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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission

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IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC DIVISION OF CITIZENS COMMUNICATIONS COMPANY TO CHANGE THE CURRENT PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE RATE, TO ESTABLISH A NEW PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE BANK, AND TO REQUEST APPROVED GUIDELINES FOR THE RECOVERY OF COSTS INCURRED IN CONNECTION WITH ENERGY RISK MANAGEMENT INITIATIVES.

Docket No.: E-01032C-00-0751

**INTERVENOR MOHAVE COUNTY'S REQUEST FOR DETERMINATION OF RATE ADJUSTMENT UNDER CITIZENS' APPLICATION OF 9/28/2000 PRIOR TO CONSIDERATION OF THE PROPOSED SETTLEMENT**

IN THE MATTER OF THE APPLICATION OF CITIZENS COMMUNICATIONS COMPANY, ARIZONA GAS DIVISION, FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO PROVIDE SUCH RATE OF RETURN.

Docket No.: G-01032C-02-0598

IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS COMMUNICATIONS COMPANY AND UNISOURCE ENERGY CORPORATION FOR THE APPROVAL OF THE SALE OF CERTAIN ELECTRIC UTILITY AND GAS UTILITY ASSETS IN ARIZONA, THE TRANSFER OF CERTAIN CERTIFICATES OF CONVENIENCE AND NECESSITY FROM CITIZENS COMMUNICATIONS COMPANY TO UNISOURCE ENERGY CORPORATION, THE APPROVAL OF THE FINANCING FOR THE TRANSACTIONS AND OTHER RELATED MATTERS.

Docket No.: E-01933A-02-0914  
Docket No.: E-01032C-02-0914  
Docket No.: G-01032A-02-0914

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1 IT IS RESPECTFULLY REQUESTED that the Commission, prior to considering the  
2 Proposed Settlement or the requested transfer of the CC&N from Citizens to UniSource, conduct  
3 the hearing in the matter of Docket No. E-01032C-00-0751 (Citizens' Electric Rate Case) under  
4 Citizens' Original Application, in order to determine what adjustment to Citizens' existing rate  
5 structure, if any, should be allowed under that Application. And, having made that  
6 determination, then conduct a hearing to compare the resulting rate with the rate proposed by the  
7 Proposed Settlement—i.e., the new contract.  
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9 Citizens' Original Application request was to adjust the basic service rate's power cost  
10 component's automatic adjustor ("PPFAC") of \$2.6 million dollars. This adjustment was sought  
11 to reflect the increased power supply expenses from Citizens' wholesaler, APS.  
12

13 The Commission has been presented with a contract between Citizens/UniSource and  
14 the Commission's Staff recommending that the Commission adopt and approve the electric rate  
15 established between Citizens/UniSource and the Commission's Staff as a substitute for  
16 conducting a rate hearing on Citizens' Application to change the power cost component of the  
17 Commission-approved basic service rate. While the desire to conflate the difficulties of  
18 conducting an electric rate hearing on Citizens' Application into an omnibus settlement package  
19 designed to facilitate the CC&N transfer from Citizens to UniSource is understandable, the fact  
20 of the matter is that some 70,000 ratepayers in Mohave and Santa Cruz Counties will face a  
21 22% increase in their electric rates without benefit of knowing whether an evidentiary hearing on  
22 Citizens' Original Application to increase automatic adjustor to the power cost component of its  
23 basic service rate from \$2.6 million would have resulted in any rate change at all, or if there was  
24 a rate change, what it would have been.  
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1 To date, the basic facts underpinning the requested electric rate hearing are that Citizens  
2 paid APS \$ 82 million for power supply expenses incurred in a manipulated power market under  
3 a disputed interpretation of provisions of the contract, and that Citizens' seeks recovery of those  
4 costs from the ratepayers without benefit of a routine legal interpretation of the contract by a  
5 neutral fact-finding body of competent jurisdiction; and then compounds this failure with its  
6 request in an Amended Application by seeking to have the Commission approve some \$50  
7 million more in pass through to the ratepayer incurred under a new contract between it and APS  
8 (Pinnacle West); and then Citizens asks the Commission to use this new contract to effect a rate  
9 increase of 22% to the service rate. This request under the Amended Application, however, has  
10 been made contingent, under a proposed Settlement Agreement, on the Commission giving  
11 Citizens a 22% rate increase, with Citizens/UniSource agreeing to forego collection of the \$82  
12 million incurred under the old contract plus the \$50 million incurred under the new.

