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REHEARING 7/30/98

ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION

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

DOCKET NO. RE-00000C-94-0165

**APPLICATION FOR REHEARING/RECONSIDERATION  
BY  
ARIZONA PUBLIC SERVICE COMPANY**

Arizona Public Service Company ("APS" or the "Company") hereby submits its Application for Rehearing and/or Reconsideration ("Application") of Decision No. 60977 (June 22, 1998). In Decision No. 60977, the Arizona Corporation Commission ("Commission") addressed various critical issues regarding stranded costs and the transition to retail electric competition. Rather than resolve these issues, however, Decision No. 60977 has introduced uncertainty into issues which were previously clear.

The provisions of Decision No. 60977 are unreasonable and unlawful for each of the reasons set forth below. APS therefore respectfully requests that the Commission reconsider and/or rehear this Decision, and that the Commission: (1) vacate Decision No. 60977, (2) issue an order adopting the Hearing Officer's recommended decision as amended by the Company's previously submitted Exceptions thereto, and (3) comply with the Arizona Administrative Procedure Act prior to issuing any new or amended regulations affecting retail electric competition.

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## I. INTRODUCTION

APS continues to support the transition to competition in retail electric power generation. As the Company has repeatedly stated, however, the Commission (together with the legislature) must nurture this transition in a cautious and well-reasoned manner to ensure that all interests are treated fairly. Equally important, the Commission must comply with both the state and federal Constitutions, as well as state law. An ill-thought out or haphazard transition could wreak havoc on an industry that is central to the economy of Arizona and on essential services upon which consumers depend daily.

As APS will discuss in this Application, Decision No. 60977 is not a well-reasoned attempt at resolving critical issues relating to stranded costs, nor does it treat stakeholders fairly or lawfully. Rather, Decision No. 60977 has undermined perhaps the only heretofore clearly established principle of electric restructuring in Arizona: that the Commission would “guarantee” all Affected Utilities an opportunity for full stranded cost recovery. (*See* Decision No. 59943 (Dec. 26, 1996), at 47.) Accordingly, the Company urges the Commission to reconsider and/or rehear Decision No. 60977 to correct the shortcomings identified below.

Many of the issues raised in the Company’s Application have been discussed in great detail in the previous comments and pleadings filed in this Docket. The Company incorporates that discussion by reference herein. Specifically, APS incorporates its:

- 1) March 16, 1998 Initial Brief;
- 2) March 23, 1998 Reply Brief;
- 3) May 29, 1998 Exceptions.

## II. DECISION NO. 60977 DOES NOT PROVIDE A REASONABLE OPPORTUNITY FOR FULL RECOVERY OF STRANDED COSTS.

Although Decision No. 60977 pays lip service to the proposition that an Affected

1 Utility should be afforded the opportunity to recover 100 percent of its stranded costs, the  
2 substance of the Decision is notably different. Significantly, the Decision recognizes that first  
3 among the “primary objectives” of the Commission is full stranded cost recovery. (Order at  
4 8.) The Decision states that full stranded cost recovery is “consistent with the results in the  
5 majority of other states”.<sup>1</sup> (*Id.*) The Decision recognizes that it is inappropriate “to reconsider  
6 previous management decisions which the Commission determined prudent at the time they  
7 were made.” (*Id.*) As the Company has argued repeatedly, full stranded cost recovery is the  
8 legally, and indeed constitutionally, required outcome of the restructuring process.

9 Yet despite the unequivocal recognition that an Affected Utility should have the  
10 opportunity to recover 100 percent of its stranded costs, Decision No. 60977 proceeds to  
11 remove the foundation for such recovery. It concludes that “there should be some type of  
12 sharing of stranded costs between ratepayers and shareholders.” (Decision at 9.) Decision No.  
13 60977 imposes a further “risk” on utilities that do not accept compelled divestiture that less  
14 than 100 percent of stranded costs will be recovered. (*Id.*) To ensure that the significance of  
15 this statement is not missed, the Commission states: “the opportunity for full stranded cost  
16 recovery should be available only to those Affected Utilities that choose to divest.” (Decision  
17 at 10, emphasis added.) Further, the process for determining this “sharing” is left  
18 impermissibly vague by a nebulous “second option” that could be read as merely allowing  
19 enough stranded cost recovery to prevent insolvency. Also, although Decision No. 60977  
20 recognizes that Affected Utilities may incur legitimate stranded costs after December 1996,  
21 it states: “those costs, if reasonable, can be factored into the market price.” (Order at 13.) As  
22 “stranded costs” are by definition costs that cannot be recovered in competitive market rates,  
23 factoring such costs into the market price is both an oxymoron and equivalent to a *per se* 100%

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26 <sup>1</sup> See, e.g., *Indianapolis Power & Light Co. v. Pennsylvania Pub. Util. Comm’n*,  
1998 WL 223225 (Pa. Cmwlth. May 7, 1998); *Stow Mun. Elec. Dept. v. Department of  
Pub. Utils.*, 688 N.E.2d 1337 (Mass. 1997).

