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ORIGINAL

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL  
CHAIRMAN  
JIM IRVIN  
COMMISSIONER  
MARC SPITZER  
COMMISSIONER

2002 APR -5 P 4: 11 DOCKETED

AZ CORP COMMISSION  
DOCUMENT CONTROL APR 05 2002

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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-02-0751

**MOHAVE COUNTY AND SANTA CRUZ COUNTY'S MOTION FOR FINDINGS OF FACT; OR IN THE ALTERNATIVE, A STAY OF PROCEEDINGS**

**(Expedited Consideration Requested)**

Mohave County and Santa Cruz County (the "Counties"), pursuant to A.R.S. Secs. 40-202 and 40-203; and A.A.C. R14-3-109 (Q), hereby respectfully request that the Arizona Corporation Commission ("Commission") enter the following findings of fact:

1. That Citizens has not established that purchase power costs charged by Arizona Public Service Company ("APS") from May 2000 to May 2001 ("disputed purchase power costs") were prudently incurred;
2. That Citizens' decision to waive the attorney-client and work product privilege (collectively referred to as the "attorney-client privilege") in connection with its dispute over the interpretation of the 1995 Power Sale Agreement with Arizona Public Service Company and overcharges in connection therewith (the "purchase power dispute") is imprudent and contrary to the public interest; and
3. That based upon Citizens' failure to establish that the disputed purchase power costs were prudently incurred and its decision to waive the attorney-client privilege, the disputed purchase power costs should not be charged to Citizens' ratepayers.

In the alternative, the Counties request that this proceeding be stayed until such time as Citizens resolves the purchase power dispute and is then in a position to present evidence

1 regarding the prudence of the disputed purchase power costs.

2 In support hereof, the Counties state as follows:

3 **1. INTRODUCTION.**

4 One of the central issues in this case is whether Citizens' purchase power costs were  
5 prudently incurred. Citizens has now filed all of its testimony in this proceeding. The Counties  
6 believe that Citizens has failed to present any evidence that the disputed purchase power costs  
7 were prudent. In fact, the testimony and pleadings establish that Citizens believes that APS  
8 overcharged it under the 1995 Power Sale Agreement and has paid the disputed purchase power  
9 costs under protest. It is oxymoronic for Citizens to claim that purchase power costs that it  
10 believes were overcharged were prudently incurred.

11  
12 Citizens has not resolved the purchase power dispute. Instead, it has sought for this  
13 Commission to order its ratepayers to reimburse it for the disputed purchase power costs. During  
14 the course of this case intervenors and Commission Staff filed testimony questioning the prudence  
15 of Citizens' decision not to resolve the purchase power dispute. Commission Staff has  
16 recommended that Citizens be required to resolve the purchase power dispute before it is  
17 permitted to recover the disputed purchase power costs. Incredibly, Citizens' response was to file  
18 the testimony of its outside counsel, waive the attorney-client privilege and divulge perceived  
19 weaknesses in its dispute with APS. The result of this strategy has been to open to public scrutiny  
20 confidential and privileged communications from attorneys and experts that APS can now obtain  
21 to use against Citizens. Additionally, Citizens' and its attorneys are now subject to discovery  
22 without the benefit of the attorney-client privilege. Thus, Citizens has provided APS with  
23 unprecedented access to its research, fact finding and strategy, thereby sabotaging any reasonable  
24 hope to successfully resolve the purchase power dispute. The relief sought by the Counties in  
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1 this motion is intended to ensure that Citizens' ratepayers will not be the victims of Citizens'  
2 imprudent actions.

3 **2. CITIZENS HAS NOT ESTABLISHED THAT THE DISPUTED PURCHASE**  
4 **POWER COSTS WERE PRUDENTLY INCURRED.**

5 In the Amended Application, Citizens states:

6  
7 AED [Citizens] and APS interpreted certain key contract provisions differently.  
8 Based upon subsequent discussions between the parties, it became clear that it  
9 was not possible to resolve the interpretation issues short of litigation, which is  
10 both expensive and lengthy. Further, litigation would do nothing to address the  
11 continuing accumulation of unrecovered costs in the PPFAC bank.

12 **In an effort to achieve a more timely resolution to the excessive power cost**  
13 **problem, AED [Citizens] shifted its focus to negotiating prospective changes**  
14 **in the contract.** Amended Application at 2-3; emphasis added.

