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BEFORE THE ARIZONA CORPORATION COMMISSION

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WILLIAM A. MUNDELL  
CHAIRMAN  
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COMMISSIONER

Arizona Corporation Commission

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AZ CORP COMMISSION  
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IN THE MATTER OF THE GENERIC  
PROCEEDINGS CONCERNING ELECTRIC  
RESTRUCTURING ISSUES.

Docket No. E-00000A-02-0051

IN THE MATTER OF ARIZONA PUBLIC  
SERVICE COMPANY'S REQUEST FOR  
VARIANCE OF CERTAIN REQUIREMENTS  
OF A.A.C. 4-14-2-1606

Docket No. E-01345A-01-0822

IN THE MATTER OF THE GENERIC  
PROCEEDINGS CONCERNING THE  
ARIZONA INDEPENDENT SCHEDULING  
ADMINISTRATOR

Docket No. E-00000A-01-0630

IN THE MATTER OF TUCSON ELECTRIC  
COMPANY'S APPLICATION FOR A  
VARIANCE OF CERTAIN ELECTRIC POWER  
COMPETITION RULES COMPLIANCE  
DATES

Docket No. E-01933A-98-0471

ISSUES IN THE MATTER OF TUCSON  
ELECTRIC POWER COMPANY'S  
APPLICATION FOR A VARIANCE OF  
CERTAIN ELECTRIC COMPETITION RULES  
COMPLIANCE DATES

Docket No. E01933A-02-0069

**POST-HEARING BRIEF OF AES  
NEWENERGY, INC. AND  
STRATEGIC ENERGY, LLC ON  
TRACK A ISSUES**

AES New Energy, Inc. ("AES NE") and Strategic Energy, LLC ("Strategic"), pursuant to A.A.C. R14-3-105, hereby offer their joint post-hearing brief on Track A issues in the above-captioned proceeding. AES NE and Strategic are hereinafter referred to as the "Joint Parties." The Joint Parties limit their comments to a single Track A issue, the proposal by Tucson Electric Power ("TEP") to deny retail customer choice to all of Arizona's residential customers and to commercial and industrial ("C&I") customers with load requirements less than 3 MW. The TEP proposal is

1 counter to commitments made by the utility in earlier settlement agreements and  
2 contrary to the express direction of the Arizona Corporation Commission  
3 (“Commission” or “ACC”).

#### 4 **I. Regulatory History**

5 On November 5, 1998, TEP filed a Settlement Proposal that had been entered into  
6 with the Commission’s Utilities Division Staff (“Staff Settlement Proposal”). On  
7 November 25, 1998, the Commission issued Decision No. 61259, which established an  
8 expedited procedural schedule for evidentiary hearings on the Staff Settlement Proposal.  
9

10 After the Arizona Attorney General’s Office, in association with numerous other  
11 parties, sought a stay of the Commission’s consideration of the Staff Settlement Proposal  
12 with TEP and Arizona Public Service Company, the Commission Staff filed a notice with  
13 the Supreme Court that the Staff Settlement Proposal had been withdrawn from  
14 Commission consideration. Subsequently, on June 9, 1999, TEP filed with the  
15 Commission a Notice of Filing Application for Approval of Settlement Agreement  
16 (“Settlement” or “Agreement”)<sup>1</sup> and Request for Expedited Procedural Order. After  
17 hearings and briefs, the Commission issued its Decision No. 62103 (the “Decision”), on  
18 November 30, 1999, which approved the Settlement with certain modifications. Among  
19 the essential elements of that Decision was the provision that TEP agreed to the  
20 modification of its CC&N in order to implement competitive retail access in its service  
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23 <sup>1</sup> The Parties to the Settlement are as follows: the Residential Utility Consumer Office, Tucson Electric  
24 Power Company, Arizona Community Action Association and the Arizonans for Electric Choice and  
25 Competition which is a coalition of companies and associations in support of competition that includes Cable  
26 Systems International, BHP Copper, Motorola, Chemical Lime, Intel, Honeywell, Allied Signal, Cyprus  
27 Climax Metals, Asarco, Phelps Dodge, Homebuilders of Central Arizona, Arizona Mining Industry Gets Our  
Support, Arizona Food Marketing Alliance, Arizona Association of Industries, Arizona Multi-housing  
Association, Arizona Rock Products Association, Arizona Restaurant Association, Arizona Retailers  
Association, Boeing, Arizona School Board Association, National Federation of Independent Business,  
Arizona Hospital Association, Lockheed Martin, Abbot Labs and Raytheon.

