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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

CARL J. KUNASEK
CHAIRMAN
JIM IRVIN
COMMISSIONER
WILLIAM A. MUNDELL
COMMISSIONER

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IN THE MATTER OF THE APPLICATION
OF ARIZONA PUBLIC SERVICE
COMPANY FOR APPROVAL OF ITS
PLAN FOR STRANDED COST RECOVERY

DOCKET NO. E-01345A-98-0473

IN THE MATTER OF THE FILING OF
ARIZONA PUBLIC SERVICE COMPANY
OF UNBUNDLED TARIFFS PURSUANT
TO A.A.C. R14-2-1601 *ET SEQ.*

DOCKET NO. E-01345A-97-0773

IN THE MATTER OF COMPETITION
IN THE PROVISION OF ELECTRIC
SERVICES THROUGHOUT THE STATE
OF ARIZONA

DOCKET NO. RE-00000C-94-0165

POST-HEARING BRIEF
OF
ARIZONA PUBLIC SERVICE COMPANY

Arizona Public Service Company ("APS" or "Company") hereby submits its Post-Hearing Brief in the above-captioned matters.

I.

INTRODUCTION

On May 17, 1999, APS and representatives of every one of the Company's major customer constituency groups submitted a Settlement Agreement (Settlement") to the Arizona Corporation Commission ("Commission").¹ The Settlement was the product of months of hard negotiations

¹ These consumer groups consist of: the Arizona Residential Utility Consumer Office ("RUCO"), representing the Company's residential customers; Arizona Association of Community Action Agencies ("AACA"), representing low-income consumers, and Arizonans for Electric Choice and Competition ("AECC"), representing the Company's large and medium general service customers, including Cable Systems International, BHP Copper, Motorola, Chemical Lime, Intel, Honeywell, Allied Signal, Cyprus Climax Metals, Asarco, Phelps Dodge, Homebuilders of Central Arizona, Arizona Mining Industry Gets Our Support, Arizona Food Marketing Alliance, Arizona Association of Industries, Arizona Multihousing Association, Arizona Rock Products Association, Arizona Restaurant Association, Arizona Retailers Association, Boeing, Arizona School Board Association, National Federation of Independent Business, Arizona Hospital Association, Lockheed Martin, Abbot Labs, and Raytheon.

Snell & Wilmer
LLP
LAW OFFICES
One Arizona Center
Phoenix, Arizona 85004-0001
(602) 382-6000

1 entered into at the urging of both the Commission and legislative leadership and provides many
2 clear benefits to customers, to potential competitors, and to APS. These include:

- 3 • Allowing competition to commence in APS' service territory months before
4 otherwise possible and expanding the initial eligible load by 140 MW;
- 5 • Establishing both Standard Offer and Direct Access rates, and providing for
6 annual rate reductions with a cumulative total of as much as \$475 million by
7 2004;
- 8 • Ensuring stability and certainty for both bundled and unbundled rates;
- 9 • Resolving the issue of APS' stranded costs and regulatory asset recovery in a fair
10 and equitable manner;
- 11 • Providing for the divestiture of generation and competitive services by APS in a
12 cost-effective manner;
- 13 • Removing the specter of years of litigation and appeals involving APS and
14 Commission over competition-related issues;²
- 15 • Continuing support for a regional ISO and the AISA;
- 16 • Continuing support for low income programs; and
- 17 • Requiring APS to file an interim code of conduct to address affiliate
18 relationships.

19 On the other hand, what have opponents of the Settlement provided the Commission
20 as an alternative? They have proposed no set of either Standard Offer or Direct Access
21 rates. They have offered no cost-of service study to challenge that of APS. They have
22 provided the Commission with no alternative calculation of the Company's stranded costs.

23 ² Contrary to the statements of some at the hearing, the dismissal of APS' pending lawsuits is a substantive
24 provision. Although APS has to date focused its resources on pursuing settlement rather than litigating its claims, the
25 bulk of APS' claims on electric competition issues are pending, and have not been dismissed, at the trial court level.
26 Moreover, appellate courts, both in Arizona and other states, have not hesitated to overrule state utility commission
actions on grounds similar to those raised by APS. *See, e.g., Consumers Power Co. v. Public Svc. Comm'n*, 1999
WESTLAW 462507 (Mich. June 20, 1999) (holding that Michigan PUC lacked statutory authority to order retail
electric competition and invalidating electric competition rules); *U S West v. Arizona Corp. Comm'n*, 1999 WESTLAW
308563 (Ariz. Ct. App. May 18, 1999), at *9 (invalidating portions of Commission rules for failure to seek Attorney
General review).

1 Aside from Staff consultant Smith, who concluded on the basis of only four months of 1999
2 data that APS' market price projections (and hence its "shopping credit") for the entire
3 period 1999 through 2004 were two mils "too low", there has been no indication of what
4 such opponents believed would be an appropriate "shopping credit."

5 Some intervenors have railed against the Company's so-called "market power" but
6 presented no analysis of market power³ outside of some "load pocket" situations—situations
7 already acknowledged by APS, that are being addressed by the Arizona Independent
8 Scheduling Administrator ("AISA"), and which are little different than many other regional
9 "load pockets" which the Federal Energy Regulatory Commission ("FERC") has had to deal
10 with and resolve. Their only "solution" to this largely non-existent problem is the tired old
11 mantra of forced divestiture—a course of action that the Commission has repeatedly
12 rejected and which would not resolve "load pocket" market power. Rather it would only
13 change the holder of such market power.