1 disallowance of such costs.

2 No matter how many times Decision No. 60977 claims that it is giving Affected  
3 Utilities the “opportunity” for full stranded cost recovery, imposing unreasonable restrictions  
4 and setting impossibly high standards for mitigation does not, will not, and cannot equate to  
5 the 100 percent stranded cost recovery that the Decision (and applicable law) recognizes is  
6 both prudent and required.

7  
8 **III. DECISION NO. 60977 SHOULD ASSURE THE RECOVERY**  
9 **OF THE COMPANY’S REGULATORY ASSETS**

10 In Decision No. 59601 (April 24, 1996), the Commission expressly authorized full  
11 recovery of the Company’s regulatory assets through July 1, 2004. Any change to Decision  
12 No. 59601 may only be made by providing specific notice to the Company and an opportunity  
13 for a hearing “as upon a complaint.” *See* Ariz. Rev. Stat. Ann. § 40-252. No such notice or  
14 hearing has been afforded the Company. Thus, Decision No. 60977 should not be construed  
15 to alter or diminish the Company’s rights to fully recover its regulatory assets pursuant to  
16 Decision No. 59601. Such an alteration would be invalid and unlawful.

17  
18 **IV. THE MORE FAVORABLE TREATMENT OF STRANDED**  
19 **COSTS UNDER DIVESTITURE IS AN UNLAWFUL ATTEMPT**  
20 **TO COERCE THAT WHICH THE COMMISSION CANNOT**  
21 **COMPEL AND EFFECTS AN UNCONSTITUTIONAL**  
22 **“TAKING” OF PROPERTY**

23 Decision No. 60977 ties stranded cost recovery for Affected Utilities to the  
24 divestiture of generation assets. The Decision does so unambiguously: “[W]e do believe that  
25 the opportunity for full stranded cost recovery should be available only to those Affected  
26 Utilities that choose to divest.” If an Affected Utility chooses not to divest, the Commission  
will impose an unspecified “different approach,” such as allowing the Affected Utility only  
enough stranded cost recovery to avoid insolvency, or, presumably, writing off a portion of

1 stranded costs through a “sharing” with ratepayers.<sup>2</sup> Such coercion is as unlawful as simply  
2 directing all Affected Utilities to divest their generation assets.

3  
4 **A. The Commission Lacks the Authority to Compel Divestiture.**

5 The Commission lacks the authority to compel divestiture of a public service  
6 corporation’s assets. *Carmel Mtn. Ranch v. San Diego Gas & Elec. Co.*, 1988 Cal. P.U.C.  
7 LEXIS 67 at \*14-15 (Mar. 9, 1988) (holding that public utility commissions lack the power  
8 to compel a public utility to sell and convey an interest in real property or to determine the  
9 price or terms of the sale); *Public Utils. Comm’n v. Home Light & Power Co.*, 428 P.2d 928,  
10 935 (Colo. 1967) (rejecting argument that public utilities commission could order the sale of  
11 public utility’s assets).

12 Moreover, the Commission lacks the power of eminent domain to force the sale  
13 of (*i.e.*, condemn) an Affected Utility’s assets. *See Hawaiian Housing Auth. v. Midkiff*, 467  
14 U.S. 229, 241-42 (1984) (noting that acquiring property and reselling to private citizens  
15 involves the power of eminent domain); *City of Phoenix v. Donofrio*, 99 Ariz. 130, 133-35,  
16 407 P.2d 91, 92-94 (1965) (holding that political subdivisions of the state could exercise  
17 eminent domain only for specific, legislatively-delegated purposes); *GTE Northwest v. Public*  
18 *Utils. Comm’n*, 900 P.2d 495, 498-501 (Ore. 1995) (holding that public utility commission  
19 lacked the power of eminent domain). Indeed, divestiture is an equitable remedy that is  
20 entrusted to the judicial branch to remedy “violations” of law. *See United States v. E. I. Du*  
21 *Pont de Nemours & Co.*, 366 U.S. 316, 349 (1961). Its adoption by the Commission in the  
22 absence of any evidence of antitrust violations or other unlawful behavior is totally  
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25 <sup>2</sup> Although the unspecified “different approach” set forth in the Decision is so  
26 vague as to be nearly meaningless, the prior statement that the Commission will allow  
full stranded cost recovery *only* to Affected Utilities that choose to divest is clear. The  
Commission intends to confiscate at least part of the stranded costs to which a  
nondivesting Affected Utility is lawfully entitled.

