

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
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AZ CORP COMMISSION
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IN THE MATTER OF THE REORGANIZATION) DOCKET NO. E-04230A-03-0933
OF UNISOURCE ENERGY CORPORATION.)
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STAFF'S REPLY BRIEF

The Utilities Division Staff ("Staff") of the Arizona Corporation Commission ("Commission") provides its reply to the initial closing briefs submitted by the other parties. This reply is intended to only clarify the appropriate legal view of Arizona Administrative Code ("AAC") R14-2-803 (C) (referred herein "the Rule"). Staff reaffirms its position previously stated through testimony and its initial closing brief.

I. INTRODUCTION.

To properly assess AAC R14-2-803 (C)¹ and accord it the appropriate weight within the context of the UniSource Reorganization ("Merger") Application analysis, the following factors should be considered: 1) the Commission's constitutional authority with regard to the subject matter; 2) the Commission's purpose in enacting the Affiliated Interest Rules; and 3) the plain meaning of the Rule.

II. APPROPRIATELY FACTORING AAC R14-2-803(C) INTO THE COMMISSION'S REVIEW OF THE MERGER.

1) The Commission's Constitutional Authority.

With regard to the subject of "Affiliated Interests", the Commission has two significant constitutional duties arising out of Article XV, section 3 of the Arizona Constitution. Arizona Corp. Comm'n v. Woods, 171 Ariz. 286, 830 P. 2d 807 (1992). These duties are: 1) the setting of just and

¹ In the Matter of the Notice of Proposed Adoption of Rules to Provide for Regulation of Public Utility Companies with Unregulated Affiliates, Docket No. R-00000-89-0194, Decision No. 56844 (Ariz. Corp. Comm'n March 14, 1990) (referred herein "Decision No. 56844"), adopting the Affiliated Interest Rules, AAC R14-2-801, et. seq., including AAC R14-2-803)

1 reasonable rates and charges to be made and collected by regulated utilities, and 2) to make and
2 enforce rules, regulations and orders in accord with the public interest.

3 **A. The Commission's Ratemaking Authority.**

4 The Commission's duty to set reasonable rates, otherwise referred to as its ratemaking
5 authority, provides the Commission exclusive authority over rate related matters. State v. Tucson
6 Gas, Elec. Light & Power Co., 15 Ariz. 294, 301-8, 138 P.781, 783-86 (1914). To that end, the
7 Arizona Supreme Court has ruled that the promulgation of the Affiliated Interest Rules is squarely
8 under the Commission's constitutional ratemaking authority. Woods, 171 Ariz. at 299, 830 P.2d at
9 820.

10 Because the Commission was delegated exclusive jurisdiction in the area of ratemaking,
11 courts have recognized that the Commission's power goes beyond strictly setting rates. Ethington v.
12 Wright, 66 Ariz. 382, 189 P.2d 209 (1948). In Garvey v. Trew, the court clarified, the Commission
13 constitutionally "may exercise all powers which may be necessary or essential in connection with
14 the performance of its duties." 64 Ariz. 342, 346-47, 170 P.2d 845, 848 (1946), cited in Woods, 171
15 Ariz. at 294, 830 P.2d at 815. With regard to the standard of review, the court in Simms v. Round
16 Valley Light & Power Co. stated,

17 The legislative duty and power to fix just and reasonable rates having
18 been by the constitution delegated exclusively to the corporation
19 commission, the courts cannot disturb the commission's ultimate
20 conclusion or findings of facts in arriving at such conclusion when
21 the same is supported by substantial evidence, is not arbitrary or is
22 not otherwise unlawful. 80 Ariz. 145, 154, 294 P.2d 378, 384 (1956),
23 citing Illinois Central Railroad Co. v. Illinois Commerce
24 Commission, 387 Ill. 256, 56 N.E.2d 432 (1944); Central Maine
25 Power Co. v. Public Utilities Commission, 150 Me. 257, 109 A.2d
26 512 (1954).

