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BEFORE THE ARIZONA CORPORATION COMMISSION

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WILLIAM A. MUNDELL
CHAIRMAN
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COMMISSIONER
MARC SPITZER
COMMISSIONER

Arizona Corporation Commission

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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF
ARIZONA PUBLIC SERVICE COMPANY FOR
AN ORDER APPROVING A NEW FIXED
INCOME MANAGER FOR THE PALO VERDE
NUCLEAR DECOMMISSIONING TRUST
FUNDS

DOCKET NO. E-01345A-02-0125

AMENDMENT TO APPLICATION

On February 15, 2002, Arizona Public Service Company ("APS" or "Company") filed an Application in the above-captioned proceeding requesting an Order from the Arizona Corporation Commission ("Commission") approving the selection of a new Palo Verde fixed-income decommissioning fund manager to succeed RCM Capital Management ("RCM"), or alternatively, an interim order authorizing the other Commission-approved fixed-income fund manager, Delaware Investment Advisors ("DIA") to manage the Company's fixed-income decommissioning trust funds pending Commission final approval of a replacement manager for RCM.¹ RCM had been recently acquired by a French company, Allianz, and indicated to APS on January 31, 2002 that it

¹ APS had met with Commission Staff prior to filing the Application to explain the problem, identify and discuss the replacement selection process (which has been used by APS and validated by the Commission since 1988), and stress the need for Commission action prior to March 31, 2002 (at the latest), and preferably prior to the March 20th APS Board of Directors meeting. APS committed to filing an application for a replacement fund manager or alternatively, for interim authority to proceed with just one fixed-income fund manager, by February 15, 2002, said application to describe the selection process and identify the "finalists" for RCM's replacement as the Company's second fixed-income decommissioning fund manager.

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1 would no longer be in the fixed-income fund management business as of March 31, 2002.
2 Fixed-income fund clients of RCM, including APS, were given until that date to secure a
3 replacement fund manager.
4

5 I. INTRODUCTION

6 As had been discussed with Staff, APS began an expedited search for RCM's
7 replacement on February 1, 2002. APS identified the three finalists for the new fund
8 manager position in its original Application. These were: NISA Investment Advisors
9 ("NISA"); Duff & Phelps Investment Management Co. ("D&P"); and Pacific Investment
10 Management Company ("PIMCO").² Therein, the Company also committed to Staff and
11 the Commission that it would further expedite its efforts and would have a final
12 recommendation for RCM's replacement as the second fixed-income decommissioning
13 fund manager by February 28, 2002.

14 As promised, and after careful consideration of both the written and oral
15 presentations made by NISA, D&P and PIMCO to the APS selection committee, APS
16 selected NISA on February 28, 2002, as the Company's recommendation to both the
17 Commission and the APS Board of Directors. On the same day as NISA's selection as the
18 Company's recommended replacement fixed-income decommissioning fund manager,
19 APS representatives again met with Commission Staff. Copies of each of the three
20 finalists' presentations to the APS selection committee were provided to Staff for their
21 review. APS also explained the reasons behind its selection of NISA and committed to
22 submit the instant amendment to its February 15th Application by the following day.

23
24 ²There are four primary fixed-income decommissioning fund managers in the United States: RCM, DIA,
25 NISA and D&P. RCM was going out of the fixed-income fund management business, and DIA was
26 already retained by the Company as a fixed-income decommissioning fund manager. Thus, the selection
of RCM's replacement was quickly reduced to a choice among the remaining established fixed-income
decommissioning fund managers and RCM's sister company, PIMCO. None of these entities has any ties
to APS or any other affiliate of APS.

II. WHY NISA?

1
2 The selection of NISA as the recommended replacement fixed-income fund
3 manager was based primarily on three fundamental criteria: 1) experience in nuclear
4 decommissioning fixed-income investments as measured both by the amount of
5 decommissioning trust fund dollars under management and the number of individual
6 nuclear utility clients; 2) specialized tax expertise in this unique area of tax law so as to
7 optimize after-tax returns to the fund; and 3) knowledge of all ongoing decommissioning
8 legislation, tax regulations, etc. A reasonable fee structure was, of course, also an obvious
9 consideration in the final selection. Attached, as Appendix A to this Amended
10 Application is a decision matrix comparing NISA, D&P and PIMCO. This matrix was
11 previously provided to Commission Staff.

12 Of the three finalists, NISA had the longest fixed-income decommissioning track
13 record (14 years), the most fixed-income decommissioning funds under management
14 (\$2.8 billion) and the largest number of fixed-income decommissioning fund clients (16).
15 In contrast, D&P had 11 years of experience, a little under \$1 billion in fixed-income
16 decommissioning funds under management, and nine fixed-income decommissioning
17 fund clients. The analogous PIMCO figures were: less than a year, \$.3 billion, and 2
18 clients.