15 Citizens' witness, Mr. Sean Breen testified in his direct testimony:

16 Citizens and APS/PWEC had numerous discussions regarding the contract  
17 elements that were a factor in their billing of the significantly higher power costs.  
18 Discussions ensued for several months, and it became ultimately clear that  
19 resolution of these matters would not be possible without litigation; both parties  
20 maintained firmly entrenched positions. Given the inevitability of a protracted  
21 legal process, the uncertainty of the outcome of litigation, and the reality of  
22 continuing charges under the PSA, **Citizens shifted its focus to the possibility of**  
23 **negotiating prospective changes in the contract.** Direct Testimony of Sean  
24 Breen at 4; emphasis added.

25 Mr. Breen then stated in his rebuttal testimony:

26 Faced with the uncertain outcomes and the cost for pursuing legal options  
measured not only in legal costs, but more importantly, by the prospect of  
continued high power costs impacting both the customers and the Company  
during years of litigation, **Citizens determined that the only reasonable course**  
**of action was to seek a new power supply contract with APS.** Rebuttal  
Testimony of Sean Breen at 16; emphasis added.<sup>1</sup>

Mr. Paul Flynn, Citizens' outside counsel testified in his rebuttal testimony:

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<sup>1</sup> The Counties will not address the merits of Citizens' determination at this time but cite the testimony to show that the dispute has not been resolved.

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Citizens determined that negotiation to engage APS in a solution to the problem of the PSA and high purchased power costs was the most prudent course to protect Citizens and its ratepayers from continued high costs. **Litigation, by contrast, would not have provided any near-term relief and undoubtedly would have forced a deferral of any serious negotiating efforts.** Rebuttal Testimony of Paul M. Flynn at 18; emphasis added.

But the fact of the matter is that the purchase power dispute was never resolved with APS-- not by litigation, arbitration, mediation or negotiation. Instead, the purchase power dispute remains an open issue and Citizens' solution is simply to pass the costs on to its ratepayers through an increase in its PPFAC.

Citizens' Response to RUCO's Third Set of Data Requests, No. 3.1 (June 7, 2001) states in part:

Citizens' understanding, based on the language of the PSA, has always been that, for the service schedules providing for "system incremental costs" ("SIC") pricing as defined in the PSA, APS may only charge Citizens for the costs of power purchases that are made for economic purposes.

...

However, **the parties were not able to reach any consensus on the proper interpretation of the contract.** In the summer of 2000, APS' bills to Citizens increased dramatically based on APS interpretation of the PSA and the large increase in the prevailing power prices in the region. **Citizens contested each of these bills from APS.** (emphasis added; Exhibit 1)

The disputed amount is approximately \$50-70 million (the "disputed purchase power costs"). The purchase power dispute was never resolved. Instead, Citizens made the business decision to simply ask the Commission to order Citizens' ratepayers to reimburse it for the disputed purchase power costs.

Citizens' 2000 Annual Report indicates Citizens' belief that it could simply pass disputed purchase power costs through to its ratepayers:

In Arizona, we are currently disputing excessive power costs charged by our power supplier in the amount of approximately \$57 million through December 31, 2000. **We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause.** Citizens

1 2000 Annual Report at 11; emphasis added<sup>2</sup> (Exhibit 2).

2 Citizens has not presented any evidence to support a finding that the disputed purchase  
3 power costs were prudently incurred. To the contrary, the evidence in this proceeding clearly  
4 establishes that Citizens believes that the disputed purchase power costs represent overcharges  
5 from APS. Consequently, the Commission should find that Citizens has failed to establish that the  
6 disputed purchase power costs are prudent.  
7

8 **3. CITIZENS' DECISION TO WAIVE THE ATTORNEY-CLIENT**  
9 **PRIVILEGE IS IMPRUDENT AND CONTRARY TO THE PUBLIC INTEREST.**

10 In order to justify its decision to abandon the purchase power dispute, Citizens filed the  
11 rebuttal and rejoinder testimony of Paul Flynn, an attorney with the law firm of Wright &  
12 Talisman. Mr. Flynn represents Citizens in connection with the purchase power dispute.  
13

14 Mr. Flynn's testimony reveals attorney-client communications and attorney work-product  
15 regarding the purchase power dispute. Citizens acknowledges that by submitting Mr. Flynn's  
16 testimony it has waived the attorney-client privilege. See: Letter dated March 12, 2002 (Exhibit  
17 3).

