIA disagrees with the CALJ's findings regarding market
5 power and the need to postpone the transfer of APS' generating assets. We believe
6 that the danger of market power has been vastly overstated and that it could be
7 mitigated effectively through oversight and bilateral contracting.

8 However, AUIA suspects that these are dead issues at this stage and we will
9 focus on the equitable issues raised by the proposed Order.

10 The Order would delay any asset transfer for two years, "until at least July 1,
11 2004," (See Order, P. 29, #35). Presumably, this would leave all of the generation
12 assets owned by Arizona Public Service Company (APS) under cost-of-service
13 regulation until the Commission re-authorizes divestiture.

14 But with regard to the assets owned by APS' affiliate, Pinnacle West Energy
15 Corporation (PWEC), the proposed Order simply ducks.

16 The CALJ recognizes that, in the absence of divestiture, APS has proposed to
17 assume ownership and financing of the PWEC assets, but the Order asserts, "The
18 issue of transferring PWEC's generation assets is not the subject of this Track A
19 proceeding, and there is not sufficient evidence on the record to make a finding, nor
20 have the parties had an opportunity to present evidence on the issue. If APS wishes
21 to pursue this issue, it should file the appropriate application(s). (See Order, P. 30,
22 #43)

23 Yet the language of the Order regarding Track B leaves the Red Hawk and
24 West Phoenix units twisting slowly in the economic winds.

25 The Order purports to assign the substance of the competitive solicitation to
26 the Track B proceeding, but the CALJ prescribes the outcome as follows: "...effective
27 upon implementation of the outcome of Track B, we will require APS and TEP to
28 acquire, at a minimum, any power that cannot be produced from its own assets,
29 through the competitive procurement process as developed in the Track B
30 proceeding." (Emphasis added, See order, P. 29, #36)

31 Under this formulation, the PWEC generation which is currently serving
32 customer needs would be excluded from APS' "own assets," even though no
33 testimony or evidence has been presented on this issue, according to the CALJ's
34 express admission.

1 As APS has testified, these units have no permanent financing and cannot
2 achieve investment grade financing as long as they remain with PWEC and APS is
3 prohibited from transferring its assets to PWEC. (See Tr. Vol. I. P. 92-93)

4 The only reason these assets are at risk is because Pinnacle West built and
5 financed them within PWEC, a decision that was made in detrimental reliance on
6 the word of this Commission in at least three instances: 1) the provisions of R14-2-
7 1615 (A); 2) the terms of the Settlement Agreement (See Sec. 4.2) to which the
8 Commission was a signatory; and 3) Decision No. 62416 (APS Code of Conduct),
9 which prohibits APS from engaging in competitive activities such as new power
10 production prior to December 31, 2002 (See Code Provision XB).

11 Some may question whether APS could have built the Red Hawk and West
12 Phoenix units and divested them later to PWEC. Apart from the fact that APS' Code
13 of Conduct prohibited it, no sane person would have financed and built these units
14 in one entity only to move them to another in a year or less.

15 The APS affiliate, PWEC, was formed precisely for the purpose of satisfying
16 the requirements of Rule 1615(A) and the Settlement Agreement, which provides,
17 among other things, that the affiliate "may competitively bid for APS' Standard
18 Offer load, but enjoys no automatic privilege outside of the market bid on account of
19 affiliation with APS." (See Sec. 4.1[3])

20 Clearly, Section 4.1, which was adopted by the Commission, anticipated that
21 an APS affiliate would become a wholesale supplier to APS for all or any part of its
22 retail load. There can be no other meaning and it is irrelevant whether retail
23 competition has taken hold or not.

24 It is also clear in Section 4.1 that the affiliate was expected to assemble a full
25 portfolio of generation resources with the potential to serve APS load, not two or
26 three incremental generating units.

27 One of the parties, Panda Gila River LLP (Panda), supported divestiture in
28 Track A primarily because it believes that all of APS' load-serving generation should
29 be subject to competitive challenge. (See Panda Post-hearing Brief, P. 2-5) However,
30 in its July 23 response to Commissioner Spitzer's letter of July 18, Panda confronted
31 the issue of the PWEC assets head-on.

32 Absent full divestiture, the fate of PWEC's assets is the remaining issue for
33 Panda. Panda opposes converting Red Hawk and West Phoenix to rate-based

1 facilities and disputes APS' assertion that the PWEC units were built to serve APS.
2 "No more so than ours," says Panda. (See Footnote 2, Panda Letter, P. 3)

3 It is an absurd proposition that Panda's and Pinnacle West's decisions to
4 construct generation resources are somehow comparable, for obvious reasons:

5 • Pinnacle West built these units in order to meet APS' legal obligation to
6 serve and fulfill its role as provider of last resort. Panda has no such obligation.

7 • Pinnacle West's decisions regarding ownership and financing were
8 directed by the Electric Competition Rules and the Settlement Agreement. Panda is
9 not a party to the Settlement, did not participate in the electric competition
10 rulemaking and has no obligations under the rules.

11 • Pinnacle West and its affiliates are continuously subject to the ratemaking
12 authority of this Commission and its affiliate interest and code of conduct rules,
13 among others. Panda has no responsibility to this Commission.

14 **The Commission Breaks Its Word**

15 By adopting this Order (and we suspect that outcome approximates a slam
16 dunk), the Commission will frustrate the intent of the Settlement Agreement, while
17 leaving \$1 billion of PWEC assets at risk and threatening the financial stability of
18 APS and its corporate parent.