1 territory<sup>2</sup> and that the Settlement Agreement provides for competitive retail access in  
2 TEP's service territory.<sup>3</sup> Finally, the Decision explicitly ordered that, "Tucson Electric  
3 Power Company's Certificate is hereby modified to permit competitive retail access  
4 consistent with this Decision and the Competition Rules."

5 The Amended Settlement Agreement, filed on December 1, 1999, provided that  
6 competitive retail access would commence sixty days after the Commission Approval  
7 Order. Per the Electric Competition Rules, twenty percent of TEP's 1995 system retail  
8 peak load would be eligible for competitive supply upon commencement of competitive  
9 retail access. The Amended Settlement Agreement provided that an additional fifty-four  
10 megawatts of load would be made available to non-residential customers. All customers  
11 would be eligible for competitive retail access on January 1, 2001

## 12 **II. Summary of the TEP Proposal**

13 TEP has suggested that customers with less than 3 MW demand do not need to be  
14 provided with "choice" since these customers do not possess the knowledge and  
15 sophistication to make their own energy decisions. As a result, TEP suggests that retail  
16 competition should not be offered to these customers. The utility further proposes that if  
17 the wholesale market matures to the point where retail electric competition is viable, that  
18 those customers could be phased in to competition. The following statement by TEP witness  
19 DeConcini indicates the rationale behind the TEP proposal:  
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22 "I believe that customers below the 3 MW threshold would be better off  
23 continuing to receive service from their incumbent utility under the existing  
24 tariffs or contracts. For example, if TEP's current customers under 3 MW  
25 remain on its system, this would insure that Residential and Small

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<sup>2</sup> Decision 62103, Finding of Fact 22, at p. 19.

27 <sup>3</sup> Id. Finding of Fact 42, at p. 21.

1 Commercial customers can receive the benefit of TEP's long term, low cost  
2 energy supply through 2008."<sup>4</sup>

3 This statement presumes that the utility is more capable of providing low cost energy  
4 supply than are competitive suppliers. However, TEP has made no showing to justify this  
5 conclusion. Moreover, the conclusion seems to be particularly self-serving since, if  
6 accepted, it would mean that the utility would have virtually no competition in its service  
7 territory, with only a few, very large customers entitled to procure competitive supplies.

### 8 **III. The TEP Proposal Conflicts with Its Settlement Commitment**

9 It is clear that the TEP proposal constitutes a fundamental breach of the obligations  
10 the utility assumed when it entered into the Amended Settlement Agreement. First, retail  
11 choice was a fundamental and significant element of the settlement. Second, the utility  
12 seeks to preserve its own benefits gained under the settlement while simultaneously  
13 denying a fundamental benefit achieved by the counterparties to the settlement. Third, the  
14 utility has demonstrably failed to comply with its obligations to defend the Amended  
15 Settlement agreement and has taken actions that are inconsistent with its provisions.

#### 16 **A. Retail Choice Was a Fundamental Element of the Settlement**

17 It is clear that retail choice was a fundamental element of the settlement. In fact,  
18 the December 1, 1999 Amended Settlement Agreement provides as follows:

19 The Parties believe that this Settlement Agreement provides for the timely  
20 implementation of Competitive Retail Access in TEP's CC&N Service  
21 Territory and for TEP's shareholders to have a reasonable opportunity to  
22 recover their prudently incurred investments and costs. The Parties further  
23 believe that competition in the electric industry will benefit all customers in  
24 providing greater efficiencies and lower electric power costs. Accordingly,  
25 this Settlement Agreement is to be interpreted so as to bring about these  
26 consumer benefits as soon as possible.<sup>5</sup>

27 Section 1.2 of the Amended Settlement Agreement also provides that, "Unless subject to  
judicial or regulatory restraint, all TEP customers will be eligible to receive Competitive

<sup>4</sup> Exhibit TEP-3, Initial Testimony of Michael J. DeConcini, at p. 11.

<sup>5</sup> Amended Settlement Agreement, Recital F., at page 2.