18 In addition to Mr. Flynn's testimony, Citizens has produced, in response to discovery  
19 requests, documents that it originally claimed were privileged communications and work-product  
20 by the law firms of Wright & Talisman and Brown & Bain, as well as by potential expert  
21 witnesses.  
22

23 Furthermore, now that Citizens has introduced Mr. Flynn as a witness, he will be subject to  
24 examination by the parties. In order for the parties and Commission to properly examine Mr.  
25 Flynn (and other Citizens witnesses who had knowledge of, or participated in, discussions with the  
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<sup>2</sup> Citizens has overlooked the legal requirement that costs be prudently incurred and that rates be just and reasonable. See A.R.S. Sec. 40-361

1 attorneys), communications and documents once claimed by Citizens to be privileged will need to  
2 be explored on the record. Indeed, the more thorough the examination of Mr. Flynn, the more  
3 attorney-client information that will be made a part of the public record. This is particularly  
4 egregious because Citizens has offered Mr. Flynn's testimony for the proposition that Citizens  
5 could not have favorably resolved the purchase power dispute. Thus, in order to represent his  
6 client's position in this case while on the stand, Mr. Flynn will need to emphasize negative aspects  
7 of Citizens' side of the dispute and de-emphasize the positive aspects. This will provide APS with  
8 unprecedented insight into Citizens' strategies and information – at a time when the purchase  
9 power dispute is still unresolved. And, Mr. Flynn can now be considered a material witness in any  
10 such subsequent litigation between Citizens and APS. As a result of the Citizens' waiver, APS  
11 will be able to pierce the cloak of confidentiality that the law normally affords to the attorney-  
12 client relationship.

13  
14  
15 Citizens acknowledged that its waiver of the attorney-client privilege will have a negative  
16 effect on any subsequent proceeding it might initiate against APS to resolve the purchase power  
17 dispute. At the Procedural Conference held in this proceeding on April 1, 2002 ("Procedural  
18 Conference"), Chairman Mundell and counsel for Citizens had the following exchange:

19  
20 **CHMN. MUNDELL:** Mr. Grant, let me -- I'm sitting here and I'm -- let me ask  
21 this question. I know you're going to bring in your expert witness. Is it Mr.  
22 Flynn? Okay. I'm looking at it from the perspective, will his again a  
23 hypothetical. Let's assume that we -- that the Commission concludes that Citizens  
24 should have filed an action in FERC or litigated the contractual dispute with APS.  
25 Is Mr. Flynn's testimony then going to be able to be used as impeachment or to  
26 the disadvantage of Citizens' position either at FERC or in a lawsuit with APS?  
See, that's the problem I'm having with what's going on here. And so that's -- you  
heard my question.

**MR. GRANT:** Sure.

**CHMN. MUNDELL:** He comes in and says whatever he's going to testify to  
about his advice to Citizens. And then won't -- that will be -- I mean, from my

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perspective it could be then used as impeachment in a FERC proceeding or a Superior Court lawsuit proceeding at some point in the future.

**MR. GRANT:** I would suspect, Mr. Chairman, that if subsequently litigation were to be filed, either before the FERC or before a court, that Mr. Flynn's testimony would probably be Exhibit 1. But the parties forced Citizens to this situation where it had other -- it was stuck with a very bad result. People were saying you acted imprudently. It had to defend itself in this forum.

Now, I would add that Mr. Flynn has never expressed an opinion, I suppose, that would elevate to Rule 11 dismissal grounds. But he has clearly indicated to you that here is the process that we went through in analyzing the litigation option. Here are all of the factors that impacted that. And I ultimately, for a variety of reasons, recommended to Citizens that it would be more appropriate to negotiate than litigate. Transcript of Proceedings of Procedural Conference (April 1, 2002)(Exhibit 4).<sup>3</sup>

Citizens' decision to waive the attorney-client privilege at a time when (1) the purchase power dispute was not resolved; and (2) there was a likelihood that the Commission could require Citizens to resolve the dispute is imprudent, and directly contrary to the public interest.

Prudence is, "determined by judging whether the utility acted reasonably, under the circumstances at the time, 'considering that the company had to solve its problems prospectively rather than in reliance on hindsight'". See Long Island Lighting Co., v. Public Service Commission of the State of New York, 134 A.D.2d 135,143-44, 523 N.Y.S.2d 615,620 (App Div. 1987) (quoting Matter of Consolidated Edison Co. of N.Y., PSC Opn No. 79-1(1979). Certainly, Citizens should have known that it may need to prospectively resolve the purchase power dispute in order to claim that any such costs were prudently incurred.

