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0000106882

Jordan R. Rose AZ Bar No.: 017452
Court S. Rich AZ Bar No. 021290
M. Ryan Hurley AZ Bar No. 024620
Rose Law Group pc
6613 N. Scottsdale Road, Suite 200
Scottsdale, Arizona 85250
Direct: (480) 240-5585
Fax: (480) 505-3925

Attorneys for Applicant SolarCity Corporation

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Arizona Corporation Commission
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BEFORE THE ARIZONA CORPORATION COMMISSION

KRISTIN K. MAYES CHAIRMAN	SANDRA D. KENNEDY COMMISSIONER	PAUL NEWMAN COMMISSIONER
GARY PIERCE COMMISSIONER	BOB STUMP COMMISSIONER	

IN THE MATTER OF THE APPLICATION OF SOLARCITY FOR A DETERMINATION THAT WHEN IT PROVIDES SOLAR SERVICE TO ARIZONA SCHOOLS, GOVERNMENTS, AND NON-PROFIT ENTITIES IT IS NOT ACTING AS A PUBLIC SERVICE CORPORATION PURSUANT TO ART. 15, SECTION 2 OF THE ARIZONA CONSTITUTION	**DOCKET NO. E-20690A-09-0346** **SOLARCITY'S NOTICE OF ERRATA AND REFILING OF REPLY BRIEF**

Applicant, SolarCity, by and through its undersigned counsel hereby files this Notice of Errata to correct a formatting issue with its original filing of its Reply Brief in the above captioned matter. Counsel for Applicant inadvertently filed a copy of the Applicant's Reply Brief that omitted page numbers from the document. The attached Reply Brief includes page numbers for ease of reference to the Reply Brief as needed. In addition, the text on page 28 lines 18-27 has been reformatted to correctly reflect when the case law quotation ends and to distinguish between the quotation and the analysis thereof. We believe each of these changes will add to the clarity of the record. There were no other changes made to the attached Reply

Brief and the Applicant encourages all references to the Applicant's Reply Brief be made to the version attached hereto.

RESPECTFULLY SUBMITTED this 19th day of January, 2010.

Rose Law Group pc

Jordan R. Rose
Court S. Rich
M. Ryan Hurley
Attorneys for Applicant SolarCity Corp.

Original and 13 copies filed this 19th day of January, 2010, with:

Docket Control
Arizona Corporation Commission
1200 W. Washington Street
Phoenix, Arizona 85007

Copies sent via electronic mail to:

Mr. Bradley S. Carroll
Snell & Wilmer L.L.P.
One Arizona Center
400 E. Van Buren
Phoenix, Arizona 85004-2202
bcarroll@swlaw.com

Mr. Timothy M. Hogan
Arizona Center for Law in the Public Interest
202 E. McDowell Rd; Ste 153
Phoenix, Arizona 85004
thogan@aclpi.org

Ms. Janice M. Alward
Legal Division Arizona Corporation Commission
1200 W. Washington St.
Phoenix, Arizona 85007
jalward@azcc.gov

Mr. Michael W. Patten, Esq.
Roshka DeWulf & Patten, PLC
400 E. Van Buren St.; Ste 800
Phoenix, Arizona 85004
mpatten@rdp-law.com

Ms. Deborah R. Scott
Pinnacle West Capital Corporation
400 N. Fifth St.;, MS 8695
Phoenix, Arizona 85004
Deb.scott@pinnaclewest.com

Mr. Steven M. Olea
Utilities Division Arizona Corporation Commission
1200 W. Washington St.
Phoenix, Arizona 85007
solea@azcc.gov

Mr. Steve Wene
Mayes Sellers & Sims Ltd.
1850 N. Central Ave; Ste 1100
Phoenix, Arizona 85004
Swene@lawms.com

Mr. David Berry
Western Resource Advocates
Post Office Box 1064
Scottsdale, Arizona 85252-1064
azbluhill@aol.com

Mr. Jeffrey T. Murray
Moyes Sellers & Sims
1850 N. Central Ave.; Ste 1100
Phoenix, Arizona 85004
jtmurray@lawms.com

Mr. Kenneth C. Sundlof, Jr.
Jennings, Strouss & Salmon, P.L.C.
201 E. Washington St.; 11th Fl
Phoenix, Arizona 85004-2385
Sundlof@jsslaw.com

Mr. Daniel W. Pozefsky
1110 W. Washington St; Ste 220
Phoenix, Arizona 85007
dpozefsky@azruco.com

Mr. Philip J. Dion, Jr., Esq.
Tucson Electric Power Co.
One S. Church St; Ste 200
Tucson, Arizona 85702
Philip.dion@azbar.org

Mr. Lawrence V. Robertson, Jr.
Attorney at Law
Post Office Box 1448
Tubac, Arizona 85646
tubaclawyer@aol.com

Mr. C. Webb Crockett
Fennemore Craig, P.C.
3003 N. Central Ave; Ste 2600
Phoenix, Arizona 85012-2913
wcrocket@fclaw.com

Mr. Kenneth R. Saline
K. R. Saline & Associates, PLC
160 N. Pasadena; Ste 101
Mesa, Arizona 85201-6764
krs@krsaline.com

Ms. Kelly J. Barr
Salt River Project
Post Office Box 52025
Phoenix, Arizona 85072-2025
Kelly.barr@srpnet.com

Mr. Michael A. Curtis
Curtis, Goodwin, Sullivan, Udall & Schwab, PLC
501 E. Thomas Rd.
Phoenix, Arizona 85012-3205
Mcurtis401@aol.com

REPLY BRIEF
OF APPLICANT SOLARCITY CORPORATON
(JANUARY 15, 2010)

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I. Introduction

It has been SolarCity's intention throughout this case to establish that the preponderance of factors in the relevant case law suggest that SolarCity cannot be a utility, and we are confident that in all relevant details, we have done so.

Before addressing these details, however, we must address a common theme running through SRP, TEP and Staff's briefs and that is a fundamental misunderstanding or mischaracterization of the activity in question.

It is uncontested in Arizona that an entity is free to generate its own power on its own premises for its own consumption without subjecting itself to Corporation Commission jurisdiction as a Public Service Corporation ("PSC"). At the same time, it is undisputed that no individual or entity in Arizona needs or is compelled to utilize distributed generation at any time. The fact that some of these entities have chosen to finance the generation of this power through the use of a lease, an SSA, or another method, does not change the fundamental character of this unregulated activity. In fact, in the case of nonprofit SSA customers, it would have the significant negative effect of denying them the benefit of significant federal incentives, and of mechanisms that eliminate the biggest historical barrier to solar adoption, namely, upfront cost.

