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BEFORE THE ARIZONA CORPORATION COMMISSION

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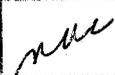
Arizona Corporation Commission

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AZ CORP COMMISSION
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7
8 IN THE MATTER OF THE APPLICATION OF
9 THE ARIZONA ELECTRIC DIVISION OF
10 CITIZENS COMMUNICATIONS COMPANY
11 TO CHANGE THE CURRENT PURCHASED
12 POWER AND FUEL ADJUSTMENT CLAUSE
13 RATE, TO ESTABLISH A NEW PURCHASED
14 POWER AND FUEL ADJUSTMENT CLAUSE
15 BANK, AND TO REQUEST APPROVE
16 GUIDELINES FOR THE RECOVERY OF COSTS
17 INCURRED IN CONNECTION WITH ENERGY
18 RISK MANAGEMENT INITIATIVES.

Docket No. E-01032C-00-0751

**STAFF'S BRIEF ON
DISQUALIFICATION OF
GALLAGHER AND KENNEDY**

14
15 **I. INTRODUCTION**

16 On March 13, 2002, Intervenor Marshall Magruder submitted a Motion, requesting that the
17 Commission order the removal of the law firm of Gallagher and Kennedy ("G&K") from
18 participation in this docket. Mr. Magruder's Motion was based on his perception of a possible
19 conflict of interest on the part of G&K. Mr. Magruder pointed out that the Application in this matter
20 involves a request by the Arizona Electric Division of Citizens Communications Company
21 ("Citizens") to recover from its ratepayers an amount of nearly \$100 million, representing charges to
22 Citizens from Arizona Public Service Company ("APS"), an affiliate of Pinnacle West Capital
23 Corporation ("PWCC").

24 Mr. Magruder pointed out that Mike Gallagher, a founding member of G&K is also a member
25 of the Board of Directors of PWCC. He was concerned about the possible conflict of interest caused
26 by the juxtaposition of Mr. Gallagher's fiduciary responsibilities as a Board member of PWCC and
27 the appearance that G&K has not actively pursued low rates from APS on behalf of Citizens. Based
28

1 on the appearance of a conflict of interest, Mr. Magruder asked the Commission to order G&K's
2 removal from participation in this docket.

3 On March 18, 2002, G&K submitted Citizens Opposition to Mr. Magruder's Motion. The
4 G&K Opposition indicated that G&K has not represented Citizens in any of its negotiations or
5 contractual disputes with APS. G&K indicates that Wright & Talisman, or other firms, were
6 responsible for that representation of Citizens. In addition, the G&K Opposition indicates that, as a
7 matter of firm policy, Mr. Gallagher is not allowed to be involved in any matters concerning PWCC
8 or its affiliates as they relate to G&K. Finally, the G&K Opposition indicated that the matters raised
9 by Mr. Magruder's Motion are beyond the Commission's jurisdiction to consider or grant relief.

10 Subsequently, a pre-hearing conference was convened on March 21, 2002 and reconvened on
11 March 22, 2002. On March 22, 2002, G&K submitted a Supplement to Citizens' Opposition to the
12 Magruder Motion to Recuse ("Supplement"). The Supplement contained G&K's analysis of the
13 Code of Professional Responsibility, concluding that G&K's representation of Citizens in this matter
14 is permissible. In addition, the Supplement concluded that the Commission is without authority to
15 disqualify G&K from representing Citizens in this matter, based on G&K's analysis of Arizona's
16 ethical rules and some cases discussing Commission jurisdiction. Finally, attached to the Supplement
17 were three Affidavits, describing Mr. Gallagher's recollection of his service as a director of PWCC
18 and APS, the results of certain reviews of APS and PWCC Board Meeting minutes and certain
19 aspects of the relationships among Mr. Gallagher, PWCC, APS, and G&K.

20 Parties were directed to submit briefs on the issues discussed during the March 21 and 22 pre-
21 hearing conference. This brief presents Staff's position on issues related to Mr. Magruder's request to
22 disqualify G&K from further participation in this proceeding on behalf of Citizens.

23 Based on our review of the circumstances, Staff requests that the Commission issue its Order
24 prohibiting G&K from further participation in this proceeding on behalf of Citizens. The procedural
25 schedule in this case should be suspended, to be reestablished in a manner that will best
26 accommodate Citizens in its need to acquire new counsel along with all parties' interest in
27 expeditious resolution of this matter. It should be noted that, in addition to the submittals referenced
28 above, on March 26, 2002, G&K caused to be submitted in this docket an affidavit of Marie A.

