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*In the*

# **Arizona Court of Appeals**

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*Arizona Public Service Co.,*

*Appellant,*

*v.*

*Arizona Corporation Commission,*

*Appellee.*

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*On a petition for special action seeking relief from Arizona Corporation Commission  
Decision No. 78317 dated November 9, 2021.*

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## **Brief of Amici Curiae National Association of Manufacturers and Arizona Chamber of Commerce & Industry in Support of Appellant**

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## INTERESTS OF AMICI CURIAE\*

- **National Association of Manufacturers.** The NAM is the largest manufacturing association in the United States, representing small and large manufacturers in every industrial sector and in all 50 States. Manufacturing employs more than 12.7 million men and women, contributes \$2.71 trillion to the U.S. economy annually, has the largest economic impact of any major sector, and accounts for nearly two-thirds of all private-sector research and development in the nation. The NAM is the voice of the manufacturing community and the leading advocate for a policy agenda that helps manufacturers compete in the global economy and create jobs across the United States.
- **Arizona Chamber of Commerce & Industry.** The Arizona Chamber of Commerce and Industry is a non-profit organization advocating for free-market public policies and working to ensure economic growth and prosperity for all Arizonans. A strong and modern energy infrastructure is essential to Arizona's ongoing growth, and our affordable and reliable energy has contributed to the influx in recent years of broad-based industry with high-wage jobs and additional tax revenue. A regulatory environment that is volatile, unreliable, and capricious will only thwart further economic growth.

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\* No counsel for any party authored this Amicus Brief in whole or part, and no person or entity other than Amici contributed to the cost of this Amicus Brief.

## INTRODUCTION

The Arizona Corporation Commission has exceeded its constitutional authority by changing its mind to prevent APS from recouping the cost of a prudent capital investment. Ariz. Const. art. XV, § 14. The Commission does not dispute that the investment was prudent when made, nor does it deny that APS had no choice but to incur the entire cost all at once. And it does not identify another means by which APS could have satisfied Arizona's energy needs.

The question before this Court is whether, despite the up-front nature of the expense and its reasonableness at the time, the Commission may simply opt for hindsight. As a legal matter, the hindsight approach offends due process, substantive constitutional provisions, and the Commission's own regulations. As a policy matter, it overlooks the need to supply reliable and affordable power to consumers and creates a perverse incentive for power companies to delay sensible emission-reduction efforts. Because the Commission lacked legal authority to reconsider its prudence finding years later and, even then, identified nothing to show imprudence, Decision No. 78317 cannot stand.



Not only is the Commission's new approach faithless to state law, but the Commission made this consequential change without any of the procedures that Arizona law requires. And its consequences for an economy that lives on electricity will be dire. Amici urge the Court to enforce the law as written and reject the Commissioners' attempt to revisit decisions that their predecessors made and on which APS and the economy as a whole have reasonably relied.

## **ARGUMENT**

Businesses in Arizona have a two-part interest in this Court correcting the Commission's legal error. First, they understand the uncertainty inherent in making significant investments with partial information or based on estimates of what the future will hold. To judge those investments years later with the benefit of hindsight is to punish imperfection when the law requires prudence. Second, businesses are consumers of electricity, water, and natural gas. They depend on reliable and affordable utility services, and many businesses choose Arizona for these very features.

Fortunately, the law does not allow the Commission to reverse its prior determination that the investment at issue was prudent long after APS made the approved, up-front investment. Authorities ranging from

the Commission's own rules to the Arizona Constitution prevent the Commission from using hindsight to punish APS for the sins of (a) making an investment in pollution-reducing technology and (b) closing a coal-fired power plant early. The law requires the Commissioners to set rates at a level appropriate to recover investments already deemed prudent. This Court should reverse Decision No. 78317 and restore confidence in the rule of law and the stable investing environment that has driven Arizona's growth.