This is where SRP, TEP and Staff miss the point – as opposed to the details. While those for profit individuals and entities that choose to generate their own power on their own premises for their own consumption through purchases or leases of solar facilities are implementing solar all over the State, SRP, TEP, and Staff argue that when schools, non-profits and governmental entities choose to finance their system through a SSA, they have embarked on an entirely distinct activity.

These other parties claim that by using an SSA, these customers are in reality seeking a third party provider of electricity that threatens the very foundations of public service regulation. This interpretation requires abandoning the interlocking tests for PSC status in the State, and could potentially eliminate any clear-cut logical barriers preventing ACC regulation of any and all consumer electrical generating equipment.

II. Analysis

A. *Reply Brief Organization*

The following Reply Brief primarily addresses the arguments that Staff, SRP, and TEP make in their Opening Briefs. In general, this Reply is broken into three sections with separate responses to Staff, SRP, and TEP in that order, referencing previous arguments where indicated for the sake of efficiency.

B. *Reply to Staff Brief*

The following is SolarCity's specific reply to various arguments that Staff raises in its Opening Brief.

1. SolarCity is not furnishing electricity.

Staff makes several arguments in an attempt to demonstrate that SolarCity is furnishing electricity under an SSA arrangement. SolarCity contends that it is not furnishing electricity, but still encourages the Commission to perform the second step of analysis under *Serv-Yu* and case law even if no furnishing is found to occur. The following responds to each of Staff arguments on this issue.

a. There is no transfer of possession of electricity

Staff insists that electricity transfers possession from SolarCity to the customer (despite the provision of the SSA that says all electricity is always the sole property of the customer.) Staff's argument is essentially that since SolarCity owns the panels from which electricity emanates, SolarCity must, therefore, at some point own that electricity and transfer it to the customer. Staff's argument ignores the fact that ownership and possession of the tools used to

create or mold something does not necessarily translate into ownership and control of the items that those tools created, harnessed, or converted.

It may serve to imagine another type of equipment whose usage is typically financed through a similar scheme – for instance, a copy machine. The lessor of this copy machine provides the lessee with a machine that, given appropriate inputs, will convert pieces of blank paper to those with an image of the user's choice. The contract provides that payment to the owner for use of this device will be based on the number of pages that pass through this conversion.

Clearly, at no point has the owner of the machine taken control and ownership of the user's copies, and then transferred them to the user. The mere fact that the fee for usage of this device is based on the number of items converted within it does not mean that the lease for the machine is a fiction concealing the momentary ownership and resale of these copies by the owner of the machine.

Just as the copy machine converts the user's paper into a more usable form, the solar panels convert energy that would usually just heat a roof into usable electricity, which electricity is placed immediately in the hands of the customer.

Staff's response (and SRP's response as well) to this argument is to say that if this is accepted then there is nothing to stop a traditional incumbent utility from entering into an agreement with all its customers, giving them an undivided interest in all electricity the moment it is generated at the power plant. The argument states that this would provide all utilities an escape clause from Commission regulation. While thought provoking, this analogy does not hold up. Unlike the solar panels that simply take and shape energy that is already flowing onto the user's property into a form that can be consumed, traditional generation takes resources from off the customer's site and turns them into useable electricity before delivering such electricity to the end user often over hundreds if not thousands of miles of electrical infrastructure. No amount of renegotiating contracts is going to change the fact that electricity is being brought to properties from far off places over a public utility grid system in the traditional utility model.

b. The SSA is structured as a financing arrangement

Staff protests that the SSA cannot be a financing arrangement because of the language of the SSA, but persists in its refusal to provide a generally accepted definition of financing, beyond their own inclinations. If the only purpose of a financing scheme could be to result in eventual ownership of a device or item, as Staff testified, it is unclear where the field of equipment and rental finance would be.

Further, in making its argument Staff simply ignores the inconvenient language of the SSA that provides that SolarCity "shall provide the Buyer [the School District] the financing...during the Initial Term and any Additional Term [ ]." Exhibit A-1, at Exhibit B at Exhibit 7, P. 4 paragraph 2. We do not feel that Staff has adequately supported their proposition that the contractual arrangement between SolarCity and the School District specifying the terms of financing is not a financing agreement.

2. <u>The *Serv-Yu* analysis favors SolarCity.</u>

Staff's *Serv-Yu* analysis is fatally flawed in several respects. Before attending to the detailed examination, it must be noted that Staff's analysis seems overly intent on reaching a conclusion in favor of regulation, such that Staff even questions several factors that clearly favor SolarCity. Throughout the *Serv-Yu* analysis, Staff has a habit of announcing that any factor that may favor SolarCity is not determinative of the outcome. Staff wrongly implies that SolarCity is arguing that victory on one of the factors dictates a finding one way or the other as to regulation, and commonly mischaracterizes SolarCity's arguments on several of the factors.

a. Factor 1: What SolarCity actually does

Staff's analysis of the first *Serv-Yu* factor relies on a misapplication of *Serv-Yu* as interpreted in *Southwest Transmission Coop.* 213 Ariz. 427, 142 P.3d 1240. Staff correctly

points out that when considering what a company actually does *Southwest Transmission* makes it clear that the Commission should consider, "whether the company's actions affect 'so considerable a fraction of the public that it is public in the same sense in which any other may be called so.'" Id. (*citing Serv-Yu*, 70 Ariz. at 240, 219 P.2d at 327). Staff contends that in the case at hand, when SolarCity provides solar services to one user from one solar system located on that user's property, SolarCity really is acting like Southwest Transmission Coop when it transfers bulk power that thousands of homeowners ultimately use. In making this argument Staff reasons, that because SolarCity says in marketing material that it intends to serve millions of customers all over the world in the future, this means that right now SolarCity must affect such a huge part of the public in Arizona such that it is "public in the same sense in which any other may be called so." Id.

There are numerous problems with using SolarCity's ambition to one day service millions the world over to justify regulation in Arizona today. First, the proposal to serve millions includes a prominent amount of sold or leased facilities which Staff itself has said are not subject to regulation. Next, SolarCity's desire to serve millions of customers is not focused on Arizona alone. Staff does not propose a plausible logical deduction which could lead any reasonable person to believe that currently serving a very small fraction of one percent of the population of Arizona serves "so considerable a fraction of the public" that it "is public in the same sense in which any other may be called so" in Arizona. Id.