14 Although no determination of fair value rate base, rate of return or other financial
15 analysis is legally necessary to justify current APS rate levels, allow the introduction of a
16 new optional service (Direct Access), or evaluate a series of voluntary rate decreases, APS
17 has, in fact, provided such information for the Commission's consideration. No party has
18 offered any contrary analysis. Rather, they urge the Commission to ignore the desires of
19 APS customers and put retail electric competition on hold for months or even years while
20 we retreat to "square one" and begin the whole process anew.

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26 ³ Enron witness Frankena conceded that he had performed only a preliminary, non-definitive analysis. (2 Tr. 188.) APS witness Hieronymus, however, performed a FERC-approved market concentration review that found no unacceptable concentrations of market power. (W. Hieronymus Rebuttal Test., Exh. APS-13, at 13-22.)

II.

**THE SHOPPING CREDIT RESULTING FROM THE COMPANY'S PROPOSED
STANDARD OFFER AND DIRECT ACCESS RATES IS SUFFICIENT TO
PROMOTE EFFICIENT COMPETITION**

As the term implies, the "shopping credit" is the difference between a customer's Standard Offer (bundled) bill and the same customer's bill from APS under a Direct Access tariff. It represents the bundle of dollars or cents per kWh that any particular customer can offer an ESP to provide competitive electric services and still pay the same or less for that customer's total electric service. Kevin Higgins, an expert employed by AECC, testified that the "shopping credit" under the Settlement was both greater than under the previous Staff/APS/TEP settlement (given reasonably foreseeable market prices of electricity) and sufficient for significant numbers of the Company's customers to seek competitive alternatives to the Standard Offer. (K. Higgins Direct Test., Exh. AECC-1, at 7-8.) APS witness Jack Davis provided his own analysis based on the 40 kW to 200 kW customer group, which comprises over 80% of the general service customers eligible for competitive access in the first phase. It showed an average margin on the "shopping credit" of over 8 mils per kWh, or a 23% markup over "cost." (J. Davis Rebuttal Test., Exh. APS-9, at 6-7.)

Every witness questioned conceded that the Settlement's shopping credits were superior to those offered by Arizona's second largest electric utility – Salt River Project. (3 Tr. 593; 4 Tr. 1019; J. Davis Rebuttal Test., Exh. APS-9, at 6.) Not one intervenor presented any ESP-specific cost information demonstrating that a reasonably efficient new entrant could not profitably serve a broad segment of APS' customer base.⁴ Moreover, both Dr. Landon and Mr. Davis reminded the Commission that artificially high shopping credits will likely increase ESP profits without lowering customer rates, will encourage inefficient firms to enter the market, and may keep rates higher than they otherwise would be. (J.

⁴ The ESP's complaints should be viewed skeptically. Enron touted the benefits of the "high" Pennsylvania shopping credits—yet Enron's own records indicate that it serves only 13 customers in that state. (Exh. APS-5). Commonwealth serves no customers in Pennsylvania. (4 Tr. 773.)

1 Davis Rebuttal Test., Exh. APS-9, at 5-9 & Att. JED-2R; J. Landon Rebuttal Test., Exh.
2 APS-14, at 5-11; 5 Tr. 1033-34)

3 Certain parties criticized both Mr. Davis and Mr. Higgins by claiming that had they
4 used a higher assumed market price for generation or a different size and type of customer,
5 or had they factored in undocumented higher marketing costs for ESPs, the margin would
6 have been less—perhaps even negative in some times of the year. APS freely admits that all
7 of these factors will affect the “shopping credit” and, by extension, the ability of ESPs to
8 earn profits.

9 Higher market prices for electricity will, all else being equal, reduce opportunities for
10 customers and ESPs to benefit from access to that competitive market. Such higher prices
11 reduce or even eliminate the gap between market price and regulated rates. If this
12 tautological result comes as news to ESPs, they are easily surprised.

13 Of course, some members of the class of customers analyzed by Mr. Davis will have
14 greater and others smaller shopping credit margins than the average. Similarly, the
15 shopping credit margin is different for residential customers⁵ and for the large customers
16 (over 3MW) of the type represented by the AECC. In addition, the “shopping credit”
17 margin may vary seasonally with the market cost of generation for the same remarkably
18 unsurprising reasons as discussed above.

19 Finally, APS does not doubt that some ESPs may spend more on marketing and
20 similar costs. Others will spend less. APS’ numbers were based on its own experience in
21 California and not on those of any ESP. (5 Tr. 1035.) APS also made a number of
22 conservative assumptions in Attachment JED-1R, each of which understated the size of the
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24 ⁵ For example, Commonwealth Energy’s Exhibit 5 uses ET-1 as the residential rate. Although APS does not
25 concede the relevance or accuracy of this exhibit, substituting the cents per kWh Standard Offer rate and “Regulated
26 Tariff” charges for E-12, the Company’s most prevalent residential rate, into this exhibit yields a substantial shopping
credit margin of over 13 mils per kWh—even using Mr. Bloom’s Palo Verde NYMEX figure for wholesale energy cost.
(See A. Propper Rebuttal Test., Exh. APS-11, at Attachment AP-1R, page 1; Commonwealth Exh. 5.) Using Mr.
Davis’s wholesale energy cost figure from Attachment JED-1R, the shopping credit margin is over 17 mils per kWh.
(See J. Davis Rebuttal Test., Exh. APS-9, at Attachment JED-1R.)

