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IN THE MATTER OF THE GENERIC )  
PROCEEDINGS CONCERNING ELECTRIC )  
RESTRUCTURING ISSUES )  
  
IN THE MATTER OF ARIZONA PUBLIC )  
SERVICE COMPANY'S REQUEST FOR A )  
VARIANCE OF CERTAIN REQUIREMENTS OF )  
A.A.C. R14-22-1606 )  
  
IN THE MATTER OF THE GENERIC )  
PROCEEDING CONCERNING THE ARIZONA )  
INDEPENDENT SCHEDULING )  
ADMINISTRATOR )  
  
IN THE MATTER OF TUCSON ELECTRIC )  
POWER COMPANY'S APPLICATION FOR A )  
VARIANCE OF CERTAIN ELECTRIC )  
COMPETITION RULES COMPLIANCE DATES )

Docket No. E-00000A-02-0051

Docket No. E-01345A-01-0822

Docket No. E-00000A-01-0630

Docket No. E-01933A-02-0069

REPLY BRIEF ON  
TRACK "B" ISSUES

Pursuant to the briefing schedule established in the above-captioned consolidated proceedings, Sempra Energy Resources and Southwestern Power Group II ("Sempra/ SWPG") hereby submit their Reply Brief on Track "B" issues.

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I.

**DETERMINATION OF "CONTESTABLE LOAD"**

**A. Introduction.**

A threshold issue requiring resolution in the Track "B" proceeding is what constitutes "contestable load" for purposes of the competitive procurement process which is to be adopted by the Commission.<sup>1</sup> In their Initial Briefs, Arizona Public Service Company ("APS"), Tucson Electric Power company ("TEP") and Arizona Utility Investors Association ("AUIA") argue for a definition of that term and concept which would restrict it to anticipated capacity and energy requirements that cannot be produced from a utility's existing generation assets. The Commission's Staff ("Staff") and a number of the Intervenor (including Sempra/ SWPG) contend that the definition and concept is larger in scope, and should also encompass capacity and energy requirements which cannot be economically generated by each utility's existing generating assets.<sup>2</sup> In making their respective arguments, each side relies upon its perception of what the Commission intended in conjunction with its issuance of Decision No. 65154 in the Track "A" phase of these consolidated proceedings.

The resolution of this issue is important because the competitive procurement process resulting from Track "B" is the means the Commission has selected for effecting the transition to a viable and robust competitive wholesale electric market in Arizona. Thus, it is appropriate to begin with an examination of the language of Decision No. 65154 and the context in which it was issued.

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<sup>1</sup> As used herein, "contestable load" means that portion of a utility's capacity and energy needs that is to be subject to the competitive procurement process resulting from the Track "B" proceedings.

<sup>2</sup> The term "unmet needs" has been used at various times during the Track "B" proceedings to describe this deficit.

1           **B.     The Commission’s Intent As Reflected In The Context and Language of**  
2           **Decision No. 65154.**

3           In Track “A” the Commission had before it the questions of whether the then impending (i)  
4           divestiture of generation assets required by A.A.C. R14-2-1615(A) and (ii) competitive procurement  
5           levels required by A.A.C. R14-2-1606(B) should be maintained or modified. In resolving these  
6           questions, the Commission made the following statements:  
7

8                     “We find that due to circumstances outside our control or the control  
9                     of any party, and in order to protect the public interest, we must take  
10                    further action to regulate the transition to competition. We want to act  
11                    in a manner that is fair to all parties and that protects ratepayers.”  
                      [Decision No. 65154, page 22, lines 20-28] [emphasis supplied]

12                    “Therefore, we find that the public interest requires that the  
13                    divestiture requirement found in A.A.C. R14-2-1615(A) . . . must be  
14                    modified . . . and both companies [i.e. TEP and APS] are hereby  
15                    directed to cancel any plans to divest interest in any generating  
16                    assets.” [Decision No. 65154, page 23, lines 7-10]

