

## Management Brief on Rehearing

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### III. Rehearing Arguments by the Arizona Consumers Council

The Arizona Consumers Council applies for rehearing on the pricing resolution and the terms and conditions resolution, and makes the two rehearing requests in two separate documents. SRP management will respond to the points raised in each application for rehearing, first on the terms and conditions issues application and second on the pricing issues application.

#### Terms and Conditions Application for Rehearing by the Consumers Council

**Consumers Council Argument Number One: The Board of Directors for the Salt River Project Agricultural Improvement and Power District (“District”) has an irreconcilable conflict of interest in this proceeding because all but two of those Board members also serve as Board members on the Board of Directors of Salt River Valley Water Users Association (“Association”). In this proceeding, the District has an absolute duty to mitigate its stranded costs and one way to do that is by eliminating the water subsidy that the District pays to the Association. Because of their dual membership on both Boards, the District Board of Directors has conflicting loyalties which create an irreconcilable conflict of interest and disqualifies it from making any decision in this proceeding regarding stranded costs.**

#### SRP Management Response

A. There is no legal conflict of interest

It is important to understand the nature of the relationship between SRP and the Association. SRP’s own enabling legislation authorizes it to engage in certain water and power functions for the benefit of the owners and occupants of the lands within its boundaries. A.R.S. § 48-2302. It further expressly authorizes SRP to sell surplus water and power outside of its boundaries “[t]o reduce the cost of irrigation, drainage and power to the owners of the lands.” A.R.S. § 48-2302(A)(7). Thus, reducing the cost of water for landowners is one of SRP’s core purposes.

Currently, the Association’s exclusive function is to act as SRP’s agent in accomplishing the water functions which SRP itself is statutorily and contractually obligated to perform. Thus, SRP’s water support payments are transferred to its agent, which merely stands in SRP’s shoes, for purposes of accomplishing SRP’s purposes. SRP is the real party in interest and none of the economic substance of the transaction affects the Association. It cannot be a conflict of interest for SRP Board members to accomplish SRP’s purposes.

SRP is no different than any other governmental entity which provides multiple services to its constituents. The City of Mesa, for example, provides electric, water and a number of other municipal services. If the SRP Board has a conflict, then so does the Mesa council, or any other governing body of a political subdivision.

B. Elimination of Water Support is not an Element of Mitigation

The Electric Power Competition Act uses the term “mitigation”, and imposes a requirement of mitigation in this context:

3. Establish a temporary surcharge on electric distribution service prices to pay for all or a portion of the unmitigated stranded costs of electric generation service, if any, that were incurred as a direct result of competition among electricity suppliers, that were incurred by public power entities to serve their customers in this state before December 26, 1996 and that may not be recoverable in a competitive electric generation service market. Unmitigated stranded costs may include employee severance costs necessitated by electric competition including unemployment compensation, training and severance benefits.

Section 30-805(A)(3). Thus the concept of “mitigation” contemplates reduction of the cost of generation. Using SRP funds to support water delivery is not a cost of generation. These expenditures do not increase the cost to generate electricity. Their elimination would not decrease the costs to generate electricity.

Included in SRP’s statutory authority is the express authority to deliver water and provide power to the owners and occupants of SRP lands (A.R.S. § 48-2303). SRP may use funds properly generated from operations to support any of its authorized functions.

C. It is proper for SRP to earn a return on the equity devoted to providing electric service, and to use money so generated to support other authorized activities.

In supporting the cost of water delivery, SRP is simply using its funds to carry out an authorized function. The real question is whether SRP may earn a return on its assets devoted to providing electric service, and use the money so generated for other purposes.

Including the allocation of revenues to support water delivery, the overall budgeted revenues for 2000 are \$79 million. Considering that SRP has invested equity of approximately \$1.8 billion to produce electric service for its customers, the \$79 million net revenues represents an approximate 4.2 percent return on equity for the year 2000. (This is a return on overall capital of 2.0%.) This is a level well below the level generally charged by investor owned utilities in investing their equity to generate comparable service, which according to the study presented by SRP Management, is over 10 percent.

Also, only 2.5% of gross revenues represents money used to support SRP’s water delivery function. This return compares favorable to the “transfer payments” (percentage of gross revenues) of other public power entities, as stated in the SRP management comments on October 21:

Los Angeles Department of Water and Power	3.08%
City of Austin	15.93%
City of Jacksonville	8.90%
City of San Antonio	13.90%
City of Tacoma	6.00%

From a municipal law perspective, it is entirely proper and customary for a public entity to earn a return on its assets devoted to providing a service to its constituents. In fact, the return can be used to support the provision of other utility services. As stated in McQuillan, *The Law of Municipal Corporations*:

A city is entitled to earn a reasonable profit and it may even use the profit for other valid municipal purposes. . . . [A] municipality may generate a profit in supplying a particular utility service and use that profit to subsidize the operation of another utility service.