1 available “shopping credit.” (5 Tr. 1034-35.) But the test for a reasonable “shopping
2 credit” should not be whether all ESPs can profit on all APS customers all of the time. If
3 success in the competitive market is assured or even made easy, one loses the essence of
4 why competition was perceived as beneficial in the first instance. (J. Davis Rebuttal Test.,
5 Exh. APS-9, at 7.)

7 III.

8 **APS DOES NOT OVER-RECOVER STRANDED OR ANY OTHER COST OF** 9 **SERVICE AS A RESULT OF ITS TRANSFER OF COMPETITIVE ASSETS TO AN** 10 **AFFILIATE AT BOOK VALUE**

11 The transfer of APS competitive electric service assets is required by proposed
12 A.A.C. R14-2-1615(a). That rule gives APS the option to transfer such assets either to an
13 affiliate or to a non-affiliated party. Generally Accepted Accounting Principles (“GAAP”)
14 require that if APS is to transfer to an affiliated party, it must be at APS’ net book value at
15 the time of transfer. (J. Davis Rebuttal Test., Exh. APS-9, at 23; 5 Tr. 1049-50.)⁶ The
16 transfer at book value has nothing to do with the consideration, if any, the transferor
17 receives in such a situation. As was discussed with Enron witness Kingerski, “book value”
18 transfers are a common provision in settlements of the kind under consideration here and
19 were an uncontested provision in the 1998 APS/Staff settlement. (J. Davis Rebuttal Test.,
20 Exh. APS-9, at 24; 3 Tr. 574-75; 4 Tr. 863-64, 866-69.)

21 Despite Enron’s agreement to similar provisions in the context of settlements
22 allowing incumbent utilities far greater stranded cost recovery than is contemplated in this
23 Settlement (4 Tr. 865-70; 5 Tr. 1222-23), Enron appeared to imply in its questioning of APS
24 witnesses that a net book value transfer would miraculously eliminate APS’ stranded costs.
25 Even if APS were to actually receive net book value from its affiliate, this would only mean

26 ⁶ Unlike APS, TEP’s assets may be “impaired” under GAAP, for reasons unrelated to the transfer. In such a
circumstance, GAAP may require TEP to transfer the impaired asset at the lower fair market value to which the asset
was written down.

1 that the economic loss—the difference between the net investment in the assets and their
2 market value—was being recognized by the affiliate rather than APS. However, in point of
3 fact, APS will receive less than net book value from the affiliate, and even after adding in
4 the \$350 million in stranded cost recovery from customers, there is still a \$183 present value
5 disallowance associated with the transaction. (5 Tr. 1047-50.)

6 The Arizona Consumers' Council has suggested (with no evidentiary support) that
7 the removal of competitive assets from the Company's regulated rate base might reduce its
8 overall revenue requirement. (AzCC Comments at 2; 5 Tr. 1111.) This simply will not
9 occur for several reasons:

- 10 1. The revenue requirement attributable to the transferred assets will be
11 essentially off-set by the combination of the cost of replacing the generation
12 through purchased power and the implicit stranded cost CTC embedded in
13 Standard Offer rates.
- 14 2. APS' overall revenue requirement will be increasing because of the addition
15 of some \$1 billion in new distribution plant.
- 16 3. Even if part of APS' existing revenue requirement were to “disappear” with
17 the transfer to an affiliate of competitive assets, APS will also lose substantial
18 generation revenues from customers opting for Direct Access.
- 19 4. APS will have reduced its rates to Standard Offer customers by 6 percent by
20 the time the transfers are scheduled.

21 (D. Robinson Rebuttal Test., Exh. APS-12, at 4; 5 Tr. 1212-14.)

22 In any event, the parties to the Settlement were well aware that a number of
23 potentially significant events were happening toward the end of the transition period:
24 regulatory asset amortization would end July of 2004; stranded cost recovery would end
25 December 31, 2004; APS will have divested itself of competitive assets by 2003, etc. That
26 is why the parties agreed that APS would submit a full-blown “bells and whistles” rate case

1 including jurisdictional, functional, and class cost-of-service studies by mid-2003.
2 (Settlement at § 2.7; 4 Tr. 893-94; 5 Tr. 1126.)

3
4 **IV.**
5 **RATE AND FINANCIAL ISSUES**

6 **A. Adjustment Mechanisms**

7 The Settlement contemplates an adjustment mechanism or mechanisms that would
8 allow APS to recover four categories of costs: (1) the cost of providing Standard Offer
9 service after July 1, 2004;⁷ (2) the cost of customers returning to Standard Offer service
10 from direct access; (3) the cost of complying with directives of the Commission under the
11 Electric Competition Rules; and (4) changes in the overall level of costs included by the
12 Commission in the System Benefit Charge contemplated by the Electric Competition Rules.

13 The first of these mechanisms will likely be similar to the purchased power
14 adjustment clause used today by Citizens Utilities Company and the electric distribution
15 cooperatives. (2 Tr. 391; 5 Tr. 1131-32.) When the Commission abolished the Company's
16 previous purchased power and fuel adjustment clause in 1989, it cited the relative stability
17 of fuel prices under the Company's long-term coal and uranium contracts, its relatively low
18 reliance on purchased power, and the ability of APS to control costs by proper operation of
19 its large base-loaded generating units. *See* Decision No. 56450 (April 13, 1989). These
20 factors will no longer prevail once APS' generating plants are owned by an affiliate.