17                    “Further, we will modify R14-2-1605(B) and Decision Nos. 61973  
18                    and 62103's [to remove the] requirement that 100 percent of power  
19                    purchased for Standard Offer Service shall be acquired from the  
20                    competitive market, with at least 50 percent through a competitive bid  
21                    process; but, effective upon implementation of the outcome of Track  
22                    B, we will require APS and TEP to acquire, at a minimum, any  
23                    required power that cannot be produced from its own existing assets,  
24                    through the competitive procurement process as developed in the  
25                    Track B proceeding. The amount of power, the timing and the form  
26                    of procurement shall be determined in the Track B proceeding.”  
27                    [Decision No. 65154, page 23, lines 20-25] [emphasis supplied]

28                    “We believe that in this way we can encourage a phase-in to  
                      competition, encourage the development of a robust wholesale market  
                      for generation, and obtain some of the benefits of the new Arizona  
                      generation resources, while at the same time protecting ratepayers.”  
                      [Decision No. 65154, page 23, line 25-page 24, line 2] [emphasis  
                      supplied]

1 It is readily apparent from the above that the Commission wants to facilitate (i) a sustained  
2 transition or phase-in to a competitive wholesale electric market, (ii) in a manner which allows  
3 Arizona electric ratepayers to realize the benefits of such competition and the presence of new  
4 generation resources within the state, (iii) yet protects those ratepayers from price volatility and  
5 reliability concerns. The construction of the Commission's language modifying the requirements  
6 of A.A.C. R14-2-1606(B) and Decision Nos. 61073 and 62103 advocated by the Staff, Sempra/  
7 SWPG and several other Intervenors is both consistent with and in furtherance of these goals.  
8 Whereas, the interpretation urged by APS, TEP and AUIA is not as demonstrated below.  
9  
10

11 More specifically, in Decision No. 65154 the Commission replaced the competitive  
12 procurement levels prescribed in A.A.C. R14-2-1606(B) with the requirement that APS and TEP

13 ". . . acquire, at a minimum, any required power that cannot be  
14 produced from its own existing assets through the competitive  
15 procurement process as developed in the Track B proceeding."  
16 [Decision No. 65154, page 23, lines 22-24] [emphasis added]

17 Had the Commission intended to define each utility's contestable load as that amount which it could  
18 not generate with its own existing assets, the Commission would not have included the words "at  
19 a minimum" in its Opinion and Order.<sup>3</sup> However that is not what the Commission intended.

20 To the contrary, the Commission intended that the power supply capability of existing assets  
21 should only be the starting point in demarcating what would represent that portion of each utility's  
22 load which was to be subject to the competitive procurement process. The parameters of each  
23 utility's contestable load were to be further refined in the current phase of these consolidated  
24 proceedings, as attested to by the following language from Decision No. 65154:

25 \_\_\_\_\_  
26 <sup>3</sup> In this regard, AUIA is in error when it suggests that Footnote 8 in Decision No. 65154 was meant  
27 to clarify the phrase "at a minimum." Rather, its purpose is to suggest one way in which a utility's  
28 "existing assets" might be reduced by its own action.



1                   **C.     The Amended Staff Report Is Consistent with the Commission’s Intent and**  
2                   **Goals in Decision No. 65154.**

3                   In their Initial Brief, Sempra/ SWPG supported the Staff’s amendment of the October 25,  
4                   2002 Staff Report [Ex. S-1] to add the word “economically” to the Commission’s conceptual  
5                   directive in Decision No. 65154 regarding the manner in which contestable load is to be defined.  
6                   Sempra/ SWPG incorporate herein by reference that discussion in continued support of the Staff’s  
7                   interpretation of the Commission’s intent [ Initial Brief, page 5, line 7- page 6, lines 16]; and further  
8                   offer the preceding discussion in subsections I(A) and I(B) of this Reply Brief in support of the  
9                   correctness of the Staff’s position on this issue.  
10

