IN THE COURT OF APPEALS FOR THE STATE OF ARIZONA
DIVISION ONE

ROY MILLER, THOMAS F. HUSBAND, JENNIFER BRYSON, and CORPUS COMMUNICATIONS, INC.,	1 CA-CV 09-0789
Appellants/Cross-Appellees,	Maricopa County Superior Court Case No. CV2008-029293
vs.	
ARIZONA CORPORATION COMMISSION, and KRISTIN MAYES, WILLIAM MUNDELL, JEFF HATCH-MILLER, GARY PIERCE, and MIKE GLEASON, in their official capacities as members of the Arizona Corporation Commission,	
Appellees/Cross-Appellants.	

APPELLANTS' BRIEF

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Statement of the Case

This lawsuit was filed as a collateral attack seeking declaratory and injunctive relief and as a special action challenging defendants' Renewable Energy Standard and Tariff ("REST") Rules (Index of Record 19, Exhibit 19) (App. 2). Both parties filed motions for summary judgment. In a minute entry dated September 2, 2009 (Index of Record 43) ("Op."), the Maricopa County Superior Court granted special action jurisdiction, denied plaintiffs' motion for summary judgment, and granted defendants' cross-motion for summary judgment. Judgment was entered on October 6, 2009 (Index of Record 48), and this timely appeal followed. This Court has jurisdiction over the action pursuant to A.R.S. § 12-2101(B) and Ariz. R. P. for Spec. Actions 1.

Statement of Facts

As the trial court recounts (Op. at 3-5), the REST Rules follow a long line of regulations by the Arizona Corporation Commission pertaining to environmental standards and renewable energy. They were adopted on November 14, 2006 in Commission Decision 69127 and submitted to the Attorney General for approval (*id.* at 4). After initially finding that the Commission's authority for the Rules was "vague," the Attorney General "requested specific authority from the Commission," which responded that it could not provide "an isolated source of statutory or constitutional authority." Nonetheless, "the Attorney General gave

deference to the expertise of the Commission" and certified the REST Rules on June 15, 2007 (*id.*).

Though the new Rules supplant prior regulations, they differ from their predecessors in two crucial respects: (1) they are far more prescriptive in terms of specific renewable energy requirements than prior rules; and (2) they pass along to consumers the entire cost of compliance through a tariff (surcharge).[1] The REST Rules require utility companies that are subject to its jurisdiction to provide specific percentages of energy, calibrated and increasing by year, from a limited selection of renewable sources (R14-2-1804).[2] The Rules specify rigid percentages of such energy to be transmitted from distributed sources (located on-site, such as solar rooftop panels) and non-distributed (off-site) sources (R14-2-1805). Within the required portion of power that must be provided from distributed generation, the Rules prescribe precise percentages for commercial and residential generation (R14-2-1805(D)). Each year, companies must submit plans for Commission approval detailing how they will comply with the standards, including a line-item budget (R14-2-1813). The Commission mandates that companies pay up to half the funding for customers to install distributed energy devices (R14-2-1809); and it

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[1] The Rules are attached to Plaintiffs' Statement of Facts ("SOF") (Index of Record 19, Exhibit 19) and are reproduced in App. 2.

[2] The specified renewable energy sources do not include such sources as nuclear or hydroelectric energy.

provides in detail how customers request funds, the minimum amount the customer must devote to the project, and how much money the customer may receive (R14-2-1809). Utilities may be penalized for noncompliance (R14-2-1815).

The Rules establish a system of renewable energy credits, with the Commission determining terms of transfer, purchase, or sale (R-14-1803-04). Credits are given when utility companies make investments in solar electric manufacturing plants (R14-2-1807(A)). The Rules devise detailed and limited actions a utility may take to obtain extra credit multipliers (R14-2-1806 & 1807(C)).

The Commission limits the type of renewable energy technologies to those it specifies in the Rules (R14-2-1802); it further limits those (with one exception) to technologies installed after January 1, 1997 (R14-2-1802(C)); and it limits the amount of wholesale electricity sold by non-utility-owned generators that a utility may use to satisfy the distributed renewable energy requirement (R14-2-1805(E)). The Commission disqualifies energy conservation, energy management, energy efficiency, and other products that use non-renewable fuels (R14-2-1802(D)).

The Commission requires utilities to recover the reasonable and prudent costs of complying with the Rules by means of a tariff (R14-2-1808). The Rules make no exceptions nor provide any flexibility for cost considerations, technological feasibility, adequacy or reliability of supply, or prices of competing

energy sources. The Rules provide for waivers for "good cause," but they set forth no specifications for when such waivers should be provided (R14-2-1816).

During consideration of the REST Rules, the Commission staff estimated the costs of distributed and non-distributed energy "above the Market Cost of Comparable Conventional Generation through 2025" at $1.2 billion (Index of Record 19, Exhibit 11, App. B pp. 72-73) (App. 4). That figure does not include the "projected cost of the infrastructure needed to supply the renewable energy required to meet the RES," which the staff considered "unknown" (SOF 61).[3] The Commission's Economic, Small Business and Consumer Impact Statement states, "The cost to consumers will also vary over time and will directly follow the costs to the Affected Utilities" (Index of Record 19, Exhibit 11, App. C p. 2) (App. 5).