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15 *It is legally valid and objectively reasonable for the Commission to determine whether*  
16 *the electric rate proposed by the proposed settlement is good, bad, or indifferent by first*  
17 *determining what a just and reasonable rate would be under the rate request of Citizen's*  
18 *Original Application, and then comparing it with the settlement's proposed rate, despite the fact*  
19 *that Citizens and APS entered into a "new" power purchase agreement without Citizens having*  
20 *first learned from this Commission whether eliminating the old contract was a prudent and*  
21 *proper action.*  
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24 Citizens' Original Application was filed on September 28, 2000 seeking a rate  
25 adjustment. Citizens forthrightly, clearly and unambiguously explains in its Application that it  
26 seeks to change the automatic adjustor to the power cost component of the basic service charge  
27 from the existing \$2.6 million PPFAC threshold to reflect unprecedented power supply expenses  
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1 incurred under its contract with APS during the summer of 2000. Citizens describes for the  
2 Commission the substantial increase in power costs that Citizens experienced that summer and  
3 discusses what Citizens believes to be the underlying causes, noting a hotter than normal  
4 summer, and then, ironically, noting the concomitant 30% -- 50% increase in the price of natural  
5 gas during the summer. **Original Application, pg 16-17.** The Application discusses these  
6 events in the context of the impact of deregulation of the wholesale electricity markets, i.e.,  
7 wholesalers were no longer constrained to a cost-based rate to justify the price of power, but  
8 were able to sell power at prices dictated by whatever the market would bear. Citizens then cites  
9 the California's Electricity Options and Challenges report which suggested "that the rules  
10 directing the California wholesale market are in fact flawed and that market participants are able  
11 to game the system to their benefit even while obeying the rules." **Original Application, pg 21.**

14 Citizens then tells the Commission that "Citizens will investigate the extent to which  
15 APS practiced due diligence in the acquisition of resources that service Citizens load during the  
16 summer of 2000...[and] ... will seek to determine whether APS resource procurement strategy  
17 resulted in the lowest possible cost to Citizens." **Original Application, pg 28.**

19 Citizens Original Application is an objective response to a unique, unprecedented, set of  
20 circumstances. It clearly identifies what component of its rate structure needs modifying, (the  
21 automatic adjustor to the power cost component of its basic service rate) explaining as best it  
22 can, given the information available to it at that time, why it thinks the prices were  
23 unprecedented, and promising to examine APS' procurement strategies to see if they were out of  
24 line. In short, Citizens' Original Application paints a picture of a Commission-regulated utility  
25 attempting to come to grips with an unprecedented set of market circumstances in reaching a just  
26 and reasonable rate, by explaining that its automatic adjustor with its \$2.6 million trigger for  
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1 recovery was not designed to accommodate a \$52.3 million power purchase expense from its  
2 Commission-unregulated wholesaler, APS, and that the Commission needed to consider an  
3 alternative recovery method to the traditional 12 month method, but with a heads-up to the  
4 Commission: natural gas prices went up 30%--50% during one of the hottest summers in years,  
5 and native-load generation had to be supplemented by high-priced power in the wholesale  
6 market with suspicions that the deregulation of the wholesale power market was not only adding  
7 to the increase, but that market participants might be gaming the system as a consequence of  
8 deregulation.  
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11 The Commission was presented with a set of observations, which in hindsight, seem  
12 remarkably prescient in light of today's knowledge that, indeed, both the natural gas and electric  
13 power markets were being manipulated and that deregulation was flawed in the California  
14 market, and that those problems migrated into the rest of the Western bulk power market.  
15 Citizens' observations that market gaming might be afoot in the power industry have been borne  
16 out by FERC investigation, with the extent and economic impact still in question.  
17