**I. The Commission's New "Planning Imprudence" Standard Is Toxic for Investment and Inconsistent with Arizona Law.**

Investors—whether individuals, businesses, or governments—make the best decisions they can with the information available at the time. With the benefit of hindsight, some investments prove prescient; others appear daft. But hindsight is an unfair lens through which to assess reasonableness. For that reason, existing regulations expressly disallow second-guessing based on new information. Thus, the Commission has historically prohibited public service companies ("PSCs") from acting in ways that are "dishonest or obviously wasteful . . . when viewed in the light of all relevant conditions known or which in the exercise of reasonable judgment should have been known, *at the time* such investments were made." Ariz. Admin. Code § 14-2-

103(A)(3)(*l*) (emphasis added). That rule mirrors the constitutional directive that utility rates should allow recovery of “reasonable” investments in infrastructure. Ariz. Const. art. XV, § 14. What the Commission did in this case is the opposite of reasonable—judging investments based on later events, upsetting settled expectations, and ignoring the law.

At the time of APS’s investment in Four Corners, the company had no choice but to adopt the “best available retrofit technology” (BART) for reducing pollutants that contribute to regional haze. 42 U.S.C. § 7491(b)(2)(A). The *whole* investment in that technology—Selective Catalytic Reduction (SCR) technology—was necessary to comply with federal regulations and begin producing electricity. The Clean Air Act does not allow electricity generating facilities to install SCR piecemeal; those facilities either comply with regulations to operate pursuant to a permit, or they do not.

When the Commission approved APS’s investment in additional Four Corners generation capacity (*i.e.*, Decision Nos. 73130 and 74876), it was well aware of the federal regulatory requirements associated with this investment. *See, e.g., United States of America v. Arizona Public Service et al.*, No. 1:15-cv-00537-JB, at Doc. 2–1 (Consent Decree)

(D.N.M. June 24, 2015). It knew that APS was committing to execute a strategy of adding capacity at Four Corners and that this investment required the entire SCR installation at the outset. APPV11-028.

The Commission approved APS's investment in the Four Corners Generating Station in 2012, recognizing that additional generating capacity and new emission-control technology would benefit consumers and the environment. APPV11-036-047. Normally, that finding would be the end of the matter; APS would proceed to make its investments, and the Commission would factor the cost of the investment into future ratemaking. *See generally Simms v. Round Valley Light Power Co.*, 80 Ariz. 145, 151 (1956). Here, however, the Commission belatedly concluded that APS had been imprudent in investing in costly pollution-control technology because of its subsequent decision to retire the Four Corners plant early. APPV2-040. The Commission did not identify any information available in 2010 when APS decided to invest in Four Corners Units 4 and 5 that would have foreshadowed the later decision to retire the plant.

Instead, the Commission adopted a new standard with an appropriately Orwellian name: "planning imprudence." APPV2-042. Under this new rule—announced without any rulemaking procedures,

and in contradiction to the existing rule—APS must continue assessing the prudence of earlier investments. APPV2-038. If later events make the earlier investment appear unwise, then the Commission infers retroactive imprudence. Never mind that SCR is an up-front rather than ongoing expense, or that the record is devoid of anything suggesting that APS knew or should have known that it would retire Four Corners early. This hindsight bias approach is poisonous to investing.

In certain circumstances, the law allows a court or regulator to guard against investment decisions that are so misguided that they cannot be the product of strategic differences or simple error. Thus, for example, trustees must “exercise reasonable care, skill, and caution” in managing trust assets. A.R.S. § 14-10804. And, relevant here, PSCs’ investments are presumptively prudent, subject to Commission repudiation only when “dishonest or obviously wasteful” based on information available “at the time such investments were made.” Ariz. Admin. Code § 14-2-103(A)(3)(*l*).

By scrapping that rule in favor of a new standard unconnected to the time of the investment decision, the Commission violated both administrative and constitutional law. As an administrative matter, the Commission has attempted a backdoor rule change. Arizona courts have

long denounced the Commission's attempts to change "policy in a piecemeal fashion through individual adjudicatory orders" rather than formal rulemaking. *Arizona Corp. Com'n v. Palm Springs Util. Co.*, 24 Ariz. App. 124, 128–129 (App. 1975). If the Commission wishes to alter the prudence standard in Administrative Code Section 14-2-103, it must comply with the Arizona Administrative Procedure Act. A.R.S. § 41-1001(21) (a "rule" includes "the amendment or repeal of a prior rule").