The Rules became effective in August 2007, and the first APS surcharge was imposed on ratepayers in May 2008. This lawsuit was filed by residential and small-business consumers of Arizona Public Service (APS) who are subject to current and constantly escalating utility rate surcharges, alleging that the REST Rules exceed the Commission's limited authority under the Arizona Constitution and statutes. The trial court found that "the dissemination of the REST Rules falls within the Commission's ratemaking authority" under the Arizona Constitution, a conclusion that "makes it unnecessary to review the parties' arguments of statutory

[3] The SOF (Index of Record 19) is reproduced in App. 3.

authority for the promulgation of the REST Rules" (Op. at 8). This timely appeal followed.

Statement of Issues Presented

1. Does the Arizona Corporation Commission possess constitutional authority pursuant to Ariz. Const. art. 15, § 3 to impose sweeping and prescriptive mandates dictating the use of specified renewable energy sources by energy companies that displace management discretion and flexibility, take no account of cost or technological feasibility, and pass along the entire financial burden of at least $1.2 billion on consumers?

2. In the absence of express legislative authorization of the Rules, and in the face of statutes evidencing a different policy approach, may the Corporation Commission dictate the State's renewable energy policy?

3. In asserting that it possesses constitutional and statutory authority to impose the Rules, must the Commission demonstrate specific authority as to each discrete Rule, or may a court sustain the Rules *carte blanche* without such authority?

Standard of Review

A challenge to Corporation Commission rules "is a question of law, subject to *de novo* review." *US West Comm., Inc. v. Ariz. Corp. Comm'n*, 197 Ariz. 16, 22, 3 P.3d 936, 942 (App. 1999). Neither the trial court's nor agency's

determinations regarding the Commission's constitutional or statutory authority are entitled to deference. *Gardiner v. Ariz. Dep't of Econ. Security*, 127 Ariz. 603, 606, 623 P.2d 33, 36 (App. 1980).

I. THE COMMISSION'S AUTHORITY IS CIRCUMSCRIBED.

The trial court treated the Arizona Corporation Commission as if it was a legislative body with broad police powers. In fact, it is an agency whose powers are narrow, defined, and limited. Over many decades, the Commission has sought repeatedly to expand those powers by regulatory fiat, and the courts have constrained its excesses just as often. The trial court's conceptual error in deferring to the Commission's unprecedented interpretation of its own constitutional authority led it to the wrong conclusion in upholding the challenged Rules.

Although some of the jurisprudence regarding the Commission's jurisdiction is a bit murky, the cases yield four bright lines that should guide the judicial inquiry, only the third of which was acknowledged by the court below:

Rule 1: The Corporation Commission possesses no implied powers. The Commission is created by the Arizona Constitution and—unlike the three principal branches of government—it has no inherent powers, but only the powers expressly granted it by art. 15, § 3 of the Constitution (App. 1) or delegated by the Legislature. *Phelps Dodge Corp. v. Ariz. Elec. Power Co-op.*, 207 Ariz. 95, 111, 83 P.3d 573, 589 (App. 2004). Where a Commission rule is challenged, "authority

must be found either in the Constitution or in statutes enacted by the legislature for it is conceded that the Commission has no implied powers." *So. Pac. Co. v. Ariz. Corp. Comm'n*, 98 Ariz. 339, 345, 404 P.2d 692, 696 (1965) ("*Southern Pacific*"). Moreover, its powers must be "derived from a strict construction of the Constitution and implementing statutes." *Id.* "The scope of an agency's power . . . may not be expanded by agency fiat." *Cochise Cty. v. Ariz. Health Care Cost Containment Syst.*, 170 Ariz. 443, 445, 825 P.2d 968, 970 (App. 1991).

Thus the nature of the judicial inquiry in the context of the Corporation Commission is markedly different than the inquiry with respect to enactments by the Legislature: in the latter context, the courts inquire whether there is an express constitutional limitation of governmental authority; whereas the Commission must demonstrate that it has express constitutional or statutory authority for each of its rules. A.R.S. § 41-1001(14)(a)(i). That explains the remarkable number of judicial decisions striking down Commission regulations.

Rule 2: The Legislature retains complete authority over public policy pertaining to regulated utilities. Ariz. Const. art. 14, § 2 confers the power to regulate corporations upon the Legislature. As established by our Supreme Court in *Ariz. Corp. Comm'n v. Pac. Greyhound Lines*, 54 Ariz. 159, 176-77, 94 P.2d 443, 450 (1939), the "paramount power to make all rules and regulations governing public service corporations not specifically and expressly given to the

commission by some provision of the constitution rests in the legislature." Counsel for appellees conceded the point at oral argument in the trial court, declaring that "the Commission acknowledges that it doesn't have the authority to set statewide energy policy" (Tr. at 83; see also *id.* at 84).

Rule 3: The Commission's constitutional authority is limited to ratemaking. In *Ariz. Corp. Comm'n v. State ex rel. Woods*, 171 Ariz. 286, 294, 830 P.2d 807, 815 (1992), the Arizona Supreme Court declined to overturn its prior decision in *Pacific Greyhound*, which held "that the Commission has no regulatory authority under article 15, section 3 except that connected to its ratemaking power."

Rule 4: The Commission has no power over corporate management decisions. "Nowhere in the Constitution or in the Statutes is the commission given jurisdiction, directly or by implication, to control the internal affairs of corporations." *Corp. Comm'n v. Consol. Stage Co.*, 63 Ariz. 257, 261, 161 P.2d 110, 112 (1945). Accordingly, Commission regulations are invalid when they "so interfere with management functions that they constitute an attempt to control the corporation rather than an attempt to control rates." *Woods*, 171 Ariz. at 297, 830 P.2d at 818.[4]

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[4] Oklahoma courts have recognized a similar dividing line, holding that its "Constitution does not clothe [the Corporation Commission] with the general power of internal management and control incident to ownership." *Okla. Gas & Elec. Co. v. Corp. Comm'n*, 543 P.2d 546, 551 (Okla. 1975).

