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27 April 2003

Arizona Corporation Commission

AZ CORP COMMISSION
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Senior Administrative Law Judge Dwight D. Nodes
Arizona Corporation Commission
1200 West Washington Street
Phoenix, AZ 85007

DOCKETED

APR 30 2003

And All Parties (see Service List)
(Via email and Priority US Mail)

DOCKETED BY *CAH*

Re: Citizens' PPFAC ACC Docket E-01032C-00-0751, Gas Case Docket G-01032A-02-0598, and Joint Application Cases E-0933A-02-0914, E-01032C-02-0914, and G-01032A-02-0914

Subject: Marshall Magruder Testimony

Dear Judge Nodes and Parties:

Attached is my Testimony dated 27 April 2003 with an errata of same date. These were in final preparation much earlier; however during afternoon of 18 April, my computer froze and my document was unable to be recovered. The document was dated 21 April with all expectations to complete the conclusions and recommendations in a few hours and in the mail by 20 April. The version attached is the best recoverable, as of 16 April. I regret testimony drafted between the 16th and 18th are not included. This 16 April version was not recovered until 1:30 AM Saturday 26 April. It contains only draft notes in Section IV to end (Conclusions and Recommendations). Further, Exhibit B-1 was reformatted and regrettably others were that remain comprehensible.

Please insert and use Attachment B to replace Sections IV (pages 42 to 45) to the Service List (page 44) and to replace Exhibit B-1 (pages 52 to 58).

Sincerely,

Marshall Magruder
Marshall Magruder

Attachments:

- A - Marshall Magruder Testimony dated 27 April 2003
- B - Errata to Marshall Magruder Testimony dated 27 April 2003 (replacement pages from page 42 line 3 to page 45 and properly formatted Exhibit B-1 replacement pages 52 to 58).

cc: Service List (same as in Attachment A)

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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION
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COMMISSIONERS

MARC SPITZER, Chairman
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

Docket No. E-01032C-00-0751

IN THE MATTER OF THE APPLICATION OF THE ARIZONA ELECTRIC DIVISION OF CITIZENS COMMUNICATIONS COMPANY TO CHANGE THE CURRENT PURCHASE POWER AND FUEL ADJUSTMENT CLAUSE RATE, TO ESTABLISH A NEW PURCHASE POWER AND FUEL ADJUSTMENT CLAUSE BANK, AND TO REQUEST APPROVAL OF GUIDELINES FOR THE RECOVERY AND COSTS INCURRED IN CONNECTION WITH ENERGY RISK MANAGEMENT INITIATIVES.

Docket No. G-01032A-02-0598

IN THE MATTER OF THE APPLICATION OF CITIZENS COMMUNICATIONS COMPANY, ARIZONA GAS DIVISION, FOR A HEARING TO DETERMINE THE FAIR VALUE OF ITS PROPERTIES FOR RATEMAKING PURPOSES, TO FIX A JUST AND RESONABLE RATE OF RETURN HEREON, AND TO APPROVE RATE SCHEDULES TO PROVIDE SUCH RATE OF RETURN.

Docket No. E-01933A-02-0914

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, THE APPROVAL OF THE FINANCING FOR THE TRANSACTIONS AND OTHER RELATED MATTERS.

Docket No. E-01032C-02-0914

Docket No. G-01032A-02-0914

TESTIMONY OF MARSHALL

MAGRUDER

APRIL 21, 2003

27

h

This document contains the Testimony of Marshall Magruder for these cases.

This testimony is arranged in parts that address each of the three cases above, the proposed Settlement Agreement, and provides Conclusions and Recommendations.

Respectfully submitted on this 21st day of April 2003.

MARSHALL MAGRUDER

Marshall Magruder
PO Box 1267, Tubac, Arizona 85646

h

Exhibit A – Additional Background Information

Exhibit B – Document Excerpts

Original and Copies are certified filed by mail/email this date as shown on Service List (last page)

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1915
1916

**Testimony of
Marshall Magruder
Evidentiary Hearings starting May 1, 2003**

1
2
3
4
5 1. Introduction.
6

7 Q. Please give us some information about you?

8 A. My name is Marshall Magruder. My residence is in Tubac, Arizona. I am self-
9 employed. Please see Exhibit A for additional background information.
10

11 Q. Did anyone provide you support or assist you in preparation of this Testimony?¹

12 A. No. I prepared this Testimony and the other documents in this docket I signed, without
13 assistance, other than from Mrs. Magruder.
14

15 Q. How is your testimony organized?

16 A. My testimony is organized into Six Parts with an introduction and conclusion as follows:
17

18 Introduction

19 Part I – Purchase Power and Fuel Adjustment (PPFAC) Case, Docket E-01032C-00-0751

20 Part II – Gas Rate Case, Docket E-01032A-02-0598

21 Part III – Proposed Settlement Agreement for PPFAC and Gas Cases

22 Part IV – Joint Application for Approval of Sale of Electricity and Gas Utility Assets and

23 Certificates of Convenience and Necessity (CC&N) from Citizens to UniSource Case,

24 Dockets E-01933A-02-0914, E-01032C-02-0914, and G-01032A-02-0914

25 Part V – Facts and Conclusions in these Cases

26 Part VI – Recommendations for these Cases

27 Conclusion of Testimony

28 Exhibits

29 Exhibit A – Additional Background Information

30 Exhibit B – Documentation Exhibits

31 In general, footnotes have been provided with quotes to facilitate reading. A few of the more
32 critical and unique documents, not filed in the various Dockets, are found in Exhibit B.
33

¹ Response to Citizens Data Request No. 1.02.

1 Q. Have you been in contact with any Citizens in-house attorneys during the course of this
2 case?

3 A. No, except during procedural meetings held in conjunction with this case.²
4

5 Q. Did you or will you receive any compensation for participation in this case?

6 A. No compensation or reimbursement has been received from any source nor will there be any
7 in the future.³
8

9 2. Definitions of the key parties and purchased electricity contract phases.
10

11 Q. How are the key party terms "Citizens", "UniSource", "TEP", "APS" and "APS/PWC"
12 used in this testimony?

13 A. The term "Citizens" is used herein as a generic term for the Citizens Utility Company
14 (CUC), later renamed as Citizens Communications Company (CZN) and its Arizona Electrical
15 Division (AED) and Arizona Gas Division (AGD), all implied under the term "Citizens."
16 UniSource is used herein as a term for UniSource Energy Corporation ("UNS") the holding
17 company for Tucson Electric Power Company (TEP) and other subsidiaries including those
18 being created under the propose Joint Application for the sale of CCC's AED and AGD to
19 UniSource. In addition, "APS" is used herein for the Arizona Public Service Company, now
20 an entity of Pinnacle West Capital Corporation (PWC), with related entities, such as Pinnacle
21 West Energy Company (PWEC). My use of the term "APS/PWC" includes all PWCC entities.
22

23 Q. What do you consider to be the two contract phases of the purchase power and fuel
24 adjustment clause (PPFAC) case?

25 A. There is a natural break between the time when Citizens was under different sets of
26 purchase power agreements with APS/PWCC before and after July 15, 2001. There are two
27 phases and sets of actions. The Application, Revised Application and Amendments relate to
28 both of these actions. For convenience, the pre-July 15, 2001 phase APS/PWC-Citizens is
29 under the "Old Agreement" and the present one of July 15, 2001 is the "New Agreement" was
30 retroactive to June 1, 2001.
31

² Response to Citizens Data Request No. 1.03.

³ Please see Exhibit A for additional responses to Citizens Data Request 1.01.

1 **Part I – Purchase Power and Fuel Adjustment Clause (PPFAC) Case, Docket E-01032C-00-**
2 **0751**

3
4 3. Old Agreement PPFAC Issues.

5
6 Q. What went wrong during the Old Agreement between Citizens and APS/PWC?

7 A. Citizens and APS/PWCC were unable to agree on some terms of the Old Agreement
8 for the purchase of wholesale power by Citizens from APS/PWC. This agreement makes
9 Citizens the largest wholesale customer for APS/PWCC in Arizona. Others have extensively
10 documented this billing dispute between these two companies.⁴

11
12 Q. Did this disagreement impact the financial relationship between these two
13 companies?

14 A. From May 2000 through May 2001, Citizens received monthly purchased power bills
15 from APS/PWCC that Citizens considered and described as "excessive charges."⁵ These
16 billings precipitated the initial Application to the Arizona Corporation Commission (ACC), or
17 the Commission, in September 2000. Citizens continued paying all these APS/PWCC bills
18 under protest. This was a billing dispute between two wholesale companies and about their
19 interpretation of the Old Agreement. Retail electricity ratepayers are not involved.

20
21 Q. Had APS monthly bills always been correct before this period?

22 A. No. The applicant stated that each month the APS bills were reviewed. Citizens questioned
23 several discrepancies and errors, some minor and others significant, before the above

⁴ See ACC Procedural Order (18 April 2002) on page 2 (lines 23 to 25):

"The facts surrounding this issue now before the Commission are not in dispute. During 2000 and 2001, a billing dispute arose concerning a 1995 Power Service Agreement ("PSA") between Citizens and APS/PWC. Citizens ultimately negotiated a 2001 PSA with PWCC in July 2001 to replace the 1995 agreement."

And on page 9 (lines 12 to 21):

"... the contract dispute issue is inextricably intertwined with this case because 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 indicate that Citizens and APS have simply agreed to let rate payers 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."

⁵ See **Exhibit B-1** for excerpts from Citizens Security Exchange Commission (SEC) Reports Forms 10-K/Q and Annual Reports which use these terms.

1 disputed period between May 2000 and May 2001.⁶ Corrections were made by APS for
2 billings prior to the above disputed payments. At the beginning of the period of disputed bills,
3 APS was refunding a previous overcharge totaling \$2,769,629.⁷
4

5 Q. Were the APS/PWCC billing practices during this disputed period consistent with prior billing
6 practices?

7 A. No. Citizens considered that APS/PWCC had changed the method of calculating the cost for
8 purchased power. This is a core issue to be resolved in these hearings. All payments by
9 Citizens to APS/PWCC during this time were annotated "paid under protest."
10

11 Q. Were the issues that resulted in what Citizens labeled "excessive charges" known to Citizens
12 prior to this period of disputed billings?

13 A. Yes, in fact, the issues that led to the "Disputed Charges" had been under discussion for over
14 a year by teams from both companies.
15

16 Q. Did Citizens do anything to solve the Disputed Charges issue or correct the Old Agreement
17 prior to the disputed payments beginning? the summer of 2000?

18 A. Yes, Citizens initiated negotiations and had been negotiating with APS/PWCC for months,
19 apparently without success.
20

21 Q. Did Citizens use the FERC dispute resolution procedures?

22 A. Citizens stated? that they did not use any FERC dispute resolution processes or any outside
23 agencies or arbitration organizations to assist in resolution.
24

25 As indicated in the New Agreement, Article 10, Alternate Dispute Resolution (ADR), there are
26 a number of ways that disputes could be resolved, including mediation, arbitration using the

⁶ In the 3 January 2003 response to Magruder Data Request 3. 02(25), Citizens stated: "All APS charges from May through December 2000 were originally disputed. However, these charges are not currently in dispute." The excessive charges continued, until the New PWCC Agreement was implement on 1 June 2000 are included as being questionable. These charges are also included in the same category for this PPFAC case and were also requested to be recovered.

⁷ In response to Magruder Data Request 3.02(10), Citizens stated: "On November 23, 1999 the Arizona Corporation Commission issued Decision No. 62094 approving a negative surcharge of (\$0.00533/kWh), intended to: a) pass back to consumers the PPFAC Bank balance of \$(2,729,629) existing as of May 31, 1000 over a period of twelve months and b) to reflect in the ten existing power supply cost recovery level, certain reductions in demand charges being billed under the APS power supply agreement."

1 Federal Arbitration Act, prevailing Commercial Arbitration Rules and others.⁸ If these one-on-
2 one or FERC processes fail, the ACC could also help resolve issues since the laws of Arizona
3 govern the Old Agreement. Going to FERC for resolution as an early alternative, at least ? by
4 May 2001 was, apparently, dropped from consideration. The Old Agreement, in Section 16
5 (Billing), states "Notice shall be given [by Citizens to APS] that the disputed amount is found to
6 be incorrect, it shall be refunded, including Interest."⁹ Citizens gave such notice to APS/PWC.
7

8 Further, the governing APS Contract 48166, in Section 24 (Subsequent Service Schedule(s)
9 Approval), permits FERC filings "to determine whether any Service Schedule is just and
10 reasonable." This is a basic argument in this case. No FERC filing was made.¹⁰
11

12 Q. Could Citizens have used other means to resolve the dispute over the "disputed payments" of
13 the Old Agreement based on statutes that pertain to the ACC?¹¹

14 A. The A.R.S. §40-203, §40-204, §40-221, §40-241 and §40-242 permit the ACC to request any
15 records of any public service company in this State. A.R.S. §40-202 discusses the
16 Commission's broad supervision and regulatory controls over public service corporations and
17 §40-203 describes the Commission ratemaking authority.¹² A.R.S. §40-246,¹³ to §40-248 has a
18 process that could have been used to resolve such a complaint or dispute.

⁸ See PWC-Citizens Agreement, in the Amended Application Exhibit 2, "Pinnacle West Capital Corporation Market-Based Tariff, Rate Schedule FERC No. 4" for the ADR process under the New Agreement. The Old APS-Citizens Contracts, "Power Service Agreement between Arizona Public Service Company and Citizens Utilities Company, APS Contract 48166," all of which were also docketed and simultaneously filed with FERC (see APS Contract 48166, ¶2.3, with related schedules in APS Contract 48167 for Wholesale Power, APS Contract 48168 for Supplemental Capacity, APS Contract 48169 for Peaking Energy).

⁹ All Citizens billing payments for period May 2000 through February 2001 were annotated as "paid under protest" and referred to Article 16.4 of this contract.

¹⁰ Article 24.2 states:

"If upon the FERC filing, the FERC orders a hearing to determine whether any Service Schedule is just and reasonable, the Service Schedule shall not become effective until the date when an order no longer subject to judicial review has been issued by FERC determining the Service Schedule to be just and reasonable."

This "FERC filing" is not the "initial" filing discussed in Section 23. Article 24.3 indicated, "Citizens agrees to fully participate in any FERC hearing and/or court proceeding regarding any subsequent Service Schedule(s)." This also responded to Citizens Data Request 1.04.

¹¹ This and the next three questions/answers responded to Citizens Data Request 1.05.

¹² A.R.S. sections in this paragraph are titled as

A.R.S. §40-202 – Supervising and Regulating Public Service Corporations... Competitive Electricity Market; Rules; Duty to Comply; Exemptions for Electric Generation; Unlawful Practice

A.R.S. §40-203 – Power to Commission to determine and prescribe rates; rules and practices of public service corporations.

A.R.S. §40-204 - Reports by public service corporations to commission; duty of corporation to deliver documents to commission; confidential nature of information furnished; exception; classification

A.R.S. §40-221 – Power of commission to prescribe record-keeping methods and accounts; ...

A.R.S. §40-241 – Power to Examine Records and Personnel of Private Service Corporations; ...

1 Q. Do you feel that Citizens could have used this "complaint" process?

2 A. The complaint process appears applicable for all public service companies. Citizens' is
3 APS/PWCC largest wholesale electricity customer. All "customers" have the right to make a
4 complaint. Either company could have initiated the process. Citizens should have brought the
5 dispute to the ACC for adjudication as soon as the APS/PWCC discussions became
6 unproductive.

7
8 Q. Could you expand on possible roles for the Commission in resolving this dispute?

9 A. There seems to be at least two ways. The Disputed Charges could be disputed and
10 resolved under A.A.R. §R14-2-212 like any other utility customer or under A.A.R. Title 14
11 Chapter 2 and §R14-2-1603, §R14-2-1614, and other statutes.¹⁴

12
13 Q. Are there other ways the Commission could have assisted with this dispute resolution?

14 A. The Commission has the power to conduct an investigation (formal or informal) and make a
15 judgment (similar to mediation or arbitration). In today's business environment, utility
16 companies may not want to provide some information to competitors, even when not
17 competing. A company's "confidential" proprietary information is protected by the A.R.S. §40-
18 202 and §40-203. If the Commission conducted an investigation or hearing, as an

A.R.S. §40-242 – Production of Records

A.R.S. §40-246 – Complaint by Public Service Corporation Hearing

A.R.S. §40-247 – Hearing; process to witnesses; report of proceedings; decision; service of order

A.R.S. §40-248 – Reparation of overcharge; action to recover overcharge; limitations

¹³ Corrected words were inadvertently deleted between A.R.S. §40-202 and §40-243 in the original Testimony.

This correction clarifies Citizens Data Request 1.05.

¹⁴ These other statutes and administrative regulations are titled and briefly described as to potential applicability to solving the APS-Citizens disputed charges as follows:

A.R.S. § 30-809E – Consumer Choice, requires

"before initiating a complaint with a public power entity or the commission, the parties to a dispute arising under subsections A through D of this section shall meet and in good faith attempt to resolve the dispute through an information dispute resolution process; could apply but the above subsections appear not to be directly applicable to the APS/PWCC-Citizens disputes.

A.R.S. § 30-803H – Competition in Retail Supply of Electricity; Open Markets, requires the governing body of a public power entity to "provide a dispute resolution process including nonbinding third party arbitrators or mediators for customers ..."

A.A.R. Title 14 – Public Service Corporations; Corporations and Associations; Security Regulation

A.A.R. Title 14, Chapter 2 – Corporation Commission Fixed Utilities

A.A.R. § R14-2-212 (Administrative Hearing Requirements, an description of various rules for hearings.

A.A.R. § R14-2-212B – Customer Bill Disputes, seem applicable to the APS/PWC-Citizens utility-customer dispute.

A.A.R. § R14-2-212C – Commission Resolution of Service and Bill Disputed, also applicable to this dispute.

A.A.R. § R14-2-1614 – Administrative Requirements, in §R14-2-1614, the ACC may develop procedures for resolving disputes regarding implementation of retail electric competition. NB: in order to implement "retail" competition, some changes may be mandated to "wholesale" distributors in order to implement such competition. This footnote provides an additional response to Citizens Data Request 1.05.

1 independent third-party, it could use its "judgment" capability or assist in making a formal
2 Settlement Agreement to solve a billing dispute. Billing statements and details from
3 APS/PWCC to Citizens may retain their proprietary nature under A.R.S §40-204. A.R.S. §40-
4 202A (first sentence), §40-202B, and §40-203 indicate the ACC has the authority to resolve
5 disputes. ARS §40-202D requires "establishing of just and reasonable rates for electricity."

6
7 Citizens protested, disputed and paid an "excessive" rate. The Commission could have been
8 asked to conduct an investigation and made a judgment.

9
10 Q. Are you providing legal analysis saying that Citizens is involved in the wrong process with
11 regard to the Disputed Charges?¹⁵

12 A. No. That was not my intention; however, it does seem plausible that Citizens could have used
13 these ACC-complaint processes and procedures to resolve this billing dispute more
14 expeditiously and at less cost than by this Application or litigation or filing a complaint with
15 FERC.

16
17 Q. Which of these did Citizens do?

18 A. None. Responses during discovery indicate that Citizens did not consider using the ACC to
19 resolve its dispute with APS/PWCC. Instead, Citizens filed the Application(s) to recover these
20 disputed charges from its customers.

21
22 Citizens rejected litigation of this billing dispute with APS/PWC. Citizens considered "filing a
23 complaint with the FERC on the contract interpretation matter" which was "under consideration
24 at the time as part of Citizens' legal analysis" as was clearly described by Mr. Breen's February
25 2002 Rebuttal, pages 15 to 16.

26
27 Q. Did you say that Citizens used none of these dispute resolution means?

28 A. Yes, Citizens negotiated a New Agreement with PWC. This New Agreement now has a written
29 "dispute resolution" process. In the "Power Sale Agreement between Pinnacle West Capital
30 Corporation and Citizens Communications Company. PWC's Market Rate Tariff and Service
31 Agreement," filed as Application Enclosure (2), with its Article 10 (Alternative Dispute

¹⁵ This question and answer are in response to Citizens Data Request 1.06; see Appendix A for additional response.

1 Resolution) provides mediation and arbitration processes. These are required for "all disputes
2 arising under or relating to the terms of this agreement."
3

4 Q. If the disputed conditions in the Old Agreement had been resolved prior to May 2000, would
5 there have been a claim that there were excessive purchase power charges?

6 A. No, it appears the areas impacting the disputed charges, in the Old Agreement, were known
7 by both sides and were being actively discussed. These areas were not resolved prior to June
8 2000, when the California energy and natural gas prices surges were heading towards a
9 critical situation.

10
11 Q. When did Citizens realize the impact that the summer 2000 price surges would have on the
12 unresolved areas in the Old Contract?

13 A. There is no indication that Citizens forecast this crises or was aware of the summer of 2000
14 energy and natural gas crisis situation until about July of 2000 when the first APS/PWCC bills
15 arrived using a disputed calculation method.

16
17 Q. Are there possible explanations why Citizens did not forecast¹⁶ the summer of 2000 energy
18 crisis?

19 A. Yes, some or all of the following factors could apply:¹⁷

20 (1) Citizens management had no personnel assigned to forecast energy market
21 prices, in particular fuel costs,¹⁸

¹⁶ Citizens Data Request 1.07 requested to identify "any entity other than Citizens forecast" for the summer 2000 energy crisis. No information was found during discovery that Citizens forecast or anticipated this crisis. Some records indicate during August 2000, some managers, including Sean Breen, knew there was a problem. Apparently, Citizens does not maintain a business planning organization to continuously maintain forecasts and predictions that could/may/might impact the AED or AGD product lines. In response to Citizens Data Request 1.07, by early July 2000, my personal files included news articles, in particular the situation in San Diego, natural gas refinery decreases, lack of natural gas drilling facilities, and other energy related factors that pointed to the beginning of a major energy crisis. An impact of this summer of 2000 energy crises on Santa Cruz County was very similar to in California. There was an article on the PPFAC case by the Arizona Utility Investors Association's *Investors Quarterly*, October 2001 (page 4) that described both Mohave and Santa Cruz Counties as "Little California" as mirror of the California Energy Crisis of 2000. The Federal Energy Commission, on 26 March 2003, concluded that the 2000 California Energy Crisis, a series of rulings and Orders, was caused by illegal and fraudulent market manipulations by many different energy companies.

¹⁷ Citizens Data Request 1.08 requested that the "source" of the information contained in (1) to (5) be provided. See my forecasting background in Exhibit A. The factors listed are tailored to this case, and are typical factors when management fails to properly forecast. I developed these factors based on my extensive experience in crisis management over the last 40 years. This responds to Citizens Data Request 1.08.

¹⁸ In Citizens Response by Mr. Sean Breen to Magruder Data Request 3-18(5), Citizens "does not maintain its own databases of the competitive power market prices... Citizens' relies on outside consultants, who do track these prices, to support the prudent management of contracts." ACC Staff Data Request LS 14.15 agreed, which states "Citizens does not routinely track competitive power market prices."

1 (2) Citizens was unable to correlate impacts, in a timely manner, of higher natural
2 gas prices on purchased fuel costs for electricity as these two Citizens utilities, natural gas
3 and electricity, were in different business units;

4 (3) Citizens' top management might have been more interested in ignoring such
5 difficulties because the Arizona units were for sale.

6 (4) Citizens' top management was, possibly, not focused on the immediate market;
7 and/or

8 (5) Citizens' top management was, apparently, not concerned or interested in the
9 early natural gas price increases since purchased power costs are a "pass through" to the
10 ratepayers.¹⁹

11 In other words, there are no profit incentives for Citizens to control purchased power costs.

12
13 Q. Which of these do you feel was the cause of the belated reactions by Citizens?

14 A. Primarily, (5) above. Why? Citizens PR literature and news releases stress that
15 "Citizens makes no profit on pass through purchase power costs" when discussing this case.

16
17 Q. Who was responsible for solving any disputed terms of the Old Agreement?