1 Papietro, Associate Corporate Secretary for APS and PWCC. Ms. Papietro's Affidavit described her
2 review of Board Minutes and included as an attachment excerpts from the minutes of Meetings of the
3 PWCC Board of Directors on January 17, 2001, June 20, 2001, and October 17, 2001. In addition, an
4 excerpt from the Minutes of the Meeting of the APS Board of Directors on September 20, 2000 is
5 included. All of this material contributes to Staff's view of this matter.

6 It should also be noted that Staff's opinion of the proper resolution of these issues gives
7 consideration to the legal ethics questions presented, but primarily rests on considerations of
8 fundamental fairness and the Commission's interest in preserving public confidence in its processes.
9 Staff believes that the Commission's authority to adopt the remedy we suggest cannot be seriously
10 doubted.

11 **II. LEGAL ETHICS REQUIRE G&K's EXCLUSION FROM THE PROCEEDING**

12
13 G&K contends that it may ethically pursue its representation of Citizens in this matter. In
14 support of this notion, G&K cites Comments to Rule 1.7, Arizona Ethics Handbook, indicating that a
15 lawyer can serve on a corporation's board of directors while that lawyer, or the lawyer's firm, serves
16 as counsel for the corporation. According to G&K, the representation is only forbidden where the
17 dual role may compromise the lawyer's independence of professional judgment. Even this potential
18 conflict may be resolved by frank discussions with the corporation regarding the limitations imposed
19 by the dual role. G&K goes on to note that the ethical rules foresee a permissible situation in which a
20 firm may represent adverse clients in the same matter, so long as the lawyer reasonably believes the
21 representation will not adversely affect the relationship with the other client, and each client consents.
22 In G&K's view, this discussion disposes of all the ethical issues presented by the current situation,
23 since G&K further asserts that it "...did not represent Citizens with respect to its decision regarding
24 whether to seek recovery of any amounts from APS or PWC." (Supplement to Citizens' Opposition
25 to the Magruder Motion to Recuse, March 22, 2002, at 3).

26 Unfortunately, G&K fails to analyze these issues in relation to the facts presented in this case.
27 As a result, the pleadings ignore most of the facts that should have been considered in deciding
28 whether to enter into this representation. The history of this case is not subject to serious

1 disagreement. Citizens receives all of its power under a contract with APS. Citizens and APS have
2 disagreed about the interpretation of that contract since at least 1999. The disagreements resulted in
3 continuing negotiations during 2000 and 2001. In fact, APS refunded approximately \$1.5 million
4 during 2000, essentially conceding that it had billed Citizens improperly. During peak periods of
5 summer 2000 and 2001, Citizens believed that APS was construing contract language improperly and
6 billing improperly under the contract. During the summer of 2000, APS and Citizens negotiated over
7 contract interpretation issues, ultimately negotiating a replacement contract. The record reflects that
8 Citizens considered litigation options during this period of negotiations. In addition, the record
9 reflects that both Staff and RUCO are of the opinion that, at the present time, Citizens should pursue
10 a litigation option against APS, as compared to recovering certain costs from its ratepayers.

11 All of these facts, taken together, result in a situation wherein G&K has at least a potential
12 conflict and the clear appearance of impropriety. G&K should have declined the representation.

13 Mr. Gallagher, a founding partner of G&K is on the board of directors of APS, an entity
14 directly adverse to Citizens. Mr. Gallagher owes a fiduciary duty to APS. Mr. Gallagher's
15 obligations are imputed to his firm, G&K. See Trustco Bank New York v. Melino, 625 N.Y.S.2d
16 803, 164 Misc.2d 999 (N.Y. Sup. Ct. 1995). Also, as an APS and PWCC director, Mr. Gallagher
17 received information about the dispute on at least four occasions between September 20, 2000 and
18 October 17, 2001. (See Excerpts from Minutes of Meetings of APS and PWCC Boards of Directors,
19 attached to Affidavit of Marie A. Papietro, March 26, 2002).

20 G&K presents two arguments for compliance with the requisite ethical standards. Under the
21 circumstances, neither is supportable. First, G&K contends that the firm has a "firewall" or "Chinese
22 Wall", separating Mr. Gallagher from the remainder of the firm as regards APS and PWCC matters.
23 However, Arizona law does not recognize screening devices to avoid imputed disqualifications in all
24 circumstances. Smart Industries Corp. v. Superior Court, 179 Ariz. 141, 147, 876 P.2d 1176, 1182
25 (App. 1994). See also Restatement (Third) of the Law Governing Attorneys §122 cmt. g(iii). See
26 Atasi Corp. v. Seagate Technology, 847 F.2d 826 (9th Cir. 1988). See also Petroleum Wholesale,
27 Inc. v. Marshall, 751 S.W. 2d 295 (App. Tex. 1988); American Dredging Co. v. City of Philadelphia
28 et al, 389 A. 2d 568 (Pa. 1978).