18 If Citizens were before this Commission in keeping with its Original Application, the  
19 Commission would be conducting a rate hearing, whose major difficulty would be attempting to  
20 winnow the wheat from the chafe of a manipulated market with a cost recovery mechanism  
21 which had been designed to capture variability in prices under a power purchase contract  
22 reflecting rational market behavior. But during the pendency of the Original Application,  
23 Citizens and APS tossed out the old contract and entered into a new contract.  
24

25 Citizens changed position from making an understandable regulatory request, to an  
26 approach under an Amended Application which begs description other than as one of treating  
27 some 70,000 ratepayers as a guaranteed cash reserve to be drawn on by Citizens and APS under  
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1 an order from the Commission approving what amounts to a regulated retailer, Citizens, and  
2 unregulated wholesaler, APS, agreeing to a new contract which sets utility rates for the  
3 ratepayers under a FERC-protected market-based rate tariff, i.e., a whatever-the-market-will-bear  
4 contract. In other words, the Commission, under the Amended Application was being asked to  
5 rubber stamp what amounts to be a 22% increase in rate and some \$130 million in purchase  
6 power costs as an additional pass through to ratepayers, all privately determined by APS and  
7 Citizens, as a substitute for the Commission conducting a constitutionally required regulatory  
8 rate hearing to set a rate which is just and reasonable to both Citizens and the ratepayer.  
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10  
11 On September 19, 2001, Citizens filed with the Commission its Amended Application as  
12 an update to its Original Application. Citizens tells the Commission in the Amended  
13 Application, that it and APS disagreed over the interpretation to be given the old contract's  
14 provisions regarding economic versus reliability purchases by APS for supplying Citizens'  
15 load—this is the old contract with APS for power supply expenses which form the power supply  
16 component, and its associated automatic (PPFAC) adjustor, of the basic service rate. But  
17 instead of proceeding to have the old contract's economic/reliability purchases' provisions  
18 interpreted by a neutral fact finder, so that the validity of the power supply expenses which  
19 Citizens had paid APS could be determined under well-understood legal standards of contract  
20 interpretation, and therefore binding as a matter of law, Citizens tells the Commission that APS  
21 and Citizens entered into a new fixed-rate contract under a FERC-approved market-based rate  
22 tariff, and requests the Commission to substitute the new contract for the existing contract---  
23 thereby effectively increasing the basic service rate by 22%. In the same breath, and in addition  
24 to this 22% rate increase, *Citizens requested this Commission to allow Citizens to recover the full*  
25 *amount of the power supply expenses incurred under the parties' disputed-different-*  
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1 *interpretation contract provisions which by the time of the Amended Application amounted to*  
2 *some \$82 million dollars. This was tantamount to asking the Commission to pass through \$82*  
3 *million in power purchase expenses on APS' and Citizens' interpretation of disputed contract*  
4 *provisions. (The \$82 million amount is now estimated to increase by some \$50 million by July*  
5 *of 2003, because Citizens has been adding to the old-contract amount, the "new" contract's*  
6 *power purchase cost to the PPFAC "bank." as if it were the power cost component basic service*  
7 *rate.)*

9           Receipt by the wholesaler, APS, of revenues under the new contract with Citizens is a  
10 guaranteed return from some 70,000 retail ratepayers whether or not its retailer, Citizens, is  
11 successful in convincing the Commission that this contract price should be passed through to the  
12 ratepayer as an automatic adjustor to the power cost component of the basic service rate. If  
13 unsuccessful, APS still gets its contract price, but Citizens loses the benefit of its guaranteed  
14 reasonable rate of return because it must make up the difference between its rate recovery and  
15 the contract price from its profits. That, however, is the choice made by Citizens in agreeing  
16 with its wholesaler to throw out the old agreement. In sum, the new contract is one by which a  
17 power wholesaler, APS, not subject to Commission regulation, can obtain the full benefit of  
18 Commission regulation—effective barriers to entry of new, competing, power generators through  
19 the power plant and line siting regulations, and a guaranteed rate of recovery from ratepayers  
20 through regulated retail utilities—as if it were a Commission-regulated utility, but without its  
21 burdens, i.e., having its recovery from the ratepayer balanced by the Commission against its  
22 actual operating costs.

