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February 16, 2012

Doug Fant, General Counsel
Arizona Power Authority
1810 W. Adams St.
Phoenix, AZ 85007-2679

Re: Memorandum Re: IEDA's Position on the Applicability of the Red Book

Dear Doug:

The Arizona Power Authority recently released the draft agenda for the regular meeting of the Commission to be held on February 21, 2012. Notably, the first Agenda Item calls for possible action on a "Motion to clarify that the Final Hoover Power Marketing Post-1987 Plan or previous 'Red Book' does not apply to [the] Hoover Post-2017 Marketing Process". As you might imagine, the proposed action provides a significant departure from customer expectations. As a result, we felt the need to address the issue. This memorandum offers our analysis of the extent to which the Red Book remains applicable to the upcoming APA allocation process. We offer it for your consideration and that of the Commission and APA staff.

The Red Book was released on June 7, 1985 as the decision of the Commission allocating Hoover Power within Arizona post-1987. The Red Book did three things: first, it summarized the administrative process used by the Commission prior to arriving at its decision; second, it interpreted the statutory authority the Commission was charged with using to come to that decision; and third, it presented the Commission's allocations. The Red Book recited the "Principles and Methods" used by the Commission for allocating Hoover Power guided by public comments and its then regulations. Red Book, pp. 9-12. The Red Book outlined a timetable for completion of the administrative process and contracting. Red Book, pp. 7-8. It summarized comments the Commission had received (pp. 16-23) and outlined the certification process and the contract conditions that would be included in all of the contracts. Red Book, pp. 24-28. Most importantly for the instant analysis, the Red Book interpreted state law as to the eligibility of entities to receive Hoover allocations under Title 30 and Title 45. Red Book, pp. 13-15.

The Upcoming Administrative Process

At the time of the allocation in 1985, the Commission used the APA regulations then in place to guide the process that was used. Since then, the Commission regulations have twice been modified, in 1993 and again in 2003. To the extent the Commission process for the upcoming allocations has been modified, it goes without saying that the current process rules pertain.

However, to the extent the substance of the process rules has not been changed, the Red Book provides a longstanding administrative interpretation of those rules and must be recognized as such.

The Resource Allocations

In 1985, the Commission announced its "principles and guidelines" for marketing Hoover Power. Red Book, p. 2. At that time, the Commission had two capacity resources to allocate: Hoover A (existing capacity); and Hoover B (uprating capacity). It had two future developments to consider: the success of the uprating of Hoover Dam generators; and the need of the Central Arizona Project (CAP) for power supplemental to the federal share of Navajo Generating Station capacity.

The upratings are in place and CAP is constructed. Nevertheless the "Allocation Principles and Methods" outlined in the Red Book (pp. 9-12) applied the law in a fashion that cannot be ignored merely because the contemplated future became a reality.

This is especially true since those principles were carried forward into Commission regulations in 1993 and again in 2003. Indeed, the Concise Explanatory Statement filed by the Commission with the Governor's Regulatory Review Council in 1992 expressly states that such principles were being carried forward and described no changes to the application of those Red Book principles (Red Book, pp. 9-12). Indeed, this is demonstrated by the Commission's current regulations, A.A.C.R. 12-14-201, paragraphs I., J. & K.

Thus, the Red Book provides a longstanding interpretation of the application of these principles and should be accorded that status.

Eligibility for Allocation

Generally speaking, an administrative agency's interpretation of an ambiguous statute is permissible unless it is arbitrary, capricious, or manifestly contrary to the statute. *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). This is commonly known as *Chevron* deference. In general, an agency rule also is subject to *Chevron* deference if such rule is within the agency's authority entrusted to it, and was promulgated only after notice and comment. *Bamonte v. City of Mesa*, 598 F.3d 1217 (2010).

However, Federal courts have held that a Federal agency's subsequent change in interpretation of a statute with which it is charged with enforcing must be supported by a reasoned analysis over and above that required for its interpretation in the first instance. *Flagstaff Medical Center, Inc. v. Sullivan*, 962 F.2d 879 (1992). Therefore, an agency's determination is entitled to considerably less deference where that determination conflicts with the agency's earlier interpretation, rather than if there had been a consistently held view by the agency. *Southwest Center for Biological Diversity v. Babbitt*, 980 F.Supp. 1080 (1997); S*ee also Arizona Health Care Cost Containment System v. McClellan*, 508 F.3d 1243 (2007) (in interpreting a statute, a court normally accords particular deference to an administrative agency interpretation of longstanding duration).

Arizona courts have adopted the Federal Court's approach to an agency's subsequent legislative interpretation, holding that: "Administrative interpretation of a statute should be accorded some weight in arriving at its proper interpretation, and while administrative interpretation is not binding, where it is long continued and the language in question is ambiguous, courts will acquiesce in such administrative interpretation." *Arizona Foundation for Neurology and Psychiatry v. Sienerth*, 13 Ariz.App. 472, 477 P.2d 758 (1970).

On pages 13-15, the Red Book analyzed the eligibility of entities to contract for power under then-existing law. Those statutory qualifications for eligibility have not changed. That this is so is bolstered by the continuation since then in Commission rules of the definition of "Qualified Entities". A.A.C.R. 12-14-101(18), to wit: "Qualified Entity" means any Entity that is eligible to purchase Power from the Authority under A.R.S. Title 30, Chapter 1 or A.R.S. Title 45, Chapter 10."

The Red Book analysis and its declared requirements for Hoover applicants are as valid today as they were in 1985. Nothing has changed concerning this subject. The Commission's interpretation of these statutes in 1985 must be deferred to by the Commission today as well as by the courts.

I hope the foregoing is of assistance in addressing Item G.1 on the proposed agenda for Tuesday. If you have any question, please do not hesitate to get in touch with me.

Sincerely,

/s/

Robert S. Lynch
Counsel and Assistant
Secretary/Treasurer

cc: Arizona Power Authority Commissioners
Joe Mulholland, Executive Director