The REST Rules violate each of these constitutional principles. They rely on no specific and clearly expressed constitutional or statutory authority. They go beyond ratemaking to establish renewable energy policy for the State of Arizona. And they trench deeply upon management prerogatives, to the detriment of the very consumers whose interest the Commission is supposed to protect. The Commission exceeds its jurisdiction when it violates any one of those rules; but in this case it violates them all.

We turn first to the Commission's lack of constitutional authority, then to its lack of statutory authority.

II. THE SWEEPING AND PRESCRIPTIVE REST RULES ARE NOT REASONABLY NECESSARY FOR RATEMAKING, THEY ESTABLISH RENEWABLE ENERGY POLICY FOR THE STATE, AND THEY INTERFERE WITH MANAGEMENT DISCRETION.

At oral argument, counsel for defendants stated that the REST Rules are authorized by the Arizona Constitution because they are "related to rate making" (Tr. 83), and the trial court's decision is grounded entirely in that constitutional basis (Op. at 8 ("the Court finds that . . . the REST Rules are reasonably necessary for ratemaking. . . . This Conclusion makes it unnecessary to review the parties' arguments of statutory authority for the promulgation of the REST Rules")). To sustain the trial court's ruling would be to grant the Commission boundless regulatory authority—an outcome at variance with plentiful case law striking down regulations far less sweeping and intrusive than the REST Rules.

In *Southern Pacific*, for instance, a railroad company decided to discontinue certain train service, and the Commission ordered the company to continue it. Holding that "plainly it is not the purpose of regulatory bodies to manage the affairs of the corporation," *So. Pac. Co.*, 98 Ariz. at 343, 404 P.2d at 694, the Court declared that "a public utility may, *in the first instance*, in the exercise of its managerial functions, determine the type and extent of service to the public within the limits of adequacy and reasonableness." *Id.*, 98 Ariz. at 343, 404 P.2d at 694-95 (emphasis in original). Accord, *Ariz. Corp. Comm'n v. So. Pac. Co.*, 87 Ariz. 310, 350 P.2d 765 (1960) (invalidating the Commission's decision to discontinue the service of a railroad agent).

Southern Pacific speaks directly to the REST Rules, through which it is the Commission that is determining in the first instance the proper mix of energy sources. Indeed, prior to the REST Rules, a company would determine in the first instance the appropriate resource portfolio and seek rate adjustments when necessary; by contrast, the REST Rules establish a minimum percentage of specified renewable resources and mandate a tariff. That is a direct imposition on managerial discretion that may be exercised by the Legislature only, and is outside of the Commission's constitutional authority. See, e.g., Ariz. Op. Att'y Gen. No. I79-099, 1979 WL 23168 (Apr. 9, 1979) (Commission has no authority to require public service corporations to purchase fuel oil jointly or cooperatively).

That same line of demarcation was recognized in *Woods*, 171 Ariz. at 297, 830 P.2d at 818, in which the Court distinguished between "an attempt to control the corporation rather than an attempt to control rates." In that regard, the Court looked to whether the rules "interfere with management functions," *id.*, or merely "are reasonably necessary steps in ratemaking." *Id.*, 171Ariz. at 294, 830 P.2d at 815.

The issue before the Court in *Woods*, 171 Ariz. at 287, 830 P.2d at 808, was "whether article 15, section 3 of the Arizona Constitution gives the Commission power to require a public service corporation to report information about, and obtain permission for transactions with, its parent, subsidiary, and other affiliated corporations." Notably, the Court did not decide the case based on the so-called "permissive" language of art. 15, § 3, which provides that the Commission may make "reasonable rules, regulations and orders, by which such corporations shall be governed *in the transaction of business within the state*" (emphasis added). Such a decision was foreclosed by the Court's earlier admonition in *Pacific Greyhound*, 54 Ariz. at 176, 94 P.2d at 450, that such permissive language "qualifies and refers only to the power given the commission by the same section to 'prescribe just and reasonable classifications to be used, and just and reasonable rates and charges to be made and collected, by public service corporation'." Accord, *US West*, 197 Ariz. at 23, 3 P.3d at 943.

Hence the Commission could justify the rules in *Woods* only if they were, as the Court put it, "reasonably necessary steps in ratemaking." Given that the rules sought to prevent a public service corporation "from engaging in transactions that will so adversely affect its financial position that the ratepayers will have to make good the losses, and it cannot do so in any common-sense manner absent the authority to approve or disapprove such transactions in advance," the Court concluded that the rules were "reasonably necessary for ratemaking" and did not "so interfere with management functions that they constitute an attempt to control the corporation rather than an attempt to control rates." *Id.*, 171 Ariz. at 297, 830 P.2d at 818. See *Pub. Serv. Co. of Okla. v. State*, 918 P.2d 733 (Okla. 1996) (prohibiting the corporation commission from passing substantial costs onto consumers based on changes in electric distribution that interfered with internal management of utility companies).

Woods has been applied by two significant subsequent decisions, both by this Court: *US West, supra*; and *Phelps Dodge, supra*. In both cases, the outcomes and reasoning are markedly different than in the trial court decision here. Indeed, the present regulations differ from those struck down in *US West* and *Phelps Dodge* only in that they are far more sweeping and prescriptive, and impose substantial costs upon consumers.