27 Considering the great deference courts have granted the Commission pursuant to its
28 ratemaking actions coupled with the clear authority over "Affiliated Interest" matters, it is important
for the Commission to be free to act in the furtherance of its constitutional duty. Clearly, it would be
counter to that duty for the Commission to construct a rule that would act to obstruct the broad
constitutional duty to take any action necessary in the furtherance of proper ratemaking.

AACR14-2-803(C) should be interpreted to be consistent with the Constitution. The Rule is
designed to be a regulatory complement to the Commission's ratemaking and other constitutional

1 review of any merger proposal. The Rule provides three areas which, given recent history, requires
2 close inspection by the Commission.

3 **B. The Commission's duty to act in the Public Interest.**

4 Article XV, section 3 of the Arizona Constitution also bestows the Commission with the duty
5 to make and enforce rules, regulations, and orders "for the convenience, comfort and safety, and
6 preservation of the health, of employees and patrons" of regulated utilities. The Arizona Supreme
7 Court has described this duty as the regulatory body's charge to require "that public utilities be
8 operated in the public interest." Southern Pac. Co. v. Arizona Corp. Commission, 98 Ariz. 339, 342,
9 404 P.2d 692, 694 (1965), cited in Woods, 171 Ariz. at 292, 830 P.2d at 813.

10 Through Article XV's text and a review of the Constitutional Convention record, it is clear
11 that its framers intended the Commission to provide consumer protection through its regulation.
12 Records of the Arizona Constitutional Convention of 1910, at 612-15, 967-81 (John S. Goff ed.,
13 1991), cited in Woods, 171 Ariz. at 290-1, 830 P.2d at 811-812. In turn, the courts have held that the
14 Commission is required to use its powers to act in accord with the public interest and good public
15 policy. Southern Pac. Co. v. Arizona Corp. Comm'n, 98 Ariz. 339, 342, 404 P.2d 692, 694 (1965);
16 Woods, at 291-92, 812-13; Arizona Community Action v. Arizona Corp. Comm'n v. Arizona Public
17 Service, 123 Ariz. 228, 230-31, 599 P.2d 184, 186-87,(1979); James P. Paul Water Co. v. Arizona
18 Corp. Comm'n, 137 Ariz. 46, 671 P.2d 404 (1983).

19 The Commission's charge to act in the public interest is a broad duty on which the
20 constitutional framers placed a great deal of emphasis.² The public interest analysis is best viewed
21 as a balancing test. The Commission should weigh all the potential harms to the public from a
22 merger against the mitigations and any identified public benefits. If the benefits are deemed to
23 outweigh the harms, the Commission may consider approval of the merger to be in the public
24 interest. As discussed with regard to the ratemaking duty, it would clearly be counter to the
25 Commission's constitutional charge to construct a rule that would act to obstruct its ability to fulfill

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27 ² (For additional information on the framers intent and the Convention, *see generally* Deborah Scott Engelby,
28 Comment, The Corporation Commission: Preserving its Independence, 20 Ariz.St.L.J. 241 (1998); John D. Leshy,
The Arizona State Constitution: A Reference Guide (prepublication manuscript 1991); and John D. Leshy, The
Making of the Arizona Constitution, 20 Ariz.L.J. 1 (1988))

1 its duty to protect the public. To view AAC R14-2-803 (C) as precluding the Commission's review
2 of any consideration beyond that specifically listed with in the Rule would create such an
3 obstruction. Such a view would, for example, render the Commission powerless to protect against a
4 merger that could potentially harm the health or safety of Arizonans if the harm was not directly tied
5 to the regulated utilities' provision of service.

6 Rather, it is only logical that the Commission drafted the Rule to be consistent,
7 complementary, to the Commission's constitutional charge. Obviously, the Rule is designed to
8 highlight particularly problematic areas that the Commission should include in its consideration.
9 Returning to the balancing test, the Rule guides the Commission in its indication that heavy weight
10 should be placed specifically on the three listed factors.³ The Rule advises that impairment of
11 financial status, attraction of capital, or in the provision of adequate service, are all factors, each of
12 which can tip the scales for the merger to not be in the public interest.