18 A. Both APS and Citizens have an obligation to adhere to the terms of their contract. They had a
19 dispute over the meaning of some terms. Neither APS/PWCC nor Citizens considered using the
20 FERC dispute resolution process or the offices of the ACC/PWCC to solve their disagreement.
21 They disagreed a year before the "disputed charges" occurred. After the disputed billing
22 occurred, they continued on a "discussion" track, as the "disputed charges" continued to be
23 billed to and paid by Citizens, under protest.

24
25 Q. Were these actions and decisions correct during the Old Agreement disagreements?

26 A. The decision by management to let this disagreement continue unresolved for so long is
27 imprudent (as discussed in section 5 below). These disagreements are unresolved.

28
29 Q. Are the ratepayers responsible for solving known these problem areas of the Old Agreement?

30 A. No. Since these areas had negative consequences on Citizens' ratepayers; it was Citizens'
31 duty to resolve such a dispute prior to paying the billing changes. For APS/PWC, any negative
32 consequences from such a dispute would impact their cost of doing business or profit margins

¹⁹ In Citizens Response by Mr. Carl Dabelstein to Magruder Data Request 3.02(27), Citizens "has the authority from the Arizona Corporation Commission to track and recover power supply costs. The genesis of such cost pass through authority for Citizens' Arizona Electric Division can be traced back to the early 1950s."

1 and therefore not directly impact their ratepayers. This is a matter between both companies
2 only.

3
4 Q. Should Citizens be reimbursed for these disputed charges by ratepayers?

5 A. No, reimbursement by ratepayers for unwise, imprudent management decisions by a utility
6 company is not proper, permitted, or legal.

7
8 4. Repayment of the Disputed Charges under the Old Agreement²⁰

9
10 Q. What is the amount of the Disputed Charges under the Old Agreement?

11 A. Citizens stated that there was \$ 63,673.956 of these Disputed Charges under the Old
12 ASP/PWCC Agreement at the end of the period.²¹ Citizens' also reported these disputed
13 charges as "unrecovered" from the ratepayers [see **Exhibit B-1**]. Through November 2002,
14 when these are added into the PPFAC Bank total was about \$119,427,777 million²² or
15 increasing to about \$132 million by June 2003. Citizens' reporting has been cumulative since
16 the first disputed payment.²³

17
18 Q. Are some charges not Disputed?

19 A. Yes. The Western Area Power Administration (WAPA) increased the "wheeling" charge for
20 electricity losses due to the transmission on high voltage lines managed by WAPA between
21 APS sources and Citizens meters. This charge has not been disputed.

22
23 Q. What do you mean by Costs Not Recovered?²⁴

24 A. This term was used in Citizens Testimony in March 2002 and is the same as Unrecovered
25 Costs. This is a portion of the monthly APS/PWCC bill at the current rate that reimburses
26 Citizens for purchased power. The term Cost Not Recovered is the difference between the
27 Total APS Bill for Purchased Power and WAPA charges minus Recovered Costs, where

28
29
$$\text{Cost Not Recovered} = (\text{Total Purchased Power Bill} + \text{WAPA charges}) - \text{Recovered Costs}$$

²⁰ Much information in this section needs the validated results from Magruder Data Request Three, which has not been answered by Citizens. All values in this section are "estimates," "approximately" or "about."

²¹ Citizens response to Marshall Magruder Data Request MM-3.02 (14) for computation of this total.

²² This value is from Exhibit 3 to the Citizens Revised Application as of 6/24/02 (page 2 of 8).

²³ As reported in Exhibit 3 to the Citizens Revised Applications(s) as of 6/24/02, the monthly total is cumulative. This responds to Citizens Data Request 1.10.

²⁴ Values for Recovered Costs and Costs Not Recovered should be in Citizens Response to my Data Request Three.

1
2 Q. What do you mean by the Disputed Charges and why are they important?

3 A. Disputed Charges should be the difference between the Citizens interpretation of the fair and
4 reasonable charges under the Old Agreement and the interpretations made by APS/PWCC,
5 starting in May 2000, for "excess" charges that have not been reimbursed or recovered by
6 routine payments of ratepayers.

7
8 Q. Who owes the Disputed Charges?

9 A. Parties, including Citizens, have discussed fair and reasonable interpretations of the Old
10 Agreement. In my opinion, Citizens has correctly evaluated costs in accordance with the "SIC"
11 clause.²⁵

12
13 Q. If Citizens is correct, who should pay the Disputed Charges?

14 A. Under these conditions, it appears APS/PWCC overcharged Citizens. APS/PWCC should
15 reimburse Citizens²⁶ the Disputed Charges, plus accrued interest, as required by APS Contract
16 48166, ¶16.5.²⁷

17
18 Q. For how much of the Disputed Charges should the Citizens ratepayers be responsible?

19 A. Since APS and Citizens have not been able to agree on the terms of the Old Agreement, it is
20 impossible to determine this amount.

²⁵ In a letter from Mr. Daniel J. McCarthy, Citizens VP to Mr. Jack Davis, APS President, on 23 March 2000, it was clear that Citizens understood the issues involved in this billing dispute. From page 4 of this letter:

"In Citizens' view, this methodology [prior pages demonstrating Citizens interpretation of the Old Agreement], and the principles outline above, are consistent with the bargained-for provisions embodied in the Agreement, and if properly employed would have resulted in significantly lower energy billing to Citizens. Citizens is entitled to a full refund for all over-billed amounts, with interest dating back to the time the erroneous billing practices began. However, it is not clear for how long APS has been erroneously billing Citizens under the Agreement, and, moreover, based on our discussions, it is consistent with the foregoing. In the event that APS, for lack of data, cannot correct its billing errors, Citizens is willing to enter negotiations with APS for the purpose of reaching negotiated settlement to these issues."

(Bates Numbers CCC006559 to CCC0065564) This letter was originally marked CONFIDENTIAL, but released by Citizens Response to Marshall Magruder Data Request 3.16B(066) on 2 January 2003. Clearly, both sides understood this was a billing dispute, Citizens stated to APS the issues involved with billing before May 2000 when the disputed charges commenced. The above letter was answered by Mr. Jack Davis (APS) reply on 17 April 2002 to Mr. Daniel J. McCarty (Bates CCC006704 to CCC006706, forward in response to Marshall Magruder Data Request 3.16B(088) when it was downgraded from CONFIDENTIAL), by not agreeing with Citizens position and recommended personal negotiations.

²⁶ In Citizens Response to Marshall Magruder Data Request MM-3.02(17), Citizens stated "PWCC (APS) has not refunded any of the "disputed" payments made for billings of May 2000 through May 2001."

1
2 Q. Why is it impossible to determine the principal for this PPFAC "loan"?

3 A. The amount of the disputed billing charges remains unresolved. The Application claims the
4 disputed billing charges are the ratepayer's responsibility. Since APS/PWCC has already
5 received payments, APS/PWCC apparently has no further interest in solving this issue.
6 Avoiding these disputed billing charges appears to be their objective in the Citizens
7 Applications. The last two PWCC Annual Reports²⁸ stated it will "vigorously defend" these
8 charges, if challenged by Citizens. APS, PWC, or PWCC have not been called or summoned
9 to appear as a witness or party to these hearings to present their side of this dispute.

10
11 Q. Do you recommend that APS be summoned to be a party to these PPFAC hearings?

12 A. That is a possible solution. Another solution could be that Citizens and APS/PWCC resolve the
13 disputed purchase power billing charges before proceeding with this case.

14
15 Q. Should these disputed billing charges be verified and validated before continuing in these
16 PPFAC hearings?

17 A. Yes, that would seem a necessary first step, since the Application asks for payment from the
18 ratepayers for the Costs Not Recovered amounts

19
20 Q. How can the Commission approve an increase of customers' rates for "disputed" and
21 "unknown" billing charges that may or may not be reimbursable expenses?

22 A. I know of no way that the Commission could justify such an action.²⁹

23
24 Q. What could happen after the disputed billing charges are resolved?

25 A. After resolution, these PPFAC hearings could be resumed, with a new PPFAC Application that
26 had a basis; an amount agreed upon by APS/PWCC and Citizens.

27
28 Q. Are you saying that these PPFAC hearings should not continue until the billing disagreement
29 between Citizens and APS/PWCC under the Old Agreement is resolved?

²⁷ APS Contract 48166, ¶16.5 reads, as "Any excess amount of bill, which, through error or as a result of a dispute may have been overpaid shall be returned upon determination of the correct amount, with interest."

²⁸ PWCC *Annual Reports* for 2000 and 2001. The PWCC 2002 Annual Report has not been issued to date.

²⁹ In response to Magruder Data Request MM-5.18, the Joint Applicants stated "The [ACC] Commission has not yet found the costs to be either recoverable or unrecoverable."

1 A. Yes. It is clear that there is an amount that APS charged Citizens for purchased power is
2 disputed. Until the actual, fair amount is known, there is no way to determine if Citizens should
3 be granted the privilege of charging the Citizens ratepayers more for purchased power.
4

5 Q. What should be done about the PPFAC "interest" that is accruing in the PPFAC
6 account?

7 A. The Commission needs to make a decision about whether such interest is justified.
8 Citizens' argues that similar interest has been reimbursed in natural gas cases. Electricity is a
9 different type of commodity. The fact that it cannot be stored, moves very fast, and other
10 precedent setting reasons, are some rationales, why the Commission should deny such
11 interest. Citizens requested in its Application that a 6 percent (6%) interest, compounded
12 monthly, be used. Even if interest were justified, until the amount of principal is determined, it
13 will be impossible to correctly determine the interest.
14

15 Q. Should the PPFAC Loan interest³⁰ be considered for reimbursement, and added to the rates,
16 paid by Citizens customers?

17 A. No interest should be paid by ratepayers for imprudent management decisions (see next
18 section). If Citizens determined APS/PWCC "overcharged," APS/WPC is obligated pay interest
19 to Citizens, agreed to under the Old Agreement in ¶16.5 and such "interest" is non-
20 reimbursable business costs.
21

22 Q. What is the relationship between UniSource and this billing dispute?

23 A. None, UniSource was not involved in the disputed billing, interpretation of the Old Agreement,
24 nor did they pay any of the bills paid under protest by Citizens.³¹
25

³⁰ In Citizens Response dated 3 January 2003 to Magruder Data Request 3.02(7), Citizens stated:
"Citizens wishes to make it clear, in its application in this proceeding, the Company is requesting
Commission approval to begin accruing carrying charges on the PPFAC Bank prospectively from the date
of the Commission's order in this proceeding. The Company is not seeking the recovery of any carrying
charges for periods prior to such Commission order."

³¹ In response to Magruder Data Request MM-5.18, UniSource stated
"It is noted that, as part of its application for Commission approval to purchase the Arizona electric assets
of Citizens, UniSource has stated that it will not seek recovery of the balance of unrecovered costs
contained in the PPFAC Bank as of the date of the sale, now forecasted to be in excess of \$136 million.
Such commitment by UniSource, however, has no, and should not be interpreted as having any, bearing
on the issue of whether citizens' power procurement actions were prudent nor whether the unrecovered
cost are recoverable."

1 Q. How can UniSource in its testimony claim it will "forfeit" collection of these unrecovered
2 charges?

3 A. UniSource was not and is not involved in the disputed billings. Even after the proposed
4 UniSource purchase of Citizens, UniSource is not involved in a billing dispute since it did not
5 make the payments that Citizens made to APS/PWC. UniSource has nothing to "forfeit."
6

7 Q. Should UniSource be able to deduct "Goodwill" for the estimated amount it claimed to "forfeit?"

8 A. Of course not. Claiming an income tax deduction for amortization over 37.0 years should not
9 be permitted by auditing or regulatory agencies. Goodwill involves a business's reputation,
10 patronage, and other intangible asset. UniSource did not incur any liability or benefit from the
11 "disputed billing charge" as previously stated. Because UniSource has nothing to "forfeit", it
12 has nothing to claim for "goodwill." In response to ACC Staff Data Request JMR 1-2,
13 UniSource is claiming \$118,620,000 for "Acquisition Adjustment (Goodwill)." This large value
14 for goodwill in an asset that cost \$92 million. It appears to include much of the disputed billing
15 that existed between Citizens and APS/PWC.³²

16 For additional comments concerning UniSource, please see section 8 below.
17

18 5. Citizens Management Decisions.³³
19

20 Q. In the above, you discussed "imprudent" decisions made by Citizens management.
21 Could you please elaborate?

22 This is an important issue. When management makes a series of illogical, irrational, or, in general,
23 imprudent decisions, it may cost the company money, if unwise decisions result in losses. Imprudent
24 decisions cannot be legally be reimbursed.
25

26 Q. What are some of the decisions Citizens made that you consider imprudent?

27 A. In Table 1, I listed some of the imprudent Citizens' management decisions and why they are
28 considered imprudent.³⁴ It my understanding that, in many cases, only a single imprudent
29 decision is enough prevent reimbursement.

³² See UniSource Response to ACC Data Request JMR 1-2, "Citizens Utilities – Total Electrical Forecast of 11/5/02: Base Case" (page 2) which provides Actual for 1998 to 2001, Projected for 2002, and Forecast with Purchase for 2003 to 2005 in a pro forma spreadsheet. There are conflicts with the amortization schedules, as the Electric Utility Goodwill is for 25.0 years (page 2) and the Gas Utility Goodwill is for 39.0 years (page 4) which starts at \$59,210,000 for 2003.

³³ Citizens Data Request One requested that each "imprudent management decision" be identified and an explanation be given as to why it is considered to be an "imprudent" decision. This section provides a response to Data Request 1.14.

³⁴ In specific response to Citizens Data Rate 1.14.

Table 1 – An Initial List of Some of Citizens Imprudent Decisions.

Imprudent Management Decision	Why I believe this Decision was imprudent
1. Decided not to solve the SIC issue, raised in 1999, by the spring of 2000	Management failed to understand and anticipate the consequences with respect to rates under conditions, such as those of 2000 and 2001. Management has not yet dealt with this problem.
2. Decided not to resolve the "disputed" APS/PWCC charges	Management decided to do nothing to resolve these "Disputed Charges paid under protest." Doing nothing fails to solve a problem.
3. Decided not to protect their customers from "excessive" charges	Management has decided not to solve the "excessive" charges issue that was noted in almost every SEC 10-K/Q since fall of 2000 as excessive. It appears Citizens has decided it does not have a moral, ethical, or legal obligation to protect its customers from these excessive charges. "Concern" for low income customers does not prevent or protect the customers from clearly excessive charges.
4. Decided not to collect a refund of Disputed Charges from APS/PWCC so that Citizens' customers are not asked pay excessive charges	Management knew these were excessive charges. They paid them, but Citizens has never asked APS/PWCC to refund any of the "excess" or overcharges. Citizens' management decided not even to try to obtain a refund for the Disputed Charges.
5. Decided not to consider the impacts of complete "pass through" to customers	Management continuously states, "we make no profit" on excessive charges. This implies there is no concern, other than profit. This attitude indicates lack of concern for their customers. Citizens' customers will never accept the "pass through" of another company's excessive charges, paid under protest, by Citizens' management. What could Citizens' management be thinking?
6. Decided not to complete what Citizens' indicated it would accomplish in its September 2000 Application, the Phase III Analysis	Management has failed to provide the analysis necessary to complete Phase III, as discussed in the original Application. Without this promised analysis, Citizens has failed to meet the goals it established for understanding the problems associated with APS's overcharges. This analysis was to provide a clear description of the problem.
7. Decided not to have a third-party determine the value of the Disputed Charges	Management has not considered or attempted to have a third party conduct an independent analysis with APS/PWCC to mediate or arbitrate a solution to the Disputed Charge issue. Until APS/PWCC is brought before an independent body and a judgment is made as to whether the charges were fair and reasonable, the disputed payments must remain as originally declared: <u>disputed and paid under protest</u> .
8. Decided not to negotiate a reasonable rate with PWCC in the proposed Agreement	Management negotiated at \$58.79/MW-hr agreement with PWC, over twice the 2002 annual Palo Verde Index wholesale electricity rate or \$27.00/MW-hr purchased by UniSource and significantly higher than \$32 to \$34/MW-hr for 2003 forecast by UniSource. APS/PWCC produced electricity for a 2002 annual rate of \$12.80 during 2002, a record low. Arizona wholesale rates should be decreasing for next few years based on an over 50% excess generation capability. Why did Citizens management negotiate nearly twice the going rate for wholesale electricity and not attempt to negotiate a fair and reasonable rate? See my Testimony of 8 November 2002 for additional detailed wholesale costs. A <u>reduction</u> not an increase should have been negotiated.
9. Decided not to re-negotiate fair and reasonable rates, now that the pressures of the summer of 2001 have been relieved	Management has failed apparently to understand the proposed contract is NOT advantageous in today's environment and management has apparently not attempted to renegotiate a better deal for its customers.

Table 1 – An Initial List of Some of Citizens Imprudent Decisions.

Imprudent Management Decision	Why I believe this Decision was imprudent
10. Decided not to reduce "energy losses" from the APS/PWCC and Citizens tie points to customers	Management has applied the same 10.96% energy loss (from last rate case) without any improvement in losses. Why has there not been any improvement in the transmission and distribution network within Citizens service area? Is this lack of improvement related to AED being "for sale" and any improvements being <u>deferred</u> to UniSource. This lack of action does not help anyone.
11. Decided not to assess, understand and validate the increased "energy losses" from the WAPA	Management has applied for this increase of 4.36% for WAPA energy loss without any validation or attempts to reduce. Again, another " <u>pass through</u> " to the ratepayers, without a "peep" from Citizens management.
12. Decided not to incorporate the financial impact of another "wheeling" charge on customers for backup electricity	Management signed an agreement (PDA) with TEP for backup electricity that will cost \$223,000 a month for firm delivery of 100 MW-hr at the Nogales Gateway Substation as "backup" at any time, it is needed. Management does not seem to care this will raise rates and cost more than any benefit ratepayers would receive for an average of 2.049 hours backup on this line annually. UniSource indicates this will result in \$1.7 million new revenues from ratepayers starting in 2005. As presently structured, it also appears that Mohave County ratepayers will be assessed these unique backup costs.
13. Decided to add a third "transmission loss" charge increasing energy losses to over 35%	Management, when it agreed to the backup TEP transmission line charges, that involve about 20% for the TEP line energy losses, plus 10.96% for APS/PWCC energy losses and 4.36% for WAPA losses. The total energy loss of over 35% extra generation is paid to others to deliver electricity to Citizens customers in Santa Cruz County. Management at TEP appreciates Citizens for adding these "pass through" for additional revenue to TEP (over 20%), APS/PWCC (10.96%) and WAPA (4.36%).
14. Decided not seek any potential customers for the 100 MW Firm delivery in Nogales, Arizona	Management has signed an agreement to pay for 100 MW of power in Nogales, Arizona, with an area customer load, that rarely exceeds 50 MW. Citizens "hopes to find" a customer for a multi-year purchase agreement of the 100 MW, but this seems unlikely without a Mexican <u>Constitutional change</u> . In addition, this could cause another dispute with PWCC since the proposed PWC/APS-Citizens Agreement limits Citizens from most other purchased power sources, such as TEP. UniSource has now lowered this to 60 MW.
15. Decided to not have a second transmission line to Nogales operational at the ACC mandated date.	Management's failure will result in a \$30,000 penalty per day after the required operational date of December 31, 2003. So far, TEP is at least 18 to 24 months behind schedule. It slips more each day. This will amount to a penalty loss (obviously non-reimbursable) of \$360,000 per annum until operational. Other reasonable options are less expensive (\$86 million versus ~\$20 million, about 23% of cost), with higher reliability, lower energy losses as a favorable economic decision.
16. Decided not to establish any "Energy Risk Management Techniques" requested in the Application	Management has failed to establish or even propose a "Demand Side Management (DSM)" program as promised in the Citizens Application. Citizens conservation program fails to reduce the peak "demand side" of the business when electricity is most expensive. Customers demand "fair and reasonable" prices that will result from load shaping.
17. Decided not to obtain "fair and reasonable" rates for Citizens customers	Management has continually failed to aggressively pursue ways to lower customers' costs. For example, in Southern Arizona, there are at least two other utilities (TEP and SWT) from whom Citizens could have purchased wholesale electricity for its customers. Why aren't they being used to "force" wholesale competition with the present Seller?

Table 1 – An Initial List of Some of Citizens Imprudent Decisions.

Imprudent Management Decision	Why I believe this Decision was imprudent
18. Decided not to find a "buyer" for AED in a reasonable period to time.	Citizens Management searched for a buyer for its Arizona resources for years. Companies "for sale," traditionally receive "cosmetic" facelifts when put on the market, capital costs and "frills" are removed and all financial statements are cleared of items to which a potential buyer might object. This asset gamble may go on for a year of two. This current situation is now, into a fifth year. Citizens' management made AED a "disposable" resource in its SEC 10-K/Q balance sheets and ceased "depreciating" capital assets that are depreciated.
19. Decided not to actively pursue innovative, renewable energy resources	Management has failed to establish an aggressive plan to reduce long-term energy requirements or to increase efficiency at all levels, other than some conservation measures. To my knowledge, no distributed generation plants are proposed to reduce energy losses, no renewable energy source incentives, no major renewable capital improvements, and no local generation resources under development.

1
2 6. New Agreement Issues.

3
4 Q. What are the principle differences between the Old and New Agreements?

5 A. The New Agreement is a seven-year, fixed rate, full service agreement. Electric power is
6 provided by APS at \$58.79 per Megawatt-Hour (MW-hr). The Old Agreement used a series of
7 cost schedules for basic and peak loads, taking into account time of the day.

8
9 Q. Are there advantages to Citizens and APS in the New Agreement?

10 A. Yes, it seems to avoid the disputed terms of the Old Agreement and appears easier to
11 administer.

12
13 Q. What are the advantages to Citizens ratepayers under to New Agreement?

14 A. One advantage is a guaranteed fixed rate, through May 31, 2008.

15
16 Q. Are there any disadvantages to Citizens in the New Agreement?

17 A. Yes. The New Agreement means higher rates (\$18.25 per MW-hr)³⁵ for its customers and some
18 additional restrictions such as Citizens' use of its generation resources (see section 7 below).

19
20 Q. How does a fixed wholesale electricity rate at \$58.79 per MW-hr compare to today's monthly
21 market prices?³⁶

³⁵ See proposed Settlement Agreement, Appendix C. This includes an increase of \$0.44 per MW-hr for an increase in WAPA energy transmission loss costs.

³⁶ The Old Agreement cost of electric generation is \$48.02 per WM-hr.

1 A. It is about twice that recently charged at western states switchyards, such as at Palo Verde. On
2 8 February 2003, the Mr. Jim Pignatelli, CEO, and Mr. Keith Larsen, CFO, hosted a First Call
3 meeting with investors. During that meeting, Mr. Pignatelli stated that the "year-round wholesale
4 electricity prices as Palo Verde were \$27.00 per MW-hr"³⁷ and Mr. Larsen sated that the 2003
5 annual wholesale electricity forecast was between \$32.00 and \$34.00 per MW-hr. About one-
6 third of the electricity in Arizona is generated by the Palo Verde Nuclear Generation Station,
7 produced electricity at \$12.80 per MW-hr production costs as reported by PWC/APS.³⁸ Fixed
8 price contracts may have higher rates to cover contingencies and unknown risks, but over twice
9 the going rate is excessive.

10
11 For example,³⁹ the national market values, reported daily in the *Wall Street Journal*⁴⁰, are the
12 high and low demand weighted average prices for the past twelve months. As of November
13 2002 is shown in Table 2 below. This shows that \$58.79 per MW-hr was not reached on a single
14 day in the prior twelve months. Due to present market volatility in the past six months, three
15 have been short time periods where spikes over \$150 per MW-hr have been recorded as shown
16 in Table 3 as of 27 March 2003. These higher peaks were not evident as of 27 March 2003
17 where the peak firm prices were \$40.90 per MW-hr in the Mirant National Power Index. In
18 addition, the Firm on Peak California-Oregon and Nevada-Oregon Borders price was \$35.49 per
19 MW-hr.⁴¹

20
21 The new PWC-Citizens Agreement is higher than regional costs in the continental U.S. The fixed
22 cost of \$58.79 per MW-hr exceeds the Mirant West Power Index 52-week high of \$45.53 per
23 MW-hr in November 2002. The New Agreement greatly exceeded the 52-week low daily values
24 that vary between \$14.73 and \$18.23 per WM-hr last November, from my Testimony of 8
25 November 2002. A few daily highs for electricity exceeded \$58.79 per MW-h during the past six

³⁷ See "UniSource Energy Reports Earnings for 2002" (Business Wire) on 30 January 2003, stated "Around-the-clock power prices on the Dow Jones Palo Verde Index returned to more normal levels in 2002, averaging \$27 per megawatt hour (MWh), down from \$94 per MWh in 2001."

