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BEFORE THE ARIZONA CORPORATION COMMISSION

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E-01345A-02-0125

9 IN THE MATTER OF THE APPLICATION OF  
10 ARIZONA PUBLIC SERVICE COMPANY FOR  
11 AN ORDER APPROVING A NEW FIXED  
12 INCOME MANAGER FOR THE PALO VERDE  
13 NUCLEAR DECOMMISSIONING TRUST  
14 FUNDS

DOCKET NO. E-01345A-02-\_\_\_\_\_

APPLICATION

15 Arizona Public Service Company ("APS" or "Company") hereby requests an  
16 Order from the Arizona Corporation Commission ("Commission") approving the  
17 selection of a new fixed-income manager to succeed RCM Capital Management  
18 ("RCM"). RCM is one of the two Commission-approved fixed-income fund managers for  
19 the Company's Palo Verde Nuclear Generating Station ("Palo Verde") decommissioning  
20 trust funds. RCM's parent company is consolidating all fixed-income management  
21 functions with a sister entity, Pacific Investment Management Company ("PIMCO"). As  
22 a result, RCM has directed all of its fixed-income fund clients, including APS, to either  
23 find a new fund manager by March 31, 2002 or to authorize RCM to transfer management  
24 of their fixed-income decommissioning funds to PIMCO.

25 Alternatively, and if the Commission is unable to act upon the Company's request  
26 for approval of a new fixed-income manager prior to March 31, 2002, APS would ask for  
an interim order authorizing the other Commission-approved fixed-income fund manager,

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1 Delaware Investment Advisors (“DIA”) to manage both of the Company’s fixed-income  
2 decommissioning trust funds pending Commission final approval of a replacement  
3 manager for RCM. In this latter case, the two funds would still be separately administered  
4 by DIA and not co-mingled. Moreover, each fund would remain subject to the fund size  
5 and scope of investment limitations imposed by the Commission in Decision Nos. 55931  
6 (April 1, 1988), 60098 (March 19, 1997) and 64393 (January 31, 2002).

### 8 I. BACKGROUND AND INTRODUCTION

9 APS is a public service corporation within the meaning of Article 15 of the Arizona  
10 Constitution and is thus subject to regulation by the Commission. APS is a 29.1% part  
11 owner of PV. Other equity participants in PV include Salt River Project, Southern  
12 California Edison, El Paso Electric Company, Public Service Company of New Mexico,  
13 and the Los Angeles Department of Water and Power. PV is licensed to operate by the  
14 Nuclear Regulatory Commission (“NRC”) pursuant to 42 U.S.C. § 2011, *et seq.* Like all  
15 nuclear power plants, PV will eventually need to be decommissioned – an expensive and  
16 time consuming process. Regulatory agencies throughout the country, including the  
17 Commission, have required that the cost of this eventual decommissioning be recovered  
18 from electric customers during the operating life of the facility.

19 Amounts collected from ratepayers during the life of a nuclear generating plant can  
20 either be administratively segregated by the collecting utility into a so-called “internal”  
21 decommissioning fund, or placed into a separate external entity (usually a trust) not  
22 controlled by the utility. Both the NRC and most state regulators prefer the external  
23 funding option, both because of the increased security of the funding for its intended  
24 purpose and because of significant income tax benefits available to external funds meeting  
25 certain Internal Revenue Service (“IRS”) qualifications, hence the term “qualified fund.”

26

1 APS was first directed by the Commission to establish an external "qualified"  
2 nuclear decommissioning trust in Decision No. 55931. That Order also established the  
3 Commission's control over certain parameters of that trust, including approval of the  
4 trustee, the various fund managers, and the categories of and limits to permissible classes  
5 of investments for the trust.

6 The first (fixed-income) fund manager, RCM, was approved in Decision No. 56384  
7 (March 9, 1989). When RCM reached its original \$50 million dollar limit, the  
8 Commission authorized first an equity fund manager (MCM) and later a second fixed-  
9 income manager (DIA). See Decision Nos. 58675 (June 22, 1994) and 60098. The  
10 present trustee for all three investment fund managers, Mellon Bank, was approved in  
11 Decision No. 57426 (June 19, 1991).

12 In Decision No. 64393, the Commission recites much of the above background  
13 concerning Palo Verde, the APS decommissioning trust funds, and the role of the  
14 Commission in approving the Company's selection of both a fund trustee and fund  
15 investment managers. APS has included this same information in the present application  
16 for the convenience of Staff and the Commission.