19 NISA's non-nuclear fixed-income expertise goes back to 1975, and it is a 100%
20 employee-owned firm. This makes a future take-over of the business, as happened to
21 RCM, less likely.

22 NISA's tax optimization strategies were the best and most detailed of the three
23 firms, and it spanned decommissioning accounts spread over many different states, each
24 with its unique state income tax provisions. Each individual trade or transaction entered
25 into by NISA on behalf of the funds under its management was analyzed for optimum
26 after-tax return. NISA's huge commitment to nuclear decommissioning fund management

1 (a third to half its total revenues) has garnered it a well-deserved reputation as one of the
2 nations most knowledgeable firms regarding both existing and proposed legislation, as
3 well as regulatory and other factors that affect or may affect nuclear decommissioning
4 fund investments. NISA's fees were also very competitive and even below those of
5 RCM.

7 III. CONCLUSION

8 As noted in the February 15th Application, APS is asking for the Commission to
9 consider the Company's recommended fund manager at its regularly scheduled March
10 Open Meeting on March 19, 2002. APS has scheduled a meeting of its Board of Directors
11 on March 20, 2002 to also consider NISA as new fund manager. If it is impossible for the
12 Commission to consider NISA at that regular Open Meeting, APS again requests that the
13 Commission schedule a Special Open Meeting prior to March 31, 2002.³ Otherwise, APS
14 will find itself, through no fault of its own, in non-compliance with prior Commission
15 orders relative to the Palo Verde decommissioning trusts.

16 APS has selected NISA after a careful and thorough selection process. It has
17 expedited that process to the extent possible and has kept the Commission Staff fully
18 informed throughout. APS therefore asks the Commission to either approve NISA as
19 RCM's replacement fixed-income decommissioning fund manager prior to March 31,
20 2002, or grant interim authority for DIA to serve as manager for both fixed-income funds.
21 To aid in the Commission's prompt consideration of this request at its next regularly
22 scheduled Open Meeting, the Company has attached to its Amended Application as
23 Appendix B a Proposed Form of Order as permitted by A.A.C. R14-2-110 (B). This
24

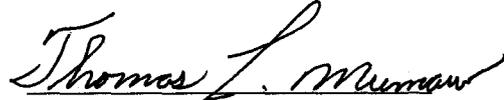
25
26 ³ This latter alternative is obviously less desirable because the APS Board of Directors would have to act
on March 20th without knowing the Commission's decision on this issue.

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Proposed Form of Order follows the format and style most-recently approved by the Commission in Decision No. 64393.

RESPECTFULLY SUBMITTED this 1st day of March 2002

SNELL & WILMER L.L.P.


Thomas L. Mumaw

Attorneys for Arizona Public Service Company

Original and 10 copies of the foregoing filed this 1st day of March, 2002, with:

Docket Control
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

Copy of the foregoing was hand-delivered this 1st day of March, 2002, to:

Ernest Johnson, Director
Utilities Division
Arizona Corporation Commission
1200 West Washington
Phoenix, AZ 85007

APPENDIX A

NDT FIXED INCOME MANAGER REVIEW
REPLACEMENT OF RCM CAPITAL
FEBRUARY 2002

Company	NDT		Decommissioning Experience	Tax-Sensitive Investment Strategy		Other Investment Issues
	Fixed Income Accounts Assets	Clients				
NISA	\$2.8 Bil	16	14 Years	<ul style="list-style-type: none"> - Separately managed for each client. - Common strategic base across accounts, Tactical decisions unique to each client. - Tax impact of every trade considered. - Year-end analysis with each client re: positioning gains and losses. - Coordinates wash sale rules among other APS fixed income investment managers. 	<ul style="list-style-type: none"> - Very conservative. Diversifies a lot among issuer names. - No interest rate bets. - Many NDT clients at Mellon Bank. Reconciles trustee data with NISA data monthly. - Very strong investment compliance monitoring system. 	
Duff & Phelps	\$0.8 Bil	9	11 Years	<ul style="list-style-type: none"> - Separately managed - Gave general overview of tax strategy. (NISA gave very specific examples). - Invests a lot in Puerto Rico muni securities (fed and AZ state tax free) 	<ul style="list-style-type: none"> - Presentation focused more on knowledge of decommissioning (matched by NISA) than on investment strategy issues. 	
PIMCO	\$0.3 Bil	2	Just a Few Months	<ul style="list-style-type: none"> - PIMCO traditionally commingled shop. Agreed to try separate accounts for small clients. - No real history of NDT tax management. Message was "trust us". 	<ul style="list-style-type: none"> - Concentrated major investment bets, for example selling all corporate bonds recently. - Takes moderate interest rate bets. 	