McQuillan, *supra*, Section 35.37.20. And, a public entity is entitled to charge prices as would a private utility:

When a municipality owns its own water, electric or other utility plant, it has the right to charge consumers who make use of its services, just as does a privately operated public utility.

McQuillan, *supra*, Section 35.37. (In fact, SRP's prices are considerably below the levels charged by comparable investor-owned utilities).

Support of water delivery is an authorized purpose of SRP (A.R.S. § 48-2303(A)(6)). There is no question that SRP has the authority to use funds lawfully derived from its owned equity, and put those funds to use for other authorized purposes. And, from a reclamation law perspective, state and federal law anticipates that returns on electric operations may be used to support water delivery. A.R.S. § 48-2303(A)(6), *Uhlman v. Wren*, 97 Ariz. 366, 401 P.2d 113 (1965).

Consumers Council has also argued that it is not fair to charge a customer for use of capital that "they have already provided to SRP". While it is true that the majority of SRP's equity has been built, generally, through its electric operations, it is not true that current retail customers have a special right to use that equity without charge. Assuming that historic prices have been fair, just and reasonable (and they have never been challenged as not being so), the money earned and built through sound operations belongs to SRP, not to any specific class of customers. It is the role of the elected board of directors to make decisions on the appropriate method of deploying this capital to carry out SRP's various functions, including delivery of electric power and water, for the benefit of all customers.

D. The Authority to Support of Water Delivery with Electric Power Revenues is Set Forth Specifically in Arizona Law.

Finally, the Authority of the Board to use electric revenues to support water delivery is specifically set forth in the statutes providing authority to SRP. Specifically, A.R.S. § 48-2303(A)(7) provides the authority:

To reduce the cost of irrigation, drainage and power to the owners of the lands in the district by the sale of surplus water or power produced, owned or controlled by the district, and the construction, maintenance, extension, replacement, financing and refinancing of the works useful for such purpose.

**Consumers Council Argument Number Two: The District's decision to offset stranded costs by one-half of the water subsidy lacks any evidentiary basis in this record and further demonstrates the conflict that the District Board members have by serving on both the District's Board and the Association's Board.**

SRP Management Response

The Board in its December 7 resolution did not offset stranded costs by one-half of the water delivery support payments. The Board considered the unrefuted evidence that SRP's estimated total stranded costs through 2004 were \$1.08 billion. The Board then set a cap on total stranded cost recovery of \$795 million.

**Consumers Council Argument Number Three: The District provided only three weeks notice to customers of the stranded costs proceeding and less with respect to other issues. As a matter of law and fact, that is an insufficient period of time in which to prepare for such a proceeding and deprives the ACC of its due process rights under both the Arizona and United States Constitutions. The District's granting of rehearing does not cure the defect because by the time rehearing was granted, the District had executed a settlement agreement with some parties to this proceeding regarding the specific amount of stranded costs that the District would recover in rates.**

SRP Management Response

A. There was no due process violation

On the question of what process is due, there is an important distinction between adjudicative (or adversarial) proceedings and legislative proceedings. Arizona courts recognize this distinction:

As has been noted above, we are here concerned with an exercise of a legislative power delegated to the Commission and the Board. It should be borne in mind that there is a fundamental distinction, as regards due process of law, between a legislative hearing and an adversary proceeding.

In a hearing of the former type, due process requires only that all interested parties be allowed to present their views and arguments.

*Hart v. Bayless Investment & Trading Co.*, 86 Ariz. 379, 389, 346 P.2d 1101, 1108 (1959); *see also Rosenberg v. Arizona Board of Regents*, 118 Ariz. 489, 492, 578 P.2d 168, 171 (1978) (“Due process is not necessarily judicial process.”). Significantly, interpreting the above-quoted language, the Arizona Court of Appeals stated: “[*Hart*’s] remarks concerning the legislative nature of the zoning process were intended to negate the applicability of strict judicial due process concepts to the public hearing aspects of that process, especially when such judicial due process concepts might be in excess of the governing statutory requirements.” *Croaff v. Evans*, 130 Ariz. 353, 356, 636 P.2d 131, 134 (App. 1981).

SRP’s Competition Meetings were legislative in nature, not adjudicative. In enacting the Electric Power Competition Act, the legislature expressly directed SRP to “determine terms and conditions for competition in the retail sale of electric generation service consistent with the provisions of this chapter.” A.R.S. § 30-802(A). The legislature also expressly established the Public Process to be followed in making that determination. A.R.S. § 30-802(B). Accordingly, the legislature has delegated to SRP’s Board the legislative responsibility for determining broad-based rules for the implementation of competition. The Competition Meetings were held in a manner consistent with the Public Process. The Public Process does not involve the adjudication of a particular interested party’s interests. The process does provide interested parties, however, an opportunity to present their views and arguments. Thus, unless Consumers Council can demonstrate SRP failed to comply with legislatively mandated procedures, it received due process because due process is, by definition, satisfied when the legislatively required procedures are used. Nothing more is required.