Staff further bases its argument on the unsupported claim that SolarCity's customers will rely on "...the solar energy generated by SolarCity *to the same extent that they rely upon the electricity generated by APS*." Staff's Opening Brief 14, l.7-8 (*emphasis added*). To the contrary, all the evidence indicates that APS (or the relevant incumbent utility) will remain the provider of last resort (there is, for instance, no solar power available at night) and that those using SolarCity's services will always remain hooked up to the grid. There actually is no sense in which customers will rely on this power "to the same extent they rely on electricity generated by APS." In point

of fact, the net physical effect on the operations of the school of a complete failure of its solar system at any one time would be nil.

b. Factor 2: Dedication to a public use

Staff's Brief focuses its entire argument regarding the dedication to a public use factor of *Serv-Yu* on demonstrating that case law indicates that SolarCity can be adjudged to have dedicated its property to a public use if "some portion of the public has the right to enjoy services" as opposed to the "entire public" having the right to enjoy services from SolarCity. Staff's Opening Brief 15, l.20-21.

In so doing, Staff fails to account for the fact that each SSA involves only one customer getting service from one solar facility located only on that customer's property, and that *no* portion of the public has the right to enjoy services from SolarCity. Certainly, all parties must agree that no customer in the State has the "right" to demand SolarCity's solar services. Quite simply put; neither the public nor any subset thereof has any interest in any of these solar facilities under the current facts. The only party with an interest is the customer himself.

Even the passages of the case that Staff prominently cites favor a conclusion that in this instance SolarCity is not dedicating its property to a public use. Staff attempts to use *Arizona Water Co. v. Arizona Corporation Commission*, 161 Ariz. 389, 778 P.2d 1285 (App. 1989) to show that SolarCity is dedicating private property to a public use. The analysis of the case, however, leads one to the opposite conclusion. In *Arizona Water Co.* the owners of a small water well that provided water service from that well to two non-owners were adjudicated to not be dedicating their well to a public use despite the fact that they were serving two non-owners. Id. 161 Ariz. at 392, 778 P.2d at 1287. The facts of the SolarCity Application are even stronger: not only will SolarCity refuse to offer service to more than one customer from the same solar system but, under the Commission's Interconnection Rules, SolarCity *cannot* provide services to more than one customer at a time from its solar facilities.

Because SolarCity's model is limited to the one customer, one rooftop scenario, the public simply never acquires any meaningful interest in any solar system. There is no risk to the public if the system fails as it will only impact one customer – and that not even to the level of any interuption in electric service. There is no risk to the public related to pricing of the services because only the customer will be paying the price. Staff's arguments would be more meaningful if SolarCity was proposing to serve more than one customer from any facility but because that is not the case it appears even the case that Staff cites supports the conclusion that SolarCity is not dedicating its property to a public use.

c. Factor 3: Articles of Incorporation

It is unclear why Staff refuses to acknowledge the fundamental difference between SolarCity's Articles of Incorporation and those of PSC utilities in Arizona. Despite Staff's assertion to the contrary, SolarCity is not contending that the outcome of the analysis of this factor or any other individual factor is conclusive on the *Serv-Yu* analysis. However, it is clear that an objective analysis of this factor can only lead to the conclusion that SolarCity's Articles of Incorporation are meaningfully different from those entities that are PSCs in Arizona, and that nothing in SolarCity's Articles indicate it is intending to, or is designed to, act as a PSC.

d. Factor 4: Dealing with a commodity in which the public has generally been held to have an interest

Staff mischaracterizes SolarCity's arguments with regard to the fourth *Serv-Yu* factor and fails to support its assertions with factual foundation. It is clear that the public has never been held to have a general interest in distributed generation projects.

SolarCity certainly agrees that electricity is electricity. However, commodity electricity, provided as a vital and essential service to millions of customers using necessarily public distribution infrastructure (the grid) and distributed generation facilities could certainly be

argued to be a distinct from electricity in the meaning of the general, observable physical force - else the Arizona Corporation Commission would have jurisdiction over all electricity in the state, starting from that trapped in static form in an individual article of clothing.

In order to prevent such an absurd outcome, there must be some distinction between a commodity involving the public interest, and that same material, service, or force delivered in a manner not involved with the public interest. The Coast Guard does not regulate the training standards of a canoeist, but of a ferry captain, though the commodity they provide may be the same.

We suggest that the distinction in question is the one provided by the public interest in utility regulation as circumscribed by relevant and explicit case law, and that the case of a generator that serves only one customer, from a facility located on the customer's property, can be shown not to have such a public interest. In fact, and contrary to Staff's implied claim, the public has never been held to have an interest in a customer producing electricity for himself on his side of the meter. Rather, in a survey of other jurisdictions provided in SunPower's Opening Brief none of the jurisdictions examined concluded that distributed generation was something in which the general public holds an interest. See SunPower Opening Brief l.23-34.

e. Factor 5: Monopoly status

Staff evades the central argument of whether or not SolarCity is, or seeks to become, a monopoly by stating that even if SolarCity is not a monopoly it does not follow that the Commission cannot regulate SolarCity. SolarCity has never contended otherwise and agrees with the statement that the fact of whether or not it is a monopoly is not controlling. It is important to note that Staff misinterprets SolarCity's arguments on this front. SolarCity contends that it is not a monopoly and certainly there is no evidence to suggest it is going to become a monopoly in Arizona. In fact, the evidence in the record shows that SolarCity was one of four companies to win the latest RFP with Scottsdale Schools and that while more than ninety school properties were listed, SolarCity won an award to provide service to less than five of

these. *See* Trans. 137, l.8; *see also* Trans. 139, l.7-8; see also Trans. 534, l.15. The existence of strong competition and less than substantial market share together definitively demonstrate that this is not a monopoly. Staff however, wrongly characterizes SolarCity as arguing that because it is not a monopoly SolarCity cannot be regulated. This is not SolarCity's contention.

SolarCity believes that the fact that it is not a monopoly means that this factor of the *Serv-Yu* test must be weighed in its favor and against regulation. The fact that this factor alone is not decisive of this issue does not take away from the fact that analysis of this *Serv-Yu* factor certainly results in a conclusion that it weighs in SolarCity's favor.

It is worth pointing out that Staff's reliance on an example from the telecommunications industry is misplaced in this instance. Staff seems to argue that because there are examples of regulated non-monopoly-PSCs in the competitive telecom industry that it no longer matters if a PSC is a monopoly. The competitive telecom industry followed from telecom companies that previously were monopolies and have been deregulated to some extent. The regulation was imposed during the time when a monopoly was in play and a move has been made to less regulation as the monopoly in that industry eroded. By contrast, there certainly is no monopoly in the solar services industry in Arizona at this time. However, rather than moving to lessen regulatory restrictions when there is no monopoly like the competitive telecom industry example, Staff seeks to actually heighten regulatory restrictions on the monopoly-free SSA business in Arizona.