NDT FIXED INCOME MANAGER REVIEW
 REPLACEMENT OF RCM CAPITAL
 FEBRUARY 2002

Company	Fees		Notes
	Qualified	NonQualified	
NISA	25bp on first \$25mm 20bp on next \$50mm 15bp thereafter	25bp on first \$25mm 20bp on next \$50mm 15bp thereafter	<ul style="list-style-type: none"> - Independently owned. - Broadest range of experience with taxable NDTs among many states. - Proprietary models specific to NDTs - Belongs to numerous national decomm. tax work groups. Strong decomm. knowledge. - No accounts lost to termination.
	Fee On RCM Portfolio (approx. \$60 mil): \$132,500		
Duff & Phelps	25bp on first \$25mm 20bp on next \$25mm 15bp on next \$150	25bp on first \$25mm 20bp on next \$25mm 15bp on next \$150	<ul style="list-style-type: none"> - Belongs to numerous national decomm. tax work groups. Strong decomm. knowledge. - Clearly a much smaller NDT manager than NISA
	Fee On RCM Portfolio (approx. \$60mil): \$127,500		
PIMCO	50bp on first \$25mm 38bp on next \$25mm 25bp thereafter	30bp on first \$50mm 25bp thereafter	<ul style="list-style-type: none"> - PIMCO admits they are in the beginning stages of establishing its presence within the NDT market place - Could not report after-tax, decommissioning-specific returns over any meaningful period. - Fees almost twice other fund managers.
	Fee On RCM Portfolio (approx. \$60mil): \$237,500		

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APPENDIX B

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
CHAIRMAN
JIM IRVIN
COMMISSIONER
MARC SPITZER
COMMISSIONER

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

DOCKET NO. E-01345A-02-0125

DECISION NO. _____

PROPOSED FORM OF ORDER

Open Meeting
March 19 and 20, 2002
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. Arizona Public Service Company ("APS" or the "Company") is a public service corporation certificated to provide electric service in the State of Arizona.
2. On February 15, 2002, APS filed an application requesting approval of a replacement fixed-income decommissioning fund manager for RCM Capital Management ("RCM") to be selected from three finalists: NISA Investment Advisors ("NISA"); Duff & Phelps Investment Management Co. ("D&P"); and Pacific Investment Management Company ("PIMCO").

1 3. APS amended its application on March 1, 2002 to reflect its final
2 recommendation of NISA as replacement fund manager for RCM.

3 4. On March ____, 2002, Commission Utilities Division Staff ("Staff") filed a
4 Staff Report recommending approval of the Company's application without a hearing.

5 5. APS owns 29.1 percent of Palo Verde. Other owner participants include
6 Salt River Project, Southern California Edison, El Paso Electric Company, Public
7 Service Company of New Mexico, and the Los Angeles Department of Water and
8 Power.

9 6. Palo Verde is licensed by the Nuclear Regulatory Commission ("NRC")
10 pursuant to 42 U.S.C. § 2001, *et seq.*

11 7. APS is responsible for funding 29.1 percent of Palo Verde's
12 decommissioning costs.

13 8. In Decision No. 55931 (April 1, 1988), the Commission ordered APS to
14 establish an external "qualified" nuclear decommissioning trust fund. In that Decision,
15 the Commission established control over certain aspects of the trust, including approval
16 of the trustee, the various fund managers, and the categories of, and limits to,
17 permissible classes of investments for the trust. To enable the trust fund to qualify for
18 favorable tax treatment under the Internal Revenue Code and IRS regulations, the
19 Commission had to specifically apportion the total amount of APS' annual contribution
20 to each of the three Palo Verde Units.

21 9. The Commission approved the first fixed-income fund manager, RCM, in
22 Decision No. 56384 (March 9, 1989). When RCM reached its original \$50 million
23 limit, the Commission authorized an equity fund manager, MCM, in Decision No.
24 58675 (June 22, 1994) and later, in Decision No. 60098 (March 19, 1997), a second
25 fixed-income manager, DIA. The Commission approved the current trustee for all three
26 investment funds, Mellon Bank, in Decision No. 57426 (June 19, 1991).

