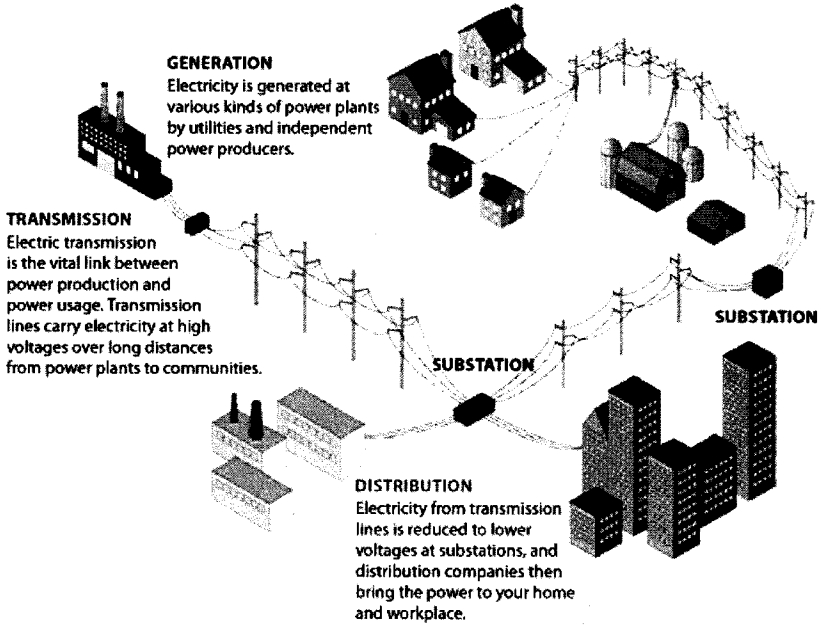
The Road Map



- Phase I
  - Free the grid
- Phase II
  - Ensure robust wholesale competition
- Phase III
  - Liberate retail choice and competition

ORIGINAL

Arizona Corporation Commission
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A TIME FOR CHOOSING

Choice in Electricity Requires a Solid Record

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All Phases: Equal Protection

- Distinctions should be rational.
  - Arizona has a rational basis test with "bite"
    - The distinction must be drawn to substantially advance a legitimate public purpose.
    - That means you need evidence in the record to justify the connection between the distinction drawn and a legitimate public purpose.
    - FIX: MAKE A RECORD
      - Why are Coops/NGS/Four Corners different? Are they really?

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Phase 1: RTO/ISO vs. AzISA

- The real issue is how best to make the grid "open"
  - With few exceptions, § 30-803 compels all utilities (including SRP) to cease anti-competitive policies and to promulgate rules and policies to open territories to competition.
  - In view of §§ 30-801, et seq., and 40-201, et seq., the "public interest" component of CCN/PCN tests (e.g. § 40-282) are now pro-competitive rather than anti-competitive.
- AzISA has the ability to enforce nondiscriminatory access to grid
  - APS and TEP have agreed to AzISA protocols
  - SRP can be compelled to furnish access through FERC tariffs/orders.
  - ACC can promulgate rules to punish non-compliance with AzISA protocols.
- ACC has legal authority to mandate an open PSC grid for PSCs
  - *Phelps Dodge* Page 112: "§ 40–202(A) did not, *standing alone*, authorize the Commission to promulgate R14–2–1609(C)–(J)."
  - Art. 15, sec. 7: "every such [public service] corporation shall have the right with any of its lines to cross, intersect, *or connect with*, any lines of any other public service corporation"
  - § 40-332 provides express authority for rules mandating "use" of and "access" to grid.
    - § 40-202(M) provides express authority to issue rules modifying requirements of 40-332 as needed to ensure competition.
    - Provides authority for rules mandating participation by PSCs in RTO/ISO.

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Phase 1 & 2: Divestiture

- *Miller v. ACC* establishes an incredibly broad understanding of ratemaking policy.
  - REST is **far** more tenuous in its connection to ratemaking than divestiture.
    - *Miller*'s "House that Jack Built" reasoning justifies almost any policy making proposal by the ACC as connected to ratemaking.
- *Phelps Dodge* does not prohibit Divestiture IF A RECORD IS MADE
  - From Page 114
  - "However, we fail to understand, *and neither the Commission nor AECC attempts to explain*, how requiring divestiture of competitive generation assets affects rates."
  - "If the Affected Utilities *choose to retain competitive assets for a period beyond the prescribed date, or indefinitely, the competitive market is seemingly unaffected*, as long as the Affected Utilities abide by R14–2–1615(B), which prohibits them from competing. *Consequently*, R14–2–1615(A) and (C) are aimed at controlling the Affected Utilities rather than rates and are therefore outside the Commission's plenary ratemaking authority."
  - "But as previously stated, while prohibiting Affected Utilities from either competing or subsidizing their affiliates in competition may protect the public from these consequences, requiring divestiture of competitive generation assets does not *seemingly* accomplish this goal. *For this reason*, we conclude that § 40–202(C)(1) did not authorize the Commission to promulgate R14–2–1615(A) and (C)."
    - FIX: MAKE A RECORD
      - Academic consensus recommends divestiture per Drs. Stanley Reynolds (U of A) and Andrew Kleit (Penn State).
      - Firewalling is preferred but difficult to enforce.
      - The interconnection of interstate/intrastate electricity markets ensures in-state pricing will be affected by out-state sales.
      - Would-be competitors tend to avoid entering markets in which past incumbents retain their vertical integration for fear that markets will be manipulated indirectly through interstate markets.
      - Would-be competitors tend to avoid entering markets in which past incumbents retain their vertical integration for fear that the rules will change—without divestiture, there is no "toothpaste out of the tube."