Equally problematic, the decision to disconnect rates from the value of APS's property offends Article 15 of the Arizona Constitution. That article requires the Commission to set "just and reasonable rates," Ariz. Const. art. XV, § 3, that are "related to" the fair value of the property used to generate electricity. *Simms*, 80 Ariz. at 151 (citing Ariz. Const. art. XV, § 14). The property in question—Four Corners Units 4 and 5—includes emission-control components necessary to comply with federal regulations. Because they are legally necessary for operation, they are unquestionably "related to" electricity generation. By excluding the SCR equipment in setting rates, the Commission violated its constitutional mandate.

The Commission's changed standard also reflects detachment from the practical reality of long-term investments. When investors make

decisions, they do not know what the future will hold. Cognizant of this fact, courts take care not to allow hindsight to color their assessment of prior decisions. In *Desert Sun Loan Corp. v. Consol. Water Utils. Ltd.*, 184 Ariz. 430 (App. 1996), a PSC argued that a note it had issued was void because the Commission had not approved it as required by statute. The statute in question, A.R.S. § 40-302(D), contained an exception for notes of modest size issued “for proper purposes,” which the PSC argued did not apply “because its original decision to purchase the property was made without full disclosure by its attorneys and at an excessive sales price.” *Desert Sun*, 184 Ariz. at 435. This court rejected that argument: “In hindsight these transactions may have been ill-advised or induced by a breach of trust, but we cannot agree that they were not, from [the PSC’s] perspective, entered into for a ‘proper purpose.’” *Id.* Although the posture in this case is reversed—the PSC here defends its investing decision—this Court’s refusal to indulge hindsight should still apply.

The importance of eschewing hindsight bias extends beyond PSCs. Courts’ historic unwillingness to consider investment decisions in light of later developments applies to corporations as well. *Kottayil v. Insys Therapeutics, Inc.*, No. 1 CA-CV 15-0765, \*41 ¶ 56 (App. Aug. 29, 2017) (citing *Dann v. Chrysler Corp.*, 215 A.2d 709, 714 (Del. Ch. 1965)

(rejecting “hindsight evidence”). And it extends to trusts, for which Arizona courts apply the Restatement: “[P]erformance’ tests and ‘hindsight’ are not to be applied in judging a trustee’s investment conduct . . . .” Restatement (Third) of Trusts § 90 cmt. b (2007); *Zilles v. Am. Legion*, 219 Ariz. 527, 534 ¶ 30 (App. 2008) (absent contrary authority, Arizona follows the Restatement). This case therefore carries economy-wide significance. The Commission’s effort to punish APS for using coal upsets the investing environment in which every Arizona decision-maker has operated for decades.

The particular method that the Commission employed to second-guess investing decisions is less important than its consequence for Arizona’s economy. Not only will the “planning prudence” standard decimate investment by PSCs, but it poses a threat to other businesses as well. If the prudence of an investment is not evaluated at the time at which the decision is made, then businesses risk an onslaught of shareholder derivative suits second-guessing investment decisions on the basis of later-discovered information. Currently, Arizona rejects that theory, *see Kottayil supra*, but the Commission’s approach opens the door for lawsuits by PSC shareholders at minimum, if not for every shareholder looking to second-guess a company’s business judgment.