Staff again makes the argument that because SolarCity indicates that its intent is to bring solar energy to millions of people, including areas beyond Arizona, that somehow this makes it a monopoly. It is not, of course, appropriate to use an imaginary future fact pattern involving a company that is orders of magnitude larger than the one before us to argue that the Commission must extend its regulatory authorities today.

There simply is no way to conclude that SolarCity is a monopoly and one must conclude that this *Serv-Yu* factor weighs against regulation.

f. Factor 6: Accepting substantially all requests for service

Nowhere in Staff's Brief does Staff reconcile its contention that this factor weighs in favor of regulation with the plain and simple undisputed fact that SolarCity simply does not accept substantially all requests for service, and that given the nature of solar energy, there never will be a time in the future when it can. The record is abundantly clear that SolarCity only closes on 9% of all the requests for service it receives for a variety of reasons. *See* Exhibit A-5, 8 l.23-28. Staff summarizes its argument in this respect to say that SolarCity accepts substantially all requests for service because, "SolarCity does not intend to turn away customers whom it is feasible for SolarCity to serve." Staff Opening Brief 21, l.25-25. The phrase "whom it is feasible to serve" is a very extensive expansion of the relevant tests, in no way supported by case law. This simply cannot be the standard for the analysis of this factor. In essence, Staff's argument is a syllogism; that SolarCity provides service to everyone it can provide service to, and SolarCity never turns down requests for service to those who it serves; therefore, it accepts substantially all requests for service.

Further, the testimony showed that provision of services to schools and governmental entities does not even work in such a way as to allow SolarCity to directly receive or accept any requests for service. As the Scottsdale Schools' witness testified, before any school can even think about acquiring solar services it must first go through a Request for Proposal (RFP) process and invite offers from multiple providers. *See* Trans. 531, l. 20-21. SolarCity is never in a position to "accept" a direct request for service from this class of customer and must always compete with others for the ability to negotiate to provide services. As a result, even if SolarCity wanted to serve, and could possibly serve, all such potential customers there is simply no way for a school or government customer to directly hire SolarCity. Further, the evidence demonstrated that even when SolarCity responds to RFPs it does not win substantially all the awards. See Trans. 137, l. 8.

The bottom line is there is simply no evidence to support a contention that SolarCity accepts, or even technically could accept, substantially all requests for service from school, non-

profit and governmental entities. This factor must be weighed in favor of SolarCity and against regulation.

g. Factor 7: Service under contract

SolarCity agrees with Staff that the analysis of providing service under a contract is, like all other *Serv-Yu* factors, not controlling on the ultimate decision, but is rather one of many factors. It appears that even Staff agrees that this factor weighs in favor of SolarCity and against regulation. It should be uncontested that SolarCity provides service through the SSA which is clearly a specific and negotiable contract.

h. Factor 8: Competition with other PSCs

Without reference to any support in the record, Staff blindly contends that SolarCity will be "in direct competition with the incumbent electric utilities." Staff's Opening Brief 22, l. 9-10. In order to make this argument, Staff must ignore the Commission's own RES standards, which require utilities to utilize distributed generation and, in the application of a recent amendments to APS and other utilities' 2010 Renewable Energy Implementation Plans, even forbids the utilities from counting any utility owned projects towards these distributed requirements. Further, Staff ignores the fact that the only utility to testify in the matter (APS) expressed that it views providers such as SolarCity as partners and not competitors. There is no evidence in the record to suggest that any utility in the State even offers the services that SolarCity provides. To the contrary, the record indicates that not one incumbent utility has ever responded to an RFP seeking solar services. In fact, it appears that the utilities need providers like SolarCity now more than ever if they are to satisfy the Commission's explicit policy requirements.

i. Serv-Yu weighs in favor of SolarCity

An honest and objective review of these factors finds that the balance of the *Serv-Yu* factors absolutely weigh in SolarCity's favor and against regulation.

3. Staff's arguments lead to the undesirable conclusion that the Commission must also regulate owned and leased distributed generation solar facilities.

Staff makes a series of important arguments that seem to strive for logical consistency at the cost of regulating *all* forms of distributed generation transacted between private parties Beginning on page 23 of its Opening Brief, Staff lays out numerous troubling statements that clearly suggest Staff now believes that the Commission must regulate all privately operated distributed generation equipment no matter its ownership – with the only test being interconnection to the grid.

> Staff: *...end-use customers own certain facilities, just as SolarCity will own its own solar generation equipment and associated facilities; these privately owned facilities are similarly imbued with a public character because they are all interconnected with the electric grid. Even in isolation, these facilities each have an impact upon the overall operation and reliability of the grid.*

Staff Opening Brief 23, l. 14-17. Staff makes the argument that if a system is connected to the grid through net metering it has a "public character." Staff does not distinguish between SSA type arrangements and customer owned facilities, and in fact, makes it clear they intended to include customer owned facilities in this discussion when they refer to "end-use customers."

> Staff: *The idea that the customer's facilities are somehow not a matter of public interest or not subject to Commission oversight is inconsistent with regulatory practice.*

Id. at P. 23, l. 25-27. Here Staff makes the argument that privately owned distributed solar facilities clearly are a matter of public interest. In fact, Staff makes the argument here that regulatory practice supports the regulation of privately owned distributed generation facilities. Again, Staff does this without drawing a distinction between purchased, leased or SSA facilities. It is true that there is regulatory oversight of the interconnection itself through the Interconnection Rules, but that is far different than the Commission regulating the customer, or for instance, the purchase terms and price, or operations and maintenance arrangements, of any electricity generation or consumption equipment that interconnects with the grid.

> Staff: *A customer's facilities implicate the public interest because of the overall interconnectedness of the electric grid, among other reasons.*

Id. at P. 23, l. 27-28. The Staff is saying that despite the fact that a customer-owned facility serves only one customer and is located entirely on the customer's side of the meter, such a facility implicates the public interest. Again they make no distinction between SSA facilities and owned or leased facilities so it is clear this statement is meant to apply to all such facilities.

> Staff: *SolarCity's electricity will be provided not only to the schools but also to the electric grid through net-metering. SolarCity will serve a portion of Arizona's electric load through its SSAs; however, it will also indirectly serve others as a result of net-metering. That SolarCity's facilities will impact not only the overall grid but also electric service to the entire public is obvious.*

P. 24 l. 5-7. This passage draws a particularly dangerous conclusion that SolarCity's facilities will impact "not only the grid but also electric service to the entire public." Staff is saying that

through net-metering, an owner of a solar facility is actually serving the public. If true, that means that every owner of a solar facility would be deemed to be "furnishing" electricity under the State Constitution, and, because of the public interest that Staff urges, every such owner would be subject to regulation. It is important to note that there simply is no difference between the interconnected nature of SolarCity's SSA solar facility and a solar facility that one might own and put on one's roof. That system would, according to Staff, also have to be adjudged to impact the "overall grid" while providing electric service to the "entire public."