B. Consumers Council was granted three separate chances over four months to make its arguments.

There have now been three public processes to determine stranded costs. The first was the proceeding which began on April 13, 1998, and ended with a board resolution on August 14, 1998. The second was the reopening of the terms and conditions issues which ended with a board resolution on December 7, the third was the rehearing opportunity following the Board’s August 14 decision. This was a period of over four months for the Consumers Council to prepare for and make any arguments. This period of time and multiple opportunities to be heard more than meets any requirements of due process.

C. The SRP Board did not enter into any settlement agreement

Consumers Council is incorrect that SRP entered into a settlement agreement with some of the participants. Rather SRP Management and participants representing many interest groups, including RUCO representing residential customers, developed joint recommendations to the SRP Board. The SRP Board was free to accept these joint recommendations, or accept proposals from other parties.

**Consumers Council Argument Number Four: The manner in which this proceeding was conducted by the District also violates the due process rights of ACC. The ACC was denied discovery rights, the right of cross-examination and any other meaningful way of testing the assertions put forward by Management or any other party to this proceeding.**

SRP Management Response

As discussed above, a legislative proceeding such as this one merely requires that interested parties have an opportunity to present their views and arguments. There is no requirement of formal discovery or cross examination of witnesses. The Public Process is not an adjudication of Consumers Council's particular rights; it involved broad policy determinations that affect all interested parties. The controlling retail competition statute, The Electric Power Competition Act, does not mandate discovery or cross-examination. Instead, it merely requires that "interested persons" be permitted to "file written comments" and that they be given "a reasonable opportunity to submit written comments and questions or make oral presentations of views, comments and questions." A.R.S. § 30-802(B)(3)(c).

Consistent with the provisions of the Electric Power Competition Act, SRP provided participants with comparable opportunities for discovery and questioning of witnesses. [attach or quote from the letter which went out to the participants]. In fact, the Consumers Council submitted three written data requests and examined, one-on-one, members of SRP management and Board consultants. [give a citation to the record].

Consumers Council can demonstrate no due process violation.

**Consumers Council Argument Number Five: Since none of the assertions made by any of the parties to this proceeding were capable of being tested through cross-examination or even discovered through depositions and because none of the assertions were made under oath or otherwise attested to, the record in this case contains no evidence, only untested assertions offered by Management and other parties. Since there is no evidence of any kind in the record, there is obviously no evidence to support any of the findings or decisions made by the Board in this proceeding.**

SRP Management Response

This point is discussed above in SRP Management's response to Consumers Council Argument Number Four.

**Consumers Council Argument Number Six: In addition to the foregoing, there is no evidence to support the Board's decision to allow for the recovery of stranded costs at the level specified in the decision. Moreover, there is no evidence to support the methodology adopted by the Board to recover stranded costs. The methodology is**

**unlawful to the extent it allows for the recovery of stranded costs that have not actually been incurred as a direct result of competition in violation of A.R.S. §30-805(A)(3).**

SRP Management Response

- A. There was substantial evidence to support the Board's stranded cost determination.

During the process, and particularly during the rehearing from the August 14 resolution (the rehearing was held on October 21, 1998) SRP presented substantial evidence of its estimated total stranded costs. This evidence indicated that SRP's estimated total stranded costs were \$ 1.08 billion. The Board approved a stranded cost recovery methodology which sets a cap on total recovery of \$ 795 million, well below the level which could have been justified by the evidence.

The evidence presented by SRP as to its stranded costs was not challenged by any party and represents a sound evidentiary basis to support the Board's decision.

- B. There is no obligation that testimony be under oath.

Arizona courts have held that "the failure to administer an oath to witnesses will not vitiate an administrative proceeding unless a statute requires the administering of the oath." *East Camelback Homeowners Association v. Arizona Foundation for Neurology and Psychiatry*, 18 Ariz. 121, 128, 500 P.2d 906, 913 (App. 1972). *East Camelback* involved a hearing before a zoning board of adjustment and a statute which gave the board chairman "the power to administer oaths," but did not expressly require that such oaths be administered. *Id.*

The rule applied in *East Camelback* applies with even more force in this context. First, the statute at issue here does not even authorize or otherwise mention the administering of oaths, let alone expressly require it. Furthermore, unlike the hearing in *East Camelback* which involved facts particular to a specific party, the matters at issue in the Public Process are broad policy issues which affect a broad range of entities in an equally broad range of potential fact situations. Thus, the Public Process is akin to the legislative process in which interested persons may appear before the legislature and provide their views and comments concerning a particular bill. Such input is seldom given under oath.