1 inappropriate.

2  
3 **B. Because the Commission Cannot Compel Divestiture, Coerced**  
4 **Divestiture is Equally Unlawful.**

5 Decision No. 60977 conditions full recovery of stranded costs on the divestiture  
6 of an Affected Utility’s generation assets. (Order at 10.) The Commission, however, cannot  
7 condition the right to recover stranded costs on the divestiture of an Affected Utility’s assets,  
8 because the Commission cannot lawfully order an Affected Utility to divest its assets. *Dolan*  
9 *v. City of Tigard*, 512 U.S. 374, 385 (1994) (holding that the doctrine of unconstitutional  
10 conditions precludes government from requiring person to surrender right to receive  
11 compensation for state taking to obtain a discretionary benefit from the state); *Davis v. Hale*,  
12 96 Ariz. 219, 225, 393 P.2d 912, 916 (1964) (holding that city cannot “do indirectly what it  
13 could not do directly”).

14  
15 **C. The Denial of Full Stranded Cost Recovery for All Affected Utilities**  
16 **Results in an Unconstitutional Taking of Private Property.**

17 Even if the Commission had the power to order or coerce divestiture (which it  
18 does not), a state-compelled sale of private assets to other private parties is unequivocally a  
19 “taking” of property. *Midkiff*, 467 U.S. at 241-42. Denying full stranded costs  
20 recovery—costs to which an Affected Utility is entitled under the regulatory compact—is  
21 likewise an unconstitutional taking of property. *See generally* J. Gregory Sidak & Daniel F.  
22 Spulber, DEREGULATORY TAKINGS AND THE REGULATORY COMPACT(1997). Moreover, the  
23 Commission cannot argue that, because a divesting Affected Utility is paid “market value” for  
24 its assets, no uncompensated “taking” has resulted. *See City of Phoenix v. Mangum*, 185 Ariz.  
25 31, 33-34, 912 P.2d 35, 37-38 (Ct. App. 1996) (“just compensation” requirement is not  
26 necessarily satisfied by paying fair market value).

1                   **V. THE AUTOMATIC RATE DECREASES CALLED FOR UNDER THE**  
2                   **DECISION ARE UNCONSTITUTIONAL**

3                   Decision 60977 states that after expenses for regulatory assets are recovered, “all  
4 customers remaining on the standard offer should receive a reduction in rates.” (Order at 20.)  
5 Single issue ratemaking such as this has long been decried by the Commission, and Arizona  
6 courts have concluded it is unconstitutional. In *Scates v. Arizona Corporation Commission*,  
7 118 Ariz. 531, 534, 578 P.2d 612, 615 (Ct. App. 1978), the court recognized that such a  
8 piecemeal approach was “fraught with potential abuse”:

9                   Such a practice must invariably serve both as an incentive for utilities to seek  
10 rate increases each time costs in a particular area rise, and as a disincentive for  
11 achieving countervailing economies in the same or other areas of their  
12 operations.

13 *Id.* Moreover, the court in *Scates* relied heavily on *Simms v. Round Valley Light & Power Co.*,  
14 80 Ariz. 145, 294 P.2d 378 (1956). In *Simms*, the Arizona Supreme Court determined that a  
15 Commission-ordered involuntary rate reduction that was imposed without a full rate  
16 proceeding violated a utility’s constitutional rights. The Commission has failed to offer any  
17 legal analysis for why *Scates* would not apply in this case.