Using the above excerpts, Staff's troublesome argument can be summarized by the following statement: *Regulation is mandated for all facilities that could place electricity on the grid through net metering; and that means that all distributed generation is subject to regulation.*

The problem is that there is no room for the Commission to distinguish between SSA arrangements and any systems that are owned or leased. All have the same relationship to the grid and by implication all would have to be regulated if the Staff's reasoning is followed.

It is clear that the public does not have any interest in a customer who, like the schools in this case, generates his own power on his own property for his own consumption, beyond regulating the interconnection for the safety of the grid. (Commission Staff admitted at the hearing on this matter that it knows of no safety measure in addition to those currently in place that should be added to the Interconnection Rules. *See* Trans 1279, l. 20-23.)

4. <u>Staff's arguments in defense of the proposed benefits of regulation fall short.</u>

Staff's attempts to assign a benefit to regulation in its Opening Brief fall short. The following addresses each of Staff's arguments regarding the proposed benefits of regulation.

a. Staff wrongly contends the Commission is needed to assure ongoing provision of service.

Staff contends that Commission oversight is necessary to create an enforceable obligation to serve electricity that the Commission can impose. The Staff asks that we "imagine the implications if a traditional utility could escape its obligations to provide adequate service..." This flight of imagination is unnecessary, as The *Serv-Yu* tests serve to demonstrate no business entity in any way resembling a traditional utility is in operation here. In fact, the failure of this imagery is illustrative of why regulation is inappropriate- the public frankly is not harmed if a distributed generation system goes off line.

In anticipation of this response, Staff argues that while the customer will not lose electricity, the impacts of system outage could be significant for budgeting reasons to the customer who may have counted on offsetting a larger amount of the incumbent utility's high priced electricity. The Staff does not elucidate why this scenario should place the Commission in the position of regulating the provider of solar equipment any more so than they might regulate a provider of copy machines, school buses, or any one of the other thousands of types of privately contracted or financed equipment, across all sectors of the economy whose failure would negatively impact the operator's budget projections

The public need to regulate utilities does not, of course, arise from the budgetary inconvenience to individual parties that might come from the failure of the grid, but from the massive economic damage and real danger to the public health and well-being that would come from a widespread failure of electrical service.

b. Regulation of SSAs is not necessary and will not solve issues related to stranded costs.

Staff continues to argue that regulation is necessary to avoid stranded costs to utilities and their customers, and posits that regulation aimed at providing planning information to utilities would be helpful. Again, Staff fails to recognize that the Commission's RES goals must necessarily have contemplated these factors, or to accept the procedure of recent Commission proceedings seeking to establish and assign these costs in a rigorous analytical framework.

Further, and importantly, Staff fails to consider the fact that regulating only SSAs would not have the desired effect, as the majority of all solar installations in the State are still customer owned or leased. Either Staff is again arguing for regulation of all distributed generation regardless of ownership, or it is missing the point that reporting and planning for SSAs will not give utilities the information they need to get a clear picture of all distributed solar in Arizona. In other words, if the perceived benefit of regulating SSAs is that incumbent utilities will get enough information from the SSA providers to avoid stranded costs associated with the proliferation of distributed generation then this benefit will not actually be derived because SSAs make up only a portion of all distributed projects.

Finally, it is troublesome to note that Staff uses language to suggest that one of the goals of regulation would not just be to have providers report projects to utilities but to actually control and limit the proliferation of SSAs. Staff says that "unchecked growth of SSAs" could be problematic. Staff Opening Brief at P. 29, L. 18. This suggests that to avoid these perceived problems the growth of SSAs should be "checked" which appears to be a Staff inclination counter to established Commission policies.

c. SSA market will not benefit from regulation and there is no evidence to support such a claim.

Staff makes the hypothetical argument that the SSA market could benefit from regulation to create a solid competitive framework. This argument is unsupported by anything other than conjecture and imagination. Staff argues, "[i]f the goal is to develop a market with many competitors, a market that is transitioning to competition justifies regulatory oversight." Staff Opening Brief 31, l. 1-2 (*emphasis added*). It is not clear in what fashion Staff understands the currently free and unregulated SSA market to be "transitioning to competition" and therefore in need of regulation that has never before existed.

In fact, the evidence in the record shows numerous companies competitively vying for various jobs and numerous different winners of different contracts. See Trans. 137, l. 8; see also

Trans. 139, l. 7-8; *see also* Trans. 534, l. 15. There is no evidence in the record to suggest the currently competitive market would be improved with regulation. As explained in Applicant's Opening Brief in more detail, the evidence in the matter suggests that the numerous players in the SSA market that either testified or provided comment in this matter do not believe that Commission regulation will help them competitively and uniformly asked the Commission not to regulate.

d. Adequate safety measures and controls are currently in place.

Despite the fact that Staff admits that adequate safety measures are in place today it still contends that there may be health and safety issues in the future that require regulation. Staff Opening Brief 32, l. 5-7. Staff does not explain why these future health and safety issues could not adequately be addressed, as they are today, through amendments to the current Interconnection Rules or the statutes covering licensure of solar installers. There is no reason to believe that regulation will provide any additional protections for the public's health and safety, or that the Commission and its Staff have left out important safety measures or authorities in their existing Interconnection Rules.

e. There are adequate customer complaint outlets in place today and no evidence exists to demonstrate the need for, or a benefit from, an additional outlet.

Staff fails to put forth any evidence to suggest the current outlets for customer complaints and dispute resolution (the Superior Court, Registrar of Contractors, and the Attorney General's Office) are insufficient. Instead, Staff merely speculates that the industry's customers would benefit from an additional body to field complaints. Staff does not seem to realize that its proposal would give SSA customers a complaint outlet that purchase and lease customers would

not have - and would certainly cause confusion for consumers as to where they could lodge their complaints.

Further, while there will no doubt be complaints of some kind at some point, as there are in all industries, there was no evidence provided to show that there are any unique or numerous complaints that are going unresolved in the State's current framework of consumer protections, or that in a highly competitive marketplace with significant consumer purchasing power, consumers need the sorts of special mechanisms put in place at the Commission to address the massive disparity in negotiating power with the utilities as they exist today.