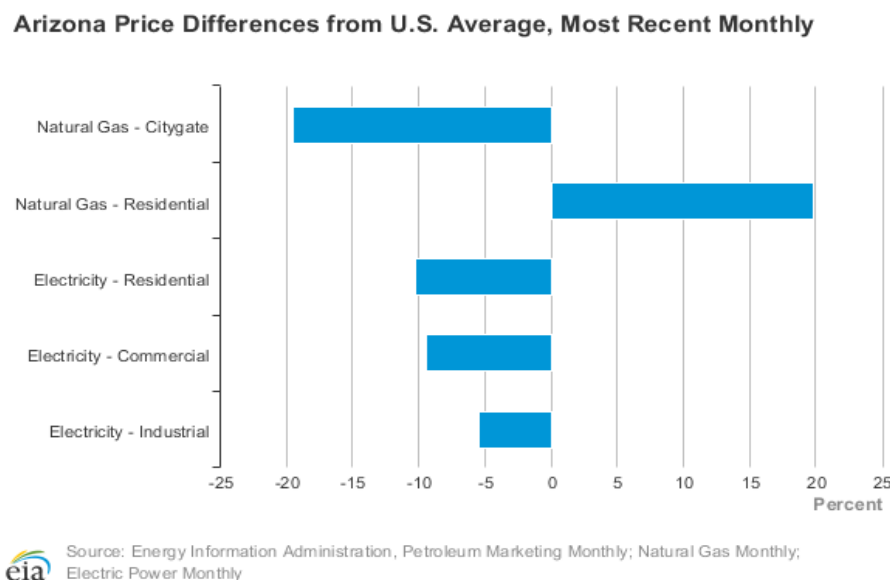
The Corporation Commission has essentially abrogated its long-standing rule without any rulemaking process. In rescinding its earlier approval based on an unheralded new rule in this case, it has trampled APS's due process rights. The Arizona Constitution guarantees PSCs a reasonable return on the property used for delivery of electricity. The Commission is not free to rescind its earlier approval through a test that enshrines hindsight and threatens businesses across the State. This Court should vacate the decision below.

**II. The Arizona Economy Has Surged in Reliance on an Up-to-Date Infrastructure Maintained by Public Service Companies.**

From a consumer perspective, Arizona's electricity market is not only an important ingredient for growth but also distinguishes this State from others. It is no accident that Arizona's economic growth coincides with more reliable and less expensive power than its neighbors. The Commission's new attack on investment threatens to undermine Arizona's progress in general and electricity-intensive high-tech industries in particular.

Arizona's electricity is reliable and affordable. Although the Commission couched its decision as an attempt to "achieve a rate

decrease” for customers, APPV13-016, the approach in Administrative Code Section 14-2-103 has already proven effective at delivering affordable electricity. The U.S. Energy Information Administration assembles data on each State’s electricity production, consumption, and efficiency. U.S. Energy Information Administration, *Electricity, State Electricity Profiles*, <https://www.eia.gov/electricity/state> (accessed Aug. 10, 2022). Arizona ranks number seven in the nation for production by its utility companies and enjoys a retail price below the national average. *Id.* <https://www.eia.gov/electricity/state/arizona> (accessed Aug. 10, 2022). In fact, as the following graphic illustrates, all of Arizona’s electricity rates are well below the national average:



Affordable electricity is not possible without ongoing investment in infrastructure like the BART necessary to keep the Four Corners plant

open. Arizona’s approach has succeeded in delivering electricity at below-average cost while complying with capital-intensive environmental regulations.

Subsequent events have confirmed the link between protecting investments and delivering low-cost electricity. As documented in the Opening Brief, credit agencies swiftly downgraded APS in response to the Commission’s actions. OB 71–72. This response should come as little surprise, as should the next event in the chain: higher prices for consumers. When ratings agencies identify greater risk, the interest rate that an issuer must pay on future debt increases to compensate for the risk. For capital-intensive industries like electricity generation, changes in interest rates transform the overall cost structure: “A utility downgrade would place upward pressure on the embedded cost of debt, as new long-term debt securities are issued at higher interest rates. Additionally, a utility’s cost of equity would increase as investors require a higher rate of return to compensate for additional risk.” United States Agency for International Development, *A Cost of Capital and Capital Markers Primer for Utility Regulators*, Section 2.3, <https://pubs.naruc.org/pub.cfm?id=CAD801A0-155D-0A36-316A-B9E8C935EE4D> (April 2020). As borrowing costs increase, a utility must

respond with a combination of two strategies. It can curtail further investment (itself undesirable) or pass higher borrowing costs along to consumers. Either way, consumers pay a heavy price in the form of aging, inefficient infrastructure and higher bills. The “risks faced by utility investors are important to utility customers because risks to investors get reflected in the capital costs to the utility which are ultimately paid for by customers.” *Id.*