21 The second cost category is admittedly more nebulous, and the Company has
22 attempted to limit the potential for such costs by the one-year waiting provision for
23 customers over 3 MW and the anti-arbitrage provisions in its proposed changes to Tariff
24 Schedule No. 1, presently pending before the Commission.⁸ In fact, by the time APS is
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26 ⁷ Although the Settlement uses the terms "Standard Offer" and "Provider of Last Resort," the latter is in fact a subset of the former, and thus the Company will refer to both as simply Standard Offer service.

1 required to actually propose a particular cost recovery mechanism or mechanisms, in mid-
2 2002 under Section 2.6 of the Settlement,⁹ this provision of the Settlement may prove
3 unnecessary. APS, however, believes that its ability under the Settlement to propose a
4 means of ensuring timely and full cost recovery of these types of potential costs is an
5 important component of the overall Settlement.

6 Category three was included in the 1998 Staff/APS settlement and is further
7 contemplated by the proposed Electric Competition Rules. See A.A.C. R14-2-1601(35)(d);
8 R14-2-1609(G). By far the most significant of the items covered by this provision are the
9 costs (lawyers, accountants, financial advisors, payments to secure various contractual and
10 financial releases, agency filing fees, etc.) to divest the Company's competitive assets and
11 the costs of AISA/Desert Star. Under the Electric Competition Rules, APS is clearly
12 entitled to full recovery of these costs. Section 2.6 (3) of the Settlement merely allows APS
13 to create, with Commission approval, a mechanism for such recovery.

14 Changes in the level of System Benefits charges (as there are changes in the level of
15 authorized system benefit costs) have always been contemplated by the Electric
16 Competition Rules. Once again, Section 2.6 (4) authorizes the eventual creation of a
17 specific mechanism to effectuate this intent. This becomes all the more important if the
18 Commission intends to implement some type of environmental resource portfolio
19 requirement, the cost of which could well be recovered through this clause. Because APS
20 cannot increase rates before July 1, 2004 to incorporate a higher System Benefit charge that
21 might result from such programs, the inclusion of such charges in the adjustment
22 mechanism is wholly appropriate.

23
24 ⁸ The anti-arbitrage provisions are aimed at the possibility that a customer might take Direct Access only during
25 the winter (off-peak) months and switch back to Standard Offer every summer, thus exacerbating the Company's
summer peak, causing a deterioration in system load factor, and generally increasing system average costs.

26 ⁹ It is sometimes forgotten that the Settlement does not establish any of these specific mechanisms. APS must
file a proposal or proposals in 2002, followed by a Commission hearing to establish the appropriate structure and other
aspects of such mechanisms.

1 In each of the above instances, APS will propose a specific mechanism or
2 mechanisms in mid-2002. By the end of 2002, the Commission will approve the actual
3 form of the mechanism, but only after a full evidentiary hearing. Even thereafter, the
4 mechanism(s) will not begin to actually collect anything from APS customers until the
5 conclusion of the general rate case provided for in Section 2.7, and all parties, including
6 signatories to the Settlement, retain the ability to challenge either the prudence of particular
7 costs or their eligibility for inclusion under the terms of the Settlement. (J. Davis Direct
8 Test., Exh. APS-1, at 8; D. Robinson Rebuttal Test., Exh. APS-12, at 6.)

9 **B. Unbundling of Standard Offer Rates**

10 The Settlement clearly provides that APS will “unbundle” Standard Offer rates to the
11 extent required by the Electric Competition Rules. (See Settlement at § 2.1.) APS has filed
12 extensive comments on that portion of the Rules and will continue to argue for a change to
13 the final version of Rules that will permit the Company to propose an alternative that makes
14 sense, such as was suggested in Attachment AP-1R to Exhibit APS-11. (See A. Propper
15 Rebuttal Test., Exh. APS-11, at 5-6, 8-9; see also 4 Tr. 783-84; 5 Tr. 1154, 1193.) But that
16 argument is for another day. APS continues to maintain, and believes that the evidence
17 overwhelmingly shows, that one cannot actually unbundle Standard Offer rates on a strict
18 cost-of-service basis unless the Standard Offer rates are themselves redesigned to equal
19 cost-of-service—a process that will result in significant rate increases for many customers.
20 (A. Propper Rebuttal Test., Exh. APS-11, at 8-9; 4 Tr. 877-87.)

21 As to revenue cycle services, APS demonstrated why avoided cost credits for
22 metering, meter reading, and billing services were appropriate, at least during the transition
23 period, and indicated its willingness to reevaluate the appropriate cost methodology in the
24 2003 rate case. (A. Propper Rebuttal Test., Exh. APS-11, at 3-5; 5 Tr. 1139-41, 1172.) No
25 party has presented an alternative to APS’ avoided cost credits that would not
26 inappropriately shift higher costs onto Standard Offer customers.

1 Pursuant to the Chief Hearing Officer's direction, APS has prepared an unbundled
2 Standard Offer bill that incorporates the unbundled billing elements specified on Hearing
3 Officer Exhibit 1. APS has circulated a copy of this Standard Offer bill format to the parties
4 to this docket, and requested comments. APS will file, on August 9, 1999, a final version of
5 the unbundled Standard Offer bill and indicate, if possible, what consensus was reached on
6 the proposed format.

7 C. Financial Data

8 APS has provided far more financial data than has been previously filed in either of
9 its last two settlement agreements with the Commission. See Decision No. 58644 (June 1,
10 1994); Decision No. 59601 (April 24, 1996). The Commission has more financial data than
11 is required for a rate increase in the great majority of instances.¹⁰ See A.A.C. R14-2-103.
12 Indeed, by its terms, the filing requirements of this regulation are only applicable to rate
13 increases. Commission regulations require no financial data in the case of either the
14 introduction of a new optional service or a voluntary decrease in general rates.