C. Reply to SRP Opening Brief

1. Intervenor SRP's Legal analysis and conclusion fail because they are based on a faulty assumption.

Intervenor SRP has provided an edifying picture of what it believes is the intent of the Framers of the Arizona Constitution, when they derived rules about public utilities with the backdrop of 19th century railroad tycoons and robber barons in mind. The applicability of these musings to the 21st century issue before the Commission in the instant case is premised upon one faulty and fatal assumption: that distributed generation solar electricity is an "essential public service." It is not; and the facts and the testimony clearly demonstrate that to be the case.

Once this flawed assumption is eliminated, the foundation for SRP's legal analysis begins to crumble; what is left is an interesting but unpersuasive dissection of the *Serv-Yu* factors and other case law. The conclusion that SRP reaches with this portion of its analysis is essentially that Arizona courts have done a poor (or perhaps simply inconvenient) job of analyzing the Constitution, and the Commission should instead use SRP's analysis.

2. SRP's analysis of Constitutional intent actually supports a finding of no jurisdiction

SRP's Opening Brief, in its historical analysis of Constitutional intent, highlights very specifically the difficulty of the instant case: determining what entities should be regulated as public service corporations. SRP painstakingly and correctly points out that the difficult task both the Framers then and the Commission now are facing is creating (or interpreting) a definition that is broad enough to protect the public and narrow enough so as not to discourage private enterprise:

> *The Constitution draws a line between the regulation of all corporations and the regulation of corporations whose business it is to provide* ***essential public service****...It is the nature of the service provided not the structure of the business that is determinative*

SRP Brief 2, l. 9-14 (*emphasis added*). Thus the question before the Commission in the instant case is one of Constitutional interpretation where the first step is attempting to determine and apply the Framers' intent regarding where to draw this line.

SRP has done a very thorough analysis of the Arizona Constitutional convention, some analogous legislative history and even the contemporaneous Oklahoma Constitutional Convention. All of this was done to in a convenient attempt to demonstrate that the Framers intended the definition of a PSC to be relatively broad. *See* SRP Brief 5, l. 2-3; see also 6, l. 10-13. Further, SRP correctly comes to the conclusion that the intent of the Framers of the Constitution does not absolutely hinge upon a definition of the word "furnish" or exclusively on the monopoly power of the entity in question. *See* SRP Brief 6, l. 15-18. However, regardless of how broad the Framers intended the definition of a PSC to be, the line defining a PSC must be drawn somewhere, to serve some compelling public interest; and, as SRP concludes, the intent of

the Framers in defining and regulating PSCs should be "guided by" the following statement from the Arizona Supreme Court:

> *...to preserve and promote those services which are indispensable to large segments of our population and to prevent excessive and discriminatory rates and inferior service where the nature a of the facilities used in providing the services and the disparity in the relative bargaining power of a utility ratepayer are such as to prevent the ratepayer from demanding a high level of service at a fair price without the assistance of governmental intervention in his behalf.*

SRP Brief 6-7, l. 19-3 citing *Petrolane-Arizona Gas Service v. Arizona Corporation Commission*, 199 Ariz. 257, 259, 580 P.2d 718, 720 (1978).

Thus, according to SRP and the Arizona Supreme Court, the key factors in determining whether the Framers of the Constitution would have intended to regulate a particular entity as a PSC are: 1) whether the service is indispensible to large segments of the population; and 2) whether there is a disparity of bargaining power that would lead to discriminatory rates and inferior service without governmental assistance. Id. Applying the facts of the instant case to the standard that SRP is "guided by" and that the Supreme Court advocated in *Petrolane* shows that the Framers of the Constitution did not intend to regulate SolarCity.

a. Distributed solar electric generation is not indispensable to anyone.

As discussed above, upon examination of SRP's legal analysis it becomes clear their entire argument rests upon the premise that distributed generation solar electricity is

indispensible to the public. This is simply not true and the testimony in the hearing provided ample evidence of this.

In order for SRP's analysis to be sound, the Commission would have to find that there is absolutely no distinction between the incumbent grid utility's generation of essential electricity and a customer choosing to generate its own power on its own premises for its own consumption as a supplement and not a replacement for that customer's grid service. At its logical core SRP would have you believe that all electricity is "essential" and that all electricity must be regulated. Taking SRP's position to the extreme conclusion, they would make no regulatory distinction between traditional incumbent-supplied grid electricity and the electricity from a customer's Duracell™ battery.

In fact, a brief examination of the facts and testimony provided in the instant case highlight the myriad distinctions between utility supplied electricity and electricity from distributed generation:

- At all times the customer remains tied to the electricity grid and continues to receive a majority of their electricity from the incumbent grid utility. *See* Trans. 222, l. 15-20; *see also* Exhibit A-4, pre-filed testimony of Ben Tarbell at questions 6, 7.

- Solar systems do not produce electricity at night or when it is cloudy, meaning the customer continues to rely on the incumbent utility for 100% of their service during these times. *See* Exhibit A-4, pre-filed testimony of Lyndon Rive at question 5.

- Customers are not required to get solar systems and they do not need additional electricity. Rather customers are simply seeking to save money by generating a portion of their own electricity through a solar facility. *See* Trans. 582-83, l. 24-5.

- The general public has no right or interest in the electricity generated from the customer's system. *See* Trans. 1065-66, l. 6-19

In addition to these examples from the record, a decision from the New Mexico Public Regulation Commission, which recently considered the same general issue before the Commission today, is instructive on this factor. The NM PRC concluded that SSA providers are not PSCs in part because they do not provide an essential public service:

> *...while [SSA] developers provide services related to essential public services, they do not provide essential public services themselves. Developers provide hosts a green alternative. Hosts who receive service from developers do so because they have determined that the service is to their benefit, not because they have no other choice. Developer-owned systems operate in parallel with a public utility's electric grid, offsetting rather than replacing the customer's use of grid electricity. Hosts...do not depend on developers for electric service. (emphasis added)*

See Exhibit SunPower-3, New Mexico PRC Decision in Case No. 09-00217-UT (pg. 16).

In short, SRP's assumption that distributed generation is an "essential public service" is wrong. The remainder of their legal analysis is built upon this foundation, and their arguments and conclusion are otherwise unsupportable. SolarCity does not provide an essential public service and as such the Framers of the AZ Constitution would not have intended to regulate them as a PSC.

b. The large market for SSA providers and the customer's ability to choose not to participate ensures there is no disparity in bargaining power.

The other factor that SRP cites from the *Petrolane* decision as indicative of Constitutional intent is whether there is a disparity in bargaining power between the company at issue and their customers, such that the customer is subjected to unreasonable rates and service.

As discussed above, however, the customer does not need SolarCity's services and as such will never be compelled to accept an unreasonable rate or level of service. The customer can simply choose not to install solar if prices presented are not deemed reasonable. This is directly evidenced by the fact that approximately 90% of initial customer inquiries to SolarCity do not result in a service contract.