The purpose of determining whether the utility has acted prudently is to protect the ratepayer from imprudent acts and ensure that the costs of such acts are borne by the shareholders, not the ratepayers. See Rochester Telephone Corp., v. Public Service Commission of the State of

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<sup>3</sup> Moreover, if Mr. Flynn is a witness, he and his firm will likely be disqualified from representing Citizens. See: Rules of the Arizona Supreme Court, Rule 42 (ER 3.7).

1 New York, 87 N.Y.2d 17, 29, 660 N.E.2d 1112, 1117 (App. 1995). *See also*, Maine Public  
2 Service Co., v. Public Utilities Commission, 524 A.2d 1222 (Me. S.C. 1987)(holding that the  
3 consequences of unreasonable or imprudent acts or practices will not be borne by the ratepayers.)

4       The California Public Utilities Commission (“CPUC”) demonstrated a notable example of this  
5 principle when it prevented Southern California Edison Company (“SCE”), and San Diego Gas and  
6 Electric Company (“SDG&E”) from passing on the costs incurred due to an imprudent act. *See*  
7 *generally* Re Southern California Edison Company, 77 P.U.R. 4<sup>th</sup> 151 (C.P.U.C. 1986). In Southern  
8 California Edison, a dispute had arisen between SCE and Westinghouse Electric Corporation  
9 (“Westinghouse”) with regard to the San Onofre Nuclear Generating Station. An alleged defect in the  
10 generators had cost SCE and San Diego Gas & Electric nearly \$71 million in repair costs and \$181  
11 million in replacement power costs. During negotiations with Westinghouse regarding a separate  
12 litigation matter, SCE management entered into a release with very broad language. The release  
13 arguably excused Westinghouse from any liability for the subsequent \$71 million dollar repair bill. In  
14 exchange for this release, SCE received roughly \$45,000 in value.  
15

16       The CPUC Staff argued that SCE was imprudent when it signed the release. The CPUC Staff  
17 pointed to the fact that SCE knew that other utilities were having major problems with similar  
18 generators installed by Westinghouse. In addition, the compensation for the release was insignificant.  
19 The CPUC Staff noted that if SCE were allowed to recoup these costs from the ratepayers, SCE  
20 would have, “no real incentive to vigorously pursue the Westinghouse litigation” *Id.* at 46.  
21

22       The CPUC ultimately did not allow SCE to recoup the expenses from the ratepayers. The  
23 CPUC noted, “in signing a broadly worded release in settlement of the earlier litigation with  
24 Westinghouse, Edison substantially undermined the possibilities for recovering the costs of the  
25 sleeving in the current litigation. By thus greatly increasing the risks of the litigation and therefore  
26

1 making it more difficult to recover the disputed costs from Westinghouse rather than from ratepayers,  
2 Edison acted unreasonably and imprudently.” *Id.* at 48. The CPUC noted that the decision to  
3 disallow collection from the ratepayers would give SCE, “a direct incentive to pursue the suit”. *Id.* at  
4 50. The CPUC’s rationale is applicable to this proceeding.  
5

6 In this case, the Counties and other parties to this proceeding have taken the position that  
7 the disputed purchase power costs should not be passed through to ratepayers. Commission Staff  
8 has recommended that Citizens be required to resolve the purchase power dispute before it be  
9 allowed to recover purchase power costs from its ratepayers. RUCO has recommended that  
10 Citizens not be allowed to pass the disputed purchase power costs onto its ratepayers, but,  
11 presumably obtain and keep any recovery by resolving the dispute with APS.  
12

13 However, by waiving the attorney-client privilege, Citizens has released to the public  
14 domain communications, strategies and work product that APS may obtain and use against  
15 Citizens in any subsequent negotiation or litigation.  
16

17 At the Procedural Conference, Citizens stated its belief that the parties to this case “forced”  
18 it to file the testimony of Mr. Flynn. That, of course, is nonsense. Citizens’ Application,  
19 Amended Application and testimony all explain why it “shifted its focus” from resolving the  
20 purchase power dispute to simply passing the costs on to the ratepayers. Citizens’ management  
21 (who ultimately made the business decision not to pursue APS) had already filed direct testimony  
22 in this case and was competent to explain **their** decision to abandon a resolution of the purchase  
23 power dispute in their rebuttal testimony. Even if Citizens believed that Mr. Flynn’s testimony  
24 was indispensable to this case, there is no reason why Citizens could not have file the testimony in  
25 such a manner as to protect the attorney-client privilege. It is common practice for parties to file  
26 portions of testimony under seal or pursuant to protective orders and confidentiality agreements.