11                   APS, TEP and AUIA endeavor to argue that Staff’s position on this issue in Track “B” is  
12                   inconsistent with the testimony Staff presented and the position Staff advocated in the Track “A”  
13                   phase of these consolidated proceedings. Whether Staff’s positions are different in each instance is  
14                   not relevant. What is relevant is the Commission’s intent as reflected in the language of Decision  
15                   No. 65154. Staff’s case presentation and advocacy posture in Track “A” preceded the Commission’s  
16                   policy declaration in that phase, and is in no way dispositive of the question of what the Commission  
17                   intended. Staff’s evidentiary presentation in this phase is based upon its interpretation of what the  
18                   Commission intended by Decision No. 65154. In that regard, it should be noted that AUIA’s  
19                   attempts to characterize Staff’s case presentation in Track “B” as a “collateral attack” on Decision  
20                   No. 65154 are at best misplaced and premature. So is APS’ attempt to suggest that Staff is  
21                   proposing to amend Decision No. 65154, which would require a notice and hearing pursuant to  
22                   A.R.S. §40-252. If the Commission believes that Staff’s interpretation of the Commission’s intent  
23                   in Decision No. 65154 is erroneous, it will surely say so in its Track “B” decision.  
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1 As noted above in subsection I(B), Decision No. 65154 indicates that the Commission's goal  
2 is to facilitate (i) a sustained transition or phase-in to a competitive wholesale electric market, (ii)  
3 in a manner which allows Arizona electric ratepayers to realize the benefits of such a competition  
4 and the presence of new generation resources within the state, (iii) yet protects those ratepayers from  
5 price reliability and volatility concerns. Staff's proposed competitive procurement process is  
6 designed to realize this goal in a timely and responsible manner. As discussed in Sempra/ SWPG's  
7 Initial Brief, Staff's approach will provide the utility with an array of information as to a variety of  
8 means by which its contestable load requirements might be served. The utility is not required to  
9 accept any of the proposals it receives, and it retains the final decision in that regard. Thus, it is in  
10 a position to be sure that any concerns it may have as to economic feasibility and reliable delivery  
11 of product are satisfied. But it is required to solicit proposals and thereby inform itself as to  
12 available alternatives. In this manner, each of the three aforementioned aspects of the  
13 Commission's goals are constructively and satisfactorily addressed. In addition, determination of  
14 that contestable load which is to be subject to the proposed procurement process, in the manner  
15 intended by the Commission and proposed by Staff, optimizes the pace of the intended transition to  
16 competition consistent with the desired protection of ratepayers.  
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21 **II.**

22 **RMR CAPACITY AND ENERGY REQUIREMENTS**  
23 **SHOULD BE INCLUDED WITHIN CONTESTABLE LOAD**

24 In their respective Initial Briefs, APS, TEP and AUIA argue against Staff's proposed  
25 inclusion of RMR capacity and energy as a part of each utility's contestable load. Generally  
26 summarized, the arguments advanced are as follows: (i) such inclusion is beyond the scope of what  
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1 the Commission intended in its issuance of Decision No. 65154; (ii) such inclusion will be a waste  
2 of time because there are not realistic short-term alternative solutions available; (iii) such inclusion  
3 will unnecessarily complicate the competitive procurement process; (iv) RMR requirements can be  
4 satisfied from the use of existing assets; (v) use of a utility's existing assets will be more efficient  
5 and cost-effective than reliance upon other resources; (vi) too many RMR issues remain at this time,  
6 and solicitation of alternatives will be premature; (vii) such inclusion may have a destabilizing effect  
7 within the financial community; and (viii) such inclusion is inconsistent with Staff's testimony and  
8 position in the Track "A" phase of the consolidated proceedings.  
9

10  
11 While numerous, these arguments are without merit, when carefully examined. First,  
12 argument (i) is merely a reiteration of the utilities' "existing asset" contention discussed above in  
13 Section I(B). In that regard, arguments (iv) and (v) in part seek support by inference from the  
14 "existing asset" interpretation the utilities advocate. But, as demonstrated in subsection I(B) above,  
15 that interpretation is not what the Commission intended in Decision No. 65154.  
16

17 Second, arguments (ii) and (v) presume the results of the competitive procurement process  
18 as a threshold assumption. In reality, the accuracy of these contentions can be tested only by  
19 including the RMR requirements in question within the very competitive procurement process from  
20 which they seek exclusion.  
21