13 **2) The Commission's Intent in Adopting the Affiliated Interest Rules.**

14 The Affiliated Interest Rules were adopted in Commission Decision No. 56844, on March 14,
15 1990. The intent of the Commission in adopting these rules, like its constitutional authority, is an
16 appropriate consideration in assessing all or part of these rules weight in this proceeding.

17 While some have suggested that the intent of these rules was to confine the Commission's
18 public interest analysis to the three rejection factors listed in subsection (C) of AAC R14-2-803, the
19 Commission's signed Opinion and Order does not support such a view. The Decision is devoid of
20 any language indicating that the Rules are intended to supercede or replace the Commission's
21 constitutional charge. Rather, the Opinion explains why the Commission has elected to highlight
22 three rejection factors.⁴ The Decision describes that events involving Pinnacle West and MeraBank
23 highlighted for the Commission the fact that, "no holding company is immune from similar dangers,
24 despite management's intentions or assurances to the contrary." Decision No. 56844, Attachment B,
25 at 2. The Decision follows by saying that the Affiliated Interest Rules are "designed to insure that
26 utility ratepayers are insulated from the dangers proven to be inherent in holding structure and

27 ³ AAC R14-2-803 (C) provides: the Commission may reject the proposal if it determines that it would 1) impair the
28 financial status of the public utility, 2) otherwise prevent it from attracting capital at fair and reasonable terms, or 3)
impair the ability of the public utility to provide safe, responsible and adequate service.

1 diversification.” *Id.* The Decision goes on to explain the Rules’ singular purpose is to provide
2 specific additional protections to ratepayers, demonstrating that the Commission’s intent was not to
3 replace or nullify, but to enhance the Commission’s analysis.

4 **3) The Plain Meaning of AAC R14-2-803(C).**

5 The plain meaning of the Rule simply provides the Commission the discretion to reject a
6 merger proposal for reasons such as: 1) the merger will impair the financial status of the regulated
7 utilities; 2) the merger will prevent the regulated utilities from attracting capital at fair and
8 reasonable terms; 3) the merger will impair the regulated utilities ability to each provide safe,
9 reasonable and adequate service.

10 It is important to note that the key active verb in subsection (C) is “may”, which is a
11 permissive, not a mandatory, term in rule construction.⁴ Given the discretionary language, the
12 Commission is not required to take any particular action under this subsection.

13 In addition, the Rule does not indicate that the three listed rejection factors are intended to be
14 an exhaustive list. Absent such indications, the three factors are merely three examples of factors
15 that may warrant rejection of a merger proposal.

16 **III. CONCLUSION.**

17 Any suggestion, that AAC R14-2-803 (C) replaces the Commission’s constitutional duties to
18 effectively regulate ratemaking and to protect the public interest, has no merit.

19 At the conclusion of this matter, the Commission may take any action necessary or essential
20 in connection with its ratemaking authority and the public interest, so long as it is supported by
21 substantial evidence, is not arbitrary or unlawful.

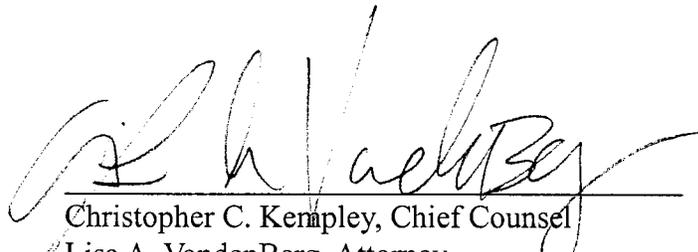
22 Staff’s recommendation remains unchanged: absent adoption of all of Staff’s proposed
23 conditions, the proposed restructuring should be denied. If Staff’s proposed conditions are adopted,
24 Staff is neutral with respect to the proposed reorganization.

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28 ⁴ see Robert J. Martineau, *Drafting Legislation and Rules in Plain English*, at 79-81 (West 1991).

1 RESPECTFULLY SUBMITTED this 16th day of August, 2004.

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