15 APS has provided an historical test period (1996) adjusted through the end of 1998.
16 (A. Proper Direct Test., Exh. APS-2, at Schedule AP-2.) It has provided actual 1998
17 results. (*Id.* at Schedules AP-3 and AP-4.) APS has provided projected 1999 results. (D.
18 Robinson Rebuttal Test., Exh. APS-12, at 7.) APS has provided cost of capital testimony
19 (*id.* at 8-9; 5 Tr. 1198-1200) and explained how cost of capital is related to return on fair
20 value (*id.* at 9). Moreover, Staff witness Williamson confirmed that Staff has regularly
21 reviewed APS' annual financial reports, including APS' earnings, as provided by the 1996
22 rate reduction agreement. (4 Tr. 931-32). This evidence allows the Commission to
23
24

25 ¹⁰ R14-2-102 establishes a graduated system of filing requirements, with smaller public service companies
26 (which constitute the large majority of all public service corporations) providing only the most cursory of information.
The Commission reserves the ability to waive even these requirements. See A.A.C. R14-2-103(B)(6).

1 establish both a fair value rate base and a rate of return and to satisfy itself that the rates
2 provided for under the settlement are just and reasonable.

3 Admittedly, APS has not spent the two or so years normally consumed by the
4 Commission in general rate increase proceedings involving APS. It is likewise true that
5 neither Commission Staff nor RUCO shared the concerns raised by Arizona Consumers
6 Council. (3 Tr. 669-67, 672; 4 Tr. 897.) As demonstrated further below, a full-blown rate
7 case is not needed for the Commission to conclude, given the financial data presented, that it
8 has sufficient information to determine that the rates proposed by the Settlement are and will
9 be just and reasonable.

10
11 V.

12 **APPROVAL OF THE SETTLEMENT IS NOT AN UNLAWFUL ABDICATION OF**
13 **THE COMMISSION'S AUTHORITY OVER RATES AND CHARGES**

14 **A. The Record Supports APS' Rates and Satisfies Article XV, Section 14 of the**
15 **Arizona Constitution.**

16 The Arizona Consumers Council argued that traditional a rate case, followed by a
17 finding of "fair value," is necessary before the Commission can lawfully approve the
18 Settlement. (1 Tr. 65-68.) Arizona Consumers Council also argued in its opening statement
19 that the record lacks evidence that would permit the Commission to conclude that APS'
20 rates are just and reasonable. (1 Tr. 66.) Such claims are both factually and legally
21 incorrect.

22 **1. The rates in the Settlement are just and reasonable.**

23 Commission-approved rates are presumptively just and reasonable. Moreover,
24 nothing precludes a public service corporation from voluntarily reducing its rates from
25 Commission-approved levels. Such a voluntary reduction does not require a rate case or
26 any other particular form of supporting data. *See, e.g.*, A.R.S. §§ 40-250(B) and 40-367;
A.A.C. R14-2-103. In fact, it does not even require a hearing.

1 Against this backdrop, the central factor overlooked by the Arizona Consumers
2 Council and other proponents of the “unjust and unreasonable” theory is that the rates at
3 issue in this proceeding are APS’ *existing rates*. APS’ stranded costs and regulatory asset
4 recovery are, by definition, a component of APS’ existing rates.¹¹ (5 Tr. 1215.) APS’
5 *Standard Offer rates are its existing bundled rates*—they are neither “new” rates nor are
6 they rate increases. The Direct Access rates filed with the Settlement are, similarly, APS’
7 existing rates functionally allocated into the unbundled components of retail service. At
8 most, they are rates for an optional new service. No customer is required to pay a rate
9 increase by opting for Direct Access.

10 Because there is no requirement for a rate case to approve voluntary rate reductions
11 to existing, approved rates, the Commission can dismiss claims that it must litigate APS’
12 rate reductions. (See 1 Tr. 66 (arguing that when considering the proposed rate reductions,
13 the Commission must ask “why not 20%?”).) In any event, there is substantial evidence¹² in
14 the record to conclude that APS’ rates as set forth in the Settlement are just and reasonable.
15 *See, supra*, section IV.C.

16 **2. A finding of fair value is not required to approve the Settlement.**

17 Article XV, § 14 of the Arizona Constitution provides that “to aid it in the proper discharge
18 of its duties” the Commission shall ascertain the fair value of utility property. Arizona courts have
19 not applied this provision outside of a traditional rate case seeking either a rate increase or (in one
20 instance) an involuntary rate reduction. *See Arizona Corp. Comm’n v. Arizona Pub. Svc. Co.*, 113
21 Ariz. 368, 370-71, 555 P.2d 326, 328-29 (1976) (increase to existing rates); *Mountain States Tel. &*

23 ¹¹ APS’ regulatory asset amortization and recovery was previously approved in Decision No. 59601 (April 24,
24 1996), and is simply continuing under the Settlement.

25 ¹² The substantial evidence test is satisfied by “evidence of substance which establishes facts and from which
26 reasonable inferences may be drawn.” *City of Tucson v. Citizens Util. Water Co.*, 17 Ariz. App. 477, 481, 498 P.2d 551,
555 (1972). Evidence is not insubstantial merely because the testimony is conflicting, or reasonable persons could draw
different conclusions from the evidence. *State v. Bearden*, 99 Ariz. 1, 3, 405 P.2d 885, 886 (1965). Further, the weight
given to evidence is a matter within the Commission’s discretion. *Arizona Corp. Comm’n v. Arizona Water Co.*, 85
Ariz. 198, 202, 335 P.2d 412, 414 (1959).