22 Third, arguments (iii) and (vi) also suffer from the defect of a presumed result, as opposed  
23 to a demonstrated result. In this instance, the result relates to a combination of the conduct of the  
24 competitive procurement process and the merits of proposed RMR alternatives. In essence, the  
25 contention is that the task should not be undertaken because it may be challenging to conduct, and  
26 with no front-end guarantee of satisfactory proposals. Surely that was not the mindset of the  
27 Commission at the time it issued Decision No. 65154.  
28

1 Fourth, absent the refuge it seeks from its inferred relationship to the “existing asset”  
2 contention, argument (iv) is irrelevant. The question is not whether a utility’s RMR requirements  
3 can be served from its existing assets. The question is whether those requirements can be equally  
4 or better served by an alternative means, consistent with protection of ratepayer interest with respect  
5 to price and reliability. That is what the competitive procurement endeavor is all about.  
6

7 Fifth, argument (vii) is both a stalking horse for the utilities “existing asset” line of argument  
8 and a “red herring.” More specifically, the specter of possible financial community discomfort is  
9 raised as a reason for adopting the utilities’ “existing asset” contention, inasmuch as RMR resources  
10 would per se exempted from contestable load under that view. Conversely, the presence of RMR  
11 resources among a utility’s existing assets is irrelevant if the utilities “existing asset” viewpoint is  
12 rejected as inconsistent with the Commission’s intent in Decision No. 65154.  
13

14 Sixth, argument (viii) is irrelevant for the reasons discussed in subsection I(C) above. Staff’s  
15 evidence and advocacy position during the hearings in the Track “A” proceedings are not  
16 determinative of what the Commission intended in its subsequent issuance of Decision No. 65154.  
17 Moreover, in these Track “B” proceedings, Staff’s proposed inclusion of RMR as a part of  
18 contestable load is based upon its understanding of what the Commission now intends.  
19

20 Seventh, it should be observed that a number of the uncertainties on which the utilities  
21 predicate their opposition would be resolved if the competitive procurement process included the  
22 integrated system analyses evaluation step recommended by Sempra witness Douglas Mitchell. This  
23 includes those issues other than price relating to reliability and deliverability of RMR capacity and  
24 energy.  
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1 Finally, it should be remembered that under the Staff Report APS and TEP retain the  
2 unilateral discretion to reject any proposals they may receive for any reason. Thus, there is no  
3 legitimate basis for contending a utility's RMR requirements should not be included within its  
4 contestable load.  
5

6 **III.**

7 **DESIGN OF COMPETITIVE PROCUREMENT PROCESS**  
8 **TO AVOID UNDUE RELIANCE ON SHORT-TERM**  
9 **OR "SPOT" MARKET PURCHASES**

10 In its Initial Brief, APS argues that it should not be required to acquire what it calls  
11 "economy energy" through the competitive procurement process resulting from Track "B." In  
12 making its argument, APS relies upon its "existing asset" interpretation of the Commission's intent  
13 in Decision No. 65154 as a predicate for its contention that the Commission did not intend that  
14 "economy energy" purchases be included as a part of a utility's contestable load. [APS Initial Brief,  
15 page 11, line 18 - page 12, line 5] As previously discussed in subsections I(A) and I(B) above, APS'  
16 construction of the Commission's intent is in error. Thus, its "economy energy" exclusion argument  
17 must necessarily fail as well because its threshold premise is defective. In addition, APS fails to  
18 rebut Sempra witness Mitchell's testimony during the Track "B" hearings that APS' proposed  
19 transactions are not what have traditionally been viewed as "economy energy" purchases within the  
20 electric utility industry.  
21

22  
23 In its Initial Brief, Wellton-Mohawk Generating Facility ("WMGF") discussed at length why  
24 long-term power supply contracts should be a part of the Track "B" competitive procurement process  
25 and results. [WMGF Initial Brief, page 18, line 4- page 23, line 11] Sempra/ SWPG made some of  
26 those same arguments as well in their Initial Brief. [Sempra/ SWPG Initial Brief, page 11, line 2 -  
27 page 12, line 21] With the excess generating capacity which is currently available in the market, it  
28