Furthermore, the testimony from the case revealed that there is a significant amount of competition within this market and thus no disparity in bargaining power; SRP does not attempt to reconcile their demands for enhanced customer protection in the face of this asymmetry with the well-demonstrated customer control over pricing demonstrated in the wide variety of solar equipment and prices available to the customer, and the explicit RFP for solar service issued by the School District.; This ample competition puts the customer in the driver's seat regarding bargaining power - as further evidenced by the dropping price of solar services. In short, a customer may choose among several different solar service providers, many offering distinct products (including varying aesthetics, domestic vs. foreign manufacture, efficiencies, additional features like production monitoring, etc.) and may do so based on the best price and service offered; or they may choose no system at all. At no time is a customer compelled to sign up for service if they feel the price or service offered are not to their benefit.

3. <u>SRP misinterprets case law including Serv-Yu.</u>

Instead of utilizing the applicable case law as a framework for useful interpretation of the Constitution to identify and analyze the appropriate factors and issues, SRP's comes to the conclusion that the existing case law framework is poorly constructed and thus SolarCity's arguments pursuant to that framework should fail.

SRP spends a great deal of time attacking the relevance of the *Serv-Yu* decision, ultimately concluding that *Serv-Yu* should not be the applicable test and rather the Commission should substitute a test of SRP's own making. SRP Brief 13-14, l. 21-7.

Instead, what is useful is to recognize that the *Serv-Yu* analysis has been held by the Arizona Court of Appeals as the test applied in the two step analysis of whether an entity is a PSC. *See Southwestern Transmission Cooperative v. Arizona Corp. Comm'n*, 213 Ariz. 427, 142 P.3d 1240 (Ariz.App.Div.1 2007). This case has not been overturned and it is the current state of the law on the issue.

As you will see, SRP's analysis of *Serv-Yu* misconstrues the case in much the same way as Staff's analysis described above. Importantly, it appears that whenever a factor favors SolarCity's position, SRP simply rejects that factor by stating that the factor in question simply cannot be a "requirement." This misses the point; Serv-Yu sets out a list of factors to be weighed, none of them are "requirements" in and of themselves.

In addition, SRP mischaracterizes SolarCity's reliance on *Serv-Yu* and argues that SolarCity is urging the Commission to find against regulation if SolarCity meets any of the factors individually. SolarCity is not, as SRP suggests for example, arguing that it should not be regulated because it is not a monopoly.

The following is a brief response to SRP's proposal. As SRP has not provided an meaningful indication as to why existing case law is inadequate or irrelevant, we will term these to be the "SRP Tests", as a means of distinguishing this exercise from the pertinent case law in "*Serv-Yu*."

a. Factor 1: What SolarCity actually does

SolarCity incorporates its analysis of this factor above and from its Opening Brief herein.

b. Factor 2: Articles of Incorporation

SRP states that this factor of current law is irrelevant. Certainly, SRP would not be saying this was irrelevant if SolarCity's Articles of Incorporation declared that it was formed to furnish electricity or to act as a PSC as other incumbent utilities in the State have declared in their Articles of Incorporation. This factor can be assigned a varying weight, but it does not seem responsible or justifiable to simply declare that it should be ignored in the absence of any case law suggesting such.

c. Factor 3: A dedication to a public use

SRP agrees to include this factor in its proposed new set of metrics and SolarCity incorporates its analysis above and in its Opening Brief herein.

d. Factor 4: Dealing with the service of a commodity in which the public has generally been held to have an interest

SRP urges that this factor has no relevance and that it should therefore be removed from the discussion. It again appears that SRP is basing this argument on its contention that distributed generation solar is "essential" to the public which it clearly and unequivocally is not. SolarCity incorporates its analysis above and in its Opening Brief herein.

e. Factor 5: Monopolizing or intending to monopolize the territory with a public service commodity

This is perhaps the best single example of where SRP must wrongly be reading the Serv-Yu factors as tests in and of themselves rather than factors to be weighed. SRP concludes for monopolies that, "[t]o apply this *requirement*, for example, would exempt the entire telecommunications industry." SRP Brief P. 12, l. 16-17 (*emphasis added*). The Serv-Yu factors are not "requirements", but rather "factors." Failing one factor would not exempt were

the other factors to weigh more heavily for regulation. Certainly, the fact that SolarCity is not - and cannot become - a monopoly over the customers at issue in the Application is central to whether or not government regulation is necessary in this regard. Even taking SRP's agreed upon guiding standard from Petrolane it would certainly be relevant if SolarCity were a monopoly as to the analysis of the strengths of relative bargaining power between the customer and the provider.

f. Factor 6: Acceptance of substantially all requests for service

Again SRP contends that if this were a "requirement" that it would exempt entire industries that should otherwise be regulated. As elsewhere, it is not a "requirement" but instead a factor to be considered along with all other factors. SolarCity incorporates its analysis above and in its Opening Brief herein on the specifics of this factor.

g. Factor 7: Actual or potential competition with other PSCs

The "SRP Test" would hold this factor irrelevant to the analysis, but no Arizona Court has rejected it. SolarCity incorporates its analysis above and in its Opening Brief herein on the specifics of this factor.

h. Factor 8: Service under contracts

Again SRP rejects this factor altogether because it says the factor should not be a "requirement." It is not a "requirement" and *Serv-Yu* makes no such suggestion. SolarCity incorporates its analysis above and in its Opening Brief herein on the specifics of this factor.

4. <u>SRP's proposed "test" is based on a false premise</u>

After rejecting established case law, SRP creates a new set of tests, apparently based on original Constitutional scholarship, and urges that these should be the controlling test to determine if a company is a PSC beginning on page 13 of its Brief.

The test is again based on a faulty premise when SRP sets out in the first step of its test that the Constitution should be given a "broad" reading when seeking to include companies in the definition of a PSC. *See* SRP Brief 13, l. 17.

Immediately after declaring this standard, SRP wrongly declares that the Arizona Corporation Commission used the same standard before when the ACC found that a "corporation providing security services, including the transmission of messages" was a PSC. The case apparently in question bears no relation to this brief. In fact, in *General Alarm v. Underdown*, the Court came to the conclusion that the Constitution was never meant to be "so elastic as to fan out and include businesses in which the public might be incidentally interested ...." General Alarm v. Underdown 76 Ariz. 235, 238, 262 P.2d 671, 673 (1953). In making this statement, the Court found that the company transmitting messages while providing security services was *not* a PSC.