1 *Tel. Co. v. Arizona Corp. Comm'n*, 137 Ariz. 566, 568, 672 P.2d 495, 497 (Ct. App. 1983) (same);
2 *Scates v. Arizona Corp. Comm'n*, 118 Ariz. 531, 534, 578 P.2d 612, 615 (Ct. App. 1978) (same);
3 *Simms v. Round Valley Light & Power Co.*, 80 Ariz.145, 153, 294 P.2d 378, 383 (1956)
4 (involuntary rate reduction).

5 In a published opinion, the Attorney General concluded that a fair value finding is not
6 required for every "modification" to a public service corporation's rates, because in many instances
7 such a finding would not "aid" the Commission in regulating rates. Op. Atty. Gen. 71-15 (May 19,
8 1971). Moreover, Arizona trial courts have already dismissed overly-strict interpretations of the
9 constitutional fair value provision. See *US West v. Arizona Corp. Comm'n*, Slip Op., Maricopa
10 Cty. Super. Ct. CV 96-18667 (July 13, 1998) (holding that fair value finding is unnecessary when
11 certifying new telecommunications providers) (review pending) (attached at Exhibit A). Because
12 APS is not seeking a rate increase, and because the adjudication of stranded cost recovery and rate
13 unbundling is not a "rate case," the Commission need not make a fair value determination to satisfy
14 the Constitution.

15 Again, however, APS has presented substantial evidence of its fair value rate base. (See
16 *supra*, section IV.C; A. Proper Direct Test., Exh. APS-2, at 6; 2 Tr. 456-58.) Although not legally
17 necessary in this proceeding, the Commission is free to give whatever weight it deems appropriate
18 to this evidence.

19 **3. The context of this proceeding gives the Commission ample authority to**
20 **approve the Settlement.**

21 The Commission also has, inherently, a "range of legislative discretion" in ratemaking
22 matters. See *Simms*, 80 Ariz. at 154, 294 P.2d at 384. Nothing requires the Commission to follow a
23 specific methodology in its ratemaking determinations, nor exclude the consideration of other
24 relevant factors. *Id.* at 151, 294 P.2d at 382. Indeed, the Commission has the authority to address
25 "specialized" situations on a case-by-case basis when particular circumstances warrant such
26 treatment. *Arizona Corp. Comm'n v. Palm Springs Util. Co.*, 24 Ariz. App. 124, 128, 536 P.2d 245,
250 (1975). The unbundling of existing rates and resolution of stranded costs in anticipation of

1 retail electric competition is such a “specialized” situation. It does not, however, require a rate case
2 nor a particular method of ratemaking.

3 **B. Several Issues Raised in Opposition to the Settlement are Subject to the**
4 **Exclusive Jurisdiction of FERC.**

5 Some parties, notably Enron (*see* 1 Tr. 53-54, 56-57; 4 Tr. 794-98), took issue with a
6 number of transmission-related issues and made (unsubstantiated) market power claims in
7 connection with APS’ generation assets located outside of several load pocket areas.¹³
8 Raising these issues with the Commission is inappropriate, as they are federally-regulated
9 by FERC. Specifically, FERC has exclusive jurisdiction over transmission issues, which
10 include the issues relating to the AISA and available transmission capacity issues raised by
11 Enron witnesses Delaney. *See, e.g.*, FERC Order No. 888 (April 24, 1996), as amended;
12 *FPC v. Florida Power & Light Co.*, 404 U.S. 453, 468 (1972); *Florida Power & Light Co.*
13 *v. Florida Pub. Svc. Comm’n*, 29 F.E.R.C. ¶ 61,140 (1984). FERC also has exclusive
14 jurisdiction over wholesale sales of energy, rendering moot much of the market power
15 speculation made by the opponents to the Settlement. *See, e.g.*, *Nantahala Power & Light*
16 *Co. v. Thornburg*, 426 U.S. 953, 966 (1986); *FPC v. Southern Cal. Edison Co.*, 376 U.S.
17 205, 209 n.5, 216 (1964). Moreover, on such transactions, APS and its affiliates would be
18 subject to FERC’s code of conduct requirements, further mitigating concerns raised at the
19 hearing. *See, e.g.*, *Re Utilicorp United*, 75 F.E.R.C. ¶ 61,168 at 61,557 (1996).

20 These federally-regulated issues will, appropriately, be addressed at FERC rather
21 than with the Commission. They should not distract the Commission when considering the
22 Settlement.

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26 ¹³ *See supra*, footnote 3. The AISA is currently considering a pricing protocol to address must run generating units in load pocket areas—a protocol that will then be filed with FERC for approval. (J. Davis Rebuttal Test., Exh. APS-9, at 27-28.)

1 **C. The Settlement Does Not Unlawfully Bind the Commission.**

2 As in any contract, the parties to the Settlement negotiated provisions meant to
3 ensure that its terms would not be unilaterally abrogated. (*E.g.*, Settlement at § 3.5.)
4 Obviously, a Settlement has no value if some parties can simply change the terms of the
5 agreement to the detriment of other parties whenever they feel like it. Thus, consistent with
6 settlement agreements negotiated in other jurisdictions, APS expects that future
7 Commissions will honor the terms of this settlement. *See, e.g., Re Miss. Riv. Transp. Corp.*
8 *55 F.P.C. 630, 633 (1976)* (noting that Federal Power Commission intended for settlement
9 to bind future commissions).