In addition to increasing the price that consumers pay for electricity in Arizona, the Commission’s post hoc prudence finding threatens future investment and, with it, reliability. Examples of the harm that follows from inadequate investment in electricity infrastructure abound. California has made headlines in recent years with its rolling blackouts. *See, e.g.,* Stevens, Pippa, CNBC, *Utilities are struggling to keep the lights on as fires, drought plague California* <https://www.cnbc.com/2021/08/01/utilities-are-struggling-to-keep-the-lights-on-as-fires-drought-plague-california.html> (August 1, 2021). In fact, the American Society of Civil Engineers (ASCE), which reviews and rates the U.S. electricity grid, reports 4,297 power outages in California compared to 530 in Arizona during the same ten-year period. ASCE,

2021 Infrastructure Report Card, *available at* [www.infrastructurereportcard.org](http://www.infrastructurereportcard.org) (accessed Aug. 10, 2022).

The California blackouts are not only a cautionary tale but also bear directly on Arizona's need for independent energy sources. California's deficient energy infrastructure drove it to petition the Federal Energy Regulatory Commission (FERC) for a new tariff allowing it to impound energy flowing through California and prioritize electric utilities in California over those in other States, including Arizona. *Cal. Indep. Sys. Operator Corp.*, 2021 WL 2633033, 175 FERC ¶ 61,245 (Jun. 25, 2021). Over the objection of Arizona utilities and power users including the Commission, FERC obliged, permitting California to adopt a discriminatory rule favoring in-state consumers. *Id.* There, the Commission argued that "the consequence" of California's neglected infrastructure and regulatory response "will be increased prices for transactions intended to serve Arizona customers and reliability risks." *Id.* at \*33 ¶ 124. The arguments before FERC illustrate the importance of maintaining electrical capacity and the arbitrariness of the Commission's recent actions. It makes no sense to appear before FERC to decry California's efforts to export its electricity problems to Arizona

while simultaneously cultivating those same deficiencies by undermining investment in Arizona.

On the opposite side of the coin, infrastructure investments in Arizona have paid off in the form of business location and relocation in the State. PSCs have played an important part in Arizona's extraordinary growth over the last several decades, including its recent transformative growth in technology manufacturing. For example, a national trade publication recognized APS in 2020 as a nationwide leader in economic development. *See* Bruns, Adam, Site Selection Magazine, *Marquee Players*, <https://siteselection.com/issues/2020/sep/2020-top-utilities-in-economic-development.cfm> (Sept. 2020) ("Each year we salute the Top Utilities in Economic Development based on corporate end-user project investment and affiliated job creation in these utilities' territories, evaluated on a cumulative and per-capita basis. These are the cream of the crop among many strong candidates that stand out from the nation's 3,300 utilities (including 900 electric cooperatives).").

Utilities are especially important for the energy-intensive tech sector. Affordable electricity, for example, helped secure a \$12 billion project with the Taiwan Semiconductor Manufacturing Company

(TSMC). See Schoolov, Katie, CNBC, *Inside TSMC, the Taiwanese chipmaking giant that's building a new plant in Phoenix*, <https://www.cnbc.com/2021/10/16/tsmc-taiwanese-chipmaker-ramping-production-to-end-chip-shortage.html> (October 16, 2021). As one industry veteran explained in commenting on TSMC's decision to build in Arizona, "[t]he two most important pieces of infrastructure for a [semiconductor manufacturer] are electricity, and more electricity." Yu, Yifan and Ting-Fang, Cheng, Nikkei Asia, *TSMC in Arizona: Why Taiwan's chip titan is betting on the desert*, <https://asia.nikkei.com/Business/Tech/Semiconductors/TSMC-in-Arizona-Why-Taiwan-s-chip-titan-is-betting-on-the-desert> (June 3, 2021).

Other companies have told the Commission itself that access to electricity was central to their decision to locate in Arizona. eBay, for example, explained that "[t]he price for electricity that eBay pays will drive whether or not it will continue to stay, and even grow, in APS's service territory for the benefit of Arizona . . . ." *In the matter of the Application of Ariz. Pub. Serv. Co. for Approval of Elec. Serv. Contracts with eBay, Inc.*, at 2 (Ariz. Corp. Commn. Apr. 8, 2015) <https://docket.images.azcc.gov/0000160605.pdf?i=1641590505001> (No.