23           Ariz. Const. art. 15, § 3 and § 14 provide the standards in Arizona by which the  
24 Commission sets regulated utilities' rates:  
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1 § 3. The Corporation Commission shall have full power to, and shall  
2 prescribe...just and reasonable rates and charges to be made and collected,  
3 by public service corporations within the State for service rendered  
therein..."

4 § 14. The Corporation Commission shall, to aid it in the proper discharge  
5 of its duties, ascertain the fair value of the property within the state of  
6 every public service corporation doing business therein.

7 A key variable in the calculus for setting a "just and reasonable" rate for Citizens, then, is,  
8 "What is the fair value of Citizens' property in the State?" In Arizona, fair value has been  
9 articulated by our Supreme Court in this way: "In the past, fair value has been the factor by  
10 which a reasonable rate of return was multiplied to yield, with the addition of operating  
11 expenses, the total revenue that a corporation could earn. *See, Scates v. Ariz. Corp. Comm'n*, 118  
12 Ariz. 531, 533-34, 578 P.2d 612, 614-15 (App.1978). That revenue figure was then used to set  
13 rates." US West Communications, Inc. v. Arizona Corporation Commission, 201 Ariz. 242, 245,  
14 34 P.3d 351, 354 (2001).

15  
16 Purchases of power under both the Old Contract and the New Contract are operating  
17 expenses, and as such, they are used to determine the total revenue Citizens could earn, with that  
18 revenue figure used to set rates. Obviously, the rate set will be higher or lower as a function of  
19 which contract is used. Since Citizens makes no profit or return from the resale of the power it  
20 purchases from APS (Pinnacle West), and only benefits as a profit-making business to the extent  
21 of the reasonable rate of return component in the rate, it is just as obvious that whichever  
22 contract results in a lower rate to the consumer is the contract that results in insuring that "both  
23 the corporation [Citizens] and the consumer are treated fairly." US West, supra at 246.

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26 As noted above, Citizen makes no resale profit on the power it purchases from  
27 APS/Pinnacle West. Citizens passes the APS power purchase costs through to the ratepayer as  
28 the power cost component (and associated PPFAC adjustor) of the basic service rate. However,

1 since Citizens is a regulated utility with no retail competition, it cannot be economically  
2 indifferent to what the cost of power is under its contracts with suppliers. As a regulated utility it  
3 must operate under a just and reasonable rate revenue stream approved by the Commission, i.e.,  
4 the approved utility rate. Therefore, by entering into a new contract with APS, and eliminating  
5 its old contract with APS, *without first* having had this Commission resolve the request made in  
6 the Original Application to determine the question of adjusting the PPFAC recovery amount of  
7 the power cost component, Citizens invades the province of this Commission by unilaterally  
8 changing the power cost component of its basic service rate before the Commission has had an  
9 opportunity to review the question.  
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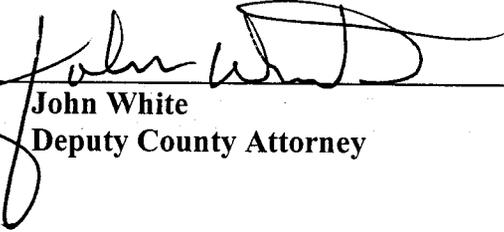
12 If it turns out that the old contractual arrangements would have resulted in a lower rate to  
13 the ratepayer than a rate under the new contract, Citizens will be in the same position before this  
14 Commission as the person who kills his parents and throws himself on the mercy of the court  
15 because he's an orphan.  
16

17 THEREFORE, it is respectfully requested that the Commission, prior to considering the  
18 Proposed Settlement, conduct the hearing in the matter of Docket No. E-01032C-00-0751  
19 (Citizens' Electric Rate Case) in accordance with the requests made in the Original Application,  
20 in order to determine what adjustment to Citizens' existing rate structure, if any, should be  
21 allowed under that Application. And, having made that determination, conduct a hearing to  
22 compare the resulting rate with the rate proposed by the Proposed Settlement—i.e., the new  
23 contract.  
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25 **RESPECTFULLY SUBMITTED THIS 25 DAY OF APRIL, 2003**  
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