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IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC DIVISIN OF CITIZENS COMMUNICATIONS COMPANY TO CHANGE THE CURRENT PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE RATE, TO ESTABLISH A NEW PURCHASED POWER AND FUEL ADJUSTMENT CLAUSE BANK, AND TO REQUEST APPROVED GUIDELINES FOR THE RECOVERY AND COST INCURRED IN CONNECTION WITH ENERGY RISK MANAGEMENT INITIATIVES.	**Docket No. E-01032C-00-0751**
IN THE MATTER OF THE APPLICATION OF CITIZENS COMMUNICATIONS COMPANY, ARIZONA GAS DIVISION, FRO A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, AND TO APPROVE RATE SCHEDULES DESIGNED TO PROVIDE SUCH RATE OF RETURN.	**Docket No. G-01032A-02-0598**
IN THE MATTER OF THE JOINT APPLICATION OF CITIZENS COMMUNICATIONS COMPANY AND UNISOURCE ENERGY CORPORATION FOR THE APPROVAL OF THE SALE OF CERTAIN ELECTRIC UTILITY AND GAS UTILITY ASSETS IN ARIZONA, THE TRANSFER OF CERTAIN CERTIFICATES OF CONVENIENCE AND NECESSITY FROM CITIZENS COMMUNICATIONS COMPANY TO UNISOURCE ENERGY CORPORATION, FOR APPROVAL OF THE FINANCING FOR THE TRANSACTIONS AND OTHER RELATED MATERS.	**Docket No. E-01933A-02-0914** **Docket No. E-01032C-02-0914** **Docket No. G-01032A-02-0914**

MARSHALL MAGRUDER

RESPONSE TO ALJ'S RECOMMENDATIONS

June 25, 2003

This presents Marshall Magruder's response with respect to the Recommended actions by Administrative Law Judge Dwight D. Nodes to the Commissioners on 6 June 2003.

Respectfully submitted this 25th day of June 2003.

MARSHALL MAGRUDER

By Marshall Magruder

PO Box 1267
Tubac, Arizona 85646

Original and Copies are certified filed this date as shown on the Service List (last page)

FIRST ISSUE: RESOLUTION OF THE BILLING DISPUTE[1] FOR PROBABLE EXCESSIVE CHARGES BY APS UNDER THE OLD AND NEW AGREEMENTS.[2]

Reference: Quote from Page 3 of the ALJ's Recommendations:

> "Because APS did not own sufficient generating capacity to meet its full load requirements, it purchased power on the spot market and charged Citizens the highest cost of market power that it purchased every hour under the "floor price" provision of the contract. The impact of the floor price provision was not evident to Citizens until May 2000 when the spot market became volatile and APS began to assess Citizens significantly higher bills under the purchase power contract. APS and Citizens disagreed regarding how the System Incremental Cost provision of the contract should be interpreted. After analyzing its options, Citizens decided not to submit the contract interpretation dispute to the FERC but, instead, renegotiated the contract with APS. Ultimately, Citizens entered into a "New Contract" with APS' parent company, Pinnacle West Capital Corporation ("PWCC"), effective June 1, 2001, that contained a simple fixed purchase power rate."

Discussion.

1. The above is a summary of the dispute that caused the PPFAC case. Questions: How could APS charge "highest cost or market power that it purchased every hour" to Citizens? APS serviced Citizens reasonably for about 30 years. What caused this abrupt change? Obviously, the formula used to make Citizens pay for APS's insufficient generation capabilities provided a subsidy to APS's shareholders. This is blatantly unfair, unreasonable and as close to fraudulent business practice as one could imagine by a public service company. APS has never been called, questioned, or summoned to these proceedings, neither by the ACC Staff nor by the ALJ. Why?