1 G&K's other argument is equally unavailing. G&K contends that it does not represent
2 Citizens in the dispute against APS. G&K suggests that this regulatory proceeding is somehow
3 distinguishable from the dispute between Citizens and APS, arguing that it is only involved in the
4 regulatory proceeding. Given Staff and RUCO's testimony in this case, the position is untenable.
5 Citizens proposes to present the testimony of counsel in support of its past decisions not to pursue
6 litigation alternatives against APS. Citizens does not claim that it is foreclosed from commencing
7 proceedings now, only that it has decided not to do so. It seems to Staff that the presentation of
8 Citizens' position in this case necessarily implies ongoing consideration of the question whether to
9 litigate against APS. Even if separate counsel were employed to advise on the litigation question, it
10 seems inextricably interwoven with this case. Presenting the case that all of these costs should be
11 recovered from ratepayers amounts to advice to not seek recovery of any of them from APS.

12 **III. THE COMMISSION SHOULD DISQUALIFY G&K, REGARDLESS OF ETHICAL**
13 **STANDARDS.**

14 The Commission is necessarily concerned with the public perception of the fundamental
15 fairness of its processes. In this case, it is undeniable that permitting G&K to represent Citizens gives
16 the appearance of impropriety. The costs that Citizens wishes to pass to ratepayers are all the result
17 of a contract between APS and Citizens. Citizens has contended in the past that APS improperly
18 construed the contract and billed inappropriately under the contract. Citizens even negotiated a new
19 contract in order to avoid charges that it believed were excessive. Now Citizens seeks to pass to
20 ratepayers all of the costs it has previously claimed were excessive, including the new, higher rates
21 from the renegotiated contract. Meanwhile, G&K has a founding member with a fiduciary
22 responsibility to APS and PWCC, and at the same time represents Citizens in the attempt to pass
23 these costs to ratepayers. While no one has suggested that this is the case, an objective observer
24 could certainly believe that APS and Citizens have simply agreed to let ratepayers bear these costs
25 and thereby avoid the necessity to litigate between themselves.

26 Staff is greatly troubled by this appearance. The appearance is exacerbated by G&K's
27 position that the Commission is without authority to remedy the situation if it deems necessary. Staff
28 completely disagrees with G&K's position of this point.

1 G&K contends that the issue is one of regulating the practice of law, a matter uniquely within
2 the jurisdiction of the Arizona Supreme Court, noting that the Commission is an administrative
3 agency and that practice before the Commission constitutes the practice of law. Finally, G&K notes
4 that the Commission's powers are limited and do not include those of a court of general jurisdiction.
5 (Supplement to Citizens' Opposition to the Magruder Motion to Recuse, March 22, 2002 at 2-6).

6 Staff agrees with G&K's general presentation regarding the regulation of the practice of law
7 by the Arizona Supreme Court. Staff also agrees that the Commission is not a court of general
8 jurisdiction and that the Commission's jurisdiction is limited. However, Staff does not agree that the
9 Commission is without power to grant relief under these circumstances. Nor do we agree that
10 preventing G&K's continued participation in this case would constitute regulating the practice of law.

11 As we indicated above, Staff believes the issue in this matter involves the Commission's
12 authority to protect the integrity of its process and preserve public confidence in the fundamental
13 fairness of that process. This is an issue on which Arizona Courts have spoken. In State ex. rel.
14 Corbin v. Arizona Corporation Commission, 143 Ariz. 219, 693 P.2d 362 (App. 1984), the Court of
15 Appeals answered the very questions raised by this matter.

16 The Corbin case involved the Commission's attempts to fashion a remedy as a result of
17 certain *ex parte* communications having tainted a rate proceeding. In that case, the Commission
18 removed a hearing officer and its Utilities Division director from further participation in the case,
19 while denying motions to completely dismiss the rate application. The Court of Appeals found the
20 Commission's remedy to be within its discretion, notwithstanding the equitable nature of the relief.