1 Retail Access on January 1, 2001.” Despite this firm commitment on the part of TEP, the  
2 utility now seeks to backtrack and deny competitive choice to the overwhelming majority  
3 of its customer base.

4 **B. TEP Seeks Preferential Treatment That It Would Deny to Other**  
5 **Parties to the Settlement.**

6 TEP wishes to deny other parties their rights under the Amended Settlement  
7 agreement, while vigorously seeking to protect its own rights as inviolable. For example,  
8 TEP witness Pignatelli states that he would consider it to be inequitable if the utility was  
9 not permitted to collect its stranded costs:

10 Q. Would you consider it a breach of AECC's obligations, its good faith and  
11 fair dealing obligations or otherwise under the settlement agreement, if it  
12 were to today propose that this Commission not allow TEP to recover any  
13 stranded costs going forward?

14 A. Yes, I would.<sup>6</sup>

15 Yet curiously, the utility does not acknowledge that its proposed unilateral  
16 modification of its settlement obligations constitutes just such a breach of its good faith  
17 and fair dealing obligations to the other parties to the Amended Settlement Agreement.

18 Moreover, the utility also does not acknowledge that its proposal gives rise to the  
19 reasonable conclusion that the other benefits of the settlement that it obtained are also put  
20 at risk. Section 13.5 provides that, “Each provision of this Settlement Agreement is in  
21 consideration and support of all the other provisions, and expressly conditioned upon  
22 acceptance by the Commission without change.” Although the Commission approved the  
23 settlement as requested, TEP now seeks unilateral modification of a fundamental  
24 consideration that it provided in return for other benefits derived by it under the Amended  
25 Settlement Agreement. The following excerpt from the cross-examination of TEP witness  
26 Pignatelli by counsel for AECC is highly illuminating in this regard:

27 <sup>6</sup> Tr. p.603, lines 10-15.

1 Q. And TEP anticipated benefits coming from that settlement agreement; is  
2 that right?

3 A. That's correct.

4 Q. What was the primary area in which TEP anticipated benefits?

5 A. Rate stability, which also provided benefits to the customer; reasonable  
6 assurance of recovery of costs.

7 Q. In fact, at the time, or at least prior to the negotiation of the settlement  
8 agreement, is it fair to say that TEP viewed itself somewhat at risk of  
9 recovery in all of its stranded costs?

10 A. TEP as well as others. TEP was in no special circumstances there.

11 Q. Right. So it was that uncertainty about whether you would recover  
12 stranded costs in part that led to the settlement agreement or benefits to TEP  
13 under the settlement agreement; is that correct?

14 A. That's correct. In changing the regulatory compact, recovering assets  
15 which had been constructed over many years to serve many different  
16 customers, we felt that we needed assurance of recovery of the dollars  
17 expended to do that.<sup>7</sup>

18 It is neither reasonable nor fair to the other parties to that agreement that TEP  
19 should be permitted to enjoy the benefits it achieved under the settlement while avoiding  
20 one of its fundamental obligations thereunder. The Commission should reject this  
21 transparent ruse and not permit TEP to escape its settlement obligations.

### 22 C. TEP Fails to Comply With Its Obligation to Defend the Settlement

23 The TEP 3 MW proposal is evidence that the utility has failed to comply with its  
24 obligations to defend the Amended Settlement agreement and has taken action that is  
25 inconsistent with its provisions. Section 14.2 of the Amended Settlement agreement  
26 provides as follows:

27 14.2 The Parties agree that they shall make all reasonable and good faith  
efforts necessary to (a) obtain final approval of this Settlement Agreement  
by the Commission; and (b) ensure full implementation and enforcement of  
all the terms and conditions set forth in this Settlement Agreement. Neither

<sup>7</sup> Tr., p. 588, line 15 through p. 589, line 20.

1 the Parties nor the Commission shall take or propose any action which  
2 would be inconsistent with the provisions of this Settlement Agreement.  
3 All parties shall actively defend this Settlement Agreement in the event of  
4 any challenge to its validity or implementation.