E-01345A-15-0117). The same applies to electric truck developer Nikola. In advocating for a tailored rate schedule, APS explained that Nikola's access to affordable electricity is "an important means of economic development in Arizona." *In the matter of the Application of Ariz. Pub. Serv. Co. for Approval of Elec. Serv. Contract Rate Sched. with Nikola Corp.*, at 2 (Ariz. Corp. Commn. Dec. 11, 2020) <https://docket.images.azcc.gov/E000010559.pdf?i=1641590313907> (No. E-01345A-20-0367). In both cases, the Commission agreed with the commonsense point that electricity drives high-tech development and approved the proposed rates.

Additionally, through collaboration with APS and others, Microsoft selected Arizona as the location for the development of three new datacenter campuses to support the growing demand for cloud and internet services across the Western United States. *See* Janous, Brian, Microsoft, *Building world-class sustainable datacenters and investing in solar power in Arizona*, <https://blogs.microsoft.com/on-the-issues/2019/07/30/building-world-class-sustainable-datacenters-and-investing-in-solar-power-in-arizona/> (July 30, 2019) ("We'd like to thank . . . the Arizona Commerce Authority, Arizona Public Service and First



Solar for their collaboration to help make our vision for sustainable datacenters and increased renewable energy in Arizona possible.”).

Finally, Chandler’s Economic Development Director has boasted that the area “offers everything that a tech company needs to be successful,” including “reliable infrastructure” and the knowledge that companies “are supported and that our regional community (government, *utility companies* and other service providers) will be dedicated partners in their growth.” PHX East Valley, *PHX East Valley Is a Hub for Tech and Innovation*, <https://www.phxeastvalley.org/phx-east-valley-is-a-hub-for-tech-and-innovation/> (August 16, 2017) (emphasis added).

Arizona’s remarkable growth is neither accidental nor guaranteed. It is the product of a business climate encompassing many variables, among them infrastructure like affordable energy and legal protections, including the assurance that investments will be safe from hindsight bias. Maintaining that business environment is a matter of utmost importance.

The Commission’s recent reinterpretation of longstanding investment rules is a threat to the State’s continued growth that only this Court can cure. Despite the Commission’s stated goal of “achiev[ing]

a rate decrease” for consumers, APPV13-016, the consequence of its action is exactly the opposite: Arizona consumers will pay more for less reliable electricity. The fallout for Arizona’s efforts to attract and retain growth industries will only compound the downside for households. The Arizona Constitution’s guarantee of a reasonable rate of return for PSCs that invest in infrastructure avoids this downward spiral. By ignoring that provision and its own regulations, the Commission has dealt a blow to Arizona’s economy.

## CONCLUSION

This Court should reverse the Commission’s novel reframing of investment “prudence” and “fair and reasonable” utility rates. The Commission’s offends the rule of law and undermines the incentive to invest in Arizona.

RESPECTFULLY submitted this 17th day of August, 2022.

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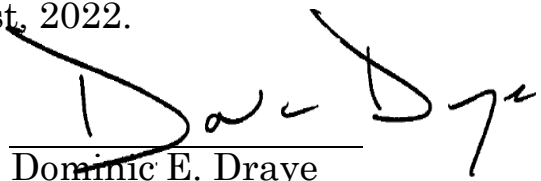
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## **CERTIFICATE OF COMPLIANCE**

This Amicus Brief complies with Rules 4 and 14(a) of the Arizona Rules of Civil Appellate Procedure in that the petition is double-spaced, employs a proportionately spaced typeface and the author's word count software program reports that this petition consists of 3,385 words.

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## **CERTIFICATE OF SERVICE**

I certify that the original of the foregoing Brief of Amici Curiae National Association of Manufacturers and Arizona Chamber of Commerce & Industry in Support of Appellant was e-filed with the Clerk of the Arizona Court of Appeals via AZTurboCourt on August 17, 2022, and that a copy was served via AZTurboCourt e-service on this same date, as follows:

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