2. Mr. Pignatelli, UniSource's CEO, testified that even he was leery of trying to negotiate a new, purchase power agreement with PWCC/APS. What is wrong with fair, honest, and open business relationships, where the "best" wins based on performance, not regulatory trickery or deceitful business practices? If APS is causing an unfair situation, the

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[1] This is the term originally used by the Administrative Law Judge (ALJ) Procedural Order of 18 April 2002 where, at 9(12-21), states "... the contract dispute issue is inextricably intertwined with this case because the Staff and RUCO advocate litigation against APS with respect to the contract billing dispute... Staff contends that an objective observer could conclude that Citizens' decision to abandon litigation against APS is an indication **that Citizens and APS have simply agreed to let ratepayers bear the PPFAC costs** and avoid the necessity of litigation. Staff adds that, contrary to Citizens' assertions, the Commission's review of this issue does not constitute an attempt to regulate the practice of law, but instead involves the **Commission's legitimate concern with the fairness of its proceedings**." [Emphasis has been added]. It should be noted that UniSource's DeConcini testified times that, UniSource never evaluated the Old Agreement.

[2] This issue is related to the first issue in Magruder Summary Brief of 15 May 2003, at 3(15-25) and at 5(6-17).

Commission should, after investigation, halt passing on excessive costs to defenseless ratepayers.[3]

3. My testimony listed nineteen, apparently, imprudent decisions that Citizens made in events leading up to and including these hearings.[4] Most of these decisions are related to the failure to pursue what's right to collect from PWCC/APS. PWCC/APS has been listed, and is under investigation, by FERC for possibly manipulating the western energy markets in 2000 and 2001, the time period the outrageous charges.

4. The only company making "windfall profits" from the Citizens purchased power contracts is a non-party. PWCC/APS has collected all of the $135 million it billed. Citizens paid these monthly bills, as required by its agreements.

5. Until PWCC/APS is brought into an open hearing, with its data laid out for all to view, PWCC/APS will always, in my opinion, have something to hide from this Commission and the parties to the PPFAC case, and possibly from the Western Market manipulation investigations.[5] The Commission should conduct the analysis and investigation of the factors leading to the billing dispute, started by Citizens in the fall of 2000, and continued to present. Arizona ratepaying citizens and smaller companies such as Citizens deserve and expect protection from predatory companies. Large companies have no special dispensation from the "fair and reasonable" requirements set forth for the Commission in Arizona Statutes.

6. As presently worded, the ALJ's Recommendations none of the under-recovered "PPFAC bank balance...may be recovered by Citizens, UniSource or any of its subsidiaries." This actually lets PWCC/APS go without requiring any effort toward recovering the $135 million.[6]

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[3] See Magruder Testimony of 27 April 2003, Exhibit A, for SEC Form 10-K and 10-Q excerpts that denounced APS charges excessive.

[4] See Magruder Testimony of 27 April 2003, Table 1 at 15(18) to 18.

[5] See *Final Report on Price Manipulation in Western Markets – Fact-Finding Investigation of Potential Manipulation of Electric and Natural Gas Prices,* of 26 March 2003, FERC Docket No. PA02-2-000 at ES-16, VI-19, and VI-36, which include Arizona Public Service Company's possible roles.

[6] See ALJ's Recommendation at 9(1-6).

7. Why haven't these charges been investigated? Where is our Attorney General? Are there high-level conflicts of interest or is there some "horse-trading" by utility industry members going on?[7] As shown in Magruder Exhibit One, and after the California energy crisis, Citizens service area is referred to as "Little California". I can only wonder why.

8. There are two "billing dispute" temporal periods result: (1) Before 1 June 2001 and (2) After 1 June 2001, when the "Old" Agreement was replaced to the "New" Agreement.

(1) For the first period, all overcharges resulting in refunds by APS should be refunded to Citizens, up to the amount "unrecovered" by Citizens from its ratepayers. If there are additional refunds from the Old Agreement, these should be refunded to ratepayers. If any regulatory body assessed fines or penalties, these should be refunded to the ratepayers or prorated between Citizens and ratepayers.

(2) For the period after 1 June 2001, any PWCC/APS refunds should be prorated as under the Old Agreement until the date of "transfer" to UniSource, or any other entity, occurs. At transfer, a new purchase power rate should be used (as discussed below).