5 TEP has made a unilateral proposal to modify a significant element of the settlement. In so  
6 doing, it has breached its good faith obligation to ensure full implementation of the terms  
7 of the settlement and not to take any action inconsistent with the provisions of the  
8 settlement. The utility should not be rewarded for this transgression. Rather, the  
9 Commission should require TEP to comply with its settlement obligations and deny this  
10 attempt to obtain Commission sanction for the utility's unilateral breach of the Amended  
11 Settlement Agreement.

12 The Joint Parties agree with the conclusion of AECC witness Higgins, who states  
13 in his rebuttal testimony at page 2 that:

14 Paragraph 1.2 of the TEP Settlement ensures direct access rights for *all*  
15 customers.<sup>8</sup> Mr. Pignatelli's proposal would abrogate that right for the vast  
16 majority of TEP's customers while offering them absolutely nothing in  
17 exchange. It is a blatant attempt by a signatory to an agreement to advance  
18 its own pre-settlement objectives in contravention of the commitments it  
19 made when it struck its deal and received the benefits of its bargain. It is a  
20 one-sided, bad faith proposition that is not even within the scope of the  
21 Track A issues identified by the Commission. Mr. Pignatelli's proposal  
22 should be rejected.

#### 23 **IV. TEP Cannot Justifiably Rely on Section 13.2 as Support For Its 24 Proposal**

25 TEP points to Section 13.2 of the Amended Settlement Agreement as support for  
26 its proposal to limit direct access to customers with demand in excess of 3 MW.  
27 However, a review of the explicit wording of that section indicates that the unilateral

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<sup>8</sup> Paragraph 1.2 states in part: "Unless subject to judicial or regulatory restraint, all TEP customers will be eligible to receive Competitive Retail Access on January 1, 2001." For TEP to be the active agent in seeking regulatory restraint of this provision is a violation of paragraph 14.2 of the Settlement Agreement which

1 proposal by TEP in this proceeding does not accord with the provisions of Section 13.2.

2 The precise wording of Section 13.2 is as follows:

3 13.2 The Parties acknowledge that TEP's ability to offer Competitive  
4 Retail Access is contingent upon conditions and circumstances, a number  
5 of which are not within the direct control of the Parties. Accordingly, the  
6 Parties agree that it may become necessary to modify the terms of retail  
7 access to account for such factors, and they further agree to address such  
8 matters in good faith and to cooperate in an effort to propose joint  
9 resolutions for any such matters.

10 However, the record reveals no instance of TEP offering to address such matters  
11 with the other parties to the Amended Settlement Agreement. Nor does it indicate any  
12 good faith effort to "cooperate in an effort to propose joint resolutions for any such  
13 matters." Instead, TEP simply made its unilateral proposal in its testimony in this  
14 proceeding and made no effort to consult with the other parties to the Amended Settlement  
15 Agreement. It is reasonable to conclude that no such effort was made because TEP  
16 recognized that such an effort would be futile. Nevertheless, this simply reinforces the fact  
17 that the utility's proposal is outside the bounds of the Amended Settlement Agreement. It  
18 seeks unilateral dispensation from the Commission, rather than making an actual good  
19 faith effort to work with the other parties to the Amended Settlement Agreement.

20 In the hearings on June 19, 2002, counsel for TEP made a preemptive effort to  
21 defend the actions of TEP when he stated that:

22 TEP believes that the testimonies of Mr. Pignatelli, Mr. DeConcini, and Mr.  
23 Glaser are in the spirit and the letter of the settlement agreement, and  
24 particularly Section 13.2, and we look forward to looking at those conditions  
25 and circumstances that exist, and to work with the parties to, if necessary,  
26 modify the terms of retail access so that we can make sure that what we do  
27 here in Arizona is in the public's best interests.<sup>9</sup>

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provides that: "Neither the Parties nor the Commission shall take or propose any action which would be  
inconsistent with the provisions of this Settlement Agreement."

<sup>9</sup> Tr. at p. 580, lines 13-21.

1 Nevertheless, the utility's actions belie its counsel's statement. As noted previously, TEP  
2 has made no effort to work cooperatively with the other parties to the Amended Settlement  
3 Agreement. A unilateral proposal made by one party, with no advance consultation, and  
4 maintained despite firm opposition from other parties, can hardly be said to be within "the  
5 letter and the spirit" of the Amended Settlement Agreement.