1 But, Citizens did none of that; instead it simply opened its files to the public—and APS in  
2 particular.

3 The waiver of the attorney-client privilege will cause the loss of the privilege on all  
4 communications relating to the same subject. *See, Sylgab Steel & Wire Corp. v. Imoco-Gateway*  
5 *Corp.*, 62 F.R.D. 454, 457-58 (N.D. Ill. 1974). The *Sylgab* Court articulated the reason for this:  
6

7 A party cannot be allowed, after disclosing as much as he pleases, to withhold the  
8 remainder. He may elect to withhold or to disclose, but after a certain point his election  
9 must remain final.

10 The purpose of the work product privilege is to prevent an opposing party from obtaining  
11 potentially damaging information. *See GAF Corp., v. Eastman Kodak Co.*, 85 F.R.D. 46, 52 (S.D.N.Y.  
12 1979). The voluntary disclosure of work product will waive the work product privilege as well. *See*  
13 *Transamerica Computer Corp. v. International Business Machines Corp.*, 573 F.2d 646, 651 (9<sup>th</sup> Cir.  
14 1978). Courts have held that the disclosure of part of a privileged communication results in a waiver  
15 with respect to all related communications. *See, e.g., In re Sealed Case*, 676 F.2d 793 (D.C. Cir. 1982).  
16 Citizens, having waived the attorney-client privilege, will not be able to re-claim the privilege at a later  
17 time. *State Farm Mutual Automobile Insurance Co., v. Lee*, 199 Ariz. 52, 13 P.3d 1169, (2000). In  
18 *State Farm*, the Arizona Supreme Court dealt with the waiver in the context of a claim of insurer bad  
19 faith. The Court noted,

20 [t]he party claiming the privilege has interjected the issue of advice of counsel into the  
21 litigation to the extent that recognition of the privilege would deny the opposing party  
22 access to proof without which it would be impossible for the fact finder to fairly  
23 determine the very issue raised by that party. In that situation, the party's knowledge  
24 about the law is vital, and the advice of counsel is highly relevant to the legal  
25 significance of the client's conduct. *Id.* at 62.

26 Consequently, Mr. Flynn will not be able to defend his client in this or subsequent  
proceedings by asserting the attorney-client privilege. Thus, significant damage has already been  
done to Citizens' ability to pursue a resolution of the purchase power dispute.

1 Citizens has done a terrible disservice to its ratepayers and, quite possibly, its shareholders  
2 by waiving the attorney-client privilege at a time when it knew that it was possible that the  
3 Commission would order it to initiate litigation against APS. Thus, the public interest has been  
4 undermined in this instance and the Counties request that the Commission take remedial action as  
5 soon as practicable.  
6

7 **3. REQUEST FOR RELIEF**

8 This is an extraordinary situation. Citizens has waived the attorney-client privilege and  
9 offered its attorney as a witness to defend its decision not to resolve the purchase power dispute.  
10 This can have deleterious affects on Citizens' ability to ever resolve the purchase power dispute in  
11 a just manner. Thus, Citizens may never be able to prove that the disputed purchase power costs  
12 were prudently incurred.  
13

14 The Counties believe that this Commission has the authority to take appropriate action at  
15 this stage in the proceeding to protect Citizens' ratepayers from the prejudice of Citizens having  
16 waived the attorney-client privilege by having its attorney testify regarding the purchase power  
17 dispute. See: A.R.S. Secs. 40-202 and 40-203; and A.A.C. R14-3-109 (Q). Accordingly, the  
18 Counties request that the Commission enter the following findings of fact:

- 19
- 20 1. That Citizens has not established that purchase power costs charged by  
21 Arizona Public Service Company ("APS") from May 2000 to May 2001  
22 ("disputed purchase power costs") were prudently incurred;
  - 23 2. That Citizens' decision to waive the attorney-client and work product  
24 privilege (collectively referred to as the "attorney-client privilege") in  
25 connection with its dispute over the interpretation of the 1995 Power Sale  
26 Agreement with Arizona Public Service Company ("APS") and  
overcharges in connection therewith (the "purchase power dispute") is  
imprudent and contrary to the public interest; and
  3. That based upon Citizens' failure to establish that the disputed purchase  
power costs were prudently incurred and its decision to waive the

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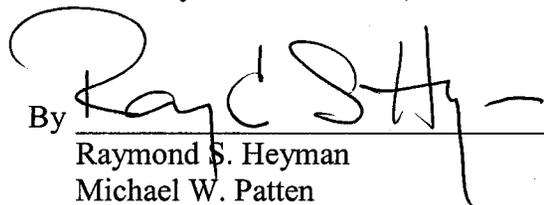
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attorney-client privilege, the disputed purchase power costs should not be charged to Citizens' ratepayers.