21 The concern in this case is whether allowing G&K to participate is fundamentally unfair. The
22 Corbin court was addressing similar concerns, "Thus, whether stated in terms of "fraud upon the
23 court" or in terms of "notions of fairness" or the right to a "fair hearing", it is apparent that a party's
24 right to due process is violated when the agency decision-maker improperly allows *ex parte*
25 communications from one of the parties to the controversy." Id. at 226.

26 Recognizing the Commission's position in utility rate setting matters, the Court of Appeals
27 deferred to the Commission's discretion is fashioning a remedy to the fundamental fairness issue
28 raised. The Court offered the following relevant holdings:

1 We conclude that the Commission is not deprived of discretion. . . . Rather, the
2 Commission has discretion in dealing with any defilement or corruption of the
3 quasi-judicial process that may arise. Under appropriate circumstances it may
4 fashion remedies less drastic than dismissal, which will accord to all parties the
5 fairness essential to fundamental notions of due process, while at the same time
6 preserving the integrity of the adjudicative body, considering the interests of that
7 body and the duties imposed on it. (Citations omitted.) Since the Commission does
8 serve, in part, a quasi-legislative function, it is appropriate to defer to the
9 Commission's fashioning of remedial measures which it deems will best vindicate
10 its procedures and processes, in the absence of a showing of an abuse of discretion.
11 Id. at 227.

12 Portland General Electric Company v. Duncan, Weinberg, Miller & Pembroke, involved a
13 determination as to the extent to which conflicts of interest would prohibit two attorneys who were
14 former employees of the utility from representing an industrial customer group in proceedings before
15 the Oregon Commission. The case is important because it recognizes that the determination of
16 whether to allow continued representation does not solely rest on analysis of the attorney discipline
17 rules. The court found that the trial court, as well as the appellate court, was able to enforce fiduciary
18 duties that attorneys have to their clients, independent of the Supreme Court's exclusive jurisdiction
19 over attorney discipline. 986 P.2d 35, 42 (1999). Under Corbin, this Commission certainly has
20 authority to consider the effects of G&K's relationships with APS and PWCC, as well as Citizens in
21 fashioning a remedy that will protect the integrity of its processes.

22 A similar result to that sought here was approved by the Minnesota Supreme Court in
23 Northern States Power Company v. Minnesota Public Utilities Commission, 414 N.W. 2d 383 (Minn.
24 1987). In that case, the Minnesota Supreme Court held that the Minnesota Commission was
25 authorized to fashion a remedy to restore public confidence in its process after a Commissioner was
26 found to have a conflict of interest as a result of participating in employment discussions with a
27 utility while at the same time considering and acting on a rate application by that utility. The Court
28 found that complete dismissal of the application was not warranted, but directed the Commission to
consider remedies to overcome the specific problems caused by the Commissioner's participation.

Staff believes that the Commission has discretion in the current situation, as well. The
appearance of impropriety that is under discussion does not amount to an assertion of actual conflict
of interest. It does, however, create a situation in which the integrity of the Commission's process is

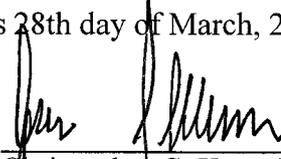
1 imperiled. Staff has proposed a solution we believe will remedy the matter, without unduly
2 prejudicing any party. Citizens should be allowed to have timely consideration of its request, but the
3 public should have confidence that the parties to the APS/Citizens contract consider possible
4 alternative remedies, including possible litigation, free from potential conflicts of interest on the part
5 of advising lawyers.

6 It is worth noting that the equitable nature of the remedy proposed by Staff does not foreclose
7 the Commission's adopting it. The Corbin court expressly recognized that it was authorizing the
8 Commission's application of remedies to a doctrine rooted in equity. 143 Ariz. at 227.

9 **IV. CONCLUSION**

10 This Application seeks to require Citizens' ratepayers to absorb upwards of \$100 million of
11 costs that have not previously been considered or allowed by this Commission for recovery. Much of
12 this amount has been the subject of disagreement between Citizens and APS. Indeed, Staff proposes
13 an indefinite delay in recovery of significant amounts of these costs until Citizens fully addresses its
14 dispute with APS. Under RUCO's proposal, Citizens would be foreclosed from recovering
15 significant amounts from ratepayers, leaving only potential litigation with APS as a means of
16 avoiding shareholder absorption of those costs. Under these circumstances, the Citizens/APS dispute
17 forms an unavoidable issue in this proceeding. G&K's representation of Citizens is inappropriate.
18 The Commission should prohibit that representation and suspend the procedural schedule until
19 Citizens obtains other counsel.

20 RESPECTFULLY SUBMITTED this 28th day of March, 2002.

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