³⁸ See "Palo Verde Sets National Production Record, Logs Best Operational Year Ever" (Business Wire) on 15 January 2003, stated:

"The [Palo Verde Nuclear Generation] station recorded a three-year average production cost of about 1.28 cents per kilowatt-hour [which equals \$12.80 per MW-hr], among the lowest in the industry."

The PVNGS is operated by APS and owned by APS, Salt River Project, Southern California Edison, El Paso, Public Service Co. of New Mexico, Southern California Public Power Authority and Los Angeles Department of Water and Power.

³⁹ This section and Exhibit B to Marshall Magruder Testimony of 8 November 2002 responded to Citizens Data Request 1.13 for more statistical data. More data are available. Electricity traders and utilities use costly subscriptions services. I am limited to public information sources to assess non-real time situations.

⁴⁰ See *Wall Street Journal*, 4 November 2002, page C10.

1 months but the latest daily average in the West Power Index as \$24.76 per MW-hr, considerably
 2 less than half the proposed new price. The new Agreement can only be defined as having
 3 excessively high rates.

4
 5 **Table 2 - Mirant National Power Indexes**

6 Demand weighted average price in \$/MW-hr for the continental United States in November 2002.

Mirant National Power Index	Mirant East Power Index	Mirant West Power Index
52-wk High		
\$49.64	58.62	45.53
52-wk LOW		
18.23	17.59	14.73

8
 9 **Table 3 - Mirant National Power Indexes**

10 Demand weighted average price in \$/MW-hr for the continental United States on 27 March 2002.

Mirant National Power Index	Mirant East Power Index	Mirant West Power Index
52-wk High		
\$152.07	143.81	114.33
27 March 2003 Firm On-Peak		
\$40.12	44.68	24.76
52-wk LOW		
20.00	19.98	14.73

12
 13
 14 Q. Do you have additional data to support a conclusion that the "New" wholesale electric rates of
 15 \$58.79 per MW-hr are **excessive**?

16 A. Yes. Tucson Electric released a report for Third Quarter Earnings.⁴² It stated

17
 18 "In the third quarter of 2002, wholesale sales volumes were down 30.8 percent compared
 19 with the third quarter of 2001, resulting from decreased demand for power in the western
 20 United States energy markets. Wholesale revenues were \$41.1 million, down from \$206.9
 21 million in the third quarter 2001. Around-the-clock power prices on the Dow Jones Palo
 22 Verde Index averaged \$28 per MWh during the third quarter 2002 compared to \$40 per
 23 MWh in the same period last year."

⁴¹ See *Wall Street Journal*, 18 April 2003, page C12.

⁴² TEP News Release, 20 October 2002, see www.businesswire.com or www.unisource.com

In addition, from several other sources, there is usually close tracking between Palo Verde and other western energy markets. For example, during two different weeks, last week and six months before, we see in Table 3 that Palo Verde is relatively stable between \$34.75 (non-firm) and \$38.00 (firm) for Peak and between \$21.00 (non-firm) and \$25.00 (firm) during October 21 to 25, 2002. As shown in Table 4, during April 14 to 18, 2003, the prices are more volatile due the war in Iraq, both Venezuela and Nigeria are having internal problems, and Mexico has opposed the U.S. intervention, all which could have significantly raised energy prices. During the energy unrest this week, the options for Palo Verde prices are lower than the \$58.76 requested by the Applicants for the PWCC New Agreement. These range from between \$48.75 for Peak Firm, \$36.00 for Peak-Non Firm, \$32.75 for Off-Peak, Firm to a low of \$24.75 for Off-Peak, non-firm delivery.⁴³

Table 3 – Western Energy Prices, Week of October 21-25, 2002.

Western Electricity Prices Week of October 21-25, 2002		
Hub	Peak (heavy)	Off-peak (light)
Mid-Columbia	30.5-36	21.5-26
COB	33-38.5	24-25
NP 15	38-43.25	23.5-26.75
SP 15	37.25-43	23-26
Palo Verde	34.75-38	21-25

Table 4 – Western Energy Prices, Week of April 14-18, 2003.

Western Electricity Prices Week of April 14-18, 2003		
Hub	Peak (heavy)	Off-peak (light)
Mid-Columbia	21-34	20.25-32
COB	29-39	N/A
NP 15	39-59	26.75-36.5
SP 15	39-55.5	26-36
Palo Verde	36-48.75	24.75-32.75

Please note the typical closeness of Palo Verde and the other western energy markets. Also, note the difference in Peak with heavy traffic and Off-Peak with light traffic

⁴³ Western Price Survey, "Prices Wax, Freeze, then Wane," 25 October 2002, see <http://www.newsdata.com/cem/pr102502.html> and [http://www.newsdata.com/](http://www.newsdata.com/cem/) for current week.

1 Other data, compiled from the *Wall Street Journal*, are found in Exhibit B of my prior Testimony
 2 of 8 November 2002. The data are not for Palo Verde because the *WSJ* stopped publishing its
 3 Dow Jones Palo Verde Index in March 2002. The DJ Palo Verde Index is available on a
 4 subscription basis so utilities have this information. The Dow Jones California-Oregon and
 5 Oregon-Nevada Border (DJ COB) Index are published daily. That Exhibit was constructed for
 6 the DJ COB data. Note this index did not exceeded \$50 per MW-hr during the prior 52-weeks,
 7 for even one day. Table 6 below shows all of these wholesale rates:

8 Table 6 – Various Wholesale rates.

Rate \$/MW-hr	Firm/Non-Firm	On Peak/ Off-Peak	Market	Remarks
\$12.80	Year- around the clock		Palo Verde	2002, APS production costs
\$18.23	Daily 52-week Low		West	Mirant Power Index, 11/2002
\$24.76	Firm	On Peak	West	Mirant Power Index, demand weighted average 3/27/03
\$27.00	Year- around the clock		Arizona, Palo Verde	2002 Year-around the clock rate, Pignatelli, TEP, Feb 03
\$28.00	Third Qtr 2002 – around the clock		Palo Verde	TEP quarterly report
Between \$32.00 and \$34.00	Year- around the clock		Arizona, Palo Verde	2003 Year-around the clock futures, Larsen, TEP, Feb 03
~\$37.00	2004-2005 – around the clock		Palo Verde	TEP forecast (DR MM-5.31)
\$38.00-\$25.00	Weekly Firm (On-Peak/Off-Peak)		Palo Verde	Week of 11/21-25/2002
\$40.00	Third Qtr 2001 – around the clock		Palo Verde	TEP quarterly report
\$40.12	Firm	On Peak	West	Mirant Power Index, 3/27/2003
\$40.90	Firm	On Peak	National	Mirant Power Index, demand weighted average 4/18/2003
\$48.02	Firm	Average	Citizens	Old APS Contract
\$48.75 - \$32.75	Weekly Firm (On-Peak/Off-Peak)		Palo Verde	Week of 04/14-18/2003
\$49.64	Daily 52-week High		Western	Mirant Power Index, 11/2002
\$58.79	Firm	Average	Citizens	7-year, fixed price, new PWCC Contract (proposed)
\$94.00	Year- around the clock		Arizona, Palo Verde	2001 Year-around the clock rate, Pignatelli, TEP, Feb 03

9
10
11 Q. How did Citizens come to agree to this New Agreement with such high charges?

12 A. During the negotiations between APS and Citizens, from late winter of 2000 through July 2001,
 13 the California energy crisis was on everyone's mind. The high charges in California were
 14 impacting all western energy markets. Citizens was under pressure on many fronts, which
 15 included:

- 16 (1) Resolving the Old Contract disputed charges with APS,
- 17 (2) Completing analytical studies described in the original Citizens Application,
- 18 (3) Keeping customer reliability high during to a class-action law suit (*Chilcote, et al versus*
 19 *Citizens Utilities*),

- 1 (4) Negotiating with Tucson Electric Company (TEP) concerning a second source of electricity
2 for Nogales and Santa Cruz County customers,
3 (5) Keeping the agreement to sell AED and AEG to CapRock, and
4 (6) Avoiding higher energy costs before the summer of 2001.⁴⁴

5 These pressures must have impacted the May-July 2001 Citizens-APS negotiation decisions.
6

7 Q. Can anything now be done to reduce the rates of the New Agreement?

8 A. Yes. The governing FERC Order, which includes dispute mediation and arbitration, was not
9 exercised before Citizens applied for this rate increase, is a way to solve that issue.
10

11 Q. What if APS/PWCC does not want to negotiate the New Agreement?

12 A. The same options, including the good offices of the ACC, FERC dispute resolution, mediation,
13 and binding arbitration are available without extensive litigation expense.
14

15 Q. Should Citizens ratepayers pay unfair or unreasonable rates under the New Agreement?

16 A. No, in addition to the information herein, the testimony by others in these hearings has shown
17 this fixed rate is above the norm therefore unreasonable.
18

19 Q. Can the Arizona Corporation Commissioners reduce rates specified in the New Agreement if
20 they are found to be not fair and reasonable?

21 A. It appears to me this is an element of their statutory and fiduciary obligations. A.R.S. §40-203⁴⁵
22 is clear. Whenever the Commission finds "the rates, charges, demanded or collected is unjust,
23 discriminatory or insufficient, the Commission shall determine and prescribe [them]".⁴⁶ This
24 article specifies rates shall not be "unjust" or "insufficient." Based on former observations, the
25 Commission considers this "balance" in making its decisions. There is nothing in this A.R.S.
26 article which specifies "wholesale" or "retail." It appears "wholesale" and "retail" are not part of

⁴⁴ In response to Marshall Magruder Data Request 3.18 (6), Citizens Sean Breen stated "Citizens entered the new APS agreement at the time it did in large part to avoid anticipated high power prices during the summer of 2001 and believes, based on the information available at the time, that it was prudent to do so."

⁴⁵ A.R.S. §40-203 (Power of commission to determine and prescribe rates, rules and practices of public service corporations) states:

When the commission finds that the rates, fares, tolls, rentals, charges or classifications, or any of them, demanded or collected by any public service corporation for any service, product or commodity, or in connection therewith, or that the rules, regulations, practices or contracts, are unjust, discriminatory or preferential, illegal or insufficient, the commission shall determine and prescribe them by order, as provided in this title.

1 the consideration. The filings with FERC indicate that that FERC does not approve "rates";
2 therefore, it is the sole responsibility of the ACC to make the "fairness" and "reasonableness"
3 ruling.

4
5 Q. Are the rates specified in the New Agreement fair and reasonable? Who should prove that
6 these new rates are fair and reasonable?

7 A. The Joint Applicants, now Citizens and UniSource, should prove these new rates are fair and
8 reasonable for the ratepayers in the Citizens service areas.

9
10 Q. What proof has been offered that the New Agreement rates are fair and reasonable?

11 A. There has been no proof presented to date that \$58.79 per MW-hr is fair and reasonable. The
12 Arizona Corporation Commission sets and approves consumer electric rates in Arizona and
13 such proof including a zero-based cost analysis are the best methodology to show fairness and
14 reasonable. A price comparison is meaningless due to so many local factors, including capital
15 expenses, population locations, adequacy of local generation, and others that make cost
16 comparisons of the "same" product meaningless.

17
18 7. Valencia Turbines.

19
20 Q. What are the Valencia turbines?

21 A. Citizens' has three combustion turbines installed at the Valencia Substation in Nogales, Arizona.
22 These turbines are described by Citizens' as "peaking" or "backup" turbines. They are rated at
23 15 to 18 MW each and together have carried loads in excess of 45 MW and have served all
24 Citizens customers in Santa Cruz County.⁴⁷ Rarely does the Santa Cruz County loads exceed a
25 peak of 45 MW-hrs.⁴⁸

26
27 Q. Are these turbines important to Citizens operations in Santa Cruz County?

28 A. After the Nogales Electric Company closed down its local generators about 45 years ago,
29 Nogales has been dependent upon a single, radial 115-kV transmission line from Tucson. The
30 transmission line was operationally rated for 60 MW and recently upgraded to 100 MW. During

⁴⁶ In response to Citizens Data Request 1.15 which requests the source of Authority of the ACC to "reduce rates in a wholesale power contract. The full title of this Application includes "change the current purchased power and fuel adjustment clause rate, to establish a new purchased power rate and fuel adjustment clause bank."

⁴⁷ In response to Magruder Data Request 3.01(17), Citizens stated "Except under extreme peak conditions of limited duration, the Valencia turbines have the capability to carry the entire Santa Cruz County load."

⁴⁸ Santa Cruz County has exceeded 50 MW-hrs only on six occasions, all during the past four years.

1 lightning storms, the Valencia turbines are "spinning without loading" so that backup, electric
2 power is available in case of an outage on the Citizens-owned 115-kV transmission line. For the
3 past five years, transmission line outages have averaged 2.049 hours per year, so such backup
4 is necessary, but infrequently necessary. As a peaking plant, these turbines can be used to
5 provide additional power.
6

7 Q. Can these turbines provide cost-effective additional generation capabilities for Santa Cruz
8 County?

9 A. These turbines are capable of providing electricity for the entire load 99.9% of the time. Further,
10 they are economical and cost-effective to run during load periods when purchased power on the
11 market exceeds their operational cost. In general, they are between one and a half (1.5) to
12 almost three (3) times more expensive to operate when compared to the fixed rate under the
13 New Agreement. They have demonstrated an average power production cost of \$151.89 per
14 MW-h for all power these turbines produced versus the \$58.79 per MW-h rate under the New
15 Agreement. These figures include extensive time periods when these turbines carried no load
16 and were operated as spinning reserves to ensure reliability, so the actual cost per MW-h is less.
17 For example, during the month of May 2002, Citizens operated these turbines to generate 863
18 MW-h at an operational cost of \$79,962.27 for value of power generated at \$92.68 per MW-h.
19 This is about 1.6 times the New Agreement fixed rate but could be economically beneficial if
20 used exclusively during advantageous peak rate times.
21

22 Q. Have these turbines been used to provide economical electricity to Santa Cruz County, at rates
23 lower than the Old Agreement?

24 A. During May of 2001, these turbines were operated during peak hours by Citizens to avoid high
25 costs (disputed) under the Old Agreement. During this month, Citizens avoided \$1,306,944 in
26 purchase power costs from APS at a cost of \$540,884 in fuel used by these generators. The
27 overall savings was \$766,060.
28

29 Q. Are there restrictions on the use of the turbines under the New Agreement?

30 A. Citizens can operate these turbines during storms for reliability purposes, but only with advanced
31 permission from APS, for economic reasons. Based on the potential savings to ratepayers
32 demonstrated during May 2001, APS/PWCC may be restricting Citizens in its ability to serve
33 customers at the best cost under the New Agreement. In addition, the New Agreement limits the

1 total output at a "reduced level (i.e., 30-35 MW) maximum."⁴⁹ Since this limit may unreasonably
2 restrict Citizens/UniSource from providing all of its Santa Cruz County customers with locally
3 generated electricity.⁵⁰

4
5 Q. Can this part of the agreement be modified?

6 A. There are at least two ways this could happen. Either

7 (1) Modify the New Agreement by methods discussed elsewhere, or the

8 (2) Commission could prohibit APS from restricting turbine operations when any economic cost
9 savings are possible for Citizens ratepayers.

10
11 8. Impact of these hearings on the proposed UniSource Purchase of Citizens AED and AGD.⁵¹

12
13 Q. The *Nogales International* has published articles that the City of Nogales is interested in
14 converting a part of Citizens AED into a municipal electric utility. Others have also expressed
15 interest. Do you have knowledge that these hearings have influenced these discussions?

16 A. In Citizens response to Data Request MM-2.10 (8), I learned that Citizens "does not know
17 whether the current power supply agreement with Pinnacle West Capital Corporation has
18 impacted any opportunities to sell the Arizona electric properties." Citizens indicated APS/PWCC
19 substantially interfered with opportunities to sell Citizens until the New Agreement was signed.

20
21 Impacts on a sale by a ruling from these hearings have not been determined. However, logically,
22 if Citizens is denied recovery of the approximately \$119.4 million (in Nov. 2002) through a rate
23 increase, potential sales opportunities could diminish. If the PPFAC balance was not collected
24 AED, this could significantly reduce the book value, shareholder's equity and reduce potential
25 gain from the sale for Citizens. In this scenario, Citizens and its shareholders are out \$119.4
26 million. Thus, if the ACC denied Citizens the ability to collect \$119.4 million from ratepayers, a

⁴⁹ From ¶1.9 of the New Agreement found in Amended Application, in Exhibit 2, sheets 6 and 7.

⁵⁰ Citizens in response to Marshall Magruder Data Request Three MM-3.6 (9) stated
"many times these turbines have been required to operate above 35 MW (maximum from above
quote). The Estimated Metering Point Demands, by Month in MW, from Sheet 33 of the PWCC
"Market-Based Rate Tariff" shows a range of values between 38.001 (November 2001) to 50.399
MW (June 2001) for the first operating year of this agreement. The estimated load requirements at
Valencia Turbines is approximately 10.69% less than at Nogales Tap, using the old contracts value
for transmission and distribution energy losses."

⁵¹ On 29 October 2002, both Citizens and UniSource, holding company for Tucson Electric Power Company
(TEP), announced that agreement had been reached for the sale of both the Citizens AED and Arizona Gas
Division to TEP for \$230M. This has not been reflected nor considered in this section of Testimony.

1 results would be (1) a reduction in the AED book value and (2) ratepayer's purchased power
2 energy costs could remain constant (also please see section 9 below).

3
4 If the ACC completely granted the PPFAC Application, then the same new energy costs, debt
5 and interest are shifted to the ratepayers. Citizens and its shareholders benefit by gaining
6 \$119.4 million (as of Nov. 2002), which has already been paid to PWCC (plus interest) and while
7 the ratepayers will have to pay \$119.4 million over several years. Citizens' customers have no
8 choice but to appeal to the Commission. The ratepayers would have their rates significantly
9 increased by an average **over 40%** for seven years in order to pay for disputed charges and
10 interest **plus 25.8%** higher purchased power energy costs (see 9 below) under the New
11 Agreement **plus 31.2%** for backup transmission line wheeling charges (see 9 below). This is a
12 staggering increase for Santa Cruz County, which has high seasonal unemployment and over
13 25% below the poverty level.

14
15 9. Calculation of Purchase Power and Fuel Adjustments under the New Agreement⁵²

16
17 Q. What are the components used to calculate the total cost of power supply in Citizens basic
18 service rates?

19 A. These components are the cost of power, called energy price, plus the costs of transmission to
20 import power into Citizens service areas.

21
22 Q. The New Agreement Energy Price.

23 A. The Amended Application established a fixed price of \$58.79 per MW-hr⁵³ for all sales by APS to
24 Citizens under the New Agreement.

25
26 Q. The New Agreement Transmission Costs.

27 A. The energy loss rate used for rate determination is 10.69% (or \$6.83 per MW-hr) based on
28 Citizens last rate case to account for the cost to deliver to customer's meters. This increases the
29 delivered electric cost from \$58.79 to \$65.83 per MW-hr.⁵⁴ In addition, Citizens has negotiated a
30 new transmission agreement with WAPA increase of \$0.44 per MW-hr or an additional \$4.36 per
31 MW-hr for a total of \$70.21 per MW-hr.

⁵² Citizens' response to Marshall Magruder Data Request Three is necessary to complete this section of testimony.

⁵³ See Amended Application, dated 21 September 2001, page 8.

⁵⁴ See Amended Application, page 7.

1
2 Q. Are there additional transmission charges the Citizens ratepayers could incur during the time
3 frame of the New Agreement?

4 A. Yes, additional transmission line "wheeling" charges have been agreed to by Citizens that will
5 raise the Santa Cruz County ratepayer's rate about \$15/customer per month for a 100 MW of
6 "backup" firm electricity delivery. For additional background, please see my Comments of 13
7 March 2002. Citizens' management agreed to this in the Project Development Agreement (PDA)
8 in January 2001 with Tucson Electric Company (TEP), a subsidiary of UniSource. Citizens
9 indicated that these costs would be added to PPFAC charges.⁵⁵

10
11 Q. What impact does the New Agreement have on typical customer rates of the Old Agreement?

12 A. The current customer service rate, under the old Agreement, is \$48.02 per MW-hr.⁵⁶ Under the
13 New Agreement, considering only Energy Price (increased by \$10.77 per MW-hr) and
14 transmission costs (increased by \$0.44 per MW-hr for WAPA increases and \$1.15 per MW-hr for
15 increased energy losses), the rate would be is \$12.36 per MW-hr higher. This is an increase of
16 $12.36/48.02 = 25.8\%$.

17
18 Q. Does this increase include just purchase and delivery costs and the increases from the New
19 Agreement and WAPA Agreements?

20 A. These are the increases only from these two Agreements, to "deliver electricity to the Citizens
21 ratepayers." This increase does not include any disputed charges or loan carrying charges or the
22 TEP "wheeling" charges. The ratepayer will have a 25.8% increase until May 31, 2008, for just
23 the New and WAPA Agreements increases if the Amended Application is approved. An
24 additional ~\$15.00 per customer per month will be requested by the utility when the backup
25 transmission line finally becomes operational, at least a year after the operational date of 31
26 December 2003. This \$15.00 becomes $15.00/48.02$ for a 31.2 % rate increase for the backup
27 transmission line. The total PPFAC rate increase is then

28 Additional Purchase Power Costs + Transmission Costs = Total PPFAC Increase

29 $25.8\% + 31.2\% = 57.0\%$ Increased Total PPFAC

⁵⁵ See Citizens Response to Magruder Data Request MM-3.01(18), when Citizens stated "Costs for the TEP transmission service will be added to PPFAC charges if and when the facilities have been placed in service and Citizens has made payment for services." In addition, in response to MM-3.01(13), Citizens indicated that the "electricity imported over the new 345kV TEP transmission facilities will be purchased directly from PWCC under the Market-Based Tariff [New Agreement], and not as Buyer's Other Resources."

⁵⁶ See Amended Citizens Application, page. 8.

1 for a **total 57.0 % PPFAC increase**, again, without including any disputed billing charges which
2 exceeds **40% increase**.

3
4 Q. Do other claims in the Amended Application increase customer costs?

5 A. Yes, the Applicant requested all "disputed" charges and PPFAC loan interest be reimbursed by
6 ratepayers. This was proposed as the ever-increasing update to Exhibit No. 3 of the Amended
7 Application. If this is judged as a reimbursable expense, or any part of the interest considered
8 appropriate, the ratepayers will see an increase greater than 46.2%. An even larger increase is
9 likely if the "bank amortization" for the disputed charges for carrying cost (interest) is included in
10 this PPFAC settlement.

11
12 Q. Do you recommend that the Commission approve the New Agreement and WAPA Agreement
13 increases that are recommended in the proposed Amended Application?

14 A. Only the WAPA Agreement should be approved, without change, to add \$0.44 per MW-hr.

15
16 The New Application has an Energy Price that is too high compared to the wholesale market.
17 APS/PWCC covered all risks with very high prices during May-June 2001 negotiation
18 environment. Diverse financial and operational pressures may have impacted Citizens during the
19 final negotiations in May to July 2001, which may have led to the New Agreement under adverse
20 environmental conditions or duress. Market characteristics since May-June of 2001 have
21 changed. The California energy crisis of 2000 has come and gone, Enron collapsed, ACC
22 changed its deregulation plans, natural gas prices are lower again, FERC proposed a standard
23 market design plan, the ACC is planning a wholesale solicitation later in 2003 called Track B.
24 FERC has conducted several detailed investigations concerning price gouging in the Western
25 states (which could be related). In general, however, the electrical market has returned to its
26 former, more stable condition. The Joint Applicants need to have the Energy Price of \$58.79 be
27 **reduced** to a level that gives a fair and reasonable prices to the customers and reasonable
28 profits to APS/PWC, perhaps, a wholesale rate of about \$35.00 near to the 2003 forecast of \$ 34
29 to 34 per MW-hr at the most and including WAPA and APS/WPC energy losses. The would give
30 a 35.00/42.08 for a 16.8% reduction.