6 **V. TEP's Efforts to Declare Competition as Dead in Arizona Ignores Its**  
7 **Own Role in Forestalling Competition.**

8 TEP seeks to portray that retail competition is dead, and that therefore the  
9 Commission is justified in accepting its proposal to limit competition to customers with  
10 demand in excess of 3 MW. The illogicality of its position is evident. If customers have  
11 no interest in retail competition, then the TEP proposal is unnecessary. If, in contrast to  
12 TEP's position, customers do wish to have the right to choose competitive suppliers, then  
13 the utility's position can only be viewed as an anti-competitive exercise in market  
14 protection. Either way, the utility's proposal fails to be persuasive. Moreover, the utility  
15 skillfully ignores its own role in the demise of the earlier attempts at retail competition in  
16 the state.

17  
18 Rather like the criminal defendant charged with killing his parents parricide who  
19 pleads for mercy on the grounds that he is an orphan, TEP would have us ignore its own  
20 role in frustrating and stymieing competition in Arizona. This role was evidenced in the  
21 cross-examination of TEP witness Pignatelli by counsel for AECC:

22  
23 Q. And isn't it true that when the CTC or competitive transition charge  
24 became a negative number because of the market prices, that TEP unilaterally  
quit paying that to the customers that elected open access?

25 A. I think we paid everything that's necessary.

26 Q. You don't recall the fact that TEP quit paying it?  
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A. I don't recall.

Q. Do you recall the settlement discussions that ensued in which TEP later agreed to comply with the settlement agreement for future customers?

A. Yes, I do recall that, but that was just a discussion how it was to be interpreted, is my understanding.

Q. Do you recall, between March and May of 2001, after TEP unilaterally quit paying the negative stranded costs or crediting the negative stranded cost payment, that all of the direct access customers returned to standard offer?

MR. HEYMAN: I'll object; again, assuming facts not in evidence. Mr. Dodge is assuming this allegation that TEP quit unilaterally, paying something that it was required to do, Mr. Pignatelli said he had no understanding or recollection of.

Q. (BY MR. DODGE) As a hypothetical, do you -- you don't have any memory of people claiming that TEP had unilaterally quit paying the charge contemplated under the settlement agreement?

A. I remember the accusation, yes.

Q. Between the time that accusation was made and the time that a settlement was reached, every one of the direct access customers had returned to standard offer; isn't that true?

A. I don't know.

Q. If that's true, in proclaiming the failure or the lack of -- the fact that retail competition hasn't taken a strong hold in your service territory, wouldn't it be fair to point out that the utility's own conduct may have in part caused that fact?

A. No, I don't believe.

Despite the witness' hazy recollection of these facts, it is evident that he was unable to rebut the basic thrust of this cross-examination -- that the failure by TEP to pay the competitive transition charge when market prices spiked in the West was the primary reason why direct access customers returned to bundled service with TEP.

1 It is interesting to note that a similar situation occurred in California, with the  
2 notable difference that the California utilities had stipulated to pay a full credit to direct  
3 access customers, regardless of whether it exceeded the customer's otherwise applicable  
4 tariff rate. So long as the utilities paid that credit, customers remained on direct access.  
5 However, when the utilities breached their obligation and ceased paying the full credit,  
6 customers were forced to return to utility bundled service. It is hardly remarkable that the  
7 same situation occurred in Arizona. Reasonably, informed customers will not pay twice  
8 for their power, once to their utility and again to their competitive supplier.  
9

10 Now the utility has made a more blatant attempt to forestall competition and  
11 frustrate competitive choice. However, the Commission should reject the TEP suggestion  
12 that retail competition is dead in Arizona. It may be on life support, but so long as the  
13 patient is not subjected to the Kevorkian-like tender mercies of TEP, it has a chance to be  
14 resurrected. The Commission should not reject that chance and deny the benefits of  
15 competition based on the slender and illogical showing of TEP.  
16

17 **VI. TEP Fails to Rebut the Fundamental Assertion of the Joint Parties –**  
18 **That Acceptance of the Utility's Proposal Will Kill Retail Competition.**