If it were found, that refunds are due, none of the recovery from any judicial or government investigatory proceeding should be allocated to UniSource.

Recommendations:

a. That the ACC (or another Arizona state entity) should continue the investigation started by Citizens and complete as suggested in paragraphs 5 to 8 above.

b. See Magruder Summary Brief at 11(11-19) for additional recommendations.

SECOND ISSUE: NEW AGREEMENT PURCHASED POWER RATES.

Reference: Quote from Pages 11 and 12 of the ALJ's Recommendations:

> "The Stipulation provides that, as of the date of closing of the acquisition of the Citizens electric assets by UniSource, the purchase power adjustor [sic] rate[8] will be set at $0.01825 per kilowatt hour ("kWhr"). Adding the current base rate for purchase power of $0.05194 per kWhr to the adjustor [sic] rate would result in a total purchased power rate of $0.79019 (See Appendix C of Settlement Agreement).
>
> "The Joint Intervenors raised concerns with this provision of the Settlement because they believe the new PPFAC adjustor [sic] rate is based on an excessive purchase power price that is

[7] Even the ACC Staff is suspicious. See Footnote 1 above.

[8] The tem from the title of the PPFAC case uses "adjustment" instead of the informal term "adjustor."

contained in the New Contract. For example, Mr. Magruder testified that the wholesale electricity rate in the New Contract of $58.79 per MWh[9] is almost twice the rate available recently on the spot market (Magruder Ex. 2, at 18-24). Mr. Magruder believes that the New Contract rate is excessive because it was negotiated during a period of volatility in the California and western energy markets (*Id.* at 22).

"The Joint Applicants and Staff Dispute Mr. Magruder's contentions. Staff contends that the purchased power price should be evaluated on a going-forward basis because, even though the New Contract was for a seven-year term (from June 1, 2001), under the Settlement Agreement customers will not be required to pay for the first two years of PPFAC costs. Staff witness Lee Smith also discussed the benefits of the "load-following" nature of the contract, the risk premium associated with a long-term contract such as the one Citizens entered into with PWCC, the cost of long-distance transmission, and the cost of ancillary services. (Tr. 300-304). Based on recent spot prices from the Palo Verde index, Ms. Smith concluded the purchased power price in the New Contract was reasonable. She indicated that, even if market manipulation created an expectation of higher prices when the New Contract was negotiated in 2001, the relevant comparison is to evaluate the New Contract to current market prices on a going-forward basis, including the appropriate adders for following load, risk premium, ancillary services and transmission (*Id.* at 306-308). RUCO's witness also testified that the New Contract was reasonable on a going-forward basis, based on an analysis that was similar to the one undertaken by Staff (*Id.* at 576).

"Joint Applicant witness DeConcini also described the benefits of the New Contract. He explained that the New Contract is a full-requirements supply agreement that requires PWCC to meet the instantaneous demand of Citizens' customers. Due to the full requirements nature of the contract, as well as the inclusion of network transmission and ancillary services, Mr. DeConcini believed that the New Contract is a reasonable agreement (Joint App. Ex. 9, at 2-4). He also claims that, compared to other contracts entered into in 2001 and the cost of constructing generation facilities at that time or in today's market, the New Contract provides a reasonable prices for power supplied to Citizens' customers, especially considering the benefit to customers associated with the forfeiture of the first two years' PPFAC costs (*Id.* at 5-8; Tr. 140, 184).

"We agree with the Joint Applicants, Staff and RUCO that the price contained in the New Contract is not an unreasonable rate for electricity considering all the relevant factors. As described by the Staff and Joint Applicant witnesses, the appropriate evaluation of market prices must include consideration of the full-requirements, load-following nature of the contract, as the inclusion of necessary transmission and ancillary services. Based on all of these factors, as well as the Stipulation's requirements that the Joint Applications may not seek recovery of PPFAC costs for a more than two-years period under the New Contract (June 1, 2001 to the expected closing date of July 28, 2003), we find that the new purchase power adjustor [sic] rate of $0.01825 is not unreasonable. Although we conclude that the new adjustor [sic] rate is the Stipulation is not unreasonable, given current market conditions we believe that UniSource should continue to negotiate with PWCC for additional concessions."