31
32 10. Demand Side Management.

1 Q. In the original Application, Citizens proposed to reduce electric costs by effective Demand Side
2 Management (DSM). What are the results of the DSM?

3 A. Citizens' provides semi-annual reports on Demand Side Management Programs to the ACC
4 Staff. In the latest report of 30 August 2002, Citizens stated its total cost of approximately
5 \$113,227 during this six month period provided savings of 2,788 MW-h per year. A review of
6 material concerning Citizens ongoing DSM program indicated excellent literature concerning
7 energy conservation and efficiency.

8
9 Q. What is Citizens definition for DSM?

10 A. Citizens response to Marshall Magruder Data Request MM-2.11 (10), "Demand Side
11 Management is the effort to improve the efficiency of using electric energy and power."

12
13 Q. What is the Department of Energy (DOE) definition for DSM?

14 A. The DOE DSM program states:

15 Demand-side management (DSM) programs consist of the planning, implementing, and
16 monitoring activities of electric utilities which are designed to encourage consumers to
17 modify their level and pattern of electricity usage. In the past, the primary objective of most
18 DSM programs was to provide cost-effective energy and capacity resources to help defer
19 the need for new sources of power, including generating facilities, power purchases, and
20 transmission and distribution capacity additions. However, due to changes that are
21 occurring within the industry, electric utilities are also using DSM as a way to enhance
22 customer service. DSM refers to only energy and load-shape modifying activities that are
23 undertaken in response to utility-administered programs. It does not refer to energy and
24 load-shape changes arising from the normal operation of the marketplace or from
25 government-mandated energy-efficiency standards.

26 (See http://www.eia.doe.gov/cneaf/electricity/dsm/dsm_sum.html)
27

28 Q. What are the differences between these definitions?

29 A. The Citizens definition is an energy efficiency or conservation definition, admirable programs.
30 Unfortunately, the DSM action words "load-shape" is missing. It is by load-shaping saves
31 generation resources, transmission and distribution costs, during peak demand periods.

32
33 When customers shift loads from peak to non-peak periods the service areas have reduced cost
34 demand and provides non-peak power at lower rates. Having large users accept interruptible
35 instead of firm delivery services, is also a savings option for Citizens and its customers. Both of
36 these "shape" loads provide for efficient use of capital equipment results. For example, in Santa
37 Cruz County, when there was the 60 MW transmission line, by having a few key industrial loads
38 shift from peak to non-peak or to interruptible from firm service, during times when the loads

1 approach 60 MW, upgrading that line to 100 MW could have been delayed for several years. On
2 June 18, 2002, Citizens peaked at 57.3 MW. A 5 MW load-shift would have given safer reserve.
3 Utilities usually offer financial incentives to customers to shift from peak to non-peak or from firm
4 to interruptible delivery options.

5
6 Q. Do you recommend Citizens employ load shaping in its DSM Program?

7 A. Yes. Citizens should implement financial incentives to ratepayers for load shaping, publicize
8 such a program, and statistically measure actual load shift changes to ensure compliance.
9 Further, the ACC Utility Division may be remiss in not monitoring DSM programs more closely
10 and promoting DSM actions aggressively. This can reduce capital and operations and
11 maintenance (O&M) expenses by utilities.

12
13 **Part II – Gas Rate Case, Docket E-01032A-02-0598**

14
15 11. Natural Gas Case Issues.

16
17 **Part III – Proposed Settlement Agreement for PPFAC and Gas Cases⁵⁷**

18 12. Settlement Agreement Issues.⁵⁸

19
20 Q. What is the purpose of this Settlement Agreement?

21 A. This settlement Agreement is to resolve all of the issues involved in the PPFAC and Natural
22 Gas cases, as a precursor and necessary step, so that the Purchase Agreement may then be
23 considered without these as unresolved issues as was requested by the Joint Applicants.

24
25 Q. Did you participate in the negotiations that resulted in the proposed Settlement Agreement
26 (SA) filed under these docket numbers on 1 April 2003?

27 A. On 13 January 2003, the ACC Staff called a preliminary meeting to start these negotiations.⁵⁹
28 There were representatives of most of the Parties in this case at that kickoff meeting.

⁵⁷ "Settlement Agreement – UniSource Energy Corporation's Acquisition of Citizens Communications Company's Gas and Electric Utility Assets" of 1 April 2003 as modified by Lewis & Roca, LLC letter of 2 April 2003.

⁵⁸ ACC Procedural Order for these dockets, dated 7 February 2003, directed that a final settlement agreement be filed by 1 April 2003. This Order continued the earlier ACC Procedural Orders of 3 December 2002 and 8 January 2003, which suspended the PPFAC Case Docket E-01032C-00-0751 and Gas Rate Case Docket G-01032C-02-0598. The Settlement Agreement was to meet all parties conditions necessary to close these cases as a precursor to consideration of the Purchase Agreement.

1 Additional weekly meetings with telephonic participation continued until the last week in
2 January. The next meeting was on Friday 28 March. A copy of the proposed SA provided to
3 parties last on Thursday 27 March.
4

5 Q. Does the proposed Settlement Agreement achieve the purpose to resolve all issues involving
6 the PPFAC and Gas cases?

7 A. Initially, discussions directly concerned these cases. During intervenor participation, as
8 discussed below, based on a handout⁶⁰ and discussions at the initial 13 January 2003 meeting,
9 resolution of these two cases was the primary emphasis of the discussions.
10

11 Q. Are you satisfied with the proposed Settlement Agreement?

12 A. No for many reasons. This proposed agreement was crafted and drafted by only three of the
13 Parties: the ACC Staff, UniSource and Citizens. None of the other Parties, which represented
14 the public, namely the RUCO, Mohave County, Santa Cruz County, City of Nogales, nor
15 myself participated after the last January meeting.
16

17 During the Friday 28 March meeting, it was obvious that many issues were incompletely
18 covered or contrary to the expectations of these excluded Parties. In fact, the first question
19 from a County Attorney at this meeting was "who represented the ratepayers during these
20 negotiations?" During this meeting, at least fifteen comments were verbally submitted and
21 quickly discussed. Some of these were incorporated in the final version of 1 April.
22

23 Q. Where your considerations included in the proposed Settlement Agreement?

24 A. No. Since the deadline for this agreement was 1 April 2003, I submitted proposed Settlement
25 Agreement Conditions to all concerned on 20 March (**Exhibit B-2**).⁶¹ The reply from the Joint
26 Applicants showed that none of my conditions were considered (**Exhibit B-3**).⁶²
27

28 Q. Did you try to improve the proposed Settlement Agreement?

⁵⁹ See ACC Memorandum "Settlement Discussions on the following cases ..." from Earnest Johnson, Director, Utilities Division of 7 January 2003 to Docket Control, cc: Parties of record.

⁶⁰ This handout, "Joint Applicant's Proposed Settlement, January 13, 2003" is annotated "pursuant to Arizona Rules of Evidence, Rule 408, this Proposed Settlement offer is not admissible in any action should the offer not be accepted" thus is not provided as an Exhibit.

⁶¹ See **Exhibit B-2**, Magruder letter "Proposed Settlement Agreement Conditions" of 20 March 2003.

⁶² See **Exhibit B-3**, Mr. Tom Campbell, Lewis & Roca LLC, Joint Applicant's attorney's letter of 28 March 2003.

1 A. Upon receipt of this draft proposed SA on 27 March, I drafted Data Request Six⁶³ (**Exhibit B-4**)
 2 to clarify, modify and/or enhance the proposed SA which was sent by email (and mail) before
 3 10:00 AM on Friday 28 March 2003, prior to the Friday afternoon Negotiation Conference,
 4 hosted by the ACC Staff. The resultant response from the Joint Applicants shows that many of
 5 the more serious defects were not addressed (**Exhibit B-5**).⁶⁴

6
 7 Q. Do you feel there any serious defects in the proposed Settlement Agreement and why?

8 A. Yes. Defects I consider needing immediate remedy are shown in Table 5 (listed in sequence, not
 9 priority). Table 5 also includes many, many smaller problems which could become significant.
 10

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
Page 1, title	Settlement Agreement – UniSource Energy Corporation’s Acquisition of Citizens Communications Company’s Gas and Electric Utility Assets	This implies that this agreement is primarily for the acquisition of Citizens by UniSource. The Procedural Order indicates this Agreement is a precursor to the acquisition.	Suggest: Settlement Agreement – Resolution of the Citizens Communications Company’s Applications and Related Issues for the PPFAC and Gas Rate Cases, as a Precursor, to the Purchase of Citizens Electric and Gas Assets by UniSource Energy Corporation
Page 1, first ¶, first sentence	In the first sentence: “...agree to the following proposed settlement agreement (“Agreement”) of the matters pending in Docket Nos. G-01032A-02-0598 (“Gas Rate Case”), E-01032C-00-0751 (“PPFAC Case”), and E-01933A-02-0914, E-01032C-02-0914, G-01302C-02-0914 ⁶⁵ (“Joint Application”) (collectively “Consolidated Cases”).	This implies that the proposed Settlement Agreement is comprehensive, that is covers all issues in five cases. Many items, in the PPFAC Case have not been addressed, for example, risk management and disputed cost. The emphasis seems to be changed from the original purpose of settlement agreement, which was to resolve all issues in the PPFAC and Gas Rate Cases, to a “consolidated” settlement agreement. Until PPFAC and Gas Rate cases are resolved, the Joint Application should be held in abeyance.	In the First change: “...agree to the following proposed settlement agreement (“Agreement”) of the matters pending in Docket Nos. G-01032A-02-0598 (“Gas Rate Case”), E-01032C-00-0751 (“PPFAC Case”), as a precursor to resolving issues in Docket Nos. E-01933A-02-0914, E-01032C-02-0914, G-01302C-02-0914 (“Joint Application”) (collectively “Consolidated Cases”).
Page 2, first ¶	WHEREAS, all intervenors were provided ... with opportunity to participate	The intervenors were and are, to this point, only permitted to comment. The Parties drafted this agreement without participation of	Suggest: Whereas, the Parties provide notice of the settlement process and of intervenor

⁶³ See **Exhibit B-4**, Magruder letter “Magruder Data Request Six” of 28 March 2003.

⁶⁴ See **Exhibit B-5**, Mr. Tom Campbell letter in reply to “Magruder Data Request Six” of 4 April 2003.

⁶⁵ This docket number is incorrect and it should read as “G-01-32C-02-0914.”

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	and comment.”	all intervenors.	meetings, with an opportunity to comment of the final version before coming to hearings.
Page 2, third ¶, et al.	“GasCo”, “ElecCo”, “HoldCo” and “New Companies”	As worded, this provides initial ambiguity in organizations, which will be defined prior to Commission decisions based on the required corporation filings necessary before closing.	Suggest: GasCo, ElecCo, HoldCo and New Companies to their real names to avoid confusion years after this agreement was implemented.
Page 2	Third, Fourth, Fifth and Sixth paragraphs: “WHEREAS, the Parties... WHEREAS, UniSource... WHEREAS, the Parties... WHEREAS, the Parties...”	These four paragraphs concern the Joint Application and not the two cases as issue: PPFAC and Gas Rate Cases, therefore, they should be deleted.	Suggest deleting Third, Fourth, Fifth, and Sixth (which continues to page 3) paragraphs.
Page 3, third WEREAS	First line: “Parties agree that adoption of this Agreement is in the public interest ...”	The use of the term Parties in this sentence only means signatories, not the many Parties to these five cases.	Change “Parties” to read “signature Parties feel that adoption of this Agreement appears to be in the interest of the public...”
Page 3, under third WHEREAS, (a)	“UniSource shall, as part of this Agreement, forfeit its right to pursue the recovery from retail ratepayers of any under-collected Purchase Power and Fuel Adjuster Clause (“PPFAC”) balance, currently the subject of Docket No. E-01032C-00-0751, up through and including the date of closing of the purchase of Citizens’ Electric Assets and Gas Assets by UniSource. The forfeited PPFAC balance is currently estimated to be at least \$135 million as of July	As worded, it appears that a legal determination that some of “estimated” PPFAC balance is recoverable from the retail ratepayers has been made. This balance is from a wholesale “billing dispute.” This issue has not been adjudicated and is presently unresolved. A legal judgment is necessary to determine if any could be considered as reimbursable by ratepayers. ⁶⁷ At this point, there is nothing available to “forfeit”. ⁶⁸ The impact of this decision is critical, as the forfeited amount is considered “goodwill” and would be amortized for 37 years, significantly reducing income tax liabilities.	Suggest: “UniSource shall not hold the retail ratepayers liable for any Purchase Power and Fuel Adjustment Clause (PPFAC) balance due prior to closing date.”

⁶⁶ See Joint Application of 18 December 2002, page 3, second paragraph, lines 7 to 9 which stated “and will be approximately \$138 million in July 2003, if a PPFAC base rate of \$0.07019 per kWh is adopted based on the current Pinnacle West – Citizens Contract.

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	28, 2003. ⁶⁶		
Page 3, under third WHEREA S, (a)	In the third sentence, "Regardless of the actual amount of the PPFAC balance that exists at the time of the closing ..."	This implies that a legal ruling is necessary to determine the actual amount of the PPFAC balance.	Suggest the beginning of the third sentence read: "Any PPFAC balance that may possibly exist at the time of the closing..."
Page 3, under third WHEREA S, (a)	In the third sentence, "..., the right(s) to recover from retail ratepayers shall be forfeited by UniSource, any of its subsidiaries, and Citizens."	This also implies some "right" exists to recover from ratepayers the costs that resulted from an unresolved and disputed billing between a wholesale buyer and wholesale seller.	Suggest: "..., any possible right(s) to recover from retail ratepayers shall be forfeited by Citizens and UniSource including subsidiaries."
Page 4, under (e)	"UniSource shall put into place a procedure to commence the process of opening up the new ElecCo's service territories to retail electric competition by no later than December 31, 2004."	This new condition was not discussed with intervenors until 28 March and not at prior working meetings. There are several challenges to implementing "retail" competition while a new company is being formed and starting to manage this large service area. 1) The wholesale rate is fixed by the proposed New PWCC Agreement, severely restricting possible "retail" competition. This may be similar to the market structure collapse in California. 2) The fixed "wholesale" rate also restricts any possible "retail" gains. 3) UniSource has no experience in managing "retail" competition. 4) Lower retail rates are not a goal. 5) No ratepayers requested this be implemented. 6) No benefits have been presented in this case for such a program in a service area that is struggling to gain reliable and quality service. 7) Retail competition is not relevant to any of the docketed cases.	Suggest deleting (e), that is, any reference to "retail" competition.
Page 4, (g)	"UniSource shall ensure participation by ElecCo in the Environmental	Citizens already participates in EPS, so there is nothing new for UniSource to ensure. No	Suggest: "UniSource shall continue and expand the ElecCo

⁶⁷ See Joint Applicants Response to Magruder Data Request MM-6.9, MM-6.10, and MM-6.12 of 28 March 2003, which states three times that the "Joint Applicants object on the grounds that it calls for a legal conclusion." See **Exhibit B-6**, page 2.

⁶⁸ A small Western Area Power Administration (WAPA) rate increase (\$0.00044 per kW-hr) for additional transmission wheeling charges is an exception and reimbursement for this cost has consistently been recommended by this intervenor. In response to Magruder Data Request MM-3-02(12), Citizens stated: "None of the WAPA charges during the period indicated were, or are in dispute."

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	Portfolio Standard ("EPS")	renewable improvements were proposed by UniSource. A EPS enhancement was added.	participation to exceed the Environmental Portfolio Standard ("EPS") levels by 0.5% by 2005."
Page 5, add new (k)		Several times UniSource discusses quality; however, the universal quality management process, ISO 9000, is not implemented by Citizens. Business success has been directly correlated with ISO 9000 certification In addition, the Environmental Management certification program using ISO 14400 results in significant cost reductions. Both are recommended to achieve risk reductions requested in the Citizens PPFAC application.	"(k) UniSource shall establish quality management programs for all Citizens assets by obtaining ISO 9000 quality management certification not later than 31 December 2005 and obtaining ISO 14400 environment management certification by 31 December 2006."
Page 5, ¶1	First sentence: "The Parties agree that the purpose of this Agreement is to resolve contested matters in the Gas Rate Case, the PPFAC Case and the Joint Application in a manner consistent with the public interest."	The settlement negotiations to date did not involve public sector intervenors, including RUCO, Mohave County, Santa Cruz County, City of Nogales, City of Kingman, or private citizens including me, an appointed Commissioner on the Joint County-City Energy Commission.	Suggest: "The Parties consisting of the utilities and ACC Staff, agree that the purpose of this Agreement is to resolve all contested matters in the Gas Rate and PPFAC Cases, so that the Joint Application issues can be made consistent. These Parties considered public interest in making decisions that form this Agreement."
Page 5, ¶1	Second sentence: "... such approval must be given in a timely fashion so that the transaction can close by July 28, 2003."	This implies that rapid approval is critical for these cases is based on a \$10M reduced cost to UniSource for closing by that date. \$10M amounts to about \$50 per ratepayer with no gain or loss to UniSource, who plans to use this \$10M as goodwill.	Suggest: "... such approval is requested by the Joint Applications by July 28, 2003, so they may receive the early transaction bonus of \$10M for ratepayers; however, if additional analysis which will benefit ratepayers by prudent decisions, then orderly closure by October 27, 2003 is requested."
Page 6, ¶3	"3. <u>Commission Authority to Modify</u> . The Parties further recognize that the Commission will evaluate the terms of this Agreement, and that after such evaluation the	This statement seems to preclude comments by the public sector intervenors including Counties, Cities, and RUCO. The Joint Applications indicated the 21 April 2003 Testimony filings may be used by the Administrative Law	Suggest: "3. <u>Commission Authority to Modify</u> . The Parties recognize the Commission will evaluate the terms of this Agreement and the comments of all intervenors, and that after

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	Commission may require modifications to the terms hereof before accepting this Agreement."	Judge and Commissioners to make modifications to this Agreement. ⁶⁹	such evaluation the Commission may require modifications to the terms hereof before accepting this Agreement."
Page 6, ¶4	Last three lines: "... approval of the Agreement in a timely fashion so that the transaction can close by July 28, 2003, and thereafter the Parties shall abide by its terms."	This implies that if the Commission fails to approve this Agreement by July 28, 2003, then this Agreement will not be considered binding on the Parties. The only motivation for this is the early closure bonus of \$10 million, which does not impact UniSource financially. This condition needs to be relaxed as later closure may be more beneficial. The next paragraph permits Agreement modification as criterion for any of the signatory parties to object, which could be closing date. Recommend minor modification so that the Agreement in not null and void on 29 July 2003.	Suggest: "... approval of the Agreement in a timely fashion so that the transaction can close by July 28, 2003 or later if more beneficial, and thereafter the Parties including intervenors shall abide by its terms at closure."
Page 6, ¶5	In the first sentence: "In the event that any signatory Party to this Agreement objects to any modifications to the terms of this Agreement made by the Commission, such Party shall timely file an Application for Rehearing... that Party shall be ..."	As worded, this condition prohibits public sector Intervenor from filing for a Rehearing. The recommended action is to permit such possible filings for a rehearing.	Suggest: "In the event that any signatory Party or public sector Intervenor to this Agreement objects to any modifications to the terms of this Agreement made by the Commission, such Party or Intervenor shall timely file an Application for Rehearing... that Party or Intervenor shall be ..."
Page 6, ¶6	In the first sentence: "If a signatory Party files an Application for Rehearing that raises objections to any modifications of the terms or this agreement, then that Party shall deemed to have withdrawn... The withdrawing Party shall be ... and remaining Parties."	As worded, this condition prohibits any Intervenor from objecting to modifications of this agreement. The recommended action is to permit such objections.	Suggest: "If a signatory Party or intervenor files an Application for Rehearing that raises objections to any modifications of the terms or this agreement, then that Party or Intervenor shall be deemed to have withdrawn... The withdrawing Party or Intervenor shall be ... and remaining Parties and Intervenor."
Page 7, ¶7	Similar to paragraph 5 and 6, the word "Party"	Similar to paragraph 5 and 6 above, Intervenor should not be	In the first line, third line, and fifth line (twice), change

⁶⁹ See Joint Applicant's response to Magruder Data Request MM-6.33 of 18 April 2003.

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	four times.	prohibited from appealing a Commission Decision.	"Party" to read "Party or Intervenor"
Page 7, ¶8	In lines 4 and 5 and 6: "... franchises, licenses and other similar authorizations..	Citizens also has DOE Presidential permits to sell electricity to Mexico. These should also be transferred. ⁷⁰ There is no mention of an application to the DOE to transfer these international export permits.	In lines 4 and 5 and 6, change to read as: "... franchises, Presidential permits, licenses and other similar authorizations..
Page 12, ¶11	11. <u>Opening ElecCos Service Territories to Retail Electric Competition</u> . Within one-hundred twenty (120) days of Commission approval of this Agreement, UniSource shall file for Commission approval a plan to open the ElecCo's service territories to retail electric competition. Topics which shall be addressed include, but are not limited to the following: (1) unbundled tariffs; (2) system benefits charges; (3) assisting new suppliers in using transmission; and (4) reliability must-run generation ("RMR"). The application shall include an implementation date to open the ElecCo's service territories to competition no later than December 31, 2004. UniSource further agrees to not oppose municipal aggregation in principle as part of any plan to make retail access more likely within ElecCo's service areas."	The issue of retail competition was not discussed with RUCO, Counties, Cities or individual intervenors prior to 28 March 2003. There are many unforeseen problems when two companies make ownership changes and several years may be necessary before efficient operations, higher reliability, and quality of service improve. These capabilities are what the ratepayers need. UniSource has not made prior mergers of this magnitude and is inexperienced in these challenges. There are no proven long-term (over 5 years) "retail" competition successes anywhere. All failed to meet expectations after 5 years. In view of extreme turmoil, cost, and very low benefit potential that the imposition on these already stressed ratepayers, a separate hearing on retail competition will be necessary and should not be a part of this agreement. Adding this condition by the ACC Staff ⁷¹ is a disservice to the present Citizens customers and strong opposition is expected. This will not help UniSource establish a good working relationship. UniSource is going to have its hands full maintaining the status quo long before making required improvements. In addition, starting retail competition in 2004 should not be attempted in a service area which has a fixed-price wholesale	Suggest: 11. Delete this paragraph.

⁷⁰ See Joint Applicant's response to Magruder Data Request MM-6.36 of 18 April 2003 which states "these will be transferred as a result of this transaction."

⁷¹ In response to Magruder Data Request MM-6.14 to MM-6.26, the Joint Applicants stated "the staff requested a commitment from UniSource to open up these areas to retail competition by December 31, 2004."