19 These assets were created to serve APS customers and they are serving them
20 now. They were also lodged in an affiliate corporation in response to the
21 Commission's rules and a solemn agreement to which the Commission was a party.
22 In these circumstances, the only fair outcome would be for the Commission to allow
23 APS to recover the PWEC assets and place them under cost-of-service regulation
24 until such time as the barriers to divestiture are removed.

25 The problem, as the CALJ has noted, is that the Track A proceeding, which
26 was invented by the Commission, does not specifically address this issue.

27 AUIA has warned repeatedly that this process is flawed because it is split into
28 two separate but highly inter-dependent proceedings, neither of which addresses
29 the disposition of APS' or PWEC's assets or the overall status of the Electric
30 Competition Rules.³

31 3. AUIA would argue that Track A was not properly noticed as an A.R.S. §40-252 proceeding or
32 conducted "as upon a complaint," as the statute requires and that findings regarding R14-2-1606(B)
33 are not appropriate in this Order. In addition, Track B, which will certainly modify the rules, has no
34 hearing schedule and has not been noticed as a §40-252 proceeding.

1 Furthermore, because the Commission commandeered the issues in Track A,
2 both the hearing and the proposed Order treat the APS Settlement Agreement as if it
3 never existed. The Order makes one furtive reference to it (See Order, P. 24, L. 13),
4 but acknowledges no responsibility on the part of the Commission to even try to live
5 up to its terms.

6 To date, virtually all of the benefits of the Settlement Agreement have accrued
7 to the Commission and the ratepayers, not to the utility.

8 • Retail rates have been capped during the convulsions of the western power
9 markets, insulating ratepayers while assigning the price risk to the utility.

10 • Hundreds of millions of dollars in rate reductions have been passed on to
11 ratepayers, again placing the revenue-cost risk on the utility and its shareholders.

12 • Utility shareholders have absorbed a negotiated write-off of \$234 million of
13 their assets.

14 • Shareholders are also at risk for millions of dollars of divestiture costs that
15 have been incurred with no assurance of recovery.

16 In contrast, the benefits negotiated for the utility have not materialized.

17 • There has been almost no stranded cost recovery due to the lack of retail
18 competition.

19 • Not only would this Order deny the agreed upon right to divestiture, but it
20 would leave \$1 billion of generation assets in limbo.

21 This cavalier treatment of the Settlement Agreement and the insensitivity in
22 this Order to the penalties imposed on those who relied on its provisions prove that
23 you can't make a bargain with government, at least not in Arizona.

24 But there is a more fundamental issue raised by this situation: If government
25 can't be required to keep its word, then the rule of law has no meaning.

26 Even if the Commission believes that circumstances have changed so much
27 that it must modify its rules, it has an obligation to hold harmless those who relied
28 on its word. This Order makes no such attempt and the Commission should be
29 embarrassed at the suggestion that it can simply dismiss the obligation because it's
30 not on today's agenda.

31

32

1 **Conclusion**

2 As it is written, this Order would unilaterally abrogate the terms of the 1999
3 APS Settlement Agreement which APS and Pinnacle West relied on in forming a
4 generation affiliate, embarking on divestiture and constructing new generating
5 facilities to serve its customers reliably.

6 Not only does the Order fail to acknowledge any Commission responsibility
7 for keeping its given word, the language in Finding of Fact #36 and the
8 corresponding ordering paragraph (P. 31, L. 27) places \$1 billion of PWEC assets in
9 financial jeopardy by wrongfully prescribing a key outcome of Track B.

10 This sleight of hand, if allowed to stand, is unfair, unethical and, we submit,
11 illegal.

12 If the Commission is conditioned to accept the main premise of this proposed
13 Order – that asset transfer should be prohibited until the perceived threat of market
14 power has become manageable – then it should modify the Order, as follows:

15 • It should strike the language in Finding of Fact #36 and the corresponding
16 ordering paragraphs that define the competitive solicitation requirements for APS
17 and TEP.

18 • It should add language to Finding of Fact #43 to provide that if APS files a
19 timely application to recover the PWEC assets, implementation of the competitive
20 solicitation will be delayed until the application can be heard and a decision is
21 rendered by the Commission.

22 • It should acknowledge that APS has a right to pursue other amendments to
23 the Settlement Agreement, such as recovery of its \$234 million write-off and its
24 divestiture costs, outside of a rate case.

25

26 RESPECTFULLY SUBMITTED this 1st day of August, 2002,

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WALTER W. MEEK, PRESIDENT

1 **CERTIFICATE OF SERVICE**

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3 Original and eighteen (18) copies of these Exceptions
4 were filed this 1st day of August, 2002, with:

5
6 Docket Control
7 Arizona Corporation Commission
8 1200 W. Washington Street
9 Phoenix, AZ 85007

10
11 Copies of the referenced Exceptions
12 were hand-delivered this 1st day of
13 August, 2002, to:

14
15 William A. Mundell, Chairman
16 Hercules Dellas, Esq.
17 James M. Irvin, Commissioner
18 Kevin Barlay, Esq.
19 Marc Spitzer, Commissioner
20 Paul Walker, Esq.
21 Christopher Kempley, Esq., Legal Division
22 Ernest Johnson, Esq., Utilities Division
23 Lyn Farmer, Esq., Hearing Division
24 Arizona Corporation Commission
25 1200 W. Washington
26 Phoenix, AZ 85007

27
28 Copies of the referenced Exceptions were faxed
29 or mailed this 1st day of August, 2002, to:

30
31 Appropriate parties of record

32
33 
34 _____
35 Walter W. Meek
36