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Phase 1 & 2: Stranded Costs

- The utilities may not be entitled to recover for stranded costs under Arizona and United States Constitutions.
  - Gift Clause may prohibit (Art. 9, sec. 7) recovery of stranded costs that are not actually necessary to make utilities whole.
    - Current ACC rules provide for recovery of stranded costs but previous APS and TEP cases provided a comprehensive resolution of the utilities' stranded cost claims. If utilities argue now that reinstating direct access causes "new" stranded costs, then they bear the burden of proof–and the prior resolution of stranded cost claims (as well as express waivers of stranded cost claims that APS made regarding certain assets) must be fully taken into account.
  - Is a utility service mandate more like an ADA service mandate than a regulatory taking?
    - Pre-New Deal case law indicates that it is a violation of takings clause and substantive due process for confiscatory mandates to be imposed on utilities—that is the foundation of the requirement of rates being based on cost recovery plus a reasonable rate of return.
    - Post-New Deal case law in other contexts has shunted the substantive due process analysis into a plain vanilla regulatory taking analysis and indicates that mandates must be so confiscatory that they deprive the utility of all or nearly all economic value of the property in question before implicating the Fifth Amendment.
  - In any event, the past recovery of costs associated with a mandate should reduce the stranded cost recovery.
    - To the extent that a substantial portion of the costs associated with a given service mandate have already been recovered, it would appear that the service mandate did not deprive the utility of all or nearly all economic value of the property in question, and there would not be a taking requiring just compensation.
- Coal plants impacted by irrational federal regulation should be accommodated.
  - Where unexpected federal regulation has caused the operation of existing coal plants to become economically infeasible, the orderly transition to choice and competition is threatened. Some measure of regulatory cost defrayment is reasonably connected to the goal of establishing robust competitive retail markets.
- If the ACC rules against your side on Stranded Costs, will your clients sue the ACC?
  - Only if the ACC is wrong and the issue is important enough to pursue taking into consideration our resources and other engagements.

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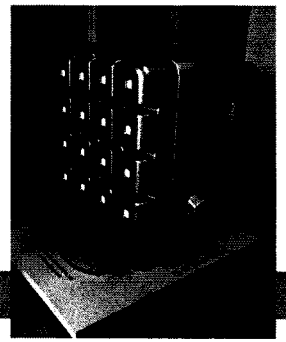
Phase 1 & 2: Off-Grid Issues



- Getting completely off-grid is possible for individuals and singular entities (could change if rate base threatened—see net metering).
- BUT when going off-grid means creating a mini-grid+generation owned <u>or controlled</u> by an entity that serves more than one individual or entity the trouble begins.
  - Classification of organization as a PSC is unavoidably debatable because of vague constitutional definition.
  - Fix 1: Clarify that Arizona's existing pro-competition public policy supersedes previous anti-competitive interpretation of CCN/PCN requirements that stand in way of the creation of mini-grids.
  - Fix 2: Mandate transparent, objective interconnection standards and <u>deadline</u> for granting interconnection to main grid for backup purposes.

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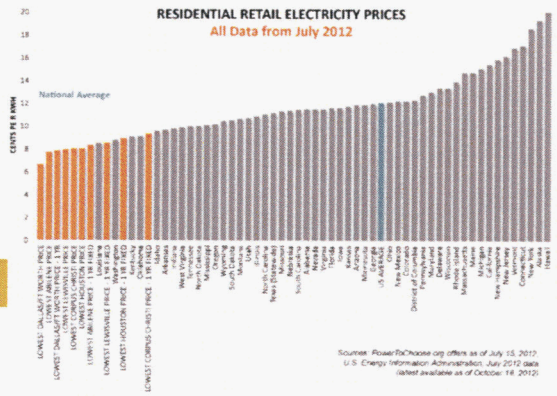
Phase 3: Rates



- *U.S. West* blesses "banded" market pricing
  - No material difference between telecom and electricity ratemaking principles.
- *Phelps Dodge* embraces *U.S. West*
  - Page 109: "Nothing in the plain language of Article 15, Section 3 requires the Commission to prescribe a single rate rather than a range of rates. Moreover, our supreme court has held that the Commission has discretion to adopt various approaches to fulfill its functions, "as long as the method complies with the constitutional mandate and is not arbitrary and unreasonable.' Consequently, assuming the Commission establishes a range of rates that is 'just and reasonable,' the Commission does not violate Article 15, Section 3 by permitting competitive market forces to set specific rates within that approved range."
  - Page 108: Ends of band must be determined applying traditional ratemaking factors.
- *U.S. West* and *Phelps Dodge* give ACC broad discretion over "fair value" weight
  - *U.S. West* Page 355: "The fair value of a public service corporation's Arizona property may be important in determining and avoiding the harsh extremes of the rate spectrum. Set too low, rates can result in a confiscatory taking of a company's property. Set too high, they can lead to state-sanctioned price gouging. Thus, fair value, in conjunction with other information, may be used to insure that both the corporation and the consumer are treated fairly. In this and any other fashion that the corporation commission deems appropriate, the fair value determination should be considered. The commission has broad discretion, however, to determine the weight to be given this factor in any particular case."
  - *Phelps Dodge* Page 106: "Commission has broad discretion in determining the weight to be given that factor in any particular case."
- DON'T FORGET TO VISIT POWERTOCHOOSE.ORG

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