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
		contract that extends until 31 May 2007. No goals are included to reduce retail ratepayer costs, which should be the primary objective for the feasibility study.	
Page 15, Part D. title	"Electric Purchase Power & Fuel Adjustor Clause ("PPFAC")"	PPFAC stands for Purchase Power and Fuel Adjustment Clause.	Change Part D title to: "Purchase Power and Fuel Adjustment Clause ("PPFAC")"
Page 15, ¶27	First three sentences: "The Parties agree that effective from the date of the closing the purchase of Citizens' electric utility assets, the adjustor rate shall be set at \$0.01825 per kilowatt hour ("kWh"). The base rate for purchased power shall remain at \$0.05194 per kWh. The composition of the total cost for purchase power is set forth in the attached Appendix C."	This base rate of \$58.79 per MW-hr exceeds the old APS contract cost of generation by \$10.77/MW-hr (58.79 – 48.02 = \$10.77/MW-hr). This rate is between 50% and 100% higher than market. This base rate assumes an increase of 22.3% in the cost of generation and the decrease should be reflected. (Cost of production for APS Palo Verde Nuclear Generation Plan is \$12.70/MW-hr, last year's cost was \$27.00/MW-hr according to TEP's CEO. TEP's CFE predicted a \$32-34 range for 2003. Other data suggests lower purchased power costs are available in Arizona.) The PWC/APS agreement is onerously higher than fair market value. The decision whether or not this rate is fair and reasonable is the subject of the PPFAC hearings and has not been decided. The wording uses terms not in Appendix C. See reworded version to right; however, <u>this Intervenor does not agree with the values. Please note that paragraph 28 below discusses renegotiation of the Cost of Generation in this proposed PPFAC adjustment. Until those negotiations have been completed, the PPFAC clause Application by Citizens remains open. And unresolved.</u>	Change to read: "The utility and AAC Staff agree that effective from the date of closing of the purchase of Citizens' electric utility assets, the total cost of purchased power shall be \$0.07019 per kWh or \$70.19 per MWh as shown in the attached Appendix C. The present total cost equals the base rate of \$0.05194 per kWh (\$51.94 per MWh) which equals the Cost of Electric Generation (\$48.02/MWh) plus Energy transmission losses and charges (\$3.92/MWh). The PPFAC adjustment factor equals the change in cost of purchased power and change in transmission charges. The increased cost of purchased power is \$0.01392 per kWh (\$13.92 per MWh) (\$0.05879 - \$0.04802). The increase of WAPA costs transmission is \$0.00044 per kWh. The total PPFAC adjustment is the sum or \$0.01825."
Page 15, ¶27	Last sentence: "UniSource, any of its subsidiaries, and Citizens shall forfeit their	This does not indicate that recovery from PWCC will still be permitted. ⁷² To clarify, please see rewording.	Last sentence: "UniSource, Citizens and any subsidiaries shall forfeit any claims or rights to recover

⁷² Magruder Data Request MM-6-67 asked "will this permit Citizens to recover costs associated with its billing dispute with APS (PWCC)? The Joint Applicants response stated "This provision [prior to rewording] only

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	right to pursue recovery from retail ratepayers of the PPFAC balance existing prior to and including the date of closing."		from retail ratepayers any of the PPFAC balance that existed prior to date of closing; however, Citizens retains all rights to recover or receive refunds of any unrecovered charges from PWCC."
Page 15, ¶28	First sentence. "This provision refers to the purchase power contract signed by Citizens and PWCC on June 1, 2001."	This sentence gives the wrong date of signing and fails to mention the effective date. The revised Citizens PPFAC Application of 21 September 2001, as shown in the title of this docket, requests approval of this Agreement. Since it is still being renegotiated, approval of the Purchase Power Agreement is premature. Closure of the PPFAC case depends upon completion of these negotiations and includes the renegotiated Agreement in this settlement agreement for approval, as requested by Citizens PPFAC Application. Thus, closure of the PPFAC case, a prerequisite prior to deciding on this final settlement agreement, is necessary for the UniSource purchase of Citizens. The PPFAC case remains suspended until the renegotiated Purchase Power Agreement is decided.	Suggest: "The provision refers to the Purchase Power Agreement signed by Citizens and PWCC on July 14, 2001 with an effective date of June 1, 2001. This contract is presently being renegotiated. Paragraphs 27 and 28 remain OPEN until completion of these negotiations. A new Purchase Power Agreement is provided for review, so that the Citizens purchase by UniSource can proceed towards closure."
Page 15 continuing to page 16, ¶28	Fourth, fifth and sixth sentences: "Sixty (60) percent of the savings shall go directly towards the benefit of ElecCo's ratepayers and forty (40) percent of the savings shall go to UniSource. ⁷³ The above-described sharing from renegotiating the PWCC contract and/or amending the existing PWCC contract shall	Previously, Citizens repeatedly stated that purchase power costs were a "pass through" and no money was ever made on these transactions. What is proposed is a precedent- setting new charge, the "share" possible future savings on "pass through" with the company who is negotiating. A general fee, with some incentive, added to the next rate case, appears more appropriate. As presently worded, the higher rates will start upon closing. There are serious	Suggest: "All savings from the renegotiated agreement shall be passed through to the ElecCo's ratepayers. An incentive fee, equaling to forty (40) percent of the savings for six months, shall be awarded to UniSource. This fee should be favorably considered during the next UniSource rate case."

relates to recovery from retail ratepayers and does not address recovery from Pinnacle West Capital Corporation."

⁷³ In response to Magruder Data Request MM-6.67, the Joint Applicants stated "the parties agreed that 40% of the benefit would go to UniSource." These "parties" are only the utility companies and ACC staff.

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
	only apply for the duration of the existing or renegotiated PWCC contract, whichever duration would expire sooner. Once that timeframe expires, any and all savings shall be passed through directly to ElecCo's customers."	problems with this open-ended "duration" being determined by the negotiators, for example, how long will this 40% be rewarded. Please see recommended rewording which could also be used for closure of negotiations prior to closing the Joint Application for purchase.	
Page 16, ¶31	"UniSource shall continue Citizens Arizona Gas Division's current practice of not using contract personnel for the performance of operation and maintenance functions, such as leak survey and valve maintenance."	This condition would prohibit UniSource from using qualified safety, cost, or operational specialists for short periods. This appears overly restrictive for any company as no company has all skills all the time.	Reword as follows: "UniSource shall continue Citizens Gas Division's current safety practice of not using contract personnel to perform any routine operational and maintenance functions, such as leak survey and valve maintenance. When skills are not available, short-term specialists maybe used in non O&M situations to provide safety, operational, training or other expertise not found in their labor pool. In general, only certified technicians, such as Certified American Corrosion Engineers, will be permitted to augment."
Page 19, ¶36(a)	"The Parties agree that the Commission shall not conduct any prudency reviews of Citizens' gas procurement practices, accounting practices or balances existing on or before October 29, 2002."	This implies that the Commission will not investigate any claims for procurement, accounting or balances prior to October 29, 2002. Ongoing FERC investigations have concluded that market manipulation, in particular in the natural gas market, was extraordinary during the 2000 to 2001 time period. In its August 2002 investigations FERC concluded that natural gas price indexes were unreliable, and on 26 March 2003 declared that natural gas market manipulation, including some in Arizona, was widespread and involved many parts of this industry. Without any possible implication of Citizens actions during this period, failure of the ACC to "not conduct" such	"The Parties agree that the Commission shall limit any future routine prudency reviews during the period prior to October 29, 2002. Prudency Reviews of Citizen's gas procurement practices, accounting practices or balances will only be performed in conjunction with other agencies, such as the Federal Energy Regulatory Agency, if fraud is suspected, or in conjunction with investigations which will protect the public interest."

Table 5 Defects Observed in the Proposed Settlement Agreement.

Location	Present Wording	Impact	Recommended Corrective Action
		investigations appears to prevent future investigations into illegal activity that are in the public interest. ⁷⁴ See suggested rewording.	
Page 19, ¶39, title	Rate Moratorium.	This paragraph discussed Rate Moratorium. When the current PPFAC case is concluded purchase power costs will remain constant, assuming the present PWCC Agreement remains a fixed price contract ⁷⁵ for 8 years, lasting through 31 May 2009. Only non-PPFAC issues would be included in a General Rate case. However, a new test year may be necessary, thus only energy loss charges appear change related. Suggest changing title and adding new sentence at end.	a. Suggest changing Title to: "General Rate Case Moratorium" b. Add new sentence at end to read: "New PPFAC cases will not be submitted until after the PWCC Purchase Agreement expires; however, if a test year is conducted during a general rate case, after the three years, an energy loss adjustment to PPFAC may be necessary."

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Part IV – Joint Application for Approval of Sale of Electricity and Gas Utility Assets and Certificates of Convenience and Necessity (CC&N) from Citizens to UniSource Case, Dockets E-01933A-02-0914, E-01032C-02-0914, and G-01032A-02-0914

13. Joint Application Issues.

Q. Did you participate in the

Part V – Facts and Conclusions in these Cases

14. Facts and Conclusions for the PPFAC Case.

Q. Do you have any conclusions concerning the Old Agreement?

⁷⁴ In response to Magruder Data Request MM-6.71, the Joint Applicants stated "the parties to the Settlement Agreement believe that it is in the public interest to waive prudence reviews of expenditures prior to October 29, 2002, in exchange for other benefits from this transactions, including reduction of the rate base." Unfortunately, the gas rate request is to increase the rates about 28%.

⁷⁵ In response to Magruder Data Request MM-6.72, the Joint Applicants stated "the current agreement is a fixed price contract."

1 A. Yes, the disputed terms should have been resolved in much shorter period of time so that they
2 would have been minimal or insignificant. Citizens failed to act in a timely, prudent manner to
3 prevent or to avoid more and excessive charges.
4

5 Q. Do you have any conclusions concerning the New Agreement and the Valencia turbines?

6 A. Yes, this contract fails to allow Citizens free use of its own generation capabilities to avoid higher
7 avoid charges by APS/PWC. This should be changed.
8

9 Q. Did the New Agreement solve the disputed billing charges of the Old Agreement?

10 A. No, the New Agreement did not solve the disputed billing charges from the Old Agreement.
11 Citizens failed to use all available means to recover these costs and interest other than this
12 Application for recovery from the ratepayers. This attempt to avoid collection from APS/PWCC is
13 unconscionable and shows an unethical corporate attitude towards its customers, who have no
14 option but to use Citizens as their electrical provider. Until the disputed costs have been
15 validated as not disputed costs, Citizens should not be reimbursed for them or any interest
16 associated with them.⁷⁶
17

18 Q. Do the WASA Agreement costs appear to be fair and reasonable?

19 A. These costs, as described in the Application, appear fair and reasonable and probably should be
20 recovered from the ratepayers.
21

22 Q. Should Citizens receive credit for developing DSM programs?

23 A. No, the DSM plan implemented by Citizens fails to shape the load. The ACC Staff has,
24 apparently, failed to provide appropriate and effective feedback to Citizens. Until the ACC Staff
25 reviews the Semi-Annual DSM Program Report must provide appropriate feedback to all utilities,
26 Citizens and the other utilities should not be permitted to deduct DSM expenses. There needs
27 to be measures and indicators that show actual DSM load-shaping results.
28

29 15. Facts and Conclusions for the Gas Case Case.

⁷⁶ In response to Magruder Data Request MM-3-02(15), Citizens responded "No amounts paid APS are currently in dispute." Also, Magruder Data Request MM-3.02(7) asked Citizens "Are all APS Monthly Purchase Power and Fuel Costs charges .. "paid under protest" to APS?". In response to this data request dated 3 January 2003, Citizens stated "The category "Purchased Power and Fuel costs" includes power supply bills received from APS, transmission service bills received from WAPA, and the cost of generation fuel consumed at the Valencia facility. No portion of such reported costs is in dispute at this time." [emphasis added]. Thus, as of January, 2003 after the Purchase Agreement had been made public, Citizens in its delayed reply to Magruder Data Request Three does not dispute the APS costs.

1 None.

2
3 16. Facts and Conclusions for the proposed Settlement Agreement.

4 The proposed Settlement Agreement, see Part III above, failed to achieve its goals and needs
5 additional work which involves all "parties" to these hearings.
6

7
8 **Part VI – Recommendations for these Cases**
9

10 17. Recommendations for the PPFAC Case.
11

12 Q. What are your recommendations for reimbursement to Citizens as requested by the Amended
13 PPFAC Application?

14 A. The following Application requested reimbursements are recommended:

- 15 a. For any disputed fuel costs under the Old APS Agreement – zero
16 b. For non-disputed fuel, costs under the Old APS Agreement – after a judgment from
17 litigation, dispute resolution, or negotiations – then a future hearing can determine what is
18 fair and reasonable.
19 c. For interest on disputed fuel PPFAC Bank Loan costs under Old APS Agreement – zero
20 d. For increases in the rates from the New PWCC Agreement – to a value equal to the Old
21 Agreement rates to closing, e.g., no change for Citizens ratepayers.
22 e. For increases in rates for the WASA Agreement – as requested.
23 f. For risk management programs – zero
24

25 Q. What are your recommendations with respect to the Citizens Dispute with APS?

26 A. From **Exhibit B-2**,

27
28 Q. Do you have additional recommendations?

29 A. Yes, see my Comments of 13 March 2002 to this docket for recommendations, not included in
30 this testimony. Some of those recommendations were modified herein based on circumstances
31 and information received since then.
32

33 **Conclusion of Testimony.**

34 Q. Has this testimony been made by you without reservations?

1 **Service List**

2 **ORIGINAL and 15 COPIES of the foregoing filed this 21st day of April 2003, with:**

3 Docket Control
4 Arizona Corporation Commission
5 1200 West Washington Street
6 Phoenix, Arizona 85007
7

8 **COPIES of the foregoing mailed this 21st day of April 2003 to:**

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10 Christopher Kempley, Legal Division
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1 A. No. I have not received a response from the Applicants for my Data Requests Five and Six. The
2 facts herein are from references that have been furnished by UniSource, Citizens or from my
3 files compiled during these hearings. Where unique references were considered important, they
4 are provided in the text. A few numbers were derived from data. When arithmetic was used to
5 change a value, it was described, and usually the steps are shown. When costs were in \$ per
6 kW-hr, they were changed to \$ per MW-hr throughout this testimony so consistent comparisons
7 can be easily made.

8 Thank you for your attention.

1 **Exhibit A**

2 Additional Background Information

3
4 Q. Please provide additional background information about yourself

5 A. At present, my consulting practice involves systems engineering and systems architecture for
6 military and aerospace companies. This year, for example, I performed consulting tasks for
7 Raytheon groups in San Diego and Fullerton, California and Marlborough, Massachusetts. I
8 performed tasks involving front-end systems engineering, architecture framework
9 development, interoperability planning, with reconfiguration analysis studies and presentations
10 for the Joint Command and Control Ship (JCCX Program Office) and developing an initial IT
11 architecture framework proposal for the Raytheon group in Plano Texas for the Objective
12 Force Warrior (OFW), Land Warrior III Program Office; the US Army at Fort Huachuca,
13 Arizona, for the Development Testing Command's Virtual Proving Ground (VPG), and Minister
14 of Defence in the United Kingdom, Defense Procurement Agency, Future Aircraft Carrier
15 (CVF) Programs Office, Abby Hill Station, Bristol, United Kingdom. I also prepare income
16 taxes for H&R Block as a seasonal employee and for the IRS Tax Consulting for the Elderly
17 program as AARP volunteer. I teach operations management and managing innovation
18 courses in the University of Phoenix MBA curricula. I was appointed and served as a
19 Commissioner on the Santa Cruz County/City of Nogales Energy Commission starting in
20 spring 2001.

21
22 Q. On whose behalf are you testifying in this proceeding?

23 A. I am testifying solely on my behalf as a resident, ratepayer, and concerned citizen of Santa
24 Cruz County and as an Arizona taxpayer who is interested in ensuring fair and equitable rates
25 with steady, reliable and efficient electrical service.⁷⁷

26
27 Q. Please describe your experience in more detail.

28 A. I have broad systems engineering background which has involved design and development of
29 large systems, varying from the Kingdom of Saudi Arabia to multi-state training ranges to
30 naval battle groups with platforms varying from aircraft carriers to all classes of warships to
31 individual soldiers with self-contained combat systems. As a systems engineer, I have
32 performed the preliminary front-end analyses, including site surveys, to assess the situation
33 that leads to defined requirements that are specified for various acquisitions and

⁷⁷ Response to Citizens Data Request 1.01.

1 procurements. I do this for industry and various federal and state government agencies as a
2 prime or as a subcontractor. I have led major program teams for several projects valued in
3 billions of dollars.
4

5 Q. What is your educational background?

6 A. I graduated from the United States Naval Academy in 1962 with a Bachelor of Science degree
7 with extra courses in operational and systems analysis; in 1970, from the United States Naval
8 Postgraduate School with a Master of Science degree in Physical Oceanography; and, in
9 1980, the University of Southern California with a Master of Science degree in Systems
10 Management (MSSM). In addition, I took post-masters level courses in electrical engineering
11 at the University of Rhode Island and while employed at Hughes Aircraft Company/Raytheon.
12 I participated in many technical, engineering and company management courses primarily
13 concerning engineering management, total systems analysis including total ownership and
14 life-cycle cost estimation, all phases of software development, system and program risk
15 management systems implementation and monitoring processes, and arranged and took the
16 only C4ISR Systems Architecture Implementation course on-site for fellow employees. I have
17 completed at least two-dozen income tax courses, varying in length from three to sixty-six
18 hours. As a naval instructor, consultant, and University of Phoenix MBA instructor, I have
19 taught tactical oceanography, underwater acoustics, anti-submarine warfare, joint command
20 and control, and operations management for over seven years.
21

22 Q. What is your primary experience with business management?

23 A. After a career in the US Navy, I was a senior systems engineer at Hughes Aircraft Company,
24 now Raytheon for almost 18 years. During most of that time, I was leading new, innovative
25 development projects, many times, working directly with and/or for the business development
26 or marketing department. In writing proposals, we always had to understand what our
27 customer said they wanted, what could be provided, and account for other natural, physical,
28 economic, and environmental factors. These factors required an in-depth understanding of the
29 customer, the total environment for the life of the item(s) to be developed, and forecast for
30 technology, customer demand and growth, and evolving markets in a transitional markets.
31

32 This required understanding forecasting.⁷⁸ A current basis for this understanding are the
33 courses I teach on business forecasting and the implementation of statistical process control

⁷⁸ This was provided in my response to Citizens Data Request 1.08.

1 in my "Operations Management for Total Quality" MBA classes. I have "forecast" very difficult
2 underwater acoustic and geophysical conditions for large and small areas worldwide and as a
3 proven and qualified naval geophysical subspecialist that routinely involved meteorology,
4 electromagnetic natural and temporal conditions, and oceanic environmental conditions. Using
5 knowledge from statistical, probabilistic, and numeric forecasting and predictions classes, I
6 have prepared business proposals nearly continuously for the past two decades, all of which
7 provided foreknowledge and understanding of forecasting.

8
9 Q. What experience do you have with electric systems?

10 A. At the US Naval Academy, my curriculum consisted of two years of electricity and electronics
11 classes and laboratory sessions with additional emphasis in other related engineering
12 courses. I have worked in a destroyer's engine room and boiler firerooms at all operational
13 positions providing operational and maintenance experiences from steam, gas turbine and
14 electric generation through distribution of electricity throughout the ship systems. Later in my
15 career, while qualifying to be an Engineering Department Head, I operated every engineering
16 positions in "casualty" modes, imposing outages, including "black ship" dead-in-the-water,
17 restart operations, again at all positions. I have lit-off boilers, synchronized electrical loads,
18 split and distributed electrical power, and even manually rerouted power with emergency
19 cables. As a naval instructor, I managed and coordinated afloat engineering training cruises
20 on gas turbine and steam-powered ships. I have also conducted operational and maintenance
21 inspections on fossil and nuclear-powered ships, including eight aircraft carriers. As the lead
22 systems engineer for new classes of aircraft carrier and surface combatant programs, I have
23 participated in the design of these electric-drive ships. The ships' propulsion systems will, in
24 essence, be large electric motors, as the US Navy transforms toward all-electric ships in the
25 next decade. These new aircraft carriers will have six times the electric generation capability
26 of today's carriers, in order to drive the electro-magnetic aircraft recovery system/electro-
27 magnetic aircraft launching system (EARS/EMALS) systems, directed energy weapons
28 systems and other information technology equipment.

29
30 I served as a member of the Academic Board at the US Naval Postgraduate School, where I
31 recommended and had approved an additional "electromagnetic compatibility" course for a
32 technical curriculum. As a systems architect, my recent consulting contracts have been
33 developing the operational, technical and systems architectures, using relational database
34 management systems to integrate, coordinate and correlate an interoperable design through a

1 build-to-implementation approach for major Army, Navy, Coast Guard, Air Force, DoD, and
2 the United Kingdom Minister of Defense programs.

3
4 Q. What is the purpose of your testimony?

5 A. My testimony represents my assessment of the Citizens Communications Company's (CZN)
6 application and amendments for its Purchase Power Fuel Adjustment (PPFAC) and some of
7 the issues involved with the purchase of CZN by UniSource. I have tried to make some helpful
8 and beneficial recommendations toward resolving the conflicts these applications present.

9
10 Q. What is your role in these hearings?

11 A. I am an Intervenor. I am not a Protestor. In some areas, I support the joint Applicants.

12
13 Q. What the goal for your testimony?

14 A. My goal is to achieve progress towards having a quality, integrated, electric and natural gas
15 utility system in Santa Cruz County. These hearings should protect all customers, ratepayers
16 and shareholders and the environment. All want all to be proud to be associated with my utility.

17
18 Q. Why did you submit testimony?

19 A. I submitted my testimony to facilitate all parties understanding the issues and their impacts on
20 consumers, residents and ratepayers in Santa Cruz County.⁷⁹

21
22 Q. Do you have in financial interest in this matter?

23 A. No. All of my efforts in these hearings are unpaid. I do not expect nor would I accept payment
24 or employment resulting from participation in these cases.⁸⁰

⁷⁹ I used the A.R.S. and A.A.R., from the Arizona State Legislature website, at www.az.gov for all statutory and administrative rule references in this Testimony. No attorney or attorneys provided such advice. This is the response to Citizens Data Request 1.06.

⁸⁰ Response to Citizens Data Request No. 1.01

1
2
3
4
5
6

Exhibit B

Documentation Exhibits

The following Exhibits are contained herein:

Exhibit	Exhibit Description	Reference in Testimony
Exhibit B-1	Excerpts from Citizens Communications SEC Forms 10-Q and 10-K and Annual Reports	
Exhibit B-2	Marshall Magruder letter, "Proposed Settlement Agreement Conditions" of 20 March 2003	
Exhibit B-3	Mr. Tom Campbell, Lewis & Roca LLC letter of 28 March 2003 [Reply to Magruder Proposed Settlement Conditions letter, Exhibit B-2]	
Exhibit B-4	Marshall Magruder letter "Magruder Data Request Six" of 28 March 2003	
Exhibit B-5	Mr. Tom Campbell, Lewis & Roca LLC letter of 4 April 2003 [Reply to Magruder Data Request Six, Exhibit B-4]	

7

1 **Exhibit B-1**

2
3 **Excerpts from Citizens Communications**
4 **SEC Forms 10-Q and 10-K and Annual Reports**

5
6 Citizens Annual Reports (SEC Form 10-K) and Quarterly Reports (SEC Form 10-Q) were reviewed
7 during the disputed period. There are statements in these documents that imply certain actions will
8 result from the PPFAC Hearings. They are quoted below. Each document short title is indicated in the
9 left column, the location of all references quoted from that document in the second column, and the
10 quote in the third column. Only the "electric utility" data are used, as the other data pertains to other
11 Citizens entities that are not involved with these hearings. Most of these reports repeat the same
12 information in more than one location in each report. These are shown by "During the past
13 year... [same as page 11]..." notations. Underlining marking and bold fonts were inserted for use by
14 questions below.
15

Document		Quote																																												
Quarterly SEC 10-Q for Quarter ending 30 September 2000	Page 22	Revenue from discontinued operations [which includes electric utilities] for the three and nine month ended in September 30, 2000 increased \$ 3.5 million, or 4%, and \$ 20.5 million, or 9%, as compared with the prior periods primarily due to customer growth, increased consumption due to favorable weather conditions and increased purchased fuel costs and <u>purchased power costs passed on to customers</u> . The increase for the nine months ended September 30, 2000 as compared with prior period were partially offset by \$3,750,000 of customer refunds recorded in the second quarter of 2000 in Arizona in the electric sector.																																												
Citizens 2000 Annual Report (c.a. February 2001)	Page 26	<p>[Table excerpt]</p> <table border="0"> <thead> <tr> <th colspan="2"></th> <th colspan="2" style="text-align: center;">Cost of Services</th> </tr> <tr> <th colspan="2"></th> <th colspan="2" style="text-align: center;"><i>(\$ in thousands)</i></th> </tr> <tr> <th colspan="2"></th> <th style="text-align: center;">2000</th> <th style="text-align: center;">1999</th> </tr> <tr> <th style="text-align: center;">1998</th> <th></th> <th style="text-align: center;">Amount</th> <th style="text-align: center;">% Change</th> </tr> <tr> <th></th> <th></th> <th style="text-align: center;">Amount</th> <th style="text-align: center;">% Change</th> </tr> <tr> <th></th> <th></th> <th style="text-align: center;">Amount</th> <th></th> </tr> </thead> <tbody> <tr> <td></td> <td>Electric energy and fuel oil purchased</td> <td style="text-align: right;">\$113,965</td> <td></td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;">16%</td> <td></td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;">\$98,533</td> <td></td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;">12%</td> <td></td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;">\$87,930</td> <td></td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased increased \$15.4 million, or 16%, in 2000 <u>primarily due to higher supplier prices and increased consumption</u>. Electric energy and fuel oil purchased increased \$10.6 million, or 12%, in 1999 primarily due to increased consumption and customer growth. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers</u>. Gas, electric energy and fuel oil purchased excludes amounts deferred for future recovery in rates.</p>			Cost of Services				<i>(\$ in thousands)</i>				2000	1999	1998		Amount	% Change			Amount	% Change			Amount			Electric energy and fuel oil purchased	\$113,965				16%				\$98,533				12%				\$87,930	
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Citizens 2000 Annual Report (c.a. February 2001)	Page 26
[Table excerpt]	Cost of Services
(\$ in thousands)	2000 1999
1998	Amount % Change Amount % Change Amount
Electric energy and fuel oil purchased	\$113,965
	16%
	\$98,533
	12%
	\$87,930
... Electric energy and fuel oil purchased increased \$15.4 million, or 16%, in 2000 <u>primarily due to higher supplier prices and increased consumption</u> . Electric energy and fuel oil purchased increased \$10.6 million, or 12%, in 1999 primarily due to increased consumption and customer growth. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers</u> . Gas, electric energy and fuel oil purchased excludes amounts deferred for future recovery in rates.	
Citizens 2000 Annual Report (c.a. February 2001)	Page 26
[Table excerpt]	Cost of Services
(\$ in thousands)	2000 1999
1998	Amount % Change Amount % Change Amount
Electric energy and fuel oil purchased	\$113,965
	16%
	\$98,533
	12%
	\$87,930
... Electric energy and fuel oil purchased increased \$15.4 million, or 16%, in 2000 <u>primarily due to higher supplier prices and increased consumption</u> . Electric energy and fuel oil purchased increased \$10.6 million, or 12%, in 1999 primarily due to increased consumption and customer growth. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers</u> . Gas, electric energy and fuel oil purchased excludes amounts deferred for future recovery in rates.	