1 10. In Decision No. 60098, the Commission increased the equity funding limit
2 from \$50 million to \$150 million. The fixed-income funds remained capped at
3 contribution limits of \$50 million each.¹ The fund caps were consistent with the
4 Commission's approved overall 60/40 equity/debt investment goal in Decision No.
5 60098.

6 11. The Commission raised the fixed-income decommissioning fund
7 contribution limit to \$75 million for each fund in Decision No. 64393 (January 31,
8 2002).

9 12. A French company, Allianz, recently acquired RCM. Allianz already had
10 a fixed-income fund subsidiary, PIMCO, and did not want two subsidiaries competing
11 against each other. Allianz decided to terminate RCM's fixed-income fund management
12 business effective March 31, 2002. APS received notice of this termination on January
13 31, 2002.

14 13. The selection of NISA as the recommended replacement fixed-income
15 fund manager was based primarily on three fundamental criteria: 1) experience in
16 nuclear decommissioning fixed-income investments as measured both by the amount of
17 decommissioning trust fund dollars under management and the number of individual
18 nuclear utility clients; 2) specialized tax expertise in this unique area of tax law so as to
19 optimize after-tax returns to the fund; and 3) knowledge of all ongoing
20 decommissioning legislation, applicable tax regulations, etc. A reasonable fee structure
21 was, of course, also a consideration in the final selection.

22 14. Of the three finalists, NISA had the longest fixed-income
23 decommissioning track record (14 years), the most fixed-income decommissioning
24 funds under management (\$2.8 billion) and the largest number of fixed-income
25

26 ¹ APS can contribute to the funds until it reaches the prescribed limit. The fund is allowed to
accumulate earnings in excess of the "cap".

1 decommissioning fund clients (16). In contrast, D&P had 11 years of experience, a
 2 little under \$1 billion in fixed-income decommissioning funds under management, and
 3 nine fixed-income decommissioning fund clients. The analogous PIMCO figures were:
 4 less than a year, \$.3 billion, and 2 clients.

5 15. NISA's non-nuclear fixed-income expertise goes back to 1975, and it is a
 6 100% employee-owned firm. This makes a future take-over and termination of the
 7 business, as happened to RCM, less likely.

8 16. NISA's tax optimization strategies were the best and most detailed of the
 9 three firms, and it spanned decommissioning accounts spread over many different
 10 states, each with its unique state income tax provisions. Each individual trade or
 11 transaction entered into by NISA on behalf of the funds under its management was
 12 analyzed for optimum after-tax return. NISA's huge commitment to nuclear
 13 decommissioning fund management (nearly half its total business) has garnered it a
 14 well-deserved reputation as one of the nations most knowledgeable firms regarding both
 15 existing and proposed legislation, as well as regulatory and other factors that affect or
 16 may affect nuclear decommissioning fund investments.

17 17. NISA's fees were also very competitive and even below those of RCM.

18 18. Staff recommends that the Commission approve the Company's request to
 19 appoint NISA as replacement fixed-income decommissioning fund manager for RCM.

20 CONCLUSIONS OF LAW

21 1. APS is a public service corporation within the meaning of Article XV of
 22 the Arizona Constitution and A.R.S. §40-285.

23 2. The Commission has jurisdiction over APS and the subject matter of the
 24 application.

25 3. It is reasonable and in the public interest to approve and authorize the
 26

1 appointment of NISA in replacement of RCM as the second Palo Verde fixed-income
2 decommissioning fund manager, with DIA remaining the other authorized fixed-income
3 decommissioning fund manager.

4 6. In approving this Order, the Commission specifically retains its authority
5 over changes in fund investment managers, fund contribution limits and in the
6 apportionment method of the fund, and both NISA and DIA shall remain subject to the
7 funding limitations imposed on RCM and DIA in Decision No. 64393.

8 **ORDER**

9 IT IS THEREFORE ORDERED that Arizona Public Service Company's request
10 for approval and authorization to appoint NISA Investment Advisors as the second
11 fixed-income Palo Verde decommissioning fund manager is approved.

12 IT IS FURTHER ORDERED that Decision Nos. 55931, 56384, 57426, 58675,
13 60098 and 64393 shall remain in effect to the extent not inconsistent with this Decision.

14 IT IS FURTHER ORDERED that this Decision shall become effective
15 immediately.

16 BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

17 _____
18 CHAIRMAN COMMISSIONER COMMISSIONER

19 IN WITNESS WHEREOF, I, BRIAN C. McNEIL,
20 Executive Secretary of the Arizona Corporation
21 Commission, have hereunto set my hand and caused the
22 official seal of the Commission to be affixed at the Capitol,
23 in the City of Phoenix, this _____ day of _____,
24 2002.

25 _____
26 BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

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