**Consumers Council Argument Number Seven: There is no evidence in the record to support the Board's conclusion that its decision regarding stranded costs considered the factors enumerated in A.R.S. § 30-805(A)(3).**

SRP Management Response

In both the initial terms and conditions proceeding and the first rehearing proceeding SRP Management presented substantial evidence on each of the twelve elements set forth in

A.R.S. § 30-805(A)(3). Particularly, these points were discussed in the testimony of Debbie Kimberly on August 14, 1998 and in the testimony of Mike Lowe on October 21, 1998.

In the August 14 resolution, the Board, in section six of the resolution, went through each of the twelve factors and discussed each one, as it related to the Board's decision. Again, in the December 7 resolution the Board found:

Section 6 of the August 14 Resolution sets forth the Board's discussion and consideration of the twelve stranded cost factors, as required by A.R.S. §30-805(a)(3). That discussion and consideration supports the Terms and Conditions the Board adopted for stranded cost recovery.

There has been no evidence presented that the Board's stranded cost determination did not comply with the twelve elements.

**Consumers Council Argument Number Eight: As a matter of fact and law, SRP is not entitled to recover stranded costs and to the extent that House Bill 2663 purports to allow it to do so, it is void for vagueness because it fails to define the term "stranded costs".**

#### SRP Management Response

A. SRP is entitled to recover stranded costs as a matter of law and fact

This appears to be the same issue raised by the Attorney General. SRP Management incorporates its response to the first argument of the Attorney General, set forth above.

B. The Electric Power Competition Act is not void for vagueness

First, it should be pointed out that the Electric Power Competition Act does define stranded costs. Particularly, section 30-805(A)(3) provides that public power entities shall:

Establish a temporary surcharge on electric distribution service prices to pay for all or a portion of the unmitigated stranded costs of electric generation service, if any, *that were incurred as a direct result of competition among electricity suppliers, that were incurred by public power entities to serve their customers in this state before December 26, 1996 and that may not be recoverable in a competitive electric generation service market.*

The italicized portion of this section clearly defines stranded costs as those costs incurred by public power entities to serve their customers, which may not be recovered in a competition electric generation service market. This is the definition which the Board used in establishing SRP's stranded costs.

On the general issue of whether the Electric Power Competition Act is “void for vagueness” the United States Supreme Court noted long ago that statutes have been found sufficiently certain when:

they employed words or phrases having a technical or other special meaning, well enough known to enable those within their reach to correctly apply them, or a well-settled common-law meaning, notwithstanding an element of degree in the definition as to which estimates might differ, or . . . that, for reasons found to result either from the text of the statutes involved or the subjects with which they dealt, a standard of some sort was afforded.

*Connally v. General Construction Co.*, 269 U.S. 385, 391-92, 46 S. Ct. 126, 127-28 (1926) (citations omitted). Moreover, “[t]he degree of vagueness the Constitution tolerates” depends on such factors as whether the statute defines criminal conduct or is merely economic regulation. *See Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 498-99, 102 S. Ct. 1186, 1193 (1982).

In this instance, it is true that “stranded cost” is not a defined term in the Electric Power Competition Act’s definition section. *See* A.R.S. § 30-801. However, its meaning is fleshed out by the statutory requirements and limitations. Thus, “stranded cost” has a “technical or other special meaning” in the specific context in which the Arizona legislature used it. That meaning is “well enough known” to be subject to comprehension by those who are required to comply. Moreover, its effect is purely economic; there are no criminal law ramifications. As such, the stranded cost provision in the Electric Power Competition Act is not unconstitutionally vague.

**Consumers Council Argument Number Nine: To the extent that the District claims that House Bill 2663 provides the authority to conduct this proceeding and impose stranded costs, it lacks such authority because HB 2663 violates the Arizona constitution’s prohibition on special laws.**

#### SRP Management Response

Without any elaboration or explanation, Consumers Council also asserts that the Electric Power Competition Act “violates the Arizona Constitution’s prohibition on special laws.” We first point out that this is not an argument or the SRP Board to decide, but it is a legal argument on the constitutionality of the law.

But in any event, the Consumers Council is wrong. The Arizona Constitution provides:

No local or special laws shall be enacted in any of the following cases, that is to say:

1. Granting divorces.
2. Locating or changing county seats.

3. Changing rules of evidence.
4. Changing the law of descent or succession.
5. Regulating the practice of courts of justice.
6. Limitation of civil actions or giving effect to informal or invalid deeds.
7. Punishment of crimes and misdemeanors.
8. Laying out, opening, altering, or vacating roads, plats, streets, alleys, and public squares.
9. Assessment and collection of taxes.
10. Regulating the rate of interest on money.
11. The conduct of elections.
12. Affecting the estates of deceased persons or of minors.
13. Granting to any corporation, association, or individual, any special or exclusive privileges, immunities, or franchises.
14. Remitting fines, penalties, and forfeitures.
15. Changing names of persons or places.
16. Regulating the jurisdiction and duties of justices of the peace.
17. Incorporation of cities, towns, or villages, or amending their charters.
18. Relinquishing any indebtedness, liability, or obligation to this State.
19. Summoning and empanelling of juries.
20. When a general law can be made applicable.