Discussion.

9. The Commission ratemaking responsibility and authority determine, establish and enforce "fair and reasonable" utility rates for both ratepayers and utility companies, no more, no less. The ALJ did not state in his Recommendations that the New Agreement rates were "fair and reasonable." At the present time, the "New" Agreement is exorbitant using every

[9] The New Contract price of $0.05879 per kWhr is the generation supply component. The total purchased power rate of $0.07019 kWh is determined by adding the $0.05879 generation component t the line loss ($0.06583) and transmission ($0.00436) components (Joint App. Ex. 6, App. C). For purposes of comparing market prices for generation, it is appropriate to use the $0.05897 kWh price.

possible measure. The Applicants did not prove that the wholesale purchase power rate of $58.79 per MW-hour was justified, or that the new rate should be applicable for the remaining part of the "new" PWCC agreement, as will be discussed below. Therefore, this rate should not be permitted to stand. Let's review the points found in the above quote.

a. "Generation Rate." This is the price Citizens (or UniSource) would pay PWCC/APS to purchase wholesale electricity (Purchase Power Price). It was increased from $48.20 (Old Agreement) to $58.79 (New Agreement). This is the "rate" being disputed. The others below are not disputed and are already accounted for in the $58.79.
b. Network Transmission Charges and Transmission (energy) Loss. These are accounted for separately when determining PPFAC. See quoted ALJ footnote. These are not disputed.
c. Ancillary Services. This cost is not PPFAC related, but appears more appropriate in a General Rate Case.

10. As shown in my Testimony at 22-23, at least six other "pressures" were impacting Citizens during these negotiations. In addition, Citizens' McCarthy testified he did not have an energy market staff as other companies, such as TEP had, during the PWCC/APS negotiations. A Citizens response to a Staff Data Request stated Citizens did not debate, negotiate or even question the $58.79 when first presented by PWCC/APS during negotiations. It was never deconstructed, zero-based or evaluated, just taken as presented. Distribution electric utilities are not directly impacted by purchase power costs, which are passed directly to ratepayers, without markups by the distribution utility company. Purchase power "pass-through" should continue if UniSource acquires Citizens.

11. On 8 February 2003, TEP's Chief Financial Officer Larsen, during an "investor's" Conference Call, stated that the "annual wholesale electricity forecast was $32.00 and $34.00 per MW-hr" for 2003.[10] This agrees with "going-forward" rates discussion by Ms. Lee Smith,[11] the Staff, RUCO and Mr. DeConcini. This and Table 6 (Magruder Testimony at 22) clearly show comparisons of "around the clock" plus firm and on-peak market values.

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[10] See Magruder Summary Brief at 4(1-5) and Magruder Testimony at 19(1-5).
[11] Smith appears confused in her testimony, as she used $42 per MW-hr then added transmission, risk and ancillaries to arrive at $58. See Tr. at 304 (20-25). It needs to be noted that $58.79 is the "New" Agreement

12. Smith discussed a "load-following" adder as a means for PWCC/APS to account for the variable load, based on Citizens demand.[12] APS has been Citizens sole-source power provider for the past 30 years. With this experience, knowledge, and the statistical records, matching the several delivery points for Citizens, load following should not be challenging for a professional energy generation company. By this time, Citizens should have been treated as a "regular" customer and service delivered as demanded. This is not like delivery to a highly variable customer, as there are few industrial and commercial/business customers with highly variable loads. The Citizens pricing structure with its "demand charges" has benefited the residential customers at the detriment of these other customer categories.[13]