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Quarterly SEC 10-Q for Quarter ending 31 March 2001	Page 19	<p>[Table excerpt]</p> <p style="text-align: center;">Cost of Services</p> <p style="text-align: center;">(<i>\$ in thousands</i>)</p> <p style="text-align: center;">For the three months ended March 31</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 10%; text-align: center;">2001</th> <th style="width: 10%;"></th> </tr> <tr> <th></th> <th style="text-align: center;">2000</th> <th></th> </tr> <tr> <th></th> <th style="text-align: center;">% Change</th> <th></th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td></td> <td style="text-align: right;">\$29,686</td> </tr> <tr> <td></td> <td style="text-align: center;">23 %</td> <td style="text-align: right;">\$24,173</td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased for the three months ended March 31, 2001, increased \$5.5 million, or 23%, as compared with the prior year period primarily due to higher purchase power prices. For [There was no mention of these PPFAC proceedings in this report.]</p>		2001			2000			% Change		Electric energy and fuel oil purchased		\$29,686		23 %	\$24,173															
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SEC Form 10-K dated 8 March 2001 (inserted and bound in the Citizens 2000 Annual Report)	Pages 11, 21, 26 and 30	<p>... [page 11] During the past year the decrease in the availability of power has caused power supply costs to increase substantially, forcing companies to pay higher operating costs to operate their electric businesses. As a result, <u>companies have attempted to offset these increased costs by either renegotiating prices with their power suppliers or passing these additional costs on to their customers through a rate proceeding.</u> In Arizona, <u>we are currently disputing excessive power costs charged by our power supplier in the amount of approximately \$57 million through December 31, 2000. We are allowed to recover these charges from ratepayers through the Purchased Power Fuel Adjustment clause.</u> In an attempt to limit "rate shock" to our customers, we have deferred these costs on the balance sheet in anticipation of <u>recovering certain amounts either through renegotiations or through the regulatory process.</u></p> <p>... [page 21] During the past year ... [same as page 11] ... through renegotiations or through the regulatory process.</p> <p>... [page 26] During the past year ... [same as page 11] ... through renegotiations or through the regulatory process.</p> <p>[Table excerpt]</p> <p style="text-align: center;">Cost of Services</p> <table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 80%;"></th> <th style="width: 10%; text-align: center;">2000</th> <th style="width: 10%;"></th> </tr> <tr> <th></th> <th style="text-align: center;">1999</th> <th></th> </tr> <tr> <th></th> <th style="text-align: center;">Amount</th> <th></th> </tr> <tr> <th></th> <th style="text-align: center;">% Change</th> <th></th> </tr> <tr> <th></th> <th style="text-align: center;">Amount</th> <th></th> </tr> <tr> <th></th> <th style="text-align: center;">% Change</th> <th></th> </tr> <tr> <th></th> <th style="text-align: center;">Amount</th> <th></th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td></td> <td style="text-align: right;">\$113,965</td> </tr> <tr> <td></td> <td style="text-align: center;">16%</td> <td style="text-align: right;">\$98,533</td> </tr> <tr> <td></td> <td style="text-align: center;">12%</td> <td style="text-align: right;">\$87,930</td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased increased \$15.4 million or 16% primarily due to higher supplier prices and increased consumption. Electric energy and fuel oil purchased increased \$10.6 million, or 12%, in 1999 primarily due to increased consumption and consumer growth. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers.</u> Gas, electric energy and fuel purchased excludes amounts deferred for future recovery in rates.</p> <p>... [page 30] During the past year ... [same as page 11] ... through renegotiations or through the regulatory process.</p>		2000			1999			Amount			% Change			Amount			% Change			Amount		Electric energy and fuel oil purchased		\$113,965		16%	\$98,533		12%	\$87,930
	2000																															
	1999																															
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Citizens
SEC Form
10-Q for Qtr
ending 30
June 2001

Page 25

[Table excerpt]

Cost of Services

(\$ in thousands)

For the three months ending June 30
For the six months ending June 30

	2001
	2000
	% Change
	2001
	2000
	% Change
Electric energy and fuel oil purchased	
	\$29,969
	\$27,801
	8%
	\$59,655
	\$51,974
	15%

... Electric energy and fuel oil purchased for the three and six months ended June 30, 2001 increased \$2.2 million, or 8%, and \$7.7 million, or 15% respectively, as compared with the prior year periods, primarily due to higher purchased power prices. During the past two years the decrease in the availability of power in certain areas of the country has caused power supply costs to increase substantially, forcing companies to pay higher operating costs to operate their electric businesses. As a result, companies have attempted to offset these increased costs by either renegotiating prices with their power suppliers or passing these additional costs on to their customers through a rate proceeding. In Arizona, excessive power costs charged by our power supplier in the amount of approximately \$88 million through June 30, 2001, has been incurred. We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause. In an attempt to limit "rate shock" to our customers, we will request that this deferred amount, plus interest, be recovered over an extended time period. As a result, we have deferred these costs on the balance sheet in anticipation of recovering through the regulatory process.

On July 16, 2001, Citizens terminated its existing contract with Arizona Public Service and entered into a new seven year purchase power agreement. This agreement allows us to purchase all power required for operations at a fixed rate per kilowatt hour. This agreement is retroactive to June 1, 2001 and will minimize any further increase in the deferred power cost account.

Document

Quote

Citizens
SEC Form
10-Q for Qtr
ending 30
September
2001

Pages
20 and
31

During the past two years the decrease in the availability of power in certain areas of the country has caused power supply costs to increase substantially, forcing companies to pay higher operating costs to operate their electric businesses. As a result, companies have attempted to offset these increased costs by either renegotiating prices with their power suppliers or passing these additional costs on to their customers through a rate proceeding. In Arizona, **excessive power costs charged by our power supplier in the amount of approximately \$98 million** through September 30, 2001, have been incurred. We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause. In an attempt to limit "rate shock" to our customers, we will request in September 2001 that this deferred amount, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet in anticipation of recovering through the regulatory process.

On July 16, 2001, Citizens terminated our existing contract with Arizona Public Service and entered into a new seven-year purchase power agreement. This agreement allows us to purchase all power required for operations at a fixed rate per kilowatt hour. This agreement is retroactive to June 1, 2001 and will mitigate further increases in the deferred power cost account. [page 31] [Table excerpt]

Cost of Services

(\$ in thousands)

For the three months ending September 30
For the six months ending September 30

	2001
	2000
	% Change
	2001
	2000
	% Change
Electric energy and fuel oil purchased	
	\$36,149
	\$32,540
	11%
	\$95,804
	\$84,514
	13%

... During the past two years ... [same as page 20] ... in anticipation of recovering through the regulatory process.

On July 16, 2001, Citizens terminated ... [same as page 20] ... will mitigate further increases in the deferred power cost account.

Document		Quote								
Citizens SEC Form 10-Q for Qtr ending 31 March 2002	Pages 17, 23, and 24	<p>(16) <u>Commitments and Contingencies</u>: On December 21, 2001, we entered into a settlement agreement resolving all claims in a class action lawsuit pending against the company in Santa Cruz County, Arizona (<i>Chilcote, et al v. Citizens Utilities Company</i>, No. CV 98-471). The lawsuit arose from claims by a class of <u>plaintiffs that includes all of our electric customers in Santa Cruz County</u> for damages resulting from several power outages that occurred during the period January 1, 1997, through January 31, 1999. Under the terms of the settlement agreement, and without any admission of guilt or wrongdoing by us, we will pay the class members \$5.5 million in satisfaction of all claims. The court approved the settlement agreement on March 29, 2002, and the lawsuit against us was dismissed with prejudice. We have accrued the full settlement amount, plus an additional amount sufficient to cover legal fees and other related expenses, during the fourth quarter of 2001.... [page 23] [Table excerpt]</p> <p style="text-align: center;">Cost of Services</p> <p style="text-align: center;"><u>(\$ in thousands)</u></p> <p style="text-align: center;">For the three months ending March 31</p> <table style="margin-left: auto; margin-right: auto;"> <thead> <tr> <th></th> <th style="text-align: center;">2002</th> <th style="text-align: center;">2001</th> <th style="text-align: center;">% Change</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td style="text-align: right;">\$26,680</td> <td style="text-align: right;">\$29,686</td> <td style="text-align: center;">-10%</td> </tr> </tbody> </table> <p>... [page 24] Electric energy and fuel oil purchased for the three months ended March 31, 2002 decreased \$3.0 million, or 10%, as compared with the prior year period primarily due to lower purchase power prices and decreased consumption. <u>Under tariff provisions, the cost of electric energy and fuel oil purchases are primarily passed on to customers.</u> During the past two years, power supply costs have fluctuated substantially, forcing companies in some cases to pay higher operating costs to operate their electric businesses. In Arizona, excessive power costs charged by our power supplier in the amount of approximately \$105 million through March 31, 2002 have been incurred. <u>We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause.</u> However, in an attempt to limit "rate shock" to our customers, we requested in September 2001 that this deferred amount, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet in anticipation of recovering through the regulatory process.</p>		2002	2001	% Change	Electric energy and fuel oil purchased	\$26,680	\$29,686	-10%
	2002	2001	% Change							
Electric energy and fuel oil purchased	\$26,680	\$29,686	-10%							

[Table excerpt]

Cost of Services
(\$ in thousands)

For the three months ending June 30
 For the six months ending June 30

2002
 2001
 \$ Change
 % Change
 2002
 2001
 \$Change
 %Change

Electric energy and fuel oil purchased

\$28,987
 \$29,969
 \$ (982)
 -3%
 \$55,667
 \$59,655
 \$ (3,988)
 -7%

Citizens
 SEC Form
 10-Q for Qtr
 ending 30
 June 2002

Pages
 26 and
 27

... Electric energy and fuel oil purchased for the three and six months ended June 30, 2002 decreased as compared with the prior year periods primarily due to lower purchase power prices. Under tariff provisions, the cost of our electric energy and fuel oil purchases are primarily passed on to customers.

During the past two years, power supply costs have fluctuated substantially, forcing companies in some cases to pay higher operating costs to operate their electric businesses. In Arizona, **excessive power costs charged by our power supplier in the amount of approximately \$111.3 million** through June 30, 2002 have been incurred. We believe that we are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause, that was approved by the Arizona Corporation Commission and has been in place for several years. However, in an attempt to limit "rate shock" to our customers, we requested in September 2001 that our unrecovered power costs, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet in anticipation of recovering through the regulatory process. Parts of our proposal have been contested by one or more parties to a pending Arizona Commission proceeding convened to consider the matter. A determination regarding recovery could be made in 2002 but the timing is not certain.

Marshall Magruder
PO Box 1267
Tubac, Arizona 85646
(520) 398-8587

20 March 2003

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

Subject: Settlement Conditions

Ref: Docket Numbers E-01032C-00-0751 (PPFAC), G-01032C-02-0598 (Gas Rates) and E-01933A-02-0914, E-01032C-02-0914 and G-0132A-02-0914 (Joint Application)

In September 2000, Citizens Communications ("Citizens") applied to the Arizona Corporation Commission (Commission) to change the purchased power rate for the utility customers based on charges under an Agreement with Arizona Public Service Company (APS). Citizens proposed to conduct an analysis to determine the basis for these charges. Citizens paid APS these "excessive charges" "under protest."

In September 2001, as amended, Citizens applied to the Commission for:

- (1) Approval to increase the Purchase Power and Fuel Adjustment Clause (PPFAC) rates to collect unrecovered revenues under the APS Contract,
- (2) Approval of a new purchase power contract with Pinnacle West Capital Corporation (PWCC), and
- (3) Approval of ways to reduce future costs through various economic and efficient energy risk management means.

To date, these three issues have not been resolved.

On 28 October 2002, UniSource Energy Corporation (UNS) agreed to purchase Citizens' assets in Arizona. UNS applied to the Commission for approval of that agreement. In January 2003, UNS started a settlement process with the parties in the PPFAC and the natural gas rate cases.

As a party to the original PPFAC case, I feel resolution of these three issues is necessary before continuing. As a party to the original PPFAC case, I feel that in order to close these, the following conditions would be expected in the settlement:

1. Resolution of the APS and Citizens Dispute. The request for collection of unrecovered revenues should never have been requested of the ratepayers before dispute resolution. My testimony and submissions on 8 November 2002, 17 September 2002, 13 March 2002 and 19 February 2002 stated this request to ratepayers was unfair, not justifiable and should have submitted to APS for resolution before attempting to recover from ratepayers. There are doubts as to basis of the amount being requested;

however, as prior submissions stated, a minor adjustment by the Western Area Power Administration (WAPA) is not being disputed. The claims by UNS that UNS will not come to ratepayers for collecting are immaterial. "Claiming" that up to \$134 million is not being pursued by UNS is not a UNS issue. This is an issue between Citizens and APS. Citizens has a right to claim damages if overcharged, especially after paying billings under protest. My 8 November 2002 testimony listed over a dozen imprudent decisions by Citizens in this matter. It is Citizen's right to continue making such decisions; however, their consequences are not reimbursable by its customers. A UNS spokesperson recently was quoted as saying these rate increases are to improve reliability and fund capital improvements not made by Citizens. This is obviously not the reason.

To resolve this issue, I would agree to a Settlement Agreement that included the following two conditions:

- 1.1 UNS, and its subsidiaries, shall agree not pursue collection of Citizens' disputed charges from its future ratepayers.
 - 1.2 UNS shall cease making misleading statements with regard to the pending Settlement in public announcements, news releases and other media and ratepayer contacts. This includes revising testimony of your witnesses to state that UNS is not involved in the APS and Citizens dispute and that UNS will not claim nor will UNS collect this amount from its future ratepayers. Such statements are, in my opinion, false, misleading and are propaganda to gain undeserved goodwill.
2. Resolution of the PWCC New Contract. As previously stated, the new, wholesale rate in the PWCC Agreement is excessive. In February 2003, the UNS CEO stated the annual wholesale rate was \$27.00 per MW-hr for 2002. APS said its Palo Verde production costs were \$12.80 per MW-hr for 2002. The new PWCC Agreement, for which approval is being sought under the ongoing joint proceedings, is for \$58.79 per MW-hr. The old APS contract was \$40.20 per MW-hr. Predictions are that electricity wholesale prices will decrease for the next few years in Arizona due to over 50% excess generation in Arizona. Therefore, any increase in the wholesale rate is without justification. It seems obvious that Citizens negotiated this proposed PWCC Agreement under stressful conditions, in May-June 2001, in a manipulated, out-of-control wholesale market environment. Those market conditions and possible multi-billion dollar excessive charges are under investigation by several legal entities. The only way to determine a fair price is to use market prices and forecasts. Such a zero-based cost estimation would indicate a goal near to \$35.00 per MW-hr is reasonable. UNS stated during its February First Call that it expects to purchase electricity in the wholesale market at between \$32 and \$34 this year.

To resolve this issue, I would agree to a Settlement Agreement that included the following three conditions or by one alternate condition:

- 2.1 UNS shall have signed an agreement with PWCC or another supplier at a wholesale price near a goal of \$35.00 per MW-hr. If this cannot be reached, then incentives shall be included in such an agreement that will benefit consumers by lowering rates through efficiency measures (see 3 below), at a maximum wholesale cost of \$40.00 per MW-hr.

2.2 The new "agreement" that meets (2.1) above shall go into force on the closing date of the sale of Citizens Arizona assets to UNS.

2.3 There shall also be a franchise application accepted by the City of Nogales.

An Alternative to 2.1, 2.2 and 2.3 above would be that UNS actively pursue the development of a local power plant in Santa Cruz County. This power plant development shall include permanently canceling the proposed TEP Transmission Line system from South Station to Nogales and building a local generation source to meet the ACC's mandate for a second source in this county. Such an application shall be submitted by the time the Citizens purchase is completed. There shall also be a franchise application accepted by the City of Nogales to resolve the long-term uncertainty in Santa Cruz County.

3. Resolution of Reduced Consumer Costs through Economical and Efficient Energy Risk Management Means. Although Citizens submitted some measures for approval, there has been no follow up during the past two and half years. Such measures are considered essential whenever a utility company requests increased rates. Again, imprudent decisions caused this lapse. Under new ownership, I would expect the Citizens service areas utility to vigorously pursue both economical and efficient improvements. This should be a synergistic effort between natural gas and electricity companies. A review of Citizens "demand side management" (DSM) showed a "shell" to obtain rebates. It failed basic tests of return on investment. DSM is a major cost saving mechanism, if properly implemented, to reduce the "demand side" of the business. DSM saves costs for both the utility and consumers. In Arizona -- where peak demands are realistically predictable -- managing demand through effective monitoring, measurement and feedback of significant customers is required. Financial incentives to ratepayers are, for example, used nationally to manage and control electrical demand during peak periods. Savings in capital and Operation & Management expenses are paid back in an effective DSM program. Other programs can save capital expense also. For example, local renewable energy use can be increased, transmission/distribution lines shortened to reduce energy losses, efficiency improved through modern generation and regeneration equipment, and probably, natural gas heating. Solar hot water heating has high, rapid payback, lowers energy (gas or electricity) demands and can reduce residential energy costs by 20 to 25%.

To resolve these issues, I would agree to a Settlement Agreement that included the following four conditions:

- 3.1A significant and effective demand side management program shall be developed and implemented within two months of purchase. This program must provide economic incentives to ratepayers to reduce electricity demand during peak demand periods. The initial DSM plan should reduce ratepayer electricity demand by 5% within 12 months of implementation; reduce customer electricity demand at least 10 % and natural gas customer demand by 5% within 48 months after the Citizens purchase. Customer electricity demand will be measured in terms of kW-hr per ratepayer per year. Semi-Annual DSM reports to all parties will track progress towards these goals. Further, a "feedback" mechanism will be implemented so consumers can participate in providing suggestions and recommendations for energy saving mechanisms. This program can be augmented by other conservation measures, but customer

demand reduction shall be the measure for accomplishment. To ensure effective implementation, all consumer electricity rates shall be reduced for the next twelve months by the percentage (to four places) when the annual goals above are not achieved.

- 3.2 Renewable energy programs, including solar hot water heaters, shall be included in the product line for UNS. The following goals shall be established, tracked and reported as a supplemental part of the regular UNS Semi-Annual DSM report. : By end of first 12 months, 1 % of consumers will have solar hot water heating, at 24 months, 3 % will have solar hot water heating, at 36 months, 6 % will have solar hot water heating, and, at 48 months, 10% will have hot water hearing. Half of the energy savings from this one program could be used as DSM credit in 3.1 above. UNS will work with solar hot water heater vendors in service area counties.
- 3.3 UNS currently has other energy efficiency programs, which shall be proposed when the Purchase agreement is implemented.
- 3.4 A group of not less than ten electricity ratepayers (non-utility employees) in each county: Mohave and Santa Cruz, shall be established to monitor these programs and provide an addendum to each Semi-Annual DSM report describing how public interaction is progressing and provide public feedback and ideas generated that have been accepted by the utility. UNS shall provide meeting facilities, administrative support, including insertion of flyers in monthly billings, when this group so recommends.

The Settlement Agreement proposal by UNS fails to resolve the three issues above required for acceptance. Until such an agreement is proposed, I must remain a dissenting party. Closure on these issues is very important to those who live, work and use energy in Santa Cruz County.

Sincerely,



Marshall Magruder

Copies mailed to:

Mr. Christopher Kempley, Chief Counsel
Mr. Jason Gellman, Attorney
Legal Division
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Ms. Holly Hawn
Ms. Martha Chase
Santa Cruz County Attorney's Office
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Nogales, Arizona 85621

Mr. Scott Wakefield
Mr. Daniel W. Pozefsky
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Mr. Jose Machado, City Attorney
Mr. Hugh Holub, Attorney
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Nogales, Arizona 85621

Mr. John White, Deputy County Attorney
Mohave County Attorney's Office
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Exhibit B-3

**LEWIS
AND
ROCA**
LLP
LAWYERS

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Thomas H. Campbell
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Internet: TCampbell@rlaw.com
Admitted in Arizona

Our File Number 35867-00009

March 27, 2003

**SENT ELECTRONICALLY
AND BY REGULAR MAIL**

Marshall Magruder
P.O. Box 1267
Tubac, AZ 85646-1267

Re: Joint Application
Docket No: E-01933A-02-0914, et al.

Dear Mr. Magruder:

Thank you for your letter of March 20, 2003 proposing potential settlement conditions.

Enclosed with this letter is a Settlement Agreement between the Arizona Corporation Commission Staff and the Joint Applicants. This Settlement Agreement addresses many of the issues raised in your letter. For instance, UniSource agrees to forfeit payment of the PPFAC balance from retail ratepayers, to pursue a renegotiation of the June 2001 Pinnacle West Capital Corporation – Citizens Power Purchase agreement, to file appropriate municipal franchises and to comply with the Environmental Portfolio Standard. Some of the issues raised in your letter, such as demand side management programs, are more appropriately addressed in future ACC proceedings.

The Joint Applicants believe the enclosed Settlement Agreement is a reasonable and fair resolution of this matter and that approval of the Settlement Agreement is in the best interest of Arizona.