US West, in a decision authored by Judge (now Justice) Ryan and joined by

Judges Garbarino and (now Justice) Berch, reviewed Commission regulations packaged as the Competitive Telecommunications Rules. The question before the Court was whether the rules had to be cleared in advance by the Attorney General, who would examine them, among other things, to determine whether they were within the Commission's legal authority. If the Rules were within the Commission's constitutional ratemaking powers, they would be exempt from review by the Attorney General; if not, they were void unless approved by the Attorney General. *Id.*, 197 Ariz. at 22-24, 3 P.3d at 942-44. Hence the nature of the inquiry is the same as here: determining whether the Commission's rules emanate from its constitutional authority to set rates.

Unlike the trial court, which gave *carte blanche* approval to the sweeping body of REST Rules without examining or requiring Commission justification for each, this Court examined each of the challenged rules in turn and assigned them to four categories:

1. It found that "[s]ome rules clearly are related to the ratemaking power"; specifically, rules pertaining to pricing of competitive telecommunications services, procedures for rate change, and establishment of a universal service fund. *Id.*, 197 Ariz. at 24, 3 P.3d at 944.

2. "Other rules arguably implicate ratemaking," the Court held. Specifically, Commission oversight of accounting records "implicates ratemaking

as review of accounting records would allow the Commission to determine whether the company has complied with ratemaking orders." *Id.* Likewise, a rule requiring Commission permission to discontinue competitive services "can affect a company's profit and loss, and thereby affect its charges for other services." *Id.*

3. "But we conclude that some rules are not reasonably related to . . . ratemaking." *Id.* Specifically, rules governing the issuance and conditions of certificates of convenience and necessity ("CC&Ns") derive not from the Commission's ratemaking power, but from legislative delegation. *Id.*, 197 Ariz. at 25, 3 P.3d at 945. The Court found that the "issuance of a CC&N may be incidentally related to ratemaking," but held that such an "incidental relationship, however, is not enough" to bring the rules within the Commission's constitutional authority and exempt them from Attorney General review. *Id.*

4. Finally, the Court also concluded that "other rules do not relate at all to ratemaking." *Id.* They included rules that require "local exchange carriers to provide equal access for customers to choose long distance services"; "local exchange carriers to 'provide appropriate interconnection arrangements with other telecommunications companies'"; and "companies to 'provide quality service in accordance with this rule and with any other service quality requirements established by the Commission'." *Id.* Likewise, rules creating administrative requirements and rules for billing and collection were "not reasonably related to

the ratemaking function." *Id.*

These four categories are helpful in evaluating the REST Rules. The closer the regulation is to setting rates, the more likely it is to fall within the Commission's authority. However, given that the invalidated rules in *US West* focused the nature of the service provided, the means by which service was provided, and the relationship between the companies and their customers—exactly the regulatory terrain encompassed by the REST Rules—the rules "do not relate at all to ratemaking," and therefore exceed the Commission's constitutional authority. *Id.*

This Court engaged in similar analysis four years later in *Phelps Dodge,* a case decided Judges Timmer, Gemmill, and Ehrlich. As here, the Commission was attempting to establish statewide energy policy, through the Retail Electric Competition Rules. As in *US West,* and in contrast to the trial court below, the Court examined each discrete challenged rule in turn. Before doing so, it articulated the applicable principles:

> The Commission does not possess any inherent powers, . . . but instead exclusively derives its power from the constitution and the legislature. . . . The Commission's ratemaking authority granted by Article 15, Section 3, of the Arizona Constitution extends beyond setting rates to include the promulgation of rules and regulations that are "reasonably necessary steps in ratemaking." . . . The legislature retains power to govern public service corporations in matters unrelated to this ratemaking authority. . . . However, the legislature can delegate authority to the Commission, thereby enlarging the Commission's powers and duties. Ariz. Const. art. 15, § 6.

Id., 207 Ariz. at 111, 83 P.3d at 589 (citations omitted).

Turning to the specific challenged rules, the Court held as follows:

1. Rules requiring utilities to create administrators to oversee fair access to transmission services in a manner substantially prescribed by the Commission were "not reasonably necessary steps to ratemaking." *Id.*, 207 Ariz. at 112, 83 P.3d at 590. Rather, the rule "invades the Affected Utilities' managerial prerogative to decide how best to open access to transmission and distribution facilities." *Id.*, 207 Ariz. at 113, 83 P.3d at 591.

2. With regard to certain divestiture requirements, the Court found that a rule requiring that companies choosing to transfer competitive assets to an affiliate must do so at fair and competitive rates "is aimed at controlling rates rather than controlling the Affected Utilities and is therefore permissible." *Id.*, 207 Ariz. at 113-14, 83 P.3d at 591-92. However, rules requiring divestiture of competitive assets "are aimed at controlling the Affected Utilities rather than rates and are therefore outside the Commission's plenary ratemaking authority." *Id.*, 207 Ariz. at 114, 83 P.3d at 592.

3. Finally, a rule requiring utilities to propose and file codes of conduct with the Commission to prevent cross-subsidization with their competitive affiliates was sustained as controlling rates. *Id.*

The same analysis applied to the challenged rules in *US West* and *Phelps*

Dodge dooms the REST Rules. The Commission has never attempted to establish authority for each of the many discrete rules embodied in its renewable energy policy—not when it adopted the Rules, nor when it submitted them to the Attorney General for review, nor in any of their briefs in the court below, nor at oral argument. Likewise, the trial court sustained the Rules in their entirety, without engaging in an analysis of each discrete rule, contrary to the approach of this Court in both *US West* and *Phelps Dodge*.