10 That said, APS did not intend for this provision to unlawfully bind a future
11 Commission on ratemaking issues. Thus, if the wording of Section 3.5 of the Settlement
12 presents a concern to the Commission, APS would not oppose the inclusion of clarifying
13 language in an order approving the Settlement stating that “to the fullest extent permitted by
14 law, the Agreement shall be enforceable against this and future Commissions.”

15 **D. The Commission May Approve a Contested Settlement.**

16 Several parties have argued that ESPs were not “at the table” during settlement
17 negotiations, and as a result the Commission cannot approve this settlement. (*See* 1 Tr. 35-
18 38, 49-50, 60.) Apart from being factually incorrect,¹⁴ this statement is legally
19 unsupportable. For example, in its opening statement, Enron suggested that *Tejas Power*
20 *Co. v. FERC*, 908 F.2d 998 (D.C. Cir. 1990), a review of a contested settlement involving a
21 natural gas pipeline company, was analogous to this proceeding. Enron argued that, in
22 *Tejas*:

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25 ¹⁴ Enron essentially asks the Commission to ignore its quite obvious participation in the settlement negotiations
26 as a member of AECC. Enron witness Delaney admitted during cross-examination that Enron was represented by
counsel at the negotiating sessions (4 Tr. 812-13), that Enron knew about the provisions of the Settlement during their
development (4 Tr. 812, 814), and that Enron was able to, and did in fact, offer substantive comments that were
considered by APS and the other parties (4 Tr. 815). Neither was Staff excluded from the Settlement. (4 Tr. 940-41.)

1 the Court of Appeals [for] the D.C. Circuit told the FERC that it could not
2 approve a contested settlement even though the customers and the pipeline
3 were on board, without first considering competitive issues and the
4 pipeline's inherent market power. The situation is very similar to this case.

5 (1 Tr. 49.) Relying on *Tejas*, however, is faulty for several reasons, none of which were
6 alluded to by Enron in its opening statement.

7 *Tejas* involved a contested settlement that was approved by FERC without
8 conducting any hearing. 908 F.2d at 1002. Further, the "market power" concerns arose
9 from the nature of the settling parties—the "customers" of the pipeline were all regulated
10 natural gas local distribution companies ("LDCs") that could simply pass any costs incurred
11 under the settlement to downstream customers in their rates. *Id.* at 1004-05. The court in
12 *Tejas* held that, given this fact, FERC could not rely solely on the LDCs' acceptance of the
13 settlement to show that the pipeline company lacked significant market power. *Id.*

14 In APS' case, however, there has been an extensive evidentiary hearing
15 demonstrating that approval of this Settlement is in public interest. There is also, to the
16 extent it is even relevant, substantial evidence in the record showing that APS lacks
17 significant market power. (W. Hieronymus Rebuttal Test., Exh. APS-13, at 13-24; 6 Tr.
18 1239-45.) And, unlike *Tejas*, the settling customers here are not just "a group of
19 monopolists."¹⁵ 908 F.2d at 1004.

20 Put simply, *Tejas* in no way mirrors the case now before the Commission. Rather,
21 there are only two prerequisites for the Commission to approve this settlement: (1) it must
22 afford all parties notice and an opportunity to be heard, and (2) it must conclude that the
23 settlement is fair, just and reasonable, and in the public interest. *See, e.g., In the Matter of*
24 *Public Service Co. of New Mexico*, 808 P.2d 606, 610 (N.M. 1991). Those prerequisites
25 have been met.

26 ¹⁵ Additionally, FERC will exercise jurisdiction over market power issues relating to APS's transmission and
wholesale generation where appropriate.

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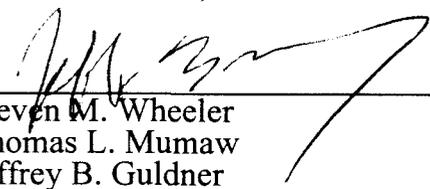
VI.
CONCLUSION

The Settlement is the only way retail electric competition can be brought to the APS service area in anything close to a timely fashion. The alternative is long and contentious proceedings that would take the Commission back to where it was last fall. Perhaps this is precisely what some intervenors hope will happen.

APS and its customers have been laboring since December 1996 to put forth a comprehensive compromise proposal. Now they have it and need only Commission approval to begin the legislative mandate of electric competition. Will this Settlement be the final chapter of the competition story? Not hardly. Will mid-course corrections be necessary in 2004 and beyond? Probably. Competition has been evolving in the telecommunications industry for over 20 years and in the gas industry for over 10 years. The electric restructuring effort, by comparison, is in its infancy. The Settlement, however, provides a solid basis on which to start, and APS urges its swift approval by this Commission.

Respectfully submitted this 5th day of August, 1999.

SNELL & WILMER, L.L.P.

By 
Steven M. Wheeler
Thomas L. Mumaw
Jeffrey B. Guldner

Attorneys for Arizona Public Service
Company

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CERTIFICATE OF SERVICE

The original and ten (10) copies of the foregoing document were filed with the Arizona Corporation Commission on this 5th day of August, 1999, and service was completed by mailing, faxing or hand-delivering a copy of the foregoing document this 5th day of August, 1999, to all parties of record herein.

Sharon Madden by Ross
Sharon Madden

693494.01

SUPERIOR COURT OF ARIZONA
Maricopa County

CLERK OF THE COURT

07-13-98
Date

HONORABLE REBECCA A. ALBRECHT

T. Robinson
Deputy Clerk

No. CV 96-18667 (CONSOLIDATED)

FILED: 7-20-98

US WEST COMMUNICATIONS, INC.

v.