13. Smith testified a "risk premium" adder for a long-term contract needs to be included. Other than during the May 2000 to July 2001 time period, when the wholesale market was out-of-control, annual around-the-clock purchase power cost in Arizona have not exceeded $35.00 per MW-hr. UniSource's *Annual Report for 2001* stated the year-around wholesale purchase power cost was $91.00 during this turbulent period. Yes, that's high, but the market was being manipulated, not managed, and the primary wholesale regulatory agency, FERC, was unwilling to stop it, until late in the fall of 2000. For a seven-year contract (one year at $91 and seven years at $35 averages $43 per year). Thus, an anomaly such as $91 is averaged out. Note $43 is considerably less than $58.79. As my Summary Brief indicated, adding $5 or so for risk should be fair and reasonable.[14]

14. DeConcini discussed "full requirements" to meet instantaneous demands as "firm capacity and energy" requirements, similar to Smith's "load following" challenge discussed above. From a wholesale pricing viewpoint, "firm" delivery is required, thus "firm" prices should be used for any comparisons. DeConcini failed to do this in his examples.

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generation purchase power base with adders for transmission, risk and ancillaries. Her $42 compares closely to Larsen's $32-34, if one adds about $5 to his for risk premium. Magruder Summary Brief (15 May 2003) discussed this as issue two at 5(19) to 6(7) and 11(21) to 12(5).

[12] The New Agreement requires Citizens to provide predicted peak load estimates.

[13] Unfortunately, the ACC Staff has not recognized this. The "Staff's Notice of Errata – Supplemental Exhibit" of 3 June 2003, still fails to account for "demand charges" which make Citizens business, commercial and industrial charges increasingly higher than residential rates. This is contrary to good business practices, detrimental for business development and economic growth, as was clearly stated during Public Comment Sessions in both Nogales and Phoenix.

[14] See Magruder Summary Brief, footnote 12, which indicated about 15% added to the wholesale generation rate would be reasonable ($35 x .15 = $5.25). Using $58.79, gives a markup of $31.05, which is neither reasonable nor fair.

15. DeConcini presented four comparisons that were all rebutted during his testimony. The Applicant's Final Brief failed to reply or question my oral or written testimony. First, each of his examples was from California, which had, in 2001, the third highest state electricity rates, about 50% more than Arizona (13.6¢ versus 8.3¢/kW-hr) according to EIA. Second, please see Transcript for details concerning non-relevance for his four examples. No example he used compared the factors necessary for Arizona with similar dates, firm delivery, around-the-clock. Third, July 2001 was the operative month (when the New Agreement was signed), but three of the four examples were in Jan. and Feb. 2001 when rolling-blackouts were simultaneously occurring in California. Fourth, "year-round" firm delivery requirements should have been used. It most interesting that Pignatelli and Larsen both discussed year-around values in his February 8, 2003, Conference Call[15] Fifth, DeConcini's discussion about a new power plant was not relevant to the New Agreement.

16. The applicants repeatedly claimed the New Agreement was "approved" by the FERC.[16] This stretches the stated FERC position that it "reviews" for compliance with applicable electrical interconnections, tariffs, and laws. This is discussed in FERC's response to PWCC's New Agreement.

17. Citizens determined, in the fall and winter of 2000, that the FERC rarely got involved in "rate" issues and that such details were usually left to the States to negotiate, litigate in order to resolve the implementation of Federal Power Act's requirements for "fair and reasonable." This appears to have been the primary reason Citizens came to the ACC for resolution of the billing dispute with APS instead of the FERC.

18. There is the mandate in A.R.S. §40-203, for the Commission to "set" utility rates in our State. This authority needs to be exercised in this case. In my testimonies of 27 April 2003, 8 November 2002, 28 September 2002 and 13 March 2002, I have provided ample statistics to show that $58.79 is excessive, out of bounds of reality by any measure, and fails to meet

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[15] See Magruder Testimony, 27 April 2003, Table 6 – Various Wholesale Rates, page 22. See UniSource Forms 10-K and 10-Q for additional quotes for year-round wholes sale prices. Further, the ALJ implies I used spot market data, which is not accurate. Please see the table and my other submissions.

[16] See page 9 at 23-25 which states "Staff also points out that it would have been difficult to prevail at the FERC on the issue of imprudence of the New Contract, because the terms of that contract had previously been approved by FERC (*Id.* At 37)." This is a significant change in the ACC Staff's position. See Footnote 1 above.