Substantively, the REST Rules could not be more different than the Commission's transparency requirements at issue in *Woods*, which pertained to a public service corporation's "transaction of business within the State," which in turn is expressly contemplated within the Commission's constitutional authority. They differ fundamentally as well with the rules upheld in *US West* and *Phelps Dodge*, which were closely associated with rates. Instead, like the train service at issue in *Southern Pacific*, the REST Rules go to the "type and extent of service" that lie at the heart of managerial discretion. *So. Pac. Co.*, 98 Ariz. at 343, 404 P.2d at 694. The REST Rules also are analogous to the regulations found in *US West* and *Phelps Dodge* to be not reasonably related to ratemaking and therefore outside the Commission's constitutional authority.

The REST Rules insinuate the Commission into the business decisions of public service corporations to a degree far more invasive and pervasive than any

Commission rules ever before considered by a court, much less upheld. Among other provisions,

- Utilities are required to obtain renewable energy credits to satisfy specified annual percentages of retail power sold, starting with 1.25 percent in 2006 and increasing to 15 percent after 2024 (R14-2-1804).

- Of each annual percentage, the Commission mandates a specific percentage of distributed renewable energy resources, starting with five percent in 2007 and increasing to 30 percent after 2011 (R14-2-1805).

- Of that percentage, the Commission prescribes that half of the distributed energy requirement be satisfied on residential property and half on commercial property (R14-2-1805(D)).

- The Commission defines what constitutes a credit, who owns it, and whether and how it may be transferred, purchased, and sold (R14-2-1803).

- The Commission authorizes itself to approve utility agreements to purchase renewable energy and credits (R14-2-1804(G)).

- The Commission establishes a regime of manufacturing credits for the non-distributed energy requirement when utilities invest in or provide incentives to solar energy manufacturing plants in Arizona (R14-2-1807(A), 1807(B), and 1804(F)).

- The Commission limits the type of eligible renewable technologies that can be used to fulfill the Rules (R14-2-1802).

- The Commission limits the amount of wholesale electricity sold by non-utility owned generators that a utility may use to satisfy the distributed renewable energy requirement (R14-2-1805(E)).

- The Commission disqualifies energy conservation products, energy management products, energy efficient products, and other products that use nonrenewable fuels (R14-2-1802(D)).

- The Rules require utilities to recover costs of compliance via a special tariff (R14-2-1808).

- The Commission obligates utilities to pay up to half of the cost for customers to install distributed renewable resources; and prescribes how customers may request funds, sets a minimum amount that customers must contribute to the projects, and limits the amount of funds customers may receive (R14-2-1809).

- The Commission requires utilities to study issues relating to implementing distributed renewable resources and submit a broad array of prescribed data to the Commission (R14-2-1810).

- The Rules require utilities to submit detailed compliance plans annually (R14-2-1812).

- The Commission provides itself with the power to impose penalties for noncompliance (R14-2-1815).

Two of the Rules in particular are true poster-children for the degree to which the Rules control the companies rather than rates. Rule 14-2-1805(D) specifies that within the percentage of renewable energy that the Commission requires to be provided from distributed sources, exactly 50 percent—not 49 or 47 or 60 but exactly 50 percent—must be derived from residential sources and the other half from commercial sources. It doesn't matter whether residential consumers can't afford to pay for the necessary equipment, or that commercial distribution may be cheaper or more reliable or more readily available. The Commission decrees half, period.[5] Why did the Commission pick this number?

[5] The Rules provide for waivers, but do not describe instances in which they might

We don't know, because there are no findings to support it. How is this Rule a necessary step in ratemaking? We don't know, because the Commission has never sought to justify it. On its face, the Rule dictates to utility companies exactly where the distributed generation should occur, a matter the companies themselves are in a far better position to determine. The Rule's connection to rates is at best remote or incidental, which as a matter of law is not sufficient to trigger the Commission's ratemaking authority.

Rule 14-2-1809 obligates utilities to pay up to half of the cost for customers to install distributed renewable resources; and prescribes how customers may request funds, sets a minimum amount that customers must contribute to the projects, and limits the amount of funds customers may receive. Those obligations are eerily similar to—though far more oppressive than—the equal access requirements and the collection and billing requirements this Court found "do not relate at all to ratemaking" in *US West*, 197 Ariz. at 25, 3 P.3d at 945.

The REST Rules as a whole establish statewide renewable energy policy implemented through the utilities subject to its regulation, while excluding such alternative sources as nuclear power and hydro-generated power and prescribing mandatory outcomes that ordinarily would be subject to business discretion,

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be available, do not establish a procedure for seeking them, and do not provide any standards to guide the Commission's discretion in considering them.

market conditions, cost considerations, technological feasibility, and the individual choices of third parties over whom the Commission has no control. The Rules relate to ratemaking only in the tortured sense that they inexorably produce higher utility prices. The Rules themselves do not reference rates or ratemaking, nor are they a "step" in the ratemaking process, except for a provision requiring corporations to recapture costs of compliance with the Rules through a regular and ever-escalating surcharge (R14-2-1408). The trial court's decision seems to suggest that anything the Commission decides is in the public interest and might affect utility bills is reasonably necessary to ratemaking and therefore lies within the agency's purview. Such a deferential standard creates an exception that entirely swallows the rule that the Commission has no implied powers and cannot establish statewide energy policy. Indeed—and at the risk of giving the Commission any other ideas—by the trial court's circular logic, the Commission could decide that utility companies should buy Toyota Priuses for their customers, which would be a reasonably necessary step in ratemaking because, after all, it would contribute to the convenience of consumers and would increase their utility bills.