Or, in the alternative, the Counties request that this proceeding be stayed until such time as Citizens finally resolves its purchase power dispute with APS and is then in a position to present evidence regarding the prudence of the disputed purchase power costs. Otherwise, the conduct at the hearing, particularly the cross-examination of Citizens' witnesses may further jeopardize Citizens claim against APS.

ESPECTFULLY SUBMITTED April 5, 2002.

**Roshka Heyman & DeWulf, PLC**

By 

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**COPIES** of the foregoing hand-delivered  
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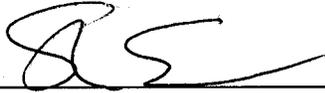
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CITIZENS COMMUNICATIONS COMPANY  
ARIZONA ELECTRIC DIVISION  
DOCKET NO. E-01032C-00-0751  
RUCO'S THIRD SET OF DATA REQUESTS

June 7, 2001

WITNESS: SEAN R. BREEN

DATA REQUEST NO. 3.1:

What was Citizens' understanding prior to June 2000, of its cost of power purchased by APS in the purchased power market? What was the basis of Citizens' understanding? Did Citizens' understanding change after that? When? Why? Please provide copies of all Power Service Agreements entered into between Citizens and APS, which govern the sale of purchased power between Citizens and APS after January 2000, which have not been previously provided.

RESPONSE:

Citizens' understanding, based on the language of the PSA, has always been that, for the service schedules providing for "system incremental cost" ("SIC") pricing as defined in the PSA, APS may only charge Citizens for the costs of power purchases that are made for economic purposes. The language in the PSA that defines SIC states, in part, that SIC is "the higher of either the incremental fuel cost of the station or unit from which energy is obtained . . . or the cost of any purchased power occurring simultaneously with sales under this Service Agreement which were made for economic purposes that would not otherwise be needed to effect transactions under this Service Agreement." Based on long-standing usage in the electric industry, purchases of power for "economic purposes" refers to those purchases where the unit cost of the purchase is less than the cost the utility would incur to generate electricity from its own plants to serve an increment of load.

For the first several years that the 1995 PSA was in effect, this element of the PSA was not a source of dispute. In 1999, however, APS sent Citizens a \$4 million billing adjustment, attributable to several months in 1998, alleging that APS had not correctly charged Citizens for APS' purchased power costs. Citizens disputed the adjustment (and similar bills from APS in subsequent months in 1999) and the parties attempted to negotiate a resolution. Ultimately, the past billing adjustment was resolved on a dollar basis in May 2000. However, the parties were not able to reach any consensus on the proper interpretation of the contract. In the summer of 2000, APS' bills to Citizens increased dramatically based on APS interpretation of the PSA and the large increase in prevailing power prices in the region. Citizens contested each of these bills from APS. For the first time APS also began to charge Citizens incremental pricing even for the "base block" of Service Schedule A to the PSA. Prior to that time, Schedule A base

block pricing had always been at agreed embedded cost rates. Again, Citizens contested these charges.

No other Power Service Agreements between APS and Citizens have been executed since January, 2000.





*on* target

power in a franchise territory. In return for monopoly status, electric utilities have been subject to comprehensive regulation at the state and federal level. The industry is now shifting toward electric customers being able to choose their energy provider much like telephone customers are able to choose their long distance provider. Generally, this involves splitting apart the generation and transmission of power from the remainder of the business, and having generators compete with one another in the sale of power directly to retail customers. The interconnected regional transmission grids will be operated independently, continuing as a federally regulated monopoly. Local transmission and distribution facilities would continue as state-regulated monopolies. This change in the industry is in various stages of development around the United States.

During the past year the decrease in the availability of power has caused power supply costs to increase substantially, forcing companies to pay higher operating costs to operate their electric businesses. As a result, companies have attempted to offset these increased costs by either renegotiating prices with their power suppliers or passing these additional costs on to their customers through a rate proceeding. In Arizona, we are currently disputing excessive power costs charged by our power supplier in the amount of approximately \$57 million through December 31, 2000. We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause. In an attempt to limit "rate shock" to our customers, we have requested that this deferred amount, plus interest, be recovered over a three-year period. As a result, we have deferred these costs on the balance sheet in anticipation of recovering certain amounts either through renegotiations or through the regulatory process.