18                   **VI. DECISION NO. 60977 RESULTS IN AN UNCONSTITUTIONAL**  
19                   **BILL OF ATTAINDER**

20                   Decision No. 60977’s divestiture requirement results in an unconstitutional bill  
21 of attainder. *See, e.g., SBC Comm. v. FCC*, 981 F. Supp. 996 (N.D. Tex. 1997) (invalidating  
22 competitive limitations of Telecommunication Act placed on named telephone companies due  
23 to unproven antitrust concerns). The Decision burdens Affected Utilities—which are  
24 identified by name in the Competition Rules—with punitive restrictions, such as compelling  
25 an Affected Utility to divest its generation assets to fully recover its stranded costs. This  
26 appears to be done over vague concerns of potential market power, and yet there was no  
specific finding that any Affected Utility had or would have, let alone had abused, any market

1 power. Nor has any Affected Utility had the benefit of a judicial trial over these perceived  
2 antitrust issues. Accordingly, the divestiture provisions of the Decision (and the “punishment”  
3 for failing to divest) constitute legislative punishment without a judicial trial and result in an  
4 unconstitutional bill of attainder.

5  
6 **VII. DECISION NO. 60977 DENIES AFFECTED UTILITIES**  
7 **EQUAL PROTECTION OF THE LAW**

8 Decision No. 60977 unlawfully discriminates against Affected Utilities, and  
9 especially investor-owned utilities such as the Company. Under the divestiture provisions of  
10 the Decision, utilities that do not select, or cannot select, the Commission’s divestiture  
11 “option” are treated differently from utilities that elect to divest generation.<sup>3</sup> Courts uphold  
12 provisions relating to economic regulation only so long as (1) a legitimate state interest is  
13 served, and (2) the classification rationally furthers the state’s legitimate interest. *See Kenyon*  
14 *v. Hammer*, 142 Ariz. 69, 688 P.2d 961 (1984). A law or requirement that does not rationally  
15 further a legitimate state interest, and instead produces whimsical, arbitrary or capricious  
16 results, does not satisfy the rational basis test of the Equal Protection Clause. *Big D Constr.*  
17 *Corp. v. Court of Appeals*, 163 Ariz. 560, 568, 789 P.2d 1061, 1069 (1990) (invalidating bid  
18 preference statute that had no rational connection to legitimate state interest). The differing  
19 treatment dictated by the Decision between divesting utilities and those that do not (or cannot)  
20 divest, is irrational and arbitrary, and does not further a legitimate state purpose.

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24 <sup>3</sup> Indeed, Affected Utilities that own nuclear generation, such as the Company, are  
25 also treated differently. The Decision allows only utilities that divest *all* generation  
26 assets to retain 50 percent of any net benefit. (Order at 12.) The overwhelming evidence  
at the hearing, however, established that nuclear assets could not realistically be subject  
to divestiture. Thus, nuclear utilities are unfairly disadvantaged by the terms of the  
Decision.

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1 **VIII. DECISION NO. 60977 DENIES AFFECTED UTILITIES**  
2 **DUE PROCESS OF THE LAW**

3 Under Article II, § 4 of the Arizona constitution, a law that is irrational and  
4 unreasonable violates due process. *See Bryant v. Continental Conveyor & Equip. Co.* 156 Ariz.  
5 193, 751 P.2d 509 (1988), *overruled on other grounds by Hazine v. Montgomery Elev. Co.*,  
6 176 Ariz. 340, 861 P.2d 625 (1993). For reasons similar to those set forth in Part VII above,  
7 the divestiture provisions of the Decision attempt to force Affected Utilities from a permissible  
8 line of business, are unreasonable, and are not rationally related to a legitimate state interest.

9 Moreover, the vagueness of "Option No. 2" in the Decision violates the  
10 procedural due process rights of the Company to the extent that the Commission imposes  
11 a specific "Option No. 2" stranded cost recovery methodology without providing the  
12 Company with sufficient due process protections (such as participation at a hearing, etc.).  
13 Also, depending on what substantive proceeding follows for adjudicating "Option No. 2"  
14 filings, the vagueness of the Decision may violate due process if it fails to give fair warning  
15 as to how the provision will be interpreted and applied, or if the provision grants  
16 discretionary powers to the agency without standards to guide or limit that discretion.  
17 Indeed, the option provisions of Decision No. 60977 violate the Company's procedural due  
18 process rights by requiring the Company to make an election of which option to pursue  
19 without any idea of what one of the two options entails.

20 **IX. DECISION NO. 60977 VIOLATES THE ARIZONA**  
21 **ADMINISTRATIVE PROCEDURE ACT**

22 Decision No. 60977 undoubtedly constitutes a "rulemaking" effort by the  
23 Commission. (*See Ariz. Rev. Stat. Ann. § 41-1001(18)* (defining "rule" as "an agency  
24 statement of general application that implements, interprets or prescribes law or policy....").  
25 The Decision, however, does not include a Concise Explanatory Statement, nor an Economic  
26 Impact Statement, nor an analysis of the Decision's impact on small businesses, all of which

1 are required by law. *See* Ariz. Rev. Stat. Ann. § 41-1055 and § 41-1057. The Economic  
2 Impact Statement prepared for Decision No. 59943 does not evaluate the impact of issues  
3 addressed in Decision No. 60977, and the Commission cannot cite that Statement in support  
4 of the Decision. Additionally, the Decision amends or repeals existing rules without  
5 complying with the notice requirements of A.R.S. § 41-1022.