17 RCM was recently acquired by a French company, Allianz. Allianz already had a  
18 subsidiary company engaged in fixed-income fund management, PIMCO. Allianz has  
19 decided that it does not want two subsidiaries competing with each other in the same basic  
20 line of business. Therefore, RCM's fixed-income business is being terminated. RCM has  
21 asked that its existing accounts be assigned to PIMCO. PIMCO has an extensive  
22 background in managing fixed-income funds for pension and benefit programs, but far  
23 less experience in handling nuclear decommissioning fund. PIMCO has also not been  
24 approved by the Commission. For these reasons, APS believed it prudent to evaluate  
25 other prominent fixed-income decommissioning fund managers as compared to PIMCO  
26 and to then seek either Commission approval of PIMCO or approval for a different

1 replacement fund manager for RCM. A description of that evaluation process is set forth  
2 below.

## 4 II. THE SELECTION PROCESS

5 As noted above, upon receiving notification on January 31, 2002 that RCM would  
6 be going out of the fixed-income fund management business within sixty (60) days, APS  
7 immediately issued an electronic RFP to ten of the largest and most experienced  
8 decommissioning trust fixed-income fund managers (excluding the other current Palo  
9 Verde decommissioning fund managers) to evaluate against PIMCO. A list of the ten  
10 non-PIMCO candidates and a written copy of the RFP have previously been provided to  
11 Commission Staff.

12 Seven of the ten non-PIMCO responded favorably to the RFP. The other three  
13 firms voluntarily dropped out of contention. From the remaining seven contenders, APS  
14 first picked two finalists. These two finalists and PIMCO, will then make individual in-  
15 person presentations to an APS selection committee composed of representatives from the  
16 APS finance, tax and accounting departments. This committee will select a recommended  
17 fund manager that will be presented to both the Commission and the APS Board of  
18 Directors for their final approval.

## 20 III. DESCRIPTION OF THE FINALISTS AND PIMCO

21 As noted above, APS has selected two finalists to evaluate along with PIMCO:

- 22 1. NISA Investment Advisors ("NISA"); and,
- 23 2. Duff & Phelps Investment Management Co. ("D&P").

24 These finalists were chosen based on size, experience, references in the industry and the  
25 general attractiveness of their proposals. Some of the key factors in this evaluation are  
26 discussed in conjunction with the following description of these three entities.



1 likewise capped at \$75 million.<sup>1</sup> Its present fund value is approximately \$62 million. If  
2 the Commission is unable to decide this matter prior to March 31, 2002, or if APS'  
3 recommended fund manager is unacceptable to the Commission, APS would ask the  
4 Commission of interim authority for DIA to manage both fixed-income funds until a  
5 second fixed-income fund manager could be approved.

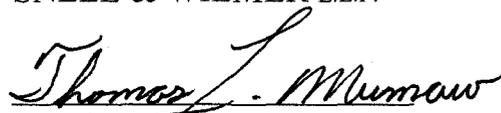
6 Under this alternative, the funds would remain separately managed by DIA and not  
7 co-mingled. They would also be subject to the same fund management agreement and fee  
8 structure as for the existing DIA fund.

#### 9 10 V. CONCLUSION

11 APS regrets that it could not have addressed this issue in Docket E-01345A-01-  
12 0878. That simply was not possible. The Company also wishes it did not have to press  
13 the Commission for such speedy action on this request, but that is also something outside  
14 its control. APS believes it has in place a prudent and reasonable selection process. It is  
15 the same process as it has used in previous fund manager selections, all of which have  
16 been affirmed by the Commission, and is the same process the Company uses in selecting  
17 managers for its pension and benefits funds. APS therefore asks the Commission to either  
18 approve its recommended replacement fixed-income fund manager prior to March 31,  
19 2002, or grant interim authority for DIA to serve as manager for both fixed-income funds.

20 RESPECTFULLY SUBMITTED this 15th day of February 2002

21 SNELL & WILMER L.L.P.

22   
23 Thomas L. Mumaw

24 Attorneys for Arizona Public  
25 Service Company

26 <sup>1</sup> Both funds could exceed the cap from fund earnings. APS would not, however, be able to make additional contributions to the funds without coming back to the Commission.