On February 15, 2000, we announced that we had agreed to sell our electric utility operations. The Arizona and Vermont electric divisions were under contract to be sold to Cap Rock Energy Corp. Cap Rock Energy Corp. has failed to raise the required financing and obtain the required regulatory approval necessary to meet its obligations under the contract for sale. The agreement with Cap Rock Energy Corp. was terminated on March 7, 2001. The Kauai electric division is under contract to be sold to Kauai Island Electric Co-Op (see Acquisitions and Divestitures below).

In Kauai, historically, we received approximately 13% of our power from a third party provider. As of January 2001, this third party provider will no longer provide power due to the closure of their sugar operations. In order to avoid power outages, we have completed negotiations with a new third party provider for a new purchase power agreement. This agreement is subject to approval by the Hawaii Public Utility Commission (HPUC). Current forecasts report that Kauai will require additional electrical generating capacity in 2002. As a result, we have entered into a 25-year purchase power agreement with Kauai Power Partners (KPP), an independent power producer, to provide firm power by July 2002. This agreement was recently approved by the HPUC.

#### *Acquisitions and Divestitures*

##### *Acquisitions*

From May 27, 1999 through July 12, 2000 we entered into several agreements to acquire approximately 2,034,700 telephone access lines (as of December 31, 2000) for approximately \$6.5 billion in cash. These transactions have been and will be accounted for using the purchase method of accounting. The results of operations of the acquired properties have been and will be included in our financial statements from the date of acquisition of each property. These agreements and the status of each transaction are described as follows:

On May 27, September 21, and December 16, 1999, we announced definitive agreements to purchase from Verizon approximately 381,200 telephone access lines (as of December 31, 2000) in Arizona, California, Illinois/Wisconsin, Minnesota and Nebraska for approximately \$1,171,000,000 in cash. These acquisitions are subject to various state and federal regulatory approvals. On June 30, 2000, we closed on the Nebraska purchase of approximately 62,200 telephone access lines for approximately \$205,000,000 in cash. On August 31, 2000, we closed on the Minnesota purchase of approximately 142,400 telephone access lines for approximately \$439,000,000 in cash. On November 30, 2000, we closed on the Illinois/Wisconsin purchase of approximately 112,900 telephone access lines for approximately \$304,000,000 in cash. We expect that the remainder of the Verizon transactions will close on a state-by-state basis in the first half of 2001.

On June 16, 1999, we announced a series of definitive agreements to purchase from Qwest approximately 556,800 telephone access lines (as of December 31, 2000) in Arizona, Colorado, Idaho/Washington, Iowa, Minnesota, Montana, Nebraska, North Dakota and Wyoming for approximately \$1,650,000,000 in cash and the assumption of certain liabilities. On October 31, 2000, we closed on the North Dakota purchase of approximately 17,000

3

## ROSHKA HEYMAN & DEWULF

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March 12, 2002

Michael Grant, Esq.  
GALLAGER & KENNEDY, PA  
Attorneys at Law  
2575 E. Camelback Road  
Phoenix, Arizona 85004

Re: *Citizens Communication Company,*  
*A.C.C. Docket No. E-01032-00-0751*  
*("Citizens PPFAC case")*

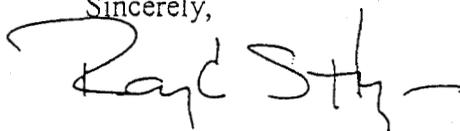
Dear Mike:

This will confirm our telephone conversation wherein we discussed the effect of Paul Flynn's rebuttal testimony on Citizen's claim to the attorney-client privilege. As a result of our conversation, it is my understanding that Citizens has waived the attorney-client privilege with regards to the subject matter and documents addressed in Mr. Flynn's testimony.

I indicated to you that it is likely that I will question Mr. Flynn regarding the written legal opinion and draft documents that were prepared by his firm. This may require me to introduce the documents into evidence at the hearing.

If I have misunderstood or misstated our conversation, please let me know.

Sincerely,



Raymond S. Heyman  
For the Firm

RSH/srs

Cc: John White, Esq.  
Holly Hawn, Esq.