19 In its filed testimony, the Joint Parties contend that should the Commission accept  
20 TEP's anti-competitive proposal, the end result for retail competition in Arizona would be  
21 the same as if the Commission acted to repeal the Retail Electric Competition Rules  
22 adopted in September 1999 -- it would be the death knell to retail competition in Arizona.  
23 Instead of dealing with that assertion, cross-examination by counsel for TEP attempted  
24 unsuccessfully to suggest that the sale of AES NewEnergy by its parent to Constellation  
25 Energy for \$240,000,000 represented a significant fact that was omitted from the Testimony  
26 of the Joint Parties' witness, Mr. William Monsen. This ignored the obvious fact that his  
27

1 testimony was filed prior to the announcement of the sale and that he could hardly be  
2 expected to have had advance knowledge of such a transaction.<sup>10</sup> Knowledge of the  
3 existence of such pending transactions is customarily restricted to the highest levels of inside  
4 company management, for obvious reasons.

5 Counsel for TEP next tried to suggest that the sale by AES indicated that retail  
6 electricity competition was a failed business strategy. Of course that theory seems a bit  
7 implausible when the company had just commanded \$240 million in the open market.  
8 Successful businesses do not ordinarily commit that degree of investment to "failed business  
9 strategies."  
10

11 The cross-examination of the Joint Parties' witness was most notable for what was  
12 omitted – any challenge to the assertion that the TEP proposal would fatally damage the  
13 prospects for retail competition in Arizona. The cross-examination is reminiscent of the  
14 famous Sherlock Holmes excerpt:  
15

16 *"Is there any point to which you would wish to draw my attention?"*

17 *"To the curious incident of the dog in the night-time."*

18 *"The dog did nothing in the night-time."*

19 *"That was the curious incident," remarked Sherlock Holmes.*<sup>11</sup>

20 Our "curious incident" is that the TEP cross-examination did nothing to dispel, or  
21 even challenge, the fundamental premise of the Joint Parties' testimony. Should the  
22 Commission approve the TEP 3 MW proposal, it can be assured, however, that unlike Mr.  
23 Holmes' dog, it will most assuredly have done something. It will have killed the  
24 opportunity for Arizona customers of TEP to obtain competitive power supplies for the  
25 foreseeable future.

26 <sup>10</sup> The sale of AES NE was announced after the close of the New York Stock Exchange on June 11, 2002.  
The Joint Parties' testimony was filed before 12 noon on that day.

27 <sup>11</sup> "Silver Blaze," from the Memoirs of Sherlock Holmes by Sir Arthur Conan Doyle.

1                   **VII. Conclusion**

2                   As noted in the testimony of the Joint Parties witness, if the Commission were to  
3 approve such an anti-competitive proposal, the end result for retail competition in Arizona  
4 would be the same as if the Commission acted to repeal the Retail Electric Competition  
5 Rules adopted in September 1999 -- it would be the death knell to retail competition in  
6 Arizona. TEP's anti-competitive proposal, if adopted by the Commission, would deny all  
7 but a handful of TEP's largest customers (>3 MW) the opportunity to choose a competitive  
8 provider. This means that all of TEP's residential customers and nearly all of its non-  
9 residential customers with less than 3 MW demand, such as grocery stores, schools and  
10 government buildings, office buildings, and retail businesses such as fast food restaurants,  
11 gas stations, drug stores, bank branches, cafes, mini-marts, and dry cleaners, to list a few,  
12 will be denied the ability to assess the benefits of competition and choose for themselves.  
13

14                   TEP's proposal is a poorly disguised attempt to derail retail competition before it  
15 has been given a fair opportunity to get off the ground. The Commission must do  
16 everything in its power to ensure the establishment of a healthy retail market to allow all  
17 Arizona consumers to realize the benefits of electricity industry restructuring and to protect  
18 themselves against incumbent retail market power. Providing all customers with the  
19 freedom to choose their own electricity service provider is the very first step that must be  
20 taken down the road towards creating a healthy retail market.  
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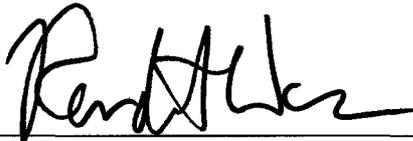
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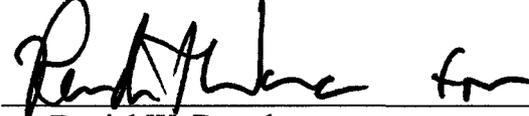
1 Respectfully submitted this 10<sup>th</sup> day of July, 2002.

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3  
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