**LEWIS
AND
ROCA
LLP
LAWYERS**

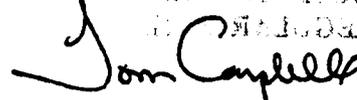
**Marshall Magruder
March 27, 2003
Page 2**

**LEWIS
AND
ROCA
LLP
LAWYERS**

Please contact me if you have questions about the enclosed Settlement Agreement. Staff is scheduling a meeting of all parties on March 31 to discuss this Settlement Agreement. I hope you will be able to participate

Very truly yours,

LEWIS AND ROCA LLP



Thomas H. Campbell

**THC/bjg
Enclosure**

**cc: Christopher Kempley/Jason Gellman
Scott Wakefield/Daniel W. Pozefsky
John White
Holly Hawn/Martha Chase
Jose Machado/Hugh Holub**

1 | **Exhibit B-4**

2 |

Marshall and Lucy Magruder
47 Saddlehorn Road
Post Office Box 1267
Tubac, Arizona 85646-1267
520 (398-9587

28 March 2003

Mr. Thomas H. Campbell
Lewis and Roca, LLP
40 North Central Avenue
Phoenix, Arizona 85004-4429

(via e-mail, original mailed)

Subject: Magruder Data Request Six

References:

(a) Proposed "Settlement Agreement: UniSource Energy Corporation's Acquisition of Citizens Communications Company's Gas and Electricity Utility Assets" forwarded by email from Jason Gillman, ACC Attorney, on 27 March 2003

(b) Joint Applications (Docket Nos. E-01032C-00-0751, G-01032C-02-0598, E-1933A-02-0914, E-0132C-02-0914, G-01032A-02-0914)

Dear Mr. Campbell:

1. Proposed "Settlement Agreement." As indicated in reference (a), additional data appears necessary to ensure we understand these for the cases indicated in reference (b).

These Data Requests are continuing in nature.

We would appreciate responses before 10:00 AM on 31 March. Respond on the Internet is preferred to marshall@magruder.org and lucy@magruder.org.

Thank you.

Sincerely,

/s/
Lucy Magruder

/s.
Marshall Magruder

Attachments:

1 -Magruder Data Request Six

Magruder Data Request Six

MM-6.1 Please provide a copy of all attachments, exhibits and addenda to the proposed "Settlement Agreement" forward on 27 March 2003.

MM-6.2 On page 2, under first WHEREAS, please provide the dates of all meetings held since 21 January 2003 that were announced by a "notice of meetings" and any other meetings held that pertained to the proposed agreement.

MM-6.3 On page 2, under first WHEREAS, please provide a list of all interveners and all other participants at these meetings, including telephonically, that were invited to any meeting held after 21 January 2003 on this proposed agreement.

MM-6.4 On page 2, under first WHEREAS, please provide a copy of all notes, minutes, handouts, or other records taken during any meeting held after 21 January 2003 which involved any parties of these proceedings.

MM-6.5 On page 2, under second WHEREAS, as used, does "Parties" include all parties or only the utility companies and the ACC Staff?

MM-6.6 On page 2, under second WHEREAS, please provide a list the principal "Party" participants and each other person who participated during these negotiations for each utility company and the ACC Staff.

MM-6.7 On page 2, under third WHEREAS, at this stage of preparation for agreement on the purchase application, the names and organizations for each element should have been determined. The Holding Company has been named in some UniSource documentation. Since all of these companies have to be incorporated prior to completion of the acquisition, please provide rationale for not using these relationships that will be determined and specified in the various Articles of Incorporation that will be submitted to the ACC as these entities must exist prior to approval of the Purchase Agreement.

MM-6.8 On page 2, under fourth WHEREAS, during the telephonic settlement agreement working meeting, held on 21 January, the lack of a franchise by the City of Nogales was mentioned as being a necessary element for acceptance by that Party of any Settlement Agreement. Please provide the status on that issue, as progress on resolution and acceptance of a franchise after the Purchase Agreement has been approved will be remote since the only action available to the City of Nogales will be condemnation.

MM-6.9 On page 3, under second WHEREAS (a), the expression "forfeit the right to pursue the recovery from retail ratepayers at the Commission of any of the under-collected Purchase Power and Fuel Adjustor Clause ("PPFAC") balance..." implies that UniSource will have some "right" to recover these funds. Please provide rationale as to how "retail" ratepayers are responsible for a billing dispute between a purchaser of electricity, namely Citizens, and a wholesaler, namely Pinnacle West (and its various subsidiaries). (also on page 15, paragraph 27)

MM-6.10 Page 3, under (a), please provide any legal reference that requires retail ratepayers to settle billing disputes between its electrical distribution company and its supplier. Please also
Magruder letter of 28 March 2003 -Data Request Six

provide any legal reference that imprudent actions (see my Testimony of 8 November 2002) are reimbursable by ratepayers.

MM-6.11 Page 3, under (a), please provide how the amount of "under-collected" PPFAC balance has been calculated.

MM-6.12 Page 3, under (a), please provide any basis or argument for UniSource to "forfeit" a right that it may not possess.

MM-6.13 Page 4, under (d), please provide enforceable mechanisms to ensure "their customers will not be harmed by the acquisition."

MM-6.14 Page 4, under (e), does the date of December 31, 2004, please indicate the date that the procedure will be issued, the date that the procedure will commence the process, and the date that retail electrical competition will have been implemented?

MM-6.15 Page 4, under (e), what does "opening up the new ElecCo's service territories" mean?

MM-6.16 Page 4, under (e), what is basis being used to establish retail competition since none is being held in this state.

MM-6.17 Page 4, under (e), please show how retail competition can be conducted if the wholesale price is fixed by the PWCC Agreement of July 2001.

MM-6.18 Page 4, under (e), how can other companies import electricity to Santa Cruz County without going through the present and/or proposed transmission lines that UniSource will control and receive transmission charges?

MM-6.19 Page 4, under (e), who will determine the transmission or wheeling charge?

MM-6.20 Page 4, under (e), please confirm that local distributed generation sources, within the service territories will be able to continue providing electricity.

MM-6-21 Page 4, under (e), please confirm that a local generation company will be able to compete for these retail services.

MM-6-22 Page 4, under (e), please confirm that a rural electrical cooperatives and municipal utilities will be able to compete for these retail services.

MM-6-23 Page 4, under (e), please indicate the steps and the approval process that will be required to establish retail competition, including any federal, state, county, and other agency approvals.

MM-6.24 Page 4, under (e), what will happen if any county or city does not approve retail competition in its area of jurisdiction?

MM-6-25 Page 4, under (e), will 25-year voter approved franchise agreements be subject to competition?

MM-6.26 Page 4, under (e), what mechanisms will be in place before retail competition commences that ensure fair and reasonable charges are passed to the ratepayers.

MM-6.27 Page 4, under (f), please confirm that the TEP (or UniSource) can file this rate case earlier than the three years after the purchase specified on page 19 in paragraph 39.

MM-6.28 Page 4, under (f), will the feasibility plan include real and actual public participation and public open meetings to ensure that the ratepayers concerns in Santa Cruz County are considered.

MM-6.29 On page 4, under (f), in second sentence, is there any rationale or basis that "ratepayer cost" was omitted as an objective for this study.

MM-6.30 On page 4, under (g), this does not appear to be a unique statement as Citizens was already a participant under EPS. If UniSource would want to double the EPS requirements, then such a statement would be valid.

MM-6.31 On page 5, under (i), please provide rationale, as also requested in Data Request Five, that supports UniSource (not TEP's) reputations so claimed.

MM-6.32 On page 5, paragraph 1, first sentence, as proposed, only the utility companies and ACC Staff are indicated as signatures for the Settlement Agreement. The terms "Parties" and "manner consistent with the public interest" fails to include the public represented by RUCO, Santa Cruz County, Mohave County, City of Nogales, and at least one ratepayer. How can such a claim can be made without any of those entities supporting this Agreement.

MM-6.33 On page 5, paragraph 1, in (3), the date July 28, 2003 implies that "approval must be given in a timely fashion" is an Applicant's self imposed deadline. This process must be timely and deadlines met, however "must be given" should not be accomplished as a primary goal, but only as a reasonable secondary objective. Why the Commissioners 'must' meet any such deadline (repeated several times) when other factors may intervene.

MM-6.34 On page 5, paragraph 1, third line from bottom, the word "unreasonable" appears to be too strong as most Parties do not agree with the Applicants efforts under the "old" and "new" electricity purchase contracts which must result in "fair and reasonable" rates. Please define the use of unreasonable in the context of this statement.

MM-6.35 On pages 6 and 7, paragraphs 3 to 7, discusses modifications of this proposed agreement. Can the other Parties to these hearings submit an Alternate Settlement Agreement for consideration by the Commissioners? In this reply, indicate if such an Alternate Settle Agreement from the other Parties could include, say a new Article Three for consideration.

MM-6.36 On page 7, paragraph 8, the Citizens Presidential permits to export electricity to Mexico are not included. Will these permits also be transferred on the closing date?

MM-6.37 On page 7, paragraph 8, last sentence on page, states that "copies" of franchise, license, and authorization documentation need to be filed up to a year after the decision. Why are these documents not filed for review and approval prior to the transfer of CC&Ns for each service area.

- MM-6.54 On page 10, paragraph 15, please indicate that that all of these entities shall be incorporated prior to the closing date of the Purchase Agreement.
- MM-6.55 On page 11, paragraph 16, will the UniSource Board of Directors unanimous, super majority, or simple majority approval be required for this financial plan and final acquisition approval?
- MM-6.56 On page 12, paragraph 16, in (b), what entity pays the interest rate for this loan? Will this interest be passed on to any ratepayers or passé on to shareholders.
- MM-6.59 On page 12, paragraph 16, in (d), how will UniSource "demonstrable" the impacts of lower bond ratings will not impact ratepayers since interest rates will increase.
- MM-6.60 On page 12, paragraph 16, in (d) last sentence, confirm that such cost will be requested in future TEP rate cases.
- MM-6.61 On page 13, paragraph 17, since new companies are being formed in mostly rural areas, what is the rationale for not forming rural cooperatives in these areas, under management of UniSource.
- MM-6.62 On page 13, paragraph 18, why does the requested waiver has no time limit.
- MM-6.63 On page 14, paragraph 25, in (b) a 40% increase in monthly service charge. As this impacts all ratepayers, rationale for such an increase is requested.
- MM-6.64 On page 15, paragraph 27, were these values derived from the PPWCC Agreement (effective 1 July 2001) or the older APS Agreement?
- MM-6.65 On page 15, paragraph 27, please compare the present rates with those proposed.
- MM-6.66 On page 15, paragraph 27, last sentence, will this permit Citizens to recover costs associated with its billing dispute with APS (PWCC)?
- MM-6.67 On page 15, paragraph 28, second sentence, how can UniSource expect to claim 40% of the rate reduction since electricity costs are "passed through" from the wholesaler to the present distribution system? What is the legal basis for such a charge?
- MM-6.68 On page 15, paragraph 28, third sentence, does "parties" mean UniSource and PWCC or the parties to these hearings.
- MM-6.69 On page 16, paragraph 31, does this prohibit hiring of specialists, who have unique operational and maintenance expertise not presently in the labor pool?
- MM-6.70 On page 16, paragraph 31, what is the benefit to safety, cost, or operations when additional, uniquely qualified personnel are prohibited from being hired to augment the present work force?
- MM-6.71 On page 18, paragraph 36, why should the Commission be prohibited from conducting such reviews of a public service company under its jurisdiction?

- MM-6.54 On page 10, paragraph 15, please indicate that that all of these entities shall be incorporated prior to the closing date of the Purchase Agreement.
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- MM-6.71 On page 18, paragraph 36, why should the Commission be prohibited from conducting such reviews of a public service company under its jurisdiction?

MM-6.72 On page 19, paragraph 39, since the PWCC agreement is for longer than three years, will electricity rates be stable until that agreement expires?

MM-6.73 On page 20, paragraph 40, could you define the scope and purpose of the "negotiated sales program" found in the last line.

MM-6.74 On page 20, paragraph 43, will the bill inserts use a readable font and size, such as Arial or New Times Roman at least 10 points in size, so that ratepayers can read the inserts?

MM-6.75 On page 20, paragraph 43, will this agreement be provided to ratepayers at least 60 days before the transaction occurs, so that ratepayers comments can be submitted to the ACC Consumer's Section?

MM-6.76 On page 21, paragraph 46, are the War on Terrorism or the Second Gulf War considered as force majeure?

MM-6.77 When will our Settlement Agreement Conditions be considered?

MM-6.78 When will we receive a reply to our Settlement Agreement Conditions?

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Admitted in Arizona

Our File Number 35867-00009

April 4, 2003

VIA EMAIL

Marshall and Lucy Magruder
P.O. Box 1267
Tubac, AZ 85646-1267

Re: *Joint Application for Sale of Assets*
Docket Nos: E-01032C-00-0751; G-01032A-02-0598; E-
01933A-02-0914; E-01032C-02-0914; and
G-01032A-02-0914
Magruder Data Requests Six

Dear Mr. and Ms. Magruder:

This letter is the Joint Applicants' response to Magruder Data Request Six, which contained 78 requests, some with subparts. After you have reviewed this letter, please feel free to call me to discuss.

MM 6.1 – You were provided copies of the attachments to the proposed settlement agreement on April 1.

MM 6.2 – The information requested is in your possession because you have attended by phone or in person each of the “all intervenors” meetings. In addition, the Joint Applicants met weekly with staff and had additional meetings with intervenors, including you.

MM 6.3 – See answer to 6.2. The invitation list was based on the Arizona Corporation Commission's service list in the consolidated proceedings.

MM 6.4 – Joint Applicants object to this request because it calls for information not in their possession and, to the extent it is in their possession, it is privileged and confidential settlement materials not admissible in this proceeding.

MM 6.5 – The referenced parties are the Staff and the Joint Applicants.

MM 6.6 – The principal negotiators were Mr. Ernest Johnson and Mr. Steve Glaser.

MM 6.7 – The New Companies will be incorporated prior to closing and those articles of incorporation will be filed with the Commission.

MM 6.8 – The Joint Applicants and the City of Nogales are involved in negotiations regarding the franchise. In addition, there are on-going discussions with the City of Nogales' about the City's desire to purchase certain utility assets in Santa Cruz County. Those discussions are confidential and are not the subject of this proceeding.

MM 6.9 – Joint Applicants object to this request to the extent it calls for a legal conclusion. Notwithstanding that objection, the right to the PPFAC balance and the process for seeking that recovery was established by the Commission and is subject to review by the Commission.

MM 6.10 – Joint Applicants object on the grounds that it calls for a legal conclusion.

MM 6.11 – The attached Purchased Power and Fuel Adjustor Bank Balance Report shows the calculation of the under collection for the month of December 2002.

MM 6.12 – Joint Applicants object on the grounds that it calls for a legal conclusion.

MM 6.13 – Please see Part B of the Settlement Agreement that contains the terms of the financing, including the "hold harmless" provision. (See 16 (d))

MM 6-14 through MM 6-26 – These questions relate to retail competition in the current Citizens' service area and are neither relevant nor reasonably calculated to lead to admissible evidence in this case. The staff has requested a commitment from UniSource to open up these areas to retail electric competition by December 31, 2004. The details of that process are to be set forth in a filing with the Arizona Corporation Commission 120 days after the order in this case. Issues related to retail competition should be addressed in that proceeding. *See also* ACC Electric Competition Rules and related proceedings.

MM 6.27 – Please see ACC Decision #62103.

MM 6.28 – TEP has not developed a procedure for preparing this feasibility plan.

MM 6.29 – Joint Applicants object on the grounds that this request is vague and ambiguous. What do you mean by the phrase “ratepayer cost was omitted?”

MM 6.30 – Joint Applicants object on the grounds that this is not a request, but merely a statement of your position.

MM 6.31 – Please see UniSource Annual Report and 10K materials.

MM 6.32 – The Joint Applicants and the ACC staff believe that this Settlement Agreement is in the public interest. The parties that you list will have an opportunity to comment on the Settlement Agreement and participate in a public hearing. The Commission will make the final decision as to whether this Settlement Agreement is in the public interest.

MM 6.33 – This Settlement Agreement is conditioned on gaining Commission approval in time for this transaction to close by July 28, 2003. The Commissioners will determine the date on which they will rule on this proposed settlement.

MM 6.34 – Joint Applicants object on the grounds this request calls for a legal conclusion.

MM 6.35 – The other parties to this proceeding were given the opportunity to file testimony and comments on April 21, 2003. The Administrative Law Judge and the Commission will consider these filings in reaching their determinations.

MM 6.36 – The Presidential Permits will be transferred as a result of this transaction.

MM 6.37 – The Commission’s normal procedure is to condition CC&N approvals and transfers on the filing franchises, licenses and other authorizations as a condition subsequent. This provision is consistent with Commission procedures.

MM 6.38 – See answer to MM 6.37.

MM 6.39 – No costs will be recovered from the ratepayers without Commission approval after an appropriate proceeding and hearing. Please also see the testimony of Kevin Larson.

MM 6.40 through MM 6.49 - See answer to MM 6.14.

MM 6.50 – “Municipal aggregation” occurs when a municipality purchases power on behalf of multiple end users within the city limits pursuant to the ACC Electric Competition Rules.

MM 6.51 – Joint Applicants believe those words speak for themselves and object to this data request on the grounds it calls for a legal conclusion.

MM 6.52 – Please see answer to MM 6.27.

MM 6.53 – This information has previously been provided to you both in the settlement meetings and in Kevin Larson’s testimony. Please let me know if you need another copy of the two county bond financing hand-out provided to all participants in the second settlement meeting.

MM 6.54 – Please see answer to MM 6.7.

MM 6.55 – The purchase of these assets has already been approved by the UniSource Board of Directors.

MM 6.56 – UniSource Energy Corporation will pay the interest from its cash flow which includes dividend payments from its subsidiaries.

MM 6.57 – No request.

MM 6.58 – No request.

MM 6.59 – Object on the grounds this request is vague and ambiguous.

MM 6.60 – Object on the grounds this request is vague and ambiguous.

MM 6.61 – Object on the grounds this request calls for legal conclusions.

MM 6.62 – A time limit is not needed because the waiver is based on how the proceeds will be used.

MM 6.63 – Object on the grounds that this request is vague and ambiguous. See Citizens gas rate case filing and testimony for explanation of rate design.

MM 6.64 – The PWCC Agreement effective July 1, 2001.

MM 6.65 – Please see Appendix C to the Settlement Agreement. Joint Applicants are not required under the Rules of Civil Procedure to perform additional analyses in response to discovery requests.

MM 6.66 – This provision only relates to recovery from retail ratepayers and does not address recovery from Pinnacle West Capital Corporation.

MM 6.67 – Object on the grounds this data request calls for a legal conclusion. As part of the Settlement Agreement, and as an incentive to UniSource to use good faith to renegotiate the agreement, the parties agreed that 40% of the benefit would go to UniSource.

MM 6.68 – In this sentence, parties means the parties to the Settlement Agreement.

MM 6.69 – The intent here is to maintain the current safety practices that exist.

MM 6.70 – See answer to MM 6.69.

MM 6.71 – Object to the extent the request calls for a legal conclusion. The parties to the Settlement Agreement believe that it is in the public interest to waive prudency reviews of expenditures prior to October 29, 2002, in exchange for other benefits from this transaction, including reduction of the rate base.

MM 6.72 – The current agreement is a fixed price contract.

MM 6.73 – The Negotiated Sales Program (“NSP”) was first approved in Arizona Corporation Commission Decision No: 59399 issued in November 1995, and reaffirmed by Decision No. 60423 issued in September 1997. The NSP permits Citizens Arizona Gas to compete for the gas commodity business of its transportation service-only customers in Northern Arizona. The current gas rate case now before the Commission proposes to expand participation in the NSP to qualifying customers in Santa Cruz County.

MM 6.74 – The notices will conform with all ACC requirements.

MM 6.75 – This Agreement is being filed in the Commission public docket on April 1, 2003, almost 120 days before the transaction occurs. Notice of this proceeding was given to customers prior to that time through bill inserts and newspaper publications. (Please see affidavit filed in this proceeding).

Marshall Magruder
April 4, 2003
Page 6

MM 6.76 – Joint Applicants believe that this language speaks for itself and object to the extent this request calls for a legal conclusion.

MM 6.77 – All intervenors' positions and testimony will be considered by the Administrative Law Judge at the May 1 hearing and by the Commissioners in an open meeting.

MM 6.78 – Joint Applicants sent you a reply on March 27, 2003.

Very truly yours,

LEWIS AND ROCA LLP

Thomas H. Campbell

THC/bjg

Document	Page (s)	Quote							
		Cost of Services							
		For the three months ending June 30				For the six months ending June 30			
		<i>(\$ in thousands)</i>							
		2002	2001	\$ Change	% Change	2002	2001	\$ Change	% Change
		\$28,987	\$29,969	\$ (982)	-3%	\$55,667	\$59,655	\$ (3,988)	-7%
		Electric energy and fuel oil purchased							
		... Electric energy and fuel oil purchased for the three and six months ended June 30, 2002 decreased as compared with the prior year periods primarily due to lower purchase power prices. Under tariff provisions, the cost of our electric energy and fuel oil purchases are primarily passed on to customers. ... During the past two years, power supply costs have fluctuated substantially, forcing companies in some cases to pay higher operating costs to operate their electric businesses. In Arizona, excessive power costs charged by our power supplier in the amount of approximately \$111.3 million through June 30, 2002 have been incurred. We believe that we are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause, that was approved by the Arizona Corporation Commission and has been in place for several years. However, in an attempt to limit "rate shock" to our customers, we requested in September 2001 that our unrecovered power costs, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet in anticipation of recovering through the regulatory process. Parts of our proposal have been contested by one or more parties to a pending Arizona Commission proceeding convened to consider the matter. A determination regarding recovery could be made in 2002 but the timing is not certain.							
Citizens SEC Form 10-Q for Qtr ending 30 June 2002	26 and 27								