Ariz. Const., art. IV, pt. 2, § 19. Most of the items in the foregoing list appear to be obviously inapplicable.

Consumers Council may be relying on the thirteenth item which prohibits “local or special laws” related to “[g]ranting to any corporation . . . any special or exclusive privileges, immunities, or franchises.” However, what in the Electric Power Competition Act Consumers Council might believe constitutes a special or exclusive privilege, immunity or franchise in favor of SRP is far from clear.

The Electric Power Competition Act does not apply to SRP alone. To the contrary, the portions of the Act which mandate the Public Process and address stranded costs apply to all public power entities. *See* A.R.S. §§ 30-802(A) and 30-805(A)(3). While the number of entities that fit within the definition of “public power entities,” *see* A.R.S. § 30-801(16), may currently be few, the Electric Power Competition Act is not unlawful special legislation. Interpreting the Constitution’s prohibition of special laws, the Arizona Supreme Court stated:

A law is general, and thus permissible, if it confers rights and privileges or imposes restrictions upon all members of a given class, when the classification has a reasonable basis. A special law applies only to certain members of a class or to an arbitrarily defined class which is not rationally related to a legitimate legislative purpose. . . . But a law is not special simply because it may have only a limited application. Such a law will be general if it applies to all cases and to all members of the specified class to which the law is made applicable.

*Arizona Downs v. Arizona Horsemen's Foundation*, 130 Ariz. 550, 557-58, 637 P.2d 1053, 1060-61 (1981). The classification of political subdivisions involved in the provision of electricity is clearly a reasonable one in light of the distinction between public service corporations and municipal corporations in the Arizona Constitution. Accordingly, the Electric Power Competition Act is not an special law.

**Consumers Council Argument Number Ten: The District acknowledges, and HB 2663 confirms, that the District has a duty to mitigate stranded costs. The District's decision fails to do so because it does not prohibit the payment by the District to the Association of funds to subsidize the cost of water provided by the Association to its shareholders.**

SRP Management Response

This argument is addressed above under Consumers Council Argument Number One, parts B and C.

**Consumers Council Argument Number Eleven: The District has further failed to mitigate its stranded costs by failing to consider or otherwise evaluate the application of excessive earnings to offset stranded costs.**

SRP Management Response

As discussed above in response to Consumers Council Argument Number One, mitigation is the reduction of costs which would otherwise be recoverable as stranded costs. Therefore, the concept of excess earnings is not a concept of mitigation, especially if the earnings are not related to the provision of generation service.

But in any event, there is no evidence whatsoever that there are any excess earnings. To the contrary, the evidence is that the revenues produced by the new price schedule adopted by the Board are just and reasonable, and will be very low considering the asset base of SRP. As set forth in the statement and materials of SRP Management (Mike Lowe) presented on October 21, SRP's total estimated stranded costs, netting stranded benefits, is approximately \$1.08 billion in nominal dollars. This should be compared to the board-imposed cap of \$795 million (nominal dollars). This number includes a netting of the positive and negative factors, including "stranded benefits" associated with certain plants.

**Consumers Council Argument Number Twelve: The District concedes that recovery of stranded costs is limited to those costs that were prudently incurred by the District. While there is a finding in the Board's decision that the costs and investment for which stranded cost recovery is sought were prudently incurred, the only evidence in the record regarding such costs was offered by ACC to the effect that hundreds of millions of dollars of costs associated with the Palo Verde Nuclear**

**Generating Station were imprudently incurred. There is no evidence in the record to support the District's finding that the Palo Verde costs were prudently incurred.**

SRP Management Response

Contrary to the assertion, Consumers Council did not present any competent evidence that any element of SRP's Palo Verde investment is imprudent. Consumers Council merely asked to incorporate by reference the entire prudency audit conducted by the Corporation Commission with respect to the investment of Arizona Public Service Company. The request to incorporate this entire record was never granted by the Board. Consumers Council pointed to no specific part of the prudency audit which would apply to SRP, nor did it submit any documents or numbers.

The question of prudency involves two considerations: first, was the plant reasonably needed to serve customers and second, were the costs of the plant prudently incurred.

On the first point, SRP Management has shown that SRP, unlike APS, recognized during Palo Verde construction that its SRP would not meet its near term load growth projections, and that therefore it did not need its entire Palo Verde share. As presented by SRP Management on October 21, since 1982 SRP, in response to the realization that it did not need its entire Palo Verde share, reduced its Palo Verde ownership to 17.49 %. Specifically, in 1982 SRP sold a 5.91 % interest to Southern California Public Power Authority. The sale was for full book value, \$259 million. And, in 1986 SRP exchanged a 5.7 % interest for 30 % interest in Coronado Generating Station with Los Angeles Department of Water and Power.