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1 is reasonable to assume that a significant amount of generation is available at costs below the cost  
2 of utility-owned generation, and that a sound strategy would be to “lock in” those low power costs  
3 now for future consumption periods through intermediate and long-term contracts, rather than  
4 gamble with the uncertainty of future short-term or “spot” market prices. Or, at the very least,  
5 prudence would appear to suggest that a utility inform itself of the power supply alternatives  
6 available on an intermediate and long-term contract basis; and thereafter the utility could make an  
7 informed decision as to how to proceed.  
8  
9

10 Yet, despite the lessons learned from California in recent years, APS proposes to procure a  
11 substantial amount of its power needs through its version of “economy energy” transactions. In its  
12 rebuttal case during the Track B” hearings APS did propose a “compromise” from its initial  
13 procurement proposal, which it discusses in its Initial Brief. [APS Initial Brief, page 12, lines 14-24]  
14 But, it does so grudgingly, and its “compromise” does not refute the fact that its overall procurement  
15 approach places undue reliance upon the future “spot” market and all of the associated risks.  
16

17 The Commission should reject both APS’ original and modified procurement proposals in  
18 this regard; and it should include in its definition of “contestable load” those power requirements  
19 APS had indicated it intended to acquire as “economy energy.” In addition, its decision should  
20 include similar power procurements by TEP as well for the reasons discussed by WMGF and  
21 Sempra/ SWPG.  
22

#### 23 IV.

### 24 INTEGRATED - SYSTEM ANALYSES AS AN AID TO 25 PRUDENT POWER PROCUREMENT DECISIONS

26 An issue exists as to when and how the prudence of a utility’s power procurements decisions  
27 are to be judged. Several parties have argued for an expedited review and approval process to be  
28

1 conducted shortly after the initial solicitation has been concluded. The Staff has taken a different  
2 view, arguing that the prudence review should be undertaken at a later point in time, when more  
3 information is available and the Commission has acquired more experience. However, there appears  
4 to be general agreement that the utilities should endeavor to provide their ratepayers with the  
5 economic benefits of the competitive market, consistent with reliability considerations.  
6

7 RUCO, in effect, has proposed addressing this goal at the front-end of the process through  
8 the use of a Least Cost Planning approach. However, its proposal has not received support from  
9 other parties for purposes of the initial solicitation because of the time required to implement the  
10 Least Cost Planning methodology. However, those concerns would not preclude use of the  
11 integrated-system analyses which Sempra witness Mitchell has recommended be incorporated into  
12 the Track "B" competitive procurement process. As demonstrated in Section III of Sempra/ SWPG's  
13 Initial Brief, such analyses could readily be incorporated into the bid evaluation stage of Staff's  
14 recommended process without extending the overall proposed timeline for conducting the  
15 solicitations. In addition to the previously mentioned benefits resulting from the use of such  
16 analyses, they also would provide some form of preliminary yardstick by which to measure the  
17 reasonableness of APS and TEP's actions.  
18  
19  
20

21 V.

22 CONCLUSION

23 Sempra/ SWPG reiterate and incorporate herein by reference any arguments and  
24 recommendations set forth in their Initial Brief which have not been discussed above; and reiterate  
25 their request that the Commission issue a Decision adopting Staff's recommended competitive  
26 procurement process, subject to the modifications discussed and suggested in Sempra/ SWPG's  
27 Initial Brief.  
28

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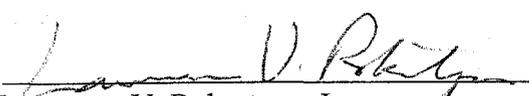
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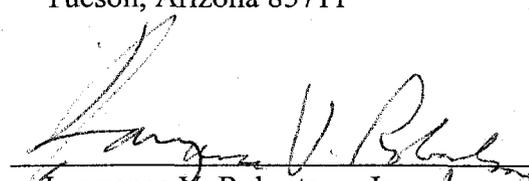
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