Never before has the Commission attempted so sweeping and intrusive a set of regulations. Never before have any individual regulations that are so prescriptive and remote from the setting of rates been upheld. As the

Commission's counsel acknowledged in the trial court (Tr. at 84), "we don't have the ability to set statewide energy policy." With that admission, appellant consumers fully agree.

III. THE REST RULES ARE NOT CLEARLY AND SPECIFICALLY AUTHORIZED BY STATUTE.

The trial court erroneously found that because the REST Rules were within the Commission's constitutional ratemaking authority, it was "unnecessary to review the parties' arguments of statutory authority for the promulgation of the REST Rules" (Op. at 8). However, the court earlier noted that "the REST Rules do not conflict with statutory authority" (*id.* at 7). While that is not correct, the legal standard is actually quite different: the Commission must demonstrate that the challenged Rules are specifically authorized by statute. As this Court put it in *Phelps Dodge*, 207 Ariz. at 112, 83 P.3d at 590, if the Commission's rules are not within its constitutional authority as necessary steps in ratemaking, "the Commission was only authorized to promulgate the rules if the legislature delegated such authority."

Again, the courts have articulated principles to guide this inquiry. As the Arizona Supreme Court stated in *Southern Pacific*, 98 Ariz. at 343, 404 P.2d at 695 (emphasis added), "In the exercise of the regulatory power, the legislature may interfere with the management of public utilities whenever public interest demands, but there is no presumption of an attempt "on the part of the legislature

to interfere with a corporation any further than the public interest requires and *no interference will be adjudged by implication beyond the clear letter of a statute*."

Several Arizona statutes further define the showing that an agency must make when it purports to exercise delegated powers. First, the agency must identify "the specific statutory authority for the rule." A.R.S. §§ 41-1001(14)(a)(1), 41-1022(A)(1), and 41-1001(1). Further, § 41-1001.01(A)(8) provides that an agency may "not make a rule under a specific grant of rule making authority that exceeds the subject matter areas listed in the specific statute." To summarize the statutes and cases, (1) the Commission must establish clear and specific statutory, (2) it must do so for each discrete rule, (3) the courts will not imply the power to regulate corporations, and (4) the rule may not go beyond the subject matter of the statutory delegation. The Commission never attempted to fulfill these obligations, much less did it accomplish them.

We examine below first the Commission's asserted bases of statutory authority, then legislative enactments pertaining to energy policy.

A. Commission's asserted statutory authority for the REST Rules. As required by A.R.S. § 41-1044(B), the Commission submitted the REST Rules to the Attorney General to determine whether, *inter alia*, they were within the Commission's legal authority. Initially, the Commission merely asserted that its "specific authority" for the REST Rules was Chapter 40 of the Arizona Revised

Statutes (SOF 20). Chapter 40 encompasses seven different chapters, each with multiple articles that comprise over 250 provisions—hardly the clear and specific statutory authority that is required.

Apparently, the Attorney General thought so too and characterized the cited authority as "vague," requesting "specific statutory authority" for the Rules (SOF 21). Two months, 15 pages, and a grab-bag of statutory citations later, the Commission admitted to the Attorney General that there is no "isolated source of statutory or constitutional authority" for the REST Rules (SOF 22). Ultimately the Attorney General approved the Rules, calling it a "close question" (SOF 23). But a "close call" cannot satisfy the requirement of "clear" and "specific" authority demanded by the statutes and court precedents.

The closest thing the Attorney General could identify as statutory authority for the REST Rules was A.R.S. § 40-321(A), with authorizes the Commission to take corrective action when it finds that "any public service corporation" is providing service, facilities, or methods that are "unjust, unreasonable, unsafe, improper, inadequate or insufficient." On its face, the statute plainly is remedial, not a grant of plenary policymaking authority. Were it otherwise, and given that the statute has been around for the better part of a century, one would suspect that the Commission would have invoked it in the many earlier cases in which Commission rules were struck down, for surely under the Commission's broad

reading the statute would have sheltered them all.

The Commission's findings supporting the REST Rules are to the effect that utilities as a whole will not be able to guarantee adequate energy supplies without diversifying their portfolios to include certain specified renewable energy sources. But it makes no finding that any particular company, or all of them, in fact are providing service, facilities, or methods that are "unjust, unreasonable, unsafe, improper, inadequate or insufficient." To the contrary, the company that serves the consumer plaintiffs—APS—contends that separate and apart from the Rules, "[w]e very much support, and we are actively engaged in, the development and deployment of renewable energy technologies" (Pl. SOF (Index of Record 19) Exh. 6, p. 2), and the Commission has made no finding that it will not do so. Absent such remedial justification, § 40-321(A) provides no basis for any Commission action, much less sweeping prescriptive Rules that extend 15 years into the future.

In *Southern Pacific*, 98 Ariz. at 346 & n.2, 404 P.2d at 696-97 & n.2, the Court examined *in pari materia* an analogous statute, A.R.S. § 40-324 (providing similar authority with respect to railroads), and found it to be quasi-judicial in nature. Tellingly, the Court held, "Obviously it is sufficient authority for the Commission to promulgate an order requiring the Southern Pacific Company to improve its service within the State of Arizona if by the elimination of the train in question service has been rendered inadequate or insufficient. Equally obvious, it

does not contemplate that the Commission shall promulgate orders upon a finding of facts by means of a crystal ball." *Id.*, 98 Ariz. at 346, 404 P.2d at 697.