THE ARIZONA CORPORATION
COMMISSION, et al

Court Admin - Civil CCB

Roger T. Hargrove

Janet F. Wagner

Andrew D. Hurwitz

Lex J. Smith

Thomas L. Mumaw

Michael M. Grant

~~Thomas H. Campbell~~

Steven J. Brown

Steven J. Duffy

Honorable John Foreman

Russell P. Rowe
1801 California St.
Suite 5100
Denver, CO 80202

98 JUL 28 AM 10:01

DOCKETED

07-13-98

HONORABLE REBECCA A. ALBRECHT

T. Robinson
Deputy Clerk

CR 96-18667

Nancy M. Coomer
145 E. University Blvd.
Tucson, AZ 85705

Russell Blau
3000 K. St., N.W.
Suite 300
Washington, DC 20007

These consolidated cases are all appeals from orders of the Arizona Corporation Commission which granted Certificates of Convenience and Necessity (CC&N's) to several competitive local exchange companies. The orders authorize the competitive local exchange companies to provide intrastate competitive local exchange services in Arizona. US West was an intervenor in the proceedings before the Commission and has brought these appeals. (The Court notes that after the motions to dismiss were argued and submitted to the Court CV 98-05980 was consolidated with these matters and has been stayed pending the outcome of these motions.)

Although the complaints in all of the cases are not identical, they raise the same issues: (1) that the Commission must conduct a traditional rate hearing and assess the "fair value of the applicant's property before issuing a Certificate of Convenience and Necessity; (2) that US West has been denied equal protection by the grant by the Commission to the other defendants flexible pricing authority; (3) all providers must meet the provider of last resort/universal provider requirements; (4) failure to require that all providers meet the provider of last resort/universal provider requirements denies US West equal protection.

The complaints filed by US West do not challenge that the Commission acted within the rules or that the decisions of the Commission based upon the rules were incorrect. Only that the application of the rules in these cases were violative of Arizona law and the Arizona and federal Constitutions. For that reason, the cases are ripe and are not barred by the doctrines of res judicata and collateral estoppel.

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The Commission has broad and exclusive power to choose the modes by which it establishes rates. Neither the courts nor the legislature may force upon the Commission one mode of meeting its constitutional obligations. (Arizona Corporation Commission v. State, 171 Ariz. 286, 830 P.2d 807(1992)). The Commission has, within the exercise of its authority, chosen to introduce competition into the provision of local exchange services. The decision by the Commission predates by about one year the enactment of the Telecommunications Act of 1996 47 U.S.C. 151 et.seq.

Article 15, Section 3, of the Arizona Constitution provides:

The Corporation Commission shall have full power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected, by public service corporations within the State for service rendered therein, and make reasonable rules, regulations, and orders, by which such corporations shall be governed in the transaction of business within the State,...

Article 15, Section 14, provides:

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

The Courts, in interpreting these two provisions, prior to the enactment by the Commission of the Competitive Telecommunications Services Rules (A.A.C. R14-2-1101 through 1115), found that the Commission was required to determine the fair value of the property of any public service corporation doing business in Arizona in determining the rates the public service corporation would be permitted to charge. The cases decided prior to the enactment of A.A.C. R14-2-1101 et.seq. stand for the proposition that in a regulated monopoly system, the Commission cannot force a public utility to accept certain rates without first conducting a fair value determination. Such a determination would assure that the monopoly would receive a fair return on its investment. The cases do not address the circumstances of a competitive market. Indeed there is no precedent for requiring a fair value determination in a competitive market.

Because the Commission is given broad discretion in the determination of how to meet its obligations; the failure to conduct a "Fair Value" Hearing prior to the issuance of the CC&N's was not violative of the Arizona Constitution or case law, the counts

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alleging such do not state a claim upon which relief could be granted and must be dismissed.

Different treatment of dissimilarly situated persons does not violate the right of equal protection. Classifications must be upheld as long as they bear a rational relation to some legitimate end. US West and the other providers are not similarly situated in the intrastate telecommunications market. Further, the regulatory scheme is related to the legitimate governmental purpose of fostering competition.

The Commission orders do not classify telecommunications providers. A violation of the Equal Protection Clause lies when there is an attempt to distinguish between two or more groups of persons. The Commission has classified the defendant's services as competitive, therefore, those services are subject to the use of flexible pricing. Further, there has been no classification of US West services in this group of decisions.

Therefore, the procedures used by the Commission in establishing flexible rate structures for the defendants is not violative of US West rights to equal protection and the counts based upon that claim must be dismissed.

The Act and the Commission's rules have changed the manner in which universal service/carrier of last resort requirements are met. The Act requires all telecommunications services carriers to contribute to preserve and promote universal service. The Commission, in fact, adopted Universal Service Fund Rules before the Act was passed. Any provider, including US West can petition for reimbursement by the fund. Further, US West may petition to be relieved of its universal service obligations.

The change in the manner in which universal service, carrier of last resort requirements are met does not state a claim upon which relief can be granted. To the extent the US West complaint alleges that it is being unfairly treated by the rules, that claim is not ripe as US West has not filed its own action(s) before the Corporation Commission.

Based on the foregoing,

IT IS ORDERED dismissing the complaints in the consolidated cases as failing to state claims upon which relief could be granted.

The Motions for Summary Judgment brought under CV 97-05564 have been rendered moot by the Court's orders dismissing that case.