Also as supported by the testimony of Mike Lowe on October 21, both sales were made at full book value. This evidence of contemporaneous market-based sales is the best evidence that SRP's cost of Palo Verde were prudently incurred.

**Consumers Council Argument Number Thirteen: The District's decision improperly identifies a specific level of stranded costs for recovery. The identification of a specific amount of stranded costs should have been made in a rate proceeding and the notice provided by the District to its customers concerning this proceeding failed to specify that the District would identify a specific amount of stranded costs for recovery. As a consequence, the notice provided by the District was insufficient and violated ACC's due process rights under the Arizona and United States Constitutions. The District's granting of rehearing on this issue does not cure the defect because, by the time rehearing was granted, the District had executed a settlement agreement with some parties to this proceeding regarding the specific amount of stranded costs that the District would recover in rates.**

## SRP Management Response

### A. The determination of stranded costs was made in a “rate proceeding”

Consumers Council is incorrect that the stranded cost cap and the level of stranded cost recovery were not recovered in a “rate proceeding”. On October 5, 1998, the SRP Board established two public processes which were to be conducted simultaneously. These were the reopening of the terms and conditions of competition and the proceeding to establish unbundled prices and new price levels (which is a “rate proceeding”). Following the public process on December 7, the Board decided both matters. This decision included a decision on the level of stranded cost recovery (the stranded cost cap and methodology) and a determination of how stranded costs would be allocated among customers and among customer classes.

The two proceedings were conducted simultaneously. Each public meeting and opportunity for comment were for both processes. The Board scheduled the processes in this manner, in part, because of a recognition that it is difficult to discuss stranded costs without also at the same time considering pricing and revenue levels.

This point raised by the Consumers Council is simply incorrect.

### B. SRP did not settle with “some parties to this proceeding”.

As discussed above, SRP Management and major stakeholders representing the various customer and competitor interests (including residential customers) reached a settlement on certain issues and made a joint recommendation to the SRP Board. The Board was free to accept or reject this recommendation, or accept the recommendation of any other party.

## **Pricing Application for Rehearing by the Consumers Council**

**Consumers Council Argument Number One: The rates established by the District in this proceeding are excessive, unjust and unreasonable. The rate levels determined by the District will continue to produce excessive levels of earnings that are unwarranted and unjustified for a governmental entity like the District.**

## SRP Management Response

The record in this case clearly demonstrates that the level of projected earnings are not only appropriate, they are below those of other public power entities. Specifically the prices set by the Board are expected to produce these financial results:

FY 2000 Return on Assets	2.30%
FY 2000 Return on Equity	3.39%
Debt Ratio as of 12/31/98	62.5%

The record also demonstrates that the levels or returns are at or below other comparable public power entities. There is no evidence whatsoever that there are any “excessive levels of earnings”.

As discussed above, it is well-established law that a public entity providing services has the right to earn a return on property devoted to providing a service, and use this return for authorized purposes. Unlike an investor owned utility which pays dividends to shareholders, SRP’s use of earnings is quite limited, and all uses inure to the direct benefit of the SRP constituents. Specifically, the funds may be used in major part to reduce electric prices, pay off debt (which ultimately reduces prices), fund new capital assets (which also serves to lower prices), and to fund other authorized operations (i.e. water delivery).

**Consumers Council Argument Number Two: The rates determined by the District in this proceeding unlawfully include a return on capital comparable to what private investor-owned utilities charge their customers. The District is not entitled to any return on capital, much less on capital that has already been provided by its customers. Additionally, even if the District was lawfully able to charge some return on capital, it is unreasonable to charge a return comparable to that charged by private investor-owned utilities and there is no substantial evidence to support such a return in this proceeding. There is no lawful or factual basis for the District to determine rates at a level that will allow it to profit from the provision of electric service.**

SRP Management Response

The authorities which establish that a public entity has the right to recover a reasonable return on capital invested in providing a service to customers is set forth above in part C of the response to Consumers Council Argument Number One re the Terms and Conditions resolution. This discussion demonstrates that the return on assets may be comparable to those charges by investor-owned utilities, and that the return of SRP assets is well within the range of the return earned by other public power entities. Also as discussed above, a public power entity may use the income so generated for any lawful purpose. It is important to remember that the income generated will be used in one way or another to benefit SRP customers: by lowering prices of electric service, by lowering prices of water delivery, by building new assets, or by paying off debt (which results in lower prices).