The case is very instructive as to precisely why SolarCity is not a PSC in this instance:

> *"Free enterprise and competition is the general rule....The public has some interest in all business establishments, but that interest must be of such a nature that competition might lead to abuses detrimental to the public interest".*

Id. The Supreme Court in General Alarm was careful to point out that regulation was to be employed only when abuses could be reasonably anticipated if regulation were not in place. There is not one piece of evidence to suggest that there has been a single abuse of the public by any SSA provider, and no reason to suspect a special nature to this industry that would present more potential for customer abuse than any other.

D. Reply to TEP Opening Brief

The following examines any unique arguments that TEP makes in its Opening Brief as they relate to the *Serv-Yu* analysis (which makes up the entirety of the TEP Brief.)

1. What SolarCity actually does

Like Staff, TEP's discussion of what SolarCity actually does misses the point. SSAs are a means of enabling users to generate their own electricity on their own property, without a massive capital investment of their own, for their own use – from a system of their own choosing among a wide variety of technologies and features. Why is pricing based on kilowatt-hours as TEP points out? Because such is the performance measure of the system installed and financed by SolarCity. Not every commercial exchange involving devices capable of generating electrical power is invested with the special public interests that require public service company regulation. As SolarCity has explained and proved throughout the hearing, it is in the business of designing, installing, maintaining and financing solar facilities – none of these services places it within the purview of the Commission.

2. Dedication to public use

TEP makes two unpersuasive arguments on this factor. First, TEP tries to argue that the "nexus of public benefit" between SolarCity and its customer is closer than the relationship between SWTC in *Southwest Transmission Cooperative*, 142 P.3d at 1245-46. SWTC carried bulk electricity for miles over a grid whose functional duplication would be an economic absurdity, to serve thousands of residents with what was presumably (unless they had their own distributed generation sources) the sole and nonnegotiable source of vital electric power.

In stark contrast, SolarCity is seeking to provide solar services to individual customers from individual solar arrays located on that customer's property, while the customer remains connected to and able to get all its power from the incumbent utility.

As an auxiliary argument, TEP argues that because rebate money is used to make the systems financially feasible, that the systems themselves have been dedicated to a public use. We do not feel, for instance, that those who have received TEP rebates to improve the energy efficiency of their buildings have therefore dedicated their buildings to the public use.

3. Articles of Incorporation

TEP's arguments on this factor are circular. TEP circularly argues that SolarCity "is furnishing electric service to the public" under its existing Articles of Incorporation and that is therefore, evidence that SolarCity is furnishing electricity. TEP Brief at P. 6, L 23. The question before this Commission is whether or not SolarCity is furnishing electricity such that it becomes a PSC in Arizona and here TEP is using the presumption that SolarCity is furnishing electricity in an effort to prove that SolarCity is furnishing electricity. In addition, TEP, like Staff, fails to acknowledge that SolarCity's Articles are significantly and meaningfully different from other PSCs in Arizona, all of whom specifically call out their status as a PSC in their Articles. Again, the Commission can attribute however much meaning it wants to this factor, but it is clear that it favors SolarCity.

4. Dealing with the service of a commodity in which the public has generally been held to have an interest

TEP's arguments on this section are a perfect example of the Company missing the point that distributed generation is substantially different from the service of bulk power to millions of customers.

5. Monopoly status

Here TEP makes the astonishing assertion that a corporation could theoretically become a monopoly regulated in the public interest, while having just one customer. TEP writes that, "once the solar facilities are installed, the customer has no other realistic option for solar energy for an extended period of time…" TEP Brief 7, l. 17-18. Under Arizona law, monopoly power is the power to control prices or exclude competition in a relevant geographic market presumably larger in extent and number of customers than a single schoolhouse roof. *See, Pasco Industries, Inc. v. Talco Recycling, Inc.*, 195 Ariz. 50, 58, 985 P.2d 535, 543 (Ariz. App. 1998). One does not become a monopoly by serving one customer as TEP suggests, nor by having the ambition to serve many more customers in the future.

If a monopoly were to be based on the ability of one customer to easily replace the purchased good or service as TEP's requests then the sellers of any expensive or large fixed good could be held to be monopolies and subject to antitrust attacks simply because their customers could not, for example, easily acquire another home once purchased from a homebuilder.

6. Accepting substantially all requests for service

TEP's arguments on this factor are similar to Staff's, and SolarCity incorporates its above response herein. TEP does make one additional argument that warrants a separate response. TEP posits that SolarCity is "not dissimilar from an incumbent utility" when it makes the decision to serve a customer. TEP Brief 8, ;. 6-7. TEP makes no reference to the record in support of these claimed similarities, nor does TEP elucidate the voluntary criteria under which TEP might choose in its own discretion not to serve a customer, as SolarCity does on a daily basis. SolarCity does not have to provide service to anyone under any circumstances. Further, as explained above, when dealing with schools and governmental entities SolarCity must respond to RFPs and cannot simply agree to serve *or even receive a request to serve*.

7. Service under contracts

TEP agrees that this factor weighs in favor of SolarCity and against regulation.

8. Competition with other PSCs

TEP offers no evidence to support its statement that that SolarCity "competes directly with… incumbent utilities." TEP Brief 8, l. 19-20. As explained more fully in the response to Staff above, SolarCity does not compete with incumbent utilities who do not offer SSAs in Arizona and who need and benefit from SSAs because of the RES requirements that the Commission imposes. Further, because of the Commission's recent decision not to count utility owned distributed generation towards an incumbent utility's distributed generation RES requirements it is essential that SolarCity and others provide this service to enable TEP and other incumbent utilities to reach their RES requirements.

III. Conclusion

Those few parties in favor of regulation in this case for the most part offered the same unpersuasive arguments they put forth during the hearing. SRP abandons argument within existing case law, and instead urges the Commission to engage in direct Constitutional interpretation and use a new test of their own devising.

A look back at the words of the *Petrolane* Court is helpful in putting this analysis in final context as it relates to the purpose of regulation:

> *…to preserve and promote those services which are indispensable to large segments of our population, and to prevent excessive and discriminatory rates and inferior service, where the nature of the facilities used in providing the services and the disparity in the*

> *relative bargaining power of a utility ratepayer are such as to prevent the ratepayer from demanding a high level of service at a fair price without the assistance of governmental intervention in his behalf.*

Petrolane, 199 Ariz. 257, 259, 580 P.2d 718, 720.

The arguments that SRP, TEP, and Staff advance in an attempt to link the typical commercial transactions at hand to the provision of bulk electricity service to the general public are utterly unpersuasive. Public Service Company regulation is a powerful legal tool that tends to profoundly restrict commerce – we urge the Commission to continue to employ this tool only with the greatest care, in demonstrable instances of overriding public interest.