The Commission, of course, made no such findings with regard to APS or any other particular public service company that are a condition precedent to exercising any remedial authority at all under § 40-321(A). It simply made generic findings regarding future energy needs. Whether by crystal ball or otherwise, the Commission then took the giant step of prescribing calibrated minimum requirements for specified renewable energy sources down to the kilowatt hour for each of the next 15 years. Plainly that exceeds exponentially whatever authority is conveyed to the Commission under this statute.

As the Court emphasized in *Southern Pacific*, 98 Ariz. at 343, 404 P.2d at 694-95 (emphasis in original), "it cannot be doubted but that a public utility may, *in the first instance*, in the exercise of its managerial functions, determine the type and extent of service to the public within the limits of adequacy and reasonableness." Given that "there is no presumption of an attempt on the part of the legislature to interfere with a corporation any further than the public interest requires and no interference will be adjudged by implication beyond the clear letter of a statute," *id.*, 98 Ariz. at 343, 404 P.2d at 695, it is clear that § 40-321(A) does not give the Commission the sweeping prospective and prescriptive regulatory powers it exercised in adopting the REST Rules.

Though the Commission has relied primarily on § 40-321(A), it has asserted with less vigor other purported bases of statutory authority such as A.R.S. § 40-202, notwithstanding that "[t]he Arizona Supreme Court has interpreted this section . . . as bestowing no power on the Commission beyond that already provided by the constitution or specifically granted otherwise by the legislature." *Phelps Dodge*, 207 Ariz. at 112, 83 P.3d at 590; see *So. Pac. Co.*, 98 Ariz. at 348, 404 P.2d at 698 (the statute "does not in and of itself grant additional powers to the Commission"). Appellants will await appellees' answering brief and respond if it seeks shelter for the Rules in additional statutory provisions, none of which provide anything approaching the degree of clear and specific authority necessary to sustain the REST Rules.

B. Legislative energy policy. The core of Arizona statewide energy policy, as established by the Legislature through its regulatory power over public service corporations, is embodied in A.R.S. § 40-361(B), which requires utilities to "furnish and maintain such service, equipment and facilities as will promote the safety, health, comfort and convenience of its patrons, employees and the public, and as will be in all respects adequate, efficient and reasonable."

Several aspects of this statute are noteworthy for present purposes. First, the statute is a direct command to utility companies, and does not delegate to the Commission any regulatory or enforcement power. Second, this statutory

command is consistent with the admonition expressed in *Southern Pacific*, 98 Ariz. at 343, 404 P.2d at 694-95, that utilities have, in the first instance, the requisite discretion to satisfy these requirements. Finally, it is the official energy policy of the State of Arizona, expressed through this statute, that utility companies provide power to their patrons in a manner that will be "in all respects adequate, efficient and reasonable."

The REST Rules are at war with this statutory command in two main ways. First, as discussed earlier, they displace management discretion over the means by which "adequate, efficient and reasonable" energy is furnished—not through remedial action when the Commission has found that a particular company has failed or will fail to fulfill its statutory obligation, but through regulatory fiat fixed in place for the next 15 years. Second, and the precipitating trigger for this lawsuit, they require utility companies to utilize specified renewable energy sources despite substantially higher costs—thus compelling them to violate their statutory obligation to furnish energy at "reasonable" cost. The Commission does this by requiring compliance with the Rules regardless of cost or technological feasibility, knowing in advance that such compliance will entail additional costs of more than one billion dollars, each and every dollar of which will be passed along to ratepayers in the form of monthly surcharges.

Absent the REST Rules, utility companies would be free in the first instance

to determine the proper mix of fuel sources to ensure "adequate, efficient and reasonable" supply. They may determine that even though solar or wind are too expensive, certain amounts are necessary to diversify their energy supply. They may want to wait to invest heavily until technology makes such fuel sources more cost-effective. They may want to be flexible in light of constantly changing fossil-fuel prices, increasing the amount of renewable energy when oil prices rise. They could decide that distributed energy is more cost-effective when produced from commercial rather than residential structures. They could determine that other renewable energy sources, such as nuclear or hydro, should be part of the mix, or even predominant. If they failed to ensure an "adequate, efficient and reasonable" energy supply, the Commission would be authorized pursuant to A.R.S. § 40-321(A) to remedy the problem.

The REST Rules turn this equation upside-down, fixing in advance minimum energy supplies from specified sources, including the precise minimum amount of distributed versus non-distributed renewable energy and the precise percentages of distributed energy from residential and commercial sources—even though the Commission cannot compel anyone to install solar panels, which in turn leads to requirements that utility companies subsidize such installations with other ratepayers picking up the tab.

Comments from utility companies during the REST rule-making process

underscore why it is important to preserve management discretion. "APS stated that it does not feel that it can reliably predict the availability or costs of renewable power for purchase beyond 2010" (SOF 49). "APS further stated that it is hopeful that several new cost-competitive technologies will become available to meet the Distributed Energy Requirement . . ., but that it does not yet know how cost effective or successful such alternatives will be for APS customers" (SOF 50). Unisource Energy Corporation (whose principal operating subsidiary is Tucson Electric Power) stated that the Commission staff's "wind assumptions are too optimistic" and its solar assumptions are inadequate to meet REST requirements (SOF 51). Unisource concluded that the REST requirements are "simply not achievable" (SOF 52).