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1 BEFORE THE ARIZONA CORPORATION COMMISSION

2

3 IN THE MATTER OF THE APPLICATION ) DOCKET NO.  
 4 OF THE ARIZONA ELECTRIC DIVISION ) E-01032C-00-0751  
 5 OF CITIZENS COMMUNICATIONS )  
 6 COMPANY TO CHANGE THE CURRENT )  
 7 PURCHASED POWER AND FUEL )  
 8 ADJUSTMENT CLAUSE RATE, TO )  
 9 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. )  
 )

ORAL ARGUMENTS

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12 At: Phoenix, Arizona

13 Date: April 1, 2002

14 Filed: APR - 4 2002

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16

REPORTER'S TRANSCRIPT OF PROCEEDINGS

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 Certified Court Reporter  
 Certificate No. 50489

23

24 Prepared for:

25

MR. RAYMOND S. HEYMAN  
 Attorney at Law

**CERTIFIED COPY**  
**(When in red)**

1 proposition that it is a broad balancing of competing  
2 interests with respect to the appearance of  
3 impropriety, and that the tribunal is not so hamstrung,  
4 not so constrained, not so limited. And, in fact, what  
5 the tribunal ought to do is consider the hardship  
6 imposed upon the Applicant balanced against the  
7 integrity of the proceedings?

8 MR. GRANT: I think what the Gomez case  
9 indicates, Commissioner Spitzer, is a very limited  
10 circumstance in which the Supreme Court considered and  
11 did not go beyond the Code of Professional  
12 Responsibility. And also discusses in some detail the  
13 problems inherent with an appearance of impropriety  
14 that is kind of just dreamed up as we go along.

15 And what we know for sure is the Supreme Court  
16 in that case, in what I would suggest to you is a more  
17 difficult set of facts than this one, a much more  
18 difficult set of facts than this one, indicated that  
19 disqualification was inappropriate and, in fact,  
20 concluded the trial court had abused its discretion in  
21 agreeing with the county prosecutor on that issue.

22 CHMN. MUNDELL: Mr. Grant, let me -- I'm  
23 sitting here and I'm -- let me ask this question. I  
24 know you're going to bring in your expert witness. Is  
25 it Mr. Flynn? Okay. I'm looking at it from the

1 perspective, will his -- again a hypothetical. Let's  
2 assume that we -- that the Commission concludes that  
3 Citizens should have filed an action in FERC or  
4 litigated the contractual dispute with APS.

5 Is Mr. Flynn's testimony then going to be able  
6 to be used as impeachment or to the disadvantage of  
7 Citizens' position either at FERC or in a lawsuit with  
8 APS?

9 See, that's the problem I'm having with what's  
10 going on here. And so that's -- you heard my question.

11 MR. GRANT: Sure.

12 CHMN. MUNDELL: He comes in and says whatever  
13 he's going to testify to about his advice to Citizens.  
14 And then won't -- that will be -- I mean, from my  
15 perspective it could be then used as impeachment in a  
16 FERC proceeding or a Superior Court lawsuit proceeding  
17 at some point in the future.

18 MR. GRANT: I would suspect, Mr. Chairman, that  
19 if subsequently litigation were to be filed, either  
20 before the FERC or before a court, that Mr. Flynn's  
21 testimony would probably be Exhibit 1.

22 But the parties forced Citizens to this  
23 situation where it had other -- it was stuck with a  
24 very bad result. People were saying you acted  
25 imprudently. It had to defend itself in this forum.

1           Now, I would add that Mr. Flynn has never  
2 expressed an opinion, I suppose, that would elevate to  
3 Rule 11 dismissal grounds.

4           But he has clearly indicated to you that here  
5 is the process that we went through in analyzing the  
6 litigation option. Here are all of the factors that  
7 impacted that. And I ultimately, for a variety of  
8 reasons, recommended to Citizens that it would be more  
9 appropriate to negotiate than litigate.

10           I'm not quite sure -- all of that advice coming  
11 from Wright & Talisman and from Brown & Bain, none of  
12 that advice coming from Gallagher & Kennedy and me.

13           CHMN. MUNDELL: Thank you.

14           ALJ NODES: Mr. Grant, let me just see if I can  
15 be absolutely clear. I think it was clear from  
16 Chairman Mundell's and Commissioner Spitzer's  
17 questions.

18           Is it your opinion that under no circumstances  
19 does this Commission have the authority to disqualify  
20 counsel under an appearance of impropriety standard as  
21 long as the law firm has complied with the Code of  
22 Professional Responsibility and Rules of Professional  
23 Conduct.

24           Is that your position?

25           MR. GRANT: Mr. Nodes, here is what I know for