"fair and reasonable" standards. The joint applications have no reason to be concerned with these rates since Citizens is a "distribution" company which "passes through" purchase power costs, with no profit or fees for this service.

19. Thus, there is no reason, other than "other transactions" beyond this case that could have any impact on UniSource, no matter what purchase power cost. Just like Citizens, UniSource has no stake in this issue; however, APS (or PWCC) is directly involved.

20. Since APS declined to participate in the analysis proposed by Citizens to determine the "bottoms-up billing" for purchase power, it must be that APS refuses to disclose means it uses. The forward market should be the basis to determine future cost for purchase power. In no year, other than May 2000-July 2001, has the year-around cost for purchase power exceeded $35.00 per MW-hr. Recently, UniSource's CFO Mr. Keith Larson stated that using "between $32 to $34 per MW-hr" for 2003,[17] thus a reasonable and conservative value of $35.00 per WM-hour, would appear to be quite reasonable to ensure APS (PWCC) has a fair and reasonable profit and customers pay fair and reasonable prices for electricity.

21. Therefore, by the authority under A.R.S. §§40-203, APS should be directed to change $58.79 to $35.00, in its New Agreement with Citizens (or successor), starting 1 August 2003 until 31 May 2007 and that Citizens, UniSource or succeeding entity be required to pay APS only $35.00 per MW-hour starting 1 August 2003.

Recommendations:

a. That PWCC/APS be informed that its New Agreement is being modified, effective 1 August 2003, by changing "$58.79" to read "$35.00."
b. That UniSource, or other purchaser of Citizens, be directed to pay PWCC/APS $35.00 per MW-hr instead of $58.79, starting 1 August 2003.
c. That the Commissioners write a letter to the FERC explaining that the purchase power rate change was made to ensure fair and reasonable rates in Arizona.

[17] Please see the discussion, facts and proof concerning rates in Magruder Testimony, 27 April 2003, 18 to 24.This is the same as Issue Three in Magruder Summary Brief at 6(9-10), 12(7) to 13(17), Tables 1 and 2.

THIRD ISSUE – RATE INCREASE MITIGATION MEASURES[18]

Reference. Quote from page 24 of ALJ's Recommendations:

> "Both RUCO and Mr. Magruder raised the issue of increased funding for demand-side management ("DSM") programs. ... Mr. Magruder recommends that customers should be given financial incentives to "load shape" in order to move usage from peak to off-peak periods (Magruder Ex. 2, at 30-31). ...
>
> "... We believe the better means of addressing the issue of DSM is through a generic investigation of the costs and benefits of such measures. In Decision No. 65743 (March 14, 2003), the Commission directed Staff to 'facilitate a workshop process to explore the development of a DSM policy and an environmental risk policy' and to file a report within 12 months from the date of that Decision. Since a broader policy investigation into DSM is already underway, it is appropriate to consider the issues raised by RUCO and Mr. Magruder within the framework of that proceeding."

Discussion.

22. Unfortunately, the ALJ missed a main issue, which was to provide ways for ratepayers to reduce the impacts of the proposed rate increase.

23. The DSM, energy efficiency and proactive performance-based goals established in my Summary Brief were more aggressive than the present ACC DSM program.

24. Waiting for at least three (really four) years and a General Rate Case will not help those immediately impacted by rate increases. Without such a program, with 31% below the poverty line and high seasonal unemployed (up to 25%) in Santa Cruz County service area, its customers will have significant burdens to pay their utility bills, especially in the winter since most homes are electrically heated.

Recommendation.

That consideration be given to implementing rate mitigation measures in my Summary Brief for possible concurrent implementation with any rate increases.

FOURTH ISSUE – WHY ARE CITIZENS RATES BEING INCREASED WHEN THE OTHER MAJOR UTILITIES ARE DECREASING THEIRS?

Discussion.