**Consumers Council Argument Number Three: The rates determined by the District in this proceeding violate the Electric Power Competition Act. That Act**

**authorizes the District to establish prices and terms and conditions that reflect the “just and reasonable price for providing the service.” A.R.S. §30-805(A)(1). The rates established by the District in this proceeding violate that provision in at least two respects. First, the rates established by the District in this proceeding provide for a return on capital comparable to that charged by a private investor-owned utility and thus do not reflect a just and reasonable price for providing service. Second, the rates established by the District are explicitly designed to generate revenues sufficient to fully subsidize the cost of providing water to the customers of the Salt River Valley Water Users Association. Therefore, the rates do not reflect the just and reasonable price for providing electric service and violate A.R.S. §30-805(A)(1).**

SRP Management Response

This point is discussed in part C of the response to Consumers Council Argument Number One on the Terms and Conditions resolution. The issue is not that electric customers are paying too much for electricity, the prices are well within the reasonable range and well below the prices charged by comparable investor-owned utilities. This issue, again, is whether SRP may earn a return on its property devoted to providing electric service to its customers. It is a fraction of this lawfully collected return which SRP uses to fulfill another authorized function, water delivery.

**Consumers Council Argument Number Four: Additionally, the District’s Board of Directors has an irreconcilable conflict of interest in this proceeding because all but two of those Board members also serve as Board members on the Board of Directors of Salt River Valley Water Users Association. By charging a profit on electric services to establish sufficient funds to pay the cost of providing water to the customers of the Salt River Valley Water Users Association, including themselves, the District’s Board members violate their duty of loyalty to the District. Moreover, their dual membership on both the District’s Board and the Association’s Board creates an irreconcilable conflict of interest that disqualifies them from making any decision in this proceeding regarding a return on capital sufficient to generate funds necessary to subsidize the cost of water storage and delivery.**

SRP Management Response

This point is addressed in subpart A of SRP management’s response to Consumers Council Argument Number One to the Terms and Conditions Resolution.

**Consumers Council Argument Number Five: The District’s inclusion of stranded costs in the rates determined by the Board in this proceeding is unlawful. The District’s decision allows for the recovery of stranded costs even though they may not actually be incurred in violation of the Electric Power Competition Act. That Act allows the District to establish a temporary surcharge to pay for all or a portion of unmitigated stranded costs, if any, that were “incurred” as a direct result of competition among electricity suppliers. A.R.S. §30-805(A)(3). There is no**

**substantial evidence in this proceeding that the District will incur any costs as a direct result of competition among electricity suppliers, much less the \$795 million that the District has included in the rates established in this proceeding.**

SRP Management Response

The Electric Power Competition Act requires that SRP “unbundle” its current bundled prices (and also lower the overall bundled price). This means that each component of the old bundled price is now determined separately. The energy portion of the bundled price is determined according to the market price for energy. Competition makes this determination necessary because if SRP were to price above market, it would be an ineffective competitor. It is the specter of competition and the corresponding unbundling of prices which makes stranded costs an issue at all. Clearly, stranded costs would not exist at all, were it not for the unbundling of prices in anticipation of competition.

**Consumers Council Argument Number Six: The manner in which this proceeding was conducted by the District violates the due process rights of ACC. Management’s rate proposal was not available until October 5, 1998. The last meaningful opportunity to comment on the rate proposal was November 16, 1998. As a matter of law, and fact, this is an insufficient period of time in which to prepare for such a proceeding and deprives the ACC of its due process rights under both the Arizona and United States Constitutions.**

SRP Management Response

This is a similar argument that has been raised twice by Consumers Council with respect to the Terms and Conditions process. We incorporate the general due process discussion set out above in SRP Management’s response to Consumers Council Argument Four to the Terms and Conditions resolution. We also again note that the notice and time frame exceeded the legal requirements of the Electric Power Competition Act.

Initially, we again point out that the pricing process was no surprise. It is required by the Electric Power Competition Act, and had to be completed by the end of the year. Consumers Council was well aware of the fact that the pricing process would be held, and the issues which would be considered.

Here, again, we must consider the circumstances of the notice and the sequence of events. The Electric Power Competition Act, which mandates that these proceedings be concluded by early December (to allow sufficient time for competition to begin on December 31), was not in effect until August 21, 1998. In spite of the fact that the Act was not in effect, SRP commenced the terms and conditions proceeding shortly after the Act was signed into law by the Governor in late May, 1998. This initial terms and conditions proceeding ended with a resolution by the SRP Board dated August 14, 1998.

It is simply not possible to establish unbundled prices until the terms and conditions of competition have been established. This is because many of the terms and conditions

affect the prices and price structure (e.g., stranded cost methodology). It must be remembered that the stranded cost methodology, one of the most important predicate determinations to establish the pricing schedule, was changed by the SRP Board on the last day of the proceeding, August 14, as a result of SRP Management negotiations with stakeholders, concluding the evening before. What had been a proposal for a floating CTC, became a resolution with a fixed CTC cap.

The August 14 resolution caused the SRP pricing department to essentially start over in calculating the prices and pricing structure. Further negotiations with the stakeholders on the method of *allocating* stranded costs among customers caused some minor additional delay.