Document	Page (s)	Quote																	
SEC Form 10-K dated 6 March 2002 (inserted and bound in the Citizens Communications 2001 Annual Report)	31	<p style="text-align: center;">Cost of Services</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2"></th> <th colspan="2" style="border-bottom: 1px solid black;">2001</th> <th colspan="2" style="border-bottom: 1px solid black;">2000</th> <th style="border-bottom: 1px solid black;">1999</th> </tr> <tr> <th style="border-bottom: 1px solid black;">Amount</th> <th style="border-bottom: 1px solid black;">% Change</th> <th style="border-bottom: 1px solid black;">Amount</th> <th style="border-bottom: 1px solid black;">% Change</th> <th style="border-bottom: 1px solid black;">Amount</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td style="text-align: right;">\$123,223</td> <td style="text-align: right;">8%</td> <td style="text-align: right;">\$113,965</td> <td style="text-align: right;">16%</td> <td style="text-align: right;">\$98,533</td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased increased \$9.3 million or 8% in 2001 primarily due to higher purchased power prices, consumer growth and increased consumption due to warmer weather conditions. Electric energy and fuel oil purchased increased \$15.4 million, or 16%, in 2000 primarily due to higher supplier prices and increased consumption. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers.</u> Gas, electric energy and fuel purchased <u>excludes amounts deferred for future recovery in rates.</u> During the past two years, power supply costs have fluctuated substantially, forcing companies in some cases to pay higher operating costs to operate their electric businesses. In Arizona, excessive power costs charged by our power supplier in the amount of approximately \$100 million through December 31, 2001 have been incurred. <u>We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause.</u> However, in an attempt to limit "rate shock" to our customers, we requested in September 2001 that this deferred amount, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet in <u>anticipation of recovering through the regulatory process.</u> We anticipate a determination regarding recovery to be made in 2002.</p> <p>On July 16, 2001, Citizens terminated our existing contract with Arizona Public Service and entered into a new seven-year purchase power agreement. This agreement allows us to purchase all power required for operations at a fixed rate per kilowatt hour. This agreement is retroactive to June 1, 2001 and will <u>mitigate further increases in the deferred power cost account.</u></p>		2001		2000		1999	Amount	% Change	Amount	% Change	Amount	Electric energy and fuel oil purchased	\$123,223	8%	\$113,965	16%	\$98,533
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Citizens SEC Form 10-Q for Qtr ending 31 March 2002	17, 23, and 24	<p>(16) <u>Commitments and Contingencies:</u> On December 21, 2001, we entered into a settlement agreement resolving all claims in a class action lawsuit pending against the company in <u>Santa Cruz County, Arizona (Chilcote, et al v. Citizens Utilities Company, No. CV 98-471).</u> The lawsuit arose from claims by a class of <u>plaintiffs that includes all of our electric customers in Santa Cruz County</u> for damages resulting from several power outages that occurred during the period January 1, 1997, through January 31, 1999. Under the terms of the settlement agreement, and without any admission of guilt or wrongdoing by us, we will pay the class members \$5.5 million in satisfaction of all claims. The court approved the settlement agreement on March 29, 2002, and the lawsuit against us was dismissed with prejudice. We have accrued the full settlement amount, plus an additional amount sufficient to cover legal fees and other related expenses, during the fourth quarter of 2001. [Page 23]</p> <p style="text-align: center;">Cost of Services</p> <p style="text-align: center;">(<i>\$ in thousands</i>)</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2"></th> <th colspan="3" style="border-bottom: 1px solid black;">For the three months ending March 31</th> </tr> <tr> <th style="border-bottom: 1px solid black;">2002</th> <th style="border-bottom: 1px solid black;">2001</th> <th style="border-bottom: 1px solid black;">% Change</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td style="text-align: right;">\$26,680</td> <td style="text-align: right;">\$29,686</td> <td style="text-align: right;">-10%</td> </tr> </tbody> </table> <p>... [Page 24] Electric energy and fuel oil purchased for the three months ended March 31, 2002 decreased \$3.0 million, or 10%, as compared with the prior year period primarily due to lower purchase power prices and decreased consumption. <u>Under tariff provisions, the cost of electric energy and fuel oil purchases are primarily passed on to customers.</u> ...</p> <p>During the past two years, power supply costs have fluctuated substantially, forcing companies in some cases to pay higher operating costs to operate their electric businesses. In Arizona, excessive power costs charged by our power supplier in the amount of approximately \$105 million through March 31, 2002 have been incurred. <u>We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause.</u> However, in an attempt to limit "rate shock" to our customers, we requested in September 2001 that this deferred amount, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet in <u>anticipation of recovering through the regulatory process.</u></p>		For the three months ending March 31			2002	2001	% Change	Electric energy and fuel oil purchased	\$26,680	\$29,686	-10%						
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Citizens SEC Form 10-Q for Qtr ending 30 September 2001	20 and 31	<p>During the past two years the decrease in the availability of power in certain areas of the country has caused power supply costs to increase substantially, forcing companies to pay higher operating costs to operate their electric businesses. As a result, companies have attempted to offset these increased costs by <u>either renegotiating prices with their power suppliers or passing these additional costs on to their customers through a rate proceeding</u>. In Arizona, excessive power costs charged by our power supplier in the amount of approximately \$98 million through September 30, 2001, have been incurred. <u>We are allowed to recover these charges from ratepayers through the Purchase Power Fuel Adjustment clause</u>. In an attempt to limit "rate shock" to our customers, we will request in September 2001 that this deferred amount, plus interest, be recovered over a seven-year period. As a result, we have deferred these costs on the balance sheet <u>in anticipation of recovering through the regulatory process</u>. On July 16, 2001, Citizens terminated our existing contract with Arizona Public Service and entered into a new seven-year purchase power agreement. This agreement allows us to purchase all power required for operations at a fixed rate per kilowatt hour. This agreement is retroactive to June 1, 2001 and will <u>mitigate</u> further increases in the deferred power cost account. [Page 31]</p> <p><i>(\$ in thousands)</i></p> <table border="1"> <thead> <tr> <th rowspan="3"></th> <th colspan="6">Cost of Services</th> </tr> <tr> <th colspan="3">For the three months ending September 30</th> <th colspan="3">For the six months ending September 30</th> </tr> <tr> <th>2001</th> <th>2000</th> <th>% Change</th> <th>2001</th> <th>2000</th> <th>% Change</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td>\$36,149</td> <td>\$32,540</td> <td>11%</td> <td>\$95,804</td> <td>\$84,514</td> <td>13%</td> </tr> </tbody> </table> <p>... During the past two years ... [same as page 20] ... recovering through the regulatory process. On July 16, 2001, Citizens terminated ... [same as page 20] ... will <u>mitigate</u> further increases in the deferred power cost account.</p>		Cost of Services						For the three months ending September 30			For the six months ending September 30			2001	2000	% Change	2001	2000	% Change	Electric energy and fuel oil purchased	\$36,149	\$32,540	11%	\$95,804	\$84,514	13%
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Exhibit B-1 (replacements for pages 52 to 58)

Excerpts from Citizens Annual SEC Form 10-K and Quarterly SEC Form 10-Q and Annual Reports between February 2001 and 30 June 2002

Statements in these documents that imply certain actions will result from these Hearings. They are quoted below. Each document short title is indicated in the left column, the location of all references quoted from that document in the second column, and the quote in the third column. No changes were intentionally made to the quotes, and for excerpts. There are many aggregated data tables in these reports. From these tables, only "electric utility" data are used. Other data pertains to other Citizens entities not involved with these hearings.

Most of these reports repeat the same information in more than one location in each report. These are shown by "During the past year...[same as page 11]..." notations. Underlining marking and bold fonts were inserted for emphasis.

Document	Page (s)	Quote																	
Citizens 2000 Annual Report (c.a. February 2001)	26	<p style="text-align: center;">Cost of Services</p> <p style="text-align: center;">(\$ in thousands)</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2"></th> <th colspan="2">2000</th> <th colspan="2">1999</th> <th>1998</th> </tr> <tr> <th>Amount</th> <th>% Change</th> <th>Amount</th> <th>% Change</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td>\$113,965</td> <td>16%</td> <td>\$98,533</td> <td>12%</td> <td>\$87,930</td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased increased \$15.4 million, or 16%, in 2000 primarily due to higher supplier prices and increased consumption. Electric energy and fuel oil purchased increased \$10.6 million, or 12%, in 1999 primarily due to increased consumption and customer growth. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers.</u> Gas, electric energy and fuel oil purchased excludes amounts deferred for future recovery in rates.</p>		2000		1999		1998	Amount	% Change	Amount	% Change	Amount	Electric energy and fuel oil purchased	\$113,965	16%	\$98,533	12%	\$87,930
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Quarterly SEC 10-Q for Quarter ending 31 March 2001	19	<p style="text-align: center;">Cost of Services</p> <p style="text-align: center;">(\$ in thousands)</p> <p style="text-align: center;">For the three months ended March 31</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th>2001</th> <th>2000</th> <th>% Change</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td>\$29,686</td> <td>\$24,173</td> <td>23 %</td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased for the three months ended March 31, 2001, increased \$5.5 million, or 23%, as compared with the prior year period primarily due to higher purchase power prices. For [There was no mention of these PPFAC proceedings in this report.]</p>		2001	2000	% Change	Electric energy and fuel oil purchased	\$29,686	\$24,173	23 %									
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Electric energy and fuel oil purchased	\$29,686	\$24,173	23 %																
SEC Form 10-K dated 8 March 2001 (inserted and bound in the Citizens 2000 Annual Report)	11, 21, 26 and 30	<p>During the past year the decrease in the availability of power has caused power supply costs to increase substantially, forcing companies to pay higher operating costs to operate their electric businesses. As a result, <u>companies have attempted to offset these increased costs by either renegotiating prices with their power suppliers or passing these additional costs on to their customers through a rate proceeding.</u> In Arizona, <u>we are currently disputing excessive power costs charged by our power supplier in the amount of approximately \$57 million through December 31, 2000. We are allowed to recover these charges from ratepayers through the Purchased Power Fuel Adjustment clause.</u> In an attempt to limit "rate shock" to our customers, we have deferred these costs on the balance sheet in anticipation of <u>recovering certain amounts either through renegotiations or through the regulatory process....</u> [Page 21]. During the past year ... [same as page 11] ... or through the regulatory process..... [Page 26]... During the past year ... [same as page 11] ... or through the regulatory process.</p> <p style="text-align: center;">Cost of Services</p> <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th rowspan="2"></th> <th colspan="2">2000</th> <th colspan="2">1999</th> <th>1998</th> </tr> <tr> <th>Amount</th> <th>% Change</th> <th>Amount</th> <th>% Change</th> <th>Amount</th> </tr> </thead> <tbody> <tr> <td>Electric energy and fuel oil purchased</td> <td>\$113,965</td> <td>16%</td> <td>\$98,533</td> <td>12%</td> <td>\$87,930</td> </tr> </tbody> </table> <p>... Electric energy and fuel oil purchased increased \$15.4 million or 16% primarily due to higher supplier prices and increased consumption. Electric energy and fuel oil purchased increased \$10.6 million, or 12%, in 1999 primarily due to increased consumption and consumer growth. <u>Under tariff provisions, increases in our costs of electric energy and fuel oil purchased are largely passed on to customers.</u> Gas, electric energy and fuel purchased <u>excludes amounts deferred for future recovery in rates....</u> [Page 30] During the past year ... [same as page 11] ... or through the regulatory process.</p>		2000		1999		1998	Amount	% Change	Amount	% Change	Amount	Electric energy and fuel oil purchased	\$113,965	16%	\$98,533	12%	\$87,930
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Q. What are your conditions for changes to the Proposed Settlement Agreement?

A. My letter of 20 March 2003, Exhibit B-2, suggesting conditions to the Proposed Settlement Agreement, was all but ignored in the response, Exhibit B-3. My further reply, Data Request Five, in Exhibit B-4, attempted to ensure my position was considered in the resultant Proposed Settlement Agreement. These conditions, are summarized below:

18. Recommendations for the Gas Case.

I reserve the right to comment later.

19. Recommendations for the Proposed Settlement Agreement.

See the recommendations for the Settlement Agreement in Table 5 and also paragraph 17 above for additional recommendations for the PPFAC case.

Q. Do you have additional recommendations?

A. Yes, see my Comments of 13 March 2002 to this docket for recommendations not included in this testimony. Some of those recommendations were modified herein because of circumstances and information received since then.

Conclusion of Testimony.

Q. Has this testimony been made by you without reservations?

A. The facts herein are from references that have been furnished by UniSource, Citizens or from my files compiled during these hearings. Where unique references were considered important, they are provided in the text. A few numbers were derived from data. When arithmetic was used to change a value, it is described, and, usually, the steps are shown. When costs were in \$ per kW-hr, they were changed to \$ per MW-hr throughout this testimony so consistent comparisons could be easily made.

2.3 There shall be a franchise application accepted by the City of Nogales before closing.

3. For the reduction of customer expenses, a concerted effort by UniSource shall be added to the Settlement Agreement with to reduce cost risk.

3.1 A significant and effective demand side management program shall be developed and implemented so that ratepayer electric demand is reduced by 5% within the first 12 months of implementation and another 5% within 4 years. Natural gas demand is to be reduced by 5% within 48 months. Failure to meet these goals shall result in lowering of rates by the same percentage as missing the goal. These goals are measured per customer in each customer category.

3.2 Exceeding these goals will be shared by 50/50 between lowering rates. For example, at 48 months, electric demand savings are say 14% per customer, so the rates would be increased by 2% per customer (demand decreased 14% - 2 % increase to UniSource = 12 % actual ratepayer savings, with a 2% higher rates for UniSource) as incentive savings for UniSource.

3.3 Renewable energy programs need to be implemented by UniSource, including permission to engage in selling solar water heaters and encouraging counties to adapt solar water heating ordinances. By 12 months after closing, 1% of UniSource customers will have solar hot water heaters, 3% at end of 36 months, 10% at end of 48 months. Half of the energy savings in this program could be used for DSM credit in 3.1 and 3.2 above.

3.4 UniSource will propose additional energy efficiency programs, preferably same as with TEP, to add to economy of scale in a revision to the Proposed Settlement Agreement. A feedback mechanism shall be implemented so customers can actively participate in making suggestions and changes necessary to achieve these modest goals. A group of not less than ten electricity ratepayers shall be established in Santa Cruz and Mohave County to monitor these programs and provide a written Addendum to the Semi-Annual DSM reports that describes how public interaction is progressing and to provide public feedback, lessons learned, and ideas to the ACC staff for aggressive implementation statewide. UniSource shall provide meeting facilities, administrative support including insertion of flyers in monthly billings, when this group so recommends.

Q. What do you recommend be reimbursed?

A. The following reimbursements requested in the Application are recommended:

- a. For any disputed fuel costs under the Old APS Agreement – zero
- b. For non-disputed fuel costs under the Old APS Agreement – after a judgment from litigation, dispute resolution, or negotiations, a future hearing can determine what is fair and reasonable.
- c. For interest on disputed fuel PPFAC Bank Loan costs under Old APS Agreement – zero
- d. For increases in the rates from the New PWCC Agreement – to a value equal to the Old Agreement rates to closing, e.g., no change for Citizens ratepayers.
- e. For increases in rates for the WASA Agreement – as requested.
- f. For risk management programs – zero, based on DSM information to date

Citizens and other utilities should not be permitted to deduct DSM expenses. There needs to be ways to measure any actual DSM load-shaping.

16. Facts and Conclusions for the Gas Case.

I reserve the right to discuss this later.

17. Facts and Conclusions for the proposed Settlement Agreement.

Q. What are your recommendations with respect to Citizens dispute with PWCC (APS)?

A. Citizens be allowed to recover any disputed charges from PWCC(APS).

Q. What are your conditions for changes to the Proposed Settlement Agreement?

A. My letter to the Joint Applications on 20 March 2003, see Exhibit B-2, was almost totally ignored in their response shown in Exhibit B-3. The reply, in Exhibit B-4, Data Request Five, attempted to ensure my position was considered in the resultant Proposed Settlement Agreement. These conditions, are summarized below:

Part VI – Recommendations for these Cases

18. Recommendations for the PPFAC Case.

Q. What are your recommendations for reimbursement to Citizens as requested by the Amended PPFAC Application?

A. Based on each element of this case, the following are recommended:

1. For the Old Contract issue concerning unrecovered charges:

1.1 UniSource and Citizens shall agree not to pursue collection of Citizens' disputed charges from ratepayers.

1.2 UniSource shall not be permitted to take "good will" or other "credit" for Citizens expenses.

1.3 UniSource shall cease claiming they are "forfeiting" the disputed amount, as UniSource spent none of this.

2. For the New Contract issue concerning the price for purchased power:

2.1 UniSource shall have a signed agreement with PWCC or another supplier before its purchase of Citizens for no more than \$35.00 per MW-hr. If this can not be reached, incentives shall be included in such an agreement that will benefit consumers by lowering rates through efficiency measures (see 3 below), to a maximum wholesale cost to UniSource of \$40.00 per MW-hr.

2.2 The New "agreement" shall meet 2.1 above and shall go into force on the closing date of the sale of Citizens Arizona assets to UniSource.

Q. Do you consider Citizens' actions to have been wise and prudent?

A. As shown in Table 1, Citizens has made and continues to make unwise business decisions in these matters.

Q. Do you have any further conclusions concerning the Old Agreement?

A. Yes, the disputed terms should have been resolved in much shorter period of time, so that they would have been minimal or insignificant. Citizens failed to act in a timely, prudent manner to prevent or avoid more "excessive" charges.

Q. Do you have any conclusions concerning the New Agreement and the Valencia turbines?

A. Yes, this contract does not allow Citizens free use of its own generation capabilities to avoid higher charges by APS/PWC. This should be changed.

Q. Did the New Agreement solve the disputed billing charges of the Old Agreement?

A. No, the New Agreement did not solve the disputed billing charges. Citizens failed to use all available means to recover these costs and interest. Avoiding the attempt to collect from APS/PWCC is unconscionable. Until the disputed costs have been validated as not disputed costs, Citizens should not be reimbursed for them or any interest associated with them.²

Q. Do the WASA Agreement costs appear to be fair and reasonable?

A. These costs, as described in the Application, appear fair and reasonable and probably should be recovered from the ratepayers.

Q. Should Citizens receive credit for developing DSM programs?

A. No, the so-called DSM plan implemented by Citizens fails to shape the load. Has ACC Staff failed to provide appropriate and effective feedback to Citizens? Until the ACC Staff reviews the Semi-Annual DSM Program Report and provides appropriate feedback to all utilities,

² In response to Magruder Data Request MM-3-02(15), Citizens responded "No amounts paid APS are currently in dispute." Also, Magruder Data Request MM-3.02(7) asked Citizens "Are all APS Monthly Purchase Power and Fuel Costs charges ... "paid under protest" to APS?". In response to this data request dated 3 January 2003, Citizens stated "The category "Purchased Power and Fuel costs" includes power supply bills received from APS, transmission service bills received from WAPA, and the cost of generation fuel consumed at the Valencia facility. No portion of such reported costs is in dispute at this time." [emphasis added].

Thus, as of January, 2003 after the Purchase Agreement had been made public, Citizens in its delayed reply to Magruder Data Request Three does not dispute the APS costs.

3. When the contract was shifted from APS to PWCC, the players changed and, apparently, working relationships changed.
 - a. By May 2000, the SIC disagreement had not been solved.
 - b. May 2000, the new APS interpretation of the SIC clause started to cause higher prices.
 - c. For the June 2000 billing, Citizens paid "under protest" the disputed billing per paragraph 16 of the Old Agreement. These written disputed billings continued until, at least, January 2001.
 - d. Citizens paid all the bills from PWCC (APS) when due.
 - e. In September 2000, Citizens filed its PPFAC Application which included an analysis of the billing process to recover, or at least analyze, PWCC's data in order to determine whether the billings were correct. Errors were apparently common. Citizens requested that prior overcharge by APS be stopped.
 - f. It is stated in SEC 10-K/Q filings that Citizens considered litigation, held various discussions with, and wrote strong letters to PWCC indicating these billings were "excessive," "disputed," and "paid under protest." Further, Citizens indicated in these filings that unrecovered charges could be obtained from ratepayers.
 - g. PWCC responded to Citizens by not cooperating with the proposed analysis in the PPFAC Application. PWCC stated, in SEC 10-K/Q filings, it would vigorously oppose actions by Citizens to recover any of the disputed claims from them.
 - h. In Spring, 2001, Citizens and PWCC met to discuss the proposed claims. The result of this meeting was an agreement to work on a New Agreement.
 - i. On July 15, 2001, effective June 1, 2001, the New Agreement went into force.

Q. From these facts and statements, were discussions held that solved the billing dispute?

A. No. The wholesale billing dispute for Citizens, as buyer, and APS (PWCC) as seller, has never been resolved.

Q. Who still owes any money in the billing dispute?

A. None is owed, as Citizens paid all the bills, as required by the Old Agreement.

Q. Why are the ratepayers obligated to pay?

A. As shown above, a clear "billing dispute" existed between two companies. Without knowing any amount of "excessive" charges, no attempt should be made to collect any of these charges from the ratepayers.

loads may cut peak-energy use without causing any interruption to businesses or any major complaints. In some cases, the cost to install relays, software, and power communications devices will be recovered in one summer's savings. California learned from the summer of 2000, Residents and businesses there was able to use conservation measures to significantly reduce loads in the summer 2001.

Table 6 Good Business practices reduce Demand and Provide Ratepayers Savings.¹

Action by Customers	
<p>Raise space temperature</p> <p>Reduce outside air intake</p> <p>Cycle window, packaged and split air conditioners.</p> <p>Switch coolers in hybrid plants to non-electrical units.</p> <p>Switch boiler auxiliaries to non-electric options.</p> <p>Shut off public TV monitors.</p> <p>Shut off electric reheat coils.</p> <p>Shut-off or cycle bathroom hand dryers, exhaust fans, water heaters and domestic, hot-water circulation pumps</p>	<p>Cycle large electric appliances.</p> <p>Use on-site, backup and emergency generators.</p> <p>Reduce hallway lighting.</p> <p>Cut stairwell lighting.</p> <p>Reduce outdoor lighting.</p> <p>Reduce public space lighting and ventilation.</p> <p>Cycle electric-resistance humidifiers.</p> <p>Shut off a portion of elevators.</p> <p>Shut off vending machines.</p>

Part V – Facts and Conclusions in these Cases

15. Facts and Conclusions for the PPFAC Case.

Q. What do you see are the key facts and possible conclusions in the PPFAC Case?

A. The elements of this case have separate facts and conclusions.

Q. What are the undisputed facts concerning the Old Agreement?

A. In my opinion, the facts are as follows:

1. As a long time, and major electricity buyer, Citizens and APS accepted the Old Agreement, in 1995, which had three schedules for determining prices.
2. About 1999, one issue, the SIC clause started discussion between the two companies.

¹ From Energy Central Daily Electric Power News, April 23, 2003, "Win-Win Energy Tactics,"

Q. Why is resolution of (2), the approval of the New Agreement, so important?

A. This was Citizens attempt to resolve (1) above. Unfortunately, that issue is still open. This contract is for a purchase power rate considerably higher than historic and current markets. The weak attempt in the Joint Application to "share" any reduction of these "pass through" charges has no basis. There is no economic reason for PWCC to want to reduce a "high" rate, as shown earlier in this testimony.

Q. Why is resolution of (3), risk reduction management, so important?

A. Citizens initially requested approval of possible measures to reduce risk but then became silent on this issue. Whenever raising rates, a good move would be to offer customers a way to avoid increases with cost-effective ways to save. For the utility, this also reduces demand with obviously lower capital expenses avoided or delayed. Even after having discussions with Mr. Glaser on 4 December 2002 about several programs already offered by TEP that could be offered to the new utility customers, nothing has been heard on this topic. Cost savings programs include the TEP Green Watt, Tucson All-Electric Home Guarantee (lowest rates), and others. Without any way for customers to save, a rate increase would severely impact customers in a low-income, high-unemployment, county.

Q. Why should UniSource or Citizens not encourage lowering demand and infrastructure risk?

A. This hurts the higher profit margins for the profitable "summer season" when demand and purchase power costs are higher. See UniSource First Quarter 2003, news release where Mr. Pignatelli states "In our desert climate, we're accustomed to reporting losses in the first quarter and making up the difference in the hot summer months. A major portion of our net income is generated between May and October."

Q. Can demand and ratepayer costs be reduced during the summer months?

A. Of course, and during the "change over" to new, management this could occur. Innovation, not continuance of past inefficient, ineffective and costly practices needs to be considered, such as ways to shift demand from high, peak rates to lower offpeak rate times of day. None of this is considered in this application. Demand responsive implementations for major loads, including the produce industry are needed and necessary to make those companies more profitable customers. Demand Side Management is not included in this application. Many new ideas, for example those shown in Table 6 below, should be standard business practices. While cycling one of two loads may not be worth the effort or save much money, doing so for a variety of sequenced

Errata to Marshall Magruder Testimony of 27 April 2003

(replacement pages 42 from line 3 through page 45)

Part IV – Joint Application for Approval of Sale of Electricity and Gas Utility Assets and Certificates of Convenience and Necessity (CC&N) from Citizens to UniSource Case, Dockets E-01933A-02-0914, E-01032C-02-0914, and G-01032A-02-0914

13. Joint Application Issues.

Q. Do you see any pending matters in this Joint Application?

A. The Joint Application, Section VI, Treatment of Pending Matters discusses both the Gas and PPFAC cases as pending. Both of these cases need to be resolved prior to approval of the Joint Application.

Q. Do you approve of the Joint Applicants request to consolidate the PPFAC and Gas cases as requested in Section VI.C?

A. Yes. It is noted that the consolidation of these two cases since resolution is necessary prior to final Joint Application Approval.

Q. Does the Joint Application address the elements of each of these two pending cases?

A. No. In particular, the PPFAC case is discussed in 9 lines of text on pages 17 and 18 with references to testimony which also fails to discuss the three elements of that case, in particular, resolution of

1. the under recovered PPFAC Bank Balance,
2. the approval of the New Agreement, and
3. risk reduction to avoid such a crises in the future.

Q. Why is resolution of the (1) under recovered charges to balance the PPFAC Bank important?

A. First, no recovery from retail ratepayers for a wholesale billing dispute has been approved or even considered; therefore, retail ratepayers are not liable for such charges. Second, the amount to be recovered is questionable. Third, without resolving these two, the exact amount of under collected or under recovered charges is not known. Fourth, without knowing the exact or an approved amount of under recovered charges, consideration of these as "accounts receivable" is doubtful. Thus, fifth, "goodwill" can not be determined, which is, supposedly, to be amortized over 37 years or at about \$3.7 million per year causing significant reduction or carry forward of federal and state income taxes. What this amounts to, is loss of a significant part of the tax base for an unknown amount from a billing dispute that have never been resolved.