Then-Commissioner Gleason asked the Commission staff to determine the estimated yearly costs of distributed and non-distributed renewable energy costs above the market cost of comparable conventional generation. The staff responded that the total compliance costs over the course of the REST Rules would be $1,204,523,824 (SOF 60). That does not count the cost of new infrastructure necessary to meet the requirements, which the staff, ominously, stated was "unknown" (SOF 61). We can safely assume that cost is substantially greater than zero.

These costs are being passed along to consumers and will continue to

increase. As the Commission's Economic, Small Business, and Consumer Impact Statement makes clear, "The impacts on consumers will be determined by the Tariffs that are filed for Commission approval under R14-2-1808." Specifically, "The cost to consumers will also vary over time and will directly follow the costs to the Affected Utilities. . . . After 2007, costs to consumers are likely to increase" (Index of Record 19, Exhibit 11, App. C p. 2) (App. 5). The costs projected by the Commission may understate that impact on consumers. "APS stated that it believes the revenue provided by the Sample Tariff will not be sufficient to support the RES except in the very near term, and that the funding necessary to support the Distributed Renewable Energy Requirement alone will likely exceed the Sample Tariff revenues after 2007" (SOF 63). "Unisource Energy stated that the Sample Tariff would not provide sufficient funding to meet the RES requirements in any year after 2006 under any sets of assumptions that were analyzed" (SOF 64).

The bottom line is that it is impossible to interpret statutes to provide authority to the Commission to impose rules that result in such a sharp conflict with the obligations that the Legislature has imposed on utility companies under § 40-361(B)—obligations that were intended to safeguard the interest of consumers, including the appellants.[6]

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[6] Indeed, the Rules and their annual escalating surcharges contradict the Commission's constitutional mandate to provide for "just and reasonable rates" under Ariz. Const. art. 15, § 3. As this Court observed in *Phelps Dodge*, 207 Ariz.

The Legislature has established renewable energy policy in a way that differs sharply with the Commission's command-and-control approach. In 2008, the Legislature enacted major tax benefits to attract solar companies to Arizona (Index of Record 19, Exh. 22, Ch. 7). Previously, it created individual tax credits for solar devices (§ 43-1085), and § 43-1164 establishes corporate tax credits for solar devices. A.R.S. §§ 43-1090 and 43-1176 provide tax credits for solar hot-water plumbing. A.R.S. § 41-1510.01 vests in the Department of Commerce—not the Corporation Commission—the power to determine which commercial solar energy projects qualify for tax credits. Likewise, § 41-1514.02 directs the Department of Commerce to establish an environmental technology assistance program to recruit and expand companies involved with solar and other renewable energy products. A.R.S. § 42-5159(A)(31) creates tax exemptions for electricity purchased from a qualified environmental manufacturer. A.R.S. § 41-1510 establishes a solar energy advisory council to advise the Legislature on the feasibility of solar power and to promote it through voluntary and cooperative action. Plainly, the Legislature has been extremely active in promoting renewable energy—using policy tools that the Commission does not possess, and without abrogating the companies' obligation to provide power at "reasonable" cost. It has

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at 107, 83 P.3d at 585, "The consideration of consumer interests in setting just and reasonable rates fulfills the protective role the constitutional framers envisioned in creating the Commission."

taken no action, much less clear and specific action, to cede to the Commission its power to establish energy policy for the State of Arizona.

Conclusion

This lawsuit is not a philosophical debate over renewable energy. It is an attack on Rules that impose unconstitutional obligations on utility companies that necessitate imposing significant utility surcharges on consumers. Though the Corporation Commission was designed to protect ratepayers, it has become a remote and opaque regulatory body that is far more influenced by special interest groups than by the concerns of ratepayers—as evidenced by the fact that all of the costs of the Rules are passed along to consumers in the form of monthly utility bill surcharges. The appellants do not dispute the need to develop alternate, renewable energy sources and a diverse energy supply. Indeed, the Legislature has taken deliberate steps to achieve such goals. The REST Rules, however benevolent their intention, inflict a regulatory straitjacket with substantial consumer costs. They exceed the Commission's constitutional authority and are not clearly and specifically authorized by statute.

Consequently, appellants respectfully urge this Court to find the Rules invalid, and to award costs and attorney fees to appellants pursuant to A.R.S. §§ 12-341, 348 and 2030, Rule 4(g), Ariz. R. P. Spec. Actions, and the private attorney general doctrine.

RESPECTFULLY SUBMITTED this 16th day of February, 2010 by:

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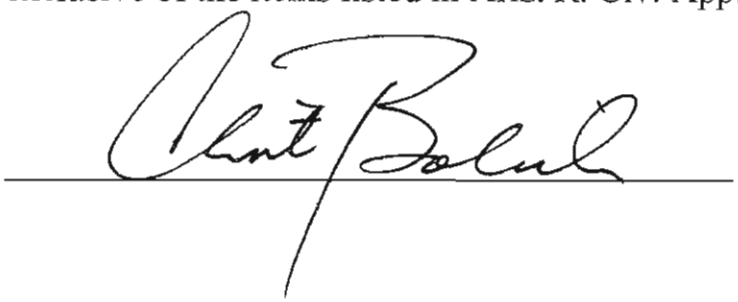
Certificate of Compliance

Pursuant to Ariz. R. Civ. App. P. 14, I certify that this brief uses proportionately spaced type of 14 points, is double-spaced using Times New Roman font, and contains approximately 7,498 words and that it does not exceed 40 pages, exclusive of the items listed in Ariz. R. Civ. App. P. 14(b).



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