6 Further, on the basis of this rulemaking proceeding alone, Affected Utilities are  
7 directed to file their “choice of options for stranded cost recovery” within 60 days of the date  
8 of the decision. (Order at 23.) Any subsequent “rulemaking” proceeding does not alter the  
9 nature of the “rules” adopted by this Order—rules adopted without complying with the  
10 requirements of the Arizona Administrative Procedure Act. Thus, the “rules” set forth in the  
11 Decision are unlawful.

12  
13 **X. THE DIVESTITURE “REQUIREMENTS” OF DECISION NO. 60977**  
14 **UNLAWFULLY INTERFERE WITH THE MANAGEMENT**  
15 **OF AFFECTED UTILITIES**

16 Although the Commission may have broad authority to regulate rates, the  
17 Commission lacks the power to direct the internal affairs of a public service corporation.  
18 *Arizona Corp. Comm’n v. Consolidated Stage Co.*, 63 Ariz. 257, 261, 161 P.2d 110, 112  
19 (1945). Decision No. 60977 goes well beyond ratemaking in compelling (or coercing)  
20 Affected Utilities to divest assets, and, indeed, to risk the termination by regulatory fiat of an  
21 entire line of business in which APS and its predecessors have lawfully engaged for more than  
22 three-quarters of a century.

23 **XI. DECISION NO. 60977 IS NOT SUPPORTED BY SUBSTANTIAL**  
24 **EVIDENCE AND IS ARBITRARY, CAPRICIOUS, AND AN**  
25 **ABUSE OF DISCRETION**

26 Apart from the legal prohibition on the Commission ordering (or coercing)  
divestiture, the Commission’s decision to reverse course in midstream and adopt a divestiture

1 policy is unsupported on the record. No party to the Stranded Costs proceeding offered a  
2 persuasive practical or economic reason to reject the Commission's earlier conclusion that  
3 divestiture was an inappropriate alternative, or to repudiate the extensive findings opposing  
4 divestiture in the Stranded Costs Working Group report. *See* Decision 59943 at 63; Stranded  
5 Costs Working Group Report at 24-25, 27-28 (Sep. 30, 1997). Among other failings, the  
6 Decision ignores the impracticability of the divestiture of nuclear facilities; it ignores the  
7 possibility that below-book prices may result, and provides no analysis of issues that witnesses  
8 identified as central to determining the likely prices that generation assets would command  
9 (such as specific fuel contract prices); and the Decision ignores any analysis of the impact of  
10 transaction costs and divestiture expenses on the stranded cost problem in Arizona. The  
11 Decision does not contain findings of fact based on substantial evidence or conclusions of law  
12 that satisfy the "reasoned decisionmaking" requirements of state law. Finally, the Commission  
13 made no finding that any market power issues applied to the generation marketplace in  
14 Arizona, yet tied divestiture to full stranded cost recovery and imposed arbitrary restrictions  
15 on utilities bidding at divestiture auctions. Indeed, the record does not support or even  
16 mention the Commission's selection of the "40 percent" market share limitation on bids for  
17 generation assets in the state.

## 18 19 XII. CONCLUSION

20 Decision No. 60977 does not result in a fair or lawful resolution of stranded costs  
21 issues in Arizona. Although the Commission repeats on several occasions the merit in  
22 allowing the opportunity for 100 percent stranded cost recovery, the substance of the Decision  
23 belies any intent to actually allow such recovery. Further, by tying full stranded cost recovery  
24 to the divestiture of an Affected Utility's generation assets, the Decision rises to an  
25 unconstitutional taking, and violates the doctrine of unconstitutional conditions. The  
26 Commission should, accordingly, rehear and/or reconsider Decision No. 60977 to remedy

1 these and the other failings identified in this Application.

2 RESPECTFULLY SUBMITTED this 10th day of July, 1998.

3 SNELL & WILMER L.L.P.

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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 10th day of July, 1998, and service was completed by mailing or hand-delivering a copy of the foregoing document this 10th day of July, 1998 to all parties of record herein.

  
James K. Dinger

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