25. See Magruder Exhibit One which has an article concerning "Little California" where the electric rates are increasing by 22% since 1997 and on the other side, an article about the three other Arizona utilities having rate decreases between 5.6% and 3.1% since 1997.[19]

Recommendation.

That Staff provide the Commission and parties an analysis as to why Citizens rates should be increased by 22% while the others three companies decreased during the same time period.

FIFTH ISSUE – CITY OF NOGALES ISSUES

Discussion.

26. There has been a continual lack of progress in obtaining a franchise with Citizens and unsatisfactory negotiations with UniSource. Based on this and the 22% increase in electric rates and 20.9% increase in natural gas rates, the City of Nogales is looking at condemning all Citizens (or UniSource) resources in Santa Cruz County as an option, based on the results of the scheduled 9 September 2003 election in Nogales.

27. Such actions will significantly impact the future makeup of UniSource's subsidiary and clauses in the Settlement Agreement.

Recommendation.

That UniSource be directed to complete a Franchise Agreement with the City of Nogales prior to closing its purchase of Citizens.

MINOR ISSUES:

1. The ALJ did not "order" UniSource to submit a retail electricity deregulation plan within 120 days or to implement it not later than 31 December 2004. Rationale for such an omission is unknown and is perceived as an oversight.
2. Typo, at 2(6), change "2003" to read "2002"

[19] See Summary Brief at 7(11-15).

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Service List

ORIGINAL and 15 COPIES of the foregoing filed this 25Th day of June 2003, with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

COPIES of the foregoing mailed this 25Th day of June 2003 to:

Dwight D. Nodes, Assistant Chief Administrative Law Judge
Christopher Kempley, Chief Counsel, Legal Division
Ernest Johnston, Director Utilities Division
Jason Gellman, Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

Thomas H. Campbell
Michael T. Hallam
Lewis & Roca, LLP
40 North Central Avenue
Phoenix, Arizona 85004

Steven W. Cheifetz
Robert J. Metli
Cheifetz & Iannitelli, P.C.
3238 North 16th Street
Phoenix, Arizona 85016

Scott Wakefield
Daniel W. Pozefsky
Residential Utility Consumer Office
1110 West Washington Street, Suite 220
Phoenix, Arizona 85007-2985

Raymond S. Heyman
Michael W. Patten
Roshka Heyman & DeWulf
400 East Van Buren, Suite 800
Phoenix, Arizona 95004

Martha S. Chase, Santa Cruz County Attorney
Holly J. Hawn, Deputy Santa Cruz County Attorney
Santa Cruz County Attorneys
2150 North Congress Drive, Suite 201
Nogales, Arizona 85621

John White
Civil Division, Mohave County Attorney
P.O. Box 7000
Kingman, AZ 86402-7000

Robert A. Taylor, City Attorney
City of Kingman
310 North 4th Street
Kingman, Arizona 86401

Walter W. Meek, President
Arizona Utility Investor's Association
2100 North Central Avenue, Suite 210
Phoenix, Arizona 85004

Jose L. Machado, City Attorney
Hugh Holub, Attorney
City of Nogales
777 North Grand Avenue
Nogales, Arizona 85621

Mr. Tom Ferry
P.O. Box 3099
Kingman, Arizona 86402-3099

L. Russell Mitten, Staff Consul
Raymond Mason, Director, Corporate Regulatory Affairs
Citizens Communications Company
3 High Ridge Park
Stamford, Connecticut 06905

Gary Smith
Citizens Communications Company
2901 W. Shamrell Blvd., Suite 110
Flagstaff, Arizona 86001

Deborah R. Scott
Citizens Communications Company
2901 North Central Avenue, Suite 1660
Phoenix, Arizona 85012

John D. Draghi
Susan Mikes Doherty
Huber, Lawrence & Abell
605 3rd Avenue
New York, New York 10158

Nicholas J. Enoch
Lubin & Enoch, P.C.
349 North Fourth Avenue
Phoenix, Arizona 85003

Andrew Bettwy, Asst. General Counsel
Southwest Gas Corporation
5241 Spring Mountain Road
Las Vegas, Nevada 89150