Through diligent efforts, SRP Management published its pricing plans on October 5, 1998. On that date SRP set a schedule for public comment. The schedule set three SRP Board meetings to consider the pricing issues, November 9, November 30, and December 7. The schedule also set forth a series of public meetings and opportunities to question management. Consumers Council in fact took advantage of the opportunities to request information and pose questions in writing, to orally question members of SRP management, to orally question the Board's consultants, and to submit written materials. SRP Management also scheduled several special meetings with Consumers Council's attorney to further provide information and answer questions.

Consumers Council has known that these proceedings would take place, and the basic structure and purpose of the proceedings, since the Governor signed the Electric Power Competition Act on May 29, 1998. Consumers Council was well aware of the pricing issues because it participated in the terms and conditions proceedings during the summer. Consumers Council received the actual proposed prices on October 5, for a scheduled decision on December 7, a total period of 63 days. And, even conceding that arguments would be best presented in the written comments due November 19, and in argument to the Board on November 30, Consumers Council still had 43 days to prepare written argument, and 54 days to present oral argument.

Finally, if Consumers Council is dissatisfied with the level of prices, there is no reason that Consumers Council cannot provide substantive information supporting its contentions (which it has not done yet), and request another price determination under the provisions of A.R.S. § 48-2334.

The notice and process far exceeded the minimum requirements that due process imposes on a legislative price setting proceeding.

**Consumers Council Argument Number Seven: This proceeding further violated the due process rights of ACC by denying to it and other parties any meaningful discovery rights, including the right of cross-examination or any other meaningful way of testing the assertions put forward by Management or any other party to this proceeding.**

## SRP Management Response

This point is addressed above in SRP Management's response to Consumers Council Argument Number Four.

In the pricing process, meetings for the purpose of examining SRP Management witnesses and the Board Consultants were scheduled and held on October 12, 13, 14, 15, and 19 for residential and small business customers, and for medium and large business customers on October 20, and for all customers on October 20 and 27. Consumers Council participated in several of these meetings, taking the opportunity to question members of SRP management and Board consultants. Additionally, throughout the process SRP Management accepted and responded to information and document requests by interested parties. Consumers Council submitted three (?) separate information requests, to which SRP Management timely responded. For Consumers Council, SRP scheduled a number of special one-on-one meetings to discuss issues of importance to that group and to provide information of relevance to Consumers Council's pricing analysis.

In this regard the Electric Power Competition Act requires that public power entities, in determining the terms and conditions of competition, shall at a minimum:

1. Provide public notice of proposed terms and conditions stating that:
  - (a) The public power entity is adopting terms and conditions for competition in the retail sale of electric generation service.
  - (b) The information in paragraph 2 of this subsection shall be available for inspection.
  - (c) The governing body of the public power entity shall hold a special meeting as required by paragraph 3 of this section and shall include a statement providing the date, time and place of the meeting.
2. Provide that for a period beginning with the public notice and until ten days after the close of the meeting prescribed in paragraph 3 of this section, the public power entity shall make available to interested parties at its main office pertinent information, including:
  - (a) Management's recommendations for proposed terms and conditions.
  - (b) Relevant financial and other information on which the management proposal is based. The public power entity shall timely supplement the information that is reasonably requested by any interested person and shall answer reasonable questions posed by any interested person.
  - (c) Current terms and conditions, if any.
  - (d) Reports of consultants, if any.

3. Provide that interested persons may file written comments with the public power entity at any time during the period prescribed in paragraph 2 of this subsection. A meeting of the governing body of the public power entity shall be held no earlier than thirty days and no later than ninety days after the public notice referred to in paragraph 2 of this subsection. At the meeting, the governing body of the public power entity shall:

(a) Afford representatives of management of the public power entity an opportunity to explain the proposed terms and conditions and the criteria for the terms and conditions and answer questions.

(b) Afford any consultants retained by the public power entities an opportunity to comment on the proposed terms and conditions.

(c) Afford interested persons a reasonable opportunity to submit written comments and questions or make oral presentations of views, comments and questions.

4. Following review of the information and comments gathered in the course of the procedures described in paragraph 3 of this subsection the governing body of the public power entity shall make its decision on the proposed terms and conditions.

The process conducted by SRP was well in excess of these minimum standards set forth by the legislature.

**Consumers Council Argument Number Eight: Since none of the assertions made by any of the parties to this proceeding were capable of being tested through cross-examination or even discovered through deposition and because none of the assertions were made under oath or otherwise attested to, the record in this case contains no evidence, only untested assertions offered by Management and other parties. Since there is no evidence of any kind in the record, there is no evidence much less substantial evidence to support any of the findings or decisions made by the Board in this proceeding.**

SRP Management Response

This point is addressed above in SRP Management